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New Zealand

Dairy and Products Annual

New Zealand 2014 Milk Supply Rebounds after 2013 Drought

Approved By:

Hugh Maginnis

Prepared By:

David Lee-Jones

Report Highlights:

New Zealand milk production in 2014 is expected to rebound from 2013's drought-impacted levels to reach 20.6 million metric tons, essentially equaling the record production levels seen in 2012.

Exports will also bounce back to top 2.9 million metric tons in 2014. Farmers are smiling at the moment enjoying a productive spring and the prospect of the highest milk price payout ever received in New Zealand. Confidence is good despite the setback Fonterra received over the contaminated whey protein concentrate issue.

Executive Summary

Barring another nationwide drought New Zealand farmers look set to increase the milk supply in 2014 to a forecast 20.6 million metric tons (MT). This represents a 4.5 percent increase from the amended estimate for 2013 of 19.7 million MT. The longer term weather forecasts are for normal rainfall and temperatures through the first quarter of 2014. Milk prices are forecast to reach a record \$NZ 8.60/kilogram of milk solids in for the first half of 2014 which will encourage farmers to produce as much as they can in the first half of the year. Slightly higher cow numbers (5.1 million versus 5.0 million) going into the second half of the year should ensure milk supply continues to grow.

The drought that took place in the first half of 2013 is over. Farmers have capitalized on good cow condition and a mild winter to make an excellent start to the 2013/2014 production year. This should result in the milk supply for the July to December 2013 period topping the record achieved during the same period in 2012. The influence of the drought means that production in 2013 is expected to be 4.3 percent less than 2012.

The milk supply in 2014 is forecast to be processed into a total of 3.19 million MT of products, a 4percent increase on the total of 3.07million MT estimated for 2013. Whole milk powder (WMP) remains the key commodity representing around 40 percent of total production. In 2014 WMP production is forecast at 1.3 million MT up two percent from the 2013 total of 1.275 million MT. Even though exports for the 2013 year to August were 86,000 MT behind 2012 it is expected the extremely high financial margins for WMP which have opened up since April 2013 and the extra production capacity now commissioned will see that gap closed by year end. The tight global supply is expected to last until the end of Q1, 2014. This should set the scene for the forecast WMP production increase in 2014.

Cheese production is likely to be stable at just on 320,000 MT in both 2014 and 2013. However there are signs that in the future cheese will assume greater importance in the product mix. New production technologies and new markets opening up in the developing countries are providing a platform for future growth.

Skim milk powder (SMP) and cream products (butter and anhydrous milk fat) are likely to stage a production upswing in 2014 at 420,000 MT (eight percent up) and 525,000 MT (four percent up) respectively.

Exports for 2014 look set to show a distinct increase over 2013, of 5.8 percent, to reach 2.9 million MT. For 2013 it is now estimated 2.75 million MT of product will be exported, down 2.4 percent from 2012, which is the result of the drought induced reduction to the milk supply. To some extent the 2014 export performance is likely to benefit from an anticipated inventory buildup of WMP at 2013 year end which will be wound back in the first half of 2014.

Even though Infant Milk Formula (IMF) exports at \$US 320million in 2012 comprised only three percent of total dairy export value it is a high value product and often seen as a model for the future for dairy processing in NZ. Over the last decade exports have expanded from 12,000 MT to 33,000 MT in 2012 and the price has appreciated from \$US 3.00/kilogram to over \$US 9.50/kilogram. The price increase has attracted many new players over the last few years. The growth in the Chinese market seems to be a big part of this. However the once lightly regulated Chinese market is undergoing a significant restructure. New regulations, increased testing, and better border control are being assembled. In addition the Chinese Government is moving briskly to rationalize and strengthen the domestic suppliers to increase their market share.

New Zealand suppliers' share of the IMF market in China was disrupted during August and September by the whey protein concentrate contamination issue sustained by Fonterra. The contamination by bacteria was found in the end not to be a food safety issue. However in the interim an extensive product recall was instituted which affected IMF products in several markets. The negative publicity played badly on the NZ brand image in China. However it is likely this will pass and the new regulations will likely benefit reputable NZ producers of IMF in the future.

Milk Production

2014

Total milk production is forecast for 2014 (the CY is the MY) at 20.6 million (M) metric tons (MT) which would be 4.5 percent ahead of the production expected for 2013. Milk production in New Zealand is not typically analyzed on a calendar-year basis. For example, the 2013/14 lactation season runs from July 2013 to June 2014. Similarly, the 2014/15 lactation season runs from July 2014 to June 2015. Quite often there may be different drivers acting as the main influencers of milk supply between production seasons.

For the first half of 2014 production is forecast to be eight percent ahead of the same period in 2013 because: Summer and autumn milk production is highly weather dependent, if rainfall is normal production is normal but if rainfall is below normal generally, production drops significantly which was the case in early 2013. At this stage the National Institute for Water and Atmospheric Research (NIWA) says the outlook for the climate is neutral between El Niño and La Niña weather patterns which would most likely lead to normal amounts of rainfall through into the autumn. In addition for the 2013/2014 production season farmers have been given forecasts that the milk price will be \$NZ 7.60 to 8.60 per kilogram (kg) of milk solids up from an average of \$NZ 6.15 per kg milk solids for the 2012/2013 season. This is likely to enable farmers to purchase supplementary feed to buffer any short term pasture deficits. In addition cow numbers being milked through this period are likely to be greater than 2013 because of an additional 40-50 new farms which came into production in 2013 and little pressure to dispose of cull cows until the end of the lactation season.

For the second half of 2014 production is forecast to be 2.2 percent greater than the same period in 2013. This is at the lower end of trend production increases of two percent to four percent per annum because: Firstly it is likely that the milk price will drop as global milk supply catches up with global demand. Higher supplies could result in a drop in the milk price to around \$NZ 6 to 6.50/kg milk solids for the 2014/2015 production season. This will mean farmers will become cautious about additional spending especially for supplementary feed as it may not be profitable. Secondly environmental limits for nitrogen, phosphorus, and effluent discharges are becoming tighter. This coupled with water availability for irrigation becoming more restricted or costly to access is leading to increased caution being exercised by the banks with regard funding land conversions to dairy and farmers are not quite so confident to expand or develop.

2013

Milk Production for 2013 is now estimated at 19.7MMT. While this is a 4.3 percent fall from the record year in 2012 it is 2.7 percent better than Posts previous forecast. Actual first half 2013 production was 7.6MMT which was one percent better than the previous estimate indicating the extensive drought did not do quite as much damage to milk supply as formerly estimated. For the second half 2013 it is now estimated that milk production will reach 12.1MMT which is a 1.9 percent year-on-year increase.

Actual production from June to the end September 2013 is approximately five percent ahead of the same period last year. Farmers after drying their cows off early in the drought to maintain condition benefited from a very mild winter and have capitalized on this with a flying start to the new production season. However the latest daily milk charts suggest that the peak production is being reached earlier and may be just less than the daily peak in 2012 which is leading to an expectation milk production for the rest of 2013(Oct to Dec) will be no higher than in 2012.

Dairy, Milk,	2012	2013	2014
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Fluid	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013			Market Year Begin: Jan 2014	
	Official	New Post	Official	Old Post	New Post	Official	New Post
New Zealand							
Cows In Milk	5021	5018	5018	5018	5043		5111
Cows Milk Production	20567	20567	19169	19169	19678		20569
Other Milk Production	0	0	0	0	0		0
Total Production	20567	20567	19169	19169	19678		20569
Other Imports	1	1	1	1	1		1
Total Imports	1	1	1	1	1		1
Total Supply	20568	20568	19170	19170	19679		20570
Other Exports	96	96	110	110	106		110
Total Exports	96	96	110	110	106		110
Fluid Use Dom. Consum.	275	275	270	270	300		300
Factory Use Consum.	20147	20147	18740	18740	19223		20110
Feed Use Dom. Consum.	50	50	50	50	50		50
Total Dom. Consumption	20472	20472	19060	19060	19573		20460
Total Distribution	20568	20568	19170	19170	19679		20570
CY Imp. from U.S.	0	0	0	0	0	0	0
CY. Exp. to U.S.	0	0	0	0	0	0	0
TS=TD		0		0	0		0
(1000 Hd, 1000MT)							

Not official USDA estimates

Dairy Production

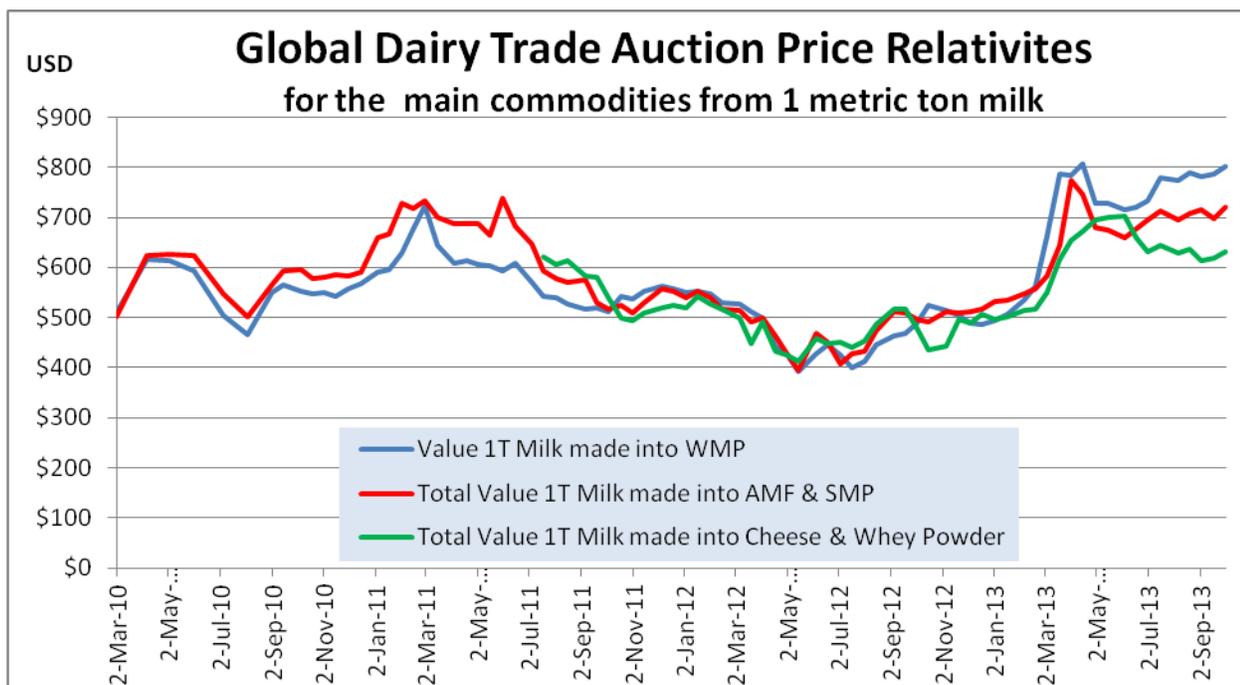
Total dairy production varies in sync with the milk supply and on that basis it is forecast that total production of all commodities will be 3.19MMT (including 410,000 MT of liquid milk) in 2014. This is four percent up from an estimated 3.07MMT (which includes 406,000 MT of liquid milk) in 2013. The mix of commodities produced varies according to the relative financial margins between the products which is dependent on the export price and the cost of manufacture for each product.

New Zealand is unique in that the peak milk supply month October is over twenty times the volume of the lowest supply month (June) which means the processors need a lot of spare capacity which may only be in use for 70 to 100 days a year.

Whole Milk Powder (WMP)

WMP is the key commodity produced in NZ comprising approximately 40 percent of the total production and in 2014 is likely to reach 1.3 MMT, up two percent from estimated production levels in 2013. New Zealand is an acknowledged leader in spray drying technology used to make milk powders and is constantly refining the process to make it more cost efficient in order to stay competitive in world markets. Apart from one 20,000 MT cheese plant, all the processing capacity added over the last decade has been in the form of powder driers -- usually dual purpose SMP or WMP systems. In New Zealand WMP is the most cost efficient product to manufacture.

Fonterra commissioned a new world leading 30 MT/hour capacity drier in August 2013, which will probably increase annual powder production capacity by at least 175,000 MT.



Source: GDT, Fonterra, GTA, Post estimates

Each value/date point on the chart above is taken from a weighted average price achieved at the Global Dairy Trade (GDT) auction event on that date. The weighted average price is made up from the prices achieved for the particular product in up to six contracts which specify the shipping date for one to six months out from the auction date. To some extent the auction shows where purchasers think the market will be in up to six months time.

The chart above shows the main reason why the powder driers in the second half 2013 and on into the first half of 2014 will be aiming to maximize the manufacture of WMP. Export prices for WMP are at record highs and show no signs of abating in the near future. Even when the relative pricing of the main commodities based on the value of a ton of milk made in to each of the commodities was moving pretty well in sync from October 2011 through to March 2013 it was still more profitable to produce WMP because of the lower costs. Over the period from April 2013 until the present the relative values for each of the commodity lines have diverged significantly which means there is a double whammy effect for WMP profitability coming from receiving the highest value per ton of milk and having the lowest manufacturing costs.

Commentators in New Zealand think this situation will last into the second quarter of 2014. It has been brought about by global demand continuing to grow and between country tradable supply being compromised by the drought in New Zealand which reduced WMP production earlier in 2013; reduced production in Australia; slow production growth in the US; and sharply reduced domestic production in China

Even though WMP exports for the year-to-date August, 2013 were 85,783 MT less than the same period in 2012 which would indicate that production had slowed in the first six months of the year (generally manufacturers in NZ don't build up stocks through the middle of the year); the market

conditions outlined above; and the increased manufacturing capacity will probably mean that production will catch up to the previous year's level and reach 1.275 MMT.

Dairy, Dry Whole Milk Powder New Zealand	2012		2013			2014	
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013			Market Year Begin: Jan 2014	
	USDA Official	New Post	USDA Official	Old Post	New Post	USDA Official	New Post
Beginning Stocks	150	150	161	161	161		185
Production	1,273	1,273	1,275	1,275	1,275		1,300
Other Imports	1	1	1	1	1		1
Total Imports	1	1	1	1	1		1
Total Supply	1,424	1,424	1,437	1,437	1,437		1,486
Other Exports	1,261	1,261	1,325	1,285	1,250		1,334
Total Exports	1,261	1,261	1,325	1,285	1,250		1,334
Human Dom. Cons.	2	2	2	2	2		2
Other Use, Losses	0	0	0	0	0		0
Total Dom. Cons.	2	2	2	2	2		2
Total Use	1,263	1,263	1,327	1,287	1,252		1,336
Ending Stocks	161	161	110	150	185		150
Total Distribution	1,424	1,424	1,437	1,437	1,437		1,486
CY Imp. from U.S.	0	0	0	0	0		
CY. Exp. to U.S.	3	3	3	0	2		
TS=TD		0			0		0

(1000 MT)

Not official USDA estimates

Skim Milk Powder (SMP)

For 2014 it is likely SMP production will show a marked upswing to reach 420,000 MT which would represent a 7.7 percent increase on the 2013 estimate of 390,000 MT. The production level in 2013 is likely to be down (-3.5 percent on 2012, and -2.5 percent on the previous forecast) because of the lowered milk supply January to June, 2013 and from July to December, 2013 with the emphasis on WMP because of its relative profitability, milk being diverted away from SMP/Fat production. On into 2014 it is likely the divergent relative prices between SMP/fat; cheese; and WMP will converge again which should mean that by the second half of 2014 SMP production will revert to trend increases and there will be a significant boost to production during that period.

Dairy, Milk, Nonfat Dry	2012	2013	2014
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New Zealand (1000 MT)	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013			Market Year Begin: Jan 2014	
	USDA Official	New Post	USDA Official	Old Post	New Post	USDA Official	New Post
Beginning Stocks	54	54	70	70	70		55
Production	404	404	390	400	390		420
Other Imports	5	5	4	4	3		3
Total Imports	5	5	4	4	3		3
Total Supply	463	463	464	474	463		478
Other Exports	390	390	405	405	404		404
Total Exports	390	390	405	405	404		414
Human Dom. Cons.	3	3	4	4	4		4
Other Use, Losses	0	0	0	0	0		
Total Dom. Cons.	3	3	4	4	4		4
Total Use	393	393	409	409	408		418
Ending Stocks	70	70	55	65	55		60
Total Distribution	463	463	464	474	463		478
CY Imp. from U.S.	0		0	0			
CY. Exp. to U.S.	0		0	0			
TS=TD		0			0		0

Not official USDA estimates

Butter and Anhydrous Milkfat (AMF) Production

Total fat production is forecast to reach 525,000 MT (butter equivalents) in 2014. This would equate to a 3.8 percent increase year on year. The 2013 total now estimated at 506,000 MT is a reduction of four percent from 2012. The drop in production in 2013 can be put down to the influence of the drought in the first half of 2013 reducing milk supply and then the subsequent rise in the profitability for WMP which will divert milk supply away from cream and skim milk processing. However as stated above it is likely that the pricing for WMP will moderate in 2014 and the underlying demand for fat/cream products will re-assert itself during the year which should see the forecast production increase achieved.

AMF production is assuming greater importance in overall cream processing. Over 2011 and 2012 AMF production comprised around 40 percent of the total, in the YTD 2013 it is running at over 45 percent, having come from around a third of total fat/cream production a decade ago. Most NZ cream plants have the flexibility to switch easily from butter to AMF production via the Anmix process.

The negative connotations around dietary fat are changing somewhat and consumer tastes and preferences are now favoring natural ingredients. Among the developing nations there isn't anywhere near the same level of historical bias away from dietary fat. This is fueling a resurgence of demand for fat/cream products especially in baked goods and food service in the developing nations. AMF is a suitable ingredient for these consumer products and can be handled more easily in the logistics chain than butter. The longer term outlook is for AMF/butter production to carry on steadily increasing.

Dairy, Butter New Zealand (1000 MT)	2012 Market Year Begin: Jan 2012		2013 Market Year Begin: Jan 2013			2014 Market Year Begin: Jan 2014	
	USDA Official	New Post	USDA Official	Old Post	New Post	USDA Official	New Post

Beginning Stocks	48	48	48	48	48		48
Production	530	527	494	494	506		525
Other Imports	0	0	1	1	1		1
Total Imports	0	0	1	1	1		1
Total Supply	578	575	543	543	555		574
Other Exports	509	506	480	474	485		502
Total Exports	509	506	480	474	485		502
Domestic Cons.	21	21	21	21	22		22
Total Use	530	527	501	495	507		524
Ending Stocks	48	48	42	48	48		50
Total Distribution	578	575	543	543	555		574
CY Imp. from U.S.	0	0	0	0	0		0
CY. Exp. to U.S.	32	32	28	28	30		30
TS=TD		0			0		0

Note AMF product weight tonnages are multiplied by 1.22 to get butter equivalents; Not official USDA estimates

Cheese

It is forecast Cheese production is going to be reasonably stable at 320,000 MT in 2014 and 319,000 MT in 2013. Generally cheese has been more expensive to produce than the other commodities and the net margins haven't justified production increases. Fonterra inherited ten legacy cheese plants when it was formed and one additional plant has been built by Open Country Dairy (27,000 MT capacity) since then. In the peak milk production months of October through December when the powder plants are working to capacity the cheese plants are used to process the peak milk supply. Nearly all the cheese production would come under the natural cheese category with only approximately seven percent of total production processed cheese and a further eight percent categorized as powdered or grated cheese. The vast majority of the natural cheese production is cheddar which is exported on a business to business basis to be further processed.

However the combination of : new processing technologies being employed which are leading to better cost efficiencies; increasing demand from the developing economies for ingredient cheese for processing; and better pricing for the whey by-products is likely to see the continuation of the reversal to the long term trend of stable to declining cheese production. Looking to the future there is likely to be production growth as the milk supply continues to grow and the dynamics mentioned above really come in to play.

Dairy, Cheese New Zealand	2012		2013			2014	
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013			Market Year Begin: Jan 2014	
(1000 MT)	USDA Official	New Post	USDA Official	Old Post	New Post	USDA Official	New Post

Beginning Stocks	62	62	50	50	50		50
Production	319	321	273	270	319		320
Other Imports	5	5	5	5	5		5
Total Imports	5	5	5	5	5		5
Total Supply	386	388	328	325	374		375
Other Exports	306	306	270	260	290		290
Total Exports	306	306	270	260	290		290
Human Dom. Cons.	30	32	28	30	34		34
Other Use, Losses	0	0	0	0	0		0
Total Dom. Cons.	30	32	28	30	34		35
Total Use	336	338	298	290	324		325
Ending Stocks	50	50	30	35	50		50
Total Distribution	386	388	328	325	374		375
CY Imp. from U.S.	0	1	0	1	1		1
CY. Exp. to U.S.	13	13	10	10	1		1
TS=TD		0			0		0

Not official USDA estimates

Trade and Exports

New Zealand Summary Table for Dairy Product Export Quantities					
Commodity Group (1000s Metric Tons)	2012	2013		2014	
	Actual	Revised Estimates	2013 % change from 2012	New Forecast	2014 % change from 2013
WMP	1,261	1,250	-0.9%	1,334	6.7%
SMP	390	404	3.6%	414	2.5%
Butter/AMF	506	485	-4.2%	502	3.5%
Cheese	306	290	-5.2%	290	0.0%
Liquid Milk	96	106	10.4%	110	3.8%
Sub-Total PSD Exports	2,559	2,535	-0.9%	2,650	4.5%
Casein	81	70	-13.5%	75	7.1%
Whey Products	34	30	-10.9%	35	16.7%
Milk Protein Concentrates	89	73	-18.4%	73	0.0%
Other Products	53	40	-24.9%	75	87.5%
Total Exports	2,816	2,748	-2.4%	2,908	5.8%

source: GTA, Post estimates Note: Butter/AMF line has the AMF adjusted to butter equivalents

New Zealand exports around 95 percent of all of its dairy production. There are no barriers to exporting apart from the normal phyto-sanitary documentation which is required. The Government of New Zealand (GONZ) provides no ongoing export subsidies. However the GONZ has announced some short term measures to assist smaller volume infant formula exporters to recover from the fallout associated with the Fonterra-whey protein concentrate contamination scare.

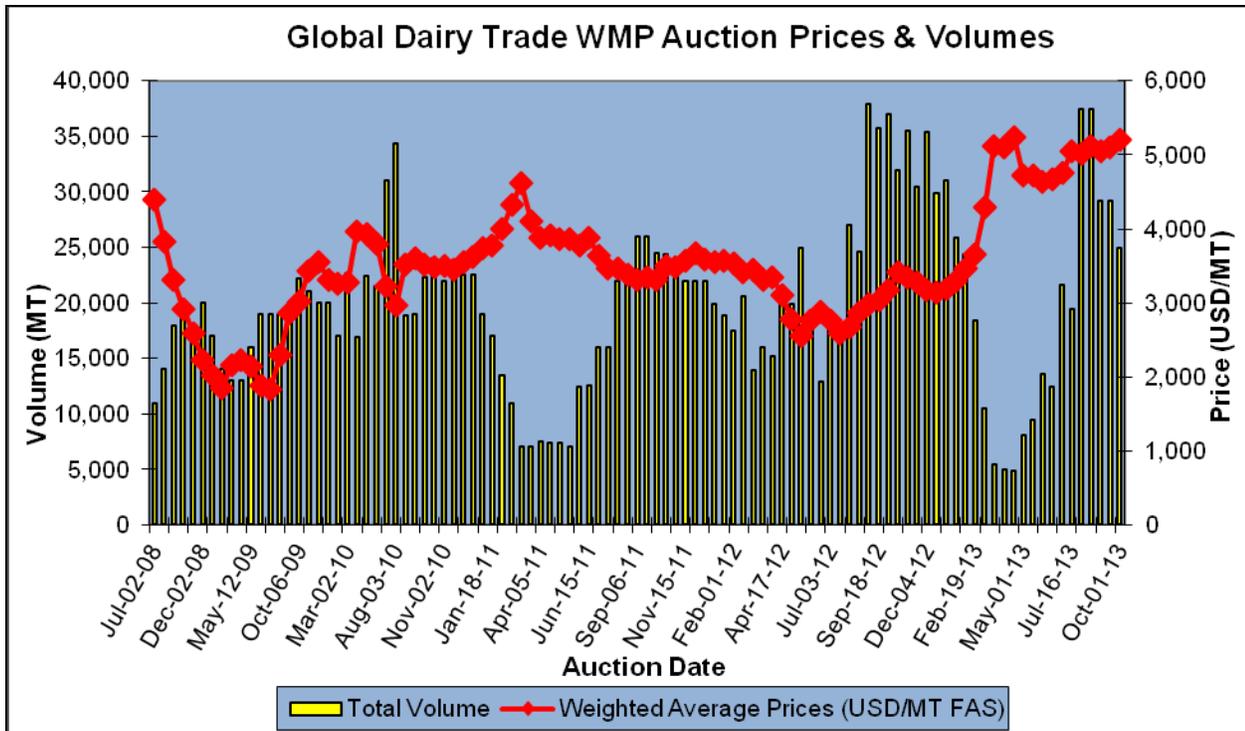
In general exports tend to reflect production which in the short term is highly influenced by the weather. Generally NZ dairy processors run lean inventories but from time to time stock build-ups or depletions can materially alter export volumes between years especially as the PSD analysis year is the calendar year which coincides with the peak production months from October through December. So if there is to be stock buildups they are quite likely to happen at December 31.

The year-to-date (YTD) WMP exports only tell half the story for 2013. The reduced exports are a result of the drought induced reduction in milk supply and the production mix before the WMP prices took off. The formidable profitability of WMP at present should see WMP exports all but catch last year's total and contribute to a buildup in stocks because the increased production isn't likely to be shipped before year's end. In 2014 the increase in WMP production in 2014 (+25,000 MT) and the likely sell-down of inventory during the year (-35,000 MT) contribute to the forecasted seven percent increase in WMP exports to 1.33 MMT.

**New Zealand Export Statistics for Whole Milk Powder,
Year To Date: January - August**

Destination Country	2011			2012			2013		
	USD	Qty (MT)	Price /T	USD	Qty (MT)	Price /T	USD	Qty (MT)	Price /T
China	775,721,5 63	210,1 25	\$3,69 2	826,342,7 36	244,7 99	\$3,37 6	1,040,133, 391	278,9 91	\$3,72 8
United Arab Emirates	162,265,4 27	41,65 8	\$3,89 5	236,732,9 12	65,75 7	\$3,60 0	190,814,3 47	52,63 5	\$3,62 5
Venezuela	173,486,9 97	42,96 0	\$4,03 8	300,385,7 83	77,69 0	\$3,86 6	136,250,6 24	33,88 0	\$4,02 2
Sri Lanka	154,739,2 85	41,71 9	\$3,70 9	158,419,1 93	43,50 2	\$3,64 2	112,173,9 43	33,34 7	\$3,36 4
Algeria	204,574,4 14	51,14 7	\$4,00 0	151,747,1 77	44,69 9	\$3,39 5	93,898,27 4	26,38 2	\$3,55 9
Malaysia	99,241,90 2	26,51 3	\$3,74 3	100,133,6 33	26,49 7	\$3,77 9	89,110,72 1	24,83 7	\$3,58 8
Singapore	79,761,91 9	22,53 5	\$3,53 9	63,717,05 9	21,96 1	\$2,90 1	80,661,25 2	24,35 0	\$3,31 3
Nigeria	48,248,34 2	12,35 8	\$3,90 4	65,404,85 4	18,30 9	\$3,57 2	75,571,49 2	19,58 0	\$3,86 0
Egypt	40,890,02 3	10,34 6	\$3,95 2	42,597,29 9	12,02 4	\$3,54 3	71,253,15 5	21,15 5	\$3,36 8
Taiwan	67,504,93 5	17,27 5	\$3,90 8	57,255,85 5	17,20 1	\$3,32 9	70,320,92 5	17,70 0	\$3,97 3
Rest of World	896,345,1 68	229,4 94	\$3,90 6	937,084,3 10	257,1 66	\$3,64 4	824,740,7 30	210,9 63	\$3,90 9
Total for World	2,702,779, 976	706,1 31	\$3,82 8	2,939,820, 811	829,6 04	\$3,54 4	2,784,928, 856	743,8 21	\$3,74 4

Source: GTA



Source: GDT

New Zealand Export Statistics for Cheese And Curd, All Types									
Year To Date: January - August									
Destinati on Country	2011			2012			2013		
	USD	Qty (MT)	Price/ T	USD	Qty (MT)	Price/ T	USD	Qty (MT)	Price/ T
Japan	169,321,262	40,812	\$4,149	165,698,528	41,553	\$3,988	170,402,896	43,024	\$3,961
Australia	141,465,787	31,891	\$4,436	118,167,822	28,629	\$4,128	112,703,769	26,280	\$4,289
Korea South	59,419,384	13,169	\$4,512	63,401,270	15,599	\$4,064	68,714,225	16,502	\$4,164
China	36,155,551	8,580	\$4,214	47,529,389	11,143	\$4,265	53,919,593	12,305	\$4,382
Saudi Arabia	21,222,913	5,055	\$4,198	45,662,775	12,828	\$3,560	32,068,061	8,503	\$3,771
Indonesia	26,910,309	6,121	\$4,396	31,734,032	8,287	\$3,829	30,857,416	7,921	\$3,896
Philippine s	25,938,557	6,117	\$4,240	30,494,590	8,152	\$3,741	30,158,293	8,033	\$3,754
Chile	2,569,885	664	\$3,870	9,538,319	2,409	\$3,959	22,515,452	6,045	\$3,725
Taiwan	20,754,250	4,855	\$4,275	13,769,685	3,520	\$3,912	19,732,839	5,076	\$3,887
Egypt	2,619,666	664	\$3,945	27,185,630	7,772	\$3,498	19,347,267	5,340	\$3,623

Rest of World	210,409,765	50,403	\$4,175	209,265,121	52,300	\$4,001	201,391,627	50,000	\$4,028
Total for World	716,787,328	168,334	\$4,258	762,447,161	192,189	\$3,967	761,811,438	189,031	\$4,030

Source: GTA

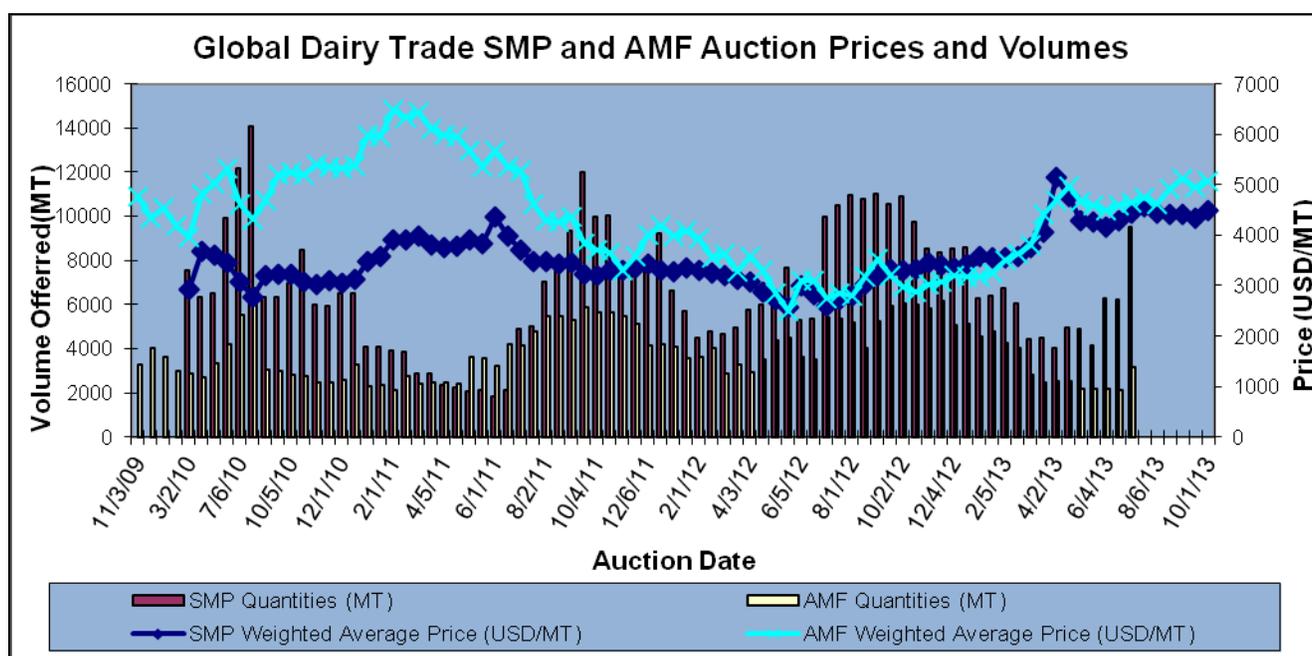
New Zealand Export Statistics for Butter, Dairy Spreads, and Anhydrous Milk Fat									
Year To Date: January - August									
Destinati on Country	2011			2012			2013		
	USD	Qty (MT)	Price /T	USD	Qty (MT)	Price /T	USD	Qty (MT)	Price /T
Egypt	74,740,833	13,729	\$5,444	94,679,024	27,267	\$3,472	98,152,610	26,772	\$3,666
China	112,426,884	21,465	\$5,238	109,840,274	28,871	\$3,805	94,894,599	23,889	\$3,972
Belgium	2,295,872	501	\$4,583	43,811,994	13,998	\$3,130	79,277,099	23,758	\$3,337
Russia	71,712,179	15,673	\$4,576	43,394,268	13,288	\$3,266	64,289,499	17,908	\$3,590
Saudi Arabia	69,784,030	12,892	\$5,413	52,431,490	14,078	\$3,724	51,447,926	14,300	\$3,598
United States	44,612,685	7,981	\$5,590	49,019,576	13,562	\$3,614	44,778,525	12,643	\$3,542
Iran	98,031,684	22,876	\$4,285	87,808,844	22,724	\$3,864	43,564,340	11,094	\$3,927
Mexico	52,033,480	9,621	\$5,408	32,503,117	8,785	\$3,700	41,170,297	11,693	\$3,521
Australia	46,256,903	9,858	\$4,692	50,629,932	14,218	\$3,561	39,999,706	10,817	\$3,698
Indonesia	29,242,973	5,418	\$5,397	26,475,055	6,647	\$3,983	37,969,081	9,475	\$4,007
Rest of World	674,965,944	134,364	\$5,023	501,888,967	134,920	\$3,720	463,662,705	121,996	\$3,801
Total for World	1,276,103,473	254,377	\$5,017	1,092,482,536	298,359	\$3,662	1,059,206,385	284,342	\$3,725

Source: GTA, Note: The quantity shown is the product weight shipped, AMF tonnages have not been adjusted to Butter equivalents.

New Zealand Export Statistics for Skim Milk Powder									
Year To Date: January - August									
Partner Country	2011			2012			2013		
	USD	Qty (MT)	Price /T	USD	Qty (MT)	Price /T	USD	Qty (MT)	Price /T
China	133,459,669	39,144	\$3,409	217,574,751	65,918	\$3,301	239,512,086	62,875	\$3,809
Indonesia	60,947,157	17,066	\$3,571	73,038,751	21,607	\$3,380	99,580,268	25,752	\$3,867

Malaysia	81,243,286	23,579	\$3,446	80,952,199	21,595	\$3,749	95,571,679	24,376	\$3,921
Philippines	79,173,260	22,610	\$3,502	69,934,019	20,759	\$3,369	72,057,810	19,204	\$3,752
Singapore	41,919,537	12,748	\$3,288	48,266,070	14,872	\$3,245	64,430,657	17,472	\$3,688
Taiwan	27,101,523	7,495	\$3,616	24,525,651	7,217	\$3,398	37,977,722	9,594	\$3,958
Thailand	58,670,469	17,812	\$3,294	31,522,423	9,973	\$3,161	37,747,653	9,890	\$3,817
Vietnam	17,071,936	4,814	\$3,546	11,276,066	3,462	\$3,257	32,166,293	8,991	\$3,578
Algeria	58,399	18	\$3,244	64,927	18	\$3,607	24,538,093	6,606	\$3,715
Japan	12,803,634	3,646	\$3,512	13,005,319	3,747	\$3,471	23,592,748	6,139	\$3,843
Saudi Arabia	73,069,491	20,743	\$3,523	38,563,869	11,506	\$3,352	23,095,717	6,013	\$3,841
Rest of World	217,579,955	61,174	\$3,557	164,686,980	48,364	\$3,405	177,144,851	45,288	\$3,912
Total for World	803,098,317	230,850	\$3,479	773,411,026	229,033	\$3,377	927,415,575	242,198	\$3,829

Source: GTA



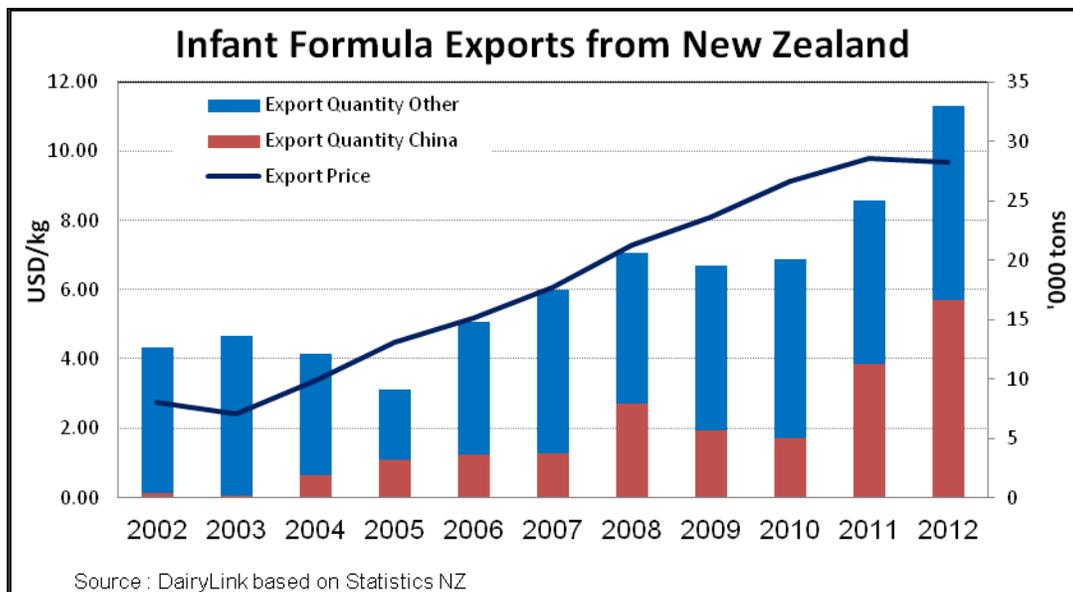
Source: GDT

Infant Milk Formula (IMF) Exports

One of the success stories for New Zealand dairy processors in their attempts to move into the manufacturing and marketing of a greater proportion of value-added products has been infant milk

formula (IMF) manufacturing. It is estimated that infant milk formula exports worldwide from New Zealand in 2012 totaled \$US320M up from \$US245M in 2011. Some 45 percent to 50 percent of the total volume over the last two years has been going to China. The Chinese IMF market is rated the second largest in the world, behind the US, and is valued at \$US 6 billion per annum. On the face of it NZ product only appears to have a three percent market share, however some of the WMP and SMP exported to China is re-processed for IMF as well as some of the specialist ingredient products such as Whey Protein Concentrates.

Only now after over ten years of solid growth and substantial price increases has the trade hit a rocky patch. Up until earlier in 2013 there were just the barest of regulations controlling the IMF market in China. Even though it is a product that needs to be produced and handled under very high quality standards to ensure its absolute food safety there was widespread mislabeling, risky manufacturing processes and little traceability. There were around 600 brands available in the Chinese market, of which 200 claimed to be product of New Zealand. In fact only 20 were produced in New Zealand.



The Chinese authorities have begun a two pronged approach to changing this market. On one side there is a suite of new regulations which will crack down on the mislabeling; enforce good manufacturing practice standards; require greater transparency of documentation and traceability; and offshore suppliers will have to be registered and undergo greater inspection either at the border or pre-border. The other facet to the intervention in the market has been to encourage and bolster the capacity of favored Chinese dairy companies to be able to compete in the market place more successfully. The longer term goal seems to be to get the domestic companies to increase their market share from approximately 30percent to back over 50 percent.

The whey protein concentrate contamination issue which played out over August 2013 (covered fully in the next section) may have played right into Chinese authorities hands. During August and September any IMF product branded with “made in New Zealand“ was having difficulty either being shunned by consumers or cautious retailers/distributors reducing their stocks and orders of New Zealand product. There have been reports that European brands have seen an opportunity to challenge New Zealand’s

premium position as suppliers and are incentivizing Chinese buyers to change. Reports are just starting to surface that consumer opinion may be starting to change to once again accept New Zealand IMF.

Interestingly Fonterra had long been a contract manufacturer of IMF for many of the ingredients for several large multi-national brands but has never had its own brand in the Chinese market. It had planned to launch “Annum” IMF in Q3, 2013 but this is reportedly being delayed to late 2013 or early 2014. In the longer term the new regulations shouldn’t harm reputable NZ producers of IMF and should probably be beneficial as it will be easier to protect their brands from the counterfeiting and mislabeling.

Trade Issues: Fonterra – Whey Protein Concentrate Contamination Issue

Background and Timelines

On August 2, 2013, Fonterra informed the Ministry for Primary Industries (MPI) that tests conducted by AgResearch (a Crown Research Institute) in New Zealand indicated the presence of toxin-producing clostridium botulinum in three batches of whey protein concentrate (WPC80) totaling 38.2 metric tons (MT). MPI initiated re-testing of the WPC80 in question early in August at two accredited laboratories, one of them in the US. By August 28, 2013 this re-testing revealed conclusively that the contamination was not clostridium botulinum but the non toxic strain of the same clostridia bacteria: Clostridium sporogenes.

The whole debacle appeared to be a false alarm. It created a big media storm whipped up mainly by the domestic media, and aided to a degree by a few hysterical pieces in the Chinese media. But it did expose some serious lapses in Fonterra’s quality assurance systems and in the way the incident was handled as it progressed. Grave errors appear to have been made by unfortunately not elevating the matter to the CEO quickly enough and by failing to take the questionable batches of WPC80 out of distribution until testing was conclusive.

The sequence of events began in May, 2012 when three batches of WPC80 were produced at the Hautapu plant (Waikato New Zealand). The contamination occurred when the batches were transferred through a non-sterile, little used pipe and exposed to high levels of clostridium bacteria. This was not known at the time and standard testing revealed no problems. The WPC80 was stored until the end of 2012, when 21.1MT was sold and 17.1MT was transferred to three other Fonterra locations for further processing into consumer products. This was completed in March 2013. Testing at the Fonterra site in Darnum Australia was positive for clostridia bacteria. This led to the technical investigation which culminated in AgResearch reporting its findings to Fonterra staff on July 31. The matter was finally elevated to the CEO on August 2nd. While testing for clostridium botulinum was being carried out product containing the affected WPC80 continued to be shipped. After the announcement to MPI and to the general public at the beginning of August Fonterra instituted an extensive but clumsily-executed product recall. The product recall was complicated because most of the affected WPC80 had been sold to eight external customers who had used it as an ingredient in several thousand tons of consumer products which translated into tens of thousands of consumer-sized packs spread over several countries.

The Immediate Fallout

Within days of the August 3rd announcement, China banned the importation of whey protein powder and whey based powder. This ban has now been lifted but there is increased inspection and supervision at the border for New Zealand dairy products, and extra testing may also be required. Russia, Kazakhstan, and Belarus placed a temporary ban on imports, affecting 75 percent of the categories of dairy products which have access to those markets. The Russian ban has now been lifted except some Fonterra plants have been de-listed. Vietnam also ordered an immediate recall and halt of circulation of a milk powder manufactured by Fonterra after the contamination. Singapore and Malaysia also recalled some Fonterra-linked baby milk products as a precaution. South Korea, Saudi Arabia, and Bangladesh are now requiring enhanced levels of testing on some products. The Bangladesh situation was problematic because approximately 600 MT of milk powder was trapped at a port waiting for Bangladesh authorities to complete the extra tests. The access requirements for future shipments to Bangladesh have not been resolved.

The New Zealand dollar depreciated over one percent on receipt of the news but subsequently recovered. Fonterra's listed investment units fell nearly nine percent but have since recovered just about the entire reduction. Perhaps the most serious effect has been on the infant formula trade into China which is covered in the section on Infant Milk Formula.

Longer Term Outcomes

As a result of the debacle four inquiries have been commenced. Firstly Fonterra conducted an operational review which is largely complete and the management has announced wide-ranging changes to its quality assurance and food safety systems. Information from the operational review will feed into a Fonterra Board level inquiry into the matter. Hard on the heels of these reviews MPI announced its own inquiry and there is also a Government Ministerial probe.

In addition, the Government has announced a market recovery plan for affected businesses. A major part of the plan is aimed at the smaller exporters (of mainly infant formula) who find their sales into China plummeting. The Government will provide professional support and co-fund travel expenses for businesses to visit the markets to help rebuild trust with their in-market partners and customers. There will also be a program to ramp up funding for government agencies and overseas embassies to regain any market access which has been lost; and promote New Zealand's food safety and quality assurance systems.

For more information see the New Zealand GAIN Report NZ1314 "Fonterra – Whey Protein Concentrate Contamination Issue"