



USDA Foreign Agricultural Service

# GAIN Report

Global Agriculture Information Network

Template Version 2.09

Required Report - Public distribution

**Date:** 5/15/2008

**GAIN Report Number:** NZ8009

## New Zealand

### Dairy and Products

### Dairy and Products Semi-Annual Report

## 2008

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**Report Highlights:**

The worldwide supply and demand situation for dairy products has translated into a record farm gate price of NZ \$7.30/kg (USD 5.62) of milk solids being paid to New Zealand dairy farmers for MY 2007/08. While next year's farm gate price will likely be lower, it is still expected to be the second highest payout on record. While the record high payout should have resulted in a jump in production, New Zealand dairy production is forecast to slump 4.6% in MY 2007/08. The main reason for the decline is the drought that covered much of New Zealand during January through April 2008. Skim milk powder and butter exports are expected to fall significantly in MY 2007/08 while whole milk powder export volumes are expected to remain constant. Cheese exports are forecast drop approximately 3% from MY 2006/07 levels.

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Includes PSD Changes: Yes  
Includes Trade Matrix: Yes  
Semi-Annual Report  
Wellington [NZ1]  
[NZ]

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## Section I Executive Summary

Prospects for the New Zealand dairy industry in the near term are positive. The worldwide supply and demand situation has translated into a record farm gate price of NZ \$7.30/kg (USD 5.62) of milk solids being paid to New Zealand dairy farmers for MY 2007/08. While next year's farm gate price will likely be lower, it is still expected to be the second highest payout on record. With the relative profitability of dairy production vis a vis sheep and beef production, conversions of land to dairying are continuing as fast as infrastructure will allow.

While the record high payout should have resulted in a jump in production, New Zealand dairy production is forecast to slump 4.6% in MY 2007/08. The main reason for the decline is the drought conditions that covered much of New Zealand during the January through April, 2008 time period.

With the drop in domestic milk supply, it has been a challenge for exporters to maintain export volumes. Skim milk powder and butter exports are forecast to record significant decreases in volume for MY 2007/08. Of the main commodity groups, only whole milk powder (WMP) is expected to record export volumes the same as last year. However, cheese exports are forecast to drop only 3% from MY 2006/07 levels. This reflects the relatively profitability to New Zealand dairy processors for WMP and cheese. In the short to medium term, it is likely that cheese exports will increase slightly faster than the increase in overall milk supply.

Over the long term, there are many factors within New Zealand that are likely to constrain the rate of increase in the milk supply and ultimately the size of the industry. Environmental concerns are impacting on dairy farming with local, regional, and national government compliance costs increasing faster than the rate of inflation. There is an increasing focus on nitrate and phosphate pollution of the waterways and there will be increased compliance costs in this area to the point of production being limited in certain areas. Because of the nation-wide shortage of labor, wage costs have risen significantly and are expected to continue increasing. While overall there is sufficient quantity of water in New Zealand, getting it water to the right place at the right time is becoming increasingly expensive both in terms of infrastructure costs and environmental planning.

Parts of the Dairy Industry Restructuring Act (DIRA) are to be overhauled this year. The main thrust of this review is the development of a new mechanism to price milk that Fonterra is obligated to supply to alternative processors. New milk processing factories are being built or are in the planning stage, which, according to the Ministry of Agriculture and Forestry, means that Fonterra's market share could drop from approximately 95% to between 85 and 90% by 2013.

## Section II Statistical Tables

<b>PSD Table</b>									
<b>Country</b>	<b>New Zealand</b>								
<b>Commodity</b>	<b>Dairy, Milk, Fluid</b>						<b>(1000 HEAD)(1000 MT)</b>		
	<b>2006</b>	<b>Revised</b>		<b>2007</b>	<b>Estimate</b>		<b>2008</b>	<b>Forecast</b>	
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
<b>Market Year Begin</b>		06/2005	06/2005		06/2006	06/2006		06/2007	06/2007
Cows In Milk (000s)	4100	4100	4100	4163	4140	4163	4200	4200	4200
Cows Milk Production	15200	15200	15200	15595	15600	15595	15830	15830	14876
Other Milk Production	0	0	0	0	0	0	0	0	0
Total Production	15200	15200	15200	15595	15600	15595	15830	15830	14876
Other Imports	0	0	0	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0	0	0	0
Total Supply	15200	15200	15200	15595	15600	15595	15830	15830	14876
Other Exports	53	50	53	61	50	61	61	61	61
Total Exports	53	50	53	61	50	61	61	61	61
Fluid Use Dom. Consum.	360	360	360	360	360	360	360	360	360
Factory Use Consum.	14742	14745	14742	15129	15145	15129	15364	15364	14410
Feed Use Dom. Consum.	45	45	45	45	45	45	45	45	45
Total Dom. Consumption	15147	15150	15147	15534	15550	15534	15769	15769	14815
Total Distribution	15200	15200	15200	15595	15600	15595	15830	15830	14876
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	0	0	0	0	0	0	0	0	0

<b>PSD Table</b>									
<b>Country</b>	<b>New Zealand</b>								
<b>Commodity</b>	<b>Dairy, Dry Whole Milk Powder</b>						<b>(1000 MT)</b>		
	2006	Revised		2007	Estimate		2008	Forecast	
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
<b>Market Year Begin</b>		06/2005	06/2005		06/2006	06/2006		06/2007	06/2007
Beginning Stocks	62	70	80	39	70	57	22	40	40
Production	611	634	611	653	655	653	685	685	670
Other Imports	1	1	1	1	1	1	1	1	1
Total Imports	1	1	1	1	1	1	1	1	1
Total Supply	674	705	692	693	726	711	708	726	711
Other Exports	634	634	634	670	660	670	685	685	670
Total Exports	634	634	634	670	660	670	685	685	670
Human Dom. Consumption	1	1	1	1	1	1	1	1	1
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Consumption	1	1	1	1	1	1	1	1	1
Total Use	635	635	635	671	661	671	686	686	671
Ending Stocks	39	70	57	22	65	40	22	40	40
Total Distribution	674	705	692	693	726	711	708	726	711
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	4	4	4	4	4	4	4	4	4

<b>PSD Table</b>									
<b>Country</b>	<b>New Zealand</b>								
<b>Commodity</b>	<b>Dairy, Milk, Nonfat Dry</b>			<b>(1000 MT)</b>					
	2006	Revised		2007	Estimate		2008	Forecast	
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
<b>Market Year Begin</b>		06/2005	06/2005		06/2006	06/2006		06/2007	06/2007
Beginning Stocks	35	35	47	35	35	47	8	20	20
Production	247	247	247	304	304	304	317	317	262
Other Imports	1	1	1	1	1	1	0	0	0
Total Imports	1	1	1	1	1	1	0	0	0
Total Supply	283	283	295	340	340	352	325	337	282
Other Exports	243	243	243	327	310	327	312	312	257
Total Exports	243	243	243	327	310	327	312	312	257
Human Dom. Consumption	5	5	5	5	5	5	5	5	5
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Consumption	5	5	5	5	5	5	5	5	5
Total Use	248	248	248	332	315	332	317	317	262
Ending Stocks	35	35	47	8	25	20	8	20	20
Total Distribution	283	283	295	340	340	352	325	337	282
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	1	1	1	1	1	1	0	1	1

<b>PSD Table</b>									
<b>Country</b>	<b>New Zealand</b>								
<b>Commodity</b>	<b>Dairy, Butter</b>						<b>(1000 MT)</b>		
	2006	Revised		2007	Estimate		2008	Forecast	
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
<b>Market Year Begin</b>		06/2005	06/2005		06/2006	06/2006		06/2007	06/2007
Beginning Stocks	22	46	22	21	46	21	15	15	15
Production	390	390	390	419	419	458	419	390	385
Other Imports	1	1	1	1	1	1	0	0	0
Total Imports	1	1	1	1	1	1	0	0	0
Total Supply	413	437	413	441	466	480	434	405	400
Other Exports	366	365	366	400	400	439	393	364	360
Total Exports	366	365	366	400	400	439	393	364	360
Domestic Consumption	26	26	26	26	26	26	26	26	25
Total Use	392	391	392	426	426	465	419	390	385
Ending Stocks	21	46	21	15	40	15	15	15	15
Total Distribution	413	437	413	441	466	480	434	405	400
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	30	30	30	30	30	30	30	0	30

Note: These butter figures include anhydrous milk fat (AMF). The AMF portion of these figures has been converted to a butterfat equivalent by multiplying by 1.22.

<b>PSD Table</b>									
<b>Country</b>	<b>New Zealand</b>								
<b>Commodity</b>	<b>Dairy, Cheese</b>						<b>(1000 MT)</b>		
	2006	Revised		2007	Estimate		2008	Forecast	
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
<b>Market Year Begin</b>		06/2005	06/2005		06/2006	06/2006		06/2007	06/2007
Beginning Stocks	32	46	46	32	46	46	6	20	20
Production	292	285	292	308	319	308	329	329	321
Other Imports	3	3	3	3	3	3	3	3	3
Total Imports	3	3	3	3	3	3	3	3	3
Total Supply	327	334	341	343	368	357	338	352	344
Other Exports	267	260	267	309	300	309	305	305	299
Total Exports	267	260	267	309	300	309	305	305	299
Human Dom. Consumption	28	28	28	28	28	28	28	28	28
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Consumption	28	28	28	28	28	28	28	28	26
Total Use	295	288	295	337	328	337	333	333	325
Ending Stocks	32	46	46	6	40	20	5	19	19
Total Distribution	327	334	341	343	368	357	338	352	344
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	30	30	30	30	30	30	30	30	30

<b>PSD Table</b>									
<b>Country</b>	<b>New Zealand</b>								
<b>Commodity</b>	<b>Dairy, Dried Whey</b>						<b>(1000 MT)</b>		
	2006	Revised		2007	Estimate		2008	Forecast	
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
<b>Market Year Begin</b>		01/2006	01/2006		01/2006	01/2006		01/2006	01/2006
Beginning Stocks	0	0	0	0	0	0	0	0	0
Production	0	0	8	0	0	11	0	0	13
Other Imports	0	0	0	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0	0	0	0
Total Supply	0	0	8	0	0	11	0	0	13
Other Exports	0	0	8	0	0	11	0	0	13
Total Exports	0	0	8	0	0	11	0	0	13
Human Dom. Cons	0	0	0	0	0	0	0	0	0
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Cons.	0	0	0	0	0	0	0	0	0
Total Use	0	0	8	0	0	11	0	0	13
Ending Stocks	0	0	0	0	0	0	0	0	0
Total Distribution	0	0	8	0	0	11	0	0	13
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	0	0	0	0	0	0	0	0	0

Sources (all PS&D tables): Ministry of Agriculture and Forestry, Statistics New Zealand, Livestock Improvement Corporation, and Post estimates derived from industry sources.

Note: Data included in these tables is not official USDA data. Official USDA data is available at <http://www.fas.usda.gov/psd>

## Section III. Production, Consumption, Trade and Policy

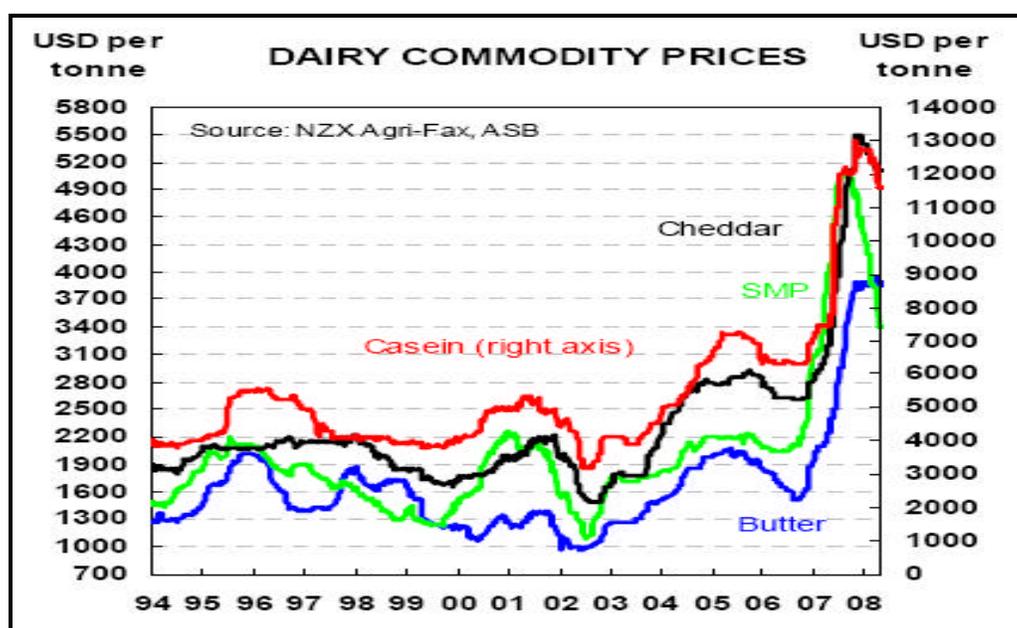
### Production

#### MY 2007/2008 Drought Conditions Temper Production

Fairly severe drought conditions over most of the North Island and part of the South Island resulted in reduced milk production. Post has adjusted its production estimate downward and now forecasts that New Zealand dairy production will fall 4.6% in MY 2007/08. The drought conditions covered much of the country from January through April of 2008, including the Waikato region, which is the main dairy producing region in New Zealand. Two regions - the west coast of the South Island and the dairying areas north of Auckland on the North Island - were largely spared from the drought. Westland Cooperative, which is located on the west coast of the South Island, is reporting increased milk production over last year.

#### Fonterra's Farm Gate Milk Price Reaches Record Level

Fonterra, a farmer cooperative and the largest milk processor in New Zealand with a 95% share of domestic milk production, announced in April 2008 that it will pay out NZD 7.30/kg (US \$5.62) of milk solids (MS) for MY 2007/08. This is the highest price ever paid out to New Zealand dairy farmers and is a direct result of the run up in world dairy prices. The record high prices are moderated somewhat by the high New Zealand dollar, which has appreciated significantly against the U.S. dollar.



#### Production Expected to Increase in MY 2008/2009 and Beyond

The effects of the drought will still be felt going into the next season, largely because of the relatively poor condition of cows going into the winter season and relatively low pasture supplies on farm. There is significant demand for supplementary feed and off-farm grazing, which is driving up the prices for hay, silage and feed grains. It is likely that the effects of the drought will moderate the recovery in production expected next year when additional farm conversions will come on stream together with increased numbers of cows.

Post forecasts a significant upturn in production in the MY2008/2009 year, with domestic milk production expected to reach 16 to 16.5 million tons of milk, up from an estimated 14.9 million tons in MY 2007/08, and 15.6 million tons in MY 2006/07. The increase is largely attributable to the increase in both the number of dairy cows and dairy area going into the MY2007/2008 season.

The ongoing conversions of sheep and beef land to dairying, combined with deforestation of land for dairying, is expected to result in approximately 150 new farms coming on stream per year for the next two to three years. As such, it is expected that milk supply will increase between 2.5 to 4% per annum for the next three to four years.

### **Environmental Concerns Over Dairying Continue to Grow**

There are several factors that will influence the level of dairy production in New Zealand in the future. One issue receiving significant attention is the environmental impact of dairy production. While only 7% of New Zealand's total land area is occupied by dairy farms, there is concern that the increasing intensity of dairy farming (e.g. a steady increase in the stocking rate and production per hectare) is causing a buildup of nitrates in the soil, which are leaching into the waterways and potentially harming water quality. In addition, there is some evidence that soil quality is being adversely affected with the loss of organic matter, compaction, and loss of micro flora and fauna.

New Zealand dairy farmers must comply with environmental regulations promulgated and administered by Regional Councils under the auspices of the Resource Management Act. While Council requirements vary by region, compliance costs associated with meeting the requirements have steadily increased over the past several years. Under Fonterra's Clean Streams Accord, farmers are required to fence off waterways and carry out nutrient budgets.

Many industry observers believe that the growing compliance costs associated with environmental regulations will diminish profitability and temper how much the New Zealand dairy industry can expand. The Waikato region on the North Island accounts for approximately 50% of dairy production in New Zealand. With the advent of the conversion of pine forests to dairying, it has been estimated by Environment Waikato that, in order to achieve no further deterioration of water quality by 2030, nitrogen leaching from all dairy farm land would need to be capped at 26 kg/ha (based on assumptions of around 60,000 ha being deforested and converted to dairying). At present, the only definitive way for dairy farms to achieve this target would be to: apply no nitrogen fertilizer, which would reduce stocking rates; or spread all of their dairy shed effluent over the farm. It is estimated that meeting this requirement would result in a reduction in gross financial margin of 9 to 10%.

### **New Zealand's Cost of Production is Increasing**

While dairy farmers are celebrating the fact that they are receiving NZ\$7.30/kg (USD5.62) of milk solids, on farm and debt servicing costs have escalated this year. Well-managed, large-scale dairy conversions in the Canterbury region of the South Island have seen their costs increase from NZ\$2.75/kg (USD 2.12) of milk solids to NZ\$3.50/kg (USD 2.70) of milk solids this year, and there is speculation that costs could escalate to NZ\$3.75/kg (USD 2.89) of milk solids next year.

The table below, which is based on Dairy New Zealand estimates for the current season, shows the estimated financial figures for an average dairy farm producing 100,000 kilograms of milk solids per year. The magnitude of the increase in farm operating costs is dramatic - a 32% increase from MY 2006/07 to MY 2007/08. It is estimated that approximately NZD80¢ (USD 0.62) per kilogram of the cost increase is due to the cost of the drought. While the

volume of supplementary feed purchased next year is likely to decrease, prices for grains and silage are unlikely to moderate very much.

<b>NZ Average Farm</b>	<b>MY2006/07</b>	<b>MY2007/08</b>	<b>Percentage</b>
<b>Estimated Financials</b>	<b>NZ\$/kg MS</b>	<b>NZ\$/kg MS</b>	<b>Change</b>
Milk Income	4.50	7.30	62%
Livestock Income	0.20	0.20	0%
Total Revenue	4.70	7.50	60%
Farm Operating Costs	3.70	4.90	2%
Debt Servicing	n/a	1.50	
Tax	n/a	0.35	
Residual	n/a	0.75	

Source: Dairy New Zealand estimates

## Consumption

### MY2007/08

Post has revised the total domestic consumption estimate for MY2007/08 downward to reflect the reduction in demand from higher consumer prices.

### Consumer Prices for Dairy Products Increase Dramatically

Prices for dairy products at the retail level have increased significantly over the last twelve months with butter showing the most significant increase. The price increases have been large enough and rapid enough to dampen demand. According to press reports, the demand for butter during the March 2008 quarter is down 12% from a year ago. Demand for cheese products is reportedly showing a similar trend.

<b>New Zealand Retail Prices for Dairy Products (New Zealand Dollars)</b>			
<b>Product</b>	<b>Mar-07</b>	<b>Mar-08</b>	<b>Percent Change</b>
Milk Std Homogenized 2 Liters	\$2.61	\$3.25	25%
Cheese Mild Cheddar 1 kg	\$6.46	\$10.69	65%
Butter salted 500gram	\$2.04	\$3.71	82%

Source: Statistics New Zealand

## Trade

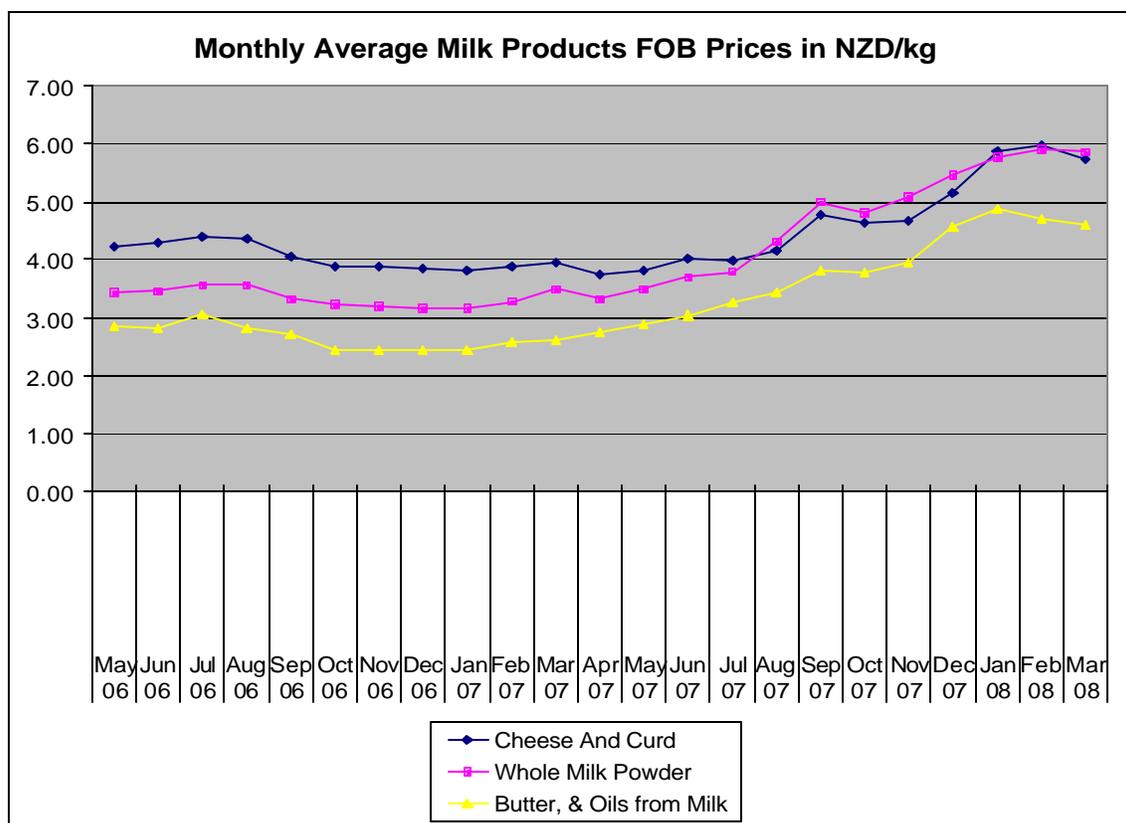
### MY2007/08 Exports

Post is revising its estimates for New Zealand exports downward slightly because of the drought. Compared to MY 2007/06, nonfat dry milk and butter exports are forecast to drop considerably while cheese exports are forecast to drop slightly and whole milk powder (WMP) exports are constant.

### Exports Year to date

As shown in the table below, New Zealand exports of skim milk powder and butter have dropped considerably while whey exports have increased. The drought is a primary factor accounting for the decline in skim milk powder and butter. Exports of WMP are largely unchanged, which reflects New Zealand's comparative advantage in production and the relatively high price for WMP vis a vis alternative products. While cheese exports have fallen slightly, exports could easily grow by 8-12% next year as production rebounds from the drought. Over time, cheese exports are expected to resume the trend established over the past fifteen years of annual growth in the order of 6-7%.

<b>Export Volume for First 10 Months of Marketing Year in Tonnes</b>			
<b>Product Type</b>	<b>June 06 to Mar 07</b>	<b>June 07 to Mar 08</b>	<b>Percent Change</b>
Whole Milk Powder	530985	530308	-0.1%
Skim Milk Powder	272931	207062	-24.1%
Butter & AMF	368690	308479	-16.3%
Cheese	252828	245941	-2.7%
Whey	8709	10579	21.5%



Source: World Trade Atlas & Statistics New Zealand

**Fonterra Capital Restructure Proposal**

Due to widespread dissatisfaction among the cooperative shareholders, Fonterra has taken its capital restructuring proposal off the table but is continuing consultations with shareholders to discuss alternatives. (See GAIN Reports NZ7030 and NZ7031 for additional information.)

**New Raw Milk Pricing Mechanism Fonterra**

To date, a third party, Duff and Phelps, has determined the commodity milk price paid to Fonterra suppliers. Fonterra proposes to supersede this with an internet based global dairy trading system that is expected to be operational in July 2008. The new system will be used to trade up to 20% of Fonterra’s total product volumes. However, customers in Latin America, China, the Middle East, North Africa and South East Asia will only be able to purchase milk powder through the monthly online auctions. The auction system will take the form of an “ascending clock auction” and the minimum lot size will be 15 tons. The products to be marketed via this channel are whole milk powder, skim milk powder, butter milk powder, butter, and anhydrous milkfat. Prices achieved will be converted back to New Zealand dollars using a benchmark foreign exchange policy and applied to all volumes.

From this gross price the “make allowance” will be deducted to give an actual commodity milk price payable to suppliers. The make allowance will be calculated from actual costs of manufacture plus depreciation and the cost of capital involved in the factories. Fonterra estimates that if the new milk price mechanism were applied today, the new calculation would be NZ 20c to NZ 30c per kg of milk solid higher than the current price.

### **Fonterra's Global Footprint Expands**

At the end of April 2008, Fonterra announced it will purchase a further 42.6% stake in Chile's largest dairy company, Soprole, which will take its total shareholding to 99.4%. Soprole has both an ingredients and a consumer brands business, which sells a range of products in the domestic market including liquid milk, UHT milk, yoghurt, spreads, and desserts. Soprole has more than one-third of the domestic consumer dairy business and exports more than Fonterra is currently exporting Chile. It also has an 86.2% share in the manufacturing company Prolesur.

### **New Zealand's Milk Processing Capacity Expands**

In collaboration with Dairy Trust, Open Country Cheese is building a new milk powder dryer this year effectively doubling their production capacity from 200 million liters to 400 million liters. New Zealand Dairies Limited, which is partially owned by Russian baby food producer Nutritek, has built a factory in South Canterbury on the South Island that is expected to become operational in August 2008. Another company, Synlait, has nearly completed their facility in mid-Canterbury. Fonterra has announced that it will build a new milk powder plant in Southland on the South Island and a company called MacNab Ventures is planning to build a factory there as well.

Based on MAF estimates, the expansion of processing capacity means that Fonterra's share of the national milk supply may drop to between 85 and 90% (from around 95%) in the next four to five years. However, in absolute terms, the volume of milk supplied to Fonterra is still expected to grow.

## **Policy Issues**

### **Dairy Industry Restructuring Act (DIRA) Under Review**

The New Zealand Government passed the Dairy Industry Restructuring Act (DIRA) in 2001 when the Fonterra Cooperative was created. At that time, Fonterra accounted for approximately 97% of the domestic milk supply. The objectives of DIRA, among other things, were to:

- Provide for the efficient operation of dairy markets in New Zealand by regulating the activities of Fonterra; and,
- Promote the principle that independent processors must be able to obtain raw milk, and other dairy goods and services necessary for them to compete in dairy markets.

Essentially, DIRA aimed at protecting the position of companies that bought milk from either Kiwi or NZ Dairy Group from monopoly pricing; protect domestic consumers from monopoly pricing; and provide an entry path for new processors into the milk processing industry.

The domestic competition provisions were largely satisfied by the requirement that Fonterra divest New Zealand Dairy Foods Limited and the subsequent allocation of up to 250 million liters of regulated milk per season. This ensured at least one significant domestic competitor to Fonterra in terms of fresh and liquid products for domestic consumption. This allocation is now held by Goodman Fielder Limited.

The level of competition is measured by different "triggers" for the North and South Islands. Under DIRA, the competition regulations will cease once triggers for both islands are met as follows:

- South Island: independent processors collect at least 5 million kilograms of milk solids (approximately 780 million liters) in a season and one independent processor

- collects at least 25 million kilograms (approximately 300 million liters) of milk solids from dairy farmers outside the border of the Westland Regional Council; and
- North Island: independent processors collect 12.5% or more of milk solids from dairy farmers in a season (or conversely, Fonterra's market share falls to 87.5%).

On the South Island, the first part of the trigger either has, or will be met, this season. As of yet, no independent processor has "tripped" the second part, though additional capacity is planned that implies this could be breached in the near future. It is expected that the South and North Island triggers could be jointly met by 2013, and potentially earlier.

MAF announced in August of 2007 that it would review the raw milk regulations in DIRA. The review was prompted by, among other things, longstanding industry concerns ranging from certainty of access to regulated milk to various aspects of the pricing methodology. The raw milk regulations permit the NZG to require Fonterra to supply up to 5% of its milk (currently around 750 million liters) to independent processors at a regulated price. The regulations were set at 400 million liters per annum from 2001/02 to 2006/07, but have been increased to 500 million liters for 2007/08 only and to 600 million liters for 2008/09 only pending the outcome of the review.

Under the review, MAF is reportedly considering the following options:

- Option 1: Total supply of 400 million liters and a series of rules to manage excess demand.
- Option 2: Total supply of 600 million liters and rationing rules should excess demand arise.
- Option 3: Similar to Option 2 with the exception that an auction mechanism would be used to manage excess demand.

The third option is preferred by MAF. The new regime resulting from this review, along with the Cabinet approval process, is expected to take effect in the 2009/10 season.

### **China FTA**

New Zealand's Prime Minister Helen Clark and Chinese Premier Wen Jiabao signed a bilateral free trade agreement (FTA) in Beijing on April 7, 2008 - China's first FTA with an OECD country. The FTA is comprehensive covering goods, services and investment, and provides for the elimination over time of tariffs on 96 percent of New Zealand's exports to China. On full implementation, this will equate to an annual duty savings of NZ \$115.5 million (U.S. \$82.4 million).

China is New Zealand's fourth largest export market. Major exports to China are dairy products, wood and wood pulp, wool, fish, meat and aluminum. Preliminary estimates put the value of the FTA to New Zealand exporters at between NZ \$180 million and NZ \$280 million a year (US \$144 to \$224 million). New Zealand goods now face average tariffs of about 9.5% on entering China – but in the case of agricultural imports, the average tariff is more than 15%. (China currently imposes tariffs of 10% on milk powder, 15% on butter, cheese and yoghurt, 12% on beef, 12% to 20% on sheep meat, and up to 20% on kiwifruit.)

Under the FTA, Chinese tariffs on some dairy products - infant milk formula, casein, yoghurt and whey - will be phased out over five years and tariffs on butter, liquid milk and cheese going into China will be phased out over ten years. Chinese tariffs on skim and whole milk powder will be removed over twelve years. There are mechanisms to delay the tariff reductions if exports exceed certain quantities.

## Other

### **Dexcel and Dairy Insight Merge to Form Dairy New Zealand**

Dairy Insight, the industry association that collected, managed and administered producer levies, has merged with DEXCEL, an industry association whose research and extension activities were largely funded by Dairy Insight. The new organization is called Dairy New Zealand.

### **Agriculture Research Funding Increases**

In January 2008, the New Zealand Government announced it would contribute NZ \$700 million to a new fund to boost agriculture and horticultural research, development and innovation. Coupled with private sector contributions, it is hoped that the fund will distribute a total of NZ \$2 billion over the next ten to fifteen years

### **Kiwis Investing in Dairy Farms Offshore**

While there has been a steady trickle of New Zealand dairy farmers moving across the Tasman Sea to Australia, in the last eighteen months. There have been two notable investments by Kiwi syndicates into dairy farming in South America. The largest is New Zealand Farming Systems Uruguay, which as of December 31, 2007, had USD\$297million in assets with total equity of USD\$192 million.

## Appendix 1. Further Information and Links

China NZ FTA details:

<http://chinafta.govt.nz/index.php>

Impact of ETS on NZ Agriculture

<http://www.maf.govt.nz/climatechange/reports/Projected-Impacts-of-NZETS.pdf>

Fonterra to measure Carbon Footprint

<http://www.scionresearch.com/Default.aspx?PageContentID=1129&tabid=62>

NZ Farming Systems Uruguay

<http://www.nzfsu.co.nz/index.pasp>

Dairy Industry Restructuring Act 2001 (includes dates for removal of quota allocation – search under ‘Statutes’)

<http://www.legislation.govt.nz/>

Government Consultation on Future Rights to Dairy Export Quotas

<http://www.maf.govt.nz/mafnet/publications/regulated-dairy-quota-market/consultation-cover-page.htm>

Fonterra Cooperative Group Ltd

[www.fonterra.com](http://www.fonterra.com)

Westland Milk Products

[www.westland.co.nz](http://www.westland.co.nz)

Tatua Cooperative Dairy Company Ltd

[www.tatua.com](http://www.tatua.com)

Ministry of Agriculture and Forestry (includes reports and statistics)

[www.maf.govt.nz](http://www.maf.govt.nz)

Livestock Improvement Corporation (see statistics under ‘Publications’)

<http://www.lic.co.nz/main.cfm>

DairyNZ - New Zealand’s dairy industry good body & research organization

<http://www.dexcel.co.nz/main.cfm?id=119>

## Appendix 2. Export Quotas GAIN report NZ7015

Removal of Fonterra Control over Export Licenses (Quota Management)		
Date	Country	Notes
June 30, 2007	Dominican Republic	
July 31, 2007	Canada	
Dec 31, 2007	European Communities	Removals between 12/31/02 and 12/31/10
Dec 31, 2008	United States	Cheddar and low-fat cheese
Dec 31, 2009	United States	American-type cheeses
Mar 31, 2010	Japan	

## Appendix 3. Reports Submitted by AgWellington in CY 2008

Previous GAIN Reports		
NZ8007	New Zealand Announces FTA with China	April 17, 2008
NZ8006	Livestock and Products March 2008 Update	March 27, 2008
NZ8003	Impact of Drought on New Zealand Milk Production	March 11, 2008
NZ8002	HRI Food Service Sector	March 4, 2008
NZ8001	Bio-Fuel Developments in New Zealand	Feb 25, 2008