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## New Zealand

### Dairy and Products

### Semi-Annual

### 2004

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**Report Highlights:**

New Zealand's milk production in the 2003/04 season is estimated at 14.78 million tons, 3 percent above a year earlier. Total exports of butter, cheese, skim and whole milk powder increased 2.5 percent to 1.667 million tons. Cheese and butter production rose marginally, with Fonterra forecasting prices to remain relatively stable during the remainder of calendar year 2004. Fonterra is now completing negotiations with the Chinese government and the Chinese dairy company Sanlu to purchase a 39 percent share of Sanlu.

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

## SECTION I. EXECUTIVE SUMMARY

New Zealand's milk production during the 2003/04 season (June-May) is estimated by Post to reach 14.78 million tons, an increase of 3 percent over the previous year. The larger milk output results from increased on-farm productivity combined with a 2 percent expansion in the number of cows and heifers in calf and milk to 3.92 million. Milk flows throughout New Zealand were mixed, although milk output in both the North and South Islands was up this season. Devastating floods in the lower North Island during February 2004 affected more than 1,500 of Fonterra's 13,000 suppliers. Most of the North Island, however, had positive conditions for pasture growth. The South Island also faced mixed production levels. Favorable conditions on the west coast increased production. But dry conditions in other areas decreased milk flow during January, especially from farms with inadequate or no irrigation.

Prompted by significant price increases for cheese and butter between November 2003 and May 2004, these dairy products were the main focus for New Zealand's increased output. Total exports of cheese, butter, skim milk powder and whole milk powder will increase 2.5 percent to 1.667 million tons for the 2003/04-season. Cheese production in 2003/04 increased 7 percent. Export volume for cheese, however, will remain at last season's 290,000 tons due to tighter exportable supplies, resulting from reduced beginning season inventories. Butter output in 2003/04 rose 5 percent over a year earlier. But this year's sharply lower beginning stocks will limit growth in butter exports to 400,000 tons. End-of-season butter stocks will fall to only 13,000 tons. Skim milk and whole milk powder production is forecast to increase 7 and 1.5 percent, respectively. Exports of skim milk will rise 7 percent, while whole milk powder shipments will marginally exceed last year's level. Milk powder inventories will be down. Fonterra anticipates that dairy product prices will remain stable for the remainder of calendar year 2004. This takes into account the recent rapid rise in cheese and butter prices in the international market.

Fonterra is currently completing negotiations with the Chinese government and the Chinese dairy company Shijiazhuang Sanlu Group Co. (Sanlu) to purchase a share of ownership in Sanlu. It is likely that Fonterra will become the second largest shareholder in the company with a 39 per cent stake. China is a key market for Fonterra, since milk consumption continues to increase markedly thanks to rising Chinese incomes and a growing demand for western-style food. Fonterra may also benefit from discussions between the governments of New Zealand and China to create a free trade agreement (FTA), which both countries hope to conclude in 2005.

Debate continues over the health benefits of A2 milk, containing no A1 beta casein, over standard milk. New Zealand-based A2 Corporation, which licenses the A2 branded milk and a method to identify A2 genes in cattle, argues that milk containing the A1 beta casein can be linked to increased autism and mental disorders, heart disease and a type of diabetes in children. Scientists continue to debate the scientific merit of A2 Corporation's claims given a lack of conclusive evidence. Marketing of A2 milk has begun in New Zealand, with the United States and Australia soon to follow under license. Following its April listing on the New Zealand alternative exchange, A2 Corporation is looking to license A2 milk in Europe.

## SECTION II. STATISTICAL TABLES

## PS&amp;D TABLES

New Zealand Dairy, Milk, Fluid						
				(1000 HEAD)(1000 MT)		
	2002	Revised	2003	Estimate	2004	Forecast
	USDA	Post	USDA	Post	USDA	Post
	Official	Estimate	Official	Estimate	Official	Estimate
	[Old]	[New]	[Old]	[New]	[Old]	[New]
Market Year Begin		06/2001		06/2002		06/2003
Cows In Milk	3749	3749	3842	3842	3900	3920
Cows Milk Production	13925	13925	14346	14346	14705	14780
Other Milk Production	0	0	0	0	0	0
TOTAL Production	13925	13925	14346	14346	14705	14780
Intra EC Imports	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	13925	13925	14346	14346	14705	14780
Intra EC Exports	0	0	0	0	0	0
Total Exports	47	47	47	47	45	45
TOTAL Exports	47	47	47	47	45	45
Fluid Use Dom. Consum.	355	355	360	360	360	360
Factory Use Consum.	13480	13480	13895	13895	14255	14330
Feed Use Dom. Consum.	43	43	44	44	45	45
TOTAL Dom. Consumption	13878	13878	14299	14299	14660	14735
TOTAL DISTRIBUTION	13925	13925	14346	14346	14705	14780
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

New Zealand Dairy, Cheese						
	(1000 MT)					
	2002	Revised	2003	Estimate	2004	Forecast
	USDA	Post	USDA	Post	USDA	Post
	Official	Estimate	Official	Estimate	Official	Estimate
	[Old]	[New]	[Old]	[New]	[Old]	[New]
Market Year Begin		06/2001		06/2002		06/2003
Beginning Stocks	43	43	51	51	20	20
Production	312	312	285	285	285	305
Intra EC Imports	0	0	0	0	0	0
Total Imports	1	1	2	2	5	2
TOTAL Imports	1	1	2	2	5	2
TOTAL SUPPLY	356	356	338	338	310	327
Intra EC Exports	0	0	0	0	0	0
Total Exports	277	277	290	290	280	290
TOTAL Exports	277	277	290	290	280	290
Human Dom. Consumption	28	28	28	28	28	28
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	28	28	28	28	28	28
TOTAL Use	305	305	318	318	308	318
Ending Stocks	51	51	20	20	2	9
TOTAL DISTRIBUTION	356	356	338	338	310	327
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	38	38	50	38	40	40

New Zealand Dairy, Butter						
	(1000 MT)					
	2002 USDA Official [Old]	Revised Post Estimate [New]	2003 USDA Official [Old]	Estimate Post Estimate [New]	2004 USDA Official [Old]	Forecast Post Estimate [New]
Market Year Begin	06/2001		06/2002		06/2003	
Beginning Stocks	50	50	51	51	29	29
Production	370	370	390	390	405	410
Intra EC Imports	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	420	420	441	441	434	439
Intra EC Exports	0	0	0	0	0	0
Total Exports	343	343	386	386	395	400
TOTAL Exports	343	343	386	386	395	400
Domestic Consumption	26	26	26	26	26	26
TOTAL Use	369	369	412	412	421	426
Ending Stocks	51	51	29	29	13	13
TOTAL DISTRIBUTION	420	420	441	441	434	439
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	27	27	22	22	18	18

New Zealand Dairy, Milk, Nonfat Dry						
	2002	Revised	2003	Estimate	2004	(1000 MT) Forecast
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin		06/2001		06/2002		06/2003
Beginning Stocks	98	98	100	100	106	80
Production	255	255	325	299	345	321
Intra EC Imports	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	353	353	425	399	451	401
Intra EC Exports	0	0	0	0	0	0
Total Exports	248	248	314	314	350	336
TOTAL Exports	248	248	314	314	350	336
Human Dom. Consumption	5	5	5	5	5	5
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	5	5	5	5	5	5
TOTAL Use	253	253	319	319	355	341
Ending Stocks	100	100	106	80	96	60
TOTAL DISTRIBUTION	353	353	425	399	451	401
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	1	1	2	1	2	1

New Zealand Dairy, Dry Whole Milk Powder						
	2002	Revised	2003	Estimate	2004	(1000 MT) Forecast
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin		06/2001		06/2002		06/2003
Beginning Stocks	20	20	78	78	57	57
Production	540	540	615	615	630	625
Intra EC Imports	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	560	560	693	693	687	682
Intra EC Exports	0	0	0	0	0	0
Total Exports	481	481	635	635	650	641
TOTAL Exports	481	481	635	635	650	641
Human Dom. Consumption	1	1	1	1	1	1
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	1	1	1	1	1	1
TOTAL Use	482	482	636	636	651	642
Ending Stocks	78	78	57	57	36	40
TOTAL DISTRIBUTION	560	560	693	693	687	682
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	4	4	3	3	3	3

## TRADE MATRICES

NEW ZEALAND DAIRY EXPORTS, CHEESE			
	Calendar years, Tons		
Country	2001	2002	2003
Japan	54,599	44,459	45,698
United States	38,203	47,742	37,842
Australia	40,170	40,128	36,395
Belgium	19,057	19,169	29,251
United Kingdom	14,832	17,016	19,258
Mexico	11,292	13,462	14,674
Korea, South	12,056	10,307	11,040
Saudi Arabia	8,281	9,737	9,891
Taiwan	4,955	5,953	6,286
Algeria	6,407	7,756	5,812
Egypt	6,508	6,190	5,767
Philippines	2,457	3,324	4,545
Hong Kong	4,314	3,854	3,305
Malaysia	2,893	3,014	3,303
Jamaica	5,736	3,324	3,238
Trinidad & Tobago	1,842	2,293	3,220
Netherlands	7,450	2,300	2,976
Guatemala	1,213	2,333	2,713
Panama	2,869	2,684	2,668
China	390	1,296	2,458
Other	31,905	32,548	31,608
Total	277,430	278,888	281,949



NEW ZEALAND DAIRY EXPORTS, BUTTER			
Calendar years, Tons			
Country	2001	2002	2003
Belgium	34,701	68,938	72,395
Iran	15,225	33,623	37,477
Russia	3,656	24,801	33,064
Egypt	24,095	32,928	25,139
United States	26,598	21,049	22,871
Denmark	5,061	4,808	20,816
Mexico	21,011	23,415	19,080
Canada	18,113	14,401	12,566
Saudi Arabia	5,170	7,049	11,033
Taiwan	8,971	10,829	10,596
Philippines	4,534	5,452	9,604
China	1,346	5,847	9,543
Australia	10,065	6,337	8,450
Thailand	3,915	7,487	7,920
United Arab Emirates	4,453	4,826	6,270
Indonesia	3,803	6,278	6,017
Morocco	5,938	8,951	5,739
Singapore	4,914	7,658	5,561
Malaysia	4,480	4,541	5,280
Algeria	5,184	6,346	4,595
Other	92,102	95,367	44,298
Total	303,335	400,930	378,314

## NEW ZEALAND DAIRY EXPORTS, NON-FAT DRY MILK

Calendar years, Tons

Country	2001	2002	2003
Philippines	29,480	25,223	50,631
Malaysia	24,727	20,895	25,079
China	7,061	20,084	21,086
Thailand	15,277	23,444	19,940
Belgium	159	12,047	19,331
Indonesia	18,686	24,200	16,013
Saudi Arabia	11,170	12,650	14,349
Japan	18,513	29,740	13,145
Singapore	3,084	8,206	11,841
Taiwan	19,789	14,250	11,409
Mexico	4,414	25,538	10,205
Vietnam	9,301	13,664	9,661
Cuba	10,167	6,346	9,158
Netherlands	369	8,905	8,875
Australia	3,308	1,483	4,571
Hong Kong	9,669	5,246	4,260
Sri Lanka	2,150	4,304	4,112
Kuwait	494	666	4,069
Peru	4,201	4,169	4,046
Egypt	4,760	4,349	3,477
Other	28,507	58,361	28,879
Total	225,285	323,772	294,137

## NEW ZEALAND DAIRY EXPORTS, WHOLE MILK POWDER

Country	Calendar years, Tons		
	2001	2002	2003
China	29,638	55,874	78,806
Malaysia	41,606	47,955	53,368
Venezuela	44,895	21,738	44,030
Mexico	37,393	25,506	40,623
Philippines	27,100	32,331	39,103
Sri Lanka	31,857	30,331	39,020
Indonesia	46,250	39,841	38,436
Thailand	27,242	25,307	34,593
Vietnam	56,974	14,196	31,098
Saudi Arabia	20,495	26,227	30,410
Canada	10,989	20,666	21,289
Taiwan	20,944	21,658	19,697
Jordan	500	13,584	18,224
Algeria	7,589	15,903	17,162
Cuba	10,864	15,939	15,457
Oman	753	8,599	14,825
El Salvador	17,419	14,106	12,571
Singapore	6,737	15,560	12,511
Nigeria	2,129	3,166	10,509
Japan	4,761	8,214	10,354
Other	76,699	91,569	74,956
Total	522,834	548,270	657,043

## SECTION III. SUPPLY, DEMAND, POLICY AND MARKETING

### PRODUCTION

Post forecasts New Zealand's milk production during the 2003/04 season (June-May) at 14.78 million tons, an increase of 3 percent on the previous season. Rapid dairy farm expansion in recent years has given way to a decreasing rate of dairy farm conversions and consolidation of existing dairy operations as farmers attempt to make milk production more efficient in response to forecast decreasing dairy returns for the foreseeable future. As a result, New Zealand's dairy herd at the beginning of the 2003/04 season is estimated to have increased only 2 percent to 3.92 million cows and heifers in calf or milk.

Devastating floods in the lower North Island during February 2004 (estimated to be a one in one hundred year event) affected over 1500 of Fonterra's<sup>1</sup> 13,000 suppliers, but appears not to have greatly restricted Fonterra's<sup>1</sup> total milk supply. Although the majority of these dairy farms returned to 'business as usual' once supply routes for milk were resumed, many will produce below their optimum well into 2005 while farms are rebuilt, with some dairy farms not capable of restarting production until the 2004/05 season. Most of the remainder of the North Island had positive conditions for pasture growth, increasing milk production. The South Island also faced mixed production levels, with favorable conditions on the West Coast increasing production, while dry conditions in most other areas decreased milk flow during January, especially from farms with inadequate or no irrigation. Overall, milk flow from both islands for the 2003/04 season is greater than the previous season.

### TRADE

Due to its small, static domestic market, 95 percent of New Zealand's dairy production is exported. Although New Zealand only produces 2 percent of the world's milk, it accounts for one-third of world dairy trade. Through its international acquisitions, Fonterra manages 40 percent of world trade. The rising New Zealand dollar, which increased in value against the U.S. dollar between April 2001 and February 2004, has negatively affected New Zealand exporters, especially in recent months. It has since retreated to approximately U.S.\$ 0.63 at the beginning of May, giving New Zealand exporters some relief.

The high dollar's negative effect on dairy earnings has been offset to some extent by strong commodity prices, which are anticipated by Fonterra to remain relatively stable for the remainder of 2004. Milk powder prices have not risen to the same extent as butter and cheese due to the U.S. export intervention price of U.S. \$1800 per ton. Fonterra's restricted exportable supply of dairy products may have contributed to price rises, following the cooperative's clearance of its excess inventories during calendar year 2003. This comes at a time when drought has also reduced Australian dairy exports. Combined, both countries account for nearly half of world dairy trade. Fonterra states that it aims to bring stability to world markets by sending clear price and quantity signals to the market to ensure that it stays in equilibrium.

### *Cheese*

New Zealand's cheese production is forecast to increase 7 percent to 305,000 tons for the 2003/04 season. Exports are estimated to remain unchanged from last season at 290,000

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<sup>1</sup> Fonterra controls 95 percent of New Zealand's dairy industry, with the cooperatives Tatua and Westland making up the majority of the remaining 5 percent of the industry.

tons as a result of Fonterra having tighter exportable supplies for the 2003/04 season, due to inventory clearances during 2003.

### ***Butter***

New Zealand's butter production for the 2003/04 season is forecast to increase 5 percent to 410,000 tons. Lower inventory levels will restrict butter exports, which are estimated to expand only 3.5 percent to 400,000 tons as a result of tighter exportable supply.

### ***Skim Milk Powder***

Skim milk powder (SMP) production in New Zealand for the 2003/04 season is forecast to increase 7 percent to 321,000 tons. This coincides with the rise in butter production, which utilizes the cream removed from fluid milk when producing SMP. Exports are forecast to also increase 7 percent to 336,000 tons as excess inventory was cleared during 2003.

### ***Whole Milk Powder***

New Zealand's whole milk powder (WMP) production is forecast to increase 1.5 percent to 625,000 tons. This coincides with the moderate increase of cheese production, which can be produced from standardized whole milk in the place of WMP. Exports are forecast to increase 1 percent to 641,000 tons as a result of tighter exportable supply due to inventory reductions during 2003.

## **MARKETING**

### ***Fonterra's Market Strategy***

Since its formation in 2001, Fonterra has repeatedly stated its goal to continue the work of its predecessors towards global dairy industry leadership. Fonterra believes that this will be achieved through the development of higher value-added products as well as global inventory management and product optimization systems. Global expansion is important to fulfill these goals as, due to the significant trade barriers facing New Zealand dairy products in overseas markets, future growth will largely come from international acquisitions, mergers, and joint ventures (see NZ2013 & NZ2035) and not from New Zealand-based dairy export increases. Fonterra further benefits from this strategy through ready access to dairy products produced offshore via both established relationships and the spot market, allowing it to guarantee a consistent supply of product to its international customers.

Although international expansion plans were well below initial expectations during Fonterra's first two years of operation, its new CEO Andrew Ferrier has indicated his desire to expand Fonterra's international operations in the near future. At formation, Fonterra generated 80-90 percent of its earnings from New Zealand production, although its alliance with Nestlé will have altered this percentage in favor of earnings from overseas operations. Fonterra believes that only a third of its future overseas sales growth will be achieved by increasing its exports of New Zealand-produced dairy products, while expanding its overseas operations will generate the lion's share. Fonterra estimates that by 2010, New Zealand derived dairy output may contribute less than 50 percent of its earnings. The principal markets targeted for expansion and promotional activity by Fonterra include Australia, Asia, the United States, Mexico and South America.

Critics of Fonterra argue that it will be difficult to fund expansion under its cooperative business structure. Fonterra has been assessing various methods to more rapidly grow its value added structure for the past three years, but a lack of suitable options has meant that it will be at least two years before a new structure can be decided on. Fonterra currently states that there are no short-term constraints on growth, however its farmer shareholders face a much lower payout next season, indicating lower cash flows for the cooperative.

### ***Fonterra's International Expansion***

Fonterra is currently closing negotiations with the Chinese government and the Chinese dairy company Shijiazhuang Sanlu Group Co. (Sanlu) to purchase a stake in Sanlu. It is likely that Fonterra will become the second largest shareholder in the company with a 39 per cent stake. China is a key market for Fonterra, who supplied 70 percent of China's dairy imports (excluding whey) in 2002. Chinese urbanization and rapidly rising per capita incomes are increasing demand for western-style food, making China an increasingly important export destination for New Zealand dairy products. Chinese companies outside China's dairy belt face serious difficulties in ensuring a regular milk supply, creating opportunities for Fonterra to supply imported milk products.

Discussions between the government's of New Zealand and China for a trade and economic framework to create a FTA between the two countries were initiated in January 2004, and will benefit Fonterra if successful. New Zealand and China are expected to sign a trade and economic co-operation framework in June, which will be followed by a study on the feasibility of a FTA by both countries and possible negotiations on a trade deal. Both countries have expressed a desire to conclude a FTA in 2005.

In North America Fonterra, through its marketing arrangement with the U.S. cooperative Dairy America, is the largest exporter of U.S.-produced non-fat dry milk powder. Fonterra also produces milk protein concentrates with its U.S. partner, Dairy Farmers of America. Acquisitions in Mexico during 1996 (pre-Fonterra) and 2001 elevated Fonterra to become a leading player in the Mexican cheese and spreads market. Fonterra is also moving ahead with production and marketing strategies in South America through a strategic business alliance Dairy Partners Americas with Nestlé. Currently operating in Argentina, Brazil and Venezuela, in April 2004 the two partners announced their second phase of development, expanding into Ecuador, Colombia and Trinidad and Tobago. Fonterra is investing U.S.\$ 35 million in this expansion. The third phase involves Fonterra merging Chilean dairy company Soprole into its Dairy Partners Americas venture with Nestlé, who is currently Soprole's major competitor in the Chilean market. Fonterra has a 51 percent shareholding in Soprole, which is one of Chile's four largest dairy organizations. Unfortunately, the other major shareholder of Soprole is against this idea. Fonterra is assessing buying out its current business partner, however it faces uncertainty as to Chilean competition authorities allowing the merger of Fonterra's business with Nestlé's, due to the dominant market share the resulting joint venture would command of Chile's dairy industry.

In Australia, Fonterra is bringing together its existing production and marketing assets, allowing it to manage its business activities more effectively. This reflects Fonterra's strategic view that Australia is part of its domestic market and should be included in its consolidation to ensure its future success. However, some industry commentators argue that Fonterra has not adequately articulated a strategy for the Australian market, with some of its investments failing to create the impression of a cohesive strategy. Fonterra's 50 percent ownership of Bonlac Foods along with shareholdings in other dairy companies in Australia may allow it to take advantage of trade benefits provided to the Australian dairy industry by the U.S.-Australian FTA that was negotiated in February 2004.

In Europe Fonterra brought its Anchor brand into a new marketing arrangement with the Lurpark brand of ARLA, a European dairy cooperative. This will ensure that Fonterra obtains maximum marketing value from its Anchor brand in the European Union, with a focus on the U.K. Fonterra also has a joint venture with Britannia in India.

### ***Farmer Payouts***

Fonterra revised its 2003/04 season payout to farmers in December 2003, increasing it 20 cents to NZ\$ 4.15 per kg of milk solids. Increased prices and demand for Fonterra's dairy products on the international market were cited as reasons for the revised payout. For the 2004/05 season Fonterra has forecast its payout at NZ\$ 3.50 per kg of milk solids, with possible variation 5 percent either side of this. Although only an estimate, the much lower payout forecast is the result Fonterra's inability to hedge the weaker U.S. dollar at as favorable a rate as for the 2003/04 season due to the continual rise of the NZ dollar and Fonterra's strategy of always hedging 100 percent of its foreign exchange 15 months in advance. Unfavorable currency conversion is forecast by Fonterra to be offset to some extent by strong commodity prices that Fonterra anticipates will remain stable for the remainder of 2004. Industry analysts estimate that the payout for the 2005/06 season will be even lower, with some estimates below NZ\$ 3 per kg of milk solids, while Fonterra has assured farmers that the payout will not drop below this mark. A recent rapid fall in the New Zealand dollar against the U.S. dollar however, has caused some analysts to increase their payout estimates for the 2005/06 season.

Although denied by Fonterra, falling farmer incomes are viewed by industry commentators as one of the key drivers for its announcement in May 2004 that it will cut 700 of 20,000 worldwide staff over the next 2 years. Most redundancies will occur in administration positions in its 10,000 strong domestic workforce. Fonterra states that the redundancies are in fact the result of ongoing streamlining of the cooperative's structure since its creation in 2001.

### ***A2 Milk***

It is still uncertain if A2 milk, which contains no A1 beta casein, offers health benefits over standard milk. New Zealand based A2 Corporation, which licenses the A2 branded milk and a method to identify A2 genes in cattle, argues that milk containing the A1 beta casein can be linked to increased autism and mental disorders, heart disease and a type of diabetes in children. Scientists continue to debate the scientific merit of A2 Corporation's claims due to the lack of conclusive evidence. Marketing of A2 milk has begun in New Zealand, with the United States (through a strategic partnership with IdeaSphere Inc.) and Australia soon to follow under license. Following its April listing on the New Zealand alternative exchange, A2 Corporation is looking to also license A2 milk in Europe.

### ***Fonterra's New Lactose Plant***

Fonterra is set to become the second largest manufacturer of pharmaceutical lactose in the world following the completion of its new lactose plant that is currently being built in New Zealand. This expansion of lactose production is part of Fonterra's strategy to create more value from milk. The pharmaceutical lactose that the plant will produce will be of a high enough quality to be sold in the rapidly growing inhalation medicines market. Although

currently only worth NZ\$ 5.5 million, the market for inhalation quality lactose is forecast by Fonterra to grow by 15 percent per year over the next five years.

## **POLICY**

### ***EU Butter Quota***

In December 2003 the E.U. introduced a new regulation that split New Zealand's one-year quota of 76,667 tons of butter into two six-monthly periods. Fonterra supported the New Zealand government in its protests to the E.U. commission, but has since had to meet the requirements of this new regulation. The E.U. states that the new regulation removes the incentive to export butter to the E.U. early in the year when prices will be higher, before the E.U. begins its annual intervention price reductions on July 1 2004. These reductions will occur annually for the next four years. New Zealand argues that the new regulation is inconsistent with the E.U.'s WTO commitments and that New Zealand's exports to the E.U. only account for 4 percent of the butter consumed there, minimizing any threat to the market.

### ***Potential Benefits of Future New Zealand Trade Deals***

The New Zealand government is currently working towards trade deals with Thailand and Chile that could be beneficial to New Zealand's dairy industry. Fonterra currently accounts for more than half of New Zealand's exports to Thailand (approximately NZ\$ 200 million per year), which could be expanded if current quota and tariff barriers were reduced. New Zealand's dairy industry could also benefit from a trade deal with Chile, although this may be limited due to the influence of Chile's dairy industry, which in the past opposed a FTA between the two countries. Fonterra currently holds a 51 percent stake in Soprole, one of Chile's four largest dairy organizations.