Dairy

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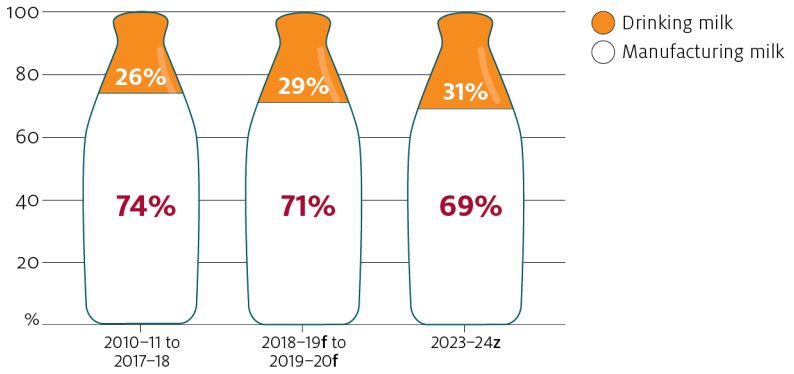
Australian milk price forecast to fall over medium term

The Australian farmgate milk price is forecast to fall in real terms each year until 2023–24. This is the result of forecast global production outpacing demand and putting downward pressure on most dairy product prices. Higher exportable supplies are expected from New Zealand, the European Union, the United States and Argentina. Production in emerging markets is also expected to expand rapidly, especially in India. Higher milk yields will drive much of the increase in production, including in the European Union and New Zealand, where the number of dairy cows is likely to fall.

Fewer cows and less milk

Falling farmgate prices will continue to put pressure on the profitability of Australian dairy businesses. After a drought-induced reduction in the dairy herd in 2018–19, dairy cow numbers are forecast to continue to fall until 2021–22. Yield increases resulting from improved productivity are unlikely to offset falling cow numbers. As a result, Australian milk production is expected to remain below 9.0 billion litres over the period to 2023–24, recovering only moderately in the second half of the projection period. Greater allocation of the milk pool to drinking milk, which is linked primarily to Australia's population growth, will leave less milk available for the manufacture and export of dairy products.

Australian milk utilisation, 2010–11 to 2023–24



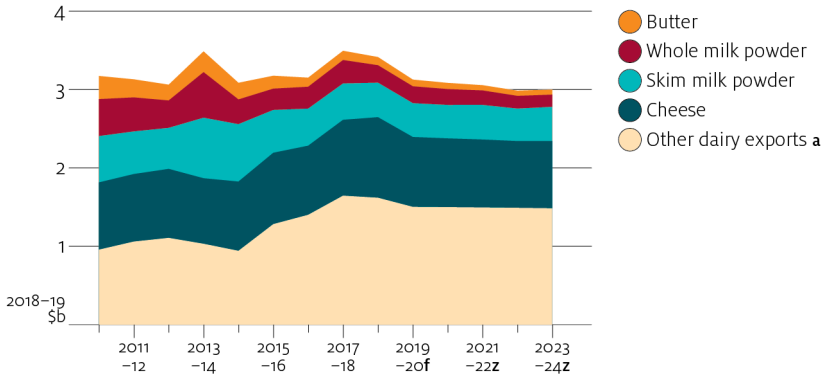
f ABARES forecast. **z** ABARES projection.

Value-added exports to rise but total exports to fall

By 2023–24 Australia's dairy exports are forecast to fall to $3.0 billion in real terms. This is towards the bottom of the $3.0 billion to $3.5 billion range for dairy exports since 2010–11. This is partly because higher domestic consumption is projected to reduce supplies of milk that can be used to manufacture exportable products. Export premiums and global prices are also expected to be lower.

Non-traditional exports, including fresh milk and value-added products such as infant formula, are projected to account for a higher share of dairy export earnings. Cheese is forecast to account for a stable share of export earnings over the projection period, but the other major commodities are projected to account for a reduced share. This reflects the industry's growing focus on Australia's competitive advantages in cheese and value-added products.

Value of Australian dairy exports, 2010–11 to 2023–24



a Other dairy exports include infant formula, fresh milk and whey. **f** ABARES forecast. **z** ABARES projection.
Sources: ABARES; Australian Bureau of Statistics

World dairy commodity prices to fall from current levels

The global prices of butter, cheese and whole milk powder are forecast to fall in 2019–20. Higher production in New Zealand and the United States over the first half of the 2018–19 season is placing downward pressure on commodity prices, especially butter. Increased production in the European Union in 2019–20 is expected to add to global supplies, assuming no adverse weather events occur.

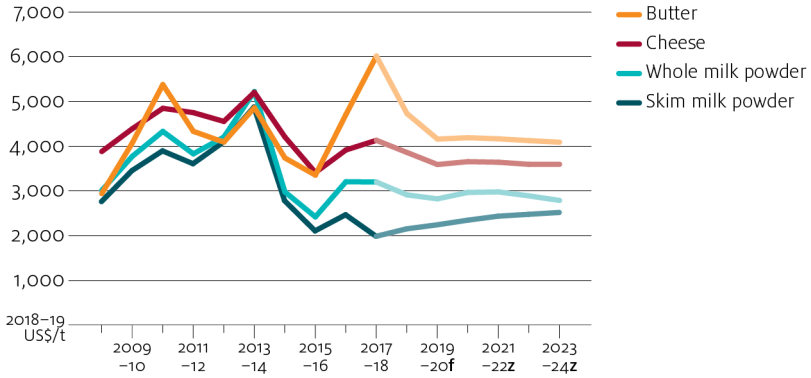
Strengthening global demand for cheese will be driven by economic growth and an ongoing shift to more westernised diets in many countries. However, medium-term prospects for cheese demand growth in Japan—Australia's most important export market—are less favourable given a weak economic growth outlook and a declining population.

Butter prices are expected to average more than US$4,000 per tonne between 2019–20 and 2023–24. This is well above the other major dairy commodities and reflects the latest health consensus on milk fats.

Skim milk powder prices are forecast to increase steadily to 2023–24 from a historically low base. In developing countries, income growth and growing consumer preferences for dairy are expected to drive demand.

In more price-sensitive regions, manufacturers of food products are expected to substitute away from butter to fat-filled powders (blends of vegetable oils and skim milk powder) in response to the higher relative cost of milk fats.

World dairy prices, 2008–09 to 2023–24



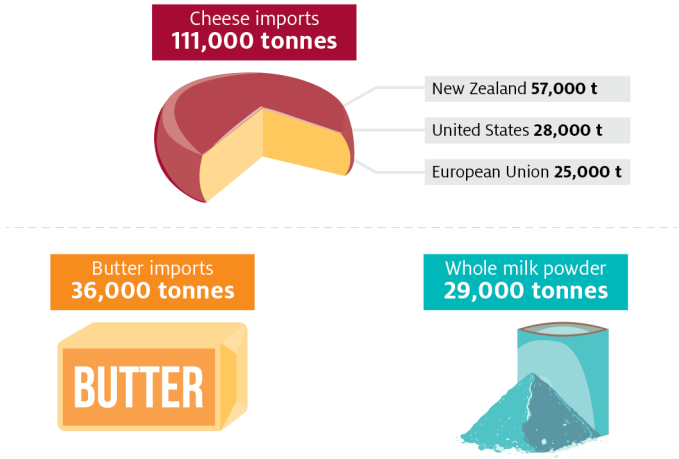
f ABARES forecast. **z** ABARES projection.

Australian dairy imports to grow

With lower forecast milk production and a growing population, Australian imports of dairy products are projected to increase over the medium term. Australia already imports a considerable volume of dairy products, primarily cheese from New Zealand, the United States

and the European Union. Imported dairy products provide food manufacturers with competitively priced ingredients and consumers with more affordable and diverse food options.

Australian dairy imports, 2017–18



Source: Australian Bureau of Statistics

Opportunities and challenges

EU–Japan trade agreement to boost cheese competition

The European Union and Japan have entered into an Economic Partnership Agreement, which came into force on 1 February 2019. The agreement is not likely to have a material impact on Australian dairy exports over the medium term due to the long implementation schedule of tariff reductions. But in the long term it could lead to a significant increase in competition for a share of the Japanese cheese market. Japan is a significant importer of cheese. It is Australia's largest export market and the European Union's second largest.

Japan currently imposes tariffs of between 21% and 38% on cheese imported from the European Union. The EU–Japan agreement will establish a European-specific tariff-rate quota for cheeses, which will gradually become a duty-free quota over a 16-year implementation period. The quota will also expand from 20,000 tonnes to 31,000 tonnes over that period. This will leave the European Union with a larger duty-free quota than Australia's 20,000 tonnes, placing EU cheese exporters in a more competitive position than Australian exporters.

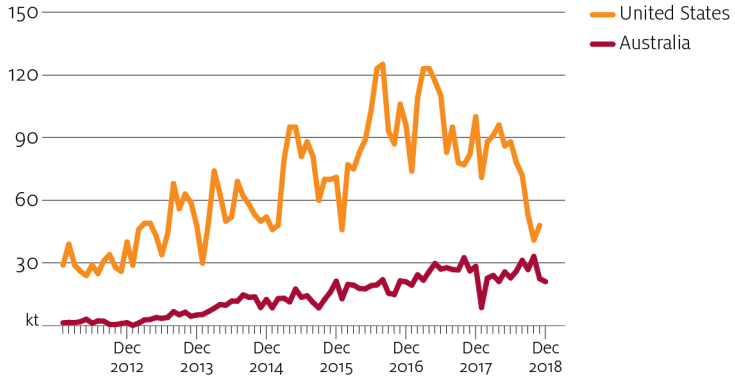
The recently signed Comprehensive and Progressive Agreement for Trans-Pacific Partnership entered into force on 30 December 2018. Read a summary of the key agricultural outcomes for Australia here.

Chinese dairy markets at risk in trade war

The Chinese dairy sector is expected to continue to undergo significant structural change over the medium term in an effort to become more productive and competitive. China's goals for agricultural sector reform include significant increases in milk yields and milk product manufacturing. The growing intensive dairy sector in China relies partly on imported feed, such as hay. The United States supplies between 70% and 80% of these imports, followed by Australia which supplies around 15%.

Hay is among those imported US goods to which China applied tariffs in September 2018 in response to the US application of tariffs on US$200 billion of Chinese imports. US hay exports fell immediately and by October 2018 reached their lowest level since January 2014. This is likely to curtail Chinese milk production and boost dairy import demand temporarily until alternative feed sources are found or tariffs are removed.

Monthly hay exports to China from United States and Australia, 2012 to 2018



Note: US data shown for HS code 1214900010. Australian data shown for HS code 12149019.
Sources: ABS; US Census Bureau

Over the medium term, China's development of its dairy sector is likely to stimulate demand for imported milk powders to be used in manufacturing. However, the effect of trade tensions on consumer confidence and consequent spending on dairy products remain the largest near-term risk to world dairy commodity prices.

Australian dairy industry code of conduct

The Australian Government is consulting on a code of conduct for the dairy industry. The scope and content of a code had not been finalised at the time of publishing. The second round of public consultation on draft clauses closed in February 2019.

The Productivity Commission inquiry into the regulation of Australian agriculture found that codes of conduct can be an effective regulatory tool for addressing unacceptable forms of commercial behaviour. The proposed clauses for the code of conduct are aimed at improving the transparency of milk supply contracts between farmers and processors, and balancing the management of production and price risk between them. More transparent prices can improve the efficiency of dairy markets, with benefits extending to farmers, processors and consumers. However, codes of conduct do not alter global market conditions, so their adoption is unlikely to result in higher milk prices in general.

All parties in vertically integrated value chains are mutually dependent on one another to remain competitive in world markets. While codes of conduct can be effective at guiding good commercial practice, their potential misuse to solve other perceived problems could have unintended consequences. In particular, it will be important to ensure that the code of conduct does not unnecessarily constrain the ability of milk producers and processors to rapidly adapt to changes in world markets and effectively manage risk.

Outlook for dairy

	unit	2016–17	2017–18 s	2018–19 f	2019–20 f	2020–21 z	2021–22 z	2022–23 z	2023–24 z
Australia									
Cow numbers **a**	'000	1,520	1,561	1,480	1,473	1,452	1,432	1,439	1,446
Milk yields	L/cow	5,930	5,951	5,942	5,990	5,996	6,020	6,062	6,104
Production									
Total milk	ML	9,016	9,289	8,794	8,820	8,705	8,618	8,722	8,827
market sales	ML	2,508	2,548	2,577	2,612	2,645	2,678	2,714	2,750
manufacturing	ML	6,508	6,741	6,217	6,209	6,060	5,939	6,007	6,077
Butter **b**	kt	100	92.7	78.0	76.0	76.0	74.0	70.0	72.0
Cheese **c**	kt	349	378	374	370	360	352	351	354
Whole milk powder	kt	60.0	82.5	72.0	70.0	65.0	59.0	56.0	55.0
Skim milk powder	kt	222	191	170	167	164	164	155	161
Farmgate milk price									
nominal	Ac/L	40.9	46.0	46.6	45.8	46.7	47.8	48.6	49.6
real **d**	Ac/L	42.6	47.0	46.6	44.8	44.6	44.5	44.1	43.9
Export value									
nominal	A$m	3,028	3,422	3,414	3,197	3,233	3,282	3,287	3,386
real **d**	A$m	3,151	3,494	3,414	3,127	3,085	3,055	2,985	3,000
Export volume									
Butter **b**	kt	21.4	16.2	16.0	15.0	14.0	12.0	12.0	12.0
Cheese	kt	167	171	183	175	172	171	171	173
Skim milk powder	kt	153	157	143	140	135	135	125	130
Whole milk powder	kt	59.9	48.7	41.0	45.0	46.0	44.0	42.0	42.0
World prices									
Butter									
nominal	US$/t	4,500	5,879	4,752	4,253	4,380	4,450	4,500	4,550
real **e**	US$/t	4,708	6,016	4,752	4,159	4,189	4,165	4,125	4,089
Cheese									
nominal	US$/t	3,742	4,038	3,860	3,670	3,820	3,890	3,920	4,000
real **e**	US$/t	3,915	4,131	3,860	3,589	3,654	3,641	3,593	3,595
Skim milk powder									
nominal	US$/t	2,356	1,938	2,190	2,300	2,450	2,600	2,700	2,800
real **e**	US$/t	2,465	1,983	2,190	2,249	2,343	2,433	2,475	2,516
Whole milk powder									
nominal	US$/t	3,063	3,125	2,910	2,885	3,100	3,180	3,150	3,100
real **e**	US$/t	3,204	3,198	2,910	2,822	2,965	2,976	2,887	2,786

a At 30 June. **b** Includes the butter equivalent of butter oil, butter concentrate, dry butterfat and ghee. **c** Excludes processed cheese. **d** In 2018–19 Australian dollars. **e** In 2018-19 US dollars. **f** ABARES forecast. **s** ABARES estimate. **z** ABARES projection.

Sources: ABARES; Australian Bureau of Statistics; Dairy Australia