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Media Release
November 16, 2006

Strong future growth for NZ dairy lies in developing markets – industry report

Despite a softening of global dairy prices from the highs of 2005, the outlook for New Zealand's dairy exports remains resoundingly positive according to a newly released report by Rabobank, the world's leading speciality food and agribusiness bank.

Growth, however, is likely to be outside of the traditional markets, driven by developing countries with increasing affluence moving towards more westernised diets and recognition of the health benefits of dairy products.

Report author Hayley Moynihan, Senior Analyst, Rabobank Food and Agribusiness Research, says the past ten years have been a 'honeymoon' period for the New Zealand dairy industry – with dairy conversions, record production levels, the formation of Fonterra and the emergence of new processors, topped off more recently by stellar international commodity prices.

"From 2002 to 2005, dairy commodity prices doubled in US dollar terms. While prices have eased by around five to ten per cent in 2006, and the impact on New Zealand dairy farmers has been compounded by the effects of the high dollar, we see many very positive indicators for the industry in world markets," she says.

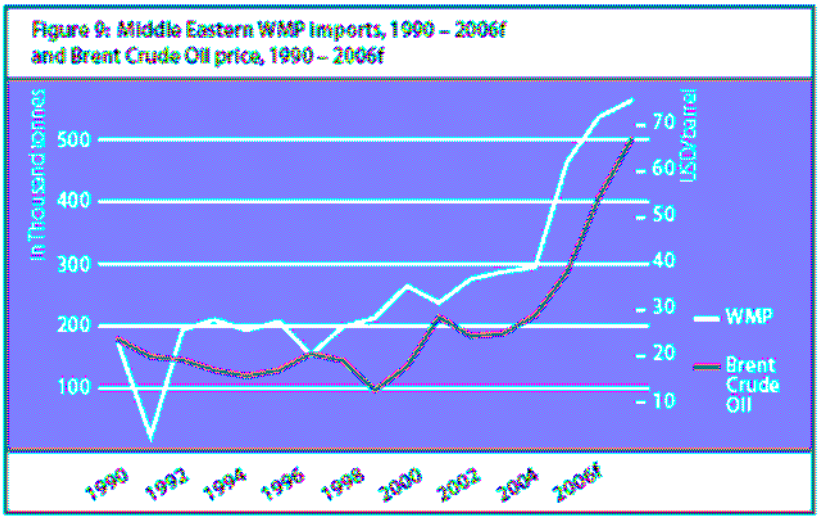
Buoyant economic growth continues to bolster demand for dairy products. Rabobank is anticipating growth of around three per cent per annum in the global market over the medium term.

The interesting question, says the report, is where production will come from to supply this growing global demand. The European Union has changed the structure of subsidy payments to farmers, resulting in stable production. Australia is battling with drought and this is restricting expansion. Even in New Zealand farmers are facing challenges, including high land prices and the options surrounding their Fonterra shareholding when increasing production. This may open the way for newer exporters, such as Argentina or even the Ukraine.

"Another factor that has changed significantly is the level of stocks held in the European Union and United States. In 2003, this amounted to over one million tonnes of butter and skim milk powder. In 2006 this volume has been reduced to less than 100,000 tonnes. Future demand now has to be met from fresh supply growth," says Ms Moynihan.

Rising oil prices have also had a positive impact for New Zealand's exports. The resulting increase in wealth in the Middle East has seen this region grow to account for 18 per cent of total dairy exports, primarily comprising whole milk powder (WMP) and smaller amounts of butter and cheese. Over 25 per cent of WMP and 24 per cent of butter exported from New Zealand is now destined for the Middle East. Total sales to this region exceeded NZD1 billion for the first time in the year ended June 2006.

"As oil income drives wealth, people are consuming more dairy products. There appears to be a strong correlation between WMP imports to the Middle East and oil prices. Domestic production in the Middle East is increasing, but this is not expected to keep pace with demand growth. Rabobank expects demand for dairy products from this region and North Africa to grow at around five per cent per annum through to 2010," says Ms Moynihan.

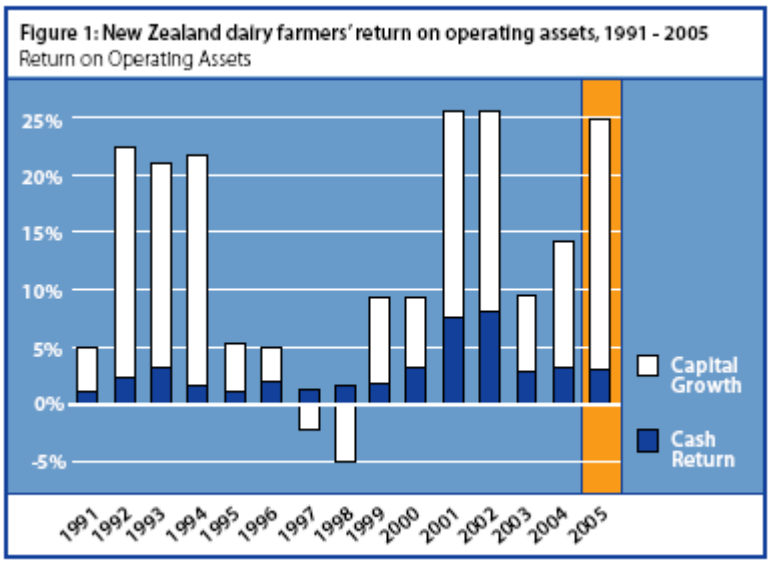


Source: FAOStat, EIA, EuroStat, Statistics New Zealand, USDA, Rabobank, 2006

The Rabobank report says New Zealand is in an excellent position to grow its share of emerging markets, not only in the Middle East, but Asia as well. Total milk production in New Zealand has increased by five per cent per annum, on average, over the past 10 years, driven by advances in farming systems and technologies, improved pasture management, genetics and cheaper land converted in the South Island. The challenge is to keep up the momentum.

There is strong evidence to show that operating profitability has not been the key driver for dairy farm investment in New Zealand. Capital gain has far outweighed cash returns over the past seven years. Dairy farm investment has been oriented towards changing land use, land development and increasing the productive value of dairy farm units. Cash returns have remained important, but with a lower priority.

High capital investment costs and rising operational costs are now forcing dairy farmers to refocus on cash returns, Ms Moynihan says



Source: Dexcel Economic Survey of New Zealand Dairy Farmers 2004-05, Rabobank, 2006

"We are seeing changes to on-farm systems, including the increasing use of feed supplements to cover short term feed deficits. We are unlikely to see a widespread move to intensive systems; however, the strategic use of supplements will increase. This adds flexibility and decreases risk in the production system," she says.

"Seasonal fluctuations, labour availability and environmental issues are three of the most challenging aspects of dairy farming in New Zealand. The farmer or investor who can tackle these areas with skill will find that many doors remain open for growth and prosperity in the New Zealand dairy sector".

Rabobank New Zealand is a part of the international Rabobank Group, the world's leading specialist in food and agribusiness banking. Rabobank has more than 100 years' experience providing customised banking and finance solutions to businesses involved in all aspects of food and agribusiness. Rabobank has a AAA credit rating and is ranked the world's safest private bank by Global Finance magazine. Rabobank operates in 38 countries, servicing the needs of more than nine million clients worldwide through a network of more than 1500 offices and branches. Rabobank New Zealand is one of the leading rural lenders and a significant provider of business and corporate banking and financial services to the New Zealand food and agribusiness sector. The bank has 29 branches throughout New Zealand.

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