

17 August 2018



Exports Feeling Full On Food

- NZ primary exports firmly higher than a year ago, via a mixture of volume expansion and higher prices
- Horticulture has been a standout - with wine, apple and kiwifruit exports all trending higher and further growth is expected
- Sheepmeat exports have also been very strong, on the back of positive pricing
- Outlook for primary export categories mixed however
- World growth has been a general support to prices, although some downside risks are now appearing
- A potential El Nino weather pattern also a risk
- Growth in the overall value of NZ goods exports is expected to slow from the past year's 11% pace

For most of NZ's major agricultural industries, global markets are critical. NZ tends to export a large share of its primary production. Here we take a brief look at various industries' recent performance through the export lens. Of course, export growth does not necessarily equate to profitability but it can be a useful barometer.

Horticulture continues to be a strong performer with all three big components in New Zealand's case – wine, apple and kiwifruit – all showing firmly positive trends.

Wine

Exports in the year to June 2018 were 2% higher than a year earlier, driven more by volume than price changes. While not particularly fast growth this year, it does represent the 23rd year of continuous expansion. No mean feat in a competitive market, through the many ups and downs in the world economy over the period, and the natural variability in harvests year-to-year. Annual wine exports are now valued at over \$1.7b. The 2018 grape harvest of 419,000 tonnes was up 6% on a year ago, welcome growth but perhaps a bit disappointing given last year's relatively small harvest. Still, it will help support export volume growth ahead.

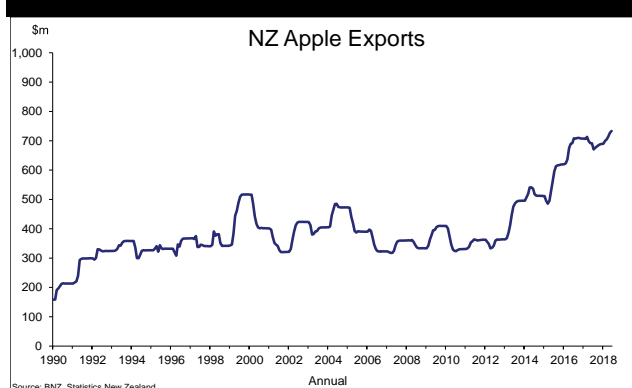
Growth Continues



Apple

Exports continue to perform strongly, building on success over recent years. Export values have pushed to a record high and well through \$700m in the year to June 2018, up 6% on a year ago. Generally buoyant prices combined with increasing volumes of new varieties earning premium prices are underpinning value growth. Further growth is expected, initially as the remainder of the bumper 2018 crop is sold and over time as the industry heads toward \$1b exports on expanding planted area and as more trees come into production.

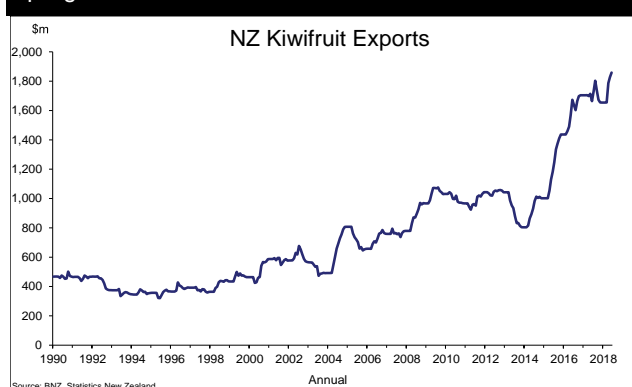
Record Year



Kiwifruit

Exports are trending firmly upwards. Export growth did pause in 2017, following a weather-affected harvest, but are surging higher again in 2018 after an estimated 20% lift in this year's crop. This year's selling season sees export volumes to date running well ahead of last year, at above average prices. This forms part of the value of kiwifruit exports doubling over the past four years, with exports to China now four times what they were four years ago. It's quite remarkable growth, even more so in

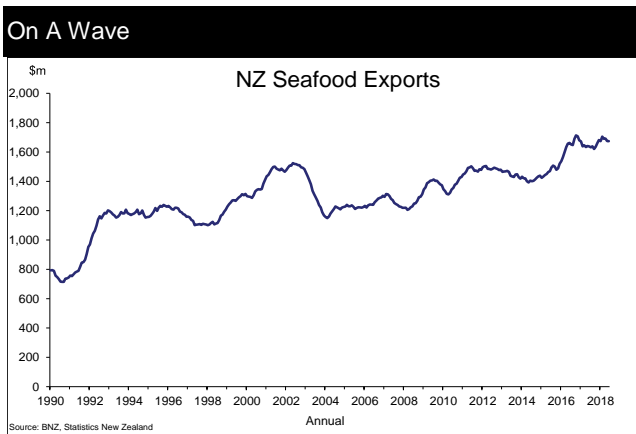
Up Again



the wake of Psa. Exports of \$2 billion are in sight. Expansion is underpinned by the SunGold (G3) variety with its increased plantings, higher yield, and premium pricing – a boon to export performance and orchard performance alike. Further kiwifruit growth is expected over coming years as additional licenses are planned to be released by Zespri and production ramps up from recently issued licenses to meet growing demand.

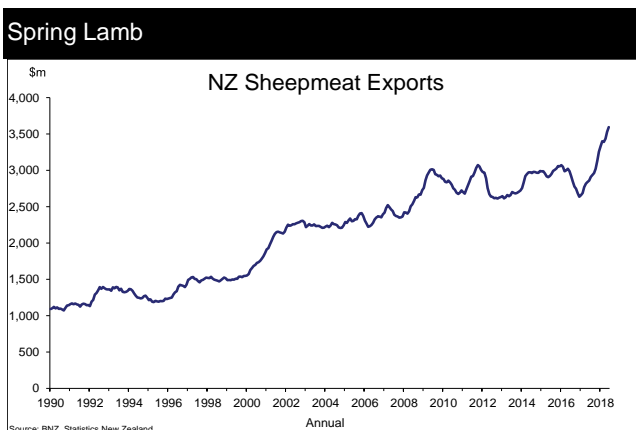
Seafood

Export values were 2% higher in the year to June 2018 compared to the previous year, essentially consolidating gains made in 2015 and 2016. Annual seafood exports are valued around \$1.7b. The export performance reflects buoyant prices offsetting somewhat lower volumes. Some volume growth is anticipated over the coming years, driven by aquaculture which, by the way, now comprises more than 23% of seafood exports up from under 20% five years ago.



Sheepmeat

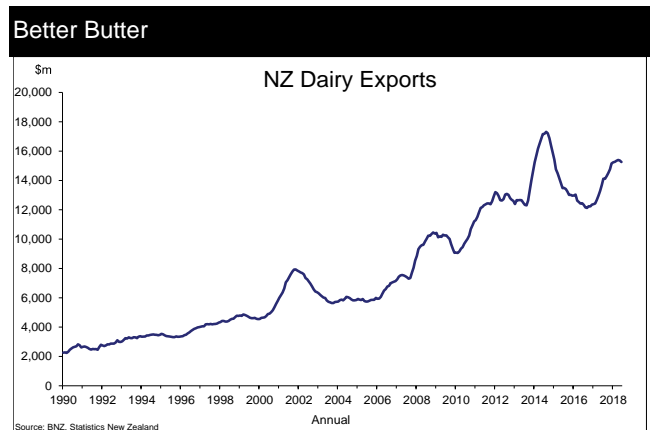
Exports have sprung higher over the past 18 months, lifting by more than a quarter in the past year alone. It's big growth in a big sector and equates to an annual gain of more than \$700m. Higher prices have been the key driver, with lamb production generally restrained. More mutton volume has added support, encouraged by high prices and pockets of adverse weather over the past season. Over the coming year, sheepmeat export values



are expected to be similar to the past year as higher average pricing offsets forecast lower volumes. Lower volume is expected over the coming 12-18 months on our assumption that lamb numbers this spring will be down around 4% on last year along with the possibility of more ewe-lamb retentions. As always, the weather during lambing will have its say on the final count. Meanwhile, mutton volumes are more likely to fall than rise from this season's level. Generally tight global supply is expected to see 2018/19 lamb prices average above the current season's already strong level, as long as demand doesn't slow too much.

Dairy

Export values rose 12% in the year to June 2018, adding to the 10% lift in the prior year. It's a decent rebound from the major slump over the two years before that. The export bounce has been entirely price-driven, with export volumes marginally lower over the past two years in line with weather-restricted milk production. Butter has been a star performer, accounting for nearly two thirds of the dairy export gains over the past year. Despite the recent overall lift, dairy exports remain well shy of their 2014 peak. Exports are expected to show modest growth over the next few years, as prices average below recent peaks and milk production bumps up against environmental constraints. That said, dairy export volumes are expected to lift over the coming year on the assumption that the weather does not hinder milk production as much as it has over recent seasons (watch the El Nino indicators though).



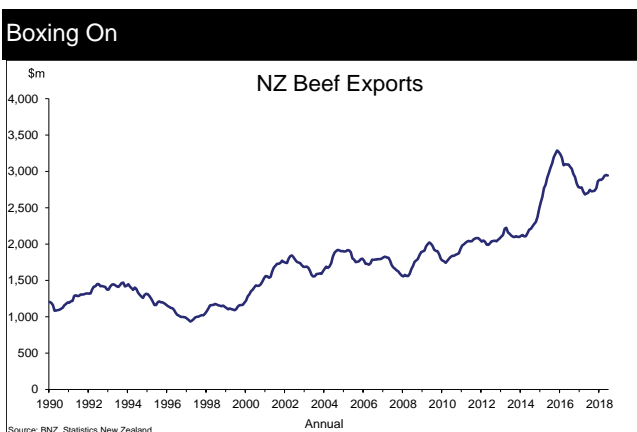
Wool

Exports were 3% higher in the year to June 2018 compared to the previous year, but that year was down nearly a third on the year before that. Overall, wool exports are close to recent lows despite volumes lifting nearly 20% over the past year. The latter was mainly a case of reducing elevated inventory of coarse wool rather than stronger underlying demand, with prices well down over the year. Beyond inventory adjustment, underlying export volume growth is expected to remain subdued on fewer sheep numbers. Coarse wool prices are expected to remain low as current inventory is worked through. A generally weaker NZD, higher oil prices (as an input into competing synthetic fibres), a tightening in underlying supply, and potential new sources of demand offer some possibility of improvement over time.



Beef

Exports in the year to June 2018 were 9% higher than a year ago. This puts exports about halfway between year ago levels and its recent 2015 highs. No record, but not weak either. A bigger bull and cow cull has supported overall volume growth over the past year, while overall pricing has been good. Over the coming year, beef exports are expected to remain close to current levels as modest volume growth is offset by lower prices.



The major food export categories detailed above contributed to the value of total goods exports rising 11% in the year to June 2018 compared to a year earlier. This is well above their previous peak in 2014.

Looking ahead we anticipate the value of total goods exports to grow up circa 4% over the year ahead. While reasonable, it would be below average as some downward pressure comes on prices.

At present, NZ's primary product export prices for all major categories sit above their respective 5-year averages. This is testament to the generally buoyant economic conditions prevailing offshore with unemployment rates trending lower and getting to



outright low levels in some countries. Looking forward, world economic growth is expected to slow over the year ahead, adding some downward pressure to primary product prices. But prices are expected to remain at generally healthy levels.

Rising trade tensions between the US and China, moderating Chinese growth in its own right, and emerging markets coming under pressure – including via a few major central banks tightening monetary policy – pose risks to the global outlook. A sharper slowing in world growth, particularly Chinese growth, than currently anticipated would present downside risk to primary product prices.

Currency movements will also be important. A recently lower NZD (not unrelated to the above risks) would offer price support if it were to persist. It is not just the NZD that's worth following. For example, the USD is important for offshore pricing, the CNY relevant for Chinese purchasing power, and EUR relevant for European purchasing power and competitor pricing.

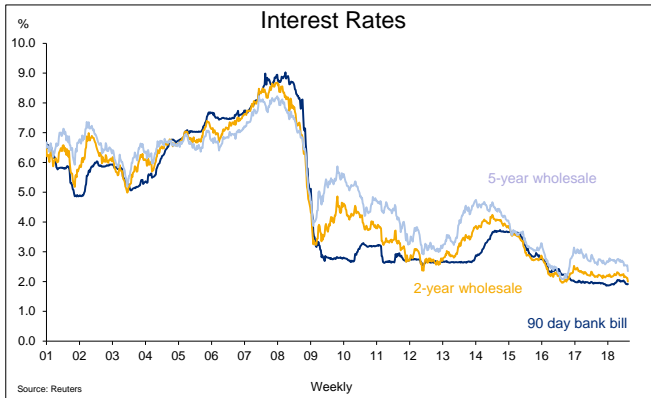
Near term primary product export volume risks mainly revolve around the weather and the elevated chance of an El Nino weather pattern this spring/summer. Dry conditions would, in the first instance, see less milk and more meat processing with flow on influences to exports.

For the external accounts as a whole, it's worth noting that while export value growth may be reasonable over the coming year it is expected to be shy of the anticipated near 8% growth in goods imports over the period such that the goods trade balance is expected to deteriorate further. An expected bigger services trade balance will be an offset, but we don't think enough to stop the current account deficit pushing a bit wider to beyond 3% of GDP before too long.

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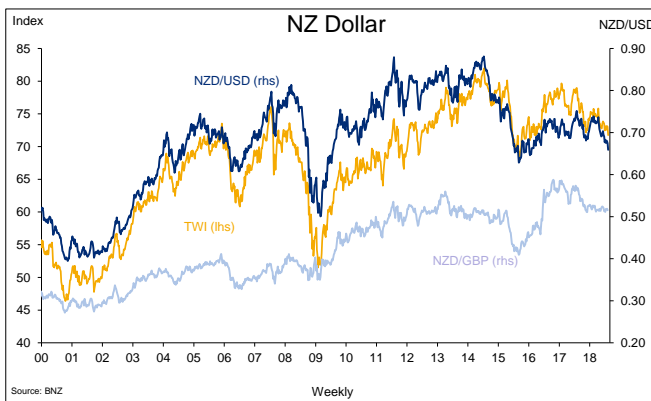
Key Macro Drivers for Commodity Producers

Interest Rates



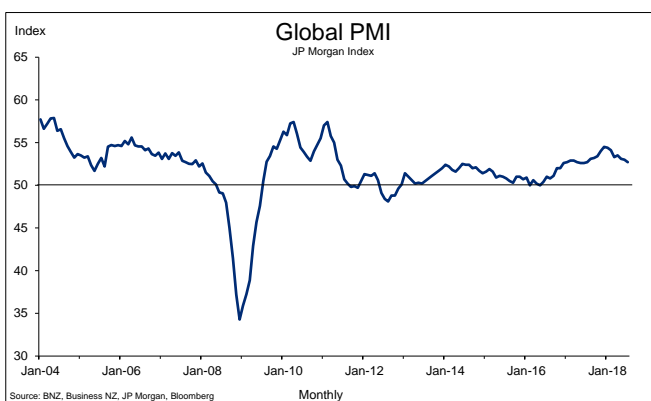
At its August Monetary Policy Statement, the Reserve Bank held the Official Cash Rate (OCR) at 1.75%. However, the new guard at the RBNZ is starting to reveal its true colours as it tilted towards a greater fear of lower growth than of higher inflation. Moreover, the messaging from the Bank seems to suggest that it will use the full flexibility of its inflation target range in setting policy. Consequently, a move in inflation above 2.0% need not necessarily result in a higher cash rate. Accordingly, we see the OCR staying steady for at least the next 12 months. Short-term fixed rates should be anchored this year by an on-hold OCR. The RBNZ has indicated that if growth doesn't pick up then rate cuts are possible. Thus the 'premium' to put on short-term rate hedges is now very low. We expect longer-term NZ fixed rates to be range-bound through the rest of this year.

Foreign Exchange



The NZD is under pressure. Weakening domestic growth was already weighing on the NZD especially as this was being accompanied by some downward momentum in commodity prices. Very soft business confidence indicators exacerbated this trend. Then, the RBNZ's surprise dovishness saw a marked drop in support for the local currency. To cap things off, some emerging market turmoil resulted in peripheral currencies (of which the NZD is one) taking another leg down. There is a good chance that the currency has over-reacted to these events so may bounce back from current levels. However, more generally, the global backdrop – including US-China tariff angst and the Reserve Bank's reluctance to increase interest rates – is likely to weigh on the currency for some time to come.

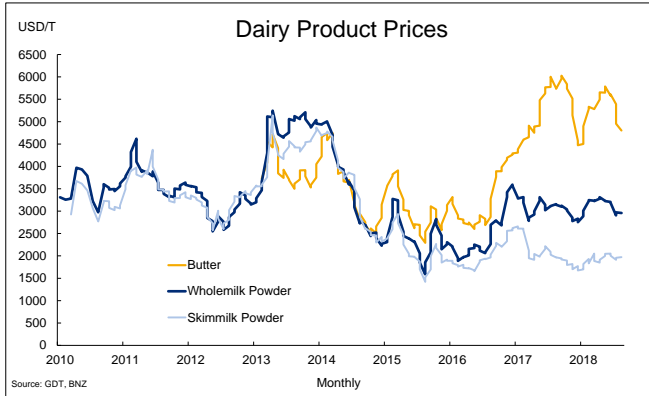
Global Growth



Worries about the global outlook continue to rise as: the threat of a trade war increases; Chinese growth moderates; and Emerging Markets struggle to maintain momentum. Despite this, global inflation is still rising, encouraging the major central banks to tighten monetary policy by reducing (or reversing) quantitative easing and/or raising interest rates. This in turn puts further downward pressure on global activity. Not surprisingly, then, New Zealand trading partner growth is also drifting lower. Growth for calendar 2018 is forecast to be 3.8%, slowing to 3.7% in 2019 and 3.3% in 2020. This should be sufficient to provide reasonable support to primary product prices, although downside risks loom larger than upside.

Key Commodities

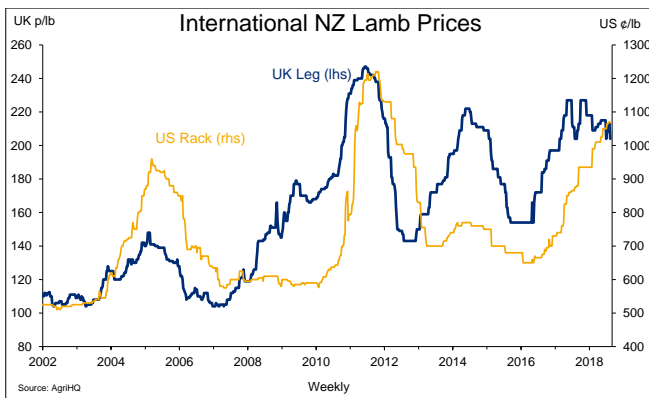
Dairy



Global dairy prices have eased around 9% since the start of the new season. Slower Chinese growth and a weaker Yuan appear to have curbed Chinese demand, while large EU skimmilk powder stockpiles continue to weigh on prices. Fonterra has nudged down its 2017/18 milk price forecast by 5c to \$6.70. Slower global growth suggests further downside risk to global dairy prices although generally underwhelming global milk supply and many lingering weather concerns may offer some price support. A lower NZD will help domestic prices. Fonterra's \$7.00 milk price forecast for 2018/19 looks too optimistic at this stage. But it remains early days. Our forecast remains at \$6.60, with a touch more downside than upside risk.

	Current	Month ago	Year ago	Next 12 months
Whole milk powder (US \$/t)	2950	2900	3175	→

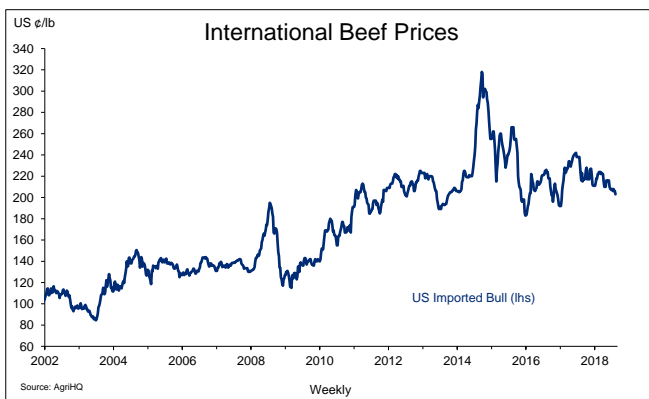
Lamb



Lamb prices remain strong and are largely expected to stay that way into next season. NZ supply looks set to remain tight, supporting prices. Lower breeding ewe numbers sees Beef+Lamb's 2018 initial lamb crop estimate nearly 4% lower than last season. Demand has been strong but seems a little less assured ahead as Chinese and world growth slows and some questions around EU and UK demand creep in. Brexit negotiations remain a wildcard. Current pricing suggests next season's average may edge above the current season's lofty average, even if prices ease a touch from here.

	Current	Month ago	Year ago	Next 12 months
Lamb leg (UK p/lb)	204	209	204	↓

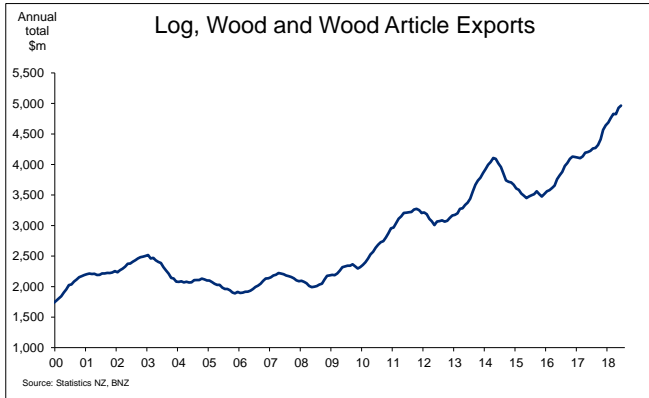
Beef



US beef prices are at reasonable levels, but have drifted lower over recent months. US demand still looks firm, underpinned by a booming economy, but supply has more than kept pace following prior herd rebuilding and accelerated by dry conditions in some areas. More supply from the US, Australia, and Brazil bring downside risks to international prices (including in key Asian markets), not so much the extra supply from NZ on account of Mycoplasma bovis. Current indicators suggest average prices for next season are likely to be lower than the current season, although a lower NZD/USD will offer support.

	Current	Month ago	Year ago	Next 12 months
Imported bull (US \$/lb)	203	206	216	↓

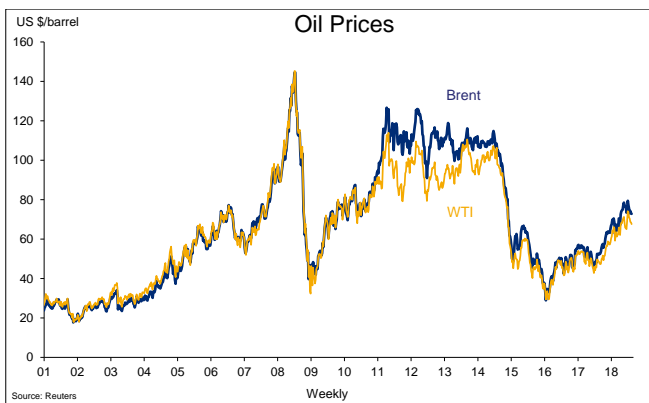
Forestry



The annual value of log, wood, and wood article exports has increased by well over \$1b in the past two years, a function of both firm pricing and very strong volume growth. Export values have lifted 20% in the past year alone. China has been the key driver, now accounting for more than half of these NZ exports. The lower NZD is helping support exports. For all the positives, the quarter-to-quarter progress hints a levelling off may be starting. Even if that is the case, it is at strong level. The AgriHQ Log Price Index remained close to a record high in July and 4.5% up on a year ago.

	Current	Month ago	Year ago	Next 12 months
S1/S2 log price (NZ \$/t)	136	135	124	➔

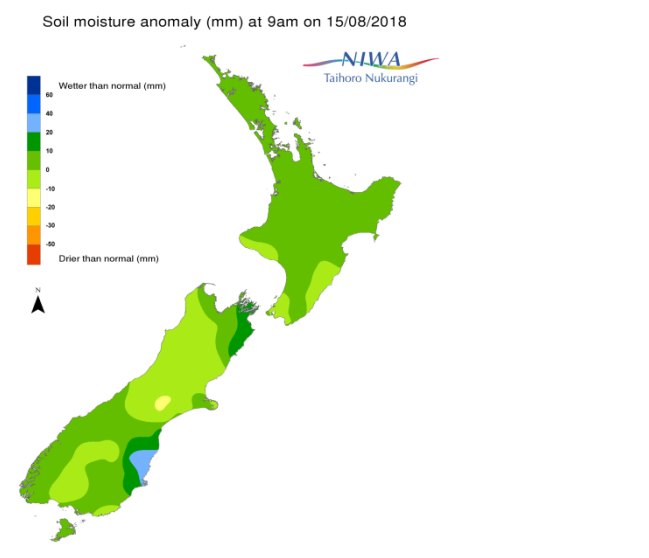
Oil



After testing \$US80/bbl in May, Brent crude oil prices have generally eased to now sit in the low \$US70s. OPEC increased its output in July, while slowing global growth is raising questions around oil demand. A strengthening US dollar has also contributed to pushing oil prices lower. Oil prices are now testing the bottom of the \$US70 to \$US80 range they have been in over the past four months. Despite this, NZ fuel prices have continued to push higher as a result of higher taxes and a lower NZD.

	Current	Month ago	Year ago	Next 12 months
Brent Crude (US \$/b)	73	75	52	➔

Soil Moisture Deficit (mm)



July was warmer than usual across much of the country, but especially in the South Island. Rainfall has been much more varied. Soil moistures are generally a bit above average. The near term outlook looks relatively benign. Most focus is on the possibility of an El Nino weather pattern developing through spring and summer. NIWA reports the consensus of international models gives a 55% chance of El Nino developing through to October increasing to 78% looking into February through April next year. The details remain uncertain at this point, but NIWA say the indications so far are that it is unlikely to be in the strong category. Every El Nino is different. Even weak El Ninos have dented pastoral agriculture production in the past. Keep watch. Of course, it doesn't have to be El Nino to get dry – just look across the Tasman at New South Wales and parts of Queensland.

Quarterly Forecasts

Forecasts as at 17 August 2018

Key Economic Forecasts

Quarterly % change unless otherwise specified

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
GDP (production s.a.)	0.8	0.9	0.6	0.6	0.5	0.8	0.7	0.9	0.5	0.7
Retail trade (real s.a.)	1.5	1.8	0.3	1.4	0.1	0.2	1.2	1.2	0.7	0.6
Current account (ytd, % GDP)	-2.6	-2.6	-2.5	-2.7	-2.8	-3.0	-3.4	-3.5	-3.3	-3.4
CPI (q/q)	1.0	0.0	0.5	0.1	0.5	0.4	0.8	0.4	0.6	0.5
Employment	1.1	-0.1	2.2	0.4	0.6	0.5	0.5	0.5	0.6	0.5
Unemployment rate %	4.9	4.8	4.6	4.5	4.4	4.5	4.4	4.3	4.2	4.2
Avg hourly earnings (ann %)	1.1	1.2	2.0	3.1	4.0	3.3	3.4	3.5	3.3	4.0
Trading partner GDP (ann %)	3.5	3.7	4.0	3.9	4.0	3.9	3.7	3.8	3.7	3.7
CPI (y/y)	2.2	1.7	1.9	1.6	1.1	1.5	1.8	2.1	2.2	2.3
GDP (production s.a., y/y)	3.0	2.8	2.6	2.9	2.7	2.6	2.7	3.0	3.0	2.8

Interest Rates

Historical data - qtr average

Forecast data - end quarter

	Cash	Government Stock			Swaps			US Rates		Spread
		90 Day	5 Year	10 Year	2 Year	5 Year	10 Year	Libor	US 10 yr	NZ-US
		Bank Bills						3 month		Ten year
2017 Jun	1.75	1.95	2.45	2.95	2.25	2.80	3.25	1.25	2.20	0.75
Sep	1.75	1.95	2.45	2.95	2.20	2.70	3.20	1.30	2.20	0.75
Dec	1.75	1.90	2.35	2.90	2.20	2.65	3.15	1.60	2.40	0.40
2018 Mar	1.75	1.90	2.40	2.95	2.20	2.70	3.20	2.20	2.85	0.10
Jun	1.75	2.00	2.35	2.90	2.25	2.70	3.15	2.35	2.90	-0.06
Forecasts										
Sep	1.75	2.00	2.45	2.95	2.25	2.75	3.25	2.30	3.10	-0.15
Dec	1.75	2.00	2.60	3.10	2.40	2.90	3.40	2.55	3.25	-0.15
2019 Mar	1.75	2.10	2.70	3.20	2.55	3.00	3.50	2.75	3.25	-0.05
Jun	1.75	2.35	3.00	3.45	2.85	3.00	3.50	3.10	3.50	-0.05
Sep	2.00	2.60	3.20	3.60	3.10	3.00	3.50	3.35	3.50	0.10
Dec	2.25	2.85	3.35	3.70	3.35	3.30	3.75	3.35	3.50	0.20
2020 Mar	2.50	3.10	3.45	3.80	3.50	3.30	3.75	3.10	3.50	0.30
Jun	2.75	3.25	3.60	3.80	3.50	3.30	3.75	3.10	3.50	0.40
Sep	2.75	3.25	3.60	3.80	3.50	3.50	3.90	3.10	3.50	0.40

Exchange Rates (End Period)

USD Forecasts

	NZD/USD	AUD/USD	EUR/USD	GBP/USD	USD/JPY
Current	0.66	0.73	1.14	1.28	111
Sep-18	0.69	0.73	1.15	1.32	109
Dec-18	0.70	0.75	1.18	1.38	110
Mar-19	0.70	0.75	1.22	1.45	108
Jun-19	0.71	0.75	1.22	1.47	106
Sep-19	0.71	0.75	1.25	1.53	104
Dec-19	0.70	0.75	1.30	1.55	102
Mar-20	0.70	0.75	1.32	1.55	100
Jun-20	0.69	0.74	1.34	1.57	99
Sep-20	0.69	0.74	1.36	1.60	98
Dec-20	0.68	0.73	1.38	1.60	98

NZD Forecasts

	NZD/USD	NZD/AUD	NZD/EUR	NZD/GBP	NZD/JPY	TWI-17
Current	0.66	0.90	0.58	0.52	72.9	71.7
Sep-18	0.69	0.94	0.60	0.52	74.7	74.1
Dec-18	0.70	0.93	0.59	0.51	77.0	74.7
Mar-19	0.70	0.93	0.57	0.48	75.6	73.8
Jun-19	0.71	0.94	0.58	0.48	75.3	74.2
Sep-19	0.71	0.94	0.57	0.46	73.8	73.5
Dec-19	0.70	0.93	0.54	0.45	71.4	72.0
Mar-20	0.70	0.93	0.53	0.45	70.0	71.6
Jun-20	0.69	0.93	0.52	0.44	68.3	70.6
Sep-20	0.69	0.93	0.51	0.43	67.6	70.4
Dec-20	0.68	0.93	0.49	0.43	66.6	69.6

TWI Weights

14.0% 20.7% 10.3% 4.8% 6.8%

Source for all tables: Statistics NZ, Bloomberg, Reuters, RBNZ, BNZ

Forecasts

Forecasts as at 17 August 2018	March Years					December Years				
	Actuals		Forecasts			Actuals		Forecasts		
	2017	2018	2019	2020	2021	2016	2017	2018	2019	2020
GDP - annual average % change										
Private Consumption	5.5	3.8	2.9	2.4	1.7	5.1	4.4	2.8	2.6	1.8
Government Consumption	1.9	4.9	2.1	1.8	1.7	1.6	4.6	2.7	1.8	1.7
Total Investment	5.6	3.9	4.7	3.7	3.8	6.4	3.5	4.8	4.1	3.6
Stocks - ppts cont'n to growth	-0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.3	-0.1	0.0
GNE	4.8	4.0	3.4	2.6	2.2	4.7	4.2	3.7	2.7	2.2
Exports	0.7	3.9	3.6	4.3	4.0	1.6	2.3	3.4	4.6	4.0
Imports	5.1	7.0	5.2	3.5	2.2	3.4	6.7	6.3	3.7	2.4
Real Expenditure GDP	3.6	3.1	2.8	2.8	2.7	4.1	3.0	2.7	2.9	2.7
GDP (production)	3.7	2.7	2.8	2.7	2.7	4.0	2.8	2.7	2.8	2.7
<i>GDP - annual % change (q/q)</i>	3.0	2.7	3.0	2.6	2.8	3.4	2.9	3.0	2.6	2.8
Output Gap (ann avg. % dev)	1.4	0.9	0.9	0.7	0.4	1.4	1.0	0.9	0.8	0.5
Household Savings (% disp. income)	-2.8	-1.8	-2.8	-2.6	-1.8					
Nominal Expenditure GDP - \$bn	270.3	286.4	299.0	315.4	327.9	266.1	283.4	294.9	311.6	325.1
Prices and Employment - annual % change										
CPI	2.2	1.1	2.2	2.1	2.1	1.3	1.6	2.1	1.9	2.1
Employment	5.7	3.1	2.1	1.6	1.6	5.8	3.7	2.1	1.9	1.6
Unemployment Rate %	4.9	4.4	4.2	4.3	4.2	5.3	4.5	4.3	4.2	4.2
Wages - ahote	1.1	4.0	3.3	3.4	2.8	1.1	3.1	3.5	3.5	3.0
Productivity (ann av %)	-1.9	-0.8	-0.2	0.8	1.2	-0.8	-1.4	-0.5	0.6	1.1
Unit Labour Costs (ann av %)	3.8	3.9	3.7	2.8	2.2	2.7	4.0	4.2	2.9	2.3
External Balance										
Current Account - \$bn	-7.2	-7.9	-9.9	-10.1	-11.7	-6.0	-7.7	-10.4	-10.5	-11.1
Current Account - % of GDP	-2.6	-2.8	-3.3	-3.2	-3.6	-2.2	-2.7	-3.5	-3.4	-3.4
Government Accounts - June Yr, % of GDP										
OBEGAL (core operating balance)	1.5	1.2	1.0	1.5	1.5					
Net Core Crown Debt (excl NZS Fund Assets)	21.7	20.8	20.6	19.7	18.3					
Bond Programme - \$bn	8.0	8.0	8.0	9.0	9.0					
Bond Programme - % of GDP	3.0	2.8	2.7	2.9	2.7					
Financial Variables ⁽¹⁾										
NZD/USD	0.70	0.73	0.70	0.70	0.68	0.70	0.70	0.70	0.70	0.68
USD/JPY	113	106	108	100	98	116	113	110	102	98
EUR/USD	1.07	1.23	1.22	1.32	1.38	1.05	1.18	1.18	1.30	1.38
NZD/AUD	0.92	0.94	0.93	0.93	0.93	0.96	0.91	0.93	0.93	0.93
NZD/GBP	0.57	0.52	0.48	0.45	0.43	0.56	0.52	0.51	0.45	0.43
NZD/EUR	0.66	0.59	0.57	0.53	0.50	0.67	0.59	0.59	0.54	0.49
NZD/YEN	79.1	77.0	75.6	70.0	66.6	81.6	78.7	77.0	71.4	66.6
TWI	76.5	74.8	73.8	71.6	70.1	78.1	73.6	74.7	72.0	69.6
Overnight Cash Rate (end qtr)	1.75	1.75	1.75	2.50	2.75	1.75	1.75	1.75	2.25	2.75
90-day Bank Bill Rate	1.98	1.93	2.08	3.08	2.92	2.02	1.88	2.00	2.83	3.17
5-year Govt Bond	2.70	2.35	2.70	3.45	3.55	2.75	2.30	2.60	3.35	3.60
10-year Govt Bond	3.25	2.95	3.20	3.80	3.95	3.30	2.80	3.10	3.70	3.95
2-year Swap	2.30	2.25	2.55	3.50	3.40	2.40	2.20	2.40	3.35	3.50
5-year Swap	3.00	2.70	3.00	3.75	3.85	3.00	2.65	2.90	3.65	3.90
US 10-year Bonds	2.50	2.85	3.25	3.50	3.50	2.50	2.40	3.25	3.50	3.50
NZ-US 10-year Spread	0.75	0.10	-0.05	0.30	0.45	0.80	0.40	-0.15	0.20	0.45

⁽¹⁾ Average for the last month in the quarter

Source for all tables: Statistics NZ, EcoWin, Bloomberg, Reuters, RBNZ, NZ Treasury, BNZ

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