

SNAPSHOTS OF OUR DAIRY AUSTRALIA LEVY AT WORK: YOUR MILK, YOUR MARKETS

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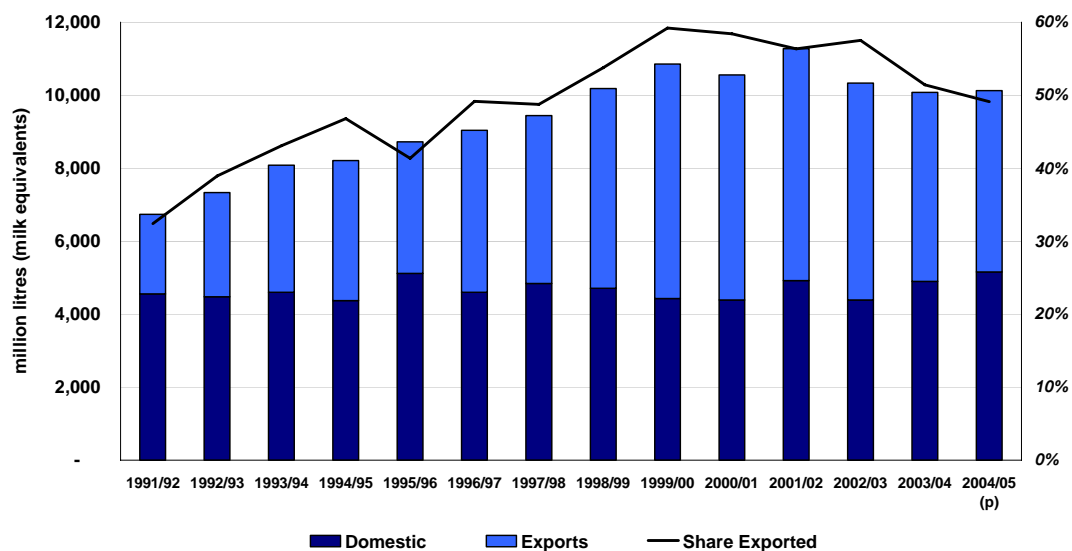
Take home messages

- Australia exports around 50% of its milk production each year. The bulk of these exports are focussed in the emerging Asian region.
- With good economic growth prospects underpinning increasing demand for dairy products, the prospects for Australian exporters in these markets are positive.
- Dairy Australia works in a number of ways to ensure to support Australian dairy exporters in these markets, by providing comprehensive market intelligence, actively building preference for Australian dairy products amongst overseas customers, and pursuing a more favourable trade environment.

Introduction

Over the last 25 years, the Australian dairy industry has developed from a domestically focussed, regionally based industry to one that exports products to over 100 overseas markets. While 50% of the industry's milk remains in Australia, each year, removal of government regulations and the open nature of the domestic market, means that farmgate returns are largely determined by movements in international prices.

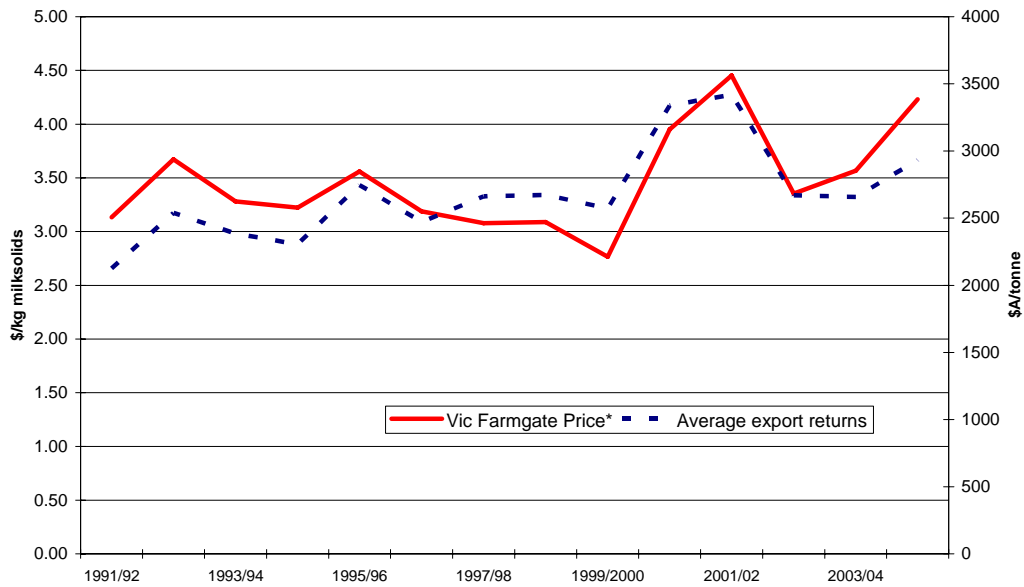
Australian consumption and exports



Source: Dairy manufacturers and ABS

In Victoria, 60% of total milk production is exported, a further 32% is used in manufacturing products for the domestic market, while the remainder is used for drinking. Looking at the close correlation between Victorian farmgate prices and export returns illustrates the point that international markets are very important to the Victorian dairy industry.

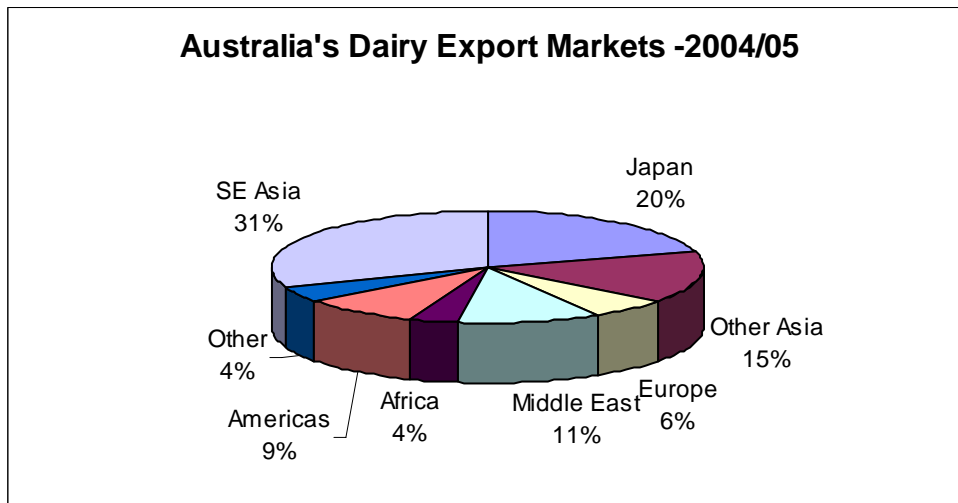
Victorian farmgate returns vs Export returns



*Manufacturing milk price only prior to 1999/2000

The importance of Asia

Australia’s dairy exports are concentrated in the Asian region. This reflects both geographic proximity, and the extent to which Australian dairy exports are excluded from a number of major northern hemisphere markets. Japan is Australia’s largest single export market, valued at A\$528 million in 2004/05. In total, exports to the Asian region were just under A\$1.7 billion in 2004/05 – representing around two thirds of the value of Australia’s dairy exports.



Dairy consumption in most of these countries is low as dairy is not a part of the traditional Asian diet. Dairy consumption in these markets is also highly correlated with income. As economies develop and incomes rise, diets become increasingly Westernised, access to refrigeration improves and demand for dairy products tends to increase. Milk powders provide an important source of nutrition, and an entry point for dairy products, often as part of government programs. Demand for cheese in these

markets has largely been driven by the foodservice sector and the increased presence of quick service restaurants featuring pizzas and burgers in their offering.

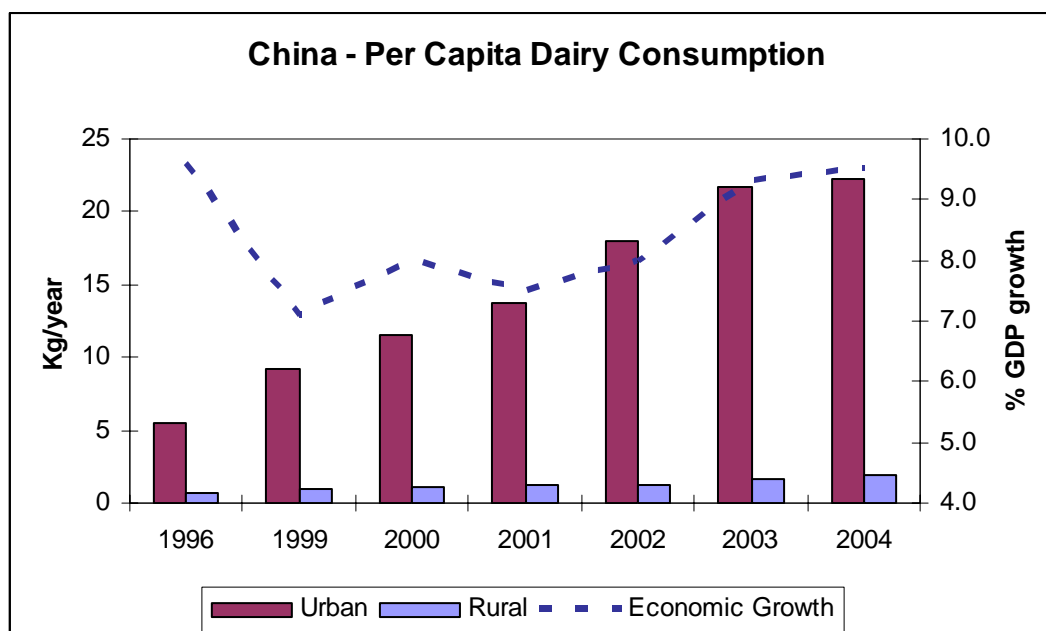
Emerging economies, particularly in the Asian region present real opportunities for Australian dairy exporters. Many are already established markets for Australia, and are likely to experience higher rates of GDP and income growth over the next five years, compared to the last. Although most have a dairy industry, self-sufficiency in dairy products is currently low in many of these countries, and production is unlikely to keep pace with growing future demand.

Table 1. Average annual GDP growth of key Asian markets

	2000-2005	2006-2010
China	8.5	8.4
Indonesia	4.7	6.0
Malaysia	5.2	6.2
Thailand	4.9	6.0
Vietnam	7.1	8.4

Source: IMA Asia, Asia Strategic Forecast, March quarter 2006 update

China will be important in fuelling demand for dairy products in the region. As a market, China is large and diverse. There are large disparities between the incomes and lifestyles of the urban and rural populations, and between patterns of dairy consumption. Around 70% of China's population live in rural areas, many at subsistence income levels. Per capita consumption of dairy products in China was estimated at 10.2 kg in 2002, compared with just 4.2 kg in 1991 – equating to an annual average growth rate of 10%. Per capita consumption in urban regions is estimated at around 20 kg.



Into the medium term, demand for dairy products is expected to rise in China, the big unknown is how much of this demand will be met by China's own production sector. The Chinese government is actively promoting the dairy industry, offering financial incentives for small landholders to switch to dairy production, and developing

infrastructure, with R D & E, breeding schemes and animal health support. While production growth to date has been impressive, there are challenges to increasing production into the future. Demand continues to outstrip supply, and imports are increasing. China is likely to remain primarily a market for commodity milk powders and whey products and so highly price sensitive. Nevertheless China's demand for milk solids will have an important role in balancing dairy commodity supplies.

China also has a wider role in fuelling economic growth in the Asian region. Trade flows between China and neighbouring countries are important in ensuring the prosperity of the region. China's ability to manage its growing economy will be critical to ensuring that consumer incomes in the region continue to rise, underpinning increased demand for dairy products.

Increasing demand from oil-producing countries

Demand for dairy products is also expected to increase in Middle Eastern and African markets, as consumer incomes rise. Sustained high oil prices have sparked unprecedented economic, social, and political transformation in the countries comprising the Cooperation Council of the Arab States of the Gulf (GCC). Similarly, member countries of the Organisation of Petroleum Exporting Countries (OPEC) have benefited from greater export returns for oil. This has translated into improved disposable incomes and boosted demand for food in these countries which are largely import dependant for dairy. Australia is less established in these markets compared to Asia, but has increased its presence over the last decade. Australia's dairy export sales to the Middle East were valued at just over US\$200 million in 2004/05, while sales to Africa were valued at US\$68 million.

So what does that all mean?

The bottom line is that the outlook for the global dairy market is positive, given the strong economic growth outlook for key importing countries. The reduced export presence of the EU and the eventual removal of export subsidies by 2013 are also positive for international dairy trade, eliminating an important source of price distortion and volatility.

So on the demand side, things are looking positive. The final outcome for Australian dairy farmers will depend on the supply response of competitor suppliers of dairy products and non-dairy substitutes. Movements in exchange rates will also be an important determinant for final returns to Australian dairy farmers.

How is Dairy Australia helping?

Dairy Australia supports the activities of Australian dairy exporters in a number of ways. Firstly, Dairy Australia purchases and commissions research on emerging markets, maintains monitoring in established country markets, as well as maintaining an extensive international dairy database. This base of market information and analysis is shared by the industry allowing Australian dairy exporters to understand both the opportunities and threats presented by different markets in a highly cost-efficient way.

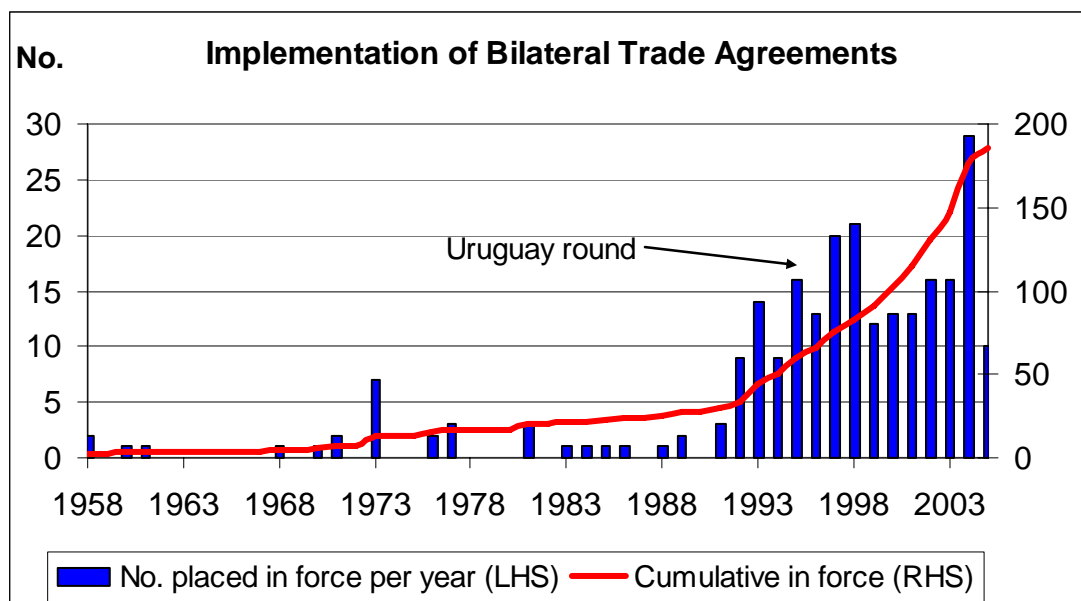
Most of Australia's dairy exports are used as ingredients, particularly in Asia. A limited retail or branded presence limits the effectiveness of marketing to overseas consumers. Recognising this, Dairy Australia works to create an active preference for

Australian dairy products – primarily by building relationships with senior executives in dairy product purchasing companies. In addition, Dairy Australia produces image building publications, and technical support materials, which support the usage of Australian dairy products.

Trade in dairy products is highly distorted, and policy decisions by countries can have a significant impact on international dairy commodity prices and therefore, Australian farmgate returns. Some farmers understandably roll their eyes when trade reform is mentioned; the fabled “level playing field” has been discussed for decades and still appears a way off. While completely free and fair trade might be the glittering prize, it should be remembered that freer and fairer trade in dairy is still well worth having.

Dairy Australia works to advance favourable outcomes for Australian dairy in World Trade Organisation (WTO) and bilateral free trade negotiations. It uses a small team of technical experts to coordinate industry level activities aimed at prioritising Australian dairy interests with domestic policy makers and overseas industry and policy groups. It also works to build effective alliances with representatives of other dairy exporting countries who are prepared to work to achieve common trade reform targets. A key example of this is the Global Dairy Alliance (GDA) – comprising Argentina, Brazil, Uruguay, Chile, India, New Zealand and Australia – and representing over 1.5 million dairy farmers. The GDA is using its combined influence in the WTO to argue for substantial reductions in domestic support, increased market access as well as the complete removal of all forms of export subsidy.

DA’s trade policy work must also take a defensive role in ensuring that existing Australian access rights are not undermined by policy and market changes in overseas countries. This work includes close monitoring major trade agreements that Australia is not a direct party to ensure that potential impacts are quickly recognised and countered as much as possible. This is particularly important given the proliferation of free trade agreements implemented in recent years.



Australia is currently involved in FTA negotiations with the United Arab Emirates, Malaysia, Japan and China. Dairy Australia works to coordinate industry positions, and provide technical advice on dairy access issues to government negotiators. This helps to ensure the best possible outcome for dairy.

Conclusion

Australia exports around 50% of its milk production each year. The bulk of these exports are focussed in the emerging Asian region. With good economic growth prospects underpinning increasing demand for dairy products, the prospects for Australian exporters in these markets are positive.

Dairy Australia works in a number of ways to ensure to support Australian dairy exporters in these markets, by providing comprehensive market intelligence, actively building preference for Australian dairy products amongst overseas customers, and pursuing a more favourable trade environment.



Joanne Bills is the Strategic Analysis Manager in Dairy Australia's Trade and Strategy group. In this role she is responsible for market and industry research, analysis and reporting to dairy industry stakeholders.

Prior to joining Dairy Australia's predecessor organisation the ADC in 1996, Joanne held roles with the National Australia Bank and the Australian Bureau of Agricultural and Resource Economics.

Joanne holds a degree in Agricultural Science and a Postgraduate Diploma in Economics, both from the University of Melbourne.