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PASSING THE BATON

FEATURE ARTICLE: PASSING THE BATON – FARM SUCCESSION

Farming – like a host of industries – faces succession and demographic challenges. The old farm succession model of passing the farm to the eldest son has largely become outdated. However, there is still a strong desire in the agri space to pass the business to family with 61 percent seeing this as their succession plan. The three key ingredients for successful succession are: a shared family vision, a strong profitable business and the separation of roles within the business during the transition process.

THE MONTH IN REVIEW

The next 6-8 months look a lot tighter for the pastoral sectors. Lower farm-gate prices and the advance milk price rate are set to prove challenging, with liquidity issues expected. The kiwifruit and viticulture sectors are cautiously optimistic.

RURAL PROPERTY MARKET

Farm turnover and values remain solid for this time of the year and up on last year. Forward-looking indicators are mixed. Cashflow constraints in the livestock sectors, especially dairy, are expected to impact on turnover this spring. However, a lack of quality, well-located properties, with good contour, soils and capital improvements is still expected to see such properties sell well. Properties that do not tick these boxes will have to meet the market.

KEY COMMODITIES AND FINANCIAL MARKET VARIABLES

The NZD remains stubbornly high versus in-market fundamentals for NZ's soft commodities. New highs for the NZD/EUR and Europe heading into a deeper recession are making life difficult for exporters to that part of the world. Dry weather conditions in the US have locked in high grain prices for at least the next 12 months. The flow-through to NZ's soft commodity basket will not be immediate though, and looks more like a 2013 story.

ECONOMIC BACKDROP

The NZ economy continues to navigate a series of large domestic and external shocks, resulting in mixed economic signals. We've pencilled in around 2½ percent growth over the next two years and we term it "grumpy" growth.

BORROWING STRATEGY

Wholesale interest rates remain close to all-time lows across the yield curve. Our preference is to remain floating or to fix for periods of 2 years or less. This is not because we expect rates to rise, but simply to spread risk.

EDUCATION CORNER: BIOSECURITY IN FOCUS

New Zealand's biosecurity system operates on three fronts: pre-border, at the border, and within New Zealand. The cost of mitigation increases as unwanted organisms move across the border. A recent independent report into the Psa-V incursion has shown gaps pre-border and at the border. While no system is infallible, accountability and performance are paramount. This means the identified problems need to be dealt with swiftly. In this regard, we have seen a number of new initiatives emerging. Government and industry have a collective responsibility to fund and support these new initiatives.

FEATURE ARTICLE: PASSING THE BATON – FARM SUCCESSION

SUMMARY

Farming – like a host of industries – faces succession and demographic challenges. This will lead to consolidation and alternative ownership models, including corporatisation across the industry over time. Farm succession will be unique to each individual situation and market conditions will be relevant (ie land prices), but there is still a strong desire in the agri space to pass on the business to family. In fact a whopping 61 percent of farmers see this as their succession plan, compared with just 18 percent of non-agribusiness owners. Farmers look a little more advanced than non-agribusiness in that over 50 percent are developing a plan, or already have one in place. However, the old farm succession model of passing the farm to the eldest son has largely become outdated as mums’ and dads’ values on fairness, equality, equity and retirement needs have changed and the surge in land values has made family succession more challenging to engineer. There is no “one size that fits all” and the reality is that many succession plans simply don’t work. The three key ingredients for a successful transition of the farm to the next generation are: a shared family vision, a strong profitable business and the separation of roles within the business during the transition process.

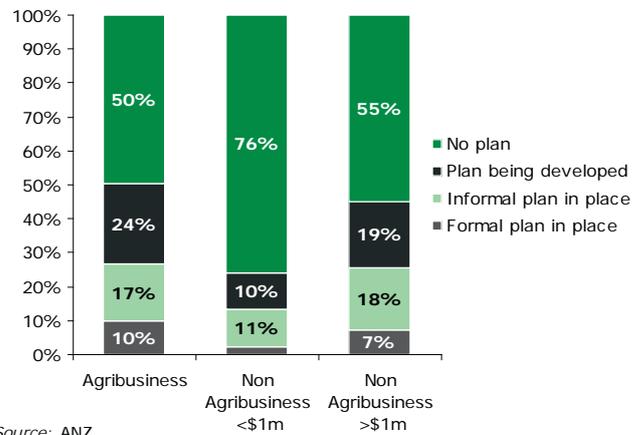
SCENE SETTING

It’s difficult to get a handle on how big the issue of succession is across NZ business and the agri sectors. Looking at the number of Field days dedicated to the subject and attendance numbers, we suspect it is front of mind for many in agriculture. The average age of a farmer varies across industry, but continues to increase for all. In the dairy sector the average age stands at 45 (although the data is a little outdated) and biased downwards with sharemilking helping to offer a road to farm ownership. Outside the dairy sector the average age for a meat and fibre producer is closer to 53, with nearly 25 percent over 60 years of age. The kiwifruit sector has an even higher average age again and a more skewed distribution (see *Education Corner*).

The issues associated with succession are immense. These go well beyond merely identifying a replacement. Think farm performance continuation, the transfer of knowledge, legal structures, family members’ emotions, the impact on rural communities of demographic shifts, and the list goes on.

The results of the ANZ Privately-Owned Business Barometer indicate that quite a proportion of the farming community have already done some thinking on the subject. **In fact the survey showed 50 percent of agri businesses have some sort of plan being developed, or in place** – although 17 percent are ‘informal’ in nature, which no doubt has a wide range of meanings.

Proportion of businesses with transition plans in place



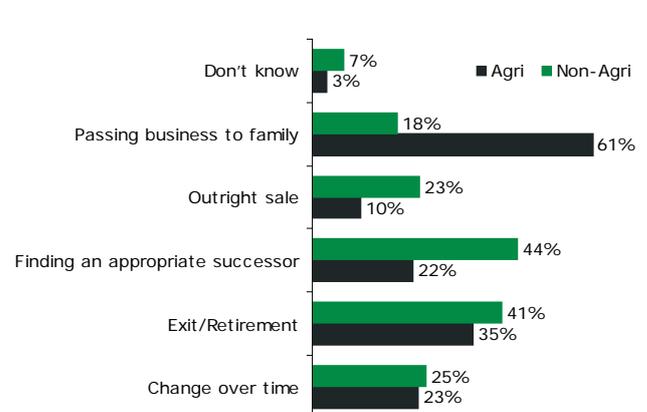
This compares well with non-agribusiness firms, even the larger ones, where 45 percent with turnover greater than \$1 million have some sort of plan being developed, or in place. As one would suspect, smaller commercial businesses have done less planning, with just 24 percent having a plan being developed, or in place.

Analysis of the 10 percent of agribusinesses who have a formal plan in place in the agri space is also reassuring. Of farmers aged between 40 and 49, 4 percent have a formal succession plan in place, compared with 22 percent of farmers aged over 65. Almost 60 percent of farmers aged between 40 and 49 have no plan, and this decreases to one in three for farmers aged over 65.

WHAT SUCCESSION MEANS TO FARMERS

For most farmers – a whopping 61 percent – succession means passing the business to family members. This compares with just 18 percent of non-agribusiness owners.

What succession means



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What's more significant among the agri sector is the polarised view of change of ownership.

When we ask non-agribusiness owners what options they would consider, the typical response is to look at a range of options – a single business owner will be considering gradual exit, an outright sale, and passing the business to family. **But for farmers, the path out is often one or the other – either they will sell the farm, or they will pass to family: there is no hybrid.** Perhaps having only two options in mind is why a larger proportion of the agri sector has a plan compared with non-agribusiness.

Nevertheless **with just 10 percent of farmers having a formal plan in place, it suggests a lot start at the end point.** They begin by deciding how they want to exit and then develop a plan to exit. Our observation is that these farmers are limiting their options by starting with the end point in mind.

There is a third option for change of ownership and it's one that has a very high success rate when employed. In a 2004 study Desiree Reid researched 15 families who have enjoyed sustained success through multiple generations. These families had a different view of generational change than the predominant one, ie to change ownership to one family member. **These families typically have what we call a 'sustained family business' model – with ownership and management shared within the family and between generations.** In these families, two generations almost always worked in the business at the same time right through their history. They had methods to avoid the three generation curse – that one builds, the next benefits and the next dissipates wealth.

This ties into international research on family business which suggests the family business sector is more successful, resilient and innovative than non-family corporates throughout the developed world. Worldwide, family business is not assumed to be small, or informal. Ford, BMW, Walmart, Samsung, Motorola, Lego, Tata Group are family businesses and certainly don't meet that definition. **On a much smaller scale than these household name companies, there is a large and dynamic family business sector that is passing the baton from one generation to the next. There are also many examples in the primary industry both in New Zealand and abroad.**

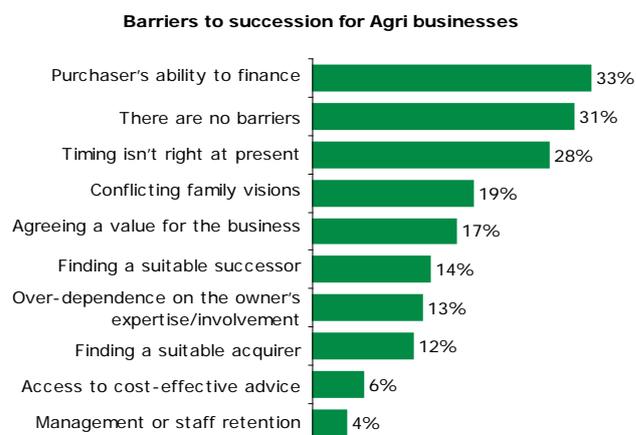
The Chief Executive of Volkswagen, now the largest car manufacturer in the world, gives credit to being a family business with committed shareholders, as one of the reasons for their tremendous growth over the last 20 years. In New Zealand, many family farms achieve the highest levels of performance as a result of the same factors – long-term commitment and consistent strategy.

BUILDING THE FOUNDATION FOR A SUCCESSFUL TRANSITION

The old farm succession model doesn't work now for a variety of reasons:

- **Farms have gotten much bigger** over the last decade.
- **Non-farming family members are less tolerant of capital left in**, especially if there is no cash dividend associated with their share.
- **We live longer and need more cash to live on in retirement.**
- **Farm values have lifted a long way**, which impacts on respective share valuations and the prospective financial entry point of successors.
- **Product prices are more volatile** and capital gains are considered less likely to offset the consequences of an over-leveraged balance sheet.
- **Marriages are less stable**, with an estimated 1 in 3 unions in New Zealand ending in divorce.
- **A greater array of skills are now required** to manage a farm.
- **Societal values on fairness and equality have changed.** This goes both ways, as some of the current generation of farmers were forced to take over farms when they wanted to do other things.

The ANZ Barometer identified the top barriers to succession in farming (see chart below). It showed 33 percent are concerned about the purchaser's ability to finance, 28 percent feel the time is not right, and 19 percent are dealing with conflicting shareholder, or family vision.



Source: ANZ

Recently, ANZ and the National Bank have been working with groups of farmers around the country to discuss the key issues that are affecting succession.

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Looking across the most successful transitions, we see a few common traits:

- **The whole family** – parents, and farming and non-farming children – **have a shared understanding of what they want to achieve in the long term.**
- **The farm is operated as a business** so it is profitable and able to give an appropriate return on family equity. As a result, it is not over-g geared when the next generation is brought in. Rather, enough capital is left to maintain the business's financial strength. Succession is used as a means to increase business performance, not weaken the business.
- **The family understands that ownership, governance and business management are separate roles and that succession can occur in these roles at different times.** There will often be two generations working in the business at the same time.

ACHIEVING A SHARED FAMILY VISION

Desiree Reid's work was one of the most in-depth studies into inter-generational farm ownership in New Zealand and focused on what successful families have in common. Farm families were no different to families in other areas of business.

Her research found three consistent features among successful farm families: trust among family members; long-term intergenerational working partnerships (which is basically a gradual transition with multiple generations working in the business at one time); and a defined family vision.

The idea of the family vision is consistent with what we have heard from other professionals who assist families to manage succession.

Last year, we invited Lyn Sykes to speak to some of our customers. Lyn is one of Australia's leading family business advisers and for the past 20 years she has helped farming families work through the emotional and personal issues related to farm succession.

In her experience, having a shared family vision is the first step to identifying the best option for you and your family. And the only way this can be achieved is through communication. So how can you start to achieve a family vision? Lyn's advice when she spoke to our customers was this.

- **Start by getting everyone's expectations on the table.** You need to talk to everyone who is involved, including partners, to know what everyone wants from the succession plan.

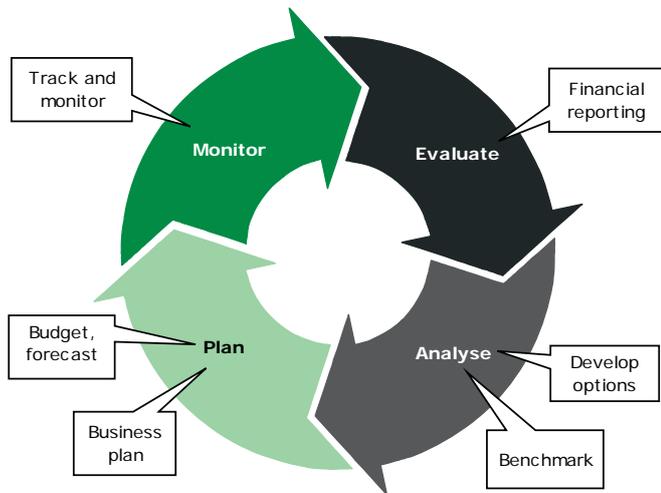
- **You can't talk too early, too much, or involve too many family members.**
- **Be prepared to have the difficult conversations.** There needs to be strong leadership with the process led by mum and dad. People are often worried that a conversation will open a can of worms but as Lyn says, left alone, those worms can easily turn into snakes.
- **If necessary, bring in an independent person.** Family succession issues are fraught with emotions and bringing in an independent person can help.

PROFITABLE BUSINESS MANAGEMENT

There is a wide range of financial performance in the agri business sector. **Unless the farm business is on a sound footing with repeatable and significant cash profits, it is unlikely that passing the baton to the next generation will succeed.** A better option is to sell up and distribute the proceeds as desired. The **farmers who are well-placed** to pass the farm on tend to **have the following traits:**

- **Have strengthened their balance sheets.**
- **Know what success looks like to them, have a plan to achieve their goals, and focus on what they can control.**
- **Are achieving good productivity, revenue and profitability.** Research suggests that this success is based more on financial and business acumen than farm type, size, region, or age of operator.
- **Benchmark their performance** against peers and identify what they need to change to reach their target. DairyBase is an excellent resource for dairy farmers, and we are working closely with them to encourage more widespread participation. Beef + Lamb NZ's Economic Survey offers similar information and insights on this point.
- **Have a regularly reviewed budget and monitor all other aspects of their business, which helps them to make informed decisions when the game changes,** be it weather, costs or returns.

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The business management cycle (shown above) sets out a process that every business, from the smallest to the largest, can follow. The key is that the cycle is linked – that these are not separate activities. The business plan is reflected in the annual budget; this is tracked and monitored during the year; and financial reporting occurs very soon after the end of the financial year. Compliance reporting, such as tax, is secondary and can happen later. Then this is benchmarked, options considered and the business plan is adapted accordingly. An example is Dairy Push, an initiative which involving 45 South Waikato dairy farms, who implemented a business management process and achieved an average lift in profit of \$600 per hectare.

Agri professionals have a big role to play in supporting farmers improving business and financial management, so they can increase profitability and achieve their goals and successful succession. External advice is mostly used at an operational rather than strategic level. Farmers are often reluctant to spend on financial reporting and advice, but it is the best investment you can make to improve performance and help succession. Dairy Push showed a 14 to 1 return on investment.

The industry “average farm” surveys by DairyNZ and Beef + Lamb NZ identify what the top performing farm metrics are for cash earnings and return on assets. These farmers have more succession options and time on their side. Strong cash profitability often allows more family capital to be retained in the business, but still provides plenty of cash for those retiring, or not farming. Well-capitalised businesses are more financially resilient, profitable and have more opportunities for growth. This also helps reduce uncertainty for the successor(s), by providing security around financial viability and opportunities for growth. This provides win-wins for those taking over the reins and those

looking to spend more time on the water and at the beach.

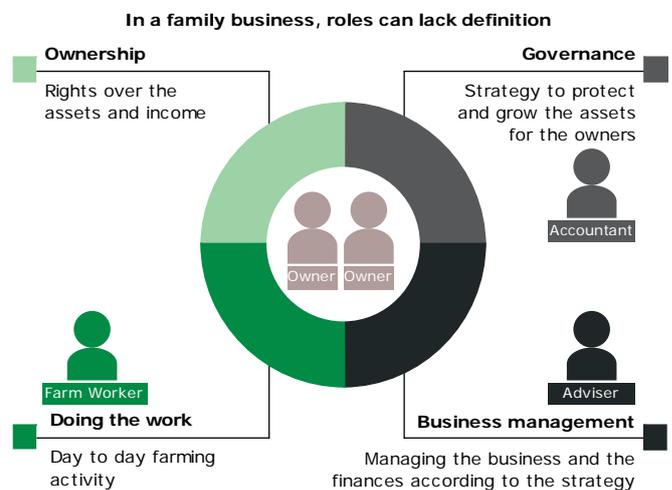
ROLE SEPARATION PROVIDES MORE OPTIONS FOR SUCCESSION

For a lot of farms the business model is that one couple own the farm and are also responsible for governance, business management, and day to day operations.

One challenge with this model is that the farm’s potential is limited to the skills and knowledge of the owners, which is always going to put a ceiling on the farm’s growth potential.

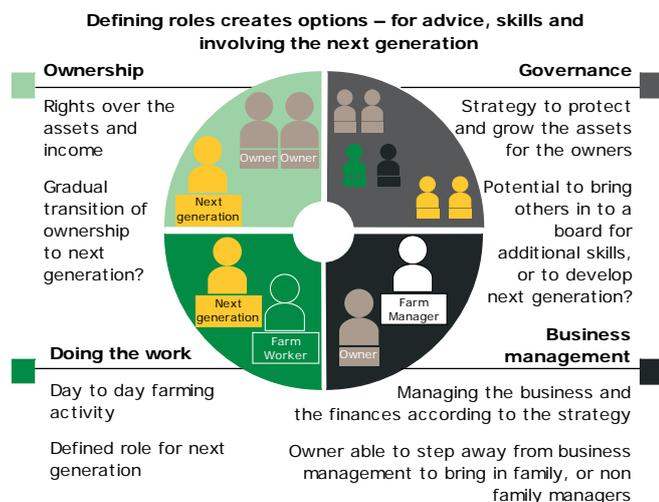
This also limits options for succession. If the understanding is that the roles are linked and that they all change at the same time, then there is limited scope:

- to bring in the next generation and skills from outside the family;
- for the non-farming family to leave capital in the business;
- for the older generation to continue to contribute their skills and experience after they cease physical farm work.



If it is understood that the roles are separate, many more options open up for successful transition. Separating the key roles of business lets you bring in family to different roles at different stages and where required. External expertise can also be easily brought in at any time.

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In the above diagram we still have the ownership passed partly into the hands of a third family member, but we have brought family and other expertise into governance. The next generation are starting to take some responsibility for the direction of the business.

The previous generation provides guidance and oversight, but the next generation are able to develop their skill set and experience to improve their contribution.

Many farmers participate in governance outside their business roles – on school boards or producer organisations, but don't develop this role back on the farm.

Governance is about protecting the business and achieving the objectives of the owners. It allows a business to involve additional skills and often to bring in the next generation to participate in setting and overseeing business strategy. The business is no longer limited to the working life span of the founder. No owner-operator business can last longer than a person's lifespan, but they can survive for hundreds of years with family succession. Family leaving capital in the business can earn a dividend, rather than the business borrowing and weakening its structure and profits.

Because the roles have been separated and defined, perhaps the owners can now step away from management without one of the family taking over. For the 53 percent of farmers who are looking for progressive involvement of the next generation, this formalised and structured transition ensures that everyone is clear of the role and responsibility of the individual family members and it is easier to scale an individual's responsibility up or down as required.

THE END GAME

The bottom line is simple: the more capability you have, or use in your business, the more options you have for change of ownership.

If you are just looking to sell up and cash out, then **having a shared family vision is important.** You want to make sure that the rest of the family is happy with this option.

There is still plenty of scope for dissension and there is still an asset to manage.

If you want to pass the business on to the next generation then the business has to be profitable. The research indicates that **the best way to achieve this is by having a robust business management strategy.**

This will lead to operational excellence – you will identify the key issues which you need to work on to improve results, and develop a plan to address them. This covers all the aspects of good farming – tracking and benchmarking performance highlights what is possible and what needs to be looked at to achieve it.

With a shared family vision and a profitable business, then the next option is open to sustaining the multi-generational family business, rather than selling out or passing it all to one family member. It also takes away some pressure on having a defined succession plan because a larger number of succession options are available.

This requires the understanding of the separation of roles of ownership, governance and management by everyone participating – both inside and outside the family.

Because it is profitable, the farm then becomes a place to leave capital as an investment for non-farming family, allowing further organic growth down the road.

THE MONTH IN REVIEW

ASSESSMENT

The next six to eight months look a lot tighter for the pastoral sector than the last two years, though divergence in performance within sectors is still stark. Early budget and cash flow revisions based on Fonterra's advance rates are highlighting significant liquidity issues for dairy farmers. The most common response so far is a reduction in debt repayments and extension of overdraft/seasonal facilities. The meat and fibre sector has similar issues, although not to the same extent.

The kiwifruit and viticulture sectors are cautiously optimistic. The kiwifruit harvest for 2012 has been better than expected and new variety licences have been released to allow regrafting of Psa affected vines. Confidence in viticulture is slowly improving, with lower volumes from the 2012 vintage rebalancing the wine market, boosting grape prices, and renewing interest in vineyards.

On the production side, **feed budgets have been under pressure since mid-June** as the good pasture covers from autumn quickly disappeared, soil temperatures dropped and grass growth slowed. **The main catalyst has been farmers carrying additional stock into the winter** because of the good autumn, extra supplementary feed on-hand, expectations of better prices, and expansion plans. **Combined with stock being in better condition this has meant feed requirements were higher** than previous winters, leading to feed surpluses disappearing more quickly than expected. The subsequent reduction in feed surpluses led to a slight pick-up in the turn-off of finishing stock and some capital stock to freezing works over the end of June. Until late July, soil moisture levels had generally been around normal for most regions, apart from North Otago/South Canterbury which have been drier. Recent rain has seen this change with the North Island and top of the South now very wet.

DAIRY

The biggest focal point for dairy farmers before calving **has been early budget and cash flow revisions** based on Fonterra's initial advance rates and cuts to retrospective payments for 2011-12. While the advanced rates and the initial forecast for 2012-13 are above historical averages, **several others influences are applying pressure to budgets.** These include:

- **Input costs and farming working expenditure,** which have increased substantially since 2000.
- **Debt servicing.** While some debt has been repaid and interest rates are lower, debt levels still remain high in some pockets.
- **Terminal and provisional tax.**
- **Additional shares** which have had to be purchased by many because of the good

production season in 2011-12. Some have paid for this out of cashflow, while others have had it deducted from milk payments in July or upcoming October payments.

Our estimates suggest around 22 percent of dairy farmers could have liquidity issues over the next six to eight months. This would be nearly double the average from the past five years. So expect to see deleveraging take a back seat over this period.

Fonterra is currently estimating total production will be back 2.8 percent in 2012-13. We would probably lean more towards the "flat" camp at this stage, but as always the spring and early summer weather will have a big say. Dairy cows are in good condition despite the late finish to the 2011-12 season. This bodes well for first quarter production.

MEAT AND FIBRE

Ewe scanning percentages across the country are generally reported to be 10-20 percent up on last year with a lower number of dry-dry's. This bodes well for lambing this spring. Combined with skinny feed budgets this has seen more grazing out of dry hoggets and excess-to-requirements breeding ewes turned off. **Export mutton slaughter is now 23 percent behind last year,** but fewer cull ewes are expected as spring approaches. **Lamb slaughter is now on par with last year after a catch-up in June.** The biggest difference compared to last year is a large increase in lamb weights from 18kg to 18.5kgs per head. This has led to an increase in total lamb production. **Total cattle production has also seen some catch-up, but is still 8.5 percent behind last year.** The North Island is the main drag, back 13 percent, whereas the South Island is up 4.1 percent. Bull slaughter is up 1.2 percent, but the other classes of stock, especially in the North Island, continue to be well behind last year.

HORTICULTURE AND VITICULTURE

The latest forecasts for the 2012 kiwifruit harvest are 72 million trays of Green, 21.5 million trays of Gold, and 5.8 million trays of other varieties. **A total of 99.3 million trays is up 8 percent on earlier expectations of 92 million trays.** However, this is still 12 percent down on last year's record of 113 million trays.

Winegrowers NZ have estimated the **2012 grape vintage to be 269,000 tonnes, down 59,000 tonnes, or 18 percent on 2011.** The harvest will produce around 194 million litres of wine (based on a conversion rate of 720 litres/tonne). This is 46 million litres (19 percent) below current sales volumes. The Sauvignon Blanc and Pinot Noir crops have suffered the largest falls, back 19 and 25 percent respectively on last year.

RURAL PROPERTY MARKET

SUMMARY

Farm turnover and values remain solid for this time of the year and up on 2010-11. Forward-looking indicators are mixed. Cashflow constraints in the livestock sectors, especially dairy, are expected to impact on turnover this spring. However, a lack of quality, well-located properties, with good contour, soils and capital improvements is still expected to see such properties sell well. Properties that do not tick these boxes will have to meet the market, often at significantly lower price levels.

The rural property market is two-speed in nature, and this is likely to continue. Support factors include: increased competition for agricultural lending; low interest rates (both floating and fixed); solid climatic conditions; offshore enquiry; a lack of good-quality properties; and those with strong balance sheets still looking to expand. The offsets heading into the first six months of 2012-13 are: lower farm-gate returns; cash-flow constraints in dairying; and a number of farmers still looking to pay back debt. Therefore, prices for livestock-aligned

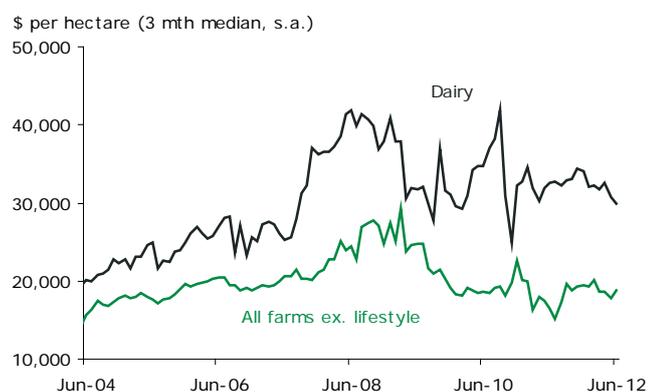
properties will no doubt be softer and turnover could drop quite a bit, but good-quality properties will still be in demand.

The 3-month period ended June saw 323 farms change hands at an average of \$18,700 per hectare. The volume is in line with the average monthly turnover from the last 12 months, but is up 50 percent on the average monthly turnover achieved in 2010-11. Perhaps surprisingly, the average price per hectare at \$18,700 is in line with the monthly average from 2010-11 and 2011-12, which were \$18,800 and \$18,500 respectively.

The table and charts below show the official statistics from REINZ for farm sales in the 3-month period ended June. The table is broken down into farm sales by each of the main farm types, both the number of sales during the 3-month period, and the median price per hectare. The figures have been seasonally adjusted and therefore the components may not necessarily add to the total. While the data is volatile, it is the best available on current market conditions.

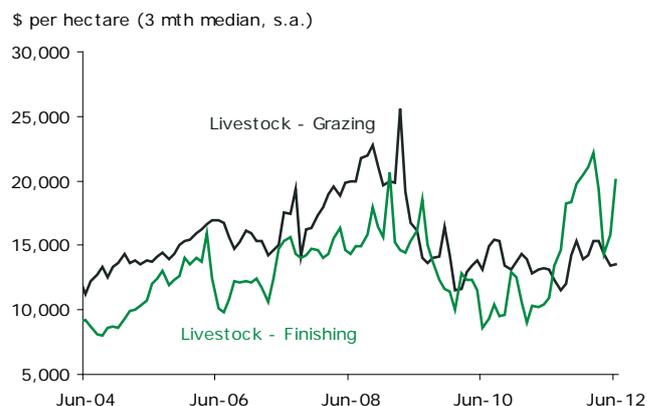
FARM SALES BY FARM TYPE								
3-Month Seasonally Adjusted		Current Period	Previous Period	Last Year	10-Year Average	Chg. P/P	Chg. Y/Y	Chg. P/10yr
Dairy	Number of Sales	37	39	46	79	↓	↓	↓
	Median Price (\$ per ha)	29,800	30,700	32,600	27,900	↓	↓	↑
Livestock – Finishing	Number of Sales	56	53	42	66	↑	↑	↓
	Median Price (\$ per ha)	20,100	15,900	10,900	12,200	↑	↑	↑
Livestock – Grazing	Number of Sales	168	202	170	244	↓	↓	↓
	Median Price (\$ per ha)	13,500	13,400	13,000	14,500	↑	↑	↓
Horticulture	Number of Sales	24	20	20	55	↑	↑	↓
	Median Price (\$ per ha)	127,700	143,100	128,300	145,900	↓	↓	↓
Arable	Number of Sales	10	12	12	19	↓	↓	↓
	Median Price (\$ per ha)	25,200	23,200	20,200	24,300	↑	↑	↑
All Farms ex. Lifestyle	Number of Sales	323	350	314	499	↓	↑	↓
	Median Price (\$ per ha)	18,700	17,800	16,500	18,800	↑	↑	↓
Lifestyle	Number of Sales	1,412	1,441	1,326	1,635	↓	↑	↓
	Median Price	470,000	468,000	455,000	384,000	↑	↑	↑

Farm Sales, Median Price



Sources: ANZ, National Bank, REINZ

Farm Sales, Median Price



Sources: ANZ, National Bank, REINZ

RURAL PROPERTY MARKET

Region	Regional Farm Sales for 2011 by Farm Type								
	Dairy			Fattening		Grazing		Horticultural	Arable
	Average sale price per ha	Average production MS per ha	Average sale price per MS produced	Average sale price per ha	Average sale price per stock unit	Average sale price per ha	Average sale price per stock unit	Average sale price per ha	Average sale price per ha
Northland/Auckland	18,000	453	28	18,900	595	11,600	1,516	183,900	–
Bay of Plenty	29,000	666	38	22,500	1,284	7,500	733	171,000	–
Waikato	37,700	806	40	19,500	1,118	10,000	1,016	166,500	–
Taranaki	45,500	827	50	21,900	899	7,400	451	123,700	–
East Coast NI	11,700	410	28	17,300	499	4,000	246	139,000	61,900
Manawatu/Wellington	28,900	968	28	20,700	704	4,100	443	156,000	40,600
Canterbury/West Coast	25,000	624	34	17,100	1,235	5,100	1,028	140,300	28,900
Otago/Southland	30,800	969	30	16,200	1,066	1,400	600	124,300	24,100
New Zealand	33,600	764	36	17,900	957	7,100	498	148,300	30,700

Sources: ANZ, National Bank, Quotable Value New Zealand

In this edition of the rural property section, we look at the regional differences in land values for different farm types. **There is a wide spread in regional prices and trends for the different farm types, which is not captured at the national level.** The differences are often associated with parameters such as weather, soils, contour, location and productivity. We have used Quotable Value NZ data, which has just been released for the 2011 calendar year. While the data lags the current situation by 6 months, it does offer an insight into the regional differences in farmland values.

The national average for dairy farmland sales averaged \$33,500 per ha, or \$36 per MS produced in 2011. Using the 2011-12 milk payout of \$6.40 per MS (for a 100% share-backed farmer) this gives a multiple of 5.6. However, there is a wide spread, from \$45,500 per ha in Taranaki to \$11,700 per ha on the East Coast of the North Island (albeit there was only one sale on the East Coast). When West Coast sales are excluded from Canterbury/West Coast the average price was \$37,800 per ha, or \$40 per MS produced. **On this basis the three most expensive regions for dairy farms are the Taranaki, Canterbury and Waikato, in that order. On a price per MS produced basis these regions look expensive.** In Taranaki the \$45,500 per ha translates into a price of \$50 per MS produced, or a multiple of 7.9 on the 2011-12 milk payout. Interestingly in Taranaki the average size of the farm sold was 42 hectares, versus the national average of 84 hectares. This suggests next-door neighbours purchasing adjoining blocks to expand their existing operations. The Waikato and Canterbury are the next most expensive on a MS produced basis at \$40 per MS, or a multiple of 6.3.

Its seems the best value for money is in the Manawatu and Otago/Southland regions, where the average price per ha was \$28,900 and \$30,800 respectively, or \$28 and \$30 per MS produced. This translates into an investment multiple of 4.4 and 4.8 respectively. Of course there are other regional considerations such as local regional council rules etc

that influence prices. Nevertheless, the relative value of existing dairying and other farm types suggests these regions could be where the largest growth in dairy production will take place.

The regional breakdown for fattening and grazing properties show different regional trends to dairy. **The spread in prices for fattening properties is a lot closer than dairy and grazing on a per ha basis.** However, this widens out substantially on a stock-carrying capacity basis. **The most expensive region for fattening properties on a per ha basis is the Bay of Plenty, followed by the Taranaki and Manawatu/Wellington regions. Fattening properties in the lower South Island regions are cheaper on a per ha basis,** but some of the more expensive on a stock-carrying basis. This is surprising, given it would be expected that dairying would have an influence for support blocks, or possible conversion. It seems the sale prices probably reflect a combination of bigger areas and access to water.

The most expensive regions for grazing properties are Northland/Auckland and Waikato, which reflects smaller properties that will no doubt have a subdivision, or lifestyle element. **The more commercially focused grazing properties are in the East Coast, Manawatu/Wellington and Canterbury/West Coast regions. On a per ha basis there is not a lot of variation between these regions.** However, there is quite a variation on a stock-carrying capacity basis. Some of the East Coast properties will have been sold for forestry conversion.

In the arable sector 41 out of a total 46 sales occurred in Canterbury. The average size of the properties sold was 74 hectares. A proportion of these would have been sold for dairy conversion. The other regions only had one or two sales. In the horticultural sector the majority of sales were on the East Coast, Northland/Auckland and Bay of Plenty. **The East Coast was the cheapest on a per ha basis, reflecting the mix of horticultural blocks to change hands.**

ECONOMIC INDICATORS

EXCHANGE RATES					
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZD/USD	0.81	0.78	0.85	↑	↓
NZD/EUR	0.66	0.62	0.59	↑	↑
NZD/GBP	0.51	0.50	0.52	↑	↓
NZD/AUD	0.77	0.78	0.79	↓	↓
NZD/JPY	61.5	61.8	67.1	↓	↓
NZD/TWI	72.0	72.3	74.2	↓	↓

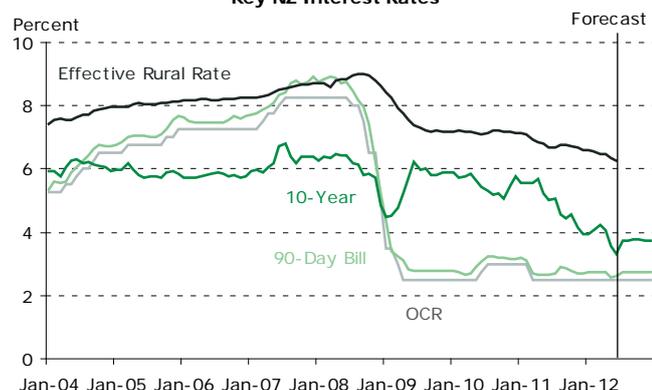
NZD Buys USD



Sources: ANZ, National Bank, Bloomberg

NZ INTEREST RATES					
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Official Cash Rate	2.50	2.50	2.50	↔	↔
90 Day Bill Rate	2.74	2.74	2.65	↓	↑
1 yr	2.60	2.70	2.89	↓	↓
2 yr	2.76	2.86	3.46	↓	↓
3 yr	2.93	3.08	3.96	↓	↓
5 yr	3.38	3.53	4.76	↓	↓
10 yr	4.07	4.23	5.68	↓	↓
Effective Rural Rate	6.25	6.36	6.68	↓	↓
Agricultural Debt (\$b)	47.12	46.78	45.79	↑	↑

Key NZ Interest Rates



Sources: ANZ, National Bank, RBNZ

The NZD continues to be driven by global sentiment as opposed to local fundamentals. Poor Western balance sheet fundamentals, a failure of policymakers across Government circles to address fiscal challenges, weakening global economic momentum and a euro that is looking suspect leads to near-term bouts of selling pressure for hi-beta currencies such as the NZD. Conversely, the deeper the malaise, the greater the prospect for central bank action (think more quantitative easing), which drives near-term fillips and bounces in risk appetites. And so **we oscillate from risk-on to risk-off and back again.** It's been the pattern for the past few years and we expect it to continue.

The NZD is expected to oscillate but remain elevated. The brutal reality is that the NZD carries tallest pygmy characteristics compared to peers. NZ's local economic challenges not as extreme as others. In a world where diversification flows continue to be attracted to nations that show even a slight modicum of yield, a floor of support remains.

Currency elevation carries two broad consequences. Interest rate convergence must continue if the NZD trades out of whack with local considerations. **In such a situation it is folly to think the RBNZ will be hiking before the Fed: hiking would merely turbo charge the NZD further.** Given the elevated NZD, New Zealand farmers will need to lift productivity to raise competitiveness. **You also need to pray that our Achilles heel (high external indebtedness and a large current account deficit) does not come under the rating agency spotlight as local fundamentals get usurped by global dynamics.** The latter is not a 2013 story but may well be one in 2014 if global forces hold excessive sway on the NZD and cause a blow-out in the external position.

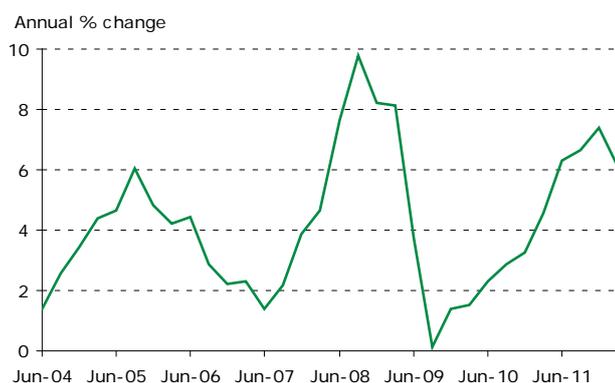
Local rates markets also continue to dance to the tune of global developments, with the RBNZ clearly adopting a neutral stance in July's OCR Review. **The hurdle to OCR cuts remains high and the RBNZ looks set to remain on hold for an extended period. We continue to look to mid-2013 for the start of the tightening cycle.** We'd encourage readers not to get too caught up with the date mentioned. The spirit of the story is more important. **We are talking about interest rate hikes remaining off the table for quite a while.**

Long term wholesale interest rates also continue to follow key global bellwether interest rates. These yields have rebounded on speculation that the offshore central banks will react, arresting slowing global growth and the deepening of the European debt crisis.

ECONOMIC INDICATORS

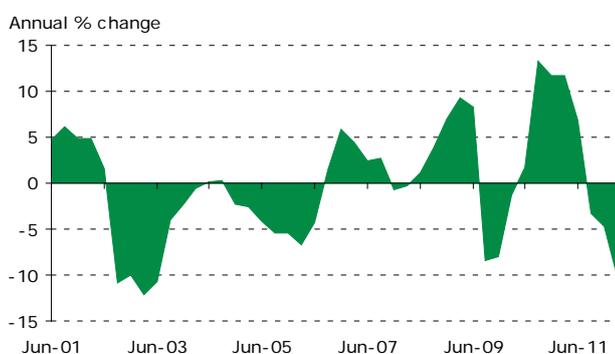
INFLATION GAUGES					
Annual % change	Current Qtr	Last Qtr	Last Year	Chg. Q/Q	Chg. Y/Y
Consumer Price Index	1.0	1.6	5.3	↓	↓
Farm Input	6.1	7.4	4.6	↓	↑
Net Imp. Margins PPI	-10.3	-4.7	11.7	↓	↓

Farm Input Inflation Gauge



Sources: ANZ, National Bank, Statistics NZ

Net Implied Margins PPI
Ag/Forestry/Fishing (Outputs - Inputs)



Sources: ANZ, National Bank, Statistics NZ

The latest annual CPI read of 1.0 percent was the lowest since December 1999. Despite higher fuel, fruit and vegetable prices, **tradable prices were up just 0.1 percent in Q2** (down 1.1 percent y/y), which was considerably weaker than the usual seasonal pattern. **The soft demand environment and high NZD continued to provide a deflationary impulse.**

Non-tradable CPI prices rose 0.5 percent in the quarter (up 2.4 percent y/y). As had been implied by our Monthly Inflation Gauge, **cost push increases in specific pockets drove the bulk of the increases, rather than generalised demand-based price increases.** For farmers the most important non-tradable prices were quarterly increases in electricity and insurance of 4.5 and 0.6 percent respectively.

All-in-all the short-term inflation outlook remains benign, with our forecasts highlighting a reasonable chance of annual inflation falling below 1 percent over the coming months. This should provide some relief to farm budgets.

The chart to the left measures the difference between the annual percentage change in prices received for rural outputs, and the annual percent change in costs of production (excluding labour costs and interest charges).

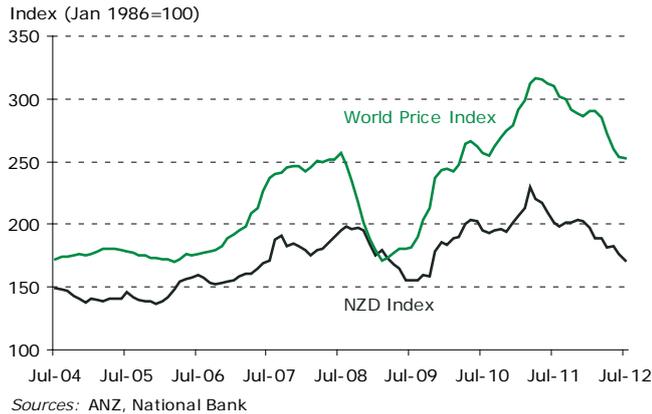
A continuation of the high NZD and softer in-market prices has seen the primary sectors PPI margins drop a further 2.7 percent since the end of 2011. The implied net margin for the primary sector has now dropped by 10.3 percent over the last 12 months and in level terms is at its lowest since the end of 2009. There were equal pressures on both the output and input side of margins. In aggregate, outputs were down 1.5 percent for the quarter, led by declines for meat, fibre and dairy. The only sector to show some improvement for the price of outputs was horticulture and fruit growing. The main driver was a poor growing season reducing supply in the main sectors (ie kiwifruit, grape and pipfruit). Input prices for the primary sector were up 1.3 percent for the quarter. Meat & fibre and cropping experienced the largest pressure on costs, up 3.5 and 2.1 percent respectively.

Overall, the implied net margins for dairy declined 2.8 percent for the quarter, and are back a massive 19.1 y/y. Meat and fibre net margins had the largest quarterly decline, back 6.0 percent, but are back only 3.7 percent y/y. Horticulture experienced a 1.3 percent q/q lift and forestry and fishing were both back 1.8 percent q/q.

KEY COMMODITIES: OVERALL INDEX AND DAIRY

ANZ COMMODITY INDEX					
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Index	171	176	201	↓	↓
World Index	253	254	311	↓	↓

ANZ Commodity Price Index



The ANZ Commodity Price Index continues to head south, easing 0.5 percent in July. Since its peak the index has **dropped 20 percent and is at its lowest level since March 2010.**

Weakening global commodity prices reflect heightened uncertainty caused by the European debt crisis and the knock-on effects to trade partners such as China. **The resurgent NZD further compounded the fall in international prices at the farm-gate.** The net result was a 3.1 percent fall in the NZD denominated index, making the pain at the farm-gate worse.

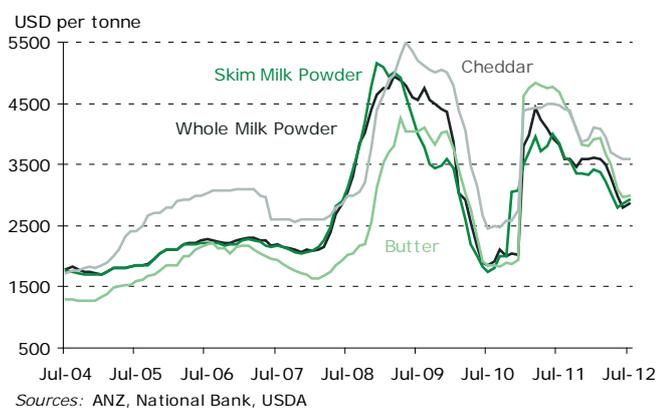
Dairy markets continue to rebalance as Southern Hemisphere supply is at its seasonal lull and Northern Hemisphere supply increases slow. **The current focus is the dry conditions in the US and India.** These two countries are the largest global producers of cow's milk, accounting for 15 and 8 percent of supply respectively. The US is also the third largest exporter of dairy products behind NZ and the EU.

So far in the US the combination of lower farm-gate prices and skyrocketing feed costs has seen the monthly increase in milk production slow from 5.3 percent in the first quarter of 2012 to 0.9 percent in the June quarter. **Higher feed costs are now locked in for the next 12 months** and make up around 50 percent of total working expenditure for the average US producer. High feed costs will diminish the incentive to feed cows extra, reducing yields and leading to cows being turned off. However, a large proportion of US dairy producers hedge their milk price and feed costs, so the flow-through at their farm-gate will not be immediate either. Meanwhile, **the start of the Indian monsoon season has been the worst in 3 years**, which could add to their import requirements. It is difficult to say how quickly and to what extent these weather events will flow through to international dairy markets. **Given inventory levels are higher, although not excessive, the flow-through won't be immediate, but it does bode well for price rises later this year and early 2013.**

Elsewhere, most indicators are pointing toward a positive start to NZ's 2012-13 milk supply, **but some recoil from last year's record 11.4 percent production increase can be expected.** On the demand side **China continues to import more dairy products**, just a different mix to the last two years. The volume of dairy products imported by China in the first six months of this year was 16 percent higher than the same period in 2012. NZ supplied 56 percent of China's dairy imports during this period. While we concur with Fonterra's initial 2012-13 forecast of \$5.50 per MS, **year-to-date market prices and currency indicate a milk price closer to \$5.10 per MS.** This indicates there is still some way to go and farmers should be budgeting conservatively and monitoring cashflow.

OCEANIA DAIRY PRICE INDICATORS					
USD per tonne	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Whole Milk Powder	2,800	3,000	3,938	↓	↓
Skim Milk Powder	2,863	2,806	4,000	↑	↓
Butter	2,975	3,100	4,763	↓	↓
Cheddar	3,600	3,625	4,488	↓	↓
World Basket	3,060	3,133	4,297	↓	↓

Dairy Products - Oceania Export Market Prices

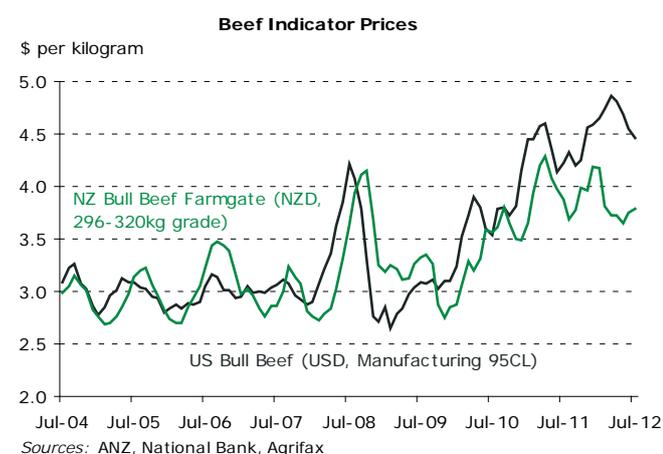


KEY COMMODITIES: BEEF AND LAMB

BEEF PRICE INDICATORS					
\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
US Bull Beef ¹	4.46	4.56	4.22	↓	↑
NZ Bull Beef ²	3.79	3.75	3.88	↑	↓
NZ Steer ²	3.84	3.78	4.03	↑	↓
NZ Heifer ²	3.26	3.19	4.00	↑	↓

¹ USD, Manufacturing 95CL

² NZD, 296-320kg Grade Bull & Steer, NZD, 195-220kg Grade Heifer



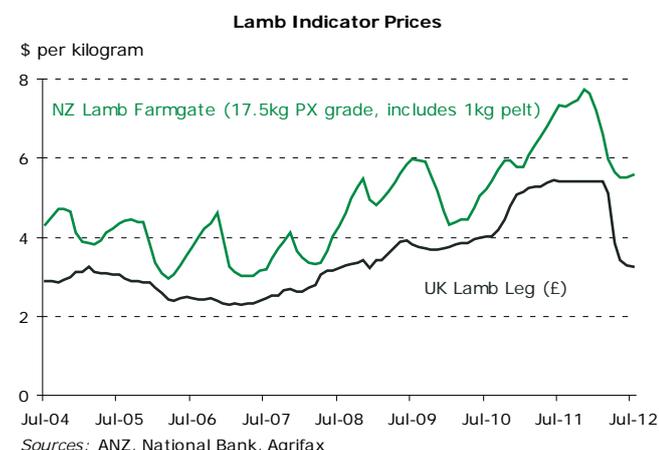
Farm-gate prices for beef cattle look like they have found support for now. Softer in-market prices and a high NZD seem to have been superseded by domestic procurement pressures. **The short-term outlook remains murky, but most indicators still look positive for 2013.**

As with dairy markets **the focus is on the US drought. The US is our largest market and still the world's biggest beef producer.** The USDA's forecasts for 2012 and 2013 red meat and poultry production have been reduced as higher feed prices are expected to slow the pace of pork and poultry expansion and temper growth in weights. **Beef production forecasts have been raised** as deteriorating pasture conditions are expected to increase feedlot placements and the turn-off of breeding beef and dairy cows. However, **the placement of lighter-weight cattle in feedlots and higher feed costs will dampen weight growth. So overall production is still forecast to decline, but not by as much as previously expected.**

The relative strength of the US dollar and strong prices in the US have had an impact on US beef exports. This helps reduce competition in our other major export markets of Japan and Korea. US exports were lower to most countries in the first 5 months of 2012 and are forecast by the USDA to be down by 8 percent in the 2012 calendar year. In contrast, US beef imports, which dropped by 10 percent in 2011, are forecast to increase by 20 percent in 2012 and a further 5 percent in 2013. **Much of the increase will come from Australia.** In the first 5 months, US beef imports from Australia were up 85 percent on 2011.

LAMB PRICE INDICATORS					
\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Lamb ¹ (NZD)	5.59	5.51	7.34	↑	↓
UK Lamb Leg (£)	3.26	3.29	5.42	↓	↓

¹ 17.5kg PX grade, including 1kg pelt



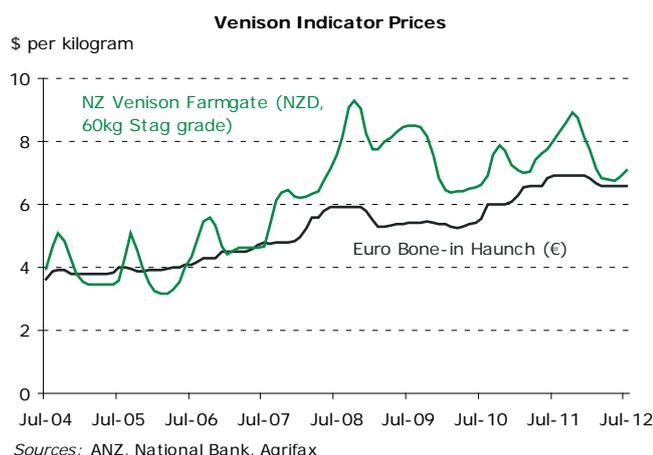
Lamb schedule prices have found a base, but there does not seem to be too much upside for the remainder of 2012 as Europe and the UK head deeper into recession. While in-market prices in Europe have bottomed at levels comparable with the 2008-09 and 2009-10 seasons, added pressure is coming from the currency as the NZD/EUR continues to post new highs.

While our last update had a season average price for 2012-13 of \$100 for a 17.5kg lamb, it seems there is now quite a bit of downside risk. To illustrate, a comparison with the 2008-09 and 2009-10 seasons shows farm-gate prices averaged \$89 and \$88 respectively. The NZD/EUR and NZD/GBP over these two seasons averaged 0.47 and 0.41 respectively, compared with 0.65 and 0.51 currently. Therefore, **something needs to change, and we do not see this being the currency, or in-market prices.** The one point of difference now is that China takes over 20 percent of NZ's lamb exports. In fact the latest monthly shipments for May were a new monthly record of 7,700 tonnes, up 46 percent on last year. If China's appetite for higher value cuts continues to grow, this will offer a valuable alternative to Europe.

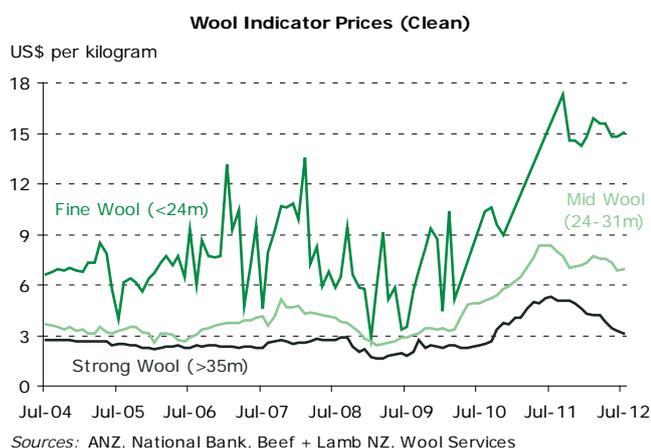
KEY COMMODITIES: VENISON AND WOOL

VENISON PRICE INDICATORS					
\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Venison ¹	7.07	6.89	8.04	↑	↓
Euro Bone-in Haunch (€)	6.60	6.60	6.90	↔	↓

¹ 60kg Stag AP grade



CLEAN WOOL INDICATOR PRICES					
\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Fine Wool (>24m)	19.05	19.05	NA	↔	NA
NZ Mid Wool (24-31m)	8.82	8.82	9.88	↓	↓
NZ Strong Wool (>32m)	3.94	4.16	6.23	↓	↓
USD Fine Wool (>24m)	15.05	14.84	NA	↑	NA
USD Mid Wool (24-31m)	6.97	6.87	8.35	↑	↓
USD Strong Wool (>32m)	3.11	3.24	5.26	↓	↓



Demand and in-market prices for venison remain robust in the face of Europe heading into a deeper recession. The key venison-consuming countries of Germany and the Netherlands continue to perform better than many of their counterparts. Together these markets make up approximately 50 percent of NZ's total export earnings. **The other advantage venison has is its niche status – it is consumed by individuals with high disposable incomes.** These consumers do not tend to change their eating habits during a recession as their prospects and fluctuation in disposable income do not weigh on their eating habits to the same degree as an average Joe.

The real risk for NZ venison exporters and farm-gate returns lies in the value of the euro rather than in-market prices. This has been holding back schedule prices as shipments of chilled venison to Europe to meet game season demand commences. Those farmers who took contracts earlier in the season are being rewarded on this basis.

Total venison production for the 12 months to June was up 1.8 percent on the year before. The increase was driven by heavier carcass weights from the good growing season over 2011-12. The total number of carcasses processed were unchanged. **Overall, hind numbers and production are expected to remain stable and well matched to market demand. Therefore, NZD/EUR movements will drive farm-gate prices into the seasonal peak in October.**

Wool prices have continued to head south due to a combination of a strong NZD and weaker in-market prices. Poor economic growth prospects in some of the main wool-consuming countries, especially Europe and Japan, remain the main drag and this is not expected to change any time soon. Farm-gate prices for strong blend wool are now back to the pre-peak levels of late 2010. Finer micron wools have not slipped to the same extent, but the direction still points down.

The good news is the price competitiveness of wool against cotton and synthetics looks to be coming back into balance. Synthetic fibre prices are elevated, but the recent softness in oil prices will feed through. Cotton prices have continued to weaken, but are finding a base on drought concerns in India and the US, who are the second and third largest producers.

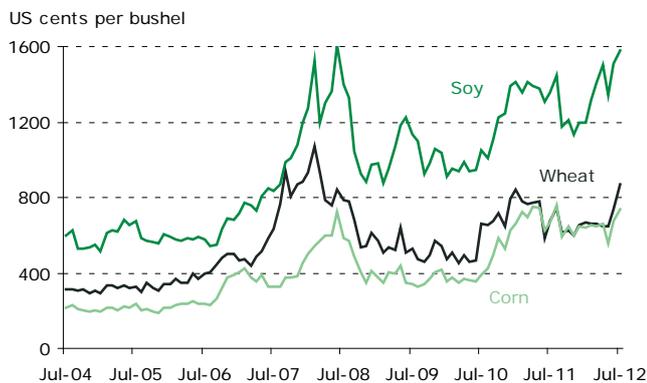
Total NZ wool exports for the 11 months to May 2012 are back 9 percent on last year. The major declines in our export markets have been in Australia, India and the UK, with volumes back 74, 24 and 22 percent respectively on last year. In total this equated to a decline of 7,100 tonnes. China has picked up most of the slack, increasing demand by 3,900 tonnes to account for 50 percent of total wool exports.

KEY COMMODITIES: GRAIN AND FERTILISER

GRAIN & OILSEED PRICE INDICATORS					
USD cents per bushel	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Wheat	8.7	7.4	6.7	↑	↑
Soy	15.8	15.1	13.5	↑	↑
Corn	7.3	6.7	6.7	↑	↑
Australian Hard Wheat ¹	350	307	307	↑	↑

¹ NZD per tonne

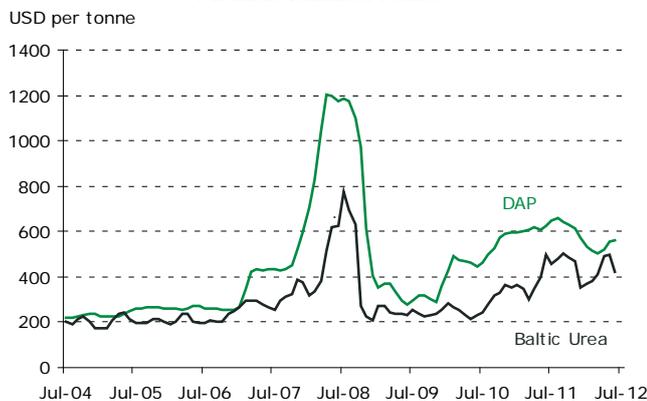
CBOT Future Grain & Oilseed Indicator Prices



Sources: ANZ, National Bank, Bloomberg

FERTILISER PRICE INDICATORS					
USD per tonne	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
DAP	564	553	625	↑	↓
Urea	420	497	500	↓	↓

Fertiliser Indicator Prices



Sources: ANZ, National Bank, Bloomberg

Dry weather conditions across the major grain producers, especially the US, have locked in high international prices for at least the next year.

The major focal point is the widespread drought in the US, where the largest contiguous area ever of 1,545 counties and 33 States have been declared natural-disaster areas. The US produces approximately 25 percent of the world's soybean, corn and wheat. This has resulted in a 54 percent increase in corn futures since mid June. Wheat prices are up by 38 percent over the same period, and soybeans by 20 percent.

On the back of the severely dry conditions the USDA lowered its expected corn yield by 12 percent to 146 bu/ac in July. This move reduced expected corn production to 13bn bu, a cut of 1.8bn bushels. However, **a recent survey of analysts has put the average US corn yield at 137 bu/ac**, which would be a yield deviation from trend of 16 percent (long term trend is 164 bu/ac). With a yield of 137 bu/ac, **the demand rationing task faced by US livestock and ethanol producers is substantial.** The current drought is being compared to 1988, and USDA crop conditions reports are so far showing a similar trajectory. In 1988, the final corn yield as a deviation from trend was 25 percent. Applying the same deviation would imply a yield of 123 bu/ac, or the need to reduce consumption by 20 percent y/y to keep stock levels constant.

The other region where grain production is expected to decline significantly is the Black Sea region. Early harvest reports have confirmed the extent of drought damage to winter wheat in southern Russia and Ukraine. Harvest results to date indicate grain yields in the Ukraine are 30 percent lower y/y, while Russian winter wheat yields in the south are reported to be 40 percent lower than in 2011. As a result the gap in grain production from this region looks set to exceed 20mmt y/y. **Combining the US corn and Black Sea grain crops, production is likely to fall by at least 40mmt relative to last year. This loss is the equivalent of 15 percent of global corn and wheat stocks.**

Domestically, trading has been at its usual winter lull. However, quoted prices have started to lift with the high international prices. **With the bumper domestic harvest in 2012 and farmers having plenty of other supplementary feed on hand it would seem the real upside to domestic feed prices won't be until later this year, or for 2013 contracts.**

Fertiliser companies reviewed their national prices in early June. There **was an increase of \$60 per tonne for Urea to \$860** due to the steady rise in international prices since the start of 2012. **DAP was reduced by \$106 per tonne to \$992** due to the decline in international prices since the end of 2011. **Superphosphate prices were left unchanged.**

KEY COMMODITIES: HORTICULTURE

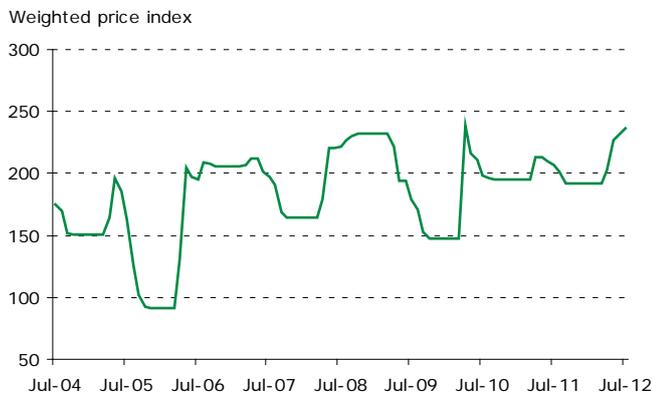
HORTICULTURE PRICE INDICATORS					
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Kiwifruit (USD per kg)	3.0	3.0	3.3	↑	↓
Apples (Weighted Index)	236	231	207	↑	↑
Wine (USD per litre)	5.6	5.6	5.8	↓	↓

Kiwifruit Indicator Price



Sources: ANZ, National Bank, Zentrale Markt- und Preisberichtsstelle

Apple Indicator Price Index



Sources: ANZ, National Bank, Zentrale Markt- und Preisberichtsstelle

Wine Indicator Price



Sources: ANZ, National Bank, NZ Winegrowers

In the kiwifruit industry Zespri has released 2,130 hectares of new variety licences for grafting this winter. This is the largest transition to a new variety ever undertaken by the industry. The previous transition to a new variety was in 2000, with the release of 1,200 hectares of Hort16A licences. The transition marks the first steps along the recovery pathway for many. **However, caution remains** as there will be a steep learning curve to get the production and taste of the new varieties in sync with market demand. In addition, while the new varieties have shown more resistance to Psa in field and laboratory trials, they are still susceptible. Newly grafted Gold3 will be particularly vulnerable come this spring, when Psa infections are at their seasonal peak.

The latest forecasts for the 2012 harvest are **99.3 million trays, which is up 8 percent on earlier expectations.** The result of the larger harvest could put some downward pressure on Zespri's indicative ranges for returns from the 2012 harvest. Early sale reports have indicated that green kiwifruit have been selling well. However, due to the late harvest, higher price point and tougher economic conditions, gold kiwifruit sales have been tougher. Therefore, we expect the bias to be toward the bottom of Zespri's indicative ranges for gold at this stage. Green returns are also biased to the bottom of the range, because of a stronger NZD/EUR.

In the viticulture sector things are slowly improving, with lower volumes from the 2012 vintage rebalancing the wine market and boosting grape prices.

Reports of last year's vintage already being sold and smaller 2012 harvest have seen a 5 percent lift in export prices in May, and these held in June. **Bulk volumes have dropped from 35-40 percent of monthly exports to average 22 percent over the last three months.** The price of bulk white wine sold in June also lifted by 20 percent from earlier in the year to \$3.66 per litre. **2013 Sauvignon Blanc prices are expected to be in the vicinity of \$1,500 per tonne,** with a number of large specialist bulk wine producers already launching their price for 2013 at around \$1,420. This is up from the \$1,200 per tonne that had been achieved over the last two years.

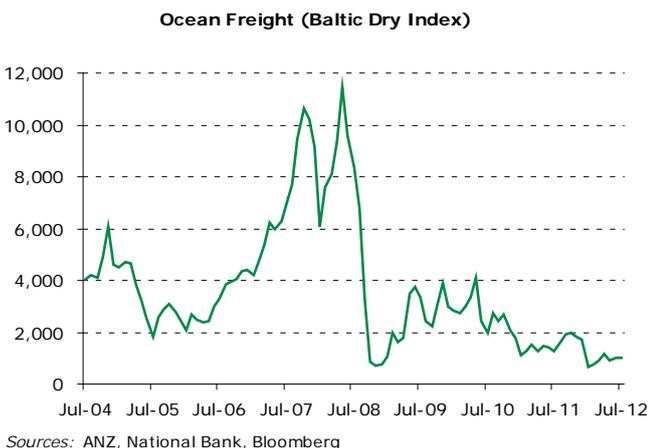
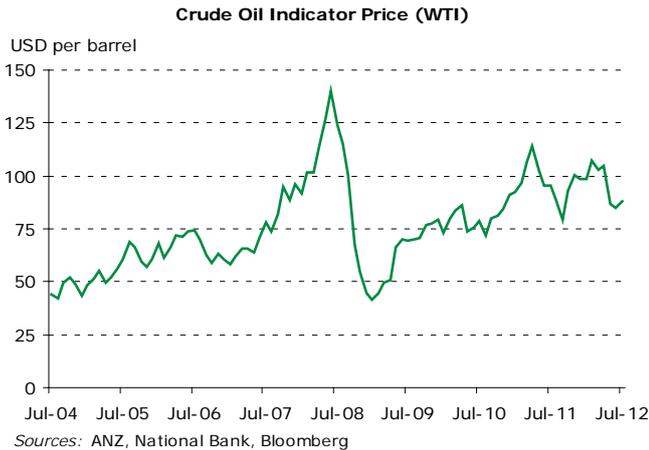
Consolidation and overseas investment in the industry is continuing, with a number of vineyard sales reported to have occurred in the Marlborough region in June. Ongoing interest for suitable vineyard properties was also reported. However, a majority of vineyards continue to struggle to remain solvent, with the pressure on wineries arising from low volumes from the 2012 vintage and high fixed cost structures. This is shown in the industry's terms of exchange, where "negative jaws" have been experienced since 2002.

KEY COMMODITIES: OIL AND FREIGHT

OTHER COST INDICATORS					
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Crude Oil ¹	88	85	96	↑	↓
Ocean Freight ²	1,037	1,004	1,264	↑	↓

¹ USD per barrel, grade WTI

² Baltic Dry Index



Oil prices have been very whippy, swinging between supply issues from geopolitical tensions in the Middle East, and negative demand factors.

Both crudes have recovered in July – Brent crude more so than WTI – after the flaring up of geopolitical tensions in the Middle East. More than half of Iranian lawmakers have supported a bill to block the Strait of Hormuz for oil tankers, while EU oil sanctions on Iran started in early July. **Over a third of the world's seaborne oil exports pass through the Strait.** The IEA forecasts about 1m bbls/day of oil could be cut from oil markets, which could dispel any OPEC oil overproduction concerns. Iran has also reportedly successfully test-fired mid-range missiles and threatened Israel. **Added to the mix are growing concerns around the escalation of the conflict in Syria,** which has certainly ignited greater political and oil supply risks in the region.

On the downside, the **slow growth in the US economy has resulted in a reduction in demand for fuel,** with the current four-week average demand back 3.2 percent on the same period last year. US crude stocks also jumped 2.7 million barrels in late July on a rise in imports, versus forecasts for a small drawdown. US crude stockpiles are still just under record-high levels and sit well above the 5-year average for this time of year. Gasoline stocks also rose 4.1 million barrels.

We think growing political tension and potential supply disruptions will be supportive for oil prices, particularly Brent, despite macroeconomic concerns – limiting potential downside risk in prices. WTI remains comfortable trading in a USD84-USD90 range, but there is scope for a move first to USD94 and possibly towards USD100 if the risk of foreign intervention in Syria increases.

The Baltic ocean freight index remains around 1,000 as Eurozone concerns and slow Chinese imports continue to weigh. At current levels the direction of freight costs is expected to be dictated by economic growth prospects over the next several years, but with things not looking overly flash they are not expected to change dramatically like they did in the 2006 to 2008 period.

ECONOMIC BACKDROP

SUMMARY

Despite a worsening global backdrop our big picture view is little changed from a few months ago. The New Zealand economy continues to navigate a series of large domestic and external shocks, which is resulting in mixed economic signals, and will do so for some time. We've pencilled in around 2½ percent growth over the next two years with an earthquake fillip assisting growth. A better national balance sheet is a precursor to a more pronounced upswing, but this will take time.

The interaction of five shocks is an unchanged thematic within our core economic view. These shocks include a wobbly global scene, ongoing deleveraging, rebalancing, a historical high terms of trade, and growing connectivity with the faster-growing Asia region, and rebuilding Canterbury. These shocks are causing huge tensions in the economy and are colliding with typical cyclical indicators such as low interest rates. Lower interest rates would normally be leading to a strong rebound in the more cyclical sectors (notably construction, manufacturing). At the same time, a number of economies are "exporting" their own problems via currency weakness, which is keeping the NZD higher than necessary.

Our proprietary indicators, including the *Truckometer*, *Banking Momentum Gauge*, and the confidence composites, **continue to portray mixed messages, a symptom of the various tensions in the outlook.** That we are also seeing patchy and volatile quarterly growth rates in the published official statistics tells us something about the environment we are now in. Brace for more to come.

The global scene is fraught with uncertainty. A banking crisis in 2008 has been replaced with a sovereign equivalent, with markets closely watching Europe. The Western world is battling a legacy of debt-driven exuberance. The solvency of entire governments now has the market's attention. Addressing these solvency issues demands hard austerity decisions and a demonstration of leadership. Global problems require global solutions. Unfortunately game theory (ie the Prisoner's Dilemma) tells us that self interest is likely to prevail over group interest. This means partial and temporary solutions will prevail in the interim.

In terms of transmission mechanisms to New Zealand, and looking beyond what we export to Europe, **we are watching the 6 C's** – contagion risks, confidence, cost of funds, China, commodity prices, and the currency. At present we are seeing tensions arise as these events and shocks clash, which is pushing the economy in different directions.

This combination has us watchful, though still cautiously optimistic over the outlook given our economic flexibility, shock-absorbers and confidence in our macroeconomic framework. **However, where the world goes, New Zealand invariably follows.**

New Zealand's balance sheet demands a period of penance. Our high net external debt of nearly 80 percent of GDP in an underlying sense makes us stand out for all the wrong reasons. A prolonged period of fiscal restraint is in prospect, with the fiscal stance forecast to tighten by around 3 percent of GDP over the coming 3 years. **New Zealand does not have the balance sheet position for a pro-cyclical upswing to occur. A stronger focus on driving growth across the economy could help improve the national balance sheet faster.** Just as businesses can turn around weak cash and balance sheet positions by growing revenue, the same applies to the economy.

Five planks anchor our economic assessment. We continue to expect a sustained period of **heightened volatility.** This reflects the global scene, but also tensions from opposing shocks. We also expect the next few years to result in **disparate rates of sector performance**, as there will be winners and losers from this re-orientation of growth. **The gaps between the strong and the weaker players within sectors will widen. There is more downside risk than up**, though this is partly mitigated by New Zealand's macro framework and the shock-absorbers provided by a floating currency and NZD-denominated debt. **The trend rate of growth for the New Zealand economy will be subdued for another five years** as cyclical support mechanisms are dampened by structural headwinds. As structural headwinds fade, and natural endowments are unlocked, we then expect to lift our estimate of trend growth.

Despite this, the **medium-term story for NZ.Inc remains strong.** This is built around New Zealand's emerging connectivity with Asia, the growth in consumerism across emerging markets, and a positive outlook in the medium term for New Zealand's terms of trade, with the latter driven by commodity price trends.

BORROWING STRATEGY

SUMMARY

Wholesale interest rates remain close to all-time lows across the yield curve, but are a little higher than they were when we published our last edition of the *Agri Focus*. In the intervening period long-term interest rates hit record lows, only to rebound on optimism that the ECB has a “plan” to deal with Europe. We remain sceptical, and expect interest rates to remain subdued for an extended period. Not only do we expect the RBNZ to remain on hold well into 2013; global leading indicators are also yet to show signs of basing. As such, any rise in rates is likely to be temporary. Accordingly, our preference is to remain floating, or to fix for periods of 2 years or less. This is not because we expect rates to rise, but simply because it makes sense to spread risk given how similar floating, 1 and 2 year rates are.

OUR VIEW

Long-term wholesale interest rates fell to new lows in July as key global bellwether interest rates like the US 10yr bond yield hit all-time lows. However, yields have since rebounded on speculation that the US Federal Reserve might ease policy, and on talk that the ECB might intervene in the market to arrest the deepening of the European debt crisis, taking New Zealand rates with them. As we will discuss, although the US and Europe are a long way from Taranaki and Southland, they still have an enormous impact on financial markets, and by extension, on rural lending rates.

One thing that has changed in the past two months is the slope of the yield curve, which has flattened. This has occurred courtesy of the fact that short-end interest rates have increased by more than long-term interest rates, which in turn reflects the RBNZ’s neutral stance, and the high hurdle for further policy easing. Whereas the market was pricing in almost 30bps of rate cuts by year-end prior to the July OCR Review, it is now pricing in much leaner odds. And to be sure, we do not expect the RBNZ to cut the OCR either. While there is always the risk that a global catastrophe may call for a rate cut, in a “business as usual” environment one is unlikely.

At issue for rural borrowers is where rates might go over the long term, and how this compares to the current choices available in the market. **We expect the RBNZ to be on hold for a considerable period.** Although a high NZD presents challenges, we do not expect it to lead to rate cuts on its own. But it will keep pressure on short-term interest rates, particularly in an environment where investors are diversifying into high-yielding quality bond markets like New Zealand’s. A high NZD will

put pressure on farm revenue as well, highlighting the need for flexibility.

Europe remains the key global focus. While potential policy intervention may well see global long-term interest rates rise further in coming weeks, such moves are unlikely to be sustained unless they are part of a credible long-term plan, and until we see a turn in global momentum. The former requires government initiatives, yet such initiatives lack electorate support. More often than not policy actions are temporary fixes, while they may contain systemic issues, they are not lasting solutions. **Consequently, we do not favour fixing for long periods such as 5 years.**

This is borne out in our breakeven analysis, which shows that interest rates need to rise gradually over the next few years in order for there to be value in fixing for longer periods.

The rise in breakevens are not as brisk as they were a month ago, courtesy of the fact that the yield curve has flattened, but we do believe there’s too much uncertainty out there to go adding long-term fixed costs to business (via a long-term fixed rate).

What is interesting is how flat the yield curve is out to 2 years, with just 0.18 percent separating the lowest and the highest rate. **In essence, there is nothing separating short term rural rates. The question then becomes, why wouldn’t you take a little certainty** given that it doesn’t cost much? In our view, it makes sense to. But it’s not because we think the RBNZ is about to hike the OCR, rather it’s about risk management, particularly given that when you do fix, you are fixing your all-up lending rate, and not just the base rate. But we don’t favour fixing everything, because there is always a risk that things change, and some flexibility is a good thing.

Rural Lending Rates (incl. typical margin)		Breakeven rates in			
Term	Current	in 6mths	in 1yr	in 2 yrs	in 3 yrs
Floating	5.64%				
6 months	5.61%	5.69%	5.86%	6.09%	6.45%
1 year	5.65%	5.78%	5.94%	6.15%	6.53%
2 years	5.79%	5.91%	6.04%	6.34%	6.64%
3 years	5.91%	6.05%	6.21%	6.48%	
4 years	6.07%	6.20%	6.34%		
5 years	6.20%				

EDUCATION CORNER: BIOSECURITY IN FOCUS

SUMMARY

New Zealand's current biosecurity system operates on three fronts: pre-border, at the border, and within New Zealand. The cost of mitigation increases as unwanted organisms move across the border and become established; hence resources and focus need to be pre-border and at the border. A recent independent report into the Psa-V incursion has shown gaps in the current processes of these channels. While no system is infallible, as the cost of perfection would be prohibitive, accountability and performance are paramount. This means the identified problems need to be dealt with swiftly. In this regard, we have seen a number of new initiatives emerging. Government and industry have a collective responsibility to fund and support these new initiatives. However, the Government is on the hook for the majority of the costs: there is clear market failure whereby the social rate of return from biosecurity exceeds the private rate of return.

Biosecurity and food safety are vitally important to the continued prosperity of farmers and all New Zealanders. We have a reputation for producing safe food, free of the disease problems affecting so many other countries. Not only does this disease-free status benefit productivity, but it also ensures access for our exports into premium markets overseas. It also allows New Zealand to maintain high import standards, which are intended to keep diseases out.

Our reputation as the source of the highest quality food must be maintained. However, the challenges for our biosecurity system continue to grow as the volume and diversity of passengers and cargo entering New Zealand expands – trade is a two-way street.

Biosecurity remains a hot topic of discussion for three reasons. One is several recent high profile and potentially expensive biosecurity incursions. Secondly, with government finances tight the Ministry for Primary Industries (MPI) have introduced Government Industry Agreements (GIAs) into the Biosecurity Act last year. GIAs are being introduced to create structures under which the Government and an industry can work together to identify priority biosecurity risks; make consensus decisions on how to respond to threats; and share the cost of responses. **Third, the National Animal Identification Scheme (NAIT) for cattle and deer** became live on the 1st July. One of the main justifications of the scheme is to help minimise the impact of any biosecurity incursion (such as foot and mouth, or Bovine Spongiform Encephalopathy) on the valuable livestock sectors.

WHAT IS BIOSECURITY?

Biosecurity is about keeping New Zealand free of unwanted organisms and managing or eradicating them should they arrive in the country. This is to prevent or at least reduce any damage such unwanted organisms cause should they occur, and to protect and preserve the primary sectors, land, water, and people of New Zealand. Under the Biosecurity Act 1993 **the MPI has the mandate to lead the biosecurity system** within New Zealand. **The MPI relies on support from other organisations** such as industry-good bodies, regional councils, the Department of Conservation, Customs, the Animal Health Board and the New Zealand public to ensure an effective biosecurity system.

WHY IS BIOSECURITY IMPORTANT?

Being a small island country, known for its lush vegetation, farming and natural beauty, major parts of the economy (farming, orchards and tourism) are dependent on the country's environment. That is why just one new pest or disease can be devastating.

Globalisation has seen increasing volumes of goods and people moving at greater speeds around the world and across our borders. One of New Zealand's greatest assets is our relative geographical isolation (and it's also one of our greatest economic challenges!). This means only a small proportion of the world's pests and diseases occur in New Zealand. Therefore, in many respects New Zealand is fortunate to be free of many pests and diseases of humans, animals and plants. However, this means that our population is more susceptible to incursions of new diseases, having not had the chance to develop immunity, or effective management practices.

The continuation of globalisation and rising connectivity between countries will only see these challenges grow. This is highlighted by the number of cross border movements of people and goods from a more diverse number of countries since the turn of the century. Total air passengers and crew movements (arrivals and departures to New Zealand) have increased by 155 percent since 2000 to 9.3 million per annum, and cruise ship passengers are up four-fold to nearly 70,000 per annum. There has been a dramatic increase in the number of Asian tourists, with Chinese tourist numbers up nearly five-fold. This has increased New Zealand's exposure to biosecurity risks from this part of the world. Container arrivals and the gross weight of all cargo has increased by 36 percent since 2000. International mail parcels have increased and so have the sources of risk, particularly with the growth of Internet mail order.

EDUCATION CORNER: BIOSECURITY IN FOCUS

These factors – and perhaps a need for further strengthening of our biosecurity system – have seen a rise in the number of biosecurity incursions since the turn of the century. In fact **there have been 546 known biosecurity incursions¹ since 2008, an average of 10.5 per month. This is well up on the early 2000s.** While not all incursions have had a big impact on New Zealand's economy, a number have. These include things such as Psa-V bacteria in Kiwifruit in 2010, Didymo in streams in 2004, Varroa mite in honey bees in 2000, Gypsy Moth that was eradicated in 2005, Psyllid in tomatoes and potatoes in 2006 and the list could go on, depending on what sector is involved.

Examining some of these more high profile and expensive incursions in recent years shows that often the biggest social and economic costs are with the food producer, forester, horticulturalist and their processors and shareholders.

An example is the discovery and effects of Psa-V in kiwifruit, which has been devastating, particularly for Hort16A (gold) growers. Kiwifruit Growers Inc reports that 600 hectares of gold kiwifruit have already been ripped out by April 2012 (23 percent of total area), with more to follow as re-grafting to more resistant varieties occurs this winter. So far 1,231 orchards have been identified as being infected with Psa-V. This means that 37 percent of kiwifruit orchards in New Zealand are currently infected, representing 46 percent of the total growing area for kiwifruit. And the numbers continue to grow.

Percentage of NZ kiwifruit hectares on orchards with Psa-V identified



Projections of the total economic impact of Psa are more uncertain and require a number of assumptions regarding the long-term impact on harvests (ie the permanent loss of production capacity), the ability to limit the spread throughout New Zealand, the uptake and success of efforts to

diversify away from the affected Hort16A variety of Gold kiwifruit, and the subsequent impact on regional economies such as the Bay of Plenty.

A recent Lincoln report² puts the direct economic impact to the kiwifruit industry at between \$310m-\$410m in the next five years; \$500m-\$600m in the next ten years; and \$740m-\$885m over the next 15 years.

When the effects on regional economies and related businesses are included these estimates are pushed much higher. The same study estimates that the loss of employment in the Bay of Plenty region alone between 2012 and 2016 to be 2,400 to 2,900 full-time equivalents.

At an individual orchardist level it is fair to say the impact for many has been devastating. The effects (particularly for gold kiwifruit orchardists) vary considerably, ranging from a complete loss of income to significantly reduced orchard-gate returns from lower yields, with orchardists also facing higher cost-structures from efforts to manage the disease. The net effect is a substantial decrease in productivity and the value of kiwifruit orchards, meaning that many orchardists now have negative equity positions and will face difficulties servicing debt over the coming years.

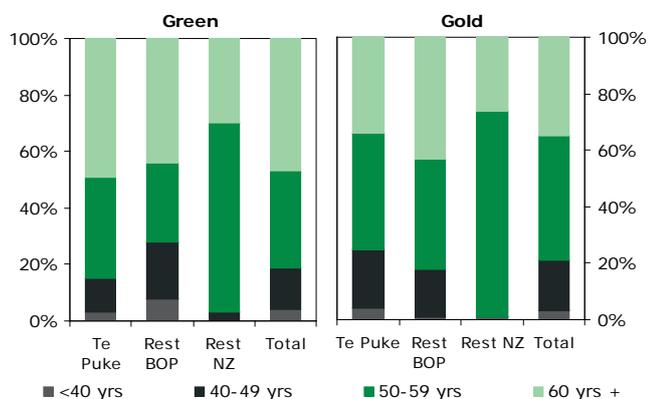
The social costs could be even greater. The kiwifruit industry is widely recognised as having a relatively high average grower age. The proportion of total green area owned by growers 60+ years is 48 percent in Te Puke and 46 percent nationally, while the proportions of gold area owned by growers 60+ years is lower, at 33 percent for Te Puke and 35 percent nationally. However, those in the 50 to 59 year age category farm the largest proportion of gold kiwifruit, which is associated with higher debt levels. As a proportion of growers, those in the 60+ years age group account for approximately 40 percent of all those reliant on orchard returns to service kiwifruit debt, both in Te Puke and nationally. For these growers, it is expected that the loss of equity, even in the short term, will be of particular concern as they approach retirement age.

¹ The definition of an incursion is "The occurrence of an organism not previously known to be present in New Zealand, where there is a likelihood that the specimen(s) found is part of a self-sustaining/breeding population. Note that reinvasion of a species that has already been eradicated or controlled is considered a new incursion" (taken from Policy for MAF's Response to Risk Organisms- July 2008).

² The costs of Psa-V to the New Zealand Kiwifruit Industry and the Wider Community. Completed by Lincoln Universities agribusiness and economics research unit.

EDUCATION CORNER: BIOSECURITY IN FOCUS

Age of orchardist in 2012 for different varieties by region



Sources: ANZ, National Bank, Lincoln University, AERU

Despite all this, there have been some recent rays of light. The industry is attempting to counteract the disease by releasing licenses for the new gold kiwifruit variety G3 (2,068 hectares) and green variety G14 (50.6 hectares) to affected Hort16A growers, and to a lesser extent other growers, in time for the regrafting/replanting of vines this winter. Both G3 and G14 have exhibited tolerance to Psa-V in testing and field trials. Once a grower has grafted across it may take up to three years for them to return to full production. However, risks persist as both varieties are not totally immune to Psa-V and are still somewhat untested in the marketplace.

Having one seller/marketer in the form of Zespri has **definitely helped manage the Psa situation and speed up the recovery process.** This needs to be kept in mind when discussing alternative industry structures, such as fully competitive models and decentralisation. The economic and social costs would have been much higher no doubt without the coordination that has been provided by Zespri in this case.

This is but one example of why biosecurity is so important to our large primary industries and the wider community. There are many more examples, all with varying degrees of impacts for different parts and sectors of the New Zealand economy.

HOW DOES NEW ZEALAND'S BIOSECURITY SYSTEM WORK?

The Biosecurity system in New Zealand operates on three fronts:

1. Pre-border
2. At the border
3. Within New Zealand

Generally, the cost of mitigation increases as unwanted organisms move across the border and become established; hence a significant focus is on prevention, early detection and eradication (if possible).

Pre-border

New Zealand takes a leading role (disproportionate to its relative size) in international organisations and agreements working to reduce the risk of importing or exporting pests and diseases. New Zealand is signatory to a number of international commitments, such as the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement), Convention on Biological Diversity and the United Nations' Convention on the Law of the Sea. These agreements all include specific provisions for the protection, eradication or management of pests and diseases.

Participating countries are required to notify significant changes in the occurrence or distribution of pests and diseases, including major diseases for wildlife. For example, an outbreak of foot and mouth disease (FMD) in one country will usually result in immediate suspension of some trade and rapid and significant changes in the processing of and movement of goods and people by other countries. **This type of information allows New Zealand to adjust its pre-border and border controls rapidly.**

Pre-border standards promulgated through Import Health Standards (IHS) are the second level of protection from offshore risks; examples include heat treatment of imported foods, disease testing of animals, and inspection of used vehicles before shipment. These standards were established to reduce the risk of harmful species entering the country in traded goods.

The IHS process has become increasingly rigorous over the past decade. During standards' development, extensive consultation is conducted to ensure all risks are identified and covered by pre-entry measures such as testing, inspection, treatment or quarantine. Sometimes additional post-border conditions are imposed, to provide further safeguards.

The development of a new IHS will likely be prompted by a specific request from an importer to import a good or animal not covered by an existing IHS. In contrast, identifying whether to review an IHS is more subjective and can be prompted by both internal and external factors. MPI has developed an internal checklist identifying 14 events that might prompt staff to initiate a review of an existing IHS.

EDUCATION CORNER: BIOSECURITY IN FOCUS

There are multiple groups within MPI with an interest in collecting and filtering information relating to emerging risks. MPI undertakes two types of activity to capture emerging risk information: active surveillance relating to pests and pathways, and passive surveillance, where MPI staff monitor information relating to their area of responsibility.

Given the huge volumes of intelligence that are received and filtered it is inevitable that the ability to effectively monitor emerging risks will in a large part depend on human judgment. This in itself is not problematic, but **one must recognise that the system of reacting to emerging risks is inherently fallible** – there will always be competing priorities. **Any system that was infallible would carry prohibitive costs.** There is no free lunch. A recent independent report into the operation of border standards, commissioned by MPI following the Psa-V incursion, has recommended that MPI reprioritise resources towards protecting large and strategically important industries. We concur with this **as the relatively small cost imposed of risk mitigation at the border can increase dramatically if unwanted organisms enter the country and require management.**

At the border

Border activity is targeted at ensuring “risk goods” comply with the requirements of IHS, and preventing the entry of exotic organisms unknowingly or otherwise. The legitimate import of risk goods will typically occur through three major entry pathways: international mail, cargo (unaccompanied consignments entering by sea and air), or passengers entering the country.

A risk good that accompanies a passenger will be identified through the customs declaration made by the passenger, or by detection at the border (screening of passengers on arrival, beagles, x-rays, etc). An unaccompanied risk good entering New Zealand may also be detected in the first instance by border staff through inspections, but in the vast majority of cases will be identified through the specific tariff code used when the consignment was shipped.

If the tariff code on the imported consignment identifies the product as a risk good then the consignment will automatically be stopped at the border and held pending further processing (eg there is a single tariff code used for all fresh produce, meaning all such imports are halted at the border as risk goods).

Once a risk good has been identified MPI analysts will determine whether the product in question is subject to an IHS and, if so, whether the importer

has the necessary import permit and Phytosanitary or Veterinary Certificate. A Phytosanitary or Veterinary Certificate is a document issued in the exporting country that states whether specific conditions have been met prior to the goods or animals leaving the country (eg whether the goods are free from visually detectable pests, whether the goods or animal have been subject to any treatment etc). The relevant IHS, or import permit will state whether the goods or animals require a Phytosanitary or Veterinary Certificate prior to entering the country and what any such certificate must specify.

The diagram on the next page provides a high level overview of the end-to-end import process. Beagles at the border are just one small part of the entire biosecurity system.

The border in numbers. In 2010-11 just under five million passengers from offshore arrived in New Zealand by air and 40,000 arrived by sea. Every one of these passengers was assessed for biosecurity risk. That same year 668,000 sea containers arrived, 233,000 of them empty, along with 91,600 vehicles and machinery, and 35 million items of mail were processed at the border.

Seizures. Of the air passengers from offshore arriving in the last year:

- 112,329 had risk goods seized from them, which is 2.3 percent, about the usual annual average.
- Of those seizures about 11 percent involved undeclared goods.

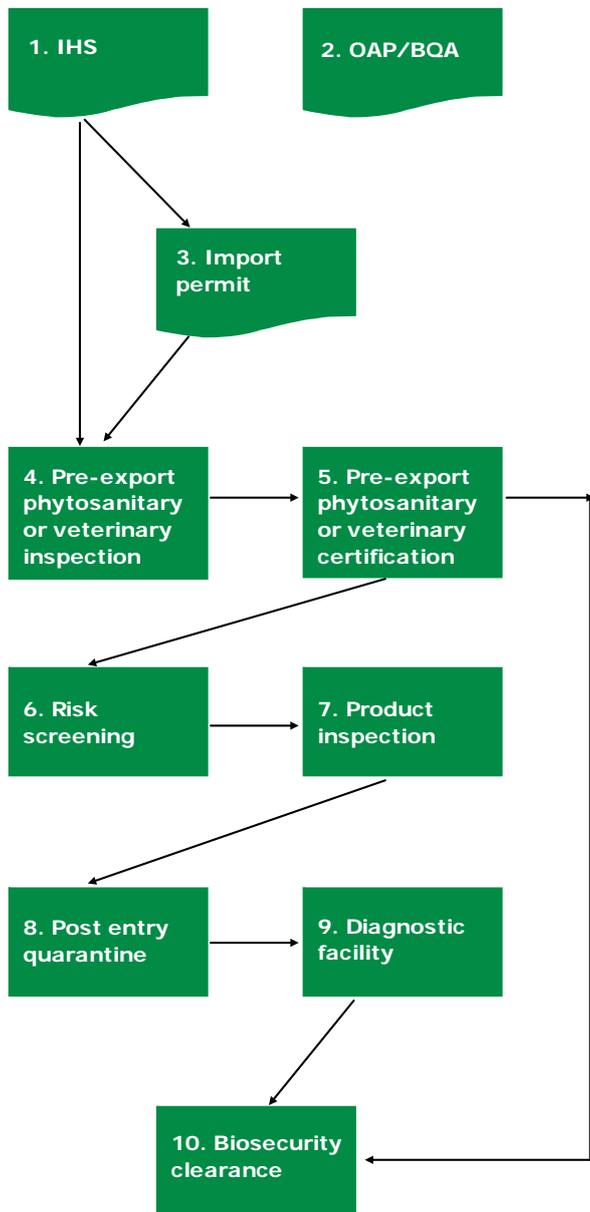
The vast majority of seizures involved lower risk goods. Counting only high-medium risk goods, the compliance rate was between 99.3 and 99.7 percent. These higher risk goods include fresh produce, contaminated used equipment and meat products.

Infringement notices and letters. Infringement notices and warning letters are issued to passengers who fail to declare biosecurity risk goods. Instant fines for border offences were increased in 2010 from \$200 to \$400 to send a signal that New Zealand takes biosecurity seriously.

In 2010-11, 4,600 infringement notices were issued to passengers arriving in New Zealand. 4,620 warning letters were issued.

Most people do not pose a biosecurity risk. About 96 percent of all passengers arriving at New Zealand airports do not carry risk goods that breach biosecurity requirements. The remaining 4 percent carry risk goods, either declared or undeclared, which do not immediately comply with biosecurity requirements. These goods are either confiscated and destroyed, or treated before being cleared.

EDUCATION CORNER: BIOSECURITY IN FOCUS



1. Import health standard (IHS)

All risk goods must be imported into New Zealand under a valid IHS.

2. Official Assurance Programme (OAP) or Bilateral Quarantine Agreement (BQA)

An official agreement may exist with the exporting country's that details the specific measures that will occur prior to export for high risk goods or animals.

3. Import permit

Some risk goods or animals require an import permit, which specifies the entry requirements for the product.

4. Pre-export phytosanitary or veterinary inspection

The exporting country inspects the goods or animals to ensure they meet New Zealand's entry conditions.

5. Pre-export phytosanitary or veterinary certification

If satisfied that the import requirements have been met, the exporting country will issue a phytosanitary or veterinary certificate that specifies the importer/exporter, the commodity/quantity, any treatment undertaken and any additional declarations required by the IHS or import permit.

6. Risk screening

The MPI Inspector will assess all documentation associated with the consignment to verify that the goods or animals are compliant with the entry conditions. This will include ensuring there is an IHS in place; an import permit has been presented if necessary, and the phytosanitary or veterinary certificate is in order. Some goods may be eligible for clearance at this stage without an inspection (e.g. canned food).

7. Product inspection

The MPI Inspector inspects the goods or animals to verify they are free from visually detectable pests and other contamination (e.g. soil, leaf material) and verify documentation is compliant. Goods or animals not requiring quarantine will be eligible for clearance at this stage.

8. Post entry quarantine

Specified risk goods or animals will be held in quarantine and subject to inspections/testing/treatment as per the IHS or import permit.

9. Diagnostic facility

Samples of plants or animals will be sent to a MPI approved facility for pre-determined testing, as per the IHS or import permit.

10. Biosecurity clearance

If appropriate, the MPI inspector will grant the risk goods or animals biosecurity clearance.

Within New Zealand

The main biosecurity agencies and different industry sectors undertake a wide range of surveillance activities directed at both detecting new species (which cross the border through inevitable gaps) and monitoring the health and pest status of plants, animals and ecosystems. Some monitoring supports health status declarations for trade; some assists pest control; some is species specific (based on high-impact risks such as fruit flies, FMD and toxic algae); some target specific pathways. Surveillance is not a latent capability waiting for the big one; there are many alerts every year.

A number of new initiatives have been implemented to boost biosecurity readiness

and response within New Zealand (these also have crossover with at-the-border measures). These include the GIAs, National Bovine TB Management Strategy, Surveillance Strategy for New Zealand, NAIT and the National Biosecurity Capability Network (NBCN).

The latest initiative to enhance biosecurity surveillance and food safety capability at the farm-gate is NAIT. It is a joint government-industry scheme that uses electronic identification eartags and web-based movement recording to trace the location of livestock throughout their lifetime. While this marks a substantial improvement to existing systems, it has been a long nine years since the idea that became NAIT first saw the light of day.

EDUCATION CORNER: BIOSECURITY IN FOCUS

All those years ago the major pastoral organisations came together to decide how the sector would deal with systems emerging overseas. **It was hard at the time to see how moves by our competitors would not see New Zealand needing its own national traceability system to access our main markets.** New Zealand did have systems of its own, including individual identification of cattle and deer for the control of TB and paper-based movement recording for mobs of all species enabled by the use of Animal Status Declaration (ASD) forms.

The problem, though, was that the data held by existing systems was incomplete, was not entirely up to date and, crucially, was paper-based and therefore incapable of being quickly analysed for use in an emergency.

As mentioned earlier, NAIT initially includes cattle and deer, and the system has been developed to be capable of including other species if considered necessary, or desirable by the representatives of those species in future. The practical farming reality of many of these other species is that the use of individual RFID button tags may not be entirely appropriate or necessary. Looking at the pig and poultry sectors, for example, location identifiers with numbers of livestock might suffice. Likewise, with the equine sector, embedded microchips or other less obtrusive identification devices could be more appropriate. The key point here is that there needs to be an open mind to the approval and fit of technology for traceability in the New Zealand farming environment. **NAIT is a step in the right direction, as it brings us in line with our competitors and main markets' requirements.** To demonstrate value to New Zealand farmers, they must be able to make use of technologies and innovations on-farm that enable benefits beyond biosecurity and market requirements.

Another step towards closer collaboration between industry and government has been the recent formation of the New Zealand National Biosecurity Capability Network (NBCN). This is an initiative being delivered by AsureQuality for the MPI with a vision to 'build one team in New Zealand capable of dealing with any biosecurity emergency'.

In any response the most important requirement is a skilled labour force, and NBCN is currently training selected people from chosen organisations on basic requirements such as the structure of biosecurity responses, the Biosecurity Act and working in response teams. Once trained, these people will be in a position to provide leadership and guidance to their organisations and sectors if they are required to assist with a biosecurity emergency. A key issue for

the NBCN to tackle will be developing a framework by which the trained resources can be successfully deployed at the regional level when needed – the nature of many of the resources required in disease outbreaks is that they are not easily transferable between different locations.

Although the NBCN may have some future cross-over with the GIA process, it is currently being progressed and designed as a purely government-only funded mechanism. **Some sectors see GIAs as an opportunity to gain greater control over their own destiny, while others (the majority) view the reforms as little more than an attempt to reduce government biosecurity funding and passing costs back to the industry.**

Funding for biosecurity should be a joint responsibility. The Government is on the hook for the majority of the costs: there is clear market failure whereby the **social rate of return from biosecurity exceeds the private rate of return.** Or put another way, the social and wider economic cost of a major breach massively dwarfs the hit to private individuals, or sectors. There will be the general angst over what proportion should be general taxpayer-funded versus the private sectors, but the general principle of joint responsibility is unequivocal.

With pressures on the fiscal purse there will be the **inevitable temptation to redraw the boundaries over the public versus private sector contribution.** Rather than enter into that debate we'd encourage policymakers to take a more holistic approach and look at the economic value added derived from various areas of government spending. **Biosecurity should be top of the pile for more and not less.**

Biosecurity is more than merely protecting New Zealand's immediate economic interests. It is about cementing the credibility of New Zealand's brand, and our brand is going to become increasingly important in driving New Zealand's economic prospects.

WHAT SHOULD THE FUTURE HOLD?

Our biosecurity strategy must strike a balance reflecting New Zealand's overall national interests. Our continuing economic well-being depends on our participation in the global economy. We trade with more than 200 countries and **our long-term economic prosperity depends on access to open global markets, particularly as agricultural exports are vulnerable to unjustified sanitary and phytosanitary restrictions. The global economy is also an essential source of imports for New Zealand, which is necessary to meet**

EDUCATION CORNER: BIOSECURITY IN FOCUS

New Zealanders' consumer demands. As a nation that wants to survive and prosper, we want world-class, dependable imports at the best prices. So, as a trading nation, New Zealand cannot expect other nations to accept our exports if we are not prepared to apply comparable objective scientific criteria to our imports.

Our isolation and a small number of points of entry into the country provide opportunities to manage the border effectively and keep pests and diseases out. Some industry structures are also more conducive to managing such risks. To maintain the competitive advantage that agriculture has, biosecurity must retain a strong focus on protection of land-based primary production. Nevertheless, this should not be to the point that domestically imposed barriers or costs impact the sector's international competitiveness. Trade facilitation must be balanced with the risks of ensuring pests and diseases are kept out of New Zealand. Emphasis should be placed at the border and pre-border, rather than management or eradication.

Funding for biosecurity should be a joint responsibility. The GIAs offer the opportunity for greater collaboration and communication between the primary sector and government, although thus far disagreement about principles and process have had contrary outcomes. While there will be the inevitable debate of how the costs should be divided, **GIAs must be true, transparent and committed partnerships between the primary sector and the government.** GIAs must enhance biosecurity, be of benefit to the sector involved, and be adaptable. The role of exacerbators and the sources of biosecurity risk should also be recognised in any funding model.

The MPI and other agencies are currently assessing a number of new biosecurity processes for border control, such as Joint Border Management System, Smart Gate, Trans Tasman travel processing and Advanced Passenger Information Collection. **The primary sectors should be supportive of new border clearance processes that are based on sound risk analysis and science.** It makes sense to combine border resources, especially around customs, biosecurity and immigration.

A robust biosecurity system is not static, but has processes to identify and prioritise new pieces of information, to assess within a reasonable timeframe whether there has been a material change in the level of risk posed to an industry, and to react appropriately. The identification and assessment of emerging risks may result in no action

being taken, or it could prompt a systematic review of whether import requirements remain appropriate. Accountability and performance are paramount – for example, if border control systems have been shown to be ineffective then there needs to be a future focus on new methods of dealing with current inefficiencies and potential threats.

Forward-focused biosecurity systems that provide confidence to farmers are critical – the risk of an incursion such as FMD is real and that is where initiatives such as NAIT come into play. Robust, transparent and scientifically based risk systems are necessary, but these must not hinder free trade or competitiveness. If balance is to be achieved then biosecurity agencies must work towards development of communication and partnerships with farmers.

KEY TABLES AND FORECASTS

FX RATES	ACTUAL			FORECAST (END MONTH)						
	Jun-12	Jul-12	2-Aug	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
NZD/USD	0.801	0.810	0.808	0.80	0.83	0.85	0.85	0.85	0.84	0.82
NZD/AUD	0.783	0.770	0.773	0.78	0.79	0.79	0.79	0.79	0.80	0.80
NZD/EUR	0.633	0.660	0.661	0.60	0.61	0.63	0.64	0.65	0.64	0.64
NZD/JPY	63.95	63.35	63.40	60.8	62.7	64.6	64.6	64.6	63.8	62.3
NZD/GBP	0.510	0.516	0.520	0.49	0.51	0.52	0.52	0.53	0.53	0.52
NZ TWI	72.3	73.0	73.0	70.6	72.1	73.9	74.2	74.6	74.1	73.1

INTEREST RATES	ACTUAL			FORECAST (END MONTH)						
	Jun-12	Jul-12	2-Aug	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
NZ OCR	2.50	2.50	2.50	2.50	2.50	2.50	2.75	3.00	3.00	3.25
NZ 90 day bill	2.68	2.75	2.64	2.80	2.80	2.80	3.20	3.30	3.30	3.70
NZ 10-yr bond	3.43	3.72	3.52	3.80	3.70	3.80	3.90	4.20	4.40	4.60
US Fed Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
US 3-mth	0.46	0.35	0.44	0.35	0.35	0.35	0.35	0.35	0.35	0.35
AU Cash Rate	3.50	3.50	3.50	3.25	3.00	3.00	3.00	3.00	3.00	3.00
AU 3-mth	3.49	3.62	3.55	3.50	3.20	3.20	3.20	3.20	3.20	3.20

ECONOMIC INDICATORS	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
GDP (% q/q)	1.1	0.2	0.4	0.6	0.7	0.7	0.7	0.7	0.6	0.6
GDP (% y/y)	2.4	2.2	2.2	2.4	2.0	2.5	2.8	2.8	2.7	2.5
CPI (% q/q)	0.5	0.3	0.5	0.3	0.8	0.7	0.8	0.3	0.7	0.8
CPI (% y/y)	1.6	1.0	1.0	1.6	1.9	2.2	2.5	2.5	2.5	2.6
Employment (% q/q)	0.4	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.3
Employment (% y/y)	0.9	0.9	1.0	1.2	1.1	1.3	1.4	1.5	1.6	1.5
Unemployment Rate (% sa)	6.7	6.5	6.4	6.2	6.2	6.1	6.0	6.0	5.9	5.9
Current Account (% GDP)	-4.8	-5.0	-5.0	-5.2	-5.1	-5.1	-5.0	-5.0	-5.0	-5.0
Terms of Trade (% q/q)	-2.3	-2.6	-0.8	-0.3	0.2	0.1	0.2	0.2	0.2	0.2
Terms of Trade (% y/y)	-2.1	-6.8	-7.0	-5.8	-3.5	-0.8	0.2	0.7	0.7	0.8

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 JUNE 2012 (NZ\$M)																					
	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	Malaysia	India	Hong Kong	Indonesia	Singapore	Taiwan	Philippines	Thailand	Saudi Arabia	UAE	Nether-lands	Canada	Venezuela
Sheepmeat	2,646	6	247	256	51	4	534	275	43		37			53	1	3	84	10	161	102	
Beef	2,015	18	21	835	191	126	28	17	23		43	96	45	130	41	7	7	23	33	98	
Other Meat	461	33	16	22	40	28	27	68	7		22	13	6	3	2	2	11		32	4	
Milk Powder	6,766	69	1,714	13	24	12			327	41	78	287	229	171	242	228	252	408	9		536
Butter	2,295	101	212	122	20	25			61	30	19	56	49	52	69	49	104	42	10	27	2
Cheese	1,420	243	82	5	328	114	49		27		18	49	9	27	59	14	60	18	27		10
Whey/Casein	1,920	68	233	784	210	53	4	125	27	4	6	31	61	13	30	2	24	1	5	34	9
Kiwifruit	1,076	65	94	28	326	78		215	14	3	30	9	10	71	1	6		3	1	3	
Apples	345		2	42	4		48	38	11	23	24	6	10	17		26		16	33	6	
Other Fruit/Vege	654	316	5	34	155	25	3	4	14	1	6	1	9	14	1	13		1	1	1	
Wine	1,176	380	25	251	13	2	284	8	2	1	18	1	15	1	1	2		6	27	71	
Wool	881	70	413	26	21	2	58	40	8	40	5	1		11		9		1	1	4	
Skins/Hides	572	16	219	3	9	20	6	1		15	37	9				9					
Logs	1,569		939		172	262				176						5					
Sawn Timber	1,100	329	137	155	89	50	2	2	15	3	1	25	6	31	54	33	26	12	5		
Fibreboard/Plywood	393	70	24	13	210	1			10	4		23		3	7	1	1			1	
Wood Pulp	628	63	195		89	85			22	13		83	10	22	6	23					
Fish/Seafood	1,481	269	268	138	136	49	13	17	8		176	2	39	8	6	28	2	5	8	15	
Crude Oil	2,203	2,105										24	48								
Aluminium	1,144	91	33	60	593	119	50		2	17	17	3	1	2		2			78	4	
Remainder	15,939	6,105	1,243	1,301	708	503	335	151	285	537	344	143	290	163	205	221	70	83	155	216	4
TOTAL	46,683	10,417	6,123	4,088	3,388	1,558	1,442	961	906	906	882	861	847	804	727	684	642	630	588	586	560

NZ MERCHANDISE EXPORTS ANNUAL CHANGE BETWEEN THE 12 MONTHS ENDED JUNE 2012 AND A 12 MONTH SPAN A YEAR EARLIER (NZ\$M)																					
	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	Malaysia	India	Hong Kong	Indonesia	Singapore	Taiwan	Philippines	Thailand	Saudi Arabia	UAE	Nether-lands	Canada	Venezuela
Sheepmeat	-272	-5	71	-56	-14		-46	2	-29		3		-3	-1		-2	-8	-3	24	-10	
Beef	-21	3	11	54	-12	-45	-9	-4	8		7	-12	1	-1	3	-1	-2	4		-21	
Other Meat	17	12	7	1	-2	2	-4	-6	3		7	-4	-1		1		2		8	-1	
Milk Powder	170	-5	-124	10	2	1			8	-2	41	58	7	13	-32	-56	-32	130	6		88
Butter	-105	7	41	47	-3				7	-16		9	8	-31	-17	3	-27	-2	10	12	-3
Cheese	64	-47	11	-10	41	-3	29		-1	-2	-2	2		-14	11		21		7	-2	
Whey/Casein	299	10	66	99		14		12	12	-1	2	4	18	4	12		1		5	16	3
Kiwifruit	81	10	10	-1	38	16		6	3		6	3	1	4	1	1			1		
Apples	-27		2	-1	3		1	-14	2	8	-1	1	2	-10		3		5	-20		
Other Fruit/Vege	71	64	1	1	16	4		1	-8	-1		-1	-3	-2		3			-2		
Wine	82	43	8	19	2		-10	2	-1		1		1					2	-1	12	
Wool	47	-32	70	5	4	1	-4	2	5	-2	-2			1		-2		1	1		
Skins/Hides	61	-2	85	-2	2	-2	2			-12	-5	1				3					
Logs	-128		-65		4	-44				-19								-2			
Sawn Timber	-41	-4	-5	-13	-3	3		-1		-5		-1	1	-8	7	2	5	5	-6	-1	
Fibreboard/Plywood	31	3	-5	-4	38				4	-2		5		-1	4		-6			-1	
Wood Pulp	-60	-14	-14		2	-3			-5			-13	3	-5	-1	-14					
Fish/Seafood	-22	-18	24	-39	10	10	-2	-22	-1		-12		6	-2	4	10		2	2	1	
Crude Oil	124	135			-46							24	41			-34					
Aluminium	-117	-14	8	-24	-39	-15	-10	-1	1	-3	4	1				-1			7	-3	
Remainder	357	-42	286	68	-25	24	-21	-8	67	77	46	-78	5	-33	12	36	-11	-1	-20	43	-6
TOTAL	611	103	488	157	17	-38	-73	-32	77	22	94	-1	87	-91	5	-49	-57	140	23	46	81

NZ MERCHANDISE EXPORTS ANNUAL CHANGE BETWEEN THE 3 MONTHS ENDED JUNE 2012 AND A 3 MONTH SPAN A YEAR EARLIER (NZ\$M)																					
	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	Malaysia	India	Hong Kong	Indonesia	Singapore	Taiwan	Philippines	Thailand	Saudi Arabia	UAE	Nether-lands	Canada	Venezuela
Sheepmeat	-251	-1	25	-41	-12	-1	-25	-38	-1		-6		-2	-3		-2	-15	1	-15	-4	
Beef	-16	1	6	24	13	-17	-6	-3	4		2	2	-3	4	-1	1		1	-5	-26	
Other Meat	-2		3	1	2	1	-1	-4	3		2	-1					1		-1	-1	
Milk Powder	-170	-10	60		1	-6			-25	-37	13	2	-17	-1	-43	1	-22	52	-1		12
Butter	-163	-5	-4	-3	1	-3			-2			-4	-3	-5	-2	-2	-18	5	1	-1	-2
Cheese	16	-6	4		2	-1	4		2		-1			-3	-2	-1	16	-1	-2		1
Whey/Casein	127	-2	16	77	6	3	-1	2	6		-1	1	6		4	1			1	6	1
Kiwifruit	12	1	4	1	33	2		-14	2		1	1		-4				-1		1	
Apples	-10		2	-1	3		4	-11			-1	1	1	-8		5		6	-10		
Other Fruit/Vege	-10	-7		-3	1	1		1					-1			-1					
Wine	10	13	2	9	1		-18	1											-2	4	
Wool	-37	-16	-3					-2	1	-1	-1					-1					
Skins/Hides	-21	1	3		1					-6	-2	1				1					
Logs	-57		-8		-14	-40				6				-2		1					
Sawn Timber	12	3	9	1	-3	1				-1		-1		-2	2		7	2	1		
Fibreboard/Plywood	3	2		-2	3				2			1					-1				
Wood Pulp	-8	-5	-5		12	-6							-2	1		-4					
Fish/Seafood	-24	-6	-6	-9	6	4	-1	-3	-1		3		1		-2						2
Crude Oil	-108	-153											48								
Aluminium	-58		2	-6	-61	6	-1		1	-2	4								-4		
Remainder	-31	-59	85	20	-12	-2	-14	-8	16	15	15	-14	-21	-9	4	-1	1		2		
TOTAL	-785	-251	195	67	-16	-58	-64	-81	7	-25	28	-11	9	-32	-38	-4	-32	66	-36	-18	12

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