

ANZ FOCUS

GREENER PASTURES

The Global Soft Commodity Opportunity for Australia and New Zealand

Greener Pastures: The Global Soft Commodity Opportunity for Australia and New Zealand is the third report in the ANZ insight series and was researched and completed by Port Jackson Partners. The following document, prepared by ANZ, provides a summary of the report.

SUMMARY

Strong agricultural demand combined with growing supply constraints are driving an enormous opportunity for agricultural trade. Australia and New Zealand stand to capture an additional A\$0.7–1.7 trillion and NZ\$0.5–1.3 trillion respectively in agricultural exports between now and 2050 if targeted actions can be taken.

- > Both countries could more than double the real value of annual agricultural exports by 2050. This would result in an additional A\$710 billion and NZ\$550 billion of revenues in 2011 dollars for Australia and New Zealand respectively over the next four decades.
- > However, both countries face significant headwinds and seizing the prize will not happen of its own accord.
- > Australia and New Zealand have fostered a host of successful agricultural industries at various points in time but agriculture in both countries faces numerous challenges. Many industries in Australia have lost momentum over the past decade, while New Zealand is heavily reliant on its dominant dairy industry which has issues of its own.
- > Maximising growth will require overcoming capital constraints, skill shortages, land and water use conflicts, un-coordinated R&D and extension services, rising supply chain costs and market access limitations.
- > An annual capital gap of \$A9 billion and NZ\$2 billion already exists today. Agriculture in Australia and New Zealand will need to find innovative ways to attract domestic and foreign investment between now and 2050:
 - **A\$600 billion** and **NZ\$210 billion** in capital investment will be needed to enable production growth
 - A further **A\$400 billion** and **NZ\$130 billion** will be needed to support farm turnover.
- > Leadership and commitment from all stakeholders will be critical in unlocking the full potential of Australian and New Zealand agriculture.

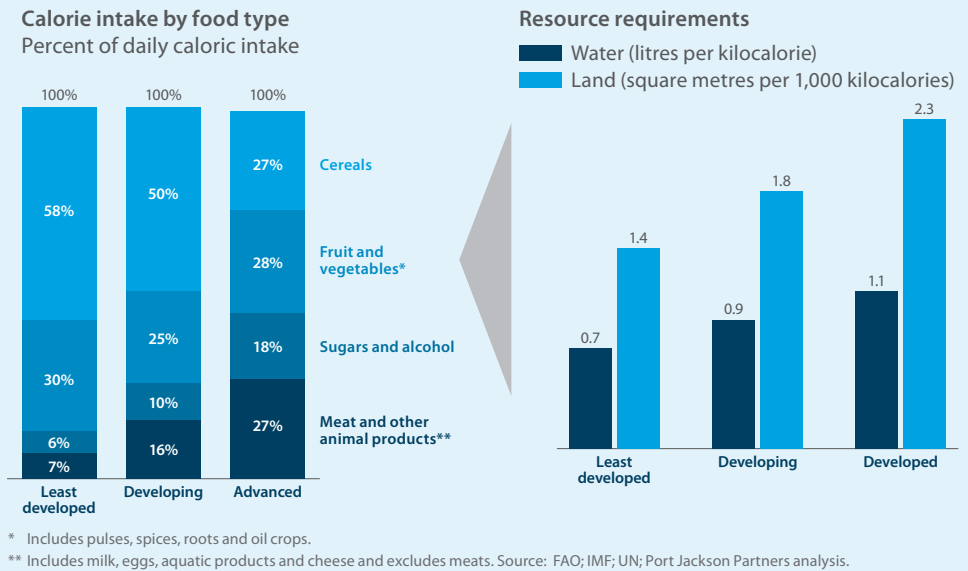
BECOMING A FOOD BOWL OF ASIA: OPPORTUNITY AND CHALLENGE

- > The continuing shift of economic growth from the developed world to the developing world is driving an enormous opportunity for agriculture in Australia and New Zealand.
- > In the five years to 2010, the developing world accounted for almost three quarters of global growth. The result has been a surge in demand for the basic materials necessary to support industrialisation and urbanisation, particularly in Asia.
- > At the same time, the new-found wealth of the developing world and rising incomes are leading to **increased calorie consumption** and higher protein diets (See Figure 1). This and population growth will see the world demand at least 60% more agricultural output by 2050 compared to 2005-07. If biofuel uptake and the economic growth of developing countries accelerate, demand for agricultural products could more than double over the same period.
- > Little or no new land and water is coming into production, and some is being withdrawn, with supply unbalanced across the world. Improvements in productivity can boost production but recent trends suggest this alone may not be enough to fill the gap.
- > Demand for many agricultural products has already begun to outstrip supply resulting in periods of high global food prices in recent years. This is in contrast to the experience of the 20th century where commodity surpluses dominated global trade discussions.
- > In the face of these shifts, some are predicting that Australia and New Zealand could become a food bowl for a developing Asia.

BECOMING A FOOD BOWL OF ASIA: OPPORTUNITY AND CHALLENGE (continued)

- > The relative scarcity of agricultural land and water in major growth markets, particularly in Asia, is central to the opportunity for Australia and New Zealand.
- > In light of the increasingly affluent and discerning global middle class, there are also a number of opportunities for Australia and New Zealand to capture price premiums. This includes expanding the production of differentiated commodity products and, in some cases, manufacturing value-added products for export markets albeit in niche areas. Coupled with an expectation that global food prices will remain high over the coming years, increased revenue per unit of production should be achievable.

Figure 1. Higher income diets are more resource intensive



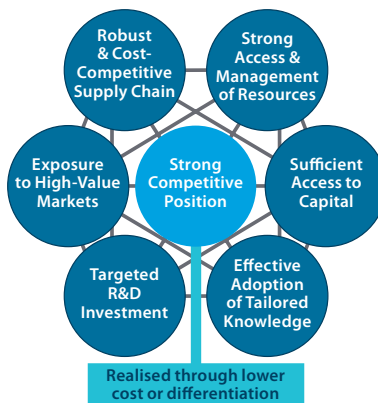
AGRICULTURE IN AUSTRALIA AND NEW ZEALAND FACES SIGNIFICANT HEADWINDS – SEIZING THE PRIZE WILL NOT HAPPEN OF ITS OWN ACCORD

- > Capturing the prize will not happen of its own accord. Success depends on the agricultural sectors in each country addressing the key issues that are hindering performance and holding back potential growth. International competitiveness in agriculture is about more than just having access to good land and rainfall.
- > It is about developing connected and mutually reinforcing areas of high capability where extremely efficient supply chains exist side by side. For this to occur there needs to be top R&D capability, innovative financing, clear strategic vision and productive profitable farms with the requisite scale, organisation, financial acumen, funding and skills.
- > These are the platforms that have seen Brazil sweep aside global competition to capture the market for soy-bean; Malaysia and Indonesia dominate the production and marketing of palm oil; while New Zealand has created and consistently grown a globally successful dairy industry.
- > This kind of success, based on clusters of highly competitive activities, has not emerged in Australian agriculture in any substantial way for some years; nor in New Zealand outside the dairy sector.

- > Future success requires a systematic focus on fostering globally competitive industries with high potential for growth. This will require the support of highly interconnected service providers including supply chain players, R&D organisations, educational institutions and financiers. When guided by the right strategies, these clusters deliver innovation and competitiveness that is realised through lower cost structures, reliable supply, consistent quality and customer-focused product differentiation (See Figure 2).

Figure 2. There is already a global race to capture the opportunity

What does Australian agriculture need to achieve a competitive advantage?



OVERCOMING HURDLES TO POSITION AUSTRALIA AND NEW ZEALAND TO SEIZE THE OPPORTUNITY

- Although the recent period of drought in Australia was severe, it would be a mistake to attribute poor recent performance to adverse climate impacts alone. Similarly, sustained farm conversions to dairy farming in New Zealand should not mask the fact that many other major industries, including red meat, lack scale and have not performed to their full potential. Closer scrutiny reveals many issues have not received sufficient attention and have now put at risk the international competitive positions of agricultural industries in both countries (See Figure 3).
- Signs that great industries are losing momentum are often subtle, particularly during times of surging commodity prices. Agriculture in Australia has been understandably pre-occupied with survival during the recent drought. However, there is an urgent need for Australia and New Zealand to overcome a series of growth-limiting hurdles.
- Positive progress has been made in recent years to recognise and address some of these challenges, but in many ways the task has only just begun and more needs to be done.

OVERCOMING HURDLES TO POSITION AUSTRALIA AND NEW ZEALAND TO SEIZE THE OPPORTUNITY (continued)

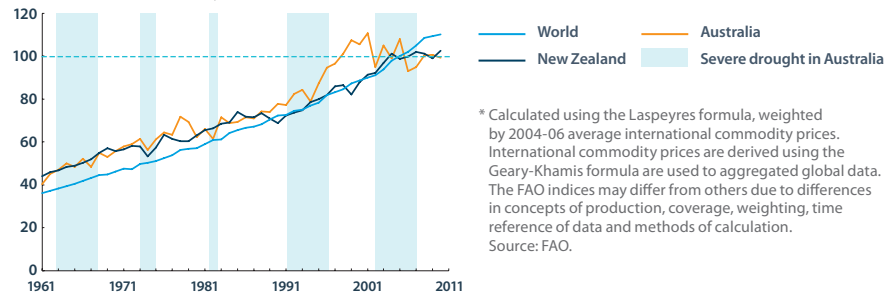
- Many farmers are aware there is a significant opportunity on offer, however a number of growth limiting hurdles have been in their way.
- These hurdles have not just been at the farm gate level and action to address these needs everyone to be aligned.

GROWTH LIMITING HURDLES

- 1. Sourcing capital:** Farmers face significant challenges in raising sufficient capital to fund growth and support farm turnover. Farm debt levels are already high and few external sources of equity capital are available to farmers, particularly in Australia. New structures for owning and operating farms need to be encouraged to attract investment from domestic and foreign investors and capital markets. These structures might include rapidly evolving equity partnerships, modern variants of share farming and use of off-take agreements, as used in the mining sector.
- 2. Attracting skilled labour:** Labour force shortages have intensified. Widespread skill shortages across supply chains and succession concerns associated with an ageing farmer population need to be addressed by boosting the image of agriculture, attracting new workers and enhancing education platforms (See Figure 4).
- 3. Accessing land and water:** Land-use conflicts are an ongoing issue and many regions in both countries still lack clear and efficient water markets. As natural resources inputs become increasingly scarce, resource management should be improved by optimising land use and making better use of each litre of water.

Figure 3. Australia and New Zealand have lost momentum

Gross Agricultural Production – Australia, New Zealand and the World
Production volume index*, Index 2004-2006 = 100

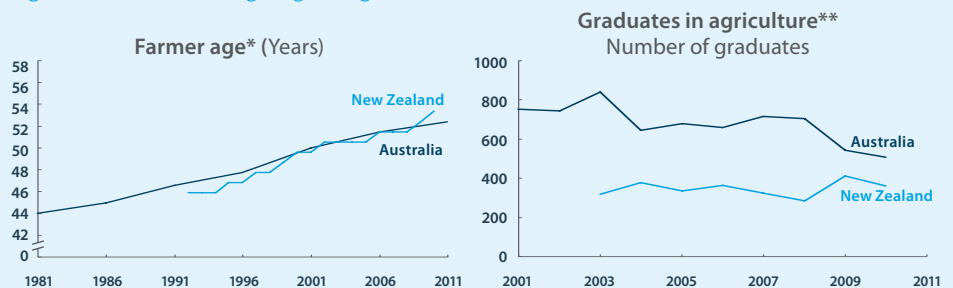


- 4. Focusing R&D:** National agricultural R&D programs need more focus and coordination to drive long-term growth particularly by identifying and pursuing the highest potential opportunities.
- 5. Variability in performance – Closing performance gaps:** Farms perform at substantially different levels with many delivering poor yield and profit outcomes. Closing the performance gaps means reinvigorating public and private extension systems in order to build farmer confidence and to encourage investment in new technologies, best practices and improved financial governance.
- 6. Improving supply chains:** Declining performance and increasing costs for major

supply chains is putting competitiveness at risk. Fixing this is critical to future growth. The key is to create or recreate contestable supply chains that are aligned with the interests of the producer, fostering greater trust and coordination. Additional investment in infrastructure is crucial.

- 7. Targeting key markets:** Further work is needed to understand consumer requirements and explore more innovative ways to access new markets. In addition to striking free trade agreements, strategic off-take agreements should be explored particularly in return for capital investment. There should also be a conscious effort to capture premium market opportunities.

Figure 4. Farmers are ageing and graduation rates are insufficient



* Australia: Median farmer age across all sectors. New Zealand: Average farmer age in meat and fibre sectors.

** Australia: Includes all 3 and 4 years undergraduate courses at universities in agricultural science, agribusiness, horticulture, viticulture, wine science, and agricultural economics. New Zealand: Includes all bachelors degrees (including honours) and postgraduate certificates/diplomas in agriculture, horticulture, viticulture, forestry, fishery, environmental studies, and other related studies. Source: Australian Bureau of Statistics; Australian Council of Deans of Agriculture; New Zealand Ministry of Education; ANZ.

SUBSTANTIAL GROWTH-ORIENTED CAPITAL IS NEEDED IN AUSTRALIA AND NEW ZEALAND OVER THE COMING DECADES

- > Agricultural growth cannot be achieved without the support of both domestic and foreign investors. Between now and 2050, around A\$600 billion and NZ\$210 billion in additional capital will be needed to generate growth and profitability in Australia and New Zealand agriculture respectively, based on current capital valuations. A further A\$400 billion and NZ\$130 billion will be needed in each country to support farm turnover, as ageing farmers make way for the next generation.
- > In a world where capital with a long-term focus is in huge demand, agriculture in Australia and New Zealand needs to find innovative ways of attracting domestic and foreign investment, particularly given strong domestic competition from sectors such as mining.
- > Successfully raising capital from a broad range of sources will be central to financing this growth. Despite foreign investment's central place in both countries' rural development since settlement, concerns have grown in recent years. Australia and New Zealand will have to get the approach to foreign investment right, safeguarding national interests without discouraging offshore investment. It will be critical to align public sentiment with the investment required to boost growth and employment.

CAPTURING A SHARE OF THE PRIZE

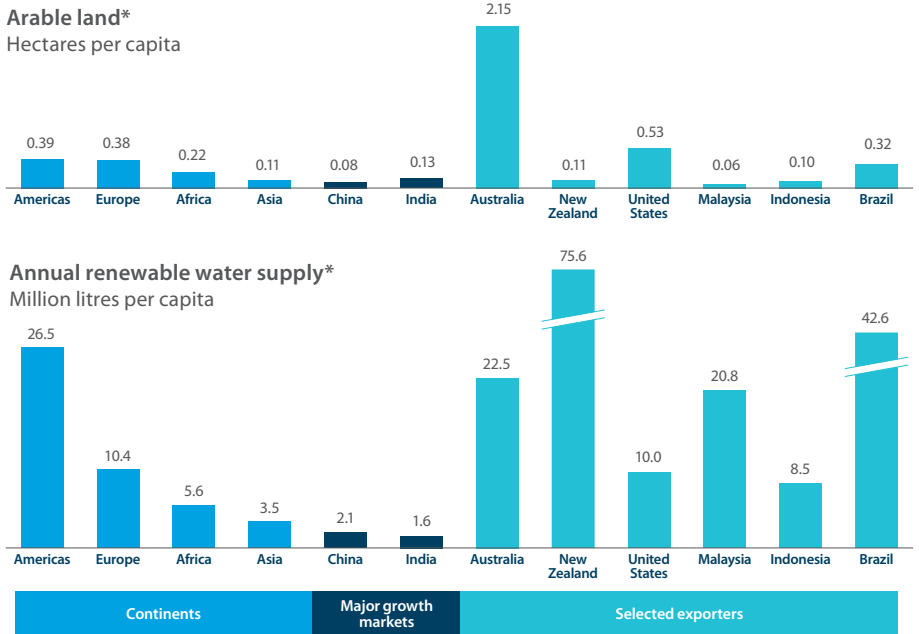
> To restore momentum, agricultural industries in Australia and New Zealand need to focus on growth of both volume and value, in which building competitive strengths is at the core of every part of decision-making. Given the difference in maturity and performance of each agricultural industry, a tailored approach should be applied to maximise growth including:

1. Selectively reinvigorating stalled industries with growth potential such as Australian grains and oilseeds.
2. Sustaining and strengthening existing high-growth industries such as New Zealand dairy.
3. Fostering new and emerging agricultural industries around high-growth opportunities such as glasshouse horticulture, almonds, soy and advanced biofuels.

LEADERSHIP AND COMMITMENT FROM ALL STAKEHOLDERS WILL BE CRITICAL IN UNLOCKING THE FULL POTENTIAL OF AUSTRALIAN AND NEW ZEALAND AGRICULTURE

- > Importantly, achieving these outcomes requires leadership and commitment from industry and government. Policy makers play a critical role in facilitating discussions on the state of their nation’s agricultural sector. This will mean addressing shortcomings in capital, innovation, labour and natural resources, while seeing agriculture as a sector of the future, not the past.
- > In Australia, this process has begun with the release of the Australian Government’s Green Paper, the National Food Plan. New Zealand does not yet have a fully-formed national strategy for food and agriculture, but recent developments have also been promising, including the release of industry-specific strategies from key industry bodies and sector-wide contributions from the Riddet Institute and KPMG.
- > The Australia in the Asia Century White Paper also contributes strongly to elevating this discussion to the national agenda.

Figure 5. Rapidly growing exports into Asia is inevitable
Land and Water Resources by Region and Country



* Land and water data for 2009. Renewable water supply comprises fresh water only from surface and underground sources, including rainfall. Source: FAO.

CONCLUSION

While the issues for agriculture are challenging, these sectors have overcome significant obstacles in the past. The global soft commodity opportunity presents a rare chance for Australia to reinvigorate its agriculture, and for New Zealand to apply its dairy success to other agricultural industries. Increasing supply constraints are expected to keep prices high. (See Figure 5).

Both countries could more than double the real value of annual agriculture exports by 2050. This would result in an additional A\$710 billion and NZ\$550 billion of revenues in 2011 dollars for Australia and New Zealand respectively over the next four decades.

Australia and New Zealand agriculture need to rediscover their direction and momentum to drive a bold, new era. The time is right for change and the potential rewards are clear. Getting this right will help lead Australia and New Zealand to greener pastures over the coming decades.

The ANZ insight series has been developed from ANZ’s outward-looking orientation, as Australia’s and New Zealand’s international bank. This allows us to make a unique contribution with our clients to the discussion of issues relating to the Australian, New Zealand and Asia Pacific economies. The research series focuses on the long-term opportunities and challenges for our clients in an Asia Pacific context. We believe business and other stakeholders have an important role to play by participating constructively in discussion related to the economies where we do business.

The series reflects the importance ANZ attaches to building dialogue among the business community and a diverse range of stakeholders to assist the development of economic relationships and growth in the region.

For more information, contact your ANZ representative or to source a hard copy of the full report please contact your Relationship Manager or ANZ Corporate Communications (corpcomms@anz.com). Alternatively, please visit our website: www.anz.com/insight for a soft copy of the report.