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CURRENT MARKET SITUATION AND MEDIUM-TERM OUTLOOK

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I. INTRODUCTION

1. As part of its regular activities, the Intergovernmental Group on Tea monitors market conditions and provides an update of potential market prospects for tea over the medium term. This document examines both the current situation and longer term prospects for production, consumption and trade of tea, and their likely impact on the world tea market. The tables mentioned in the document may be found in document CCP:TE 05/CRS 6. Delegates are requested to update market information pertaining to their country, and discuss possible strategies for the sustainable development of the world tea economy.

II. CURRENT SITUATION

A. PRODUCTION

2. World tea production continued to reach new highs in 2004, when output grew by 2 percent to reach an estimated 3.2 million tonnes (Table 1). The expansion was due mainly to the increases recorded in Turkey, China, Kenya, Malawi, Sri Lanka and Indonesia. The growth in output from these countries more than offset declines in other major producing countries including India and Bangladesh. Production in Turkey was reported to have expanded dramatically in 2004 as output increased by 32 percent to reach 205 431 tonnes. As there were no reported new areas planted in the last five years, it is assumed that the expansion was due to higher yields.

3. Provisional returns from China indicate that output for 2004 approached the 800 000 tonnes milestone as policy initiatives to promote production and trade of tea began to have an impact on the sector. Tea production in Sri Lanka increased slightly by 1.3 percent to 309 000 tonnes in 2004, reflecting the recovery from crop losses after devastating floods in low grown tea areas of the island in 2003. This region usually accounts for more than 50 percent of the country's tea output. Slight relief was also evident in high grown areas after drought conditions contributed to the overall decline in output during 2003. A similar increase was recorded by Indonesia, where a 1.2 percent growth was recorded. Output in that country reached 170 000 tonnes in 2004.

4. Tea production in Kenya increased by more than 11 percent in 2004 to reach 328 000 tonnes, as a result of favourable weather in most of the growing regions and the expansion in processing capacity. The major challenge facing the tea industry in Kenya is the rising labour cost adding to the rise in cost of production, which was slightly offset by the depreciation of the Kenyan shilling. Malawi also reported a significant increase of 19 percent in tea production in 2004 with output reaching 50 000 tonnes. Again favourable weather conditions in the whole of Eastern Africa contributed to this increase, including the output in Tanzania and Uganda where marginal increases occurred.

5. Tea production in India declined by 4.3 percent, as output in both the Northern and Southern production regions contracted. A major factor contributing to the decline was the closure of up to 70 tea gardens in Assam due to the widespread recession in the industry. The downturn was further exacerbated by unfavourable weather both in the North (floods in the first half of 2004) and South (drought). Output in 2004 was 820 216 tonnes for the country with 634 485 produced in the North and 185 730 in the South.

B. EXPORTS

6. World tea exports increased by 4.4 percent in 2004 to reach 1.47 million tonnes (Table 2), as shipments from all major exporting countries increased during the year. Kenya was the largest exporter, once more surpassing Sri Lanka. The 8.9 percent increase in exports from Kenya brought total shipments for the year to 292 704 tonnes, in line with expanded output from that

country. A similar proportional increase of 8.9 percent was recorded by Indonesia bringing the total for that country to 98 000 tonnes.

7. Tea exports from China expanded by more than 7 percent to reach 282 212 tonnes, and were dominated by green tea, which accounted for more than 75 percent of its total exports. Most of the increase was due to the recovery of market share in the EC and Japan following problems of non-compliance of MRL requirements in 2003. Exports to Morocco, Uzbekistan, and Ghana remained strong, while shipments to the Russian Federation and the United States showed no significant change.

8. Exports from East Africa also recorded significant increases; 11.9 percent from Malawi, 20 percent from Tanzania and 2.9 percent from Uganda, while exports from Bangladesh and Sri Lanka remained relatively unchanged in 2004.

9. Tea exports from Sri Lanka were 290 604 tonnes in 2004 compared to 291 472 tonnes in 2003, a marginal gain of some 0.3 percent. Attempts to expand demand for Sri Lankan tea in the Far East have led to the establishment of a tea promotion office in Tokyo to promote black tea exports to the predominantly green tea markets of China, Japan and the Republic of Korea in 2003.

10. Tea exports from India recovered slightly by 3 percent in 2004 after a major fall of 13 percent in 2003 to the lowest level in a decade, due mainly to weaker demand from the Russian Federation, the United Arab Emirates, and the United Kingdom.

C. IMPORTS

11. World net tea imports continued to increase in 2004, by 1.5 percent, reaching 1.42 million tonnes (Table 3). This trend reflected the increases in traditional developed country markets of the EC (an increase of 2.4 percent), the United States (5.3 percent), and Japan (2 percent), where imports reached 215 000 tonnes, 99 000 tonnes, and 56 000 tonnes, respectively. Most of the growth in these markets is reportedly in response to promotional efforts on the health benefits of tea consumption.

12. Net imports into Pakistan, the largest developing country importer also continued to increase. Shipments were larger by 10 percent in 2004, from 109 000 tonnes in 2003 to 120 000 tonnes in 2004, directly influenced by lower tea prices. India could not take advantage of its recent trade agreement with Pakistan for this precise reason. Tea prices were comparatively high, resulting in a significant decline in the volume shipped to Pakistan. Imports to Syria increased by 13 percent from 26 000 tonnes in 2003, a net gain of 3500 tonnes. Imports by countries in the Near East in Africa increased by 2 percent in Morocco, where quantities reached 45 000 tonnes, while in Egypt imports declined by 11 percent.

D. PRICES

13. The FAO Composite price, as a world price indicator for tea, increased by 2 percent in 2004, reflecting the significant gains in the Calcutta and Mombasa auctions. Prices in 2004 opened at US $1.56 per kg in January and after increasing to US$1.65 per kg in April declined to US$1.56 per kg in June, before surging to US $1.77 per kg in September and closing at US $1.73 per kg in December. This volatility reflected fluctuations in tea output in major producing countries in 2004 and improvement on the demand side which eased the supply pressure on prices. The increases were quite significant in local currencies as local currencies of major tea producing countries have depreciated against the US dollar.

III. MEDIUM TERM OUTLOOK

A. PRODUCTION

14. This section of the document examines projections that were generated for the medium term (10 years from the latest complete set of data available, i.e. 2003) to 2014. It takes into account the Group's projections to 2010, which incorporated the revisions provided by members at the 15th Session of the Intergovernmental Group on Tea in Sri Lanka. Members are requested to review the data and forecasts pertaining to their own situation and provide updates, where necessary, to allow the Secretariat to revise the projections.

15. The projections were based on dynamic time series models. Principally, autoregressive distributed lag models were used to capture the dynamic process of market adjustment in tea markets. The forecasts are obtained from s-step a-head ADL models, where s is the forecast horizon. The FAO Tea Composite Price was included as an exogenous factor. Its values, over the forecast horizon, were obtained from its autoregressive representation. Projections were based on the assumption of normal weather conditions, and a continuation of the past trends in yields, planted areas, population and income growth. Adjustments were made to reflect current policies and future market prospects. The forecasting models captured cycles and trends in tea markets to a satisfactory level.

16. World black tea production is projected to grow by 1.7 percent annually from 2003 to reach 2.7 million tonnes in 2014, mainly due to improvements in yields (Table 5). Among countries in Africa, a significant growth in output is expected as tea bushes reach optimum producing age and smallholder skills are maximized through intensive capacity building. Tea harvested in the largest producing country, Kenya is expected to grow by 2.4 annually to reach 379 000 tonnes in 2014, signifying a slowing in growth rates of the last decade. Other producing countries of significance include Malawi where output is projected to increas by 7 000 tonnes to reach 49 000 tonnes by 2014, while in Uganda and Tanzania output should reach 38 000 tonnes and 33 000 tonnes, respectively by 2014.

17. In the Far East, output in India, is expected to grow by 1.6 percent annually to reach 1.01 million tonnes in 2014. Among the other major black tea producing countries in the region, a slightly higher growth rate of 1.9 percent is projected for Sri Lanka to reach 370 000 tonnes, while output in Indonesia will reach 150 000 tonnes, an annual growth rate of 1.5 percent. Black tea production in China is expected to decline, as the balance of production shifts to other teas with stronger market prospects.

18. World green tea production is expected to grow at a faster rate than black tea at 2.3 percent per annum, but volumes are much smaller at a projected total of 975 000 tonnes by 2014 (Table 6). China would continue to account for more than 75 percent of world green tea output with an output of 740 100 tonnes, replacing some of its black tea production. However, the annual growth rate would slow from 3.8 percent over the last decade (1993-2003) to 2.2 percent over the next (2003-2014). A similar slow-down is expected in Viet Nam as the expansion in area has somewhat abated in recent years, but volumes are considerably smaller. Production in Viet Nam is projected to grow at 2.6 percent from 30 000 tonnes in 2003 to 39 600 tonnes in 2014, while production in Japan will slightly increase by 0.5 percent annually to reach 92 000 tonnes in 2014. For Indonesia, growth rates are expected to pick up again in the next decade after a slow-down since the Far East economic crisis in 1997. Output in Indonesia is expected to expand to 49 100 tonnes in 2014, from 41 000 in 2003. Most of the growth in green tea output would be due to an expansion in area planted and harvested.

B. CONSUMPTION

19. The growth rate in world black tea consumption is expected to be reduced from 2.2 percent over the last decade (1993-2003) to 1.2 percent over the next (2003 to 2014) to reach 2.67 million tonnes by 2014 (Table 6). The main reason is the slow-down in consumption in producing

countries, as the production growth rate outpaces the growth in demand for exports. Global tea consumption is divided into net imports for non-tea producing countries, and domestic consumption in producing countries, measured by production less exports.

Net imports

20. World net imports of black tea, a proxy for consumption in importing countries, are projected to increase annually by 1.2 percent to reach 1.34 million tonnes in 2014 from a base of 1.17 million tonnes in 2003.

21. Imports by the CIS (predominantly the Russian Federation) and Pakistan are expected to increase by 3.0 percent and 3.4 percent annually, respectively, in line with GDP growth expectations. Net imports by these countries are expected to reach 342 000 tonnes and 120 300 tonnes, respectively, by 2014. In the EC (15) a slight decline in imports is expected due mainly to the 1.6 percent annual contraction expected in the United Kingdom. Notable increases are expected in Germany, the Netherlands and France, but the expansion in these countries will be insufficient to offset the decline in the United Kingdom.

Domestic consumption

22. In 2014, the quantity of black tea consumed in producing countries is expected to grow by 1.3 percent per year to reach 1.33 million tonnes. Producing countries consumed 52 percent of their black tea production in 1993-2003, and are projected to consume only 49 percent in 2014, adding to the demand and supply imbalance. The largest increase in domestic consumption would occur in the Far East, as tea-producing countries in Africa are expected to continue to export most of their output. Domestic consumption of black tea in India is expected to increase by 1.5 percent annually to reach 805 700 tonnes in 2014 or almost 80 percent of the tea produced in that country. Consumption in Indonesia is expected to increase at an annual rate of 1.6 percent to reach 57 000 tonnes by 2014, while in Bangladesh and Sri Lanka, tea consumption would grow at 3.0 percent and 2.5 percent to reach 48 400 tonnes and 17 500 tonnes, respectively.

C. EXPORTS

23. World black tea exports are projected to reach 1.3 million tonnes in 2014, reflecting an average annual increase of 1.4 percent per year from 1.1 million tonnes in 2003 (Table 8).

24. About half of the increase would originate in Africa, where production is likely to continue to grow while domestic consumption remains small. The region's total black tea exports are projected to amount to 518 000 tonnes by 2014. Exports from Kenya would increase by 2.7 percent annually to reach 358 000 tonnes in 2014, giving Kenya a 27 percent share of the global black tea export market. Privatization of the Kenya Tea Development Authority (KTDA) and the abolition of grower permits and export licences are expected to improve Kenya’s export performance. Substantial growth in black tea exports is also projected for some other East African countries, such as Malawi (1.2 percent annually) and Uganda (2.2 percent annually).

25. The Far East would account for the other half of the expansion in black tea exports. Sri Lanka, the second largest exporting country in the world, is expected to increase exports by 1.2 percent annually to reach 330 000 tonnes by 2014, continuing to account for 25 percent of the global total. Exports from India are projected to increase annually by 2 percent to reach 211 000 tonnes in 2014. More modest growth rates are expected for Indonesia and Bangladesh where exports contracted in the previous decade and annual increases of 0.4 percent and 0.2 percent, respectively should now be attained.

26. World green tea exports are projected to grow by 2.8 percent annually to reach 275 000 tonnes by 2014 (Table 6). China is expected to continue to dominate this trade with a volume of 242 000 tonnes, followed by Viet Nam with 28 000 tonnes, and Indonesia with 5 800 tonnes.

IV. CONCLUDING REMARKS

27. Recent developments in the world tea market suggest that the major players have adapted pretty well to the uncertainty in prices in the short term, particularly for black tea. Green tea does not have the same difficulty as it currently enjoys a premium over black tea. A recent study conducted by the Secretariat on value chains (CCP: TE 05/4) indicated that, of the 27 agricultural commodities studied, tea showed the second lowest variability in prices (2 percent decline in tea prices compared 39 percent for cocoa and 38 percent for coffee).

28. The major issues plaguing black tea include the erosion of market shares in the total beverages market, coupled with stagnant consumption in some markets, leading to reduced prices. The fundamental oversupply in the world market is likely to persist and prices are likely to remain depressed. New strategies particularly aimed at enhancing consumption and increasing value-addition as well as further reduction in production and marketing costs are required.

29. In the medium-term, the projections indicate an increasing imbalance between supply and demand of 98 000 tonnes. Part of the reason is due to the actual projections on production given by some members which appear to be higher than those generated by the model. However, if the projected imbalance is realized then further weakening in prices may be expected. In terms of profitability, a major concern is the rising cost of production, which can only be minimally reduced by increasing mechanization as the the scope is limited if quality is to be maintained. Improving yields through capacity building of growers, optimising inputs, streamlining marketing channels and improving infrastructure could also reduce production cost, but may also lead to over-supply. The preferred solution must lie in stimulating demand.

30. Appropriate marketing strategies, including market access, could lead to improved returns to the industry. Variation in demand among countries suggest that marketing activities need to be tailored to individual markets. Value addition possibilities and quality standards need to be identified for each market and strategies devised to reap the appropriate premium. The results from extensive research demonstrating the health benefits of tea should also be more aggressively used in promoting tea consumption in an increasingly crowded beverage market. Finally, food standards, particulary MRLs, need to be complied with. Global harmonization of MRLs in tea could reduce costs of compliance on tea exporters. This is a major agenda item at this session, and the Group might wish to adopt recommendations on the way forward.