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INSIDE

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BULL RUSH

FEATURE ARTICLE: ALTERNATE ASIAN MARKETS – A BIG PICTURE VIEW

China represents a huge opportunity for the New Zealand economy. Yet with opportunity comes vulnerability. So we decided to assess the attractiveness of the opportunities other nations across the wider Asia region offered using a range of indicators. The top 5 (of 28) ranked countries were Singapore, Hong Kong, Japan, Korea and China. Not surprisingly, these are already well-established export markets for many sectors. The up-and-comers throw up a mix of a few less well-known nations and some more familiar names. They include Malaysia, Brunei Darussalam, Kazakhstan, Azerbaijan, Thailand, Armenia, Indonesia and Vietnam. Each have their own pros and cons. Some are growing rapidly on a number of metrics, highlighting that new opportunities will rapidly emerge. Other markets are more mature, but offer growth opportunities if market penetration and share can be increased.

THE MONTH IN REVIEW

Widespread rain from mid-April restored soil moisture and pasture covers heading into the winter. Milk production hit a new record in 2013/14, but slower growth is anticipated in 2014/15. Red meat production forecasts have been increased slightly.

RURAL PROPERTY MARKET

Activity in the rural property market has cooled further since the start of the year, with total turnover easing to sit around the 10-year average. Average prices have bounced a bit over the same period, particularly for dairy and horticulture-aligned property. With a lower milk price forecast, rising interest rates, and plenty of robust discussion on political and environmental regulatory risks, it would seem pricing has topped out in recent months though.

KEY COMMODITIES AND FINANCIAL MARKET VARIABLES

Both local and global food prices have declined in recent months. Combined with only a limited decline in the NZD this has placed downward pressure on farm-gate prices. Continued NZD strength is likely to keep the pressure on farm-gate prices in the near term, but as the 2014/15 season progresses we expect a further softening, which should provide some relief.

BORROWING STRATEGY

The indicative rural lending curve has flattened in recent months. This makes it relatively more attractive to fix for longer terms, despite expectations for additional OCR hikes being built into the term structure and a curve that remains upwards-sloping.

ECONOMIC BACKDROP

The economy continues to perform strongly, though momentum has softened somewhat from the break-neck pace experienced in late 2013.

EDUCATION CORNER: CHINA'S GREAT BEEF CHALLENGE

China's beef consumption looks set to grow rapidly, driven by the same dynamics that are boosting general protein consumption, but also supported by disease issues in China's domestic pork and poultry production. New Zealand is in a prime position to participate in the lift in imports. We have many competitive advantages over other larger global players including an exclusive FTA, geographic location, a good food safety reputation, and established relationships with many multinational foodservice chains that have expanded rapidly throughout China.

FEATURE ARTICLE: ALTERNATE ASIAN MARKETS – A BIG PICTURE VIEW

INTRODUCTION

China represents a huge opportunity for the New Zealand economy. Yet with opportunity comes vulnerability to adverse developments, and the obvious concentration risks that servicing such a huge market can entail.

We assess the attractiveness of the opportunities across the wider Asia region using a range of indicators (29 in total) including proxies for food market size and development, consumer purchasing power and affluence, alignment with NZ-orientated trade, market access, and infrastructure.

The top 5 (of 28) ranked countries were Singapore, Hong Kong, Japan, Korea and China. Not surprisingly, these are already well-established export markets for many sectors. The up and comers throw up a mix of a few less well-known nations and some more familiar names. They include Malaysia, Brunei Darussalam, Kazakhstan, Azerbaijan, Thailand, Armenia, Indonesia and Vietnam. Each have their own pros and cons. Some are growing rapidly on a number of metrics, highlighting that new opportunities will rapidly emerge. Other markets are more mature, but offer growth opportunities if market penetration and share can be increased.

Our simple framework highlights some of the wider opportunities across the region, which are far broader than China alone.

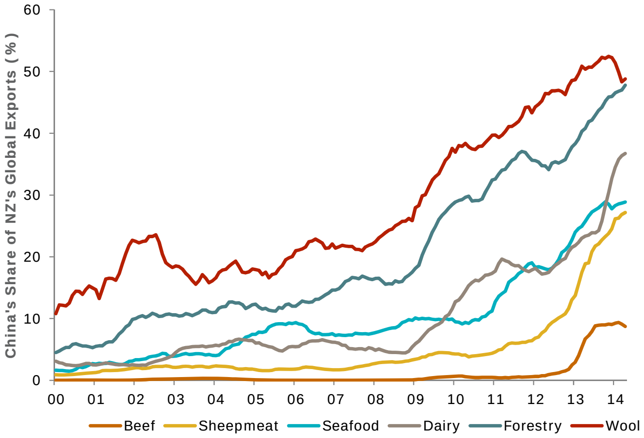
BACKGROUND

The speed of the increase in New Zealand's trade connectivity with China has been staggering. Exports have been compounding at 23% per year since the free trade agreement was signed in 2008. China now takes 50% of our wool and forestry exports. Seafood, dairy, sheep-meat and beef shares have risen sharply. And it hasn't been confined to primary exports, with growing connectivity apparent in the likes of the tourism industry as well.

With opportunity and connectivity comes vulnerability to a) adverse internal market developments (think regulatory risk, such as recent changes in the infant formula arena) and b) wider macroeconomic forces (i.e. a material turn in the Chinese economy). This naturally leads to 'what-if' questions being posed – namely, what if it all goes pear-shaped for some reason?

In reality, while diversification might be a sound long-term strategy, it is very difficult to turn down the highest-paying market and not fulfil the business/trade relationships that companies and officials have worked hard to create in recent times (and for some, over much longer time frames). Moreover, to be credible in some markets an element of scale is often desirable. There will clearly be ups and downs to manage like any business relationship though.

SHARE OF NZ'S TOTAL EXPORTS SENT TO CHINA



Source: ANZ, Statistics NZ.

While China is now New Zealand's largest export market – at 22.6% of total exports – the concentration risk argument can be overplayed.

- **China is a huge market;** it represents 19% of the global population and 12% of GDP. They will always be material as a trading partner.
- **There is an aggressive free trade agreement (FTA) agenda being pursued, which is opening up new trade opportunities.** In fact NZ already has FTAs in place with 28% of the global population and 18% of global GDP. Additional FTAs currently under negotiation cover a further 43% of global GDP and 30% of the globe's population. That's a big playground.
- **New Zealand has hardly been standing still in other markets.** In fact over the last five years double-digit growth in exports has occurred for 46 of the countries New Zealand trades with (22% of total). We also export more than $100 million worth of goods and products to 43 countries each year. Of these countries many such as Bangladesh, Brazil, Turkey, UAE, Peru and Chile have been growing in excess of 20% per annum.
- **We believe many businesses have created, or are in the midst of creating, propositions that can be easily transferred to alternative markets if things go awry in China**. While China is currently the highest-paying market for many of these propositions, it doesn't mean other

markets won't rise to match, or even out-compete China in the future.

However, New Zealand can ill-afford to be complacent. One of the dangers of embracing huge opportunities in one market is that you become blinkered to wider developments and other opportunities that are fast developing in other parts of the Asian region (and further afield, such as in South America).

With this in mind, we decided to take a deeper look at the wider Asian region. We're not big believers in subjective woolly analysis; any work has to have a degree of objectivity and statistical grunt. Data availability is often the constraint here, but what follows is our attempt – using the best information we could find – to identify the key characteristics that might make countries attractive export markets for NZ-orientated products, and the key obstacles currently holding them back.

BROAD CATEGORIES AND BACKGROUND

We selected six broad categories to assess the potential of different Asian export markets.

- Food market size and development;
- Consumer purchasing power and affluence;
- Alignment with New Zealand-orientated trade;
- Market access;
- Regulatory and political risk; and
- Supply and cool chain development/infrastructure.

We collected data for 30-odd countries in the Asian region, but as always, in some instances the data quality was poor, or does not exist. Where a country was missing a large number of data points (e.g. Taiwan and Afghanistan) across multiple categories, it was excluded from our analysis. North Korea and Myanmar were excluded on the basis that trade and investment is restricted by trade sanctions under international treaties. However, it needs to be noted that exports to Myanmar still totalled $26m over the last 12 months. For some indicators, especially under the food market size and development categories, there were a number of countries where data wasn't available, and they were excluded from this part of the analysis. For the overall evaluation we therefore used a truncated set of criteria for the food market size and development to allow comparison. Most of the countries where data was limited ranked fairly low down the pecking order on this basis, which is not surprising, as a shortage of data often goes hand-in-hand with a less-developed economy. Some of the indicators overlap between the categories, but we discuss their alternate relevance as we go.

For each statistic we calculate a percentage score, which is a measure of how each country is placed relative to all other countries evaluated. For instance, GDP per capita ranged from USD640 to USD55,570. Because Thailand's GDP per capita is US5,450, its score is 9% (US5,450 is 9% of the way through the US640 to US55,570 range). For each of the six categories an average score is then derived for each country, with equal weightings applied to each indicator. This is then used to rank and provide a "relative attractiveness" measure for each country for New Zealand's soft commodity exports. We also calculate an absolute ranking for each indicator to rank countries within categories. A lower score indicates a more favourable ranking.

1. FOOD MARKET SIZE AND DEVELOPMENT

The New Zealand primary sector is involved in a wide range of end food markets/channels. These vary greatly according to a specific product's characteristics, the sector, supply chain partners and the export market in question. **But for the majority of sectors and products the food markets that are most desirable are those that are well developed with a heavy presence of foodservice and organised retail operators. There are several reasons for this.**

1. **The product mix of New Zealand's main soft commodities tends to be more suited to foodservice, or organised retail channel formats**, as opposed to wet markets. This is due to our traditional markets and supply chain partners being wealthier Western countries, where these are the main channels to market. Therefore, many businesses and products, such as packaged wine, or chilled cuts of red meat, are set up to target such markets.
2. **Many of our main products are highly perishable, and** in order to maximise shelf life and maintain high food safety standards **a robust cool chain is required,** with proper refrigeration and handling facilities until final consumption.
3. **A well-developed market with size is usually an indicator of the presence of multi-national retailers and foodservice operators who will tend to have global sourcing capabilities.** They are usually more receptive than local operators to introduce imported products, as they are more familiar with them

FEATURE ARTICLE: ALTERNATE ASIAN MARKETS – A BIG PICTURE VIEW

and already have a business relationship. This provides a better avenue for food imports.

4. **A more-developed food market is an indicator of more westernised consumer preferences, packaged food consumption, and viability of other ‘value-add’ products.** Many sectors are already well down the ‘value-add’ track with a product suite that promotes different functionality (eg helps with a specific health ailment, or provides consistent taste/quality attributes), service/convenience, provenance, brand, and food safety assurances. This means businesses are looking for markets that can understand their proposition, or can be educated, and who are willing to pay a premium for their products’ specific qualities.

The indicators we collected to get a feel for a country’s food market size and development were:

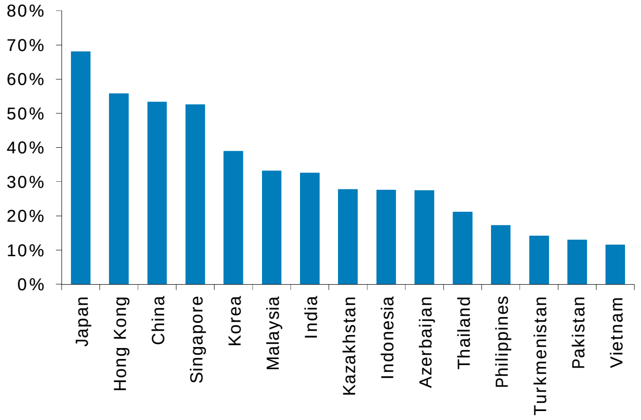
1. **Estimated size of the food and non-alcoholic market.** This indicates the relative size of the food market and opportunities that might exist.
2. **Population.** Another indicator of the overall potential size of the market.
3. **Annual growth in the food and non-alcoholic market.** This gives a feel for the new opportunities that might be emerging.
4. **Per capita expenditure on food.** This provides a view of the average consumer’s purchasing power and affluence. This is an indicator of demand for New Zealand’s mix of soft commodities, ability to pay, and higher expenditure per kilogram of food purchased (i.e. higher price point).
5. **Proportion of income spent on food.** This is a similar indicator to per capita expenditure on food.
6. **Catering consumer expenditure per capita.** Indicator of the prevalence and development of the foodservice channel.
7. **Urbanisation ratio.** Usually linked to consumer affluence, more-Westernised consumer preferences, the prevalence of food retail and foodservice providers, and concentration of potential customers.

The analysis

We excluded 13 out of 28 countries due to data limitations for the seven indicators we used. **For the 15 countries where robust data was available, the top 5 were Japan, Hong Kong, China, Singapore and Korea** in that order when ranked on an average attractiveness basis for the seven indicators in this category.

RANKED ATTRACTIVENESS OF COUNTRIES FOR FOOD MARKET DEVELOPMENT AND SIZE

(REGION'S RELATIVE ATTRACTIVENESS SCORE)



Source: ANZ

On an accumulated ranking basis for the indicators, the top five were the same but the order was slightly different. Japan was still the most attractive, followed by China, Korea, Hong Kong and Singapore.

In the middle of the table there were less well-known trading partners, including some potential up-and-comers: Indonesia, Malaysia, Kazakhstan, Thailand and Azerbaijan. The results varied a little more for these nations though, depending on the measure used – especially for Thailand, Indonesia and India. For India the results were heavily influenced by it being at two ends of spectrum. It ranked well for both the size metrics, but was just about dead last for all the other indicators for growth in the food market, through to consumer purchasing power and affluence metrics, such as food expenditure per capita. Indonesia was similar to India, but not quite so extreme, with better rankings for urbanisation, growth in the food market, and catering expenditure all implying better growth opportunities in foodservice. Thailand’s downfall on the relative attractiveness measure was its low urbanisation and catering expenditure.

For the remaining 13 countries where there was limited data we completed a truncated analysis using population, urbanisation and GDP per capita (a proxy for food expenditure per capita and purchasing power). As would be expected, they ranked fairly low compared with the 15 countries where better data was available.

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Food market size & development	Ranking on placings for indicators	Ranking on average attractiveness score for indicators
Japan	1	1
China	2	3
Korea	3	5
Hong Kong	4	2
Singapore	5	4
Indonesia	5	9
Malaysia	7	6
Kazakhstan	8	8
Thailand	8	11
Azerbaijan	10	10
Brunei Darussalam	11	n/a
Philippines	12	12
India	13	7
Pakistan	14	14
Turkmenistan	15	13
Mongolia	16	n/a
Vietnam	17	15
Armenia	18	n/a
Uzbekistan	19	n/a
Bangladesh	20	n/a
Sri Lanka	21	n/a
Laos	22	n/a
Bhutan	23	n/a
Timor-Leste	24	n/a
Kyrgyzstan	25	n/a
Nepal	26	n/a
Tajikistan	27	n/a
Cambodia	28	n/a

What stood out in the results?

The top five were as expected, but the different indicators do shed some light on the various features of each market. China and Japan highlight the differences well. China is a behemoth in terms of its overall size, and apart from Azerbaijan has been the fastest-growing food and non-alcoholic market in recent years. However, it ranked only middle of the pack on the consumer purchasing power and other development metrics. At the other end of the scale Japan ranked very high for all these measures, as well as being a reasonably large market – this is why it pipped China at the post. However, its one drawback is it's a fairly mature food market with annual growth of only 5% in recent years, compared with 18% in China. Still, as we discuss in the next section, given New Zealand can only feed between 40-60 million people (depending on the assumptions you use) it is about targeting the super-wealthy segments in big markets, such as China, Japan, India and Indonesia, to maximise returns.

Beyond the top five some of the more interesting up-and-comer rankings were for Malaysia, Kazakhstan and Azerbaijan. Malaysia isn't a big market, but the food market has had solid growth and ranked well (5th or 6th) for all the other food development and consumer purchasing power indicators. Azerbaijan and Kazakhstan aren't the biggest markets either, but their food markets have experienced some of the fastest growth in recent years. In addition, Kazakhstan has the third-highest per capita expenditure on food behind Hong Kong and Japan, and both countries are relatively highly urbanised.

2. CONSUMER PURCHASING POWER AND AFFLUENCE

All the primary sectors are trying to target the highest-paying channels and markets; therefore an assessment of consumer purchasing power is required. Additionally, in order to find channels with opportunities to sell 'value-add' products, some assessment of affluence and the wealthier segments that exist within a country is required. There is a limit to the number of meals New Zealand can produce, meaning the different sectors need to be targeting the super wealthy with propositions that they are willing to pay extra to have. All countries were included in this analysis. There were several data points that were missing, but these were proxied with other indicators.

The indicators we have collected to get a feel for a country's purchasing power, affluence and wealthier segments are:

1. **GDP per capita.** A direct measure of the level of purchasing power for the average consumer in a country.
2. **Wealth per capita.** Another indicator of direct purchasing power for the average consumer in a country.
3. **Average % change in GDP over last seven years.** Indicates how the purchasing power of a country is changing. Greater growth will usually indicate higher growth rates for food intakes; specifically protein and fat consumption.
4. **Percentage change in GDP per capita over the last seven years.** Indicates how the purchasing power of the average person in a country is changing.

The above four indicators give a feel for the level and growth of food consumption and specifically protein and fat consumption. This makes them a proxy for demand for New Zealand's mix of soft commodities, their ability to pay, and expenditure per kilogram of food purchased (i.e. price point).

5. **Income share for the country held by the highest 10% of earners.** Measure of the distribution of income within a country and indicator of the size of the wealthiest segment.
6. **Disposable income for the highest 10% of earners.**
7. **Number of adults with wealth greater than US$100,000.**

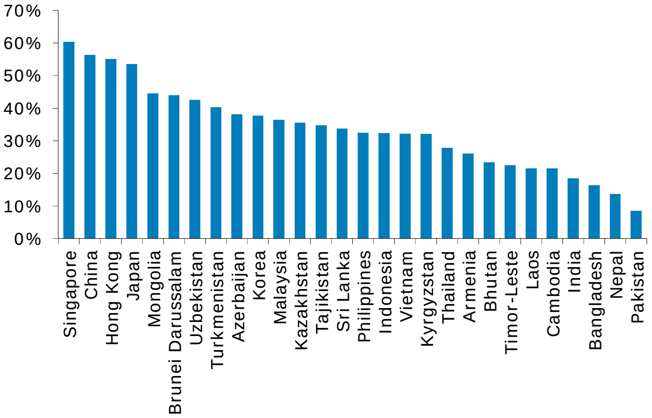
   The above three indicators give a feel for the number of wealthy consumers that reside within a country, as well as their purchasing power. With New Zealand only able to deliver a limited volume of soft commodities, these need to be the priority target to maximise earnings.
8. **Secondary education attainment.** Educational attainment feeds into wealth indicators, but also into ability/willingness to learn about different foods and products. This is particularly important when selling more sophisticated propositions, be it a provenance story or the special attributes (i.e. flavour, texture, taste, tenderness) of a product. Imported products/brands in emerging markets are also often new, and some education is required for households to understand the product, and how it should be prepared and cooked.
9. **Adult literacy.** Similar dynamics to secondary education attainment.

The results and what stood out

The top five were Singapore, China, Hong Kong, Japan and surprisingly, Mongolia, in that order when ranked on an average attractiveness basis for the nine different indicators. On an accumulated ranking basis the top five were slightly different with Azerbaijan jumping into fourth spot and Japan, Mongolia and Turkmenistan 5th equal.

RANKED ATTRACTIVENESS OF COUNTRIES FOR CONSUMER PURCHASING POWER AND AFFLUENCE

(REGION'S RELATIVE ATTRACTIVENESS SCORE)



Source: ANZ

It could be argued that Hong Kong, Japan and Singapore should be top of this category as they ranked near the top for most of the main indicators, apart from the change in GDP and change in GDP per capita. These countries already have high levels of economic activity and wealth. The other slight difference for Japan and Singapore was the top 10% of earners held a lower share of income, implying wealth is a bit more evenly distributed in these countries. China stood out on the growth metrics, as well as the concentration of wealth in the top 10% of earners. It ranked first, with the top 10% of earners accounting for 43% of total income (not exactly the communist ideal). In terms of the number of adults with wealth greater than US$100,000 China ranked second behind Japan. In total it is estimated nearly 25 million Chinese have wealth in excess of US$100,000 and in Japan there are an estimated 55.4 million. **The wealthier individuals in these countries outnumber the entire population of 15 out of the 28 countries analysed. This highlights the size of the wealthier echelons in some of the bigger Asian markets.** In terms of "super wealth" segments, the incomes of the top 10% in Hong Kong and Singapore were US471,800 and US400,400 respectively. This was nearly seven times that of China.

Consumer purchasing power & affluence	Ranking on placings for indicators	Ranking on average attractiveness score for indicators
China	1	2
Hong Kong	2	3
Singapore	3	1
Azerbaijan	4	9
Japan	5	4
Mongolia	5	5
Turkmenistan	5	8
Korea	8	10
Brunei Darussalam	9	6
Malaysia	9	11
Uzbekistan	11	7
Kazakhstan	12	12
Indonesia	13	16
Philippines	14	15
Sri Lanka	15	14
Thailand	16	19
Timor-Leste	17	22
Vietnam	18	17
Bhutan	19	21
Kyrgyzstan	20	18
Armenia	20	20
India	20	25
Tajikistan	23	13
Laos	24	23
Cambodia	25	24
Bangladesh	26	26
Pakistan	27	28
Nepal	28	27

The other interesting performers, those countries pushing hard on the heels of top-ranking countries, were Azerbaijan, Mongolia and Turkmenistan. These three tended to be middle of the pack for most of the indicators. Azerbaijan and Turkmenistan have fairly high wealth and GDP per capita, with the latter having the fastest overall economic growth of all countries over the last seven years. Mongolia had very fast growth, but not such high levels of wealth and GDP per capita. Azerbaijan didn't perform so well on the relative attractiveness measure, largely due to it having a small number of individuals with wealth greater than USD100,000. This is largely due to its smaller population, but also income and wealth are relatively evenly distributed across the economy.

The middle of the table is occupied by Korea, Brunei Darussalam, Malaysia, Uzbekistan, Kazakhstan and Indonesia. Korea was very similar to Japan, ranking high for the level of wealth and income metrics, but it has had slower growth for these over the last seven years. Arguably it should be ranked higher if you put more weight of the level of wealth as opposed to the change. It also ranked third for the number of adults with wealth over USD100,000 and sixth for the incomes of the top 10% of earners. But in general the top 10% held a lower proportion of income, implying wealth is more evenly distributed. In Malaysia the income held by the top 10% of earners was high and the level of income earned was the 5th highest. Brunei Darussalam had the second-highest GDP per capita and the incomes of their top 10% of earners was the third-highest. Kazakhstan didn't really have any standouts, and while Uzbekistan had low levels of wealth and GDP per capita, this has been changing fast in the last seven years.

3. ALIGNMENT WITH NEW ZEALAND ORIENTATED TRADE

To grow markets there needs to be a degree of alignment between what they require and what we produce. New Zealand's main competitive advantage is the production of livestock (specifically dairy and red meat), horticulture (wine, kiwifruit and pip fruit) and a number of other niche products, usually of livestock or horticulture origin. Therefore, we want to identify countries where import demand opportunities will be rising for these products in the future. So in this section we look at indicators that identify the presence of such alignment and opportunity. Three regions, Bhutan, Singapore and Hong Kong were excluded from this part of the analysis due to lack of data.

The indicators we collected were:

1. **Fruit / Meat / Milk / Seafood / Vegetable expenditure per capita.**
2. **Average fat and protein consumption per capita.** With increasing income comes higher fat and protein consumption. Many of New Zealand's products are high in both. These are also usually an indicator of more westernised diets.
3. **Change in per capita fat and protein consumption over last seven years.** Change highlights emerging opportunities within the country.
4. **Share of dietary energy derived from cereals, roots and tubers.** A lower share indicates a higher proportion of food consumption is of livestock or horticultural origin. It is also usually an (inverse) indicator of Westernised diets and development stage of a food market.

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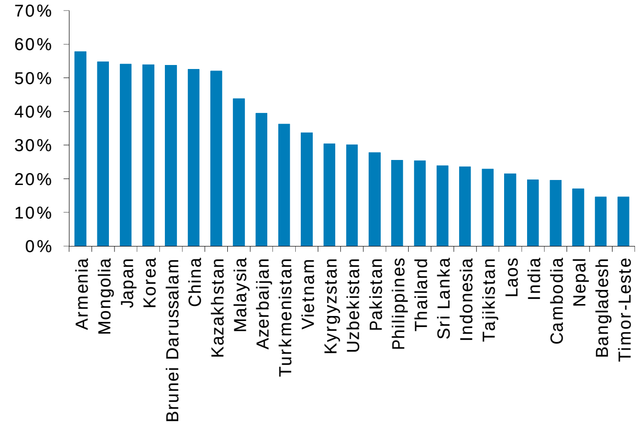
5. **Cereal import dependency ratio.** We struggled to find a reliable indicator for total food import dependency, but decided this would be a reasonable proxy. This indicator highlights the willingness to trade in base soft commodities, but also the shortfall/limitations in domestic food production to meet total demand.
6. **Bilateral trade conducted between NZ and other country in last 12 months (total NZD).** This shows current demand for New Zealand exports, but also willingness to trade by capturing the two-way trade occurring.
7. **Recent change (5-year window) in bilateral trade between NZ and other country.** Highlights the growth in trade opportunities in recent times.

The results and what stood out



RANKED ATTRACTIVENESS OF COUNTRIES FOR ALIGNMENT WITH NZ-ORIENTATED TRADE

(REGION'S RELATIVE ATTRACTIVENESS SCORE)

Source: ANZ

There were certainly some surprises in this section. The top five were Armenia, Mongolia, Japan, Korea and Brunei Darussalam in that order when ranked on an average attractiveness basis for the nine different indicators. **On an accumulated ranking basis, the top five were slightly different, with Armenia still taking top spot followed by Korea, China, Mongolia and Brunei Darussalam.**

Alignment with NZ-orientated trade	Ranking on placings for indicators	Ranking on average attractiveness score for indicators
Armenia	1	1
Korea	2	4
China	3	6
Mongolia	4	2
Brunei Darussalam	5	5
Azerbaijan	6	9
Kazakhstan	7	7
Japan	8	3
Malaysia	9	8
Vietnam	10	11
Thailand	11	16
Turkmenistan	12	10
Indonesia	13	18
Uzbekistan	14	13
Philippines	15	15
Pakistan	16	14
Sri Lanka	17	17
Kyrgyzstan	18	12
Cambodia	19	22
Laos	20	20
Bangladesh	20	24
India	22	21
Tajikistan	23	19
Timor-Leste	24	25
Nepal	25	23

So why did Armenia take top spot for both measures? Well the main indicators it dominated were the growth in fat and protein consumption over the past seven years, taking top spot for both. In fact per capita consumption of fat has supposedly grown a massive 46% over this period and protein 22%. This was much more than many other countries. This rapid growth has seen per capita fat consumption reach 84 g/capita/day and protein 89 g/capita/day, which were the 8th and 6th highest respectively of the countries we analysed. However, given the low levels of economic growth measured under the consumer purchasing power and affluence section, the recorded growth looks a little suspect. Countering this somewhat is a low level (4th) of dietary energy derived from cereals etc. For the other indicators bilateral trade with Armenia ranked 15th, but growth over the last five years was the 8th fastest. Current annual expenditure on NZ-orientated products was 9th highest at USD439 per person.

Japan and Korea had very similar scores for each of the indicators. They both ranked high for annual expenditure on NZ-orientated products, with

Japan taking top spot with expenditure of USD1,546 per person. They also have high fat and protein consumption, a low share of dietary energy sourced from cereals etc, and high dependency on imports and bi-lateral trade, behind only China. Where they fell behind was low growth in bilateral trade and fat and protein consumption. In fact Japan has experienced falls in fat and protein consumption over the last seven years. This was the main reason it ranked lower (8th as opposed to 3rd) when using the placing method. **So arguably Japan and Korea could be ranked above Armenia, but trade and growth in these markets look to be somewhat mature at this stage.**

China ranked well on the current level of fat (4th) and protein (2nd) consumption, as well as taking first spot for bilateral trade. It was middle of the pack for all the other indicators. However, as mentioned under the first two categories, China is not just one market, but a multiplicity of markets with a large wealthy segment that can be targeted. **Mongolia was another interesting placing in the top five.** It ranked 1st for the growth in bilateral trade, but this was from a low base with trade of only $20 m over the last year (16th). For all the other indicators it ranked between 5th and 12th suggesting it should perhaps have finished slightly outside the top five.

The up and comers for these indicators were Azerbaijan, Kazakhstan, Malaysia, Vietnam and Thailand. What stood out for all these countries, apart from Vietnam (25th for this measure), was relatively high current expenditure on NZ-orientated produce compared with their overall ranking. Kazakhstan had the highest level of fat and protein consumption of all countries analysed and some of the fastest growth. Vietnam and Azerbaijan have also experienced fast growth, but had lower levels of fat and protein consumption. Malaysia had the second-highest cereal import dependency ratio, behind Brunei Darussalam. It also had the 4th highest bilateral trade flow, indicating a good trading relationship is already established.

4. MARKET ACCESS

Tariff and non-tariff barriers globally are very high for agricultural goods. This is often due to food security concerns and countries' desire to have some level of self-sufficiency for protection against food inflation, or times of conflict. These barriers are slowly disappearing, but in many cases they still significantly inhibit trade. This is most often by pricing imported products out of the market through high tariffs, restricting trade volumes for certain goods, creating investment and policy uncertainty by arbitrarily changing the rules, and/or creating other technical barriers to trade.

Luckily, New Zealand has championed free trade agreements to improve market access for our exports and we also have favourable trade access resulting from our historical relationships with the likes of the UK. Out of the 28 countries we have analysed we have free trade agreements with 11. **Often these have created a competitive advantage by giving us better market access than competitors.** All countries apart from Timor-Leste and Turkmenistan were included in this part of the analysis.

The indicators we have used to gauge market access for NZ's mix of soft commodities are:

1. **Simple mean tariff rate applied to primary products.** A higher tariff rate implies limited market access and a higher likelihood of arbitrary changes to trade rules to protect local producers.
2. **Simple mean tariff rate applied to primary products for the most favoured nation.** Similar measure to the first. This is the non-discriminatory rate countries must apply to all trading partners under the WTO agreement.
3. **Whether or not New Zealand has a free trade agreement in place.** Depending on the quality of the agreement and when it came into force this can provide a significant competitive advantage, especially when there are high trade barriers in place for competing countries.

The results and what stood out

Not surprisingly Hong Kong, Brunei Darussalam and Singapore took out the top three spots with virtually the same rankings, as no tariffs are applied to primary products. Additionally we have a free trade agreement with Hong Kong and Singapore. **No tariffs make sense for these three as they have virtually no domestic producers to protect and will always be reliant on imported primary products.**

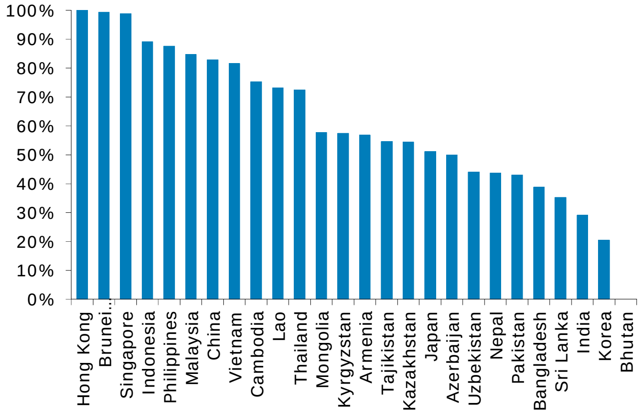
The next most attractive countries were Indonesia, Philippines, Malaysia and China. We have free trade agreements with all these countries, but without them all four would drop down to middle of the table, with tariff rates applied to primary products ranging between 6-11%. **New Zealand is also lucky enough to have had exclusive market access to the likes of China, which places us at a distinct advantage against competitors when the average tariff rate applied is 8% and there**

are many other non-tariff barriers that inhibit trade (though arguably NZ has experienced an increase in non-tariff barriers from China in recent times). For the next group of Cambodia, Laos and Thailand, with whom New Zealand also has FTAs in place, this advantage is even greater with an average tariff rate around the 15% mark.

However, a free trade agreement doesn't always guarantee free trade, or a lack of arbitrary change in trade barriers. Indonesia was NZ's third-largest beef market in 2009/10 before trade fell substantially due to the implementation of trade barriers as the Indonesian government wanted to become at least 90% self-sufficient in beef production. However, the trade barriers are again being relaxed with more import permits being issued as beef prices moved substantially higher due to domestic production not being able to keep up with rising demand. This is just one example of where trade rules have been arbitrarily changed despite an FTA being in place.

RANKED ATTRACTIVENESS OF COUNTRIES FOR MARKET ACCESS

(REGION'S RELATIVE ATTRACTIVENESS SCORE)



Source: ANZ

However, what is perhaps most interesting is the lost opportunities: those at the bottom of the table that scored well in other categories, such as consumer purchasing power / affluence. The main culprits in this case are Japan and Korea with average tariff rates of 8% and 24% respectively applied to primary products. We are actually surprised Japan's average tariff rates applied to primary products are so low, given the protection and subsidies offered to local producers. Protection, subsidies and trade barriers are particularly high for the rice, sugar, beef, pork, dairy, and wheat sectors, which are major sticking points for Japan in the current TTP negotiations. So depending on the sector, trade to both Korea and Japan could be quite restricted by high tariffs and other trade barriers despite their much stronger consumer purchasing power, alignment with NZ trade and more developed food market. Other markets that don't have quite the same appeal on the purchasing power metrics, but have high tariffs, are India (20%), Sri Lanka (18%) and Bhutan (43%).

5. REGULATORY AND POLITICAL RISK

The regulatory and political framework is important for investment certainty. Investment uncertainty can often be the key reason a business might not pursue an opportunity. From a trade perspective this is tied to market access, but we also wanted to get a feel for the support local producers might get from their government. This is a proxy for the protection offered to domestic producers and the likely treatment) and competition food imports might face in a country (less favourable when more support exists. Unfortunately data on subsidies to local producers was only available for China, Indonesia, Japan and Korea.

Consistent with the market access indicators, Japan and Korea have very high support for local producers, with around 55% of local producers' incomes coming from subsidies and other support mechanisms. In China and Indonesia support was closer to the 20% mark. We examined a couple of other indicators, such as the global food security index and depth of the food deficit, but didn't feel they accurately reflected the regulatory and political risk primary products might face when exporting to a particular country. So we have not assessed this in our framework, but would note that it is important.

6. SUPPLY AND COOL CHAIN DEVELOPMENT / INFRASTRUCTURE

The majority of our primary products are highly perishable and require a robust cool chain to ensure high standards of food safety and adequate shelf life when they arrive in market. A robust cool chain is also usually a sign of the presence of a strong food retail and service sector.

The indicators we used to assess a country's supply chain development/infrastructure were:

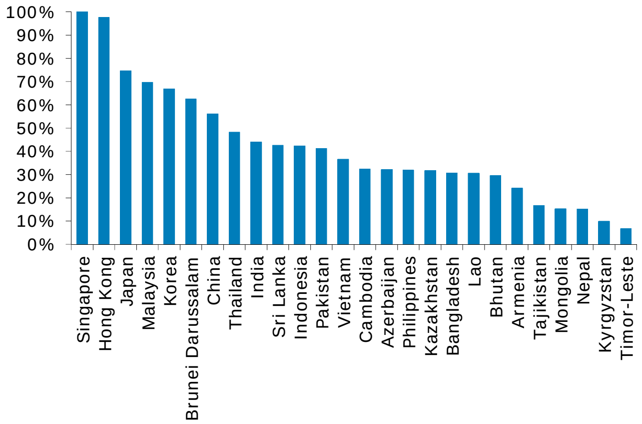
1. **Burden of customs procedures;**
2. **Quality of port infrastructure;**
3. **Logistics performance index.**

The three indicators come from a World Bank survey in partnership with academic, other international institutions and private companies. The overall score reflects perceptions of a country's logistics based on the efficiency of the customs clearance process, quality of trade- and transport-related infrastructure, ease of arranging competitively priced shipments, quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled time. The index ranges from 1 to 5, with a higher score representing better performance. The burden of customs procedures can put off smaller-sized companies, and the quality of port infrastructure matters given the majority of New Zealand's trade is shipped. Turkmenistan and Uzbekistan were excluded from the analysis due to no data being available.

The results and what stood out

RANKED ATTRACTIVENESS OF COUNTRIES FOR SUPPLY & COOL CHAIN DEVELOPMENT / INFRASTRUCTURE

(REGION'S RELATIVE ATTRACTIVENESS SCORE)



Source: ANZ

The countries' rankings were unsurprising. The trade hubs of Singapore and Hong Kong took the top spots with Japan, Malaysia and Korea rounding out the top five. The results were fairly similar for both measures used. Laos ranked higher on the placing measure, but lower on average attractiveness. This was due to good customs procedures, but a lower overall logistics performance due to poorer infrastructure, such as ports. There is no cut-off point where one might decide to avoid to trade with a country because of poor infrastructure. However, **the more perishable a product, the more robust the supply chain needs to be.**

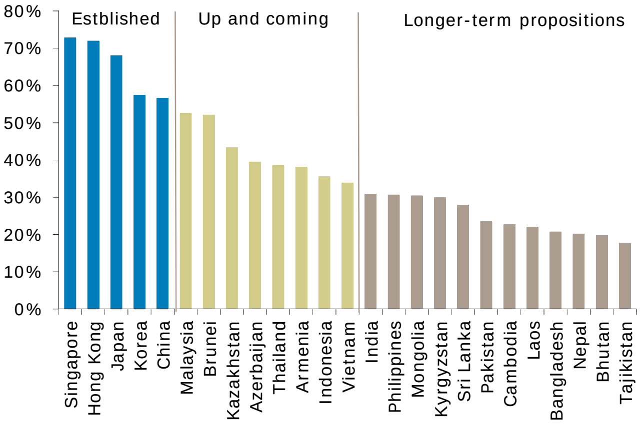
Supply & cool chain development	Ranking on placings for indicators	Ranking on average attractiveness score for indicators
Singapore	1	1
Hong Kong	2	2
Japan	3	3
Korea	5	5
Malaysia	4	4
Brunei Darussalam	6	6
China	7	7
Thailand	8	8
India	9	9
Sri Lanka	10	10
Pakistan	12	12
Indonesia	10	11
Vietnam	13	13
Kazakhstan	15	17
Cambodia	16	14
Azerbaijan	18	15
Laos	14	19
Philippines	18	16
Bangladesh	17	18
Bhutan	18	20
Armenia	21	21
Tajikistan	22	22
Nepal	24	24
Mongolia	23	23
Kyrgyzstan	25	25

OVERALL RESULTS ACROSS ALL CATEGORIES

The overall results are a simple average across all indicators.

RANKED ATTRACTIVENESS OF ASIAN COUNTRIES FOR NZ PRIMARY PRODUCTS

(REGION'S RELATIVE ATTRACTIVENESS SCORE)



Source: ANZ

It is perhaps testament to the appropriateness of the framework we have adopted that **the top five ranked countries of Singapore, Hong Kong, Japan, Korea and China are already well established export markets for many sectors.** Together these five account for 70-odd percent of New Zealand's bilateral trade flow and 77 percent of total exports within the Asian region. The up-and-comer bunch of Malaysia, Brunei Darussalam, Kazakhstan, Azerbaijan, Thailand, Armenia, Indonesia and Vietnam throw up some more interesting and less well-known opportunities. Each have their own pros and cons. Some are fast-growing on a number of metrics, highlighting rapid growth of new opportunities. Others are more mature, but offer growth opportunities if market penetration and share can be increased.

Overall rankings	Ranking on placings for indicators	Ranking on average attractiveness score for indicators
Hong Kong	1	2
Singapore	2	1
China	3	5
Korea	4	4
Japan	5	3
Brunei Darussalam	6	7
Malaysia	7	6
Azerbaijan	8	9
Kazakhstan	9	8
Thailand	10	10
Indonesia	11	12
Mongolia	12	16
Armenia	13	11
Vietnam	14	13
Philippines	15	15
Bhutan	16	25
Sri Lanka	17	18
India	18	14
Kyrgyzstan	19	17
Laos	20	21
Pakistan	21	19
Cambodia	22	20
Tajikistan	23	24
Bangladesh	24	22
Nepal	25	23

WHERE TO FROM HERE

Our simple framework highlights some of the wider opportunities across the region, which are far broader than China alone. While any analysis is subject to data limitations, this should not stop us from trying to use simple frameworks to provide some objectivity.

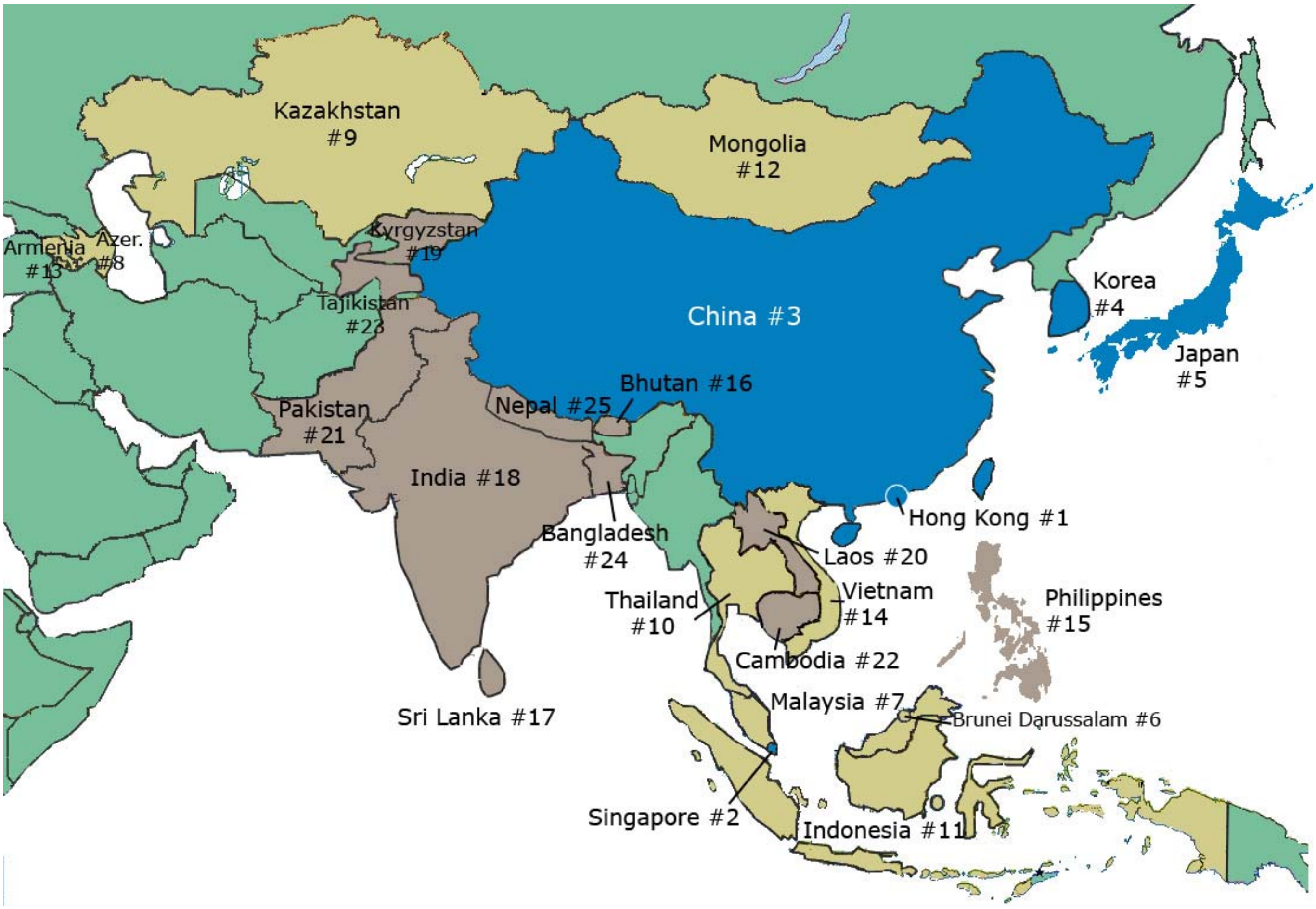
However, such macro-style analysis can only take you so far. Ultimately, the pursuit of opportunity within markets depends on microeconomic factors.

The next step for businesses requires an even deeper dive, to gain an intimate knowledge of a chosen market based around a specific proposition. Lessons from those who have gone before have shown essential elements for success in Asia include:

- **Strong business relationships** built up over time and based on mutual trust;
- **An intimate knowledge of a targeted market segment**;
- **Cultural understanding of tastes and business practices**;
- **Local staff or collaborators**;
- **Scale** as many of these markets are super-sized compared with New Zealand, and therefore collaboration will often be required within a sector;
- **Patience,** with a long-term view: time, cost and effort are required to become truly established in many of these markets.

For New Zealand it isn't just about establishing trade relationships and business. In order to make the most of the opportunities on offer there is another leg – deepening of economic and financial ties – that needs to take place. This involves the exchange of skills (migration), services, technology and capital (foreign direct investment). At the current juncture there is no doubt significant progress has been made on the migration and trade links from many countries, but deepening financial ties seems to be in the early adoption stages.

MAP OF COUNTRY RANKINGS



Source: ANZ

THE MONTH IN REVIEW

SUMMARY

Widespread rain from mid-April restored soil moisture and pasture covers heading into the winter. However, dairy farmers will need a good winter to get cows into appropriate condition before next season. Milk production hit a new record in 2013/14, but slower growth is anticipated in 2014/15. Red meat production forecasts have been increased slightly.

Much of the North Island and parts of the South became very dry in late March. However, widespread heavy rain from mid-to-late April broke the dry conditions in most regions. Throughout May it was generally milder westerly weather with periodic bouts of rain. This led to wilder weather in Southland and the West Coast of the South Island, but unseasonably mild conditions on the East Coasts. The recent rain has restored soil moisture levels and water tables to those of mid-winter in most regions. This has restored pasture covers heading into winter.

DAIRY

The 2013/14 season has come to an end with a new record for production and average yields. Despite the dry conditions in the first quarter of 2014 most dairy farmers took the opportunity to extend lactation for as long as possible to take advantage of the record milk price. **At this stage it looks like total NZ production will hit 1.84 billion kg MS (+11% y/y). This will beat the previous peak set in 2011/12 by 9%.**

Most dairy farmers will be hoping for another kind winter, as cow condition is reportedly mixed. This is a reflection of the strong milk flows produced throughout the season, and the extra use of supplements to extend the season. Therefore, it could well be a slower start to next season if weather and pasture growth conditions are unfavourable and cows struggle to put on enough condition.

Attention is beginning to turn to what NZ might be able to produce next season, as this will influence milk powder prices. Fonterra's initial estimate is for a 2% increase; conservative, given trend growth in recent years has been close to 6%.

At this stage the cull cow kill has run 7% ahead of the five-year average, implying no large retention of budget, or extra cows for next season. However, estimates on the number of new conversions coming into production vary from 80 to 150, implying an extra 1 to 2% increase in cow numbers. **So it seems the real question is whether average yields can be pushed higher. Mother Nature will have the final say**, but given the dramatic increase this season and a lower milk price forecast for next it seems unlikely in the short term. The other dynamic behind the conservative production estimate is the increased competition Fonterra is facing to secure milk supply, with expansion of existing dairy companies and a new competitor ,Oceania Dairy (a subsidiary of China's Yili Group) set to enter the market. This implies Fonterra's forecast of total NZ production is likely to be higher than 2%.

MEAT AND FIBRE

Industry forecasts for red meat production have been revised up slightly since our last update. Lamb production is now expected to hit 19.8 m head, 5% behind last year. Year-to-date production is tracking in line with this. Average weights are slightly better than last year, courtesy of a 0.5kg/hd lift in the North Island due the better seasonal conditions, especially on the East Coast.

Mutton slaughter is forecast to be 3.8m head, or 7% behind last year. However, year-to-date production is 3.6m head, with scanned dry ewes yet to be turned off. **This implies throughput could be similar to last year, which would see another decline in breeding ewe numbers.** Throughput has been particularly strong in the South Island, running 16% ahead of last year. **This reflects the continued expansion of dairying despite new limits being imposed for nutrient losses in the hotspots for dairy conversions.**

Year-to-date wool exports are 9% behind the same period last year. China's market share has declined to 48% from 52% for the same period last year. This will see the first yearly decline in market share for China since the early 2000s. India, Nepal, Egypt, France and Lithuania have picked up the majority of the market shift.

HORTICULTURE AND VITICULTURE

There is continued speculation of a large 2014 vintage despite some fruit being dropped and rain affecting the last third of the harvest. Those grape growers who harvested early benefited from fine weather, but heavy rain during the last third of the harvest period resulted in some growers having to leave grapes on vines to rot, or dump them. **The kiwifruit harvest started earlier than last year. Green supply looks like it will be slightly below earlier estimates, but there looks to be more G3 and G14 than earlier anticipated.** There is a bit of variation between lines for vines producing their first G3 crop, but that was to be expected.

RURAL PROPERTY MARKET

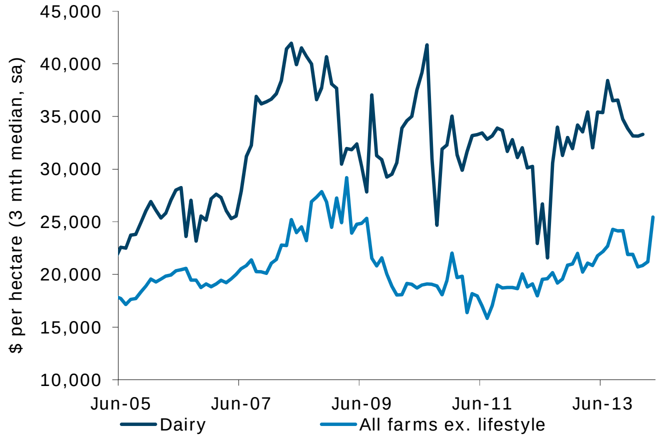
SUMMARY

Activity in the rural property market has cooled further since the start of the year, with total turnover easing to sit around the 10-year average. Turnover of all property types has eased over the past few months, though is still well above last year for all property types (excluding grazing when the widespread dry conditions affected confidence). Average prices have bounced a bit over the same period, particularly for dairy and horticulture-aligned property. With a lower milk price forecast, rising interest rates, and plenty of robust discussion on political and environmental regulatory risks, it would seem pricing has topped out in recent months. Elsewhere kiwifruit orchards have moved quickly and at prices not seen since Psa was discovered in 2010. In the sheep and beef sector, apart from the odd marquee property selling for good money, the market remains subdued.

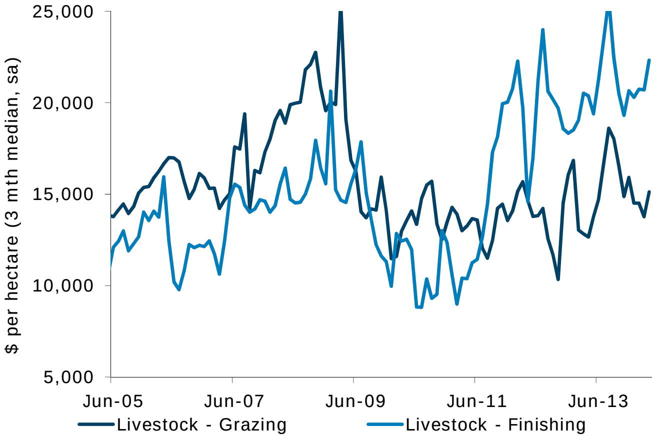
Total turnover in recent months has eased back toward the 10-year average. The earlier strong activity will see annual 2013/14 sale volumes return to pre-GFC levels for the first time though. Sale volumes of finishing properties have led the charge, followed closely by dairying. But the buoyancy in sales volumes has generally been broad-based with all property types exceeding, or on par with, their turnover average from the last 10 years. **The average all-farm price has bounced again to $25,400/ha in April,** but this is influenced by the mix of sales (both region and type) from one period to the next. The bounce seems to have come through on all property types except dairying, which was unchanged. With many of the traditional valuations metrics now stretched, a lower milk price forecast, higher interest rates, and increasing environmental regulation, it seems 2014/15 will be a year of consolidation as opposed to further price and activity increases.

Farm Sales by Farm Type								
3-Month Seasonally Adjusted		**Current Period**	**Previous Period**	**Last Year**	**10 - Year Av.**	**Chg. P/P**	**Chg. Y/Y**	**Chg. P/10yr**
Dairy	Number of Sales	72	77	59	72	↓	↑	↓
	Median Price ($ per ha)	33,300	33,100	33,500	30,500	↑	↓	↑
Livestock - Finishing	Number of Sales	98	102	76	66	↓	↑	↑
	Median Price ($ per ha)	22,300	20,700	20,400	14,600	↑	↑	↑
Livestock - Grazing	Number of Sales	160	212	178	219	↓	↓	↓
	Median Price ($ per ha)	15,100	13,800	13,000	15,300	↑	↑	↓
Horticulture	Number of Sales	48	54	31	46	↓	↑	↑
	Median Price ($ per ha)	178,400	139,900	121,200	147,000	↑	↑	↑
Arable	Number of Sales	26	31	16	19	↓	↑	↑
	Median Price ($ per ha)	25,900	25,700	31,100	26,500	↑	↓	↓
All Farms ex. Lifestyle	Number of Sales	423	498	377	455	↓	↑	↓
	Median Price ($ per ha)	25,400	21,200	20,900	20,300	↑	↑	↑
Lifestyle	Number of Sales	1,670	1,692	1,661	1,558	↓	↑	↑
	Median Price	509,000	503,000	517,000	429,000	↑	↓	↑

FARM SALES, MEDIAN PRICE



FARM SALES, MEDIAN PRICE

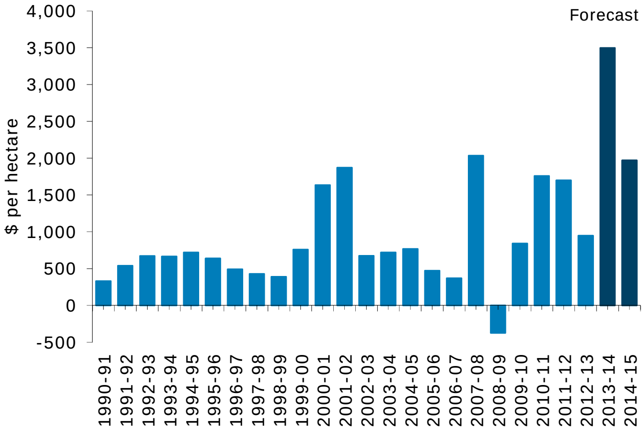


Source: ANZ, REINZ

RURAL PROPERTY MARKET

Given the record dairy payout in 2013/14 has driven much of the activity in the rural property market in recent times there will be lots of talk about how the drop in the Fonterra forecast milk price to $7/kg MS + dividend will affect the market in 2014/15. **We believe it will cause a leveling off in prices as opposed to a downward correction. Cash flow and profitability still look historically strong.**

AVERAGE DAIRY FARM PROFITABILITY BEFORE TAX



Source: ANZ, Dairy NZ

In fact if you look at average profitability in 2013/14 it is still expected to be nearly $3,500/ha, which is three times greater than the seven-year average. This is courtesy of a record milk price this season (despite the recent $0.25/kg MS decrease), constrained expenditure, strong productivity, and record production in many regions. That's a potent mix. And while the opening milk price of $7/kg MS represents a substantial fall in percentage terms from the 2013/14 season, it would still be the 4th highest on record if achieved, and is above the seven year average of $6.63/kg MS. The dividend also needs to be added, and we expect that it will be better than the current seasons $0.10 per share. **This means at the moment the average dairy farmer's budget is showing decent profitability around the $2,000/ha mark for 2014/15.**

The other interesting dynamic is that cash-flow over the next 12 months should still be solid, and as the season progresses may well be similar to the past financial year. This due to the bow wave of cash from 2013/14 that is yet to hit bank balances, as well as an expectation that the advance schedule will move up in 2015 as more certainty around milk powder prices basing emerges and the NZD tops out. The opening milk price forecast is a little stronger than we thought, and the uncertainty of where milk powder prices will base has been reflected in the advanced schedule, as opposed to the forecast.

From a long-term perspective the fall in the coming year's milk price is likely to be a good thing. That might sound like an odd thing to say, but back-to-back record high payouts would have been a red rag to a bull, likely fostering over-investment, unsustainable land prices, and too large a supply response around the globe. The latter ultimately ends up in prices materially undershooting a season or so down the track, causing a lot of unnecessary investment volatility.

Examining the backward-looking indicators for the rural property market on page 15 shows the turnover of dairy properties has come off in recent months, but is still running around the 10-year average. **In the month of March, 41 dairy farms were sold, at an average sale value of $43,300/ha, or $44 per kg MS.** The average farm size was 117 hectares and the average production/ha was 981kg MS. **In the month of April, 28 dairy farms were sold with an average sale price of $31,500/ha, or $40 per kg MS.** The average farm size was 125 hectares and production/ha was 787kg MS.

Turnover for finishing properties has come off earlier highs, but is still sitting around 50% above the 10-year average. Average prices kicked up to $22,300/ha in April, but look to have settled back into a range of $18,000-$21,000/ha depending on the mix of sales from period to period. Turnover activity and sale prices will be key to watch over the coming year for trends in dairying investment, as this has driven a lot of activity for finishing properties. **Turnover of grazing properties dropped below the 10-year average in April for the first time since October 2013. Average prices were $15,100/ha in April and seem to have settled into a range of $14,000-$15,000/ha over the past six months.** This is in line with the 10-year average and prices achieved over the same period a year earlier. **The turnover of arable properties remains strong and above the 10-year average. Additionally, the average sale price has risen to $26,000/ha in recent months,** which while $2,500/ha off the highs of 2013, is in line with the 10-year average.

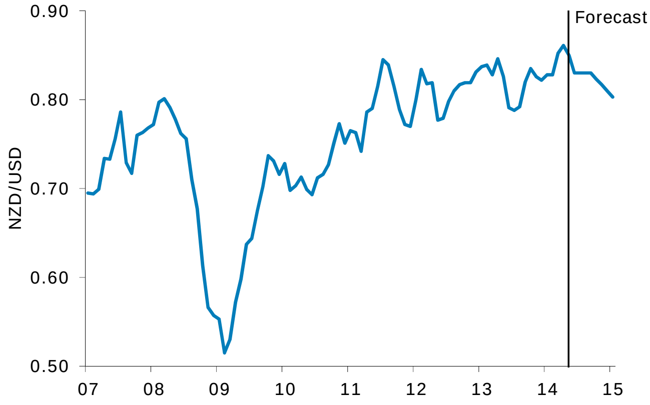
In the horticulture sector improved confidence and appetite for investment in kiwifruit and pip fruit assets in recent times is starting to show up in the statistics. **In recent months total turnover has exceeded the 10-year average for the first time since the GFC, and average prices have moved up.** Expectations are for consolidation in prices at recent levels as valuation metrics have started to become stretched in some sectors.

ECONOMIC INDICATORS

Exchange Rates

	Current Month	3 Mth Trend	Last Year	Chg. M / 3M	Chg. Y / Y
NZD/USD	0.850	0.847	0.826	↑	↑
NZD/EUR	0.611	0.616	0.636	↓	↓
NZD/GBP	0.501	0.509	0.540	↓	↓
NZD/AUD	0.930	0.929	0.832	↑	↑
NZD/JPY	87.36	86.66	83.30	↑	↑
NZD/TWI	78.90	79.58	74.72	↓	↑

NZD BUYS USD

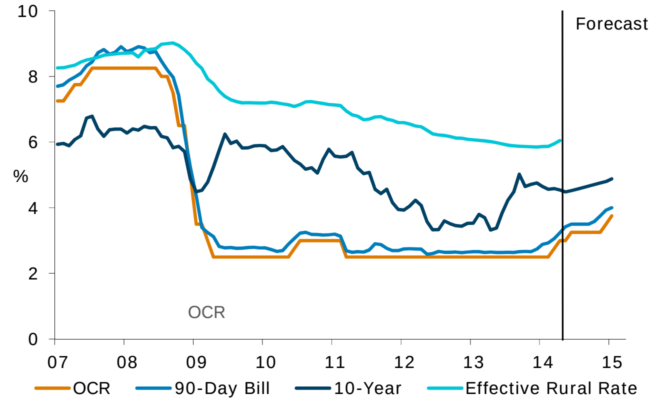


Source: ANZ, Bloomberg

NZ Interest Rates

	Current Month	3 Mth Trend	Last Year	Chg. M / 3M	Chg. Y / Y
Official Cash Rate	3.00	2.75	2.50	↑	↑
90 Day Bill Rate	3.42	3.07	2.64	↑	↑
1 yr	3.40	3.39	2.50	↑	↑
2 yr	3.59	3.69	2.51	↓	↑
3 yr	3.78	3.95	2.62	↓	↑
5 yr	4.20	4.14	2.86	↑	↑
10 yr	4.48	4.56	3.38	↓	↑
Effective Rural Rate	5.81	5.95	5.98	↓	↓
Agricultural Debt ($b)	51.85	51.85	50.71	↑	↑

KEY NZ INTEREST RATES



Source: ANZ, RBNZ

In our last edition we highlighted New Zealand's relatively sound economic prospects, and expressed the view that NZD/USD would likely trade in a 0.82-0.87 range through to the end of Q3, with the key thematic being one of *strength*, rather than *strengthening*. **In broad terms, we remain of that view, although we must acknowledge that dairy (and other commodity) prices have fallen further than we expected.** While there are important offsets (like the easing fiscal stance, the flatter yield curve, booming migration and tighter margins), FX markets have pounced on the commodity story, to the detriment of the NZD. **Weaker commodity prices are a reason to be cautious, and point to the "Kiwi" habituating a slightly less elevated range of 0.81-0.86 through Q3.**

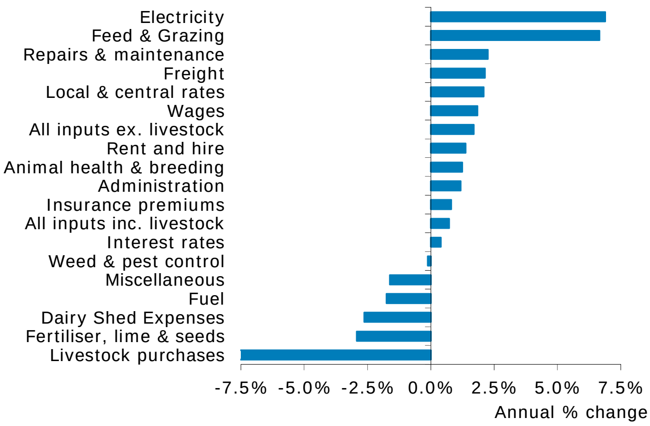
However, let's not throw the baby out with the bath water: NZ growth may be levelling off, but it remains "best in class". The terms of trade have peaked, but overall commodity prices remain elevated. **It's the interest rate picture that is the biggest thorn in the side of the Kiwi bears**, for NZ interest rates are the highest in the developed world and are set to climb further. This makes it very expensive to "short" the NZD/USD. Furthermore, we expect the US Federal Reserve to keep the Fed Funds rate at zero for another year, and with market expectations pointing to the NZ/US 2 year interest rate spread holding above 3% for a similar period, this situation won't change any time soon. **The NZD/AUD is likely to remain elevated for similar reasons.** While the strong New Zealand / weak Australia story is mature, and well understood by markets, interest rates strongly favour the NZD, and this will not change materially until the Australian economy starts to turn the corner.

Although the RBNZ has lifted the OCR twice (and is set to deliver a third hike on June 12th), New Zealand long-term interest rates have fallen to their lowest levels this year. This largely reflects the sharp fall in US bond yields, and a narrowing in peripheral European sovereign bond spreads. **From here, we expect US interest rates to rise gradually, taking NZ interest rates with them.** However, with expectations of a higher OCR now largely built in, we do expect NZ rates to rise to a lesser extent than in the US, steepening the yield curve.

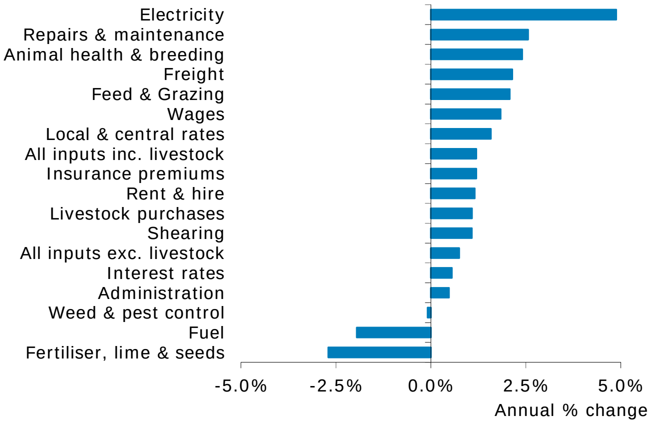
ECONOMIC INDICATORS

Inflation Gauges					
Annual % change	**Current Qtr**	**Last Qtr**	**Last Year**	**Chg. Q/Q**	**Chg. Y/Y**
Consumer Price Index	1.5	1.6	0.9	↓	↑
Farm Input	0.6	-1.3	-0.8	↑	↑
Net Imp. Margins PPI	19.6	20.8	-1.4	↓	↑

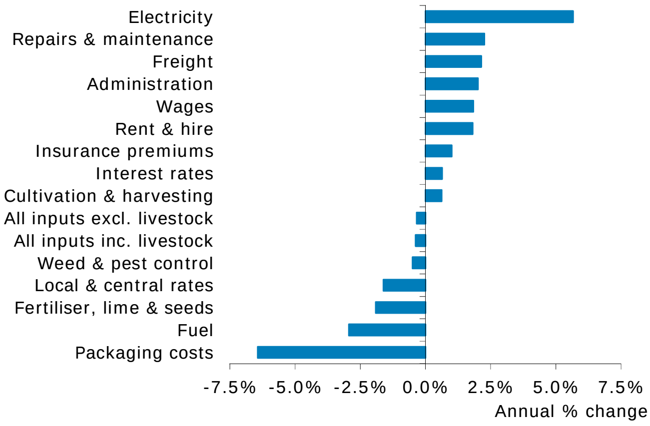
FARM EXPENSES MOVEMENT 2013/14 -DAIRY



FARM EXPENSES MOVEMENT 2013/14 –SHEEP & BEEF



FARM EXPENSES MOVEMENT 2013/14 – HORTICULTURE & FRUIT GROWERS



Source: ANZ, Statistics NZ

Earlier in the year we held some fears that the record dairy milk price and a general increase in inflation might put a high cost base in place heading into the 2014/15 season. This fear seems to have been somewhat misplaced for now at least, with Statistics NZ's **latest annual survey of on-farm cost movements showing an annual movement of 1.0% for the "all farms" measure in 2013/14 when livestock are excluded.** This was below general inflation for the broader economy and the 4th lowest outturn since the turn of the century. **Combined with improved productivity this is helping keep cost lines under control and adding to bottom lines across the agri sector.**

Within the main farming categories **dairying experienced the largest annual increase in farm costs of 1.7% y/y** when livestock where excluded. **Sheep and beef experienced a more modest 0.7% y/y increase, and horticulture and fruit growers actually had a decline of -0.3% y/y.** For horticulture and fruit growers this was the first annual decline since the late 1990s and follows a 0.2% y/y increase in 2012/13, meaning the cost of inputs are little changed in two years.

The biggest upward lift across the different farming categories occurred for electricity (5-6%), freight (2-2.5%) and repairs & maintenance (2-2.5%). In the dairy sector the cost of feed and grazing also increased by 6.7% y/y. This wasn't surprising given the increased demand for supplement feed as farmers tried to make the most of the high milk price, a shift to more intensive farming systems continued, and the need for dairy support grew.

At the other end of the spectrum there were some welcome declines in fuel, fertiliser, lime & seeds, and weed & pest costs. Fuel costs declined by about 2% across the farming categories; fertiliser, lime & seeds prices were back 2-3%; and weed & pest costs fell 0.5%. These declines were driven by the high NZD and lower international oil and fertiliser prices. For dairy farmers there was also a decline in dairy shed costs of 2.6% and miscellaneous costs fell 1.6%. For horticulture and fruit growers there was a substantial 6.4% decline in packaging costs, which seems to have been driven by industry consolidation, especially in the kiwifruit sector.

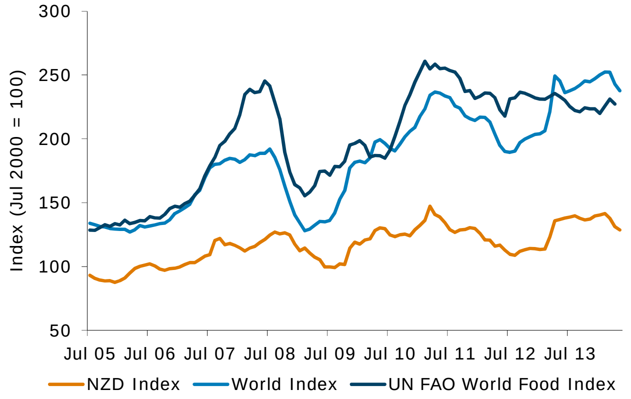
There was the perennial increase in many of the non-discretionary expenditure items though. Rates moved 1.6-2.0% higher for the livestock sectors, but perhaps surprisingly dropped by 1.6% for horticulture and fruit growers. Wages moved up by 1.8% and there were generally small increases for administration, rent & hire, and administration costs.

KEY COMMODITIES

Soft Commodity Price Indices

	Current Month	3 Mth Trend	Last Year	Chg. M/3M	Chg. Y/Y
ANZ NZD Index	129	137	137	↓	↓
ANZ World Price Index	238	249	245	↓	↓
FAO World Food Index	227	228	236	↓	↓

SOFT COMMODITY PRICE INDICES

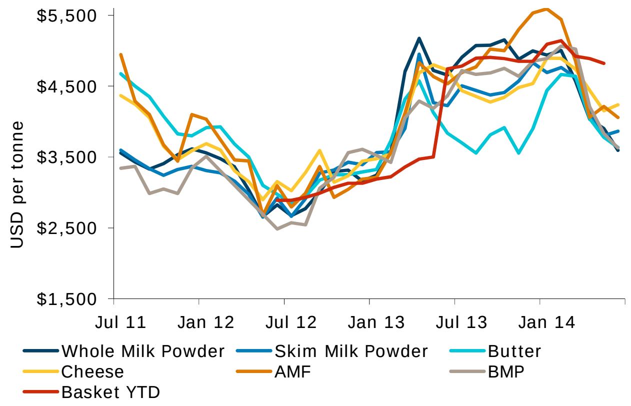


Source: ANZ, FAO

Oceania Dairy Price Indicators

USD per tonne	Current Month	3 Mth Trend	Last Year	Chg. M/3M	Chg Y/Y
Milk Price YTD ($ per MS)	8.40	8.50	8.10	↓	↑
Milk Price Forecast ($ per MS)	7.00	n.a	8.10	n.a	↓
Whole Milk Powder	3,594	4,979	4,656	↓	↓
Skim Milk Powder	3,863	4,762	4,224	↓	↓
Butter	3,634	4,335	3,834	↓	↓
Anhydrous Milk Fat	4,058	5,521	4,533	↓	↓
Butter Milk Powder	3,628	4,936	4,363	↓	↓
Cheese	4,236	4,773	4,727	↓	↓
Basket YTD	4,820	4,983	4,744	↓	↑

DAIRY PRODUCTS – NZ EXPORT MARKET PRICES



Source: ANZ, GlobalDairyTrade, USDA

Both local and global food prices have declined in recent months. The drop has been led by dairy, oil and sugar prices. Meat and cereal prices have remained resistant so far. Combined with only a limited decline in the NZD this has placed downward pressure on farm-gate prices. **Continued NZD strength is likely to keep the pressure on farm-gate prices in the near term**, but as the 2014/15 season progresses we expect a further softening, which should provide some relief.

There has been a lot to digest since our last update on dairy prices. So far milk powder prices and in particular whole milk prices are yet to base, which combined with only a small decline in the NZD is placing pressure on the outlook for the 2014/15 milk price. **At this stage we are retaining a forecast in the low-to-mid $7/kg MS range (bottom end of this range at present),** but continued weakness at the price levels seen in the GDT auction in early June would reduce our forecast back toward $6.50/kg MS.

The two main factors that have led to continued weakness in WMP prices have been the seasonal increase in domestic Chinese raw milk supply, and an overhang of imported product during the first four months of the year. In total China imported nearly 420,000t of WMP during the first four months of 2014, which was a 70% increase on the same period in 2013. This unprecedented demand has been the main focus of NZ, with year-to-date shipments of WMP up by 13% and China accounting for a massive 57% of this. While China's import demand is expected to remain strong it's a matter of the degree of strength, and at the moment it is clearly struggling to digest recent imports.

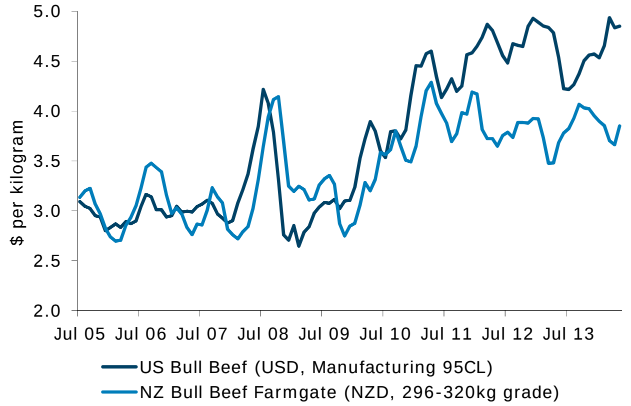
Where to from here? Well to us prices seem to have now undershot. Outside of GDT, demand for WMP has reportedly been picking up, many NZ and Australian dairy companies have limited stock available as the 2013/14 season finishes and SMP prices continue to hold up. Additionally as China has lifted its market share of WMP this has reduced supply to many other markets. While Argentina and Europe have stepped up to fill the void, domestic WMP prices in the likes of Europe are still well above the global price. **So we expect prices to start to settle before a modest improvement toward the end of the year, but uncertainty is high following the early June GDT auction.** Fonterra's opening milk price and advance schedule also imply some confidence of a lift. We were expecting a slightly lower opening forecast of between $6.50 to high $6's/kg MS in May. Additionally the effective advance schedule looks not too far off last year when prices were higher and rising, although comparisons are a little more difficult to make because of the changes to the capacity adjustment payment.

KEY COMMODITIES

Beef Price Indicators					
$ per kg	**Current Month**	**3 Mth Trend**	**Last Year**	**Chg. M/3M**	**Chg. Y/Y**
NZ Bull Beef[1]	3.85	3.74	3.68	↑	↑
NZ Steer[1]	4.00	3.91	3.71	↑	↑
NZ Heifer[1]	3.42	3.33	3.17	↑	↑
NZ Cow[1]	2.62	2.57	2.58	↑	↑
US Bull Beef[2]	4.85	4.81	4.54	↑	↑
US Manu. Cow[3]	4.53	4.57	4.03	↓	↑
Steer Primal Cuts	7.39	7.30	6.61	↑	↑
Hides[4]	76.1	74.6	62.9	↑	↑
By-Products[4]	52.8	53.4	46.0	↓	↑

1:(NZD, 296-320kg Grade Bull & Steer), (NZD, 195-220kg Grade Heifer)(NZD, 160-195kg Grade Cow),2:USD, Manufacturing 95 CL, 3:USD Manufacturing 90 CL, 4: USD$ per Hide.

BEEF INDICATOR PRICES

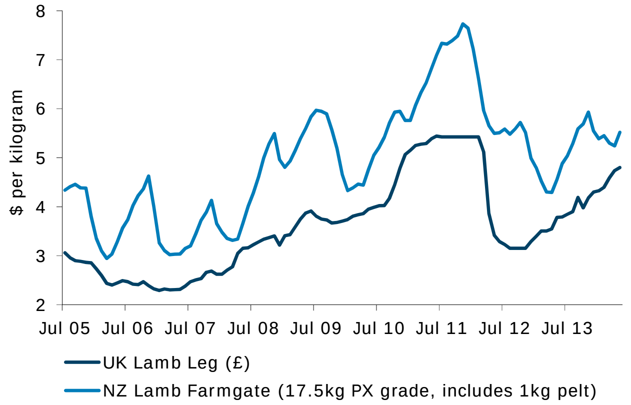


Source: ANZ, Agrifax

Lamb Price Indicators					
$ per kg	**Current Month**	**3 Mth Trend**	**Last Year**	**Chg. M/3M**	**Chg Y/Y**
NZ Lamb[1] (NZD)	5.52	5.33	4.56	↑	↑
UK Lamb Leg (£)	4.80	4.58	3.78	↑	↑
Rack US(USD)	16.8	16.8	15.4	↔	↑
Flaps(USD)	5.74	5.71	4.80	↑	↑
Skins[2]	6.43	7.30	8.01	↓	↓

1: 17.5kg YX grade, inc. 1kg pelt, 2: USD per skin.

LAMB INDICATOR PRICES



Source: ANZ, Agrifax

Confidence remains high for decent farm-gate returns from prime cattle in 2014/15. An early indication post this year's cull cow slaughter is that meat companies have recently put out winter contracts with up to $4.80-$4.90/kg offered for prime beef cattle for August-September supply. This is 30-40c/kg above spot schedule prices in early June and provides some insight into beef schedules through the winter period.

Many of the familiar drivers for better prices remain in play. In the US year-to-date beef production continues to lag. There is weakness across all categories of beef animals, but the biggest driver is an 11% y/y fall in cow slaughter. This is not expected to change any time soon, with large incentives to retain beef cows and record milk prices keeping cull dairy cow numbers tight. Pork production is also under pressure from the PEDv virus and is expected to tighten further over coming months. Historically chicken would fill the shortfall in beef and pork supply, but so far the sector is yet to respond, mainly due to production issues (aging breeding flock, some hatching and/or chick survival difficulties) and high soymeal prices. Confidence in the food service industry also appears to be improving and all these factors point to higher meat protein prices. **Australia's beef supply remains key to watch.** There has been some rain, but slaughter rates are yet to slow with processing space well forward booked.

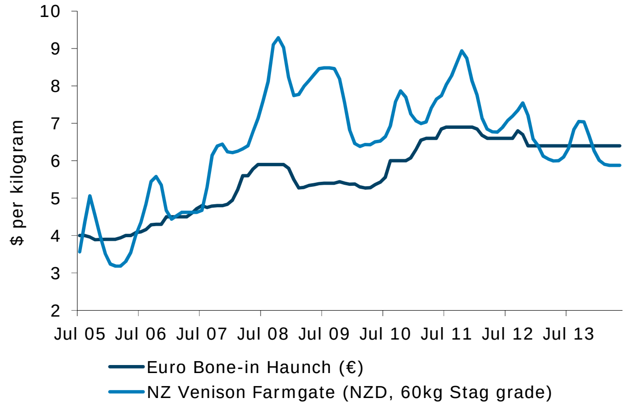
During April meat companies announced a number of lamb contracts for late winter and early spring delivery. The contract terms varied for prices, weight ranges and supply dates. But generally pricing ranged from $6-$6.50/kg depending on the terms. Post Easter the focus has shifted to frozen product and maximising returns from any chilled programmes. Steady demand continues in both Europe and China and as NZ's seasonal throughput slows, overseas pricing for key frozen products continues to firm. The main frozen CKT leg cut is now at £4.80/kg, its highest level in nearly two years. End demand was strong enough to negate a build-up of inventories post-Easter, which bodes well for winter and spring prices. It appears that there may finally be some upward pressure in pricing for middle cuts of the lamb carcass, with lamb on a few more restaurant menus in the US. Strong demand from China for whole and half lamb carcases and 6-way cuts is also supporting demand for the middle sections of the carcass, as there are less individual middle sections available to sell. **Overall, the prices received for product into China are now helping to support prices paid elsewhere in key markets such as the US and EU.**

KEY COMMODITIES

Venison Price Indicators					
$ per kg	**Current Month**	**3 Mth Trend**	**Last Year**	**Chg. M/3M**	**Chg. Y/Y**
NZ Stag[1]	5.9	5.9	6.0	↔	↓
NZ Hind[1]	5.8	5.8	5.9	↔	↓
Euro Bone-in Haunch (EUR)	6.4	6.4	6.4	↔	↔
Boneless Shoulder (EUR)	4.4	4.5	4.7	↓	↓
Loin (EUR)	12.7	13.0	14.0	↓	↓

[1] (60kg Stag AP grade), (50kg Hind AP grade).

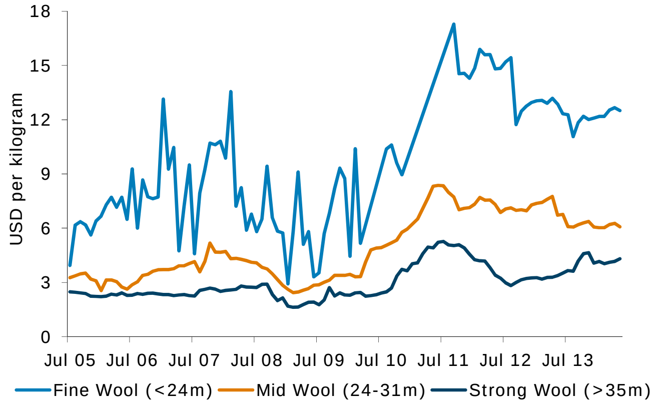
VENISON INDICATOR PRICES



Source: ANZ, Agrifax

Clean Wool Indicator Prices					
$ per kg	**Current Month**	**3 Mth Trend**	**Last Year**	**Chg. M/3M**	**Chg. Y/Y**
NZ Fine Wool (>24m)	14.71	14.71	15.58	↔	↓
NZ Mid Wool (24-31m)	7.15	7.28	8.13	↓	↓
NZ Strong Wool (>32m)	5.08	4.85	4.09	↑	↑
USD Fine Wool (>24m)	12.50	12.46	12.87	↑	↓
USD Mid Wool (24-31m)	6.08	6.17	6.72	↓	↓
USD Strong Wool (>32m)	4.32	4.11	3.37	↑	↑

WOOL INDICATOR PRICES (CLEAN)



Source: ANZ, Beef + Lamb NZ, Wool Services International

There has been some better news for venison from the European market recently, with a lift in enquiries. Increased enquiries have been most notable from Germany, but improvement has also been reported in other parts of Europe. It appears lower prices have encouraged an increase in consumption and lowered inventories. This has encouraged buyers who had hung back to order frozen venison earlier than they have in the past few years. There have also been slow gains made in the US restaurant market as foodservice demand has picked up following the harsh winter with an improvement in economic conditions. Interest has been highest for middle cuts, while demand for legs has remained more subdued. It appears some importers have substituted striploins for leg cuts.

Year-to-date production for 2013/14 is up 1%, with a 9.4% increase in hind throughput offset by a 7.3% decline in stag slaughter. Frozen exports over the same period have been stronger though, implying a reduction in inventory in New Zealand. The higher hind throughput implies a reduction in breeding hind numbers and lower medium-term production.

All up, better European enquiry, lower on- and offshore inventories and a lower NZD/EUR are providing slightly brighter price prospects than last year for the key September to November sales window when venison production increases.

Strong wool auction prices have been slowly moving up. Auction supply has been lower than expected lately due to wet weather limiting shearing. Most of the demand recently has been from local exporters to meet contracts to supply customers with sales already made and for contracts 12 months out – rather than strong demand from overseas buyers pushing up prices. **Year-to-date wool exports are running 9% behind the same period last year.** China exports have declined by 15% leading to the first annual decline in market share since the early 2000s. Sluggish end demand in export markets and a slowdown in domestic construction have left higher inventory levels of finished product and less demand for imports of raw wool.

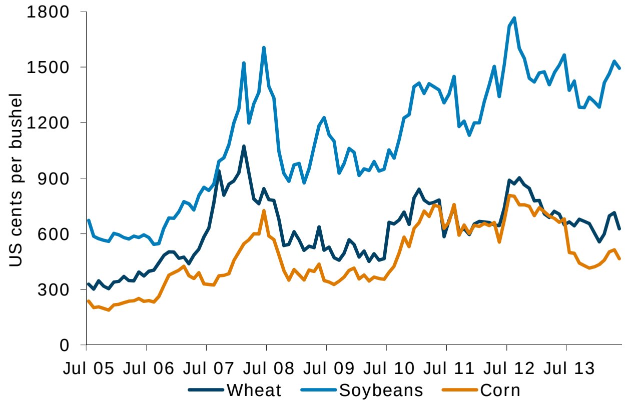
Wool prices are expected to remain around current levels, though they may deviate up and down at each auction depending on buyer sentiment and need to fill a specific order. Certain wool types, such as good quality colour wools, have slightly higher demand. This means that pass-in rates and average sale prices will shift between auctions depending on the variety of wool types on offer.

KEY COMMODITIES

Grain & Oilseed Price Indicators					
	Current Month	**3 Mth Trend**	**Last Year**	**Chg. M/3M**	**Chg. Y/Y**
NZ Milling Wheat[1]	438	425	409	↑	↑
NZ Feed Wheat[1]	426	410	373	↑	↑
NZ Feed Barley[1]	429	405	366	↑	↑
Palm Kernel Expeller[1]	349	340	336	↑	↑
US Wheat[2]	6.3	5.9	7.1	↑	↓
US Soybeans[2]	14.9	13.4	15.1	↑	↓
US Corn[2]	4.7	4.4	6.6	↑	↓
Australian Hard Wheat[1]	426	420	451	↑	↓

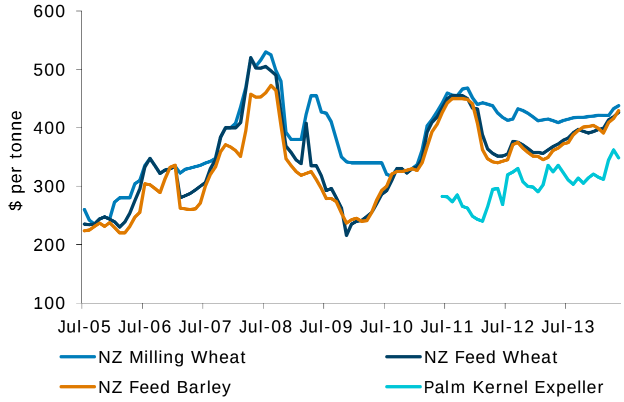
1: NZD per tonne, 2: USD per bushel

CBOT FUTURE GRAIN & OILSEED INDICATOR PRICES



Source: ANZ, Bloomberg

KEY NZ GRAIN PRICES



Source: ANZ, Agrifax

The Arable Industry Marketing Initiative survey has revealed the estimated total tonnages of feed wheat (290,000t) and feed barley (340,000t) harvested in 2014 are slightly less than the previous two years. Feed wheat tonnage is estimated to be down by 6% and feed barley down by 1% compared to the 2013 harvest. The drop reflects two things: (1) an estimated 2% decrease in the harvested areas of both feed wheat and feed barley as compared to the previous year; and (2) a drop in the average yield of feed wheat crops in 2014 compared to the exceptionally good 2013 harvest (8.9t/ha in 2014 and 9.4t/ha in 2013), and identical average yields of feed barley crops in the last two seasons (7.6t/ha for both 2013 and 2014 harvests).

The survey also revealed large sales of feed wheat and feed barley as at April 1, which leaves little unsold domestic feed grain heading into 2014/15. Higher demand for feed from the dairy sector was the main driver. Unsold tonnages of milling and feed wheat were both about half the unsold tonnages a year ago. The unsold tonnage of feed barley was about one third that of a year ago. Feed wheat and barley prices are currently sitting at about $430/t in Canterbury, and have been steadily climbing since this year's harvest. These are the highest May prices since 2008.

Though sales are reported to have slowed recently at these high prices, this is not unusual for this time of year. **It's unlikely that slower sales will cause easing prices, as there is little incentive for growers to lower the price in order to clear volumes.** Most will have sold good volumes at high prices already this year and this will mean that they won't mind holding some in reserve for later on.

The two factors that could weigh on domestic prices are global grain prices, which have shifted down recently, and a lower milk price. Lower global grain prices combined with the high NZD is making a wide range of alternate feed sources viable to import. A recent example is the importation of 20,000t of maize from the US (largest shipment ever received) for use in compound feeds. The most aggressive move lower for global grain prices has been for wheat, as there are large volumes in storage and generally positive reports on Northern Hemisphere planting. Prices had earlier been pushed up by Ukraine/Russia tensions and the poor condition of US winter wheat. However, there has been little disruption to grain exports from the Ukraine so far and in the US there has been rain in key winter wheat-producing areas, which has helped improve the prospects for yields.

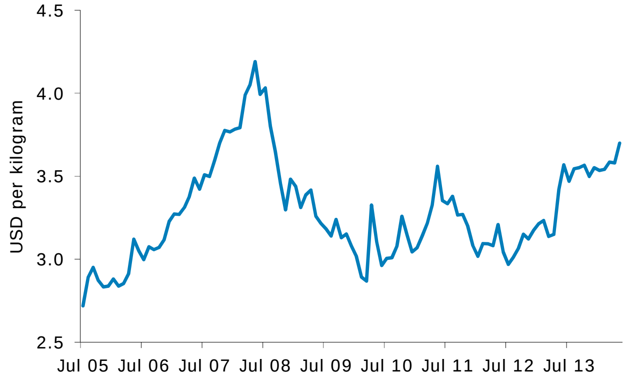
KEY COMMODITIES

Horticulture Price Indicators

	Current Month	3 Mth Trend	Last Year	Chg. M/3M	Chg. Y/Y
Kiwifruit (USD per kg)	3.7	3.6	3.4	↑	↑
Apples (Weighted Index)	267	265	269	↑	↓
Average Wine Price[1]	6.3	5.8	6.4	↑	↓
Packaged White Wine[1]	6.5	6.5	6.7	↑	↓
Packaged Red Wine[1]	10.1	10.0	10.3	↑	↓
Bulk wine[1]	3.9	3.5	3.7	↑	↑

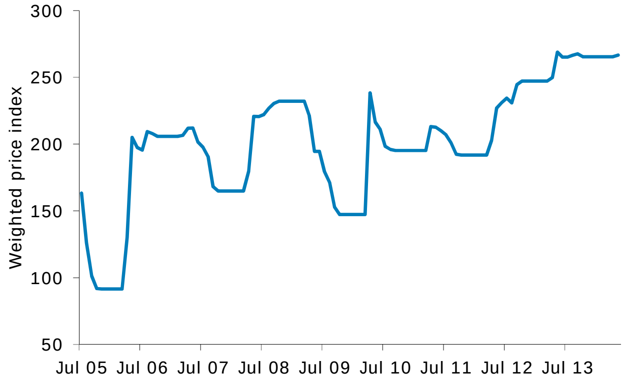
1: USD per litre

KIWIFRUIT INDICATOR PRICE



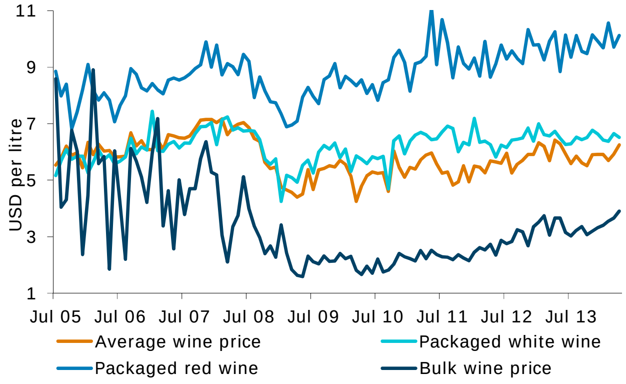
Source: ANZ, Zentrale Markt- und Preisberichtstelle

APPLE INDICATOR PRICE INDEX



Source: ANZ, Zentrale Markt- und Preisberichtstelle

WINE INDICATOR PRICES



Source: ANZ, NZ Winegrowers

The 2014 kiwifruit harvest got off to an early start and as at 1 June sales were 21% ahead of the previous season. The 2014 crop is expected to be around 88.5m trays. This would be slightly larger (+3%) than the 86m trays harvested in 2013, but still well down on 101m trays in 2012**. Within this, total gold production is expected to increase 70% to 18.5m trays, which is slightly better than earlier estimates.** This increase is due to better yields and some earlier grafted Gold3 beginning to produce fruit. **Green production is forecast to decrease 5% to 65.8m trays.** This is largely due to some re-grafting of Green vines to Gold, reducing the producing area. **Overall after a dry summer good dry matter levels are expected, but there is some variability amongst lines so fruit loss is expected to be up on last year – 2013 was a record low year for fruit loss.**

On the pricing front Zespri have just released their indicative ranges for the 2014 harvest. **The indicative range for Green is $5-5.5/tray, which is similar to the 2013 result.** In-market returns look positive from reduced supply and less competition from Chile, but the high NZD remains challenging for orchard gate returns**. Returns for the other categories are looking softer due to the increase in volumes, market mix impacts and the high NZD. The indicative range for Gold is $9.40-$10.10/tray,** which is well back on the $12.9/tray achieved for the 2013 harvest. As Gold volumes recover from Psa and grow toward 50m plus trays returns are expected to continue to fall toward the $7/tray range, depending on exchange rates and seasonal factors. Organic returns are expected to be significantly affected by the weak Japanese yen, given a relatively high proportion of this category is sold to Japan.

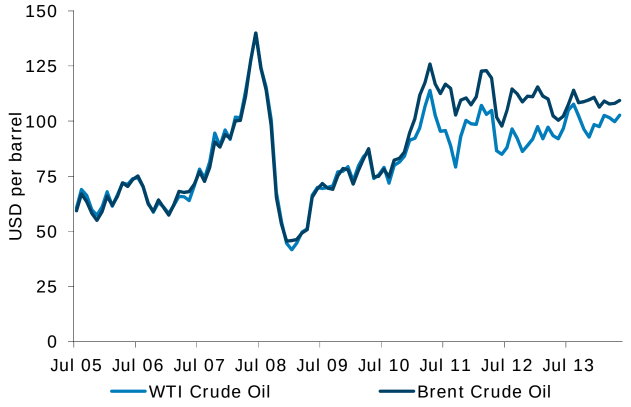
Export wine prices have continued their trend of slow improvement. The main movement has been in bulk wine prices, which for the 10 months to April 14 were $4.10/litre, 8% ahead of the same period the year before. This is surprising given a 16% increase in the volume sold, but as a proportion of total exports bulk wine remains stable at 30%. The charge in bulk exports has been led by sales to the UK and US as their economies recover. Bulk wine export returns to the UK were $3.95/l for the 10 months to April 14, which was up 16% on the same period a year before. Year-on-year export volumes were up 24% over the same period also. The US is the highest-returning market of the big three at $4.52/l for the 10 months to April 14, which was an 8% lift on the same period a year before. Volumes exported lifted by 11% over the same period.

KEY COMMODITIES

Other Cost Indicators					
	Current Month	**3 Mth Trend**	**Last Year**	**Chg. M/3M**	**Chg. Y/Y**
WTI Oil[1]	103	101	92	↑	↑
Brent Oil[1]	109	108	100	↑	↑
Ocean Freight[2]	934	1,548	809	↓	↑

1:US$ per barrel, grade WTI
2:Baltic Dry Index

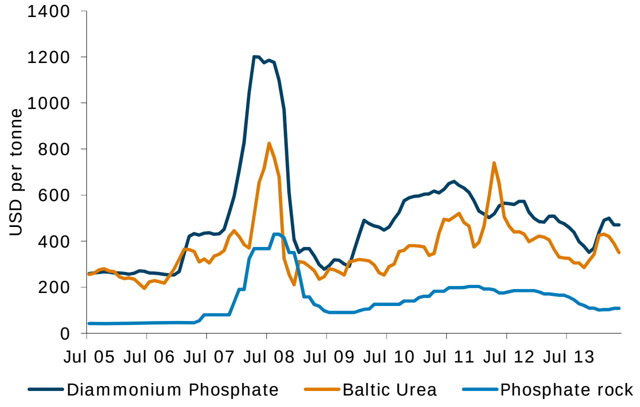
CRUDE OIL INDICATOR PRICES



Source: ANZ, Bloomberg

Fertiliser Price Indicators					
$ per tonne	**Current Month**	**3 Mth Trend**	**Last Year**	**Chg. M/3M**	**Chg. Y/Y**
DAP (USD)	471	487	485	↓	↓
Urea (USD)	350	413	330	↓	↑
Phosphate Rock (USD)	108	104	165	↑	↓
Farm-gate DAP (NZD)	797	836	NA	↓	NA
Farm-gate Urea (NZD)	605	694	NA	↓	NA
Farm-gate Super phosphate (NZD)	316	326	NA	↓	NA

INDICATIVE INTERNATIONAL FERTILISER PRICES



Source: ANZ, Bloomberg

We take a positive view on oil prices for the next quarter, as physical demand improves due to seasonally higher summer consumption and a more supportive macroeconomic backdrop. Geopolitical factors will continue to feature in the coming months, largely with a bullish bias. Supply risks from Russia and Libya will linger and dominate upside risks, alongside potential disruptions from Iraq as post-election sectarian violence worsens. The main downside risk remains returning Iranian supply, although we maintain a view that a meaningful supply response isn't likely until at least the latter part of the year.

A stronger than expected OECD stock build in Q2 was offset by record high global supply outages. Disruptions to supply totalled 4.2 million barrels through the quarter, which offset rising inventories and left total stock levels well below previous year Q2 averages. OECD commercial oil & fuel stocks stood at a 4-year low at May-end and with the seasonal draw already underway, the supply position will continue to tighten and keep prices elevated. Product inventories are similarly low; both US stocks of distillate and gasoline are tracking below long term averages. Distillate stocks are particularly thin following the abnormally cold US winter.

Global fertiliser prices have moved lower, and combined with the high NZD this has driven a reduction in farm-gate fertiliser prices. DAP and Urea have experienced the largest declines. DAP has been reduced by $39/t to $797/t and Urea dropped $89/t to $605/t. Super phosphate has declined by only $10/t to $316/t.

Global Urea prices have been pressured by increased Chinese supplies, which have been assessed at 7.8m tonnes for the Jan-September period. This is a nearly a 40% increase on the same period a year before. Year-to-date exports have also been ahead of expectations and are forecast to further increase from July when a lower tax window is allowed. In contrast, political issues continue to reduce both output and exports from the Middle East, but these have not been material enough to influence the decline in prices.

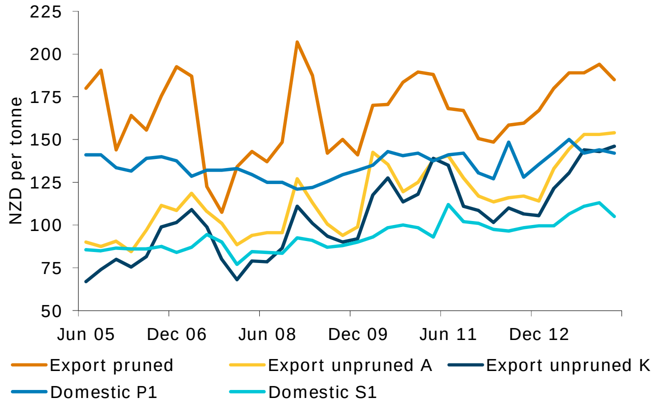
Global phosphate prices have weakened as American and Europe demand has softened. Further pressure is being applied from India where subsidies are placing a ceiling on the imported price. The market is expected to move into more of a surplus situation over coming months as supply increases.

KEY COMMODITIES

Forestry Price Indicators

	Current Quarter	3 Period Trend	Last Year	Chg. P/3P	Chg. Y/Y
Export: (NZ$ per JAS m3 f.o.b.)					
Pruned	185	191	180	↓	↑
Unpruned A Grade	154	150	133	↑	↑
Unpruned K Grade	146	139	122	↑	↑
Pulp	133	128	107	↑	↑
Domestic: (NZ$ per tonne delivered at mill)					
P1	142	145	143	↓	↓
P2	126	124	121	↑	↑
S1	105	110	100	↓	↑
S2	105	102	97	↑	↑
Pulp	50	50	48	↑	↑

NZ FORESTRY INDICATOR PRICES



Source: ANZ, MPI

Export log prices have fallen by 20% in the past two months. There was a significant price correction in the Chinese market after inventory levels near doubled to 4 million m^3 over the first quarter of the year. At the same time there was a tightening of credit, which has led to a slowdown in China's property market and affected several industries in China. This slowdown, combined with log deliveries coming in at a record pace, meant supply and demand became unbalanced very quickly.

Log prices are expected to find a bottom in June, with a bounce possible later in the year. PF Olsen believe there are several reasons this could occur. Despite the increase in log inventories, off-take has increased from a daily level of 46,000 m^3 per day to 68,000 m^3 per day in April 2014, an increase of 48%. We are still several months from the Chinese "hot season" during which log consumption slows as workers divert to harvesting summer crops. Some of the recent increase in log deliveries to China was a result of Russia retaliating against European sanctions and diverting logs that otherwise would have gone to Europe to China. This is expected to be a one-off as Russia suffered significant losses in doing this. Some seasonal slowdown in deliveries is expected from New Zealand and Russia, as well as supply being diverted to alternative market such as Korea, India and the US.

BORROWING STRATEGY

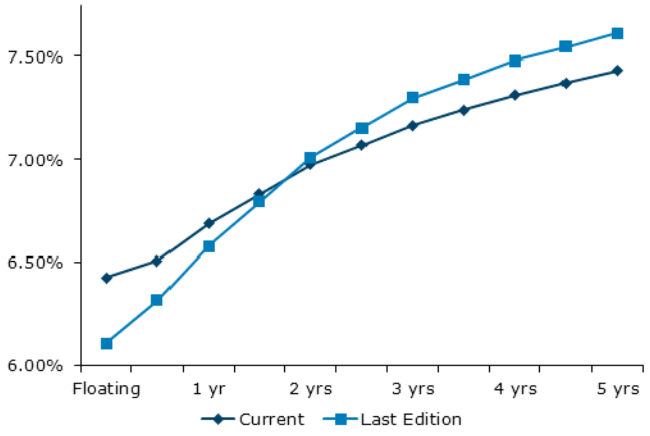
SUMMARY

The indicative rural lending curve has flattened in recent months with front-end rates higher as the RBNZ continues to lift the OCR, while long-term rates have fallen in response to lower global bond yields. This makes it relatively more attractive to fix for longer terms, despite expectations for additional OCR hikes being built into the term structure and a curve that remains upwards-sloping. With the market now starting to under-price how high the OCR could go, and global yields looking too low (making NZ yields prone to some recoil higher) we can see value further out the curve.

OUR VIEW

The indicative lending curve for rural borrowers has flattened in the past few months with floating rates rising 0.3% while 5 year rates fell by a similar amount. The lift in floating rates reflected another 25 basis point hike to the Official Cash Rate at the RBNZ's April OCR Review, and we're expecting an additional 50 basis points of OCR hikes over the remainder of 2014, which are likely to feed directly through into higher floating rates.

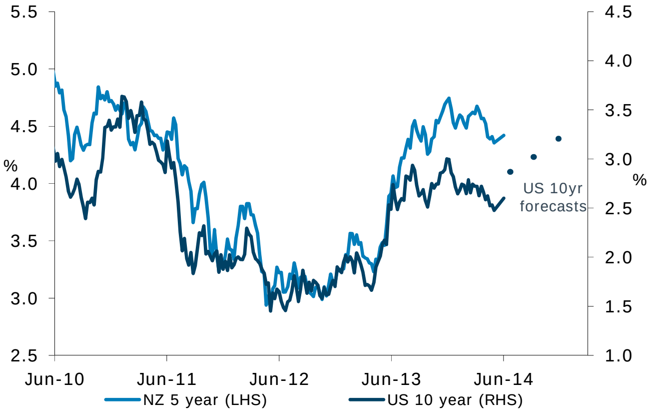
INDICATIVE RURAL LENDING RATES



Source: ANZ, Bloomberg

In contrast, long-term fixed rates have fallen in response to lower global bond yields, which tend to be a key driver of NZ long-term interest rates (as the second chart shows). Subdued global inflation and further interest rate cuts in Europe have driven global bond yields lower, although there are signs that **US bond yields are close to basing. Thus, from a relative value perspective, it's now more cost-effective to fix for longer terms** than it was in early April. While fixing for longer terms provides borrowers with greater interest rate certainty, it's not the only factor than borrowers need to consider. For one, the yield curve remains upward sloping (increasing the cost of fixing), while some exposure to floating rates enhances borrower flexibility.

NZ 5YR SWAP RATE VS US 10YR YIELDS



Source: ANZ, Bloomberg

In our view the market is also under-pricing the extent of overall RBNZ OCR hikes, suggesting upside risk to rural lending rates. We aren't expecting a dovish RBNZ *Monetary Policy Statement* on 12 June (as some in the market are), and we're cognisant that market expectations are as much as 75bps below the RBNZ's implied interest rate track (from March). Thus, we see value in hedging for longer terms with the term structure of interest rates biased higher. **We compare breakevens (forward rates of what's currently priced in) versus our own forecasts to gauge where the best value lies** along the curve. The table below shows that market breakevens are pricing 1 year, 2 year and 3 year rates to lift only 0.8%, 0.7% and 0.6% over the next two years, respectively. Compared to our own view that US bond yields will move gradually higher and the RBNZ will lift the OCR by a further 1.5% over the next two years, these **breakevens suggest there is now some value in fixing for longer terms** (especially when compared to levels of a few months ago).

Rural Lending Rates (incl. typical margin)		Breakeven rates			
Term	**Current**	**in 6mths**	**in 1yr**	**in 2 yrs**	**in 3 yrs**
Floating	6.43%				
6 mths	6.51%	6.88%	7.50%	7.44%	7.67%
1 year	6.69%	6.99%	7.23%	7.53%	7.74%
2 years	6.96%	7.19%	7.38%	7.64%	7.82%
3 years	7.15%	7.35%	7.50%	7.73%	
4 years	7.30%	7.47%	7.60%		
5 years	7.42%				

To summarise, with interest rates biased higher in the medium term, we favour reducing exposure to floating rates while **increasing the proportion of borrowing across several fixed-rate terms** (for example, a mix of 3 and 5 year terms).

ECONOMIC BACKDROP

SUMMARY

The economy continues to perform strongly, though momentum has softened somewhat from the break-neck pace experienced in late 2013. Supportive financial conditions, strong commodity prices, rebuild and construction activity, and mammoth migration flows lay the groundwork for a solid outlook going forward. With the demand-side of the economy still growing faster than supply, inflation is on the rise and the OCR will move up, though with the Reserve Bank already delivering two rate hikes, and another pending in June, they are close to taking a pause.

OVERVIEW

The NZ economy continues to perform strongly, underpinned by supportive financial conditions, recovering construction activity (recoil from lows, housing shortages and city rebuild-inspired) and a 40-year high in the goods terms of trade. Business and consumer confidence have moderated of late but remain elevated. Net migration inflows are strong. An overvalued NZD, contractionary fiscal policy, and a leveraged national balance sheet continue to act as headwinds to growth.

There are, however, clears signs that momentum has peaked. Commodity (dairy) prices have eased back, the housing market (house sale volumes) has cooled, and consumer and business confidence have waned. Some of this reflects demand-side measures (LVR restrictions and OCR hikes) while others are being driven by global conditions (dairy prices). And in some sectors it is simply natural to consolidate somewhat after a period of strong growth.

The moderation needs to be put in perspective. A drop in the dairy payout between the current season and the pending one is, on the face of it, a huge drag on economic growth. Yet we all know spending tends to get smoothed out. A chunk of the current season's boost went to debt repayment so was not stimulatory towards the economy in the interim. The coming year's payout is forecast to be the fourth highest on record, and cash-flow looks strong. Chicken Little style commentary is not helpful.

There is still enough petrol in the economy's engine to record 3.5-4% growth in 2014 and 3% in 2015. These sorts of growth rates are the envy of a lot of developed nations around the globe.

At that pace of growth demand is still outstripping supply; the likes of business demand for labour (think construction workers) drives the unemployment rate down, and wages up. It's a good thing but it comes with a side effect, namely inflation.

Encouragingly, the supply side capacity of the economy is on the ascent; we can run faster without generating inflation. This is being driven by uplifts in productivity, capital investment and rising migration (with around ⅔ of the latter coming from fewer departures). You don't need to go too far around New Zealand to see first-hand the next wave of innovation and productivity coming through – and most notably in the primary sector. We currently put potential growth at just under 3% per annum.

We expect a further 25 basis point rise in the Official Cash Rate in June and place a 50% probability on a move in July, with the OCR to move up further in 2015. The speed of the tightening cycle continues to be heavily influenced by the high NZD (it will remain high, suppressing growth and inflation) and the large proportion of borrowing either floating or fixed up to 1 year, which gives OCR hikes considerable bite.

We expect LVR restrictions to remain in force until 2015. The restrictions have worked a treat; if they had not been enacted we would likely have seen interest rates 30 basis points higher. However, such measures cannot be kept in place indefinitely or the law of unintended consequences will start to unfold, so such a mechanism is on borrowed time. And if they've saved the RBNZ having to hike by 30 basis points, bringing LVR restrictions off carries the reverse implications.

Beyond the obvious issues the economy faces there are some bigger picture themes to think about. Key secular thematics within our economic assessment include:

- **Consumer restraint** – a necessity given NZ's balance sheet, and a requirement if the building boom is to be accommodated while inflation remains in check. NZ does not have the resources to absorb both a building and consumption boom.
- **The continued gradual rebalancing of the NZ economy** (despite headwinds such as a high NZD). Those earnings dollars are key to supporting the spending side of the economy.
- **Continued lifts in productivity growth.** With the economy performing well, and spare capacity being absorbed, the trend for productivity growth over the coming years will have a huge influence on the outlook for inflation.
- **The growing significance of the microeconomic agenda.** With the economy now into a full-blown expansion, our attention is turning to the duration of the upswing, which can be lengthened by getting microeconomic facets right. Things like addressing Auckland's housing woes are micro-centric. The same applies for Christchurch's city rebuild. There are niggly aspects, but all up we seem on a reasonable path.

EDUCATION CORNER: CHINA'S GREAT BEEF CHALLENGE

SUMMARY

China's beef consumption looks set to grow rapidly, driven by the same dynamics that are boosting general protein consumption, but also supported by disease issues in China's domestic pork and poultry production. Official beef imports have recently jumped as rising demand has run into stagnant domestic supply. After a long period of government policy-driven growth, domestic production has stagnated as rationalisation and modernisation have been prioritised to improve efficiencies, boost food safety, increase productivity throughout the supply chain, and decrease costs.

New Zealand is in a prime position to participate in the lift in imports. We have many competitive advantages over other larger global players including an exclusive FTA, geographic location, a good food safety reputation, and established relationships with many multinational foodservice chains that have expanded rapidly throughout China. So far the majority of lift in NZ exports has been manufacturing beef for quick service restaurants. However, there are also substantial opportunities for 'lower-to-mid' value beef cuts that are used in traditional cooking styles and Chinese cuisine such as soups, stews and hot pots.

Acknowledgement goes to Glen Thompson and Ben Nixon from Client Insights for providing the majority of background material for this article.

BACKGROUND

In this Education Corner we put the spotlight on the Chinese beef sector: how it has evolved and what opportunities are available for New Zealand beef farmers. Historically, beef consumption in China has been at the lower end of the spectrum, with current annual consumption around 4.1kg per capita. By comparison, New Zealanders carve our way through just under 30kg each per year. But this is anaemic in comparison to the Uruguayans, who chew through 60kg each year, placing them at the top of beef consumption charts. In China beef makes up only a small percentage (approximately 7.8% of total meat consumption) of the Chinese diet.

The old story of a growing population, larger middle class, urbanisation, and higher personal incomes is set to propel Chinese beef consumption higher. Add in the modernisation of the food supply chain, and an increasing presence of modern retail outlets and quick-service chains, and beef consumption is set to grow potentially very quickly.

With a population the size of China's **even a small increase in consumption creates significant additional demand: every 100g increase in per capita consumption** (that's a mere 2.4% lift from current consumption levels) **equates to an extra 140,000 tonnes of beef consumed – equivalent to nearly a quarter of New Zealand's annual production.** An increase in annual per capita consumption of 2kgs would increase demand by approximately 2.7 million tonnes, which is nearly five times New Zealand's annual export production.

HISTORICAL PERSPECTIVE ON CHINA'S DOMESTIC SUPPLY

The Chinese beef industry has undergone many structural changes over the past four decades, driven largely by government programs and policies.

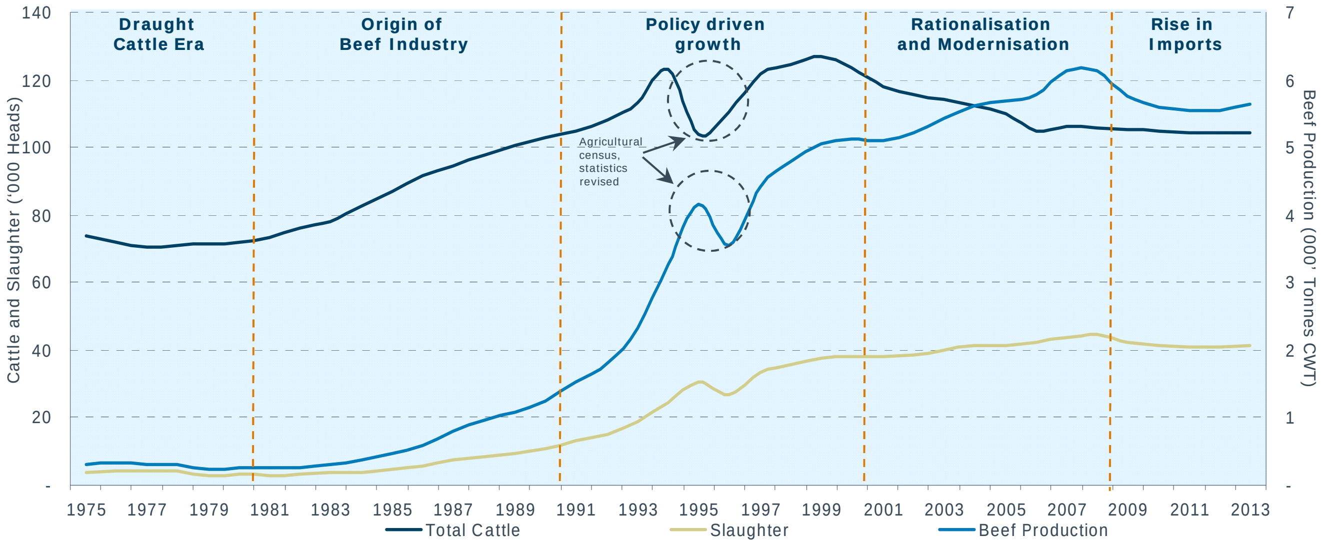
During the Maoist era, cattle were considered public property and collectively owned by communities. They were used as draught animals and could not be slaughtered unless they were injured, or had passed their use-by date. Reforms in the 1980s allowed the allocation of cattle to households and a relaxation of a ban on backyard slaughter. It was during this period that the Chinese beef cattle sector emerged. Agricultural markets were liberalised and breed improvement programs were implemented. These events provided an impetus for growth that saw China's bovine (cattle, yak and water buffalo) numbers increase from 71.7m to 102.9m in 1990.

A wave of further government support programs in the 1990s acted as the next catalyst for growth. The first was the Straw for Beef Program (now known as the Straw for Ruminants Program). The program took excess straw from the triple-cropping program (a policy introduced in the 1960s to increase productivity from cropping land), and converted the straw into silage to feed to cattle. The premise behind the Straw for Beef program was that the 600 million tonnes of crop residue could be converted into feed for beef cattle, thereby displacing other meat such as poultry and pork, which are raised on grain-intensive diets.

By 2000 the Chinese central government had invested close to RMB380 million in the program across 380 counties. Local governments matched this funding. The funding was used for straw treatment inputs, infrastructure such as silage pits, and training. Funds were also put into breeding services, disease control and the development of live cattle markets. Local households and companies invested heavily in the program, and as a result of the increased investment, beef productivity increased, both in terms of numbers slaughtered and carcass weights.

EDUCATION CORNER: CHINA'S GREAT BEEF CHALLENGE

HISTORICAL SNAPSHOT OF THE CHINESE BEEF SECTOR



TIMELINE

Pre 1980s	1980-90	1990-2000	2000-09	Post 2009
Draught Cattle Era	**Origin of Beef Industry**	**Policy driven growth**	**Rationalisation and Modernisation**	**Rise in Imports**
– Cattle owned for draught power – Permissions necessary before slaughter – Marketing of beef is controlled by Ministry of Commerce – Beef distributed through state stores, based on a coupon rationing system	– Agricultural markets liberalised – Market liberalisation leads to rise of the small scale abattoir competing against established government meat companies – National bovine breeds program started for breed improvement	– Straw for beef program started – Large modern abattoirs constructed – Pig slaughter regulations applied to cattle at local government discretion	– Emergence of wholesale markets across big cities – Large scale specialised households cattle farming encouraged by government – Beef quality grades introduced	– Production remains stagnant – Rise in imports to meet growth in demand

After the period of policy-driven growth, the Chinese beef sector went through a decade of rationalisation and modernisation. Wholesale markets appeared across the larger cities and with the Government's encouragement, large-scale household farms were developed.

But with substantial growth occurring across the Chinese economy, the opportunity cost of cattle farming increased for households. Labour was diverted to other industries. As a result, the infrastructure that had been developed over the past two decades is now underutilised.

Today, beef production in China is highly fragmented, with a large number of small scale operators dominating the supply chain from cattle breeding to slaughtering and processing. Industry experts say that as much as 90% of total production is supplied by small operators.

It has been estimated that as much as 85-90% of China's beef production is processed in small, local slaughter houses, producing low-value beef. This 'generic' beef is generally sold through local wet markets. Such fragmentation from the farm-gate through to processing makes for a number of inefficiencies and results in the production of low value 'generic' beef.

Though the beef sector continues to get support from the government, this has decreased dramatically. As a result, cattle numbers, slaughter rates and production have stagnated since 2008. According to various agencies the number of cattle being slaughtered caught up with the annual calf crop number in the late 1990s, with the two tracking closely from that point. This has led to a serious decline in cattle numbers, with the cattle herd only stabilising in the last few years. **Continual foot and mouth outbreaks since late 2008 and a shift to dairy have also contributed to the gradual decline in beef cattle numbers.**

EDUCATION CORNER: CHINA'S GREAT BEEF CHALLENGE

CATTLE PRODUCTION SYSTEMS IN CHINA (FROM LONGWORTH ET AL 2001)

Category	Type	Number of Head	Ownership	Type/ use of cattle
Unspecialised households	Unspecialised cow-calf household – agricultural area	Up to 3 cows	Individual household	Draught- local breeds
	Unspecialised cow-calf household – pastoral area	4-10 cows	Individual household, lease cropland, communal grazing land or on state farms	Grazed with other livestock. Mainly local breeds
	Unspecialised fattening household	Feed up to 5 weaners. Also 2-3 cows	Individual household	Variable quality feeder
Specialised households	Specialised cow calf household – agricultural areas	Own up to 3 cows	Individual household	Crossbred cows, sell most claves at weaning. Best calves sometimes kept for feeding
	Specialised cow calf household – pastoral areas	More than 10, typically 30-100	Individual household, lease cropland, communal grazing land or on state farms	Often F1 or F2 crossbred/ local cows. Usually castrate bull calves
	Specialised fattening household	Feed more than 5 weaners, rarely more than 50	Individual household. In certain regions are contracted by abattoirs to fatten	Crossbred bulls
Feedlots	Small commercial feedlot	50-200	Mixed, tend to be privately owned	Crossbred bulls, rarely steers
	Medium-sized commercial feedlot	200-1000	Mixed, often integrated with abattoirs	
	Large commercial feedlot	>1000	Mixed, tend to be government-invested, or integrated with abattoirs	

THE FIVE-YEAR PLANS

The origin, evolution and structure of the Chinese beef industry have been largely shaped by the Chinese government's Five-Year Plans and the policies that have arisen from these. The most recent five-year plan is steering the industry down the track toward more structured and large-scale production and away from the traditional farming model of household production. **The 12th plan aims to accelerate restructuring and modernisation by promoting:**

1. **Joint breeding programs** with other countries and accelerated genetic improvement of livestock to increase yield;
2. **Modern farms** that are well equipped with state-of-the-art facilities; and
3. **Technologies to improve processing and quality, and decrease cost and waste.**

As part of the 12th five-year plan, there is an **increased focus on the expansion of beef production through the promotion of large-scale farms** in preferential areas, standardising production, and consolidation of the various players along the supply chain. The **number of slaughtering houses is expected to decrease from 21,000 to 3,000 by 2015**. Half of the manual or semi-mechanised meat production is to be eliminated at a national level and 80% for developing regions.

The plan aims to increase sales of beef products through brand development and marketing. Sales of hot fresh meat, chilled fresh meat and frozen meat would be distributed at 50%, 30% and 20% respectively in provincial markets. The chilled meat sector is also set to be developed more vigorously, but much of the focus looks to be on the development of Western-style processed meats, with a production target of 15 million tonnes by 2015. This would account for half of all the total processed meat volume.

There is also a focus on food safety and traceability, with systems to be put in place in all meat enterprises located in cities. **Finally the plan proposes to strengthen the cold chain system for the delivery of live and fresh farm produce and establish a group of key national large wholesale markets and regional wholesale markets.**

Overall the plan looks to increase beef productivity and in turn promote the consumption of beef. **The current five-year plan aims to increase the consumption of beef by 0.5kg per capita in the near term, which equates to additional demand of 700,000 tonnes**.

EDUCATION CORNER: CHINA'S GREAT BEEF CHALLENGE

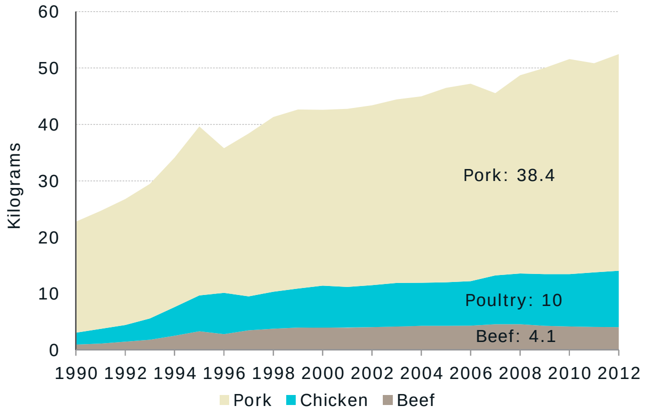
CHINESE 5-YEAR PLAN BEEF HIGHLIGHTS

Plan	Period	Highlights	Cattle	Slaughter	Beef Production
6th	1980-85	Household responsibility system	3.9%	6.6%	11.7%
7th	1986-90	Market reforms	3.5%	18.9%	21.9%
8th	1991-95	Straw for beef, commercialisation	0.2%	22.9%	27.0%
9th	1996-00	Straw for beef, Agricultural Census	3.5%	4.6%	4.3%
10th	2001-05	Rationalisation and stabilisation	-2.3%	1.6%	2.1%
11th	2006-10	Modernisation	-0.9%	-0.2%	-0.3%
12th	2011-15	Restructuring	-0.2%	0.1%	0.2%

BEEF CONSUMPTION IN DETAIL

Unlike pork and poultry, beef is not part of regular Chinese diets and accounts for only 7.8% of total meat consumption. Beef is perceived as a special item, with the average Chinese family unfamiliar with how it should be prepared and cooked. When it is consumed within the confines of the family home, it is mainly in the form of hot pots and stews.

MEAT CONSUMPTION IN CHINA

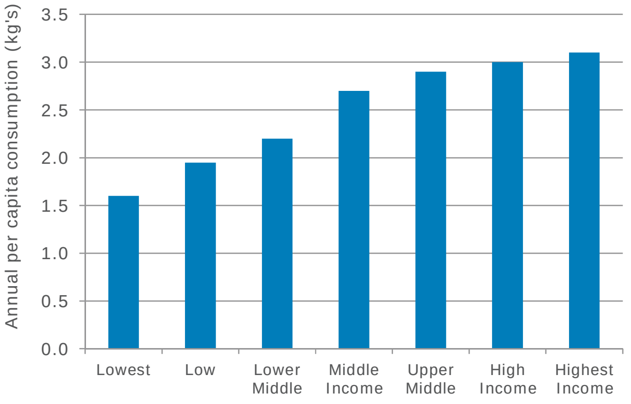


Source: ANZ, USDA

The majority of beef is consumed outside of the family home. As income levels have grown, the popularity of dining out has increased, particularly for urban households. In some urban areas it is thought that more than half of an individual's beef intake is consumed away from home, mostly in restaurants. Add in an increasing Western influence – think burgers and steaks – and beef is rapidly gaining acceptance as an alternative meat source.

Furthermore, among the wealthier urbanites beef is becoming a larger part of their diet – so much so that the 'Upper Middle' to 'Highest Income' household groups consume as much as 40% more beef than the 'Low Income' urban dwellers.

URBAN AT-HOME BEEF CONSUMPTION BY HOUSEHOLD INCOME CATEGORY

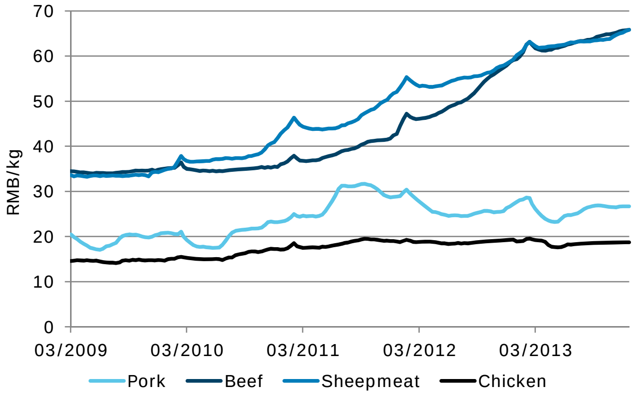


Source: ANZ, China Statistical Yearbook.

Not to be left out, the rural population has also seen a significant rise in beef consumption. This trend has been particularly evident from 2010.

However, tighter domestic supplies, changing food safety regulations, low profitability, and disease issues have seen a large increase in retail meat prices for sheepmeat and beef. **With pork and chicken not following suit, this potentially acts as a handbrake on future increases in consumption. However, this is also opening up the opportunity for beef imports.**

CHINESE RETAIL MEAT PRICES



Source: ANZ, USDA

BEEF IMPORTS TO FILL THE GAP

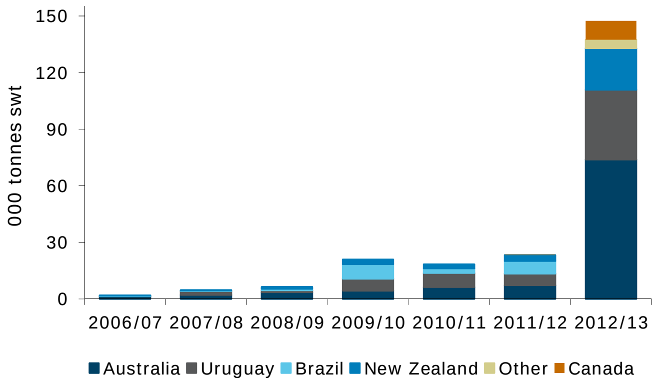
Numerous food safety issues have plagued Chinese pork and poultry recently, prompting consumers to substitute these products with beef. In 2013 pork consumption took a hit due to 'The Floating Dead Pig Incident' in Shanghai. This incident involved 16,000 dead pigs floating down the Huangpu River. Suspicious consumers steered clear of pork, wondering how 16,000 pigs mysteriously ended up in a river. Similarly, poultry consumption is

EDUCATION CORNER: CHINA'S GREAT BEEF CHALLENGE

frequently impacted due to outbreaks of avian influenza H7N9. China's growing demand for beef has been amplified by these food safety fears surrounding other meat products.

With beef consumption rates increasing and domestic production stagnating, the shortage of beef is being filled by imported product.

CHINESE BEEF IMPORTS (July-May)



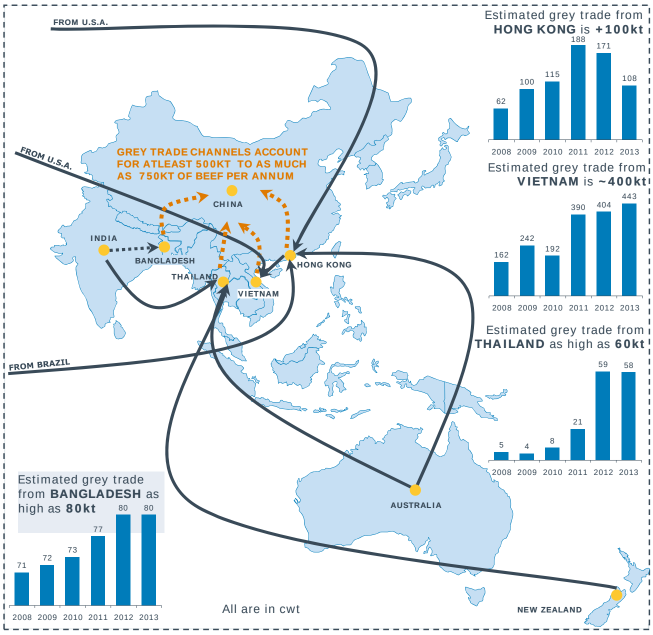
Source: ANZ, Global Trade Atlas, Chinese Customs

Today China relies predominantly on Australia and Uruguay for its beef, but New Zealand is also well positioned. Smaller volumes are sourced from Canada and Argentina. Already in the past year there has been a huge uplift in the amount of beef "legally" imported into China. We emphasise "legally" as there are many grey channels through which beef can enter China.

Beef and cattle received into China via grey channels have played an important role in recent years supplementing constrained local supplies. Vietnam is thought to be the largest middle market, supplying Indian-sourced buffalo meat in volumes that may be higher than 400,000 carcase weight tonnes (cwt) annually. Large volumes (probably more than 100,000 cwt annually) of higher quality, predominantly Brazilian and US-sourced beef, is also entering China via Hong Kong.

Smaller volumes are entering via other Asian countries. It is estimated that as much as 60,000 cwt could be entering via Thailand. It is also understood that high volumes (as much as 20,000 head per day) of cattle are walked across the Indian border, processed in Bangladesh, and then enter China via Myanmar.

GREY CHANNEL TRADE OF BEEF INTO CHINA



Source: ANZ

THE OPPORTUNITY

New Zealand is in a prime position to maximise the beef opportunity in China. Our FTA, geographic location, food safety standards, and high-quality beef products provide us with a competitive advantage over some of the other large global beef players. Already we are in a better position than the US, which was effectively banned from exporting since the 2003 outbreak of bovine spongiform encephalopathy (BSE). Similarly Brazil, the world's-largest beef producer, has been suspended since 2012 after a positive BSE case in Parana state. With global beef supply tightening there is already a significant increase in New Zealand beef exports heading to China. This is tightening the supply of manufacturing beef into our largest traditional market, the US, and could even spill over into other categories such as chilled cuts as the market grows and develops.

The New Zealand beef sector certainly looks to be grasping the bull by the horns. In 2013 we exported 53,000 tonnes of beef to China up from a paltry 3,000 tonnes in 2011 - a remarkable jump. Furthermore we are exporting a range of products to suit the broad consumption preferences of the Chinese population.

The majority (79%) of beef exported was manufacturing beef. New Zealand is currently the second-largest supplier of manufacturing beef, supplying 42,000 cwt. We rank behind Uruguay, but are currently exporting almost four times more than Australia, who exported 11,000 cwt in 2013. The growth in exports for manufacturing beef has largely been driven by the expansion of fast food chains in urban areas, which has boosted burger consumption.

While the import demand for manufacturing beef has increased, so too has consumption of 'lower-to-mid' value beef cuts. This is due to their use in urban restaurants and for use in home cooking. **The largest growth in China's beef imports over 2012 and 2013 has been in the 'lower-to-mid' value cuts like shin / shank, brisket, silverside and thick flank / knuckle.** Braised shin/shank used in stews is popular in Chinese cuisine. The other cuts are generally leaner and are consistent with the requirements of the major cooking styles used in Chinese cuisine such as soups, stews and hot pots.

The increase in demand for the 'lower-to-mid' value beef cuts has resulted in a larger share of these types of cuts being diverted to the China market from other traditional New Zealand beef export markets. New Zealand's production of these cuts has not increased materially over recent years, but China's share of these New Zealand exports has gone from almost nothing in 2011 to about 20% in 2013. It is anticipated that China's demand for beef imports will continue to be dominated by 'lower-to-mid' value beef cuts.

Demand for the higher value, 'centre of the plate' cuts is being driven by the high-end restaurant and luxury hotel markets. **Demand for higher quality chilled beef imports was rising rapidly until China suspended imports of chilled beef in the latter part of 2013.** No real reason was ever provided for the suspension, but rumours were that the rate of growth alarmed officials and trade was stopped to ensure adequate trade protocols were in place. Reportedly trade has now resumed in April this year. Growth for these higher-value cuts is expected to be strong, albeit at a much lower volume compared to the 'low-to-mid' value cuts that dominated import demand in 2012 and 2013. New Zealand exports about 7% of its beef in chilled form, 94% of which is boneless. The majority of New Zealand's high-value chilled beef exports go to Japan. In 2013, less than 1% of New Zealand's beef exports to China were in chilled form.

We have a number of competitive advantages, but cracking what is now the world's biggest food and beverage market is not a task for the faint-hearted, or uncommitted.

Beef companies serious about China need to start building relationships with potential partners sooner rather than later. Partnerships will need to be formed as everything is super-sized compared with New Zealand and some scale is required.

In this regard, opportunities exist right along the supply chain. For example, as China moves to larger-scale cattle production there will be a need for an increase in developing breeds and genetics to increase performance and yields. Similarly, with China consolidating their slaughter houses and focusing on commercialised processing there are a number of opportunities for New Zealand producers to partner directly with Chinese processors. Additionally, companies associated with servicing the meat-processing sector could introduce their technology and intellectual property to help develop the Chinese meat-processing sector.

Given the sheer size and complexity of the Chinese market, having a local partner who knows the culture, tastes and market could make it a lot easier to crack. Teaming up with a Chinese beef distributor or supermarket chain offers many benefits to a New Zealand beef exporter, including a local presence, local market knowledge, access to distribution networks and marketing. But distribution channels could also involve luxury hotels and high-end restaurants where New Zealand's premium beef products are already sought after.

While the opportunity for increased beef exports to China looks like the proverbial knight in shining armour for the beef sector, **we must temper this by mentioning that our competitors such as Australia and Uruguay will also be looking at ways to increase their exports to this market.** These two countries are substantially larger beef producers than New Zealand, which provides a reason to tinge our optimism with a little caution.

KEY TABLES AND FORECASTS

FX RATES	ACTUAL			Forecast (end month)						
	Apr-13	May-13	9-Jun	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
NZD/USD	0.862	0.850	0.850	0.83	0.83	0.81	0.79	0.78	0.77	0.76
NZD/AUD	0.928	0.924	0.911	0.92	0.94	0.95	0.94	0.93	0.92	0.90
NZD/EUR	0.621	0.612	0.623	0.60	0.59	0.57	0.56	0.55	0.53	0.51
NZD/JPY	88.10	87.36	87.27	87.2	88.8	89.1	86.9	85.8	84.7	83.6
NZD/GBP	0.511	0.501	0.506	0.49	0.48	0.47	0.45	0.45	0.44	0.43
NZ TWI	79.8	78.8	79.2	77.7	77.9	76.6	74.8	73.7	72.5	71.1

INTEREST RATES	Apr-13	May-13	9-Jun	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
NZ OCR	3.00	3.00	3.00	3.25	3.25	3.50	3.75	3.75	4.00	4.25
NZ 90 day bill	3.33	3.42	3.42	3.50	3.50	3.90	4.00	4.00	4.40	4.50
NZ 10-yr bond	4.41	4.24	4.36	4.50	4.70	4.80	5.10	5.20	5.30	5.40
US Fed Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00
US 3-mth	0.22	0.23	0.23	0.30	0.40	0.50	0.60	0.80	1.10	1.40
AU Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50	2.75	3.00	3.25	3.50
AU 3-mth	2.68	2.71	2.69	2.70	2.70	2.70	2.90	3.20	3.40	3.70

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16
GDP (% qoq)	**1.3**	**0.7**	**0.7**	**0.8**	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**	**0.5**
GDP (% yoy)	**3.8**	**4.1**	**3.7**	**3.5**	**3.0**	**3.0**	**2.9**	**2.7**	**2.6**	**2.4**
CPI (% qoq)	0.3	**0.3**	**0.7**	**0.2**	**0.6**	**0.6**	**0.8**	**0.3**	**0.7**	**0.7**
CPI (% yoy)	1.5	**1.7**	**1.4**	**1.6**	**1.8**	**2.1**	**2.2**	**2.3**	**2.4**	**2.5**
Employment (% qoq)	0.9	**0.5**	**0.4**	**0.4**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**	**0.3**
Employment (% yoy)	3.7	**3.8**	**2.9**	**2.3**	**1.7**	**1.5**	**1.3**	**1.2**	**1.1**	**1.1**
Unemployment Rate (% sa)	6.0	**5.7**	**5.6**	**5.5**	**5.4**	**5.4**	**5.3**	**5.3**	**5.3**	**5.3**
Current Account (% GDP)	**-2.9**	**-2.9**	**-2.7**	**-3.3**	**-3.8**	**-4.3**	**-4.6**	**-4.8**	**-5.0**	**-5.1**
Terms of Trade (% qoq)	1.8	**-2.5**	**-3.0**	**-2.2**	**-2.1**	**-1.7**	**-1.4**	**-1.1**	**-0.9**	**-0.7**
Terms of Trade (% yoy)	17.3	**9.4**	**-1.3**	**-5.8**	**-9.5**	**-8.8**	**-7.3**	**-6.3**	**-5.1**	**-4.1**

Figures in bold are forecasts. Quarter-on-Quarter yoy: Year-on-Year

NEW ZEALAND'S 20 LARGEST EXPORT MARKETS

NZ'S TOP EXPORT MARKETS FOR THE 12 MONTHS ENDED APRIL 2014 (NZ$M)

	Global Total	China	Australia	USA	Japan	Korea	UK	Singapore	Germany	Taiwan	Malaysia	Indonesia	UAE	Philippines	Thailand	Hong Kong	India	Saudi Arabia	Netherlands	Canada	Vietnam
Sheepmeat	2,956	151	74		54	84				22	19	120		5	17		14				9
Beef	2,111	184	12	897	171	116	30	33	11	140	34	71	24	19	11	34		30	34	73	3
Other Meat	455	20	43	27	36	23	29	5	60	5	6	10	1	3	2	31		5	23	4	
Milk Powder	10,075	5,180	72	2	42	11		287		255	420	326	524	287	293	80		250	1	7	171
Butter	2,567	389	92	63	16	16	5	43		67	65	93	70	100	43	23		83	8	6	81
Cheese	1,458	140	221	6	316	89	39	11		39	37	57	16	53	16	19	1	61	10		8
Whey/Casein	1,967	193	55	686	236	46	2	82	186	10	27	53	1	30	26	1	7	25	15	30	2
Kiwifruit	910	100	59	22	237	40		11	183	58	13	10	4	2	7	24	4			3	3
Apples	551	13		81	6		64	17	57	41	13	7	22	1	46	23	21		54	13	16
Other Fruit/Vege	912	16	406	36	157	19	13	13	8	20	32	13	3	1	13	9	2	1	16	3	1
Wine	1,320	23	381	319	14	2	319	21	15	1	3	1	6	1	2	18			34	80	1
Wool	744	363	39	14	16	1	48		40	5	5	2	1		7	5	38		1	4	1
Skins/Hides	596	174	22	3	7	30	5		1	4		7			7	30	17				13
Logs	2,676	1,947			155	342				12					3	1	207	1			2
Sawn Timber	1,128	161	330	170	73	54	2	4	4	41	14	21	10	39	31	1	3	14	19	1	63
Fibreboard/Plywood	327	20	39	15	195	1				4	3	21		9	1		5			1	3
Wood Pulp	637	151	74		54	84				22	19	120		5	17		14				9
Fish/Seafood	1,401	405	252	154	97	23	14	29	23	7	8	2	12	7	30	59		1	8	13	9
Crude Oil	1,656		1,449			1		148							17	16					
Aluminium	964	23	79	31	464	125	42	2	1	3	2	7			2	6	13		49	5	1
Remainder	15,204	1,131	5,462	1,371	510	590	378	320	186	209	239	150	86	228	190	344	331	55	192	210	129
Total	**50,611**	**11,436**	**9,093**	**4,118**	**2,851**	**1,617**	**1,527**	**1,039**	**1,018**	**975**	**971**	**971**	**789**	**787**	**771**	**756**	**664**	**627**	**623**	**533**	**518**

NZ'S MERCHANDISE EXPORTS ANNUAL CHANGE BETWEEN THE 12 MONTHS ENDED APRIL 2014 AND A 12 MONTH SPAN A YEAR EARLIER (NZ$M)

	Global Total	China	Australia	USA	Japan	Korea	UK	Singapore	Germany	Taiwan	Malaysia	Indonesia	UAE	Philippines	Thailand	Hong Kong	India	Saudi Arabia	Netherlands	Canada	Vietnam
Sheepmeat	290	300	-1	10	7		-3	-2	6	-13	-10		-1		1	5		2	18	-10	3
Beef	-114	35	-1	-104	-27	-3		-11	-7	4	9	35	2	-21	-1	-2		17	3	-9	
Other Meat	12	1	1	4	-6	-8	1	-2	4	3	-2	6			1	4		-7	4	1	
Milk Powder	3,053	2,860	20	-14	5	2		75		91	125	56	106	60	95	-70	-1	-1	-5	7	-1
Butter	650	213	19	-56	5	3	4	8		15	19	45	31	37	13	7		-19	-4	-13	20
Cheese	5	36	6	-44	3	-43	21	1		6	9	-5	-2	-8		3	1	-16	-21		2
Whey/Casein	34	-86	6	-32	26	-5		22	31	-2	2	9		5	24			-5	7	-5	
Kiwifruit	-114	-7	-12	-4	-57	-21		2	-5	-35	-1	1	1		1	-5	1			-1	1
Apples	132	3		27	-1		14	4	7	32	1	1	-5	1	9	1	1		13	6	10
Other Fruit/Vege	96	2	57	4	-8	-4	-1	1	-1	3	6	6	1		-3	1			-1	1	
Wine	108	-6	6	35	1		44	5	6							-2			9		
Wool	-8	-16	-8	-6	-3	-1	4		-2	-4	-2	1	1		-1	1	6		1	1	1
Skins/Hides	33	-24	1		-1	5	2			-1		-1			-4	2	4				
Logs	856	741			-13	71				1					-1	1	52	1			
Sawn Timber	31	-9	10	10	-5			-2	3		-1	3	3	-6	2	-1		-12	8		19
Fibreboard/Plywood	-40	-9	-13	5	-13						-4	1		-1			1				-11
Wood Pulp	51	-22	9		-23	22		-3		1	1	25		1	-6		4				7
Fish/Seafood	-71	26	-31	21	-30	-18	3	4	1	-1		-2	8	-4	-1	-16			2	1	-6
Crude Oil	-386		-400		-33	1		13							17	16					
Aluminium	-29	-12	-2	-19	-5	13	-15	1	-1		1	4			-1	-10	-2		-19	3	
Remainder	-211	-121	-302	20	-66	-12	80	9	29	26	-6	-42	22	41	-5	-11	-122	-17	19	1	26
Total	**4,377**	**3,904**	**-635**	**-140**	**-245**	**1**	**152**	**125**	**70**	**127**	**147**	**143**	**168**	**106**	**140**	**-76**	**-55**	**-58**	**34**	**-18**	**71**

NZ'S MERCHANDISE EXPORTS ANNUAL CHANGE BETWEEN THE 3 MONTHS ENDED APRIL 2014 AND A 3 MONTH SPAN A YEAR EARLIER (NZ$M)

	Global Total	China	Australia	USA	Japan	Korea	UK	Singapore	Germany	Taiwan	Malaysia	Indonesia	UAE	Philippines	Thailand	Hong Kong	India	Saudi Arabia	Netherlands	Canada	Vietnam
Sheepmeat	195	81	1	4	2		20	-1	21	-1	-6		-1		1			21	19	-1	2
Beef	-4	-12		-5	-11	3	2	-2	1	10	1	14	1	-7	-2			1	1	6	
Other Meat	3	-2	-1	1	1	-3	1		1	2		4		-1		-1		-3	1		
Milk Powder	908	720	3	-3	2			3		30	26	37	91	8	26	-24		56			6
Butter	241	91		-6	2	2	1	5		6	6	14	16	19	4	2		10	-5		1
Cheese	36	12	16	1	-12	-12	10			2	2	7			-2	2		6	-11		
Whey/Casein	48	-37	7	20	16	3		10	9		7	-3		5	8			-1	1		
Kiwifruit	66	18	1	3	12	4		1	5	1	1	1				1	1				1
Apples	47	-8		8			8	1	4	27			-6			3			2		8
Other Fruit/Vege	21	-2	5	1	-7	-3	-1	1	-1		-4	5							-2		
Wine	55	1	-6	16			33		4				1						1	3	
Wool		-20		-1			2		1		-1					-1	7			1	
Skins/Hides	-5	-23			2	3	1					1			-2	-2	-1				
Logs	199	173			-3	10										1	16	1			
Sawn Timber	10	-8	8	-1	4	-3		-1	1	-4	-1	2	1	1	1			-2	1		5
Fibreboard/Plywood	-1	-2	-1	2	3						-1	-1									-2
Wood Pulp		-7	2		-6	4				-1	1	-3			1		3				2
Fish/Seafood	-31		-18	9	-10	-8	1		-1	-1			1	-8		-1				1	1
Crude Oil	1		30					-29													
Aluminium	30	-5		-1	34	-1	1				1	1			-1	-5			-6	2	
Remainder	29	-88	-4	16	-2	1	26	-6	2	4	-12	-7	3	6	-3	3	-28	-3	6	-2	16
Total	**1,846**	**881**	**43**	**62**	**28**	**2**	**105**	**-17**	**47**	**76**	**21**	**73**	**109**	**23**	**32**	**-23**	**-2**	**87**	**9**	**10**	**39**

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