Ministry for Primary Industries
Manatū Ahu Matua

SITUATION AND OUTLOOK FOR PRIMARY INDUSTRIES 2014

MID-YEAR UPDATE

DECEMBER 2014

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SITUATION AND OUTLOOK FOR PRIMARY INDUSTRIES

MID-YEAR UPDATE DECEMBER 2014

The global economy's recovery from the 2008 financial crisis has been dampened due to the legacies of high debt and unemployment levels. Recent projections of world GDP for 2014 and 2015 have been revised downwards.

Dairy export earnings are forecast to decline $4.2 billion or 23.5 percent from last season's historic highs.

Forecast total primary industry export earnings
2014/2015
$34.6 billion
▼ **9.5%**

Forecast total primary industry export earnings
2015/2016
$36.1 billion
▲ **4.3%**

Better-than-expected growth of $933 million across the Meat and Wool, Horticulture, Fisheries and Other Sectors will partially offset the fall from Dairy.

Grape supply from the 2014 vintage will bring an increase of 7.6 percent in wine export volumes.

New Zealand should fill its beef quota of 213 402 tonnes for USA exports for the first time since 2004.

Rising seafood prices in key international markets and lower exchange rates will continue to favour exporters.

Demand for logs in China is expected to pick up through economic stimulus and reducing local stockpiles.

PRIMARY INDUSTRIES FORECAST 2014/15 TO 2015/16 YEAR ENDING JUNE ($ MILLION)

	ACTUAL 2013/14	FORECAST 2014/15	EXPORT REVENUE CHANGE YE 2015		FORECAST 2015/16	EXPORT REVENUE CHANGE YE 2016	
DAIRY	$18 068	$13 830	▼ $4 238	-23.5%	$14 560	▲ $730	+5.3%
MEAT & WOOL	$8 093	$8 611	▲ $518	+6.4%	$8 811	▲ $200	+2.3%
FORESTRY	$5 144	$4 822	▼ $322	-6.3%	$5 021	▲ $199	+4.1%
SEAFOOD	$1 427	$1 525	▲ $98	+6.9%	$1 619	▲ $94	+6.2%
HORTICULTURE	$3 709	$3 865	▲ $156	+4.2%	$4 120	▲ $255	+6.6%
OTHER	$1 790	$1 951	▲ $161	+9.0%	$1 973	▲ $22	+1.1%
TOTAL	$38 231	$34 604	▼ $3 627	-9.5%	$36 104	▲ $1 500	+4.3%

1 OVERVIEW

The Situation and Outlook for Primary Industries released in June 2014 (SOPI) assessed the prospects for New Zealand's primary sectors over the next four years. This mid-year review updates the short-term forecasts for the primary sectors based on the key changes in domestic production and export market dynamics for each sector.

HIGHLIGHTS

The updated forecasts have revised down total primary industry export earnings to $34.6 billion for the current year (July 2014 to June 2015). The revised forecasts represent a 9.5 percent drop for the June 2015 year from a historic high of $38.2 billion for June 2014. The driver of this change has been a $4.2 billion decline in dairy export earnings (or 23.5 percent). This current year weakness is also now expected to flow into the 2015/16 season with forecasts revised down to $36.1 billion.

While we have revised down our forecasts, they are underpinned by an expected dairy sector recovery from the June 2015 quarter and continuing through the 2015/16 year – albeit from a lower base. The other key shift in our forecasts has been a higher than expected growth from the other sectors, offsetting the declines in dairy by $933 million in 2014/15.

Dairy export earnings are forecast to decline $4.2 billion or 23.5 percent from last season's historic highs.

The ongoing weakness in international dairy prices is due to several key shifts in global market dynamics. The key market shifts since our June forecasts include the continued strong growth in global production, the displacement of global dairy supply due to trade sanctions, and the utilisation of in-market reserves. Although these factors will see global dairy trade remain uncertain through to June 2015, we expect global demand and prices to start to stabilise and recover over the next six months.

USA beef prices are now 40 percent higher than a year ago.

Further recovery of primary sector exports is supported by the favourable market conditions for beef due to an undersupply in the USA market.

Looking through the forestry sector's commodity cycle we expect that export revenues will drop to $4.8 billion (a decline of $322 million or 6.3 percent) to June 2015, recovering to $5.0 billion by June 2016. The recovery in export earnings will be led by a shift in product mix as companies target higher-value markets and an increased demand for logs from China.

Forestry exports are expected to return to growth in 2015/16.

The seafood sector is expected to go through a period of export growth; annual export earnings are expected to grow 6.9 and 6.2 percent respectively out to June 2016. This growth is the result of both price and volume increases. In particular, the demand outlook for New Zealand's top earning stocks such as rock lobster, mussels and salmon is improving.

Similarly, horticulture export revenues are forecast to rise by $156 million, led by the recovery of the kiwifruit sector and continued growth from the wine sector.

The remaining smaller export sectors (arable, live animals, other agriculture and other food products) are also forecast to increase by $161 million (9.0 percent) in 2014/15. This is largely due to an improved price and volume outlook for "other food" (for example confectionery products) and live animal exports.

RESPONDING TO COMMODITY PRICE VOLATILITY

This year's SOPI update illustrates the impact that the dairy commodity cycle can have on our export earnings and how susceptible they are to external influences that can amplify the underlying trends. While fluctuations are normal, the current level of adjustment is not.

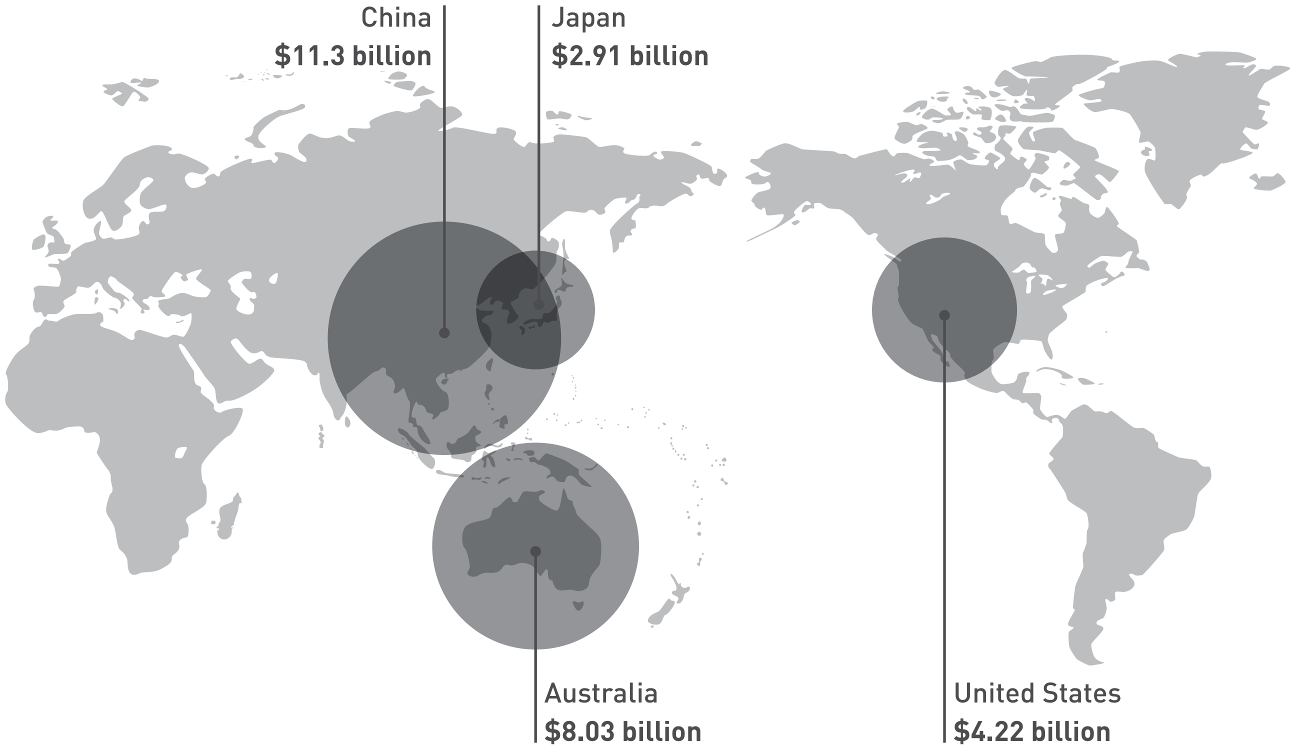
There is continued strength and a broad base of growth from our other main primary sectors, and sustained growth of our smaller Fast Moving Consumer Goods (FMCG) food sector. This continued diversification of products is important to safeguard our export earnings from sector-based commodity cycles. Moreover, it strengthens our opportunities for growth across markets and consumer channels.

This is an underpinning principle of MPI's Primary Growth Partnership (PGP) programmes, such as Transforming the Dairy Value Chain, to de-commoditise our basket of dairy products and to give producers greater opportunities to create value through market niches. These supply-side initiatives can reduce the adverse impact of terms of trade volatility and commodity cycles.

The potential benefits of trade negotiations, such as the recent Free Trade Agreement (FTA) with the Republic of Korea (New Zealand's sixth-largest goods export market), are important to strengthen our demand-side export diversification. These trade wins, although tough and protracted, do deliver real gains to primary producers.

Although our forecasts reflect a difficult export climate for our dairy exports, the broadening of our primary sector growth and gains made in trade negotiations will underpin a continued growth story for the remaining exporting sectors.

NEW ZEALAND'S TOP EXPORT DESTINATIONS FOR MERCHANDISE GOODS
IN THE YEAR ENDED SEPTEMBER 2014



GLOBAL TRENDS

The global economy's recovery from the 2008 financial crisis has been dampened due to the legacies of high levels of debt and unemployment in developed economies.

The International Monetary Fund's recent projections of world Gross Domestic Product (GDP) for calendar years 2014 and 2015 have been revised down slightly from their July projections to 3.3 and 3.8 percent respectively. The robust growth in the USA, the world's largest economy, is expected to be moderated by a slowing but more sustainable growth rate in China, the second largest economy.

These changes are critical to understanding key macro drivers of export growth – our top four export destinations for merchandise goods account for 54 percent of New Zealand's total of $49 billion.

EXCHANGE RATES

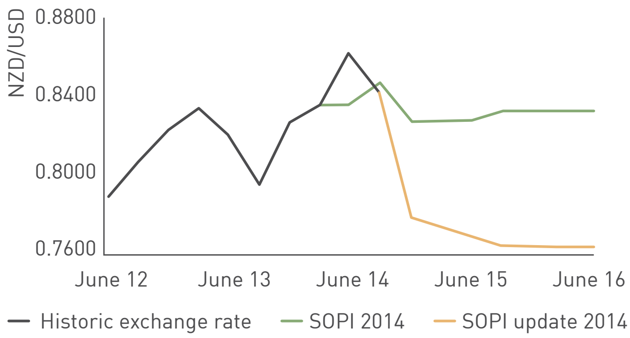
The main drivers of foreign exchange rates are relative central bank policy, global growth outlook and international politics. In addition, global commodity prices have an influence.

Over the outlook period, the New Zealand dollar (NZD)/United States dollar (USD) exchange rate is assumed to track lower than that forecasted in June's SOPI report (Figure 1).

This is due to the strengthening of the USD as the USA economy grows, and the end to quantitative easing by the US Federal Reserve. It may also reflect the perception that the NZD is over-valued, particularly since the fall in dairy export prices during 2014.

The exchange rate with the Australian dollar and the United Kingdom pound is also assumed to track lower over the outlook period than stated in SOPI 2014. The cross rates with the Japanese Yen and the Euro are assumed to track higher, reflecting a weaker outlook for GDP growth in both Japan and the European Union.

FIGURE 1: **EXCHANGE RATE**




PACKER 1
PACKER 2
EMERGENCY
STOP

High Beef Prices an Opportunity for Farmers?

KEY POINTS

- Global beef prices are expected to stay high for at least the next two years.
- The current high prices will enable farmers to invest in the quality of their herds to target higher value from each animal.
- Higher retention of dairy calves offers the greatest potential to grow our beef production in the medium term.

Sustained high beef prices will enable further improvements in on-farm production.

HIGH PRICES FOR AT LEAST THE SHORT TERM

The USA's beef production in 2014 has been low and is likely to remain so for the next couple of years as it rebuilds its herd after droughts. This has resulted in very strong demand from the USA (our largest beef market) and sharp price rises in the current season. There are also opportunities for our beef in other established markets, helped by an expected drop in Australian volumes from 2015 after extensive herd culling in 2014.

NEW ZEALAND PRODUCTION CONSIDERATIONS

Not all of our beef farmers will be able to lift beef production over the short-term. The key considerations are the long lead times (up to two years) to grow out calves to slaughter weights and a lack of evidence that more dairy calves from the current season have been retained (Figure 2). On this basis, the main driver for short-term beef production increases will be from the culling of capital stock or fluctuations from dairy farmers managing their herds (for example adverse weather events).

CURRENT HIGH PRICES WILL ENABLE GREATER REINVESTMENT ON FARMS

The lead times associated with beef production systems means that farmers need to look through pricing cycles to make longer-term investment decisions. The current prices will allow farmers to invest in improved genetics and pasture to improve the quality attributes of animals as they strive to increase the value of their meat. Farmers' ability to invest in their production will further support the sector's investment in improving the value of its products through MPI's PGP programme. The scale and nature of these meat sector investments show the confidence the companies have to improve the sector's value equation.

COULD THE HIGH PRICES DRIVE CROSS-SECTORAL CHANGES?

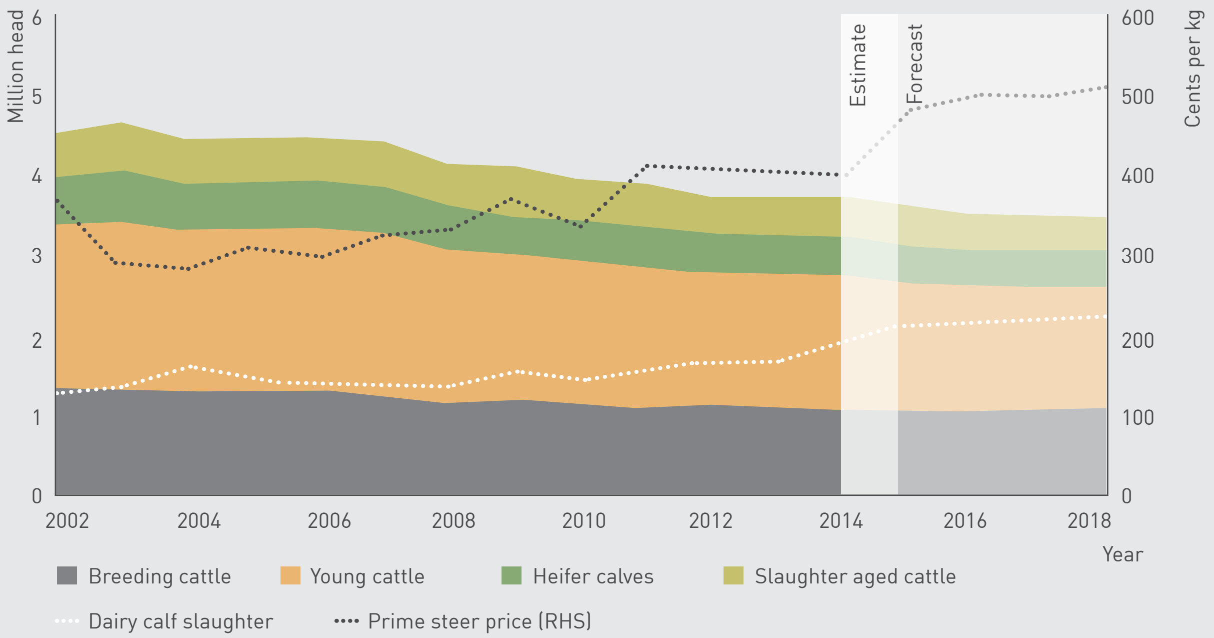
If these prices were to persist beyond the next two years we could expect a shift in the sector's current revenue sources. Over the last decade increasing numbers of sheep and beef farmers have become contract grazers to the dairy industry or to meat processors. Farmers have sought stability of income from these contracts. However, a protracted period of lower dairy payouts and high beef prices could see beef production increase over the medium term and reduce sheep and beef farmers' reliance on supplementary income from dairy support grazing.

OPTIONS TO INCREASE BEEF PRODUCTION

There are two options to increase beef production in future years: retain more heifer calves or raise more dairy calves to finished beef slaughter weights (Figure 2). Both require confidence that future seasons will be as good to justify modifying farming systems to capture the opportunity. Higher retention of dairy calves offers the greatest potential to grow our beef production in the medium term with the bulk of first weaned calves not available until next season.

MPI will monitor shifts in beef farm production and profitability changes over the coming years – watch for updates and analysis on the beef sector in future SOPI reports.

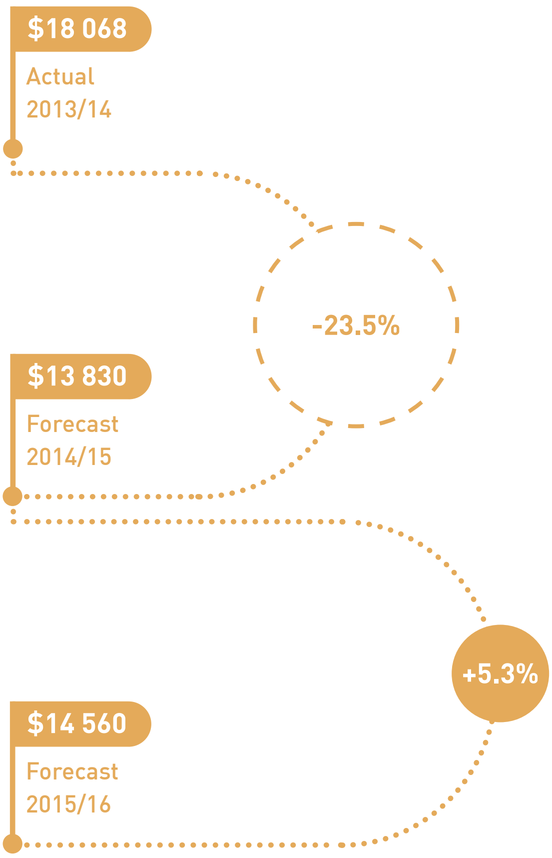
FIGURE 2: **NEW ZEALAND BEEF HERD IS FORECAST TO CONTINUE TO DECLINE DESPITE RISING PRICES AND INCREASING AVAILABILITY OF DAIRY CALVES**



2 DAIRY

Dairy export revenue is forecast to be $13.8 billion for 2014/15, 23.5 percent lower than the historic high in 2013/14. This is due to a larger-than-expected drop in international dairy prices over the past two quarters. This weakness is best reflected in our forecasted sector farm-gate price of $4.82 per kilogram of milksolids to June 2015. We expect this continued weakness will now impact the 2015/16 year through lower prices at the start of the season.

DAIRY EXPORT REVENUE ($ million)



CHANGE FACTORS

Global dairy prices are expected to return to growth in the June 2015 quarter and continue to grow through the 2015/16 season.

Global shifts affecting demand for dairy products:

The Russian ban on imports from key dairy exporting regions is causing a temporary surge in global dairy supply.

Demand from China will grow as high inventory levels are utilised.

Global production is up this season, far exceeding growth in global demand.

PRODUCTION GAINS

New Zealand milksolids production is expected to increase by 3 percent for the 2014/15 and 2015/16 production seasons – this assumes normal climatic conditions, and continued increases in cow numbers and on-farm productivity.

Current pilots testing the benefits of farming system change are indicating that system enhancements can deliver substantial production, animal welfare and environmental benefits. The development of these systems will enable both continued growth and improvements in the sector's environmental sustainability.

Domestic production of milk solids

▲ 3% for 2014/15.

International dairy supply has increased by 4.1 percent over the last year, driven by last season's historically high dairy prices, low animal feed costs, and good climatic conditions. Although current production levels are remaining high at this stage, we do expect the recent sharp declines in dairy prices will help moderate future growth in both the US and EU due to their higher cost production systems.

DEMAND DRIVERS

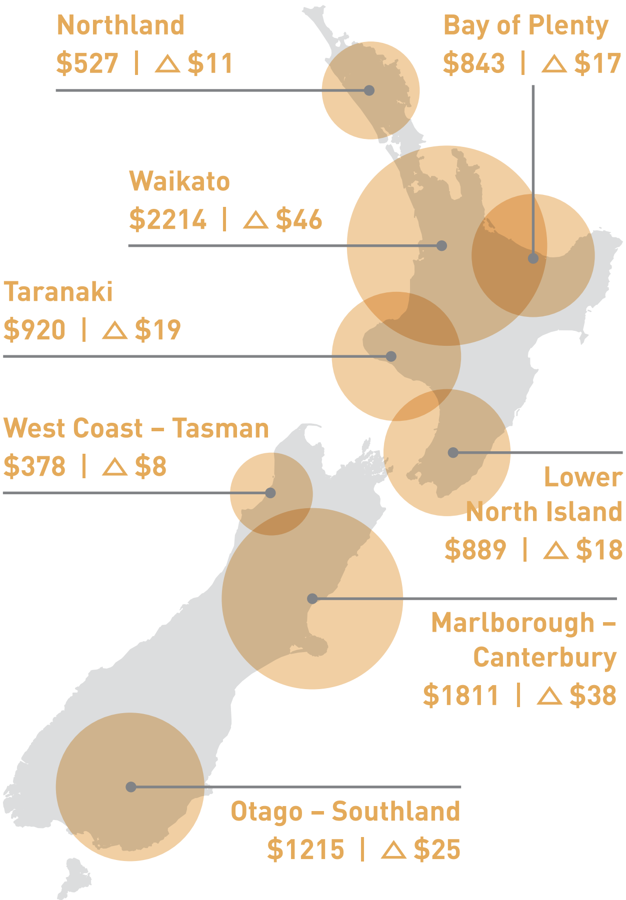
The Russian ban on primary imports from some major dairy exporting countries has created a displacement in supply of around US$3.6 billion in the current year. This is the result of dairy products that would have been exported to Russia being diverted to other markets creating increased levels of uncertainty. The result has been an accelerated decline in global dairy prices.

When the ban was introduced it was initially limited to a year, however we expect global production to be impacted beyond this period. Continued uncertainty will remain until notification of the sanctions being lifted or any easing of the sanctions is worked through and global supply is rebalanced.

Demand growth from China for dairy products has been muted over the first two quarters of this year. This has largely been the result of significantly higher imports in 2013/14, as China ensured security of supply through a shortage in their domestic milk supply, and fears that supplies could be disrupted due to the 2013 drought in New Zealand.

This action had two impacts, firstly driving record high prices last season and secondly resulting in a sharper price correction as supply outstripped demand in the current season. We expect that the stockpiles will be used in the March 2015 quarter, and that this will result in increased demand and some correction in global prices from the June 2015 quarter.

EXPECTED DAIRY FARM-GATE REVENUE | IMPACT OF A $0.10 PRICE CHANGE (△)
2014/15 BY REGION ($ MILLION)



Based on milk price $4.82/kgMS. Change (△) represents the change in dairy farm-gate revenue ($ million) for every 10 cents change in the farm-gate milk price.

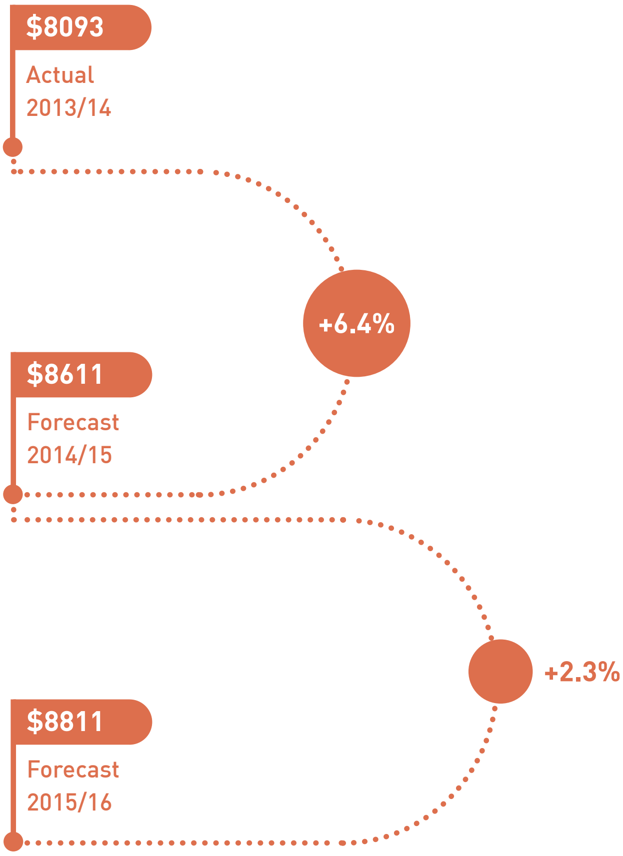
INTERNATIONAL DAIRY PRICES

We expect international dairy prices to remain relatively low in 2014/15, with a gradual recovery from the first half of 2015 as growth in demand shifts to exceed supply in key markets. Longer term, prices are projected to trend upwards as demand for dairy products grows, particularly in emerging economies, and as supply growth moderates.

3 MEAT & WOOL

Meat and Wool export revenue is forecast to reach $8.6 billion for 2014/15, a 6.4 percent increase over 2013/14 export earnings. Most of this is due to very high beef prices, driving an expected 20 percent increase in export revenue for beef and associated offal products.

MEAT AND WOOL EXPORT REVENUE
($ million)



CHANGE FACTORS

Prices are more than 40 percent higher than a year ago for boneless lean beef into the USA market.

Cooler temperatures have resulted in slower lamb growth rates.

Demand from China has increased the range of wool imports from New Zealand, raising overall revenue.

SECTOR DRIVERS

A global shortage for boneless beef has resulted in significantly higher beef prices for New Zealand farmers. These market dynamics are expected to persist for at least the next two years as herds are rebuilt after drought impacts in both Australia and the USA.

The current high demand will result in a higher proportion of the carcasses processed into the lean manufacturing beef mix, shortening supply of both mid-value beef cuts and some co-products over the short term.

In addition, we expect the higher profitability of beef farmers will enable greater reinvestment into their farm operations to lift the quality and value of their products. The benefits of these high prices will be partially muted by a continued decline in the beef herd (by 1.4 percent).

Overall we expect lamb production to be down 0.5 percent compared to a year ago. The number of lambs born in 2014 is estimated to be higher, but increased hogget retention in the North Island as part of drought recovery will see lower numbers processed. Moreover, lamb carcass weights will be slightly lower due to the cold start to the season.

Lamb production is forecast to be 0.5 percent lower than the previous year.

We expect that the level of mutton being processed will fall after very high production over the past two years, driven by drought in the North Island and dairy farming expansion in the South Island.

GLOBAL DRIVERS

The US Department of Agriculture expects the USA's beef import volumes in both 2014 and 2015 to be more than 30 percent higher than that in 2013 (600 000 tonnes) to compensate for the lower domestic supply of lean beef after prolonged drought.

Australian beef exports to the USA have increased by over 100 000 tonnes in 2014, following large-scale liquidation of the Australian beef herd due to widespread drought. Beef production should then fall from 2015 as the herd is rebuilt.

Demand from the USA will increase as a result of lower domestic supply.

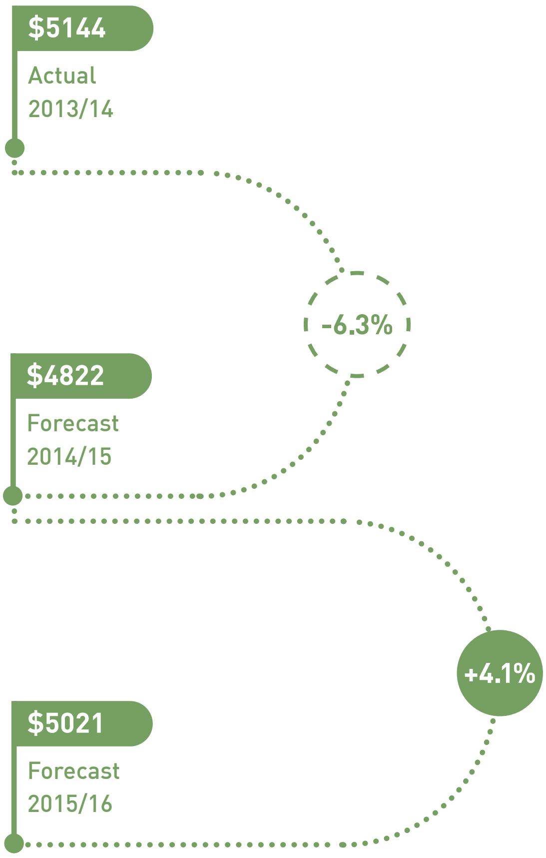
Our beef exports to the USA are expected to increase by around 25 000 tonnes in 2014 (December year) and 45 000 tonnes in 2015 (compared to 2013). This growth is expected to result in New Zealand's beef quota of 213 402 tonnes for USA exports being filled in 2015 for the first time since 2004. This strong demand will divert products away from more price-sensitive markets in Asia.

We expect strong prices for New Zealand sheep meat in Europe and China to be sustained by lower export volumes of both lamb and mutton. Moreover China, our largest wool market, has widened its range of wool imports to include coarser wools – these form the bulk of New Zealand's exports. This should improve the overall value of New Zealand wool exports.

4 FORESTRY

Forestry export revenue for 2014/15 is forecast at $4.8 billion, a decrease of 6.3 percent from 2013/14. This reduction is primarily due to a lower level of log exports to China and an expected price decline toward the historical average from the price peaks of 2014.

FORESTRY EXPORT REVENUE ($ million)



CHANGE FACTORS

Demand for logs in China is expected to pick up through economic stimulus and reducing local stockpiles.

Increasing demand for new housing in Auckland as well as the Christchurch rebuild is expected to drive the domestic timber market.

Improving economic conditions in high-value markets will lift demand for processed timber products.

PRODUCTION DRIVERS

Log production is expected to be constrained by demand through to 2017, with current-year harvest levels forecast to fall below the 2013/14 high of 17 million cubic metres.

The available volume for harvest is expected to increase as the age profile of the forestry estate moves toward maturity. This volume is largely composed of forest planting that took place in the early 1990s. As a result, small forest owners are expected to make a larger contribution to overall log production over the coming years.

Log production will be constrained by demand until 2017.

Harvest figures are also expected to be constrained by roading and access costs, particularly for some small forest owners, so international prices will be a major determinant of harvest timing and volume.

In addition, sawmills could face capacity constraints in the short term and this may have spill-over impacts on the development of new housing in Auckland and the Christchurch rebuild.

DEMAND DRIVERS

Demand in the Chinese market has been declining over the last year due to high log inventories. However, the situation is improving as log stockpiles have decreased considerably since September. Chinese housing market stimulus packages mean demand for logs could increase rapidly over the coming year. In the longer term, the ongoing urbanisation of Chinese rural populations will see steady demand growth for New Zealand logs.

India is an emerging market for radiata pine logs. As the country's infrastructure improves and housing growth strengthens there will be greater demand for imported wood.

Our traditional log markets of Korea and Japan are expected to remain steady.

China remains a key market, while India shows potential.

New Zealand sawn lumber producers are expected to take advantage of increasing demand in the domestic market, driven largely by construction in Auckland and the Christchurch rebuild.

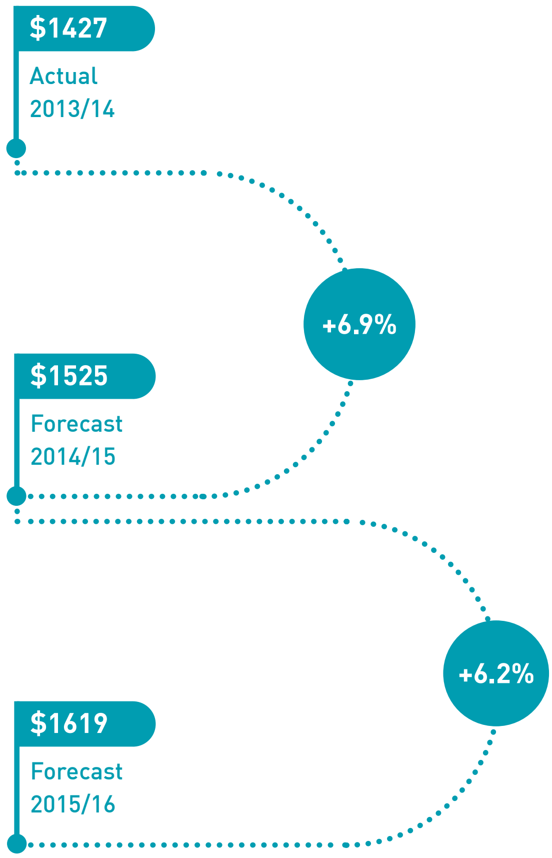
Producers are also likely to increase focus on more valuable offshore markets, such as clear lumber into the USA DIY market, as demand increases and the exchange rate remains favourable.

Demand for pulp products is expected to remain steady, with any price gains largely attributable to a more favourable exchange rate.

5 SEAFOOD

Seafood export revenue is forecast to reach $1.5 billion for 2014/15, up 6.9 percent from 2013/14, driven by increases in both volume and price.

SEAFOOD EXPORT REVENUE ($ million)

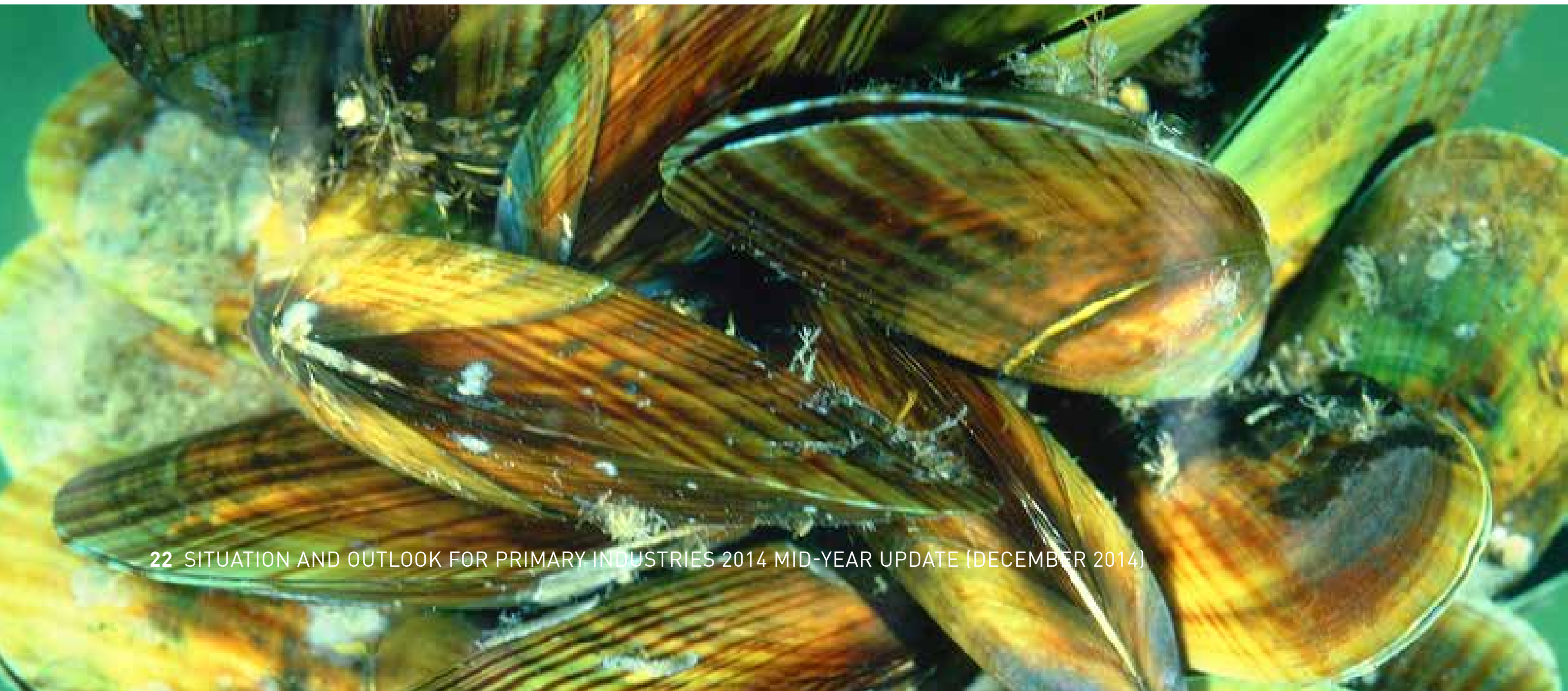


CHANGE FACTORS

Some wild fisheries have been able to increase their maximum sustainable catch levels.

Rising prices in key international markets and lower exchange rates will continue to favour exporters.

Aquaculture production is recovering for mussels and oysters



PRODUCTION DRIVERS

A small increase in seafood export volumes is expected in 2014/15 due to increased catch limits for some species such as hoki and southern blue whiting. However, there is limited scope for further increases as wild capture fisheries are set to maximum sustainable levels under the Quota Management System.

A few fisheries have had their total allowable commercial catch limits revised upwards in 2014.

A focus on precision harvesting and environmental certification is expected to secure a premium price for New Zealand inshore and deepwater fisheries. Hake and ling were certified by the Marine Stewardship Council in September 2014. Additional deepwater species, including orange roughy, are in the assessment process.

Aquaculture production has been increasing as mussel harvests have recovered from the climate-driven decline in 2012/13. The production increases seen during 2014 are expected to continue through 2015.

An expansion in salmon farming is expected within the next few years, as New Zealand King Salmon Limited has received resource consent for three new farms. Volume predictions are unavailable, however it is expected that the salmon farms will make a material contribution to aquaculture export revenues.

DEMAND DRIVERS

China remains the largest market for New Zealand seafood products, followed by Australia, the EU, and the USA. Prices for our top earning stocks such as rock lobster, hoki, mussels, and salmon are improving due to increased demand. The demand outlook from these countries is likely to remain strong as demographic and economic conditions are relatively stable.

Prices for top earning stocks such as rock lobster, hoki, mussels, and salmon are improving.

Oyster production has started to recover from 2013, following oyster herpes virus issues that caused significant oyster juvenile loss in some Northland farms in 2009/10.

6 HORTICULTURE

Horticulture export revenues for 2014/15 are expected to be $156 million (4.2 percent) higher than 2013/14. This is due to an improving export outlook for kiwifruit (+16.9 percent) and wine (+7.6 percent) offsetting a decrease in other fresh and processed fruit and vegetables (-5.3 percent).

HORTICULTURE EXPORT REVENUE

($ million)

$3709
Actual
2013/14

+4.2%

$3865
Forecast
2014/15

+6.6%

$4120
Forecast
2015/16

CHANGE FACTORS

Gold Kiwifruit is recovering from Psa at better than expected rates, adding a 10 percent increase to kiwifruit export revenues for 2014/15.

Grape production has increased by around 6 percent this year. However, a large proportion of wine will be exported in bulk versus bottled form, resulting in a relatively small value gain across the sector.

Pipfruit export earnings in 2014/15 are expected to be lower due to reduced production and prices.

PRODUCTION DRIVERS

The impact of Psa on production of Gold3 Kiwifruit has been less significant than anticipated. Over 4000 hectares of the Gold3 cultivar are maturing, with large production increases expected over the next few years – around 50 million export trays in 2017, compared to 11 million trays in 2013.

Post-harvest operators are investing in targeted technology to manage increased volumes and lower cost structures. This will provide direct benefits back to growers.

The impact of Psa on the Gold3 Kiwifruit cultivar has been less significant than anticipated.

Current year apple production has been impacted by hail. Export volumes are expected to increase from 2015 as additional and replacement plantings become productive.

Grape supply from the 2014 vintage is expected to net $1.43 billion in export earnings, an increase of 7.6 percent on last year. A greater proportion of wine will be exported in bulk versus bottled form, lowering average price per litre expectations in the short term, but with prices expected to recover longer term.

DEMAND DRIVERS

Consumer demand for kiwifruit is expected to grow as it is successfully marketed to health-conscious consumers in high-value markets. The challenge for exporters is to maintain high prices as export supply of Gold3 rapidly increases.

Above average apple crops in Europe and the USA in 2014, and the import ban by Russia, will mean a more competitive market for southern hemisphere fruit in 2015, resulting in a drop in export prices. Export prices are forecast to improve thereafter due to ongoing changes in the variety mix and further expansion into higher-paying markets.

The United Kingdom, Australia and the USA are absorbing much of the increase in export volumes for wine.

The main markets for New Zealand wine (UK, Australia and the USA) are absorbing much of the increase in export volumes. Marketing efforts in Northern Europe are beginning to create a demand lift for higher-value New Zealand wine, and the sector will look to consolidate these gains over the coming year.


Growing and Protecting New Zealand
New Zealand Government