NEW ZEALAND ECONOMICS
NBNZ AGRI FOCUS

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INSIDE

Feature Article	2
The Month in Review	14
Rural Property Market	15
Economic Indicators	17
Key Commodities	19
Borrowing Strategy	25
Education Corner	26
Key Tables and Forecasts	30

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COMMODITY ROLLER COASTER

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012-13

The outlook for New Zealand's main commodities is mixed for 2012-13. Some are set to improve, but largely due to a poor growing season and off levels that are often below the cost of production. Others are set to decline, but off all-time highs (i.e. lamb and wool).

THE MONTH IN REVIEW

The 2011-12 financial year will be one to remember for the livestock sectors. A mix of solid farm-gate prices, controlled costs, excellent seasonal conditions, and lower interest rates ensure P&L statements will be very solid. Autumn conditions across the country were milder than normal. This has set up most regions with quality pasture cover and lots of supplement heading into winter. Livestock have flourished in this environment – which augurs well for production in 2012-13.

RURAL PROPERTY MARKET

While the end of the season for selling farms has largely drawn to a close for 2011-12, sentiment has softened as prices for key commodities have dropped. Properties that are well located, with good contour, soils and capital improvements are still selling well. The trouble is there are very few properties on the market that tick all these boxes. Properties that do not tick these boxes have to meet the market often at significantly lower price levels.

KEY COMMODITIES AND FINANCIAL MARKET VARIABLES

Over the last two months the ANZ *Commodity Price Index* has fallen nearly 7 percent in USD terms. The index has now fallen a cumulative 18 percent from last year's peak and eased to a 21-month low in May. Fortunately, the NZD responded in May declining against all our main trading partners. This left the index only 1.7 percent lower in NZD terms over the same period.

BORROWING STRATEGY

Wholesale interest rates have fallen sharply in the past two months, taking rural lending rates with them. Even though rural lending margins have increased in recent years, reflecting tighter funding conditions for banks, this has been offset to a large degree by the recent fall in wholesale rates to record lows. As a result, rural rates are at levels not seen for some time, where it may be worth considering fixing some debt for 1-2 years.

EDUCATION CORNER: EUROPEAN PALPITATIONS

It's Groundhog Day. The world's financial problems did not disappear in 2008; they were simply shuffled to one side. The focal point is now Europe and some key sovereigns. With so much debt out there we are sceptical that a durable and sustainable solution is pending, which makes transmission mechanisms to New Zealand key to watch. We detail 6 focal points: competency, confidence, the cost of funds, commodity prices, China and the currency. There is enough occurring across these 6 C's to have us extremely watchful, though it is pleasing to see natural shock absorbers providing insulation. Deeper malaise will be met by more of the same. With much of what is going on beyond farmers' control, the messages are to focus on the basics and get used to continued volatility.

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

AGRICULTURAL PRICE PREVIEW FOR 2012–13					
June Year End	**2009-10**	**2010-11**	**2011-12p**	**2012-13f**	**% change**
Finance					
Weighted Rural Interest Rate	7.20	7.00	6.60	6.50	NA
Dairy ($ per kilogram of milksolid)					
Fonterra Milk Price	6.10	7.60	6.05	5.50	-9%
Dividend per share after retentions	0.27	0.30	0.35	0.40	14%
Tatua	6.37	8.10	7.00	6.10	-13%
Westland	6.15	7.70	6.35	5.90	-7%
Open Country Dairy	6.02	7.56	6.42	5.90	-8%
Synlait	6.12	7.66	6.20	5.90	-5%
Wool ($ per kilogram greasy, whole of clip net of costs)					
Fine (<24 micron)	8.30	9.25	13.20	12.40	-6%
Medium (25-31 micron)	4.90	6.15	6.90	5.55	-20%
Crossbred (>31 micron)	2.30	3.80	4.20	3.00	-29%
Sheep ($ per head, weighted averages, GST exclusive and net levies at farm gate)					
Lamb (17.5 kg carcass)	88	105	117	100	-15%
Mutton (24.5 kg carcass)	55	86	93	85	-9%
Stores (LW 30-35 kg)	55-65	75-100	80-110	75-90	-13%
Beef ($ per kilogram of carcass weight, weighted averages, GST exclusive and net levies at farm gate)					
Steer (296-320 kg carcass)	3.35	4.00	4.00	4.10	2%
Heifer (195-220 kg carcass)	3.30	3.90	4.00	4.10	2%
Bull (296-320 kg carcass)	3.15	3.80	3.90	4.00	3%
M Cow (160-195 kg carcass)	2.15	2.90	2.90	3.00	3%
Deer ($ per kilogram of carcass weight, weighted averages, GST exclusive and net levies at farm gate)					
Stag (60 kg carcass)	7.25	7.35	7.80	7.60	-3%
Hind (50 kg carcass)	7.10	7.20	7.65	7.45	-3%
Velvet ($ per kg)	97	96	95	95	0%
Grains ($ per tonne, Agrifax prices grower bids delivered nearest store or mill, net levies and freight to this point)					
Milling Wheat	340 to 420	355 to 460	400 to 450	380 to 400	-6%
Feed Wheat	280 to 310	295 to 330	350 to 455	290 to 310	-25%
Feed Barley	270 to 300	290 to 340	340 to 450	290 to 310	-26%
Kiwifruit ($ per tray OGR)					
Zespri™ Green	3.70	4.21	3.72	4.00	8%
Zespri™ Gold	7.73	8.89	7.60	9.30	22%
Apples (Weighted FAS returns $ per TCE)					
Braeburn	16.13	18.25	18.04	20.00	11%
Royal Gala	21.11	22.90	24.20	21.00	-13%
Fuji	25.53	25.71	20.95	21.00	0%
Jazz™	19.46	21.59	18.97	20.00	5%
Pacific Rose	27.29	30.72	28.01	33.00	18%
NZ Average	20.52	22.22	20.47	20.90	2%
Grapes ($ per tonne, national average)					
Sauvignon Blanc	1,636	1,194	1,166	1,250	7%
Merlot	1,588	1,570	1,521	1,520	0%
Pinot Noir	2,891	2,752	2,439	2,500	3%
Chardonnay Mendoza	1,317	1,089	1,258	1,320	5%
Chardonnay Other	1,362	1,070	1,129	1,200	6%
Pinot Gris	1,687	1,419	1,236	1,250	1%

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

SUMMARY

The outlook for New Zealand's main commodities is mixed for 2012-13. Some are set to improve, but largely due to a poor growing season and off levels that are often below the cost of production. Others are set to decline, but off all-time highs.

- Dairy prices are expected to be softer in 2012-13, courtesy of strong milk flows from the major producing countries and with inventory levels having been rebuilt. At this stage we would concur with Fonterra's milk price of $5.50 per MS for 2012-13. Longer-term a milk price range of $6.00 to $6.50 per MS still looks prudent.
- Lamb returns face a number of challenges over the next 18 months. These include weaker retail prices, higher wholesale and processor margins, a modest increase in the supply of tradable lamb and a continued strong NZD/EUR. A budgeting price in 2012-13 of $100 per lamb, down from $117 this year, looks prudent.
- The outlook for beef prices remains positive, albeit not quite as rosy as the last two years. A modest 2.5 percent lift in farm-gate prices is expected.
- A farm-gate price of $7.60 per kg for stags and a $0.15 per kg reduction for hinds is expected. The 3 percent decrease from last year is largely due to a stronger NZD/EUR.
- Key levels for strong wool prices look like NZ$3.00 per kg, back some 30 percent on last year. Medium and fine wool prices are also forecast to be lower, but not to the same extent.
- An abundance of local grain and lower international prices are expected to weigh on domestic grain prices. Budgeting prices are lowered to the bottom of our ranges for 2012-13.
- Sauvignon Blanc grape prices are expected to increase to at least $1,250 per tonne. Other white varieties are expected to lift, but not to the same extent, and red varieties are forecast to be stable.
- Lower Southern Hemisphere production and continued growth in Asian and Middle Eastern markets are expected to lift average pipfruit prices by 2 percent. However, with a wide range of –8 to +18 percent is expected depending on variety.
- Gold kiwifruit prices are expected lift to above $9.00 per tray in 2012-13 due to lower volumes from Psa. Green kiwifruit prices increase, but not to the same extent, up 8 percent to $4 per tray.

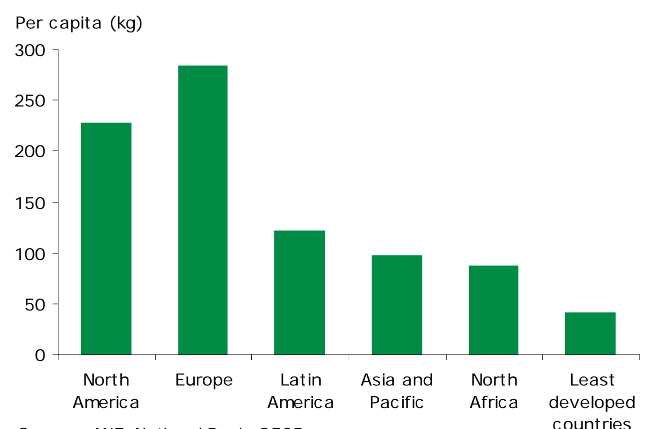
DAIRY

The flow of New Zealand's dairy exports continues to be towards higher-growth countries and regions. This is being fuelled by:

1. Preferential market access, via exclusive free trade agreements.
2. Demand for safe, high-quality dairy products, which New Zealand has a good reputation for producing.
3. Population growth.
4. More Westernised diets, fuelled by the modernisation of the food supply chain and increasing presence of modern retail outlets and quick service chains.
5. All these factors are energized by rising income levels and urbanisation.

While the demand for some dairy products is expected to weaken in 2012-13 in developed economies, particularly Europe, import demand from Asia, North Africa and the Middle East is expected to remain relatively firm.

There are varying forecasts for the growth in global dairy demand over the next several years. However, it is clear that when you compare the current levels of milk and dairy consumption in our main Asian and Middle East markets with Western society there is plenty of potential upside to per capita consumption. With a large proportion of the world's population and economic growth residing in these regions, there is little doubt about demand upside. However, any price increases need to be affordable, with 30 to 50 percent of disposable income currently spent on food this means the rate of price increases cannot be too far out of whack with wage growth in these countries.



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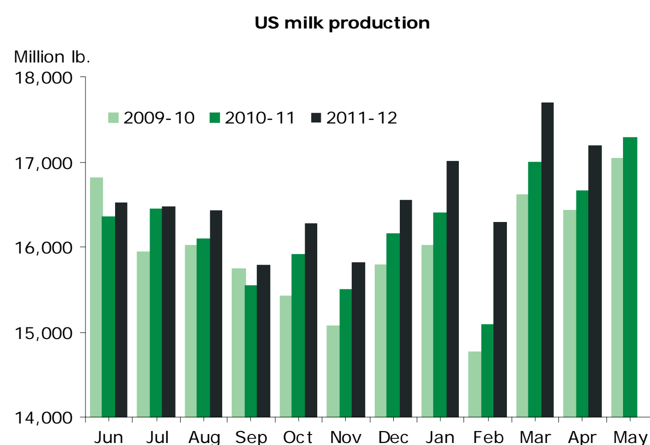
GLOBAL SUPPLY

Softer dairy prices in 2012 have been a function of increased supply, not reduced demand. Milk supply has increased from all the major exporters over the last 12 months, and from some of the minor players also. Things have turned bearish in the last two months as the long tail to the New Zealand season has overlapped with Northern Hemisphere production. The growth in Northern hemisphere production has been above historical averages, with good weather conditions and high farm-gate returns over the last 12 months being the main drivers. Known inventory levels of key dairy products have been rebuilt, but not to excessive levels. Nonetheless, farm-gate prices in the Northern Hemisphere countries have started to adjust downward and costs of inputs, such as feed, while lower, remain historically high. **This implies the tap will be turned off, as the marginal incentive to produce extra milk is not as great as it has been in the last 12 months.** Over the medium-term, milk production is projected to rise in the key exporting countries as dairy product prices remain historically favourable. At the same time, milk output in the developing countries of Asia is also expected to rise.

Two key countries to watch in 2012-13 are:

United States

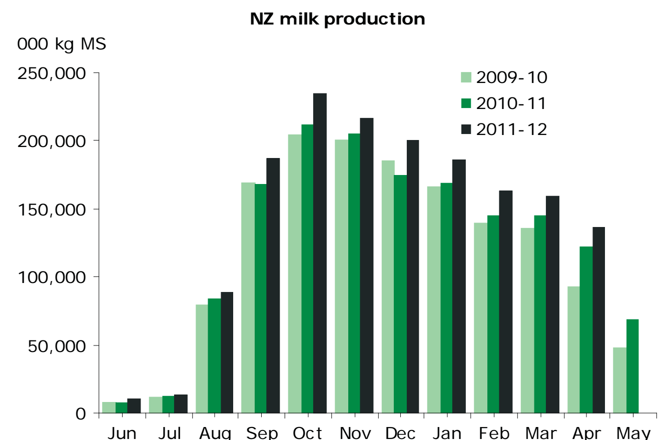


Sources: ANZ, National Bank, USDA

US production has made a very strong start to the 2012 calendar year largely due to mild winter conditions. Cow numbers have been higher than expected despite lower returns and relatively high dairy cow slaughter over the last six months. Still, a reduction in herd size is expected later in 2012 as high feed prices, combined with higher cull cow prices and lower milk prices, see cows turned off. The offset: higher production per cow is expected as a result of the mild winter and the heavy slaughter which removes marginal cows from the herd.

Consequently, milk production increases by around 2.9 percent, similar to the expansion seen in the 2011-12 season. However, in 2013 production gains are expected to moderate.

New Zealand



Sources: ANZ, National Bank, DCANZ

The lift in NZ production this season has been driven by a 2.8 percent increase in the number of cows being milked and an 8.0 percent increase in milk yields. **Milk yields have hit an all-time record of 362 kgs of MS per cow, up 6 percent from the trend rate of growth and the highest growth above trend since 1996-97.** Cow numbers are expected to continue to increase by around 2 percent per annum over the next couple of seasons. The drivers are increased stocking intensity and new dairy conversions, mainly in the South Island.

Looking ahead to next season, it is very unlikely the weather gods will be as kind. The past two seasons have seen La Niña conditions present, but El Niño is forecast next season. During periods of El Niño pasture production is generally not as favourable. A moderation in seasonal pasture conditions is likely to return milk yields to trend. **If milk yields do return to trend in 2012-13 (346 kgs of MS per cow) and cow numbers grow by 2 percent, this would see production fall 2.6 percent in 2012-13.** That means that for production to be unchanged next season milk yields would need to be 2.6 percent above trend. This remains a possibility, with the use of more feed in farm systems and the growth in yields under-shooting trend from 2007-08 to 2010-11. However, this magnitude of growth in milk yields has occurred only in five of the past 20 seasons, and the forecast lower milk prices will diminish the incentive to feed extra supplements. **So flat milk production in 2012-13 remains the likely outcome at this point in time, but there are downside risks.**

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

GLOBAL PRICES

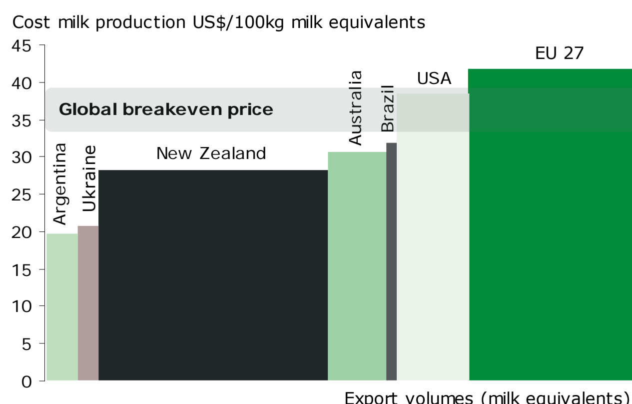
Previous analysis has concluded commodity price movements are influenced by cyclical (temporary) and structural (i.e. supply and demand) factors. For example, the trend decline in commodity prices from 1960 to 1990 involved a secular down-trend that was punctuated every few years or so by cyclical upswings and corrections.

Dairy is no different. Dairy prices at the start of 2011 were pushed higher by weather events affecting supply and cost of production parameters. **This has now largely been unwound by the production response we have seen.** Consumer/country resistance was also evident when international prices hit US$4,200 per tonne. Using several statistical methods to analyse Fonterra's notional basket of dairy products to derive a farm-gate milk price, the following can be concluded:

1. The average price trend for Fonterra's notional basket has been US$3,300 per tonne since 2006.
2. The cycle around the trend since 2006 has doubled compared to prior periods, implying the volatility in dairy prices has increased. This is a result of some of the structural shifts that are being seen in dairy markets and the wobbly global environment.
3. The cyclical trend in pricing suggests the absolute bottom is 20 percent below the trend average. This suggests prices will bottom out around $2,650 in the coming months. The latest auction actually bouncing off these levels suggesting stabilisation might happened more quickly than previously thought.

These conclusions are supported by the chart below that shows the share of tradable product for each country and their break-even cost of production. High grain prices mean the US and EU have the highest break-even cost of production at US$3,800-$4,200 per tonne. Compare this with NZ at US$2,900 per tonne. Overall, if international prices fall below US$3,500 per tonne for a sustained period then we are likely to see a contraction in supply from the US and EU. Southern Hemisphere supply is more conditional on seasonal conditions, but a lower farm-gate price also reduces the incentive to feed extra supplements. Of course we can often push through the cost of production floor for a period of time, and in the dairy sector this has happened over the last two months.

Cost of production for tradable dairy production for selected countries



Sources: OECD-FAO, IFCN, DairyNZ Economics Group

BUDGETING MILK PRICES

BUDGETING MILK PRICES						
Basket of NZ Dairy Products	Fonterra Milk Price Component Scenarios (NZ$ per kg MS)					
	NZD/USD					
	USD	0.75	0.77	0.78	0.79	0.80
	2900	5.37	5.23	5.17	5.10	5.04
	3000	5.56	5.41	5.34	5.28	5.21
	3100	5.75	5.60	5.52	5.46	5.38
	3200	5.93	5.77	5.70	5.63	5.56
	3300	6.12	5.95	5.88	5.81	5.73
	3400	6.30	6.14	6.06	5.98	5.91
	3500	6.49	6.32	6.24	6.16	6.08

Sources: ANZ, National Bank

For the 2012-13 season the notional dairy basket is assessed as US$3,100 per tonne, and 2013-14 as US$3,280 per tonne. Given recent declines, if prices do take longer to recover than anticipated this would weigh on first and second quarter earnings in 2012-13. It is expected if dairy pricing were to head substantially lower or remain weaker for longer than anticipated, then the NZD/USD would trade below 0.75, providing a safety buffer to farm-gate pricing. Therefore, at this stage we would concur with Fonterra's opening milk price of $5.50 per MS for 2012-13.

In the longer-term, higher cost bases in the Northern Hemisphere, limited opportunities to substantially grow supply in New Zealand and other Southern Hemisphere countries, and growing demand from Asia and the Middle East are expected to see dairy prices range between US$3,200 to US$3,500 per tonne. Combining this with our cyclical fair value estimate for the NZD/USD of 0.75 gives an estimated milk price range of $6.00 to $6.50 per MS.

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

DIVIDEND

Fonterra's half year results for 2011-12 were strong, with revenue up and normalised earnings before interest and tax up 8 percent on the same period last year. This prompted the co-operative to increase its interim dividend to 12 cents per share, up from 8 cents per share in the same period a year earlier. These results suggest the co-operative is well on track to achieve, or exceed, the flagged range of 40 to 50 cents per share before retentions in 2011-12. With lower dairy product prices forecast and other costs seemingly well contained it is expected earnings will continue to be in the 50 to 60 cents per share range going forward. The strategy of paying out a higher or lower dividend according to the milk price is also expected to continue in the short term, although Trade Among Farmers (TAF) with the introduction of outside shareholders might change this slightly. Therefore, a final dividend of 35 cents per share is expected in 2011-12 and something north of this in 2012-13. **If we were to see the milk price deteriorate below $5.50 per MS then we would likely see a larger proportion than the flagged 75 percent upper range returned, providing an offset to the lower milk price.**

OTHER DAIRY COMPANIES

Provisional payments from other milk companies have by and large tracked Fonterra, as would be expected with most companies benchmarking against Fonterra's cash payout to farmers. Legislative changes to Dairy Industry Restructuring Act (DIRA) and expansion plans by Fonterra and the small companies in the growth areas for milk supply (i.e. Mid-Canterbury) mean we do not expect to see too much divergence between company payouts. The end results for independent companies in 2011-12 is expected to be a lot closer this year than last.

LAMB AND MUTTON

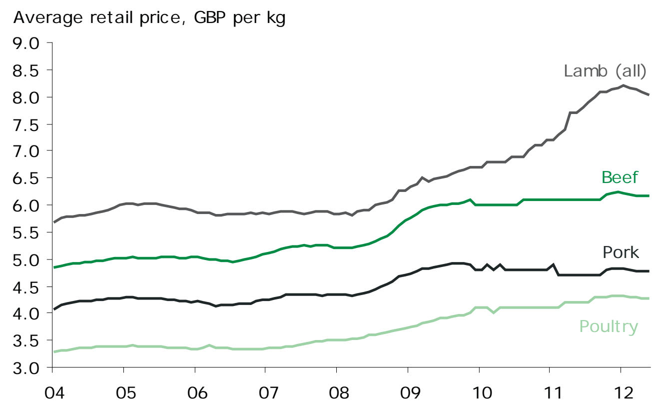
The most important export destinations for NZ lamb continue to be the quota markets of Europe. The restaurant trade into North America is the next most important market, accounting for 15 percent of total returns and 9 percent of total volume.

The Middle East and China continue to take lower and middle-value cuts as they consume and import more meat. China has accounted for 20 percent of the total volume sold so far in 2011-12, but only 10 percent of total returns. **This reflects the lower-value mix of cuts where the average return per tonne was $4,800. This is much less than half of the average return in Europe ($11,890 per tonne).**

EUROPEAN AND UK OUTLOOK

The prospects for demand in the bellwether market of the UK and Europe remain bleak.

British retail meat prices
Domestic and imported



Sources: ANZ, National Bank, Beef + Lamb NZ, Kantar

Consumption levels have begun to stabilise in the last several months – albeit at low levels – as retail prices have remained at elevated levels. Middle-class consumers are expected to continue to purchase lamb for special occasions, and when discounted during Easter and Christmas. **However, with other protein prices expected to be constrained, lamb will need to maintain its price competitiveness; otherwise consumption will decline further. The retail price gap between NZ and other lamb sold in the UK (mainly domestic) has also closed completely over the last 12 months.** This is another sign that there will be limited further upside for retail prices of NZ lamb. **All these factors cap in-market returns for lamb at current levels in the UK and Europe.**

SUPPLY CHAIN MARGINS

NZ farmer share of retail price of
NZ lamb sold in Britain

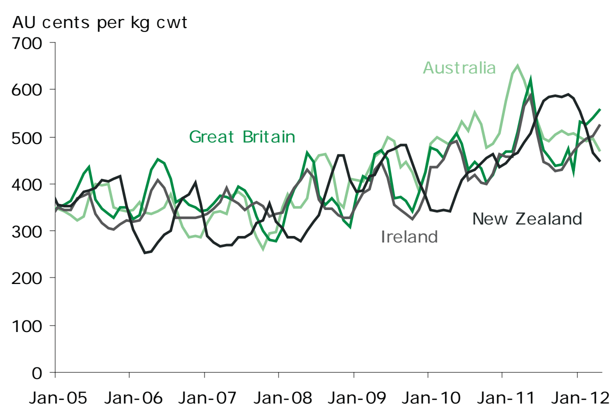
Sources: ANZ, National Bank, Beef + Lamb NZ, Global Trade Atlas, Kantar

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

The farm-gate price as a percentage of the retail price has increased from around 35 percent to 45-50 percent over the past few years. **These margins now look to have topped out at an average of 60 to 65 percent over the back-end of 2011.** This has been slightly above what UK farmers receive in the high 50's.

Until the last couple of months, lamb prices have been over-inflated as meat processors have had to pay above market prices to attract stock because of the very good seasonal conditions. To get a feeling for how much meat processor margins need to increase, one can examine the difference in farm-gate prices (adjusted for exchange rates) between NZ and some of the other major producers. In the year-to-date, farm-gate prices in New Zealand have averaged $7.05 per kg versus Australia at $6.38, UK at $6.24, and Ireland at $6.00. **This implies that on average New Zealand farm-gate prices have been $0.85 per kg above other producers. This means average farm-gate returns need to come back $15 per head (assumed 17.5 kg lamb) from those achieved in the first seven months of the 2011-12 season.** This implies that a national weighted average of $108 per head would have been more appropriate than the $123 per head that was achieved.

Lamb price comparison between countries



Sources: ANZ, National Bank, Agrifax, Irish Food Board

CO-PRODUCTS

Although skin prices have tripled over the last two and half years, they now look to have topped out at around $10-12 per skin. Skin prices are expected to remain under pressure in the short term and follow wool prices lower. The skin market is expected to struggle due to subdued demand in Europe, Japan and the US impacting on discretionary spending on products such as leather and sheepskin accessories.

The offset to lower – albeit vastly improved – skin prices are better prices for sheep offal across most categories. It is anticipated there will be continued strong demand from Hong Kong and the Middle East.

BUDGETING LAMB PRICES

Overall lamb prices are set to weaken from the record highs that will be posted in 2011-12. Recent winter contracts for 2012, with a range of $6.00 to $6.75 per kg, provide some guide. However, as usual, these contracts are for the chilled market during the off-season, and we suspect spot prices are likely to be lower. Factors that are expected to weigh on farm-gate returns over the next 18 months include:

1. Weaker retail prices, especially in Europe.
2. Higher wholesale and processor margins, which lead to lower farmer margins.
3. A modest increase in the supply of tradable lamb, especially from Australia.
4. Stable co-product prices (skins down, offal up).
5. Continued NZD strength, especially against the EUR.

This gives a budgeting price of $100 per head in 2012-13 for a 17.5 kg lamb.

Mutton prices have experienced similar dynamics to lamb, from reduced supplies and consumers trading down in Europe. This is expected to continue, with lower NZ mutton production in 2011-12 and 2012-13 and consumer spending under further pressure. Exports to the Middle East are expected to continue to be strong, providing inter-market competition with Europe. Hence, mutton prices are expected to remain strong, albeit not quite as strong as in the first part of the 2011-12 season.

BEEF

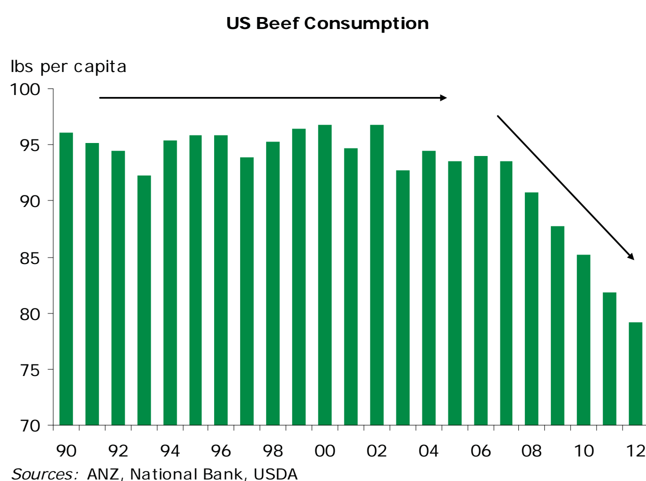
Export performance for New Zealand beef in the three largest markets (Japan, the United States and Korea) is forecast to be mixed in the short term. In Japan, demand for New Zealand beef is expected to fall as a result of stagnant per capita beef consumption and increased competition from US beef. In the US, the lower supply of domestic beef available to consumers and the absence of lean finely textured beef (LFTB) in retail and food service packages is expected to remain supportive of New Zealand imports. However, we face increased competition from Canadian and Brazilian exports. The Korean market is expected to be more difficult in 2012, as local production rises, high stocks are cleared, and the US ramps up its efforts to recapture

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

market share – buoyed by a FTA, weaker currency and an ability to deliver the product most sought after by Korean importers, short ribs.

US BEEF OUTLOOK

The outlook for the US beef market remains positive despite a number of recent events that have unsettled the market. It is expected there will be lower demand as a result of several recent high profile food safety and quality issues, and ongoing slow recovery and strong competition from other proteins. However, while supply has been tracking above expectations it is now starting to decline, with weekly cow slaughter dropping in April. **The USDA has forecast total beef and veal production for the US will decline 4.5 percent in 2012, to 10,902 million tonnes cwt. To put this in context, the decline equates to nearly 90 percent of NZ's annual production.**



Sources: ANZ, National Bank, USDA

The LFTB issue has the potential to have the biggest impact on the NZ beef market. It is a 90CL meat product processed from beef fatty trim (50CL). The recent public controversy on LFTB has caused many retailers and wholesalers to stop using the product as an additive in ground beef and other processed meats. In total it has been estimated that LFTB made up 3 to 6 percent of total US beef supply and its use has been reduced by 75 percent. Those who have moved away from the product have had to find alternative lean beef sources. With US cow inventories at low levels, cow slaughter – a primary source of lean beef for ground products – is expected to decline. So far this has led to higher cow prices and higher prices for fresh lean processing beef. The other alternative is imported beef, which benefits NZ exports of cull cows and bull beef. It only seems a matter of time before the higher US fresh prices flow through to frozen US imports.

CO-PRODUCTS

Hide prices have softened over the back-end of 2011, as global growth concerns, especially in Italy and other parts of Europe, our largest export destination, have weighed on tanners' demand. This is expected to be ongoing and will cap hide prices in a range of $45 to $55 per hide.

Beef offal remains reasonably well sought after from demand in emerging markets, which have a more traditional affinity for tripe, liver, tongue and the like. **Other co-product prices continue to show strength, mainly buoyed by the high price levels of substitutes such as palm oil and soy.**

SUPPLY

Cattle numbers are yet to bottom in the EU, US, Mexico and Russia, while Canada, Argentina and Uruguay are still only in the early stages of expanding herds. In Brazil, herd rebuilding efforts are more advanced, but export volumes have been constrained by growth in domestic consumption. Herd rebuilding is set to continue in Australia after two good seasons. This will start to see increased exports from Australia back into several key New Zealand markets. New Zealand supply is expected to continue to be stable in the 2.2 to 2.3 million head range. However, the cull cow slaughter will remain the swing variable and looks like it could be softer than industry expectations in 2011-12 courtesy of good seasonal conditions and strong offshore demand for NZ dairy genetics.

BUDGETING BEEF PRICES

The outlook for beef prices remains positive, albeit not quite as rosy as the last two years. Farm-gate prices for beef have had a definite softening tone since the end of 2011. Culprits include weaker Asian demand for NZ beef, a slow domestic market due to less than ideal weather for summer barbecuing, the high NZD, and what looks to be higher meat processor margins. However, constrained shorter-term supply domestically and in several key markets, along with the NZD/USD topping out, provide a more positive outlook for 2012-13. **Therefore, a modest 2.5 percent lift in farm-gate prices is anticipated in 2012-13.**

Longer-term herd rebuilding in several key countries, such as Australia and Brazil are likely to offset modest increases in consumption in our main export markets. With a relatively strong NZD set to continue, this caps the upside potential for farm-gate returns.

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

VENISON

Barring a meltdown in Europe, stable markets and prices are expected in 2012-13. Venison is now classified as a high-value niche meat. This means it is largely consumed by wealthy high-income consumers, and their purchasing power is not affected to the same extent as Europe's middle class during a downturn. Other protein prices, especially lamb, have moved higher in Europe. This allows venison to maintain a higher price point. German and Scandinavian markets are forecast to perform well and as the restaurant trade has picked up in North America this has provided a valuable alternative market to help counterbalance softness elsewhere. This trend is expected to continue as slow growth in the US outperforms recession in many parts of Europe.

The only downside for farm-gate prices in 2012-13 is a stronger NZD/EUR.

Longer term, the changes that the industry has undertaken to diversify their markets and product offerings should lead to more stable pricing than that achieved prior to 2008.

A budgeting price of $7.60 per kg for stags in 2012-13 looks prudent and a $0.15 per kg reduction should be used for hinds.

VELVET

Stable production, manageable inventory levels and growth in Chinese domestic velvet consumption will continue to promote high and stable velvet prices over the next few seasons. **A budget price of $95 per kg in 2012-13 looks reasonable.**

Export statistics show a dramatic swing in velvet sales to China in the six months ending March 2012. During this period China has accounted for 72 percent of total exports, nearly double the rate of two years ago. Chinese interests are generally well capitalised, have an increasing level of processing investment, and sales opportunities in both South Korea and China. Chinese importers have therefore become very competitive with their South Korean counterparts, and are strengthening their ties with New Zealand.

For now, while a larger proportion of velvet is being exported directly to China, the industry estimates Korea still consumes 65 percent of New Zealand's total production. This implies China is re-exporting a large proportion of their imports as finished products to Korea.

WOOL

As with many commodities the flow of wool exports is increasingly towards China. This is mainly for processing into finished products for re-export, but a larger proportion of these finished products are now being consumed domestically. This is not just New Zealand wool, but also wool from many other exporters such as Australia, Argentina, Uruguay and South Africa. **Australia now exports 73 percent of its wool to China, versus 37 percent ten years ago.**

In China, rising per capita incomes, changes in consumer lifestyles and changes in apparel preferences over the past decade have translated into increasing demand for higher quality textiles. Currently per capita consumption of apparel wool products in China is low compared with other wool-consuming countries. In the mid-2000s, per capita consumption of apparel wool in China was estimated to be 0.09 kg's, compared with 0.62 kg's per person in Japan, 0.56 kg's per person in Korea, and 0.69 kg's per person in the UK. Over the medium term, Chinese demand for woollen products is expected to increase in response to rising incomes.

The other main export destination remains Europe. Europe took 30 percent of New Zealand's total wool exports by volume and value in the nine months to March 2012. Italy and UK remain the two main destinations within Europe, representing a combined 60 percent of New Zealand exports to Europe. **Growth in wool demand has moderated as economic concerns in Europe have weighed on consumers' discretionary spending.** Japan has faced a similar situation, but not to the same extent.

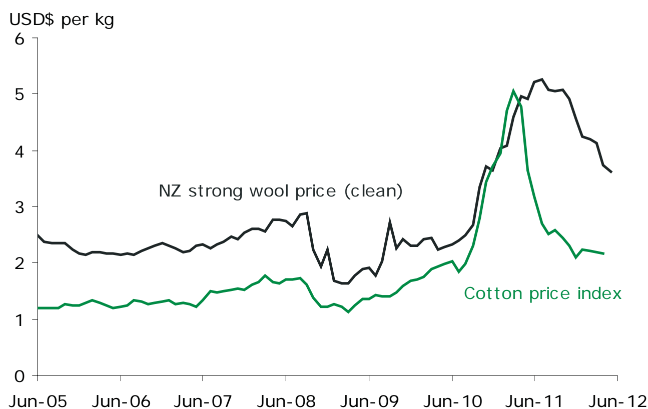
This has been offset to some degree by growth in the US, albeit slow, and Chinese domestic demand expanding. Fibre demand in the US continues to show slow improvement, with the total value of textile and wool imports up 8 percent in 2011-12. In 2012-13 demand is expected to slow, and spending on discretionary items such as textiles and woollen products remain constrained.

COMPETING FIBRES

Textiles manufacturing supports a high degree of substitutability between wool, cotton and synthetic fibres, such as polyester and acrylic. The relative prices of textile fibres are an important factor influencing the degree of substitution between fibres in textile manufacturing. The ratio of wool prices to synthetic fibre and cotton prices provides a guide to wool's relative price competitiveness.

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

Synthetic fibres, in particular polyester, are produced from refined petroleum and therefore their price is responsive to changes in the world oil market. Oil and polyester prices increased in 2010-11 and have remained relatively firm. With oil prices projected to remain historically high over the medium term, synthetic fibre prices are expected to remain close to the average price for 2011-12. In these circumstances, the wool-to-synthetic price ratio is projected to trend down as wool prices are forecast to be softer. Such an outcome would lead to stronger demand for wool as manufacturers increase the proportion of wool in blended yarns and fabric.



Sources: ANZ, National Bank, World Bank

On the other hand, both cotton and wool prices have declined substantially in USD terms over the last six months. However, the proportionately sharper fall in the cotton price led to a significant improvement in its competitiveness relative to wool and has led some manufacturers to substitute cotton for wool in their fibre blends. Combined with softer demand in Europe and hand-to-mouth buying by Chinese manufacturers, these have been the three main drivers of lower wool prices since the beginning of 2012.

With both wool and cotton prices projected to be softer over the next few years it is likely that the wool-to-Cotlook 'A' price ratio will remain above its historical averages. Under these circumstances cotton is likely to maintain its price competitiveness with wool over the next few years. **Consensus forecasts for cotton prices of US$1.80 to $2.00 per kg imply a wool price of US$2.85 to $3.20 per kg.**

BUDGETING WOOL PRICES

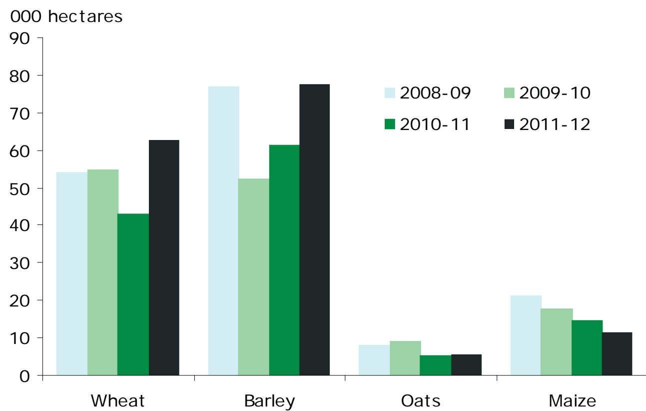
The farm-gate prices for wool since the start of 2012 have dropped sharply due to a combination of weaker in-market prices and a strong NZD. Key levels for strong wool prices look like US$3.00 per kilogram. A US$3.00 per kilogram price is in line with price expectations of UK farmers and cotton price forecasts. **This translates coincidentally into a greasy farm-gate price of NZ$3.00 per kilogram for strong wool.** This is well down on the provisional $4.20 per kilogram that is expected to be achieved in 2011-12, but back only 5 percent from the auction prices achieved in early May 2012. **Medium and fine wool prices are also forecast to be lower, but not to the same extent.** A number of farmers have multi-year contracts in place at higher levels than those being achieved at auction. This helps underpin the market at a higher level and gives these farmers a certain level of income protection.

GRAINS

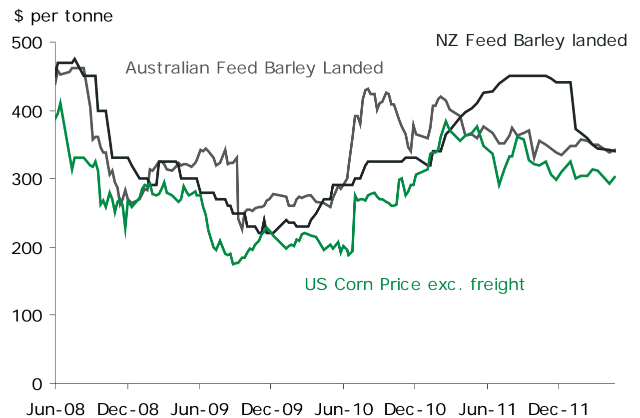
An abundance of local grain and lower international prices are expected to weigh on domestic prices over the next 12 months. Despite the prolonged and difficult harvest, the arable research grower survey has shown crops harvested by 1 April achieved record yields. Combined with larger areas of wheat and barley planted in the spring this has seen a significant increase in wheat and barley supplies compared with the last three years.

The survey estimates that **the total area of wheat, barley, oats and maize planted increased by 27 percent in the spring of 2011.** There were large increases in the planted area of feed wheat and barley in response to the high prices at the time. The planted area of milling wheat declined, malting barley and oats were largely unchanged. **The yields for the crop harvested by 1 April were up 25-30 percent for wheat and 12-15 percent for barley.** Oats yields were down 15 percent, with milling performing better than feed. While a notable proportion of feed wheat, feed barley and oats were still to be harvested after April, because of the late season, the results suggest a big increase in the supply of wheat and barley. **Combining higher yields and area planted the total harvest of wheat and barley are estimated to have increased by 50 and 40 percent respectively on last year.** One bright spot for prices from the grower survey is an increased tonnage of feed wheat (255,000 tonnes) and feed barley (210,000 tonnes), that had been sold by contract as at 1 April. This high volume of contracted feed grains means that the free market for feed grains could be quieter.

FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13



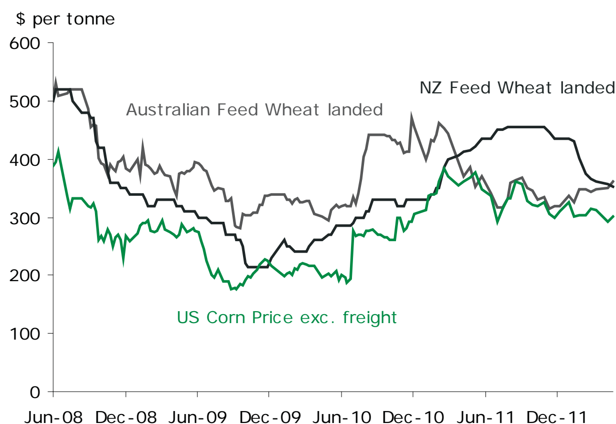
Sources: ANZ, National Bank, Foundation of Arable Research



Sources: ANZ, National Bank, Agrifax, USDA

BUDGETING GRAIN PRICES

There are not too many positive indicators for domestic grain prices over the coming months. Domestic prices for feed wheat and barley have slipped nearly 20 percent since the beginning of the year. This has finally brought them back into line with international prices. However, the short-term outlook is challenging, with the very good seasonal conditions having seen livestock farmers restock with a substantial amount of green feed, and despite the difficult harvest the national grain crop is significantly up on last year. Lower reported inventories of key grains helps out, as does a larger proportion of the 2012 crop being contracted. Nevertheless with farmers having ample feed supplies and international prices expected to head lower, domestic prices will remain under pressure in the coming 12 months.



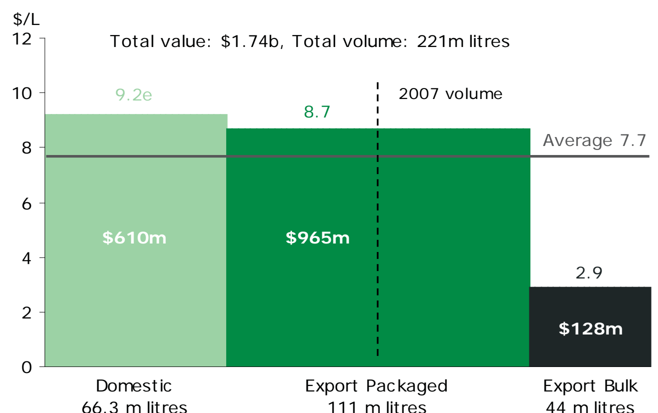
Sources: ANZ, National Bank, Agrifax, USDA

On this basis, budget prices are lowered to the bottom of our bands for 2012-13. Longer-term international grain prices are expected to remain above historical averages and growing dairy intensification and expansion is expected to limit suitable land for grain production and increase demand for feed grains. Milling wheat prices are expected to remain higher on account of below-average quality this harvest and reduced area.

VITICULTURE

An over-supply of grapes and a subsequent large increase in wine, coupled with the GFC in 2008, have been the main drivers of lower returns since 2008. The 2012 harvest looks like the turning point though.

The reduction in the overall crop is largely courtesy of a large fall in Sauvignon Blanc yields. A poor growing season in Marlborough is expected to see at least a 20 percent drop in the



Sources: ANZ, National Bank, PwC

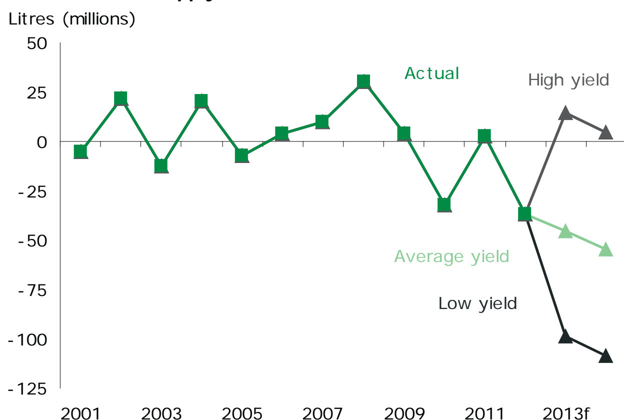
FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

2012 Sauvignon Blanc crop, but there is currently a wide range of views. Other varieties are forecast as flat to slightly down on last year. This sees Sauvignon Blanc yields reduce to 10 tonnes per hectare, similar to the yields achieved in the 2006 and 2007 vintages.

The use of bulk wine exports to shift some of the "homeless" wine in recent years has pushed margins down throughout the supply chain for bulk wine and grape growers. This has created competitive pressure on packaged/branded products in some of our higher-volume sales channels, such as supermarket chains in the UK. It has also transferred brand power from New Zealand wineries to private supermarket labels. A smaller 2012 Sauvignon Blanc crop is expected to see this volume stabilise, if not decrease, helping in the short-term with average wine and grape pricing. **It is acknowledged that an element of bulk wine will remain a feature of the industry,** especially as a relief valve when there is a large vintage due to good seasonal/growing conditions.

SUPPLY AND DEMAND BALANCE

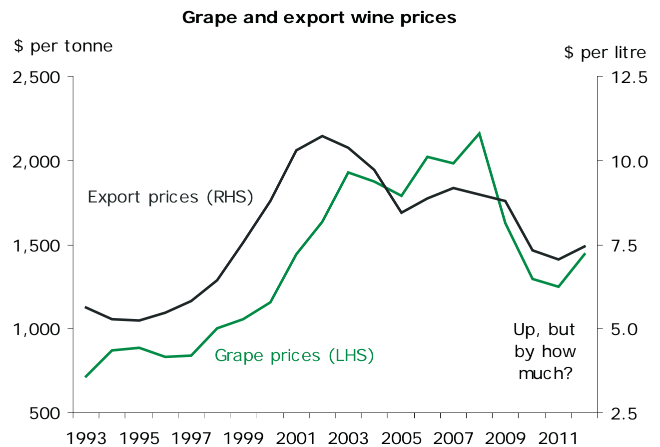
Factoring in 5 percent growth in export markets and a small decrease in domestic sales sees a significant shortfall in wine from the 2012 harvest. The shortfall for Sauvignon Blanc is estimated at 39 million litres. Hence bulk wine sales are expected to be flat, if not reduced, over the coming months. This will lift average export earnings per litre and flow into grape prices that are not already contracted for the 2012 and 2013 vintages. Even flat export growth sees a 32 million litre deficit. Therefore, it is possible that both export and domestic sales could decline over the next 12 months. However, total stocks at the end of 2011 were estimated at 300 million litres and therefore the slack is likely to be made up from a reduction in inventories. This will be beneficial for longer-term grape pricing.



Sources: ANZ, National Bank, NZ Winegrowers

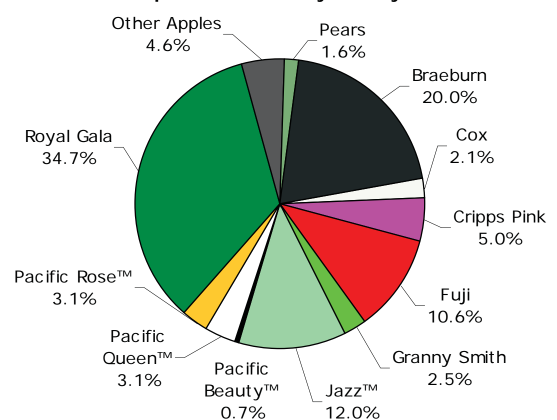
BUDGETING GRAPE PRICES

Examining the relationship between export prices for wine and grapes shows the two broadly move in the same direction. **With export prices averaging $7.07 per litre in 2011, this translated into a national average grape price of $1,252 per tonne.** Given anecdotal evidence of upward pressure on grape prices we are likely to see these move up more than wine prices. Wine prices are likely to increase from a reduction in bulk exports, but the ability to pass on higher prices for packaged wine is expected to be difficult in a wobbly global environment. **Therefore, it is expected Sauvignon Blanc prices will increase to $1,250 per tonne in 2012. Other white varieties are expected to lift, but not to the same extent, and red varieties are forecast to be stable.**



Sources: ANZ, National Bank, NZ Winegrowers

PIPFRUIT



Sources: ANZ, National Bank, Pipfruit NZ Inc

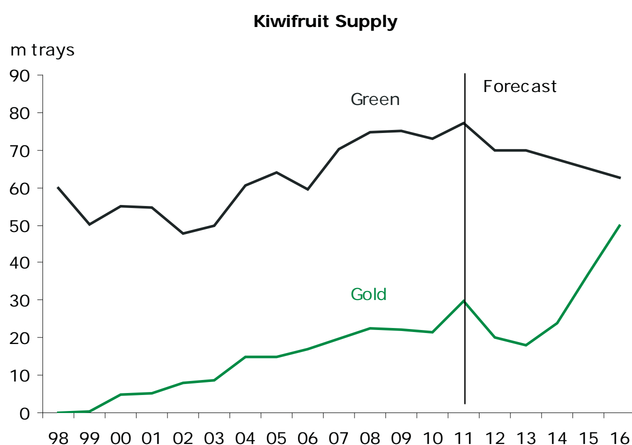
FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW 2012–13

Lower Southern Hemisphere production and continued growth in Asian and Middle Eastern markets are expected to provide price tension for pipfruit in European markets. This sees budgeted prices up 2 percent on average in 2012, but with a wide range of –8 to +18 percent depending on variety. Those varieties with a greater exposure to Asian and Middle Eastern markets are expected to outperform others. **Braeburn prices are expected to be stronger this season due to the substantial reduction in supply due to an average growing season in the Hawkes Bay.**

KIWIFRUIT

Zespri have released an industry recovery plan that involves a significant grafting opportunity for G3 (new cultivar of Gold) to existing growers of both Gold and Green. **The supply of kiwifruit for the different varieties will be the biggest determinant of orchard-gate pricing over the next 5+ years.** The forecast decrease in Gold (Hort16A) volumes will bring price tension across key markets and allow Zespri to sell to higher-returning markets (i.e. reduced volumes will mean less fruit has to be pushed into low-returning markets). The lower volumes also shorten the selling season, reducing fruit loss and providing pricing tension for packhouse services because of over-capacity. As Green volumes are more slowly reduced from 2012 to 2016 the same effects on pricing will also be prevalent, but not to the same extent because Green is more of a commodity.

Therefore, we believe orchard-gate returns for Gold will move up towards $9 per tray over the next couple of seasons until increased supplies of G3 start to hit the market from 2014 onwards. Green will also benefit, but not to the same extent, moving up towards $4.50 per tray.



Sources: ANZ, National Bank, Zespri

THE MONTH IN REVIEW

ASSESSMENT

Despite recent price falls the 2011-12 financial year will be one to remember for the livestock sectors. A mix of solid farm-gate prices, controlled costs, excellent seasonal conditions and lower interest rates ensure P&L statements will be very solid. Nevertheless, the recent rapid deterioration in prices has the farming community holding its breath for what the 2012-13 farming year might deliver. Thankfully, New Zealand's flexible macro-economic framework has begun to respond, with the NZD and interest rates both falling.

On the production side of things, the main indicators remain encouraging. Autumn conditions across the country were milder than normal. This has set up most regions with quality pasture cover and lots of supplementary feed heading into winter. Livestock have flourished in this environment and are in top condition. These dynamics augur well for production in 2012-13. In Southland feed conditions have recovered due to the mild autumn. Dairy production was just below budget.

DAIRY

The majority of dairy farmers have hit record production in 2011–12. Across New Zealand we estimate total production will be **up 11 percent on last year,** three and a half times the normal rate of growth. **There has been a much stronger than expected finish to the season, with autumn milk flows estimated to be up a massive 35 percent on the average from the last four years.** This has meant Fonterra have had to shift volumes similar to the peak of the season in May via the GDT, explaining the rapid decline in prices. Of those farms that have achieved record production, most are choosing to purchase additional shares, the majority out of cashflow before the end of June. Some whose cashflow is not as positive are choosing to have the payment come out of the October milk cheque.

The rapid decline in dairy prices and the need to shift extra product at lower prices has also seen Fonterra lower its 2011-12 milk price by $0.30 per MS to $6.05. The dividend range remained unchanged. This reduction was more than expected, but could be compensated to a certain extent by a higher proportion of the dividend being paid out. **This reduces farm profit before tax (after interest payments) for an average-sized property from an estimated $250,000 to closer to $205,000.** On a per hectare basis, this is a reduction of 18 percent, from $1,825 to $1,500. This will still be the third-highest result on record since Fonterra's formation, behind 2007-08 and 2010-11.

Fonterra also flagged a milk price of $5.50 per MS for 2012-13 and increased their dividend range by 5 cents to $0.45-0.55 per share. **The lower milk price in 2012-13 is more problematic as it will be impossible to get the same production boost next year.** This means dairy farmers will need to ensure they remain well informed, keep a tight rein on expenditure and look for any further productivity improvements, as the $5.50 per MS is by no means guaranteed. **Fortunately, the lower payout has been signalled well in advance and most farmers will have enough 'flex' in expenditure to get through one tighter year.** Two good years with topped-up fertiliser, repairs and maintenance, as well as a lot of supplementary feed on hand provide a good starting point. **A move in the milk price to the low $5.00 per MS, while still in line with historical levels, would cause some pain due to higher leverage and cost structures.**

MEAT AND FIBRE

Lamb processing has been tracking at near normal seasonal levels over May, but the season total remains around 450,000 head, or –2.8 percent behind last year. The good season is reflected in average weights, which are up 0.5 kg on the same period last year. Given where current lamb slaughter is, it is likely that more ewe hoggets could be retained for breeding this coming spring. Wool exports are tracking 9 percent behind last year.

Total beef slaughter continues to track 12 percent behind last year. There has been weakness across the board for all classes of stock. The good seasonal conditions in the North Island are the main culprit, with production down nearly 220,000 head (–16.5 percent) on last year. **The key watch seems to be the cull cow slaughter,** which continues to drag its heels despite most dairy farmers now well dried off. It seems a combination of farmers retaining cows, a number of new conversions, and strong offshore demand is likely to see this year's cull cow slaughter well short of expectations this season.

HORTICULTURE AND VITICULTURE

The weather has caused a 10 percent reduction in this season's apple crop. The average size is also down one to two counts. However, quality is very good and colour is exceptional.

Onions will not have another golden year like the previous two. EU crops have rebounded this year, resulting in lower prices. Squash has seen a significant late season rise in price, benefiting those with quality stock available, or a late harvest. Some early season quality issues have disappeared as supply runs low.

RURAL PROPERTY MARKET

SUMMARY

While the season for farm sales has largely drawn to a close for 2011-12, sentiment has softened as prices for key commodities have dropped. Properties that are well located, with good contour, soils and capital improvements are still selling well. The trouble is there are very few properties on the market that tick all these boxes. Properties that do not tick these boxes have to meet the market, often at significantly lower price levels.

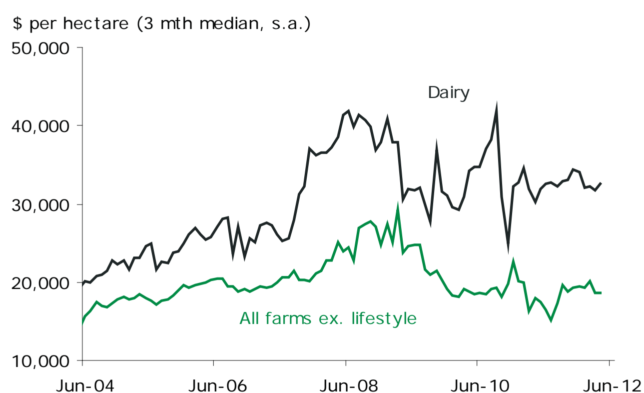
The rural property market is two-speed in nature, and this is likely to continue. Support factors are: increased competition for agricultural lending; low interest rates (both floating and now fixed); solid climatic conditions; and the fact that those with strong balance sheets are still looking to expand. The offsets heading into the first 6 months of 2012-13 are lower farm-gate returns, cash-flow constraints in dairying from a lower advanced rate for 2012-13, share purchases and tax requirements, as well as 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 April saw 398 farms change hands at an average of $18,700 per hectare. This volume was down from the 427 farms that changed hands in the preceding 3 months. Total turnover in recent months has now ticked up to 80+ percent of its 10-year average. This is up from 46 percent in the same period last year. However, the price per hectare has softened by $780 (–4 percent) versus the spring and summer period.

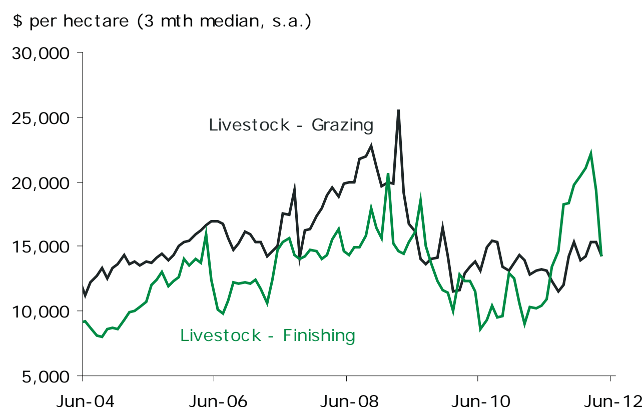
The table and charts below show the official statistics from REINZ for farm sales in the 3-month period ended April. The table is broken down into farm sales by each of the main farm types, both the number of sales during the 3-month period, and the median price per hectare. The figures have been seasonally 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	50	52	38	80	↓	↑	↓
	Median Price ($ per ha)	32,500	31,800	30,300	27,600	↑	↑	↑
Livestock – Finishing	Number of Sales	63	70	34	68	↓	↑	↓
	Median Price ($ per ha)	14,300	19,400	10,200	12,000	↓	↑	↑
Livestock – Grazing	Number of Sales	219	241	132	247	↓	↑	↓
	Median Price ($ per ha)	14,300	15,300	13,000	14,400	↓	↑	↓
Horticulture	Number of Sales	19	17	24	56	↑	↓	↓
	Median Price ($ per ha)	148,200	179,500	154,300	145,300	↓	↓	↑
Arable	Number of Sales	16	21	10	19	↓	↑	↓
	Median Price ($ per ha)	25,300	20,200	22,400	24,100	↑	↑	↑
All Farms ex. Lifestyle	Number of Sales	398	427	261	506	↓	↑	↓
	Median Price ($ per ha)	18,700	18,600	17,900	18,700	↑	↑	↔
Lifestyle	Number of Sales	1,449	1,445	1,125	1,641	↑	↑	↓
	Median Price	459,000	452,000	449,000	380,000	↑	↑	↑



Sources: ANZ, National Bank, REINZ



Sources: ANZ, National Bank, REINZ

RURAL PROPERTY MARKET

In our last update on the rural property market we believed farmland values would be capped by "softer returns, a moderation in seasonal conditions, sensible heads across the banking sector and uncertainty around foreign investment". **The largest change since this update has been a more rapid deterioration in farm-gate prices than expected. This, along with cash-flow constraints for dairy farmers during the first six months of the 2012-13 farming season, will be the key factors that weigh on prices and the turnover of livestock-aligned properties over this period. That said, we are not heading back to the dark days of 2008-09.** Competition amongst lenders, low interest rates, farmers with strong balance sheets actively pursuing expansion, a positive decision on the Crafar properties, a strong belief in the long-term future of agriculture, and a continuation of the golden season provide something of a counter weight.

How much might prices fall on a pure economic valuation basis? Meat and fibre rates of return have been around 2-3 percent versus dairy's 6-7 percent in recent years. Benchmarking these against the cost of rural borrowing of around 6.75 percent over this period suggests finishing and grazing property values are overvalued and dairy has been about right. Of course dairy earnings have supported finishing and grazing property prices for support blocks, or conversions. A lot however depends on what you consider "normal", and arguably, recent history has not been normal. **The lower milk price could see the average rate of return for dairy farms drop by 1.2 percent depending on how much 'flex' there is in cost structures. If farmers choose to factor this into purchasing decisions to maintain an average rate of return of 6-7 percent then this would see dairy farmland prices adjust substantially lower. While we don't expect to see this happen due to a number of other support factors,** it does suggest asking prices on properties that don't tick all the boxes will remain under pressure, and perhaps remain unsold unless absolutely necessary. This suggests the turnover of livestock-aligned property will be under some pressure this coming spring.

Examining the backward-looking indicators for the rural property market on page 15 shows that the tick-up in turnover since the start of 2011 peaked in March 2012. **The median price for all farm sales peaked a month earlier in February at $20,360 per hectare.** In the 3-month period ended April turnover fell slightly to 398 farms, and the average value was $18,700 per hectare. The average value during this period was up 6.5 percent, or $1,150 per hectare, on the same period as last year. However, caution is required when analysing average values as these can be influenced by the composition of sales.

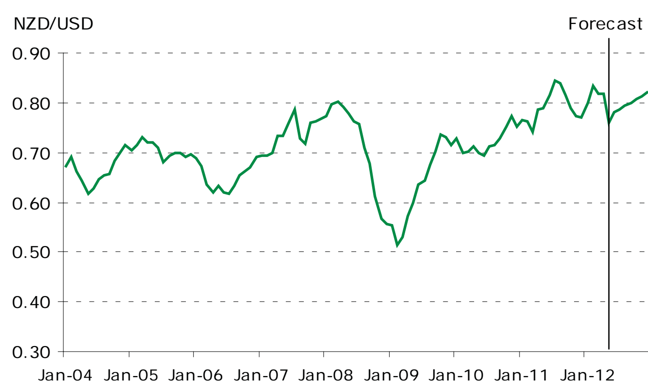
The median dairy price for a 3-month period has consolidated around the $32,000 per hectare mark over the last two months. This is in line with the range of $32,000-$34,000 per hectare that extends back 12 months. The three previous 3-month periods have also seen 152 farms change hands. This was the highest turnover since November 2008 and is at 62 percent of the 10-year average. **In the month of April turnover softened, with 20 dairy farms sold at an average sale value of $30,210 per hectare and $38 per MS.** The average farm size was 118 hectares and the average production per hectare across all dairy farms sold was 790 kgs of MS. **The 2011-12 $6.40 per MS for a 100 percent share backed farmer gives an investment multiple of nearly 6, which is above the historical average of between 5-5.5.** We'd consider an investment multiple toward the lower end of the historical range to be more normal going forward. **Next year's forecast of $5.90 gives an investment multiple of 6.5.** To bring land values back in line with historical averages would imply the land price per MS would need to drop to $32.50 per MS, or $25,600 per hectare. We don't think this will occur, but it does emphasize how much of the good news food story has already been factored into farm prices.

Finishing land showed a sharp reduction in prices from earlier in 2012. The median price for finishing property fell by nearly 30 percent to $14,300 per hectare. We believe the biggest change would have been compositional, due to a smaller proportion of these blocks being sold for dairy support or conversion. These transactions would have occurred earlier in the season to ensure the properties were operational for the 2012-13 dairy season. The $14,300 per hectare probably gives a better reflection of where sheep and beef finishing property has being trading in recent months. Grazing values have also fallen, but not to the same extent, back 6.5 percent to $14,300 per hectare. For both types of properties turnover has come off its March peak, but remains around its 10-year averages. Arable sales have held up, with good volumes and values, despite a large drop in domestic feed grain prices.

Things remain challenging in the horticultural sector. Orchard-gate pricing is expected to improve for apples, grapes and kiwifruit, but this is largely due to a poor growing season and lower production. Therefore, profitability is likely to remain constrained for many and there is expected to be a number of continued distressed sales. However, there has been a reported lift in the sales of vineyards, with four confirmed unconditional contracts in Marlborough – one in particular a strong bona fide sale at approximately $160,000 per hectare. Buyers have ranged from a medium-scale wine company, to robust existing growers and semi-retired lifestylers.

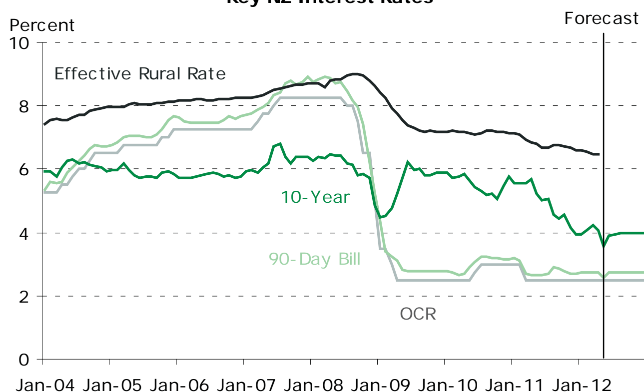
ECONOMIC INDICATORS

EXCHANGE RATES					
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZD/USD	0.76	0.82	0.79	↓	↓
NZD/EUR	0.61	0.62	0.56	↓	↑
NZD/GBP	0.49	0.51	0.49	↓	↑
NZD/AUD	0.77	0.79	0.75	↓	↑
NZD/JPY	60.5	66.6	64.6	↓	↓
NZD/TWI	70.0	72.5	70.9	↓	↓



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	6.46	6.49	6.83	↓	↓
Agricultural Debt ($b)	46.80	46.49	45.81	↑	↑



Sources: ANZ, National Bank, RBNZ

The NZD has fallen substantially since our last update, especially against the USD. Although softening NZ data and lower commodity prices have played a part, there has also been a significant shift in global risks, with a re-emergence of fears associated with the European sovereign debt crisis, concerns over Chinese growth prospects, and more recently, a softening in US data. Together, these have contributed to a classic "flight to quality" shift in markets, which has been detrimental to the so-called "risk" or "hi-beta" currencies, which includes the NZD.

It now appears that a base has formed following the recent declines and that it will take something more to push the AUD and NZD currency markets lower. We suspect this requires systemic red flags as opposed to purely economic and data-driven developments. The risks remain tilted towards the former given that European politics will be driving sentiment through much of June. **A sustained lift in the NZD requires political leadership in Europe aimed at addressing solvency concerns.** Central bank action may drive temporary risk-on fillips.

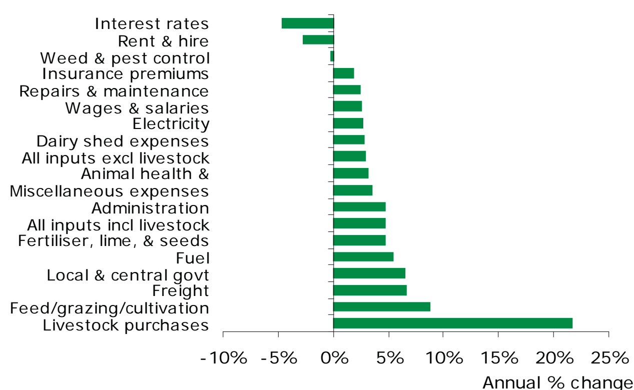
Wholesale interest rates have fallen to record lows in the past month. As a result, we have seen the 5 year swap rate move below 3 percent, and the short end price in 50bps of rate cuts by the end of the year. Looking forward, **there are two key issues that the market needs to "resolve". The first is the "disconnect" between market expectations and our forecasts, which are suggestive of higher short end rates.** With so much easing priced in, some adjustment is likely should the RBNZ hold rates steady in June, as we expect. Although we believe the hurdle to an OCR cut is high, particularly when one considers the "easing" we have seen in the NZD and mortgage rates, we don't disagree with the market moving to price in some probability of cuts in light of the non-trivial risk that current unease could turn into a full-blown crisis. Market pricing reflects the risk profile, and given the lack of fiscal leadership to arrest the market's fiscal solvency concerns, you can understand why caution prevails.

By contrast, the long end looks to be under further downward pressure as global high-quality bond yields converge. New Zealand interest rates may appear low in the historic context, but they are very high in comparison to global peers. At 3 percent they certainly compare favourably with German and US 10 year bond yields at 1.2 and 1.5 percent respectively. Furthermore, New Zealand interest rates are above current and expected inflation rates, unlike elsewhere. Global investors are also attracted to NZ because of its fiscal responsibility and policy flexibility. As global yields converge, this should put downward pressure on long end interest rates, "flattening" the yield curve.

ECONOMIC INDICATORS

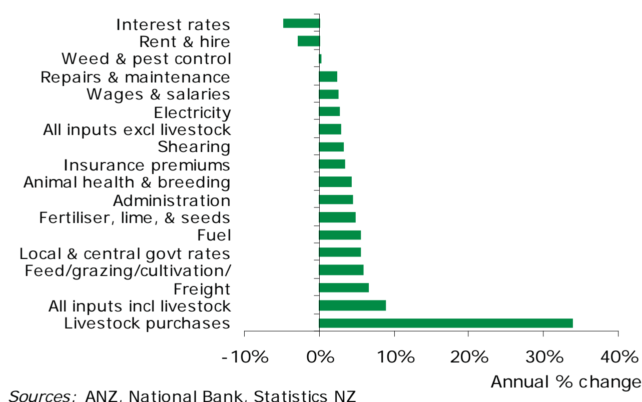
INFLATION GAUGES					
Annual % change	Current Qtr	Last Qtr	Last Year	Chg. Q/Q	Chg. Y/Y
Consumer Price Index	1.6	1.8	4.5	↓	↓
Farm Input	6.1	7.4	4.6	↓	↑
Net Imp. Margins PPI	–10.3	–4.7	11.7	↓	↓

Farm expense movements 2011/12 - Dairy



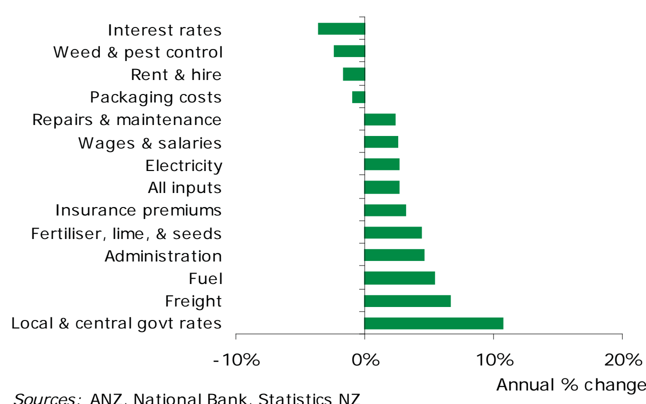
Sources: ANZ, National Bank, Statistics NZ

Farm expense movements 2011/12 - Sheep & Beef



Sources: ANZ, National Bank, Statistics NZ

Farm expense movements 2011/12 - Horticultural



Sources: ANZ, National Bank, Statistics NZ

Statistics New Zealand has released their latest annual survey of on-farm cost movements. **The annual movement for the "all farms" measure was up 6.7 percent including livestock and up 2.6 percent when livestock are excluded.** The 2.6 percent increase that excludes livestock was above headline inflation in the March quarter of 1.6 percent. **The result was slightly below the 2.8 percent increase in 2010-11.**

Livestock purchases increased a substantial 28.8 percent in 2011-12, because of the very good seasonal conditions. Store stock prices were pushed up due to a storage of all livestock classes in the sheep and beef sector. Capital livestock values rose in all of the livestock sectors because of the good seasonal conditions and strong cash profits over the last two seasons. Overall livestock values have increased by some 51 percent over the last 2 years.

Other big movers in 2011-12 were freight (+6.6 percent), local and central government rates (+6.3 percent) and fuel (+5.4 percent). Obviously two of these three were influenced by high oil prices during this period. Electricity, which has been a perennial bug-bear over the last 10 years, increased a modest 2.6 percent. Wage increases were generally well contained at 2.5 percent. However, specialist skills such as shearers (+3.2 percent) and contractors increased by more.

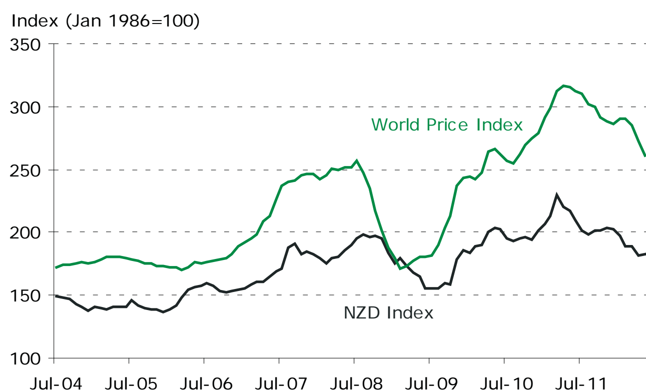
Dairy and sheep and beef farms experienced the largest increases in overall costs of the different farm types, at 2.9 percent. This was followed by cropping and horticulture at 2.7 percent. **The biggest increase for dairy farmers was, surprisingly, feed, grazing, cultivation and harvesting at 8.8 percent,** probably reflecting contracting costs, with these services in high demand to take advantage of the good seasonal conditions. **The next biggest movers were freight, and local and central government rates.** Sheep and beef farms faced similar cost increases to dairy, with the same three categories topping its list of biggest movers. **Interest rates and rent and hire were the only two categories to decrease, back 4.7 and 2.7 percent respectively.** Fertiliser, lime and seed costs were up 4.8 percent for both farm types.

Packaging costs declined by 1 percent on horticultural farms, which probably started to reflect the tensions of Psa in the kiwifruit sector and continued rationalisation in pipfruit packaging. These costs also fell by 1.1 percent for cropping farms. **Local and central government rates increased a substantial 10.7 percent for horticultural farms,** which hasn't gone down well, as many have had thin margins. **Overall, with a mixed outlook ahead farmers need to ensure they maintain a tight rein on costs and are actively monitoring and budgeting for price movements.**

KEY COMMODITIES: OVERALL INDEX AND DAIRY

ANZ COMMODITY INDEX	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Index	183	181	217	↑	↓
World Index	261	272	315	↓	↓

ANZ Commodity Price Index



Sources: ANZ, National Bank

The ANZ commodity price index took another step down in May, with eleven commodities registering weaker in-market prices and only four price increases being measured. The index **fell a further 4.2 percent in the month,** its twelfth monthly decline in the past thirteen months. The index has fallen a cumulative **18 percent from last year's peak, easing to a 21-month low.** Fortunately, the NZD responded on the other side of the equation for farm-gate prices, declining against all our main trading partners. **The size of the decline was greater than the fall for in-market prices, resulting in a 0.8 percent lift in the index when measured in NZD terms.**

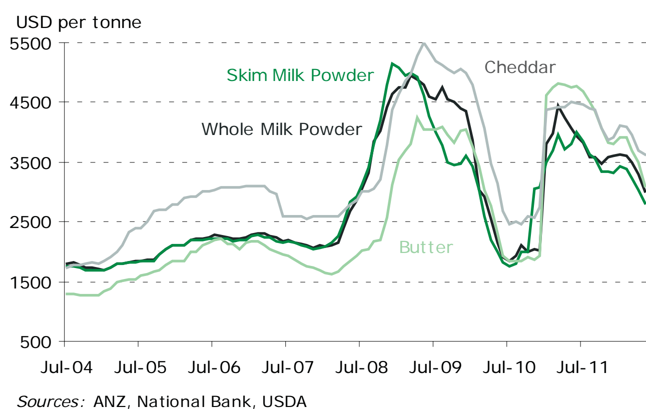
Since our last update, dairy markets have turned sharply lower, as a long tail to the New Zealand season has run up against good supply out of the Northern Hemisphere. The overall GlobalDairyTrade (GDT) price has slipped 15 percent since the end of March, or US$500 per tonne to US$2,900. **Fortunately, the NZD/USD has softened,** although not to the same extent, down 7.1 percent over the same period.

With New Zealand's season now wound up, attention will focus on any extra product that now needs to be shifted out of season, Northern Hemisphere production, and offshore inventory levels. While Oceania inventory levels are unknown, a number of factors suggest they are not excessive heading into the 2012-13 season. First, the recent volumes shifted via GDT have been large (similar to the peak of the season), and we saw a large reduction in volumes on offer for the first auction of June. Second, there were comments earlier in the season that Fonterra was well forward sold. This should see volumes offered via the GDT return to more normal seasonal levels. Along with the contracted delivery periods falling into the latter half of this year and early 2013 when tariffs into China are lower, this should support prices in finding a floor. This argument has been supported by a bounce in prices in the first auction of June.

How sustained the bounce will be is conditional on Northern Hemisphere supply increases moderating and inventory levels not getting too excessive. So far in the US there has been a slight decline in the growth of milk supply as farmers respond to very low margins. Nevertheless, good weather conditions continue to push up milk yields. On the back of this, inventory levels of butter and cheese are up, along with the production of SMP and non-fat dry milk. European supply has also continued to increase, although lower farm-gate prices have now started to feed through. **Despite all this, these markets have also started to shows signs of stability in recent weeks, which bodes well for a mild recovery over the coming months.**

OCEANIA DAIRY PRICE INDICATORS					
USD per tonne	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Whole Milk Powder	3,000	3,294	4,075	↓	↓
Skim Milk Powder	2,806	3,025	3,806	↓	↓
Butter	3,100	3,500	4,750	↓	↓
Cheddar	3,625	3,700	4,500	↓	↓
World Basket	3,133	3,380	4,283	↓	↓

Dairy Products - Oceania Export Market Prices



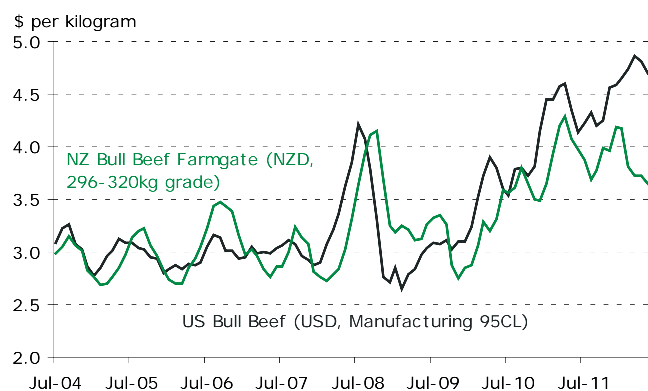
Sources: ANZ, National Bank, USDA

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]	4.70	4.81	4.34	↓	↑
NZ Bull Beef[2]	3.65	3.72	4.08	↓	↓
NZ Steer[2]	3.62	3.70	4.14	↓	↓
NZ Heifer[2]	3.60	3.65	4.08	↓	↓

[1] USD, Manufacturing 95CL

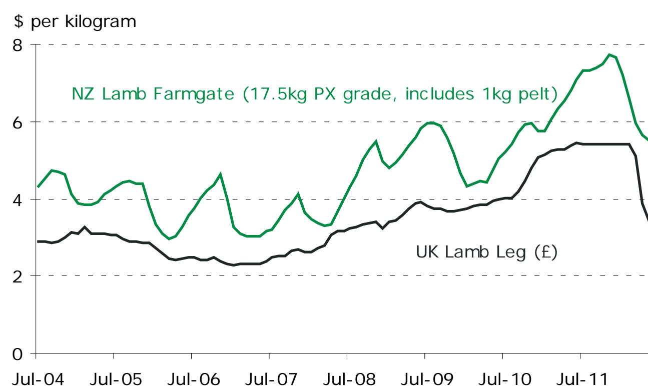
[2] NZD, 296-320kg Grade Bull & Steer, NZD, 195-220kg Grade Heifer



Sources: ANZ, National Bank, Agrifax

LAMB PRICE INDICATORS					
$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Lamb[1] (NZD)	5.50	5.66	6.82	↓	↓
UK Lamb Leg (£)	3.45	3.86	5.39	↓	↓

[1] 17.5kg PX grade, including 1kg pelt



Sources: ANZ, National Bank, Agrifax

The beef market remains intriguing. **In the US market there is continued fallout from the LFTB saga. There has also been a new case of BSE in the US, the first since 2006.**

The recent public controversy about LFTB in the US has caused many retailers and wholesalers to stop using the product as an additive in ground beef and other processed meats. In total it has been estimated that it made up 3 to 6 percent of total US beef supply, and its use has been reduced by 75 percent. With cull cows in the US in short supply, it is expected the shortfall will be made up with imports. However, so far it has led to stronger demand and prices for fresh US 90CL beef rather than frozen imported beef. It only seems a matter of time before the two normalise, which should be supportive of NZ exports to the US. Other support factors look to be a fizzer of a cull cow slaughter in NZ this season, and a lower NZD/USD. Nevertheless, caution remains to the fore as it is difficult to known how such controversies will weigh on overall beef consumption that has been under pressure since 2007.

The identification of BSE in the US has larger implications for competition in our main Asian markets. So far there has not been a significant knee-jerk reaction from the main markets of Japan, South Korea and Taiwan. In South Korea there have been a couple of sporadic reports about consumer resistance and two retailers not wanting to stock US product. In Japan it will probably prolong the current market restrictions on US beef imports.

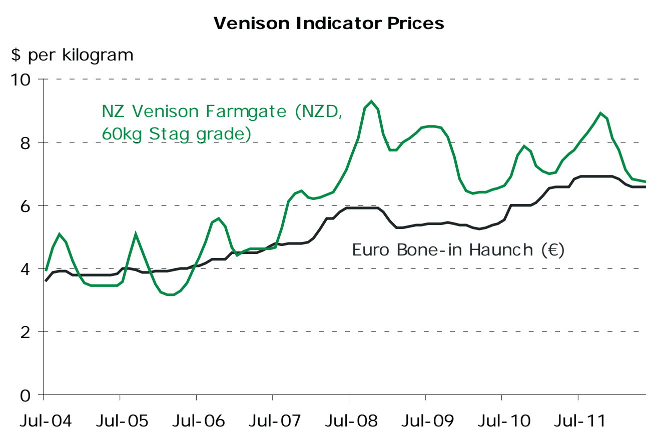
The lamb market has pretty much declined as expected. The question is, where to now? It certainly looks like things are starting to find a bottom and winter contracts of $6.00 to $6.75 per kg provide a guide. But as usual, these contracts are being used to supply niche off-season chilled markets. **These contract prices are mostly lower than last year, indicating we will not be seeing a farm-gate price above $7 per kg over the next six months.** The recent fall in lamb legs is concerning, but anecdotal evidence that the Chinese have started buying these for the first time suggests things will start to stabilise soon. Other lamb cuts are trading within relatively wide price ranges. Forequarter prices have been squeezed, but middle cuts have held up well due to support from the US, while Chinese demand has allowed prices of lower value cuts such as flaps, to remain elevated.

Overall, it seems farm-gate returns are starting to align with in-market returns. Some exporters are under greater pressure than others, depending on inventory levels, cash-flow needs, processing expectations, and product forward sold. Therefore, we suspect a pick-up in lamb turn-off could provide further downside, but not too much before things stabilise.

KEY COMMODITIES: VENISON AND WOOL

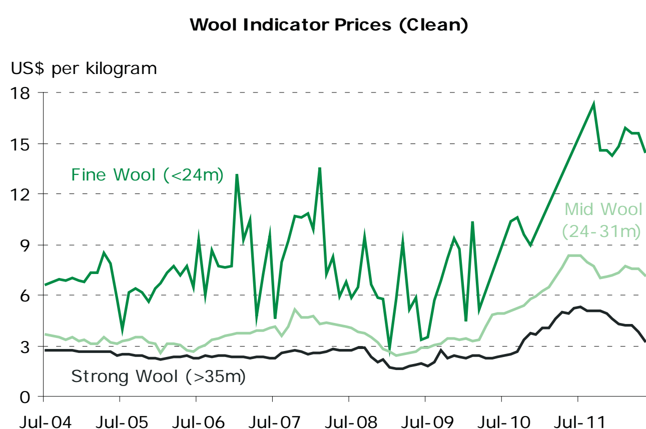
VENISON PRICE INDICATORS					
$ per kg	**Current Month**	**Last Month**	**Last Year**	**Chg. M/M**	**Chg. Y/Y**
NZ Venison[1]	6.77	6.77	7.64	↓	↓
Euro Bone-in Haunch (€)	6.60	6.60	6.60	↔	↔

[1] 60kg Stag AP grade



Sources: ANZ, National Bank, Agrifax

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	↔	↓
NZ Mid Wool (24-31m)	9.40	9.23	10.53	↑	↓
NZ Strong Wool (>32m)	4.35	4.66	6.21	↓	↓
USD Fine Wool (>24m)	14.48	15.60	NA	↓	↓
USD Mid Wool (24-31m)	7.14	7.56	8.32	↓	↓
USD Strong Wool (>32m)	3.31	3.82	4.91	↓	↓



Sources: ANZ, National Bank, Beef + Lamb NZ, Wool Services

Venison markets remain steady with production well matched to export levels. Current production for the season is tracking ahead of the same time a year ago. Despite a slump in December – the only month that has so far been behind last year's production levels – every other month since October has tracked ahead of the 2010-11 season.

Estimated stored product in New Zealand is now steady and should remain this way until the tail end of the season. So far this season's production is running at 45 percent of the estimated total, allowing for a slight increase in total slaughter over 2010-11. However, stock numbers being processed will now taper off going into the winter, which should see prices turn up at the same time. **The only downside during this period seems to be a weaker EUR.** The NZD/EUR cross is 11 percent higher than this time last year. This explains the $0.85 per kg lower schedule price in May this year compared to last. **Achieving similar in-market prices to last year with a higher NZD/EUR would imply hitting a peak schedule of just above $8 per kg in October this season.**

The recent slide in the NZD has helped farm-gate returns for wool stabilise in May. In-market prices, on the other hand, remain biased to the downside. Poor economic growth prospects in some of the main wool-consuming countries, especially Europe and Japan, remain a clear risk. **On the upside, China continues to buy wool from both New Zealand and Australia, and production for both countries has been below expectations.** Australia Wool Innovation recently revised down its production forecast for 2011-12 to 345m kgs, little changed from 2010-11. They also provided a first forecast for 2012-13 of a 1.4 percent increase to 350m kgs, indicating any wool production recovery from Australia will be slow.

The price competitiveness of wool against cotton and synthetics remains an issue, and definitely caps wool price increases. Synthetic fibre prices are elevated, but the recent decline in oil prices will feed through. Cotton prices have weakened further as inventories build and expectations of another large crop in 2012-13 are factored in. US cotton planting is running well ahead of schedule, which bodes well for yields.

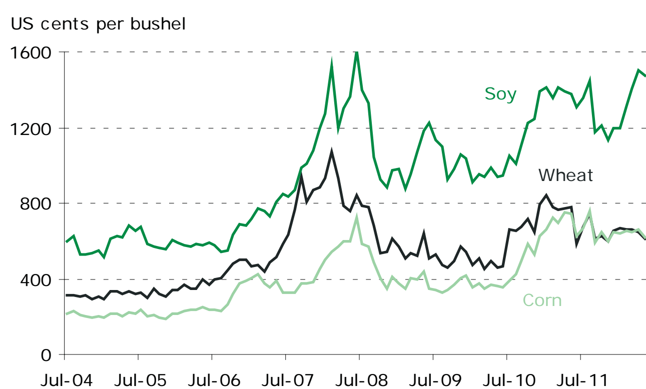
Total New Zealand exports for July to April 2012 are back 9 percent on last year. The major declines in our larger exports markets have been in Australia, India and the UK, with volumes back 75, 28 and 23 percent respectively on last year. In total this equated to a decline of 7,100 tonnes. China has picked up most of the slack, increasing demand by 4,500 tonnes to account for 50 percent of our 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	6.1	6.5	7.8	↓	↓
Soy	14.8	15.0	13.8	↓	↑
Corn	6.2	6.6	7.5	↓	↓
Australian Hard Wheat[1]	292	285	333	↑	↓

[1] NZD per tonne

CBOT Future Grain & Oilseed Indicator Prices



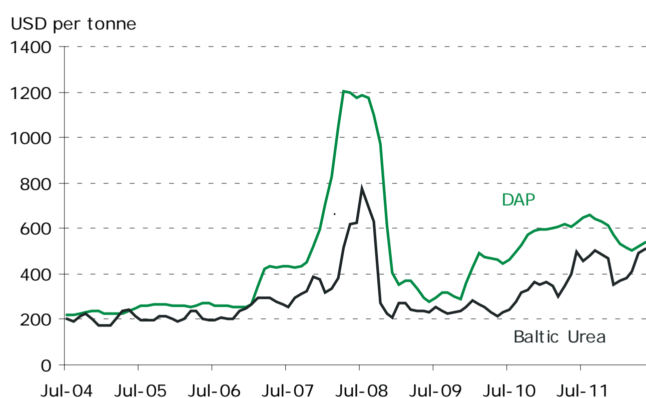
Sources: ANZ, National Bank, Bloomberg

As mentioned in our last update a lot rests on a three-month period when US corn yields will be determined. The USDA has been very aggressive pegging US corn production for 2012-13 at a record 14.79 billion bushels, up 20 percent on last year. **However, we continue to wonder how realistic their above trend yield estimate is.** Mother Nature is playing along for now with most of the crop planted early, which helps with early emergence. Early emergence does not guarantee great yields, but it lowers the probability that the crop will be exposed to late July heat during its pollination phase. The sharp expansion in corn plantings has also brought more marginal and lower yielding land into the mix, and the recent strength in soybean prices might have incentivised some late-planted land to be switched from corn to soybeans. Therefore, a lot of water still needs to flow under the bridge before the 20 percent increase is realised.

Domestically, the latest AIMI survey of cereal areas and volumes indicates that **autumn feed wheat and barley plantings in 2012 will be down slightly compared to last season.** Feed wheat plantings are estimated to be down 2.8 percent on last year, at just over 31,000 hectares. The feed barley estimate came in at a little under 23,500 hectares, down 4.2 percent on 2011. The trend in the milling wheat planting estimates is a little more pronounced. It is estimated that 1,800 hectares less will be sown this autumn. This takes plantings down to around 8,200 hectares. On the ground, cereal seed sales are reported to be similar to last year, indicating that the survey estimates are probably not far off the mark.

FERTILISER PRICE INDICATORS					
USD per tonne	**Current Month**	**Last Month**	**Last Year**	**Chg. M/M**	**Chg. Y/Y**
DAP	538	518	610	↑	↓
Urea	510	493	399	↑	↑

Fertiliser Indicator Prices



Sources: ANZ, National Bank, Bloomberg

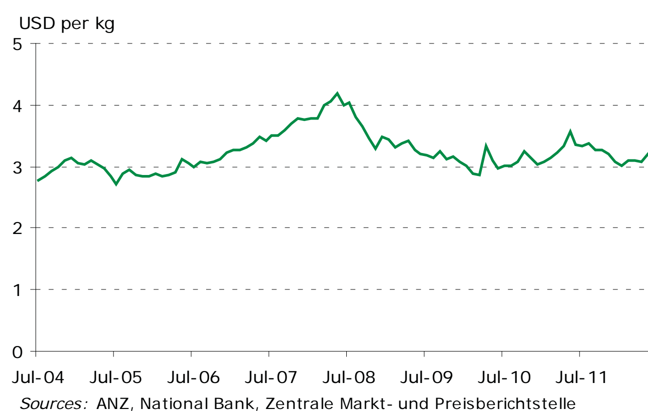
The upward movement in global benchmark prices and a lower NZD suggests there could be some slight upward pressure on farm-gate fertiliser prices in coming months. The counter is that these price increases might be smoothed over by fertiliser companies ,as the outlook for key soft commodities is weaker in 2012-13. This should moderate the upward march we have seen over the last couple of months.

Global urea markets have experienced the biggest increase, moving up 40 percent since the end of 2011, while diammonium phosphate has seen more modest price increases. International urea prices have responded to strong demand in the US and to a lesser extent South America. The surge in US demand was earlier and larger than expected due to early planting of this year's corn crop, and as previously reported, one of the biggest planting programs ever. Phosphate markets have been far less volatile than nitrogen markets. Tight supply from North Africa (due to civil unrest) and Russia have combined with solid demand in the US and India.

KEY COMMODITIES: HORTICULTURE

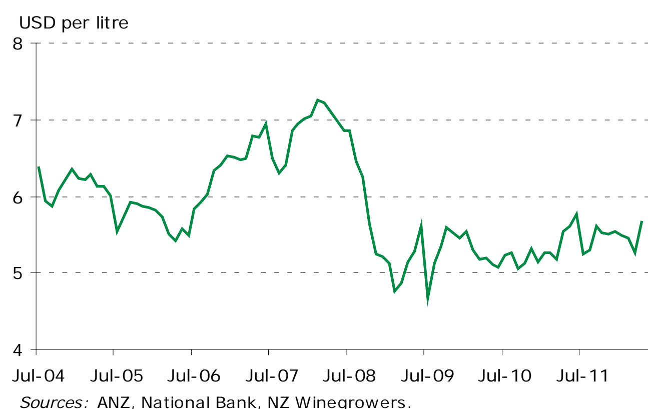
HORTICULTURE PRICE INDICATORS					
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Kiwifruit (USD per kg)	3.2	3.1	3.6	↑	↓
Apples (Weighted Index)	227	203	213	↑	↑
Wine (USD per litre)	5.7	5.3	5.5	↑	↑

Kiwifruit Indicator Price



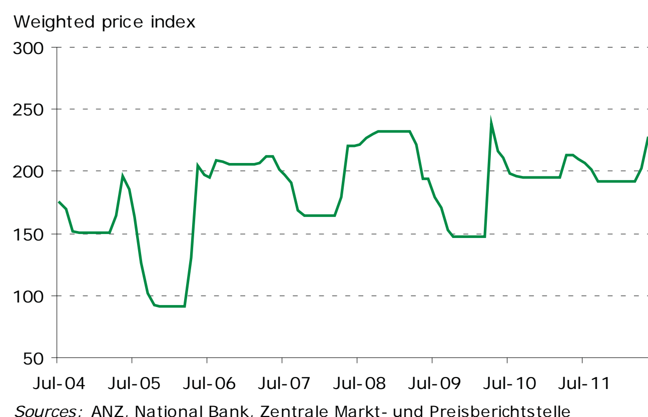
Sources: ANZ, National Bank, Zentrale Markt- und Preisberichtstelle

Wine Indicator Price



Sources: ANZ, National Bank, NZ Winegrowers.

Apple Indicator Price Index



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

The main horticultural sectors have been amongst the few who have experienced price increases over the last two months. With a lower NZD to boot this has set up better prospects for prices for this season's crops. **However, the main driver of the higher prices in most cases has been a poor growing season, so there won't be so much product to sell.**

Zespri have announced indicative ranges for the 2012 kiwifruit crop. Conventional Hayward is at \$6.80 to \$7.30 per tray, with the mid-point of \$7.05 the same as 2011. Organic Hayward has a range of \$8.45 to \$8.95 per tray, with the mid point of \$8.70 unchanged from 2011. The Gold varieties have a range of \$13.70 to \$14.20 per tray. **This has a mid point of \$13.95, which is up 17 percent, or nearly \$2 per tray, on 2011.**

These price ranges exclude post-harvest charges and loyalty payments. As previously mentioned we believe lower volumes will reduce fruit loss and provide pricing tension for packhouse services because of over-capacity. This is likely to reduce post-harvest charges and increase loyalty payments. **One of the larger packhouses has increased their loyalty premium for Conventional Hayward in 2012 by \$0.10 per tray. All these factors mean orchard-gate returns are likely to climb toward \$3.90-\$4.00 per tray.**

The national wine price increased to \$6.94 per litre in April, up 7.6 percent on March. While the price is still \$0.10 per litre less than last year, this is largely due to a stronger NZD. In-market prices for April this year are actually up \$0.13 per litre on last year. Therefore, given the fall in the NZD during May, we expect an improvement wineries' returns in the short term.

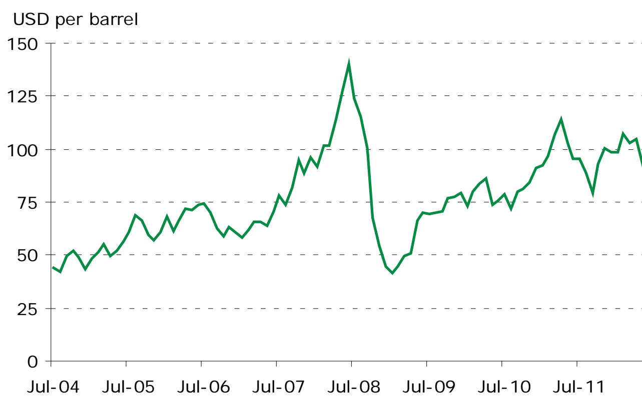
The large reduction in this year's Marlborough Sauvignon Blanc has seen further anecdotes of a step change in bulk wine and grape prices. There is a strong 'market' for people negotiating grape supply contracts, which has seen instances such as a guarantee of \$1,800 per tonne for Sauvignon Blanc grapes for the next three years. There is now a pervading belief in the industry that per tonne prices will be significantly stronger over the next two years; and this will no doubt flow through to wine prices.

The first of the new season apples have hit offshore markets and prices have been reported as positive. **The average size is reportedly down 1 to 2 counts which will weigh on orchard-gate returns, but a shortage of Southern Hemisphere supply will help maintain price tension between Europe and Asia.** This sees budgeted prices up 2 percent on average in 2012, but with a wide range of –8 to +18 percent depending on variety.

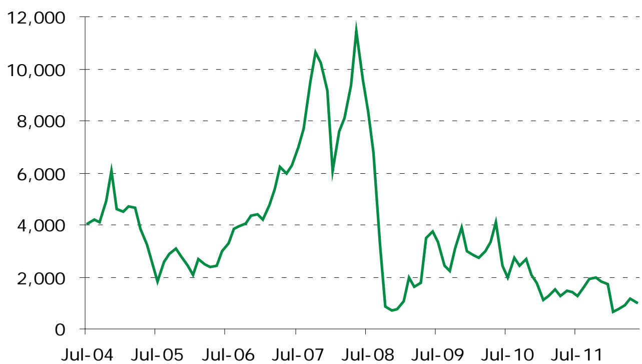
KEY COMMODITIES: OIL AND FREIGHT

OTHER COST INDICATORS					
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Crude Oil[1]	93	105	103	↓	↓
Ocean Freight[2]	1,000	1,155	1,480	↓	↓

[1] USD per barrel, grade WTI
[2] Baltic Dry Index



Sources: ANZ, National Bank, Bloomberg



Sources: ANZ, National Bank, Bloomberg

Oil prices have fallen to eight month lows as concerns about global demand have trumped a supposed tightness of supply. The fall-out from the escalating crisis in the Eurozone and economic weakness in China have more than offset any disappointment at the lack of progress in talks with Iran. Talks over Iran's nuclear programme appear to have faltered, with negotiators from the US, UK, France, Germany, China and Russia rescheduling to meet their Iranian counterparts on June 18-19. Markets are also keeping an eye on political tensions and violence in Syria and Egypt.

Brent and WTI have dropped by similar amounts, keeping the spread between the two at around $15 per barrel. WTI crude has come under additional pressure lately due to domestic oil stockpiles rising towards record levels (currently within 3.5m bbls of the record). However, a recent industry report showed total US oil inventories dropped 353k bbls to 386m bbls, although market participants will be looking at the official stockpile data for confirmation. Right now, expectations are for yet another 1.0m bbl build, which would bring stocks just below the record high levels reached in 1990. The rally in the US dollar to the highest level since September 2011 has also pressured crude markets.

Barring a meltdown in Europe, which has an increasing probability, oil prices could find some near-term support due to the recent failure in talks between Iran and western countries and the start of the US driving season.

The Baltic ocean freight index dropped below 1,000 again in late May as Eurozone concerns and a slow-down in Chinese imports weighed. At current levels the direction of freight costs are expected to be dictated to 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.

BORROWING STRATEGY

SUMMARY

Wholesale interest rates have fallen sharply in the past two months, taking rural lending rates with them. Even though rural lending margins have increased in recent years, reflecting tighter funding conditions for banks, this has been offset to a large degree by the recent fall in wholesale rates to record lows. As a result, rural rates are at levels not seen for some time, where it may be worth considering fixing some debt for 1-2 years. We do acknowledge that there are scenarios where we could envisage a lower OCR, but it is not our core view. However, OCR cuts are "baked in" to 1 and 2 years rates, and as such, it is debatable whether rates would fall much further even if the OCR was cut. We thus see value in short-term fixed rates, but prefer to maintain some exposure to floating rates given the high degree of uncertainty.

OUR VIEW

Wholesale interest rates (which are a key determinant of rural rates) have fallen to record lows in the past few weeks as the market has become increasingly concerned about the global environment. In broad brush strokes, markets are worried about the intensification of the European sovereign debt crisis and have growing fears of a slowing in Chinese growth. These in turn have implications for the NZ economy, and the OCR.

As a result of the falls, the market is now pricing in high odds of OCR cuts, which, when coupled with aggressive competition, has seen lending rates fall. Rural lending rates are partially "priced" off wholesale interest rates – and if wholesale rates are trading on the expectation of rate cuts, this basically means that rate cuts are "baked in" to new ultra-low fixed rates like the 1 year. Consequently, if the RBNZ does end up cutting the OCR, lending rates may not fall. For this reason alone, it is hard to look past the 1 year rate. Moreover, borrowing costs are also influenced by credit costs, and what we are seeing at present is offshore markets deteriorating. This suggests the recent falls in deposit rates (a substitute proxy for offshore borrowing costs) may not be sustained, and borrowing rates would follow them up in turn.

That said; borrowers ought to also bear in mind that any decision to fix is a serious one. NZ interest rates are still relatively high by global comparison, and if the global situation turns nasty, we may see interest rates fall further here. At this stage, our feeling is that the RBNZ will not cut the OCR. But there are grey clouds gathering over Europe. Our intention is not to scare our readers, but at the same time we must acknowledge that markets are very fluid, and with the level of suspicion surrounding a possible Greek exit of the euro literally rising by the day, anything is possible.

Of course, it can often be darkest before the dawn, and it also goes without saying that the fallout from an untimely Greek exit would be large. Thus there are strong incentives for Europe to keep Greece in the euro. But even so, with the level of uncertainty likely to remain high at least until the second Greek election on June 17 (and given rapidly escalating concerns about Spain), interest rates are likely to remain subdued for at least a few more weeks.

What matters most for borrowers is where rates might go over the long term, and here we expect fiscal policy and regulatory changes to be influential. In short, tight fiscal policy and tighter macroprudential policy will both take the heat off monetary policy in years to come, which in turn suggests monetary policy will be on hold for longer, and long-term wholesale interest rates have scope to remain low. It is these considerations, rather than fears about what might happen in Europe, that are preventing us from favouring longer-term fixed rates (3 years+).

Breakeven analysis is a regular feature of this page, and as it has for a while, **it shows that interest rates would need to rise fairly briskly over time for there to be value in fixing for longer periods.** However, because the 1 year rate is the low point, this means you would actually need to see the 6 mth rate fall in 6 months to be better off choosing the shorter term. Similarly, we note that breakevens rise only slowly between now and 6 months and 1 year, but rise sharply in 2 years. This is because longer-term fixed rates incorporate an expectation that interest rates will start to normalise from about December. By contrast, we expect interest rates to remain lower for longer, consistent with our "bathtub with waves" (flattish but volatile) economic prognosis, and as such, our preferred fixed terms are the 1 and 2 year – bearing in mind that if rates do stay lower for longer, it also makes sense to maintain flexibility and have some exposure to floating.

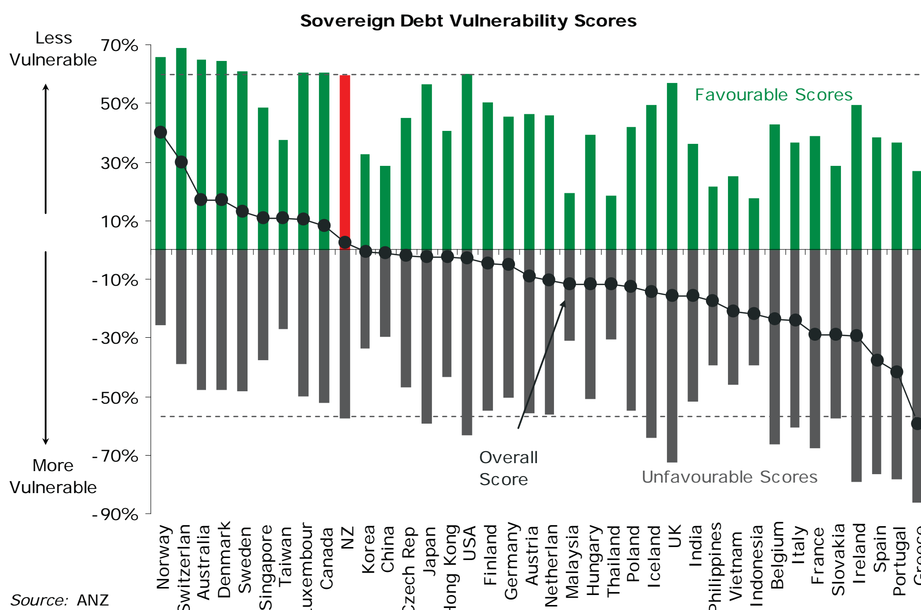
Rural Lending Rates assuming a 3% margin		Breakeven rates in			
Term	Current	in 6mths	in 1yr	in 2 yrs	in 3 yrs
Floating	5.53%				
6 months	5.45%	5.12%	5.39%	5.74%	6.20%
1 year	5.29%	5.26%	5.43%	5.81%	6.30%
2 years	5.36%	5.43%	5.62%	6.06%	6.50%
3 years	5.51%	5.63%	5.85%	6.27%	
4 years	5.71%	5.85%	6.06%		
5 years	5.90%				

EDUCATION CORNER: EUROPEAN PALPITATIONS

SUMMARY

It's Groundhog Day. The world's financial problems did not disappear in 2008; they were simply shuffled to one side. The focal point is now Europe and some key sovereigns. With so much debt out there we are sceptical that a durable and sustainable solution is pending, which makes transmission mechanisms to New Zealand key to watch. We detail 6 focal points: competency, confidence, the cost of funds, commodity prices, China and the currency. There is enough occurring across these 6 C's to have us extremely watchful, though it is pleasing to see natural shock absorbers providing insulation. Deeper malaise will be met by more of the same. With much of what is going on beyond farmers' control, the messages are to focus on the basics, get used to continued volatility, and pay even more attention to microeconomic differentiation (think management decision-making) as opposed to the general macroeconomic picture.

Here we go again it seems. Financial markets are once again on edge, running scared from the possibility of an untimely Greek exit from the euro. The reality is that Greece is just the tip of the iceberg, for it's the level of debt in aggregate across the whole continent (and for that matter, the US and UK too) that is the real problem. The level of debt in Europe and the OECD is substantially higher than it was on the eve of the 2008 Global Financial Crisis. What has changed is that it is governments, rather than the private sector, who are now shouldering the burden. The market is flexing its muscles, and unless we see some kind of circuit-breaker (a display of political leadership or an unconventional policy response), the sovereign debt crisis risks snowballing out of control.



Source: ANZ

Our sovereign vulnerability analysis highlights the tensions between indebtedness and flexibility, with the bottom end of the table heavily Europe-centric.

What we do know is that it is the fallout from Greece, rather than what happens to Greece *per se* that matters most. Even if it is too late to save Greece, it is almost inconceivable to think policymakers will stand idly by and watch the contagion spread beyond the point of no return.

It is therefore likely that we will see some sort of policy response. In all likelihood, it will end up being more quantitative easing from central banks, or some similar "sugar pill" solution. A temporary quick fix will be welcome, but it won't solve the problem. This is, to coin a phrase, the biggest game of chicken you've ever seen, one where governments don't want to make the hard decisions. It's not the job of central banks to bail out governments either, but a failure of either party to act risks turning the situation into a systemic crisis.

How does it all unfold? A sustained solution requires a combination of the following:

- Continued deleveraging and steps to improve fiscal solvency. This means fiscal austerity and leadership over populism.
- Fiscal union (a currency union is not sustainable without one).
- Europe's ESM (euro stability mechanism) needs to be expanded.
- The ECB needs to provide more liquidity support (and cut interest rates) to mitigate short-term challenges, and restore confidence in the interim.
- Some form of deposit guarantees to protect Eurozone periphery nations from the fallout from the likes of Greece.

Each faces challenges. Voters don't want a bar of austerity. Witness populist election results in Greece and France. Asking 27 sovereigns to cede sovereign elected power to some universal fiscal compact is challenging to say the least. We are reminded of the TV series called A Dog's Show which involved 3 sheep and 1 dog. Try corralling 27 sheep into the same pen when 5 of them think they are dogs! As economists we are tracking political events in Europe equally with economic

EDUCATION CORNER: EUROPEAN PALPITATIONS

developments, which we take as a sad indictment. Germany is balking at having to expand the ESM, or introducing Eurobonds without fiscal integration. The ECB head, Mario Draghi, noted of late that "the ECB isn't responsible for filling the vacuum of lack of action by national governments". And deposit guarantees are only as credible as the guarantor. On top of all these challenges you need greater economic flexibility to drive growth. An austerity plan alone is half a plan. You need a growth plan too. Yet the region is inflexible – just look at labour market practices.

So for now it's a huge game of chicken. We fully expect to keep lurching from risk-on to risk-off. Swings to the latter, and declines in sentiment, will invariably invoke a policy response. Eventually action will follow inaction. However, lacking fiscal unity and political agreement in a multi-lateral fashion, such a policy response will provide only temporary respite. A sustained solution requires the weak fundamentals to be addressed, and we appear a long way off that politically, with recent French and Greece election results thumbing their noses at austerity.

We suspect the endgame of sorts will involve some sort of accident. For a local corollary on Europe's challenges, cast your minds back to New Zealand in 1981-82. Borrowing exceeded income growth. The public sector was bloated and inefficient. Sectors were protected and subsidised. The economy was inflexible with poor incentives, which created perverse behaviours and a poor allocation of capital. The warning signs were flashing red yet it was not until 1984 that the "holy grail" moment was reached. Why was the holy grail moment important? It was required to deliver the mandate to instigate the necessary economic change. Without it, easy and soft decisions prevail over the tough ones. This is pockets of Europe today. It will not be Europe a few years down the track.

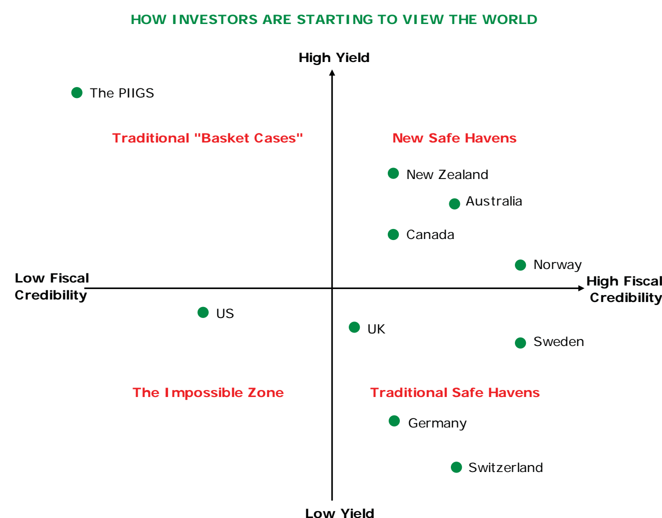
This accident could bring tremendous opportunities for NZ.Inc but also challenges. Things like protectionist trade barriers will be broken down. However, with this will come a far more productive and efficient agriculture sector – necessary for survival.

For New Zealand we are back once again to watching the so-called 6 C's: competency, confidence, cost of funds, commodity prices, China, and the currency. While we need to be alert to the direct consequences of slower global growth on export demand, our chosen 6 C's more broadly reflect the key areas we are watching.

So what do these mean in turn, and how does New Zealand stand at present?

COMPETENCY

Attention is squarely centred on the fiscal profligacy or responsibility of governments. Leadership and tough decisions need to prevail over populism. Election results in Greece and France have returned populist results. This has destabilised markets and sentiment. There is nothing New Zealand can do to address Europe's (or America's) fiscal woes. However, we are masters of our own destiny locally. In a world where investors are shunning populism, governments need to be whiter than white.



So where does New Zealand stand? **The Government is sticking to its guns over turning deficits into surpluses.** They have a plan, it's being articulated and has the confidence of rating agencies (a big tick). Second, there appears to be **broad agreement across both the red and blue hue** over the importance of limiting government borrowing and achieving fiscal surpluses. They may have different policy prescriptions to get us there, but there is a consensus on the goal. Such consensus is a far cry from what we are seeing across Europe and the US. These dynamics are being reflected in continued offshore interest in New Zealand Government bonds.

CONFIDENCE

Growth headwinds emanating from Europe will impact on the New Zealand economy via a number of channels besides the direct impact on export incomes and tourism flows. If a weaker European economy starts to affect business and consumer confidence, it could have a wider impact throughout the economy as household and businesses put spending, employment and investment decisions on hold. **Downturns can quickly become self-fulfilling.**

To date, confidence readings have remained reasonably resilient. While business sentiment surveys

EDUCATION CORNER: EUROPEAN PALPITATIONS

have generally been over-estimating growth for a number of years, we are **detecting a "just get on with it" attitude** percolating behind the scenes and across the agriculture sector.

However, the danger is that the longer the likes of Europe's problems linger, and policymakers stand idly by, we see turns in business sentiment that turn into self-fulfilling prophecies on economic momentum.

COST OF FUNDS

NZ has a net external debt position of 72 percent of GDP, and runs a current account deficit of 4 percent of GDP. **Swings in global financial market could therefore have a huge bearing on the economy via both the cost and availability of funds.**

Of late we have seen a sharp rise in CDS wholesale bank credit spreads. This represents tangible evidence that events in Europe are "spilling over" into New Zealand financial markets.

Given the global environment, it is no wonder that the Reserve Bank painted a cautious picture when it released its Financial Stability Review (FSR) in early May. That said, the RBNZ did note that domestic banks "have improved their capital and profitability positions" and that the Bank intends to take further regulatory steps to strengthen the financial system.

The fact is though, that **the RBNZ has implemented several regulatory changes** since the GFC, including the introduction of the Core Funding Ratio and Open Bank Resolution systems. **These changes have made the financial system more robust,** and more able to withstand shocks, but it is not bulletproof. Indeed, the biggest financial system risks New Zealand faces at the moment would be either a closure of offshore funding markets (as seen in late 2008) and/or a fall in property prices, which would in turn threaten bank collateral quality. We expect neither, but we cannot be smug and dismiss them as not possible.

There are other aspects that reduce the level of vulnerability at the farmer level, even if as a nation we are aggregate net debtor. The first is the impact that recent events have had on wholesale interest rates. These have been able to fall sharply because New Zealand interest rates are so much higher than their global counterparts. Markets have completely repriced where they think the OCR will be a year out. **Two months ago, some commentators were talking about hikes: the market is now pricing in almost two 25 basis point rate cuts!** As a result, we have seen borrowing rates fall. We have also witnessed **a pick-up in the level of competition, which is benefitting borrowers.** The fact that banks have been more willing to lend tells you it's still a case of all power to the consumer and that banks are well placed with their funding. One sign to watch that funding pressures are hitting the New Zealand economy would be deposit rates moving up: instead they've moved down.

Another consideration relates to expectations – in particular the level of wholesale funding that domestic banks have done in anticipation of a pick-up in lending. As the RBNZ pointed out in its FSR, the fact that credit growth has been slower than expected has reduced the amount of external funding required, and in its judgement, NZ banks have already "covered a significant portion of their 2012 funding requirements". This gives us more time to respond to a worsening in the global credit environment.

Moreover, should it be necessary, the RBNZ is well placed to respond to a crisis, having learned from the GFC, when it adopted a myriad of policies that were successful in averting a liquidity crisis in New Zealand.

COMMODITY PRICES

Commodity prices are a key transmission mechanism for swings in global momentum. New Zealand is now facing at least a $2 billion hole in its export receipts courtesy of the recent price declines. Fewer exports mean more borrowing or less spending across the general economy.

As noted in our research piece, **the outlook for New Zealand's main commodities is mixed in 2012-13.** The wobbly scene in Europe is feeding through to reduced middle-class demand for high-quality protein and foodstuffs. This creates a number of challenges for those sectors that sell a large proportion of their product to this region. Value-for-money food segments through retail are likely to continue to grow in this environment, which benefits some sectors that have a bigger profile through this channel.

But the big offset to weaker European demand is China and the wider Asian/Middle East region taking up the slack as diets westernise, energised by income growth and urbanisation. New Zealand also has a good reputation in this part of the world for producing quality food products, and has free trade agreements with key countries such as China to boot. **Lower soft commodity prices of course help with the affordability issues that were prevalent in emerging countries during 2011,** when food inflation rose quickly above 10 percent per annum. We still maintain that the trend in soft commodities is up, but it will have to be at a rate that is affordable to emerging countries. An annual increase of 10 percent per annum is not insignificant when 30 to 50 percent of disposable income is spent on food. The US is also growing slowly and provides another avenue to shift extra product. In particular, confidence levels in the food service trade in the US have picked up to a six-year high.

EDUCATION CORNER: EUROPEAN PALPITATIONS

Globally, production costs in many exporting countries remain at high levels for the major soft commodities. This means there needs to be a higher price floor for many soft commodities. Of course we can often push through the cost of production floor for a period of time, and in the dairy sector this has happened over the last two months.

The volatility in soft commodity prices looks likely to continue due to the wobbly global scene. The safety valve for farm-gate returns in this case is the NZD. Therefore, for now we remain constructively cautious on the outlook for commodity prices. However, market conditions are very fluid.

CHINA

Much has been penned about the upside potential that being more aligned to China *et al* brings to New Zealand. China is now our second-largest trading partner and one of the fastest growing. **With opportunity comes vulnerability, and New Zealand is now more susceptible to swings in Chinese growth.**

Concerns are rising over a hard landing in China. Financial conditions have tightened at the same time that China is attempting to transition from an investment-centric model to a consumption-based growth model. These sort of transitional swings are difficult to manage. April economic data is pointing to a slowing economy, with lending having collapsed. Credit growth has been rising at an exponential rate over the past five years, and along with it, house prices. The overvalued property market is now showing visible signs of slowing: prices falling, credit drying up, and developers going bust at a rate of knots. A bursting of the real estate bubble would have far-reaching implications for both China and the global economy. Moreover, China's economic engine remains heavily dependent upon demand from Western society, with Europe being China's largest trading partner.

While we are closely watching the direct consequences of slower growth in China on the New Zealand economy via areas such as export demand and commodity prices, more **critical is the indirect channel, via our largest trading partner Australia.** China is, in turn, Australia's largest trading partner, and Australia is benefiting from an intergenerational terms of trade boom. However, global commodity prices are now on the slide and Australia's hard commodity basket has not been immune to recent falls.

A China slowdown and further falls in hard commodity prices could have significant implications for the Australian economy. Economic growth and national income could slide materially, and house prices correct lower. We are closely watching the implications for the Australian banking system, which is of course a trans-Tasman model. A glass half full assessment of Australia's economic prospects would note that a tougher economic climate across the ditch could stymie the net migration flow and see some of the hoards return.

Of course policymakers are likely to intervene before a completely bearish scenario is allowed to take hold. Indeed, RBA cuts have already mitigated the potential downside and we expect to see further use of the monetary policy ammunition. We would also envisage further currency weakness to soften the potential blow to the economy.

THE CURRENCY

The NZ dollar has fallen of late, with the move long overdue. Commodity prices have been falling since February. The currency is now playing catch-up to local fundamentals. Commodity prices suggest the currency should be lower, though we need to be aware that currencies are two-sided coins and the flipside to a lower NZ dollar is a stronger USD and euro. Neither region seems an obvious candidate for a stronger currency.

The NZD's movement still represents an important safety valve for the economy. It will help support the export sector in the face of a tougher global climate. It will mitigate what falls in commodity prices mean at the farm gate. The NZ dollar will remain pressured until we see a necessary circuit breaker.

A weaker currency also brings challenges. Absent falling commodity prices, there could be pressure for import costs (petrol being the usual suspect, however oil prices have fallen more than the NZD recently) to move up. Consumers will increasingly feel the pinch here. If the RBA cuts very aggressively (and more so than the RBNZ) in response to an adverse China or Eurozone scenario, the NZD/AUD would move up sharply, placing the export sector under additional pressure.

THE UPSHOT

In many ways **recent events are hardly new news: they're a continuation of what we always thought would be a long drawn-out slog for the global economy.**

With much of what is going on being beyond farmers' control, the messages are to **focus on the basics, get used to continued volatility, and pay attention to microeconomic differentiation** (think management decision making) as opposed to the general macroeconomic picture.

KEY TABLES AND FORECASTS

FX RATES	ACTUAL			FORECAST (END MONTH)						
	Apr-12	May-12	7-Jun	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
NZD/USD	0.819	0.754	0.770	0.78	0.80	0.82	0.83	0.84	0.85	0.85
NZD/AUD	0.785	0.774	0.777	0.77	0.78	0.78	0.78	0.79	0.79	0.79
NZD/EUR	0.618	0.610	0.613	0.62	0.62	0.62	0.61	0.62	0.64	0.65
NZD/JPY	65.33	59.03	61.10	60.1	60.8	62.3	63.1	63.8	64.6	64.6
NZD/GBP	0.504	0.489	0.497	0.49	0.50	0.50	0.51	0.52	0.52	0.53
NZ TWI	72.5	69.1	70.04	70.4	71.1	71.8	72.2	73.0	74.2	74.6

INTEREST RATES	ACTUAL			FORECAST (END MONTH)						
	Apr-12	May-12	7-Jun	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
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	2.70	2.75	2.57	2.80	2.80	2.80	3.20	3.30	3.30	3.70
NZ 10-yr bond	3.99	3.93	3.33	3.90	4.00	4.00	4.10	4.10	4.20	4.00
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	0.47	0.47	0.47	0.35	0.35	0.35	0.35	0.35	0.35	0.35
AU Cash Rate	4.25	3.75	3.50	3.50	3.25	3.00	3.00	3.00	3.00	3.00
AU 3-mth	4.05	3.88	3.41	3.70	3.50	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)	**0.5**	**0.4**	**0.6**	**0.7**	**0.7**	**0.7**	**0.8**	**0.8**	**0.7**	**0.6**
GDP (% y/y)	**1.3**	**1.4**	**1.8**	**2.2**	**2.4**	**2.7**	**3.0**	**3.1**	**3.1**	**3.0**
CPI (% q/q)	0.5	**0.6**	**0.7**	**0.3**	**0.8**	**0.7**	**0.9**	**0.3**	**0.8**	**0.7**
CPI (% y/y)	1.6	**1.2**	**1.5**	**2.2**	**2.4**	**2.5**	**2.6**	**2.6**	**2.7**	**2.7**
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)	**-4.6**	**-4.8**	**-4.6**	**-4.6**	**-4.7**	**-4.7**	**-4.7**	**-4.8**	**-4.8**	**-4.9**
Terms of Trade (% q/q)	-2.3	**-1.5**	**-0.8**	**-0.3**	**0.2**	**0.1**	**0.2**	**0.1**	**0.2**	**0.2**
Terms of Trade (% y/y)	-2.1	**-5.7**	**-5.9**	**-4.8**	**-2.3**	**-0.8**	**0.2**	**0.6**	**0.5**	**0.7**

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

NEW ZEALAND'S 20 LARGEST EXPORT MARKETS

NZ'S TOP EXPORT MARKETS FOR THE 12 MONTHS ENDED APRIL 2012 (NZ$M)

(NZ$million)	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	India	Malaysia	Indonesia	Hong Kong	Singapore	Taiwan	Philippines	Thailand	Saudi Arabia	Nether-lands	Canada	UAE	Venezuela
Sheepmeat	2,760	6	222	287	59	5	543	296		43		41	12	56	1	5	87	169	106	9	
Beef	1,995	17	15	801	181	132	32	17		20	95	42	45	125	41	7	7	36	119	22	
Other Meat	453	33	14	21	38	27	27	67		5	14	20	6	3	3	2	10	31	4		
Milk Powder	6,728	77	1,626	13	24	16			60	346	285	71	239	164	260	229	259	8		357	519
Butter	2,350	106	209	124	20	27			30	64	61	20	51	50	67	50	116	10	28	38	3
Cheese	1,407	249	78	5	322	113	48			25	47	18	9	28	59	13	48	32		19	10
Whey/Casein	1,839	70	217	743	208	50	4	122	3	24	30	6	55	13	27	1	23	5	30		8
Kiwifruit	1,053	65	85	26	304	74		223	3	12	8	28	10	70	1	6		1	2	4	
Apples	339		1	40			45	46	24	10	5	23	10	18		22		39	6	11	
Other Fruit/Vege	663	324	5	37	152	25	3	4	1	13	2	5	9	14	1	14		1	1	1	
Wine	1,160	371	24	242	12	2	292	7	1	2	1	18	15	1	1	1		29	65	6	
Wool	897	79	416	26	21	2	59	40	37	8	1	7		10		10		1	3	1	
Skins/Hides	588	16	220	3	8	20	6	1	20		9	37		2		7					
Logs	1,591		938		165	290			176					11		4					
Sawn Timber	1,088	330	129	153	88	48	2	2	5	15	26	1	5	32	55	33	21	4	1	11	
Fibreboard/Plywood	388	67	23	15	206	1			4	10	23	1		3	7	1	2		1		
Wood Pulp	626	66	191		82	86			13	22	84		11	22	6	26					
Fish/Seafood	1,485	274	268	145	128	45	14	20	1	9	2	178	39	8	5	28	2	8	14	5	
Crude Oil	2,221	2,171									24										
Aluminium	1,172	91	31	62	627	114	52		18	2	3	14	1	2		2		80	4		
Remainder	15,866	6,134	1,153	1,290	684	486	341	156	538	287	155	327	303	172	207	219	69	144	207	84	4
TOTAL	**46,667**	**10,547**	**5,867**	**4,034**	**3,329**	**1,563**	**1,471**	**1,003**	**933**	**916**	**873**	**857**	**819**	**804**	**742**	**681**	**644**	**599**	**592**	**568**	**544**

NZ MERCHANDISE EXPORTS ANNUAL CHANGE BETWEEN THE 12 MONTHS ENDED APRIL 2012 AND A 12 MONTH SPAN A YEAR EARLIER (NZ$M)

	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	India	Malaysia	Indonesia	Hong Kong	Singapore	Taiwan	Philippines	Thailand	Saudi Arabia	Nether-lands	Canada	UAE	Venezuela
Sheepmeat	-41	-6	68	-7	-4	1	-37	39		-27		2	-3	3		1	1	55	-9	-5	
Beef	-39	2	6	13	-26	-40	-2	-1		7	-30	2	2	-5	4		-3	7	9	4	
Other Meat	10	15	6	1	-5	1	-5	-10		2	-7	4	-2		2		1	10			
Milk Powder	236	7	-276	11	3	10			33	36	75	38	25	-1	-1	-67	-4	6		95	68
Butter	26	14	57	49	-4	4			-30	13	16		9	-34	-24	5		10	15	-5	-1
Cheese	22	-46	10	-9	33	-5	20		-2	-5	-3	-2	-2	-15	10	-1	9	11		-2	-3
Whey/Casein	238	12	53	77	-10	12		23	-2	11		3	12	5	8	-1	1	4	7		3
Kiwifruit	96	11	11	-2	20	16		23	1	2	3	7	1	11		1		1	-2	1	
Apples	-23		1	-14			2	-4	13	2	1	2	2	-12		2		-16		1	
Other Fruit/Vege	80	74	2	6	14	4		1		-12		-1	-4	-2		4		-2			
Wine	68	33	9	10	1		-2	2				2	1	1				4	4	2	
Wool	78	-20	86	5	5	1	-2	4	-8	5				-1		-2				1	
Skins/Hides	101	-1	102	-3	2		4		-9			-5		-2		-1					
Logs	-15		8		-10	-3			-7					-1						-4	
Sawn Timber	-91	-12	-23	-28	-6	3		-1	-2		-2		1	-6	11	3	-6	-8	-1	3	
Fibreboard/Plywood	31		-8	-2	41	-1			-2	3	6			-1	4		-5		-1	-1	
Wood Pulp	-106	-14	-18		-30	-7				-5	-14		7	-12	-2	-9					
Fish/Seafood	-7	-12	53	-38		-2		-25				-25	5	-4	3	12	1	2		2	
Crude Oil	169	258			-76						24		-7			-34					
Aluminium	-85	-21	6	-16	-6	-18	-5	-4								-1		15	-4		
Remainder	431	-25	192	104	-45	13	-19	2	109	82	-66	-2	29	-21	19	37	-10	-39	38		-6
TOTAL	**1,177**	**267**	**343**	**156**	**-104**	**-10**	**-47**	**49**	**93**	**113**	**5**	**26**	**77**	**-97**	**34**	**-51**	**-15**	**58**	**55**	**94**	**61**

NZ MERCHANDISE EXPORTS ANNUAL CHANGE BETWEEN THE 3 MONTHS ENDED APRIL 2012 AND A 3 MONTH SPAN A YEAR EARLIER (NZ$M)

	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	India	Malaysia	Indonesia	Hong Kong	Singapore	Taiwan	Philippines	Thailand	Saudi Arabia	Nether-lands	Canada	UAE	Venezuela
Sheepmeat	-222	-3	18	-15	-10		-28	-23		-4		-2	-3	-1		-1	-13	-4	-13	-1	
Beef	-40		2	20	-4	-32	-6	-5		5	3	3	-4	-7	-1	1		-4	-9	2	
Other Meat	-1	2	3	-1	-3		-2	-2		2		5	-2				1		-1		
Milk Powder	-395	-7	-199	1	2	-2			-18	-2	18	15	7	-23	-33	-26	-44	-2		-2	17
Butter	-183	8	-10	7	-12	-1					-1	-1		-19	-8	-1	-7	1	1	-3	
Cheese	26	-5	4	-2	-4	-3	5			-1	-3	-1		-8	5	-2	10	6		-1	-2
Whey/Casein	30	4	5	-16	3	2			-1	4	-1		3		2		2	2			2
Kiwifruit	-21	1	-5	-3	3	-2		-6				-1		-4							
Apples	-32		1	-2			-1	-5	8			-2	1	-8		1		-14			
Other Fruit/Vege	-3	8	2	1	-12	2				1	-1					-1		-1			
Wine	1	3	1	7			-10	1					1					1			
Wool	-42	-16	1	2	1		-4	-3	-5	1		-1									
Skins/Hides	16	-1	26		1	-1	1		-4			-1									
Logs	-138		-90		-11	-20			-16					-2		1					
Sawn Timber	-4	2	1	-5	-8	-1			-1		-1			-3	5		4	1		3	
Fibreboard/Plywood	4	-1	-3		7					2	2				1		-1				
Wood Pulp	-44	-5	-5		-16	-7				-2	-2		-1	-2	-1	-3					
Fish/Seafood	-11	-1	-6	-15	7	4		-4				14	2			-1			1	1	
Crude Oil	-163	-164			-23						24										
Aluminium	-67	-4	1	-9	-36	-6	-4		-3	1		3						-6			
Remainder	-169	-156	61	26	-22	-46	-19	-2	14	22	-18	7	-6	-12		-8	-4	-15	2		
TOTAL	**-1,455**	**-335**	**-191**	**-4**	**-136**	**-112**	**-69**	**-50**	**-25**	**29**	**21**	**38**	**-3**	**-90**	**-30**	**-42**	**-52**	**-34**	**-20**	**-2**	**17**

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