

# Dairy and beef

## Dairy prices rebound strongly ...

### Dairy: prices rebound

What a difference three months can make! International dairy prices have surged higher on an improving outlook for world economic growth, a winding back of intervention and an outlook of tightening supply. Our sub-Index of global dairy prices is up 16% in the three months to October (or up 31% in US dollar terms).

As noted by Fonterra, restocking of supply chains on positive signals and expectations of demand recovery, together with further contraction in main supply regions of the world is creating a situation where availability of fresh production seems insufficient for current demand levels. At the Fonterra auction in early November the average milk powder price was US\$3,437/t. Average prices have surged 88% in four months and the longer dated contract is 10% higher than the near spot contract, indicating an expected further tightening of supply.

Whereas earlier in the year there was a build-up of intervention stocks in the EU and the US, releases of government stocks have begun and to date have not been disruptive to the market. Moreover, the EU announced reductions of export refund levels.

## ... as demand firms and supply tightens.

Tightening milk supply has contributed to the sharp improvement in prices. US milk production in the September quarter dropped below year ago levels and the USDA forecast a 0.9% fall in US milk supply in 2010 aided by the herd retirement program, following an anticipated 0.6% contraction in 2009. In New Zealand, the predicted upcoming El Niño points to downside risk from potential drought conditions in the eastern areas.

## Australian production declines as farm gate price drops.

Australian producers will be squeezed this year, but prospects are far better for the 2010/11 year. The farm gate milk price for 2009/10 is forecast to be 33¢/l, down 22% on last year and a third lower than two years ago. The start of the new season has not been good, with milk production for the three months to August down 2% on a year. Indeed, domestic milk production is forecast to decline by 2% this year, reflecting relatively low prices, limited irrigation allocations in the Murray-Darling Basin area, seasonal conditions and the cost of supplementary feeds. This production environment points to constrained exports.

## Global beef demand improves ...

### Beef: higher AUD a headwind

International developments present both opportunities and challenges for the beef market. A plus is the upswing in general global demand. However, the surge in the Australian currency against the US dollar will reinforce competitive pressures for Australian exports to key markets.

Australian beef exports performed well in 2008/09, a time of switching flows and mixed demand – as we emphasised in our last report. Volumes actually increased, rising by 4%, despite the generally weak world economy. The rise in exports was boosted by an 18% jump in sales to the US, as consumers switched away from restaurant meals to groceries and fast food.

## ... but greater competition and higher AUD will crimp Australian exports.

Perhaps a little counter intuitively, exports are expected to soften a little in 2009/10. Increased competition and a sharply higher Aussie dollar are a challenging combination. ABARE's forecast is for a 3% fall in total volumes. Sales to the US and Japan, which will account for almost 70% of total exports, are expected to be little changed. However, Korean demand for Australian beef is weakening, with a further decline of 7% forecast. That follows a 23% drop in 2008/09, at a time of economic slowdown and increased consumer acceptance of US beef following the relaxation of import restrictions in mid-2008. Korean imports of US boneless beef displaced more than half of Australia's market share. Increased competition will also be evident in the Japanese market, with Japanese imports of US beef in 2008/09 still less than a quarter of what they were in 2002/03.

## Saleyard prices moderate as slaughter rates rise.

Domestically, an anticipated rise in the slaughter rate will be a key driver of conditions in 2009/10. With the likelihood of below average rainfall in south eastern Australia, ABARE is forecasting a 2% increase in total cattle slaughter to 8.8 million head. That more than reverses a 1% decline in 2008/09. By implication, saleyard prices are expected to moderate, with ABARE forecasting a fall of 3% in 2009/10 to 285¢/kg (dressed weight). The appreciation of the Australian dollar is also placing downward pressure on prices by crimping export demand for Australian beef. Indeed, a step-down in prices is already evident, with saleyard prices in September down 3% on last financial year.

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Chart 1.

**Global dairy prices: snap back**

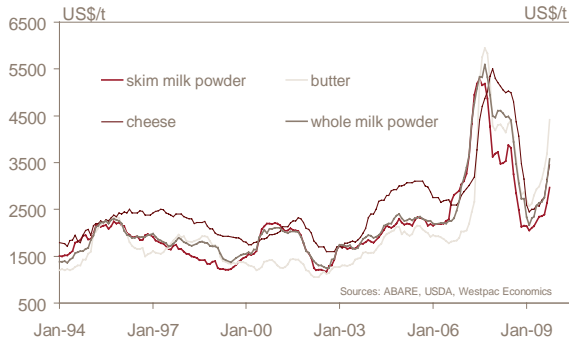


Chart 2.

**Global powdered skim milk prices**

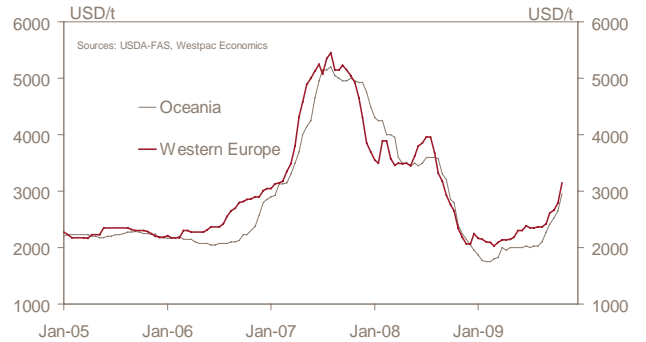


Chart 3.

**Dairy prices rebound**

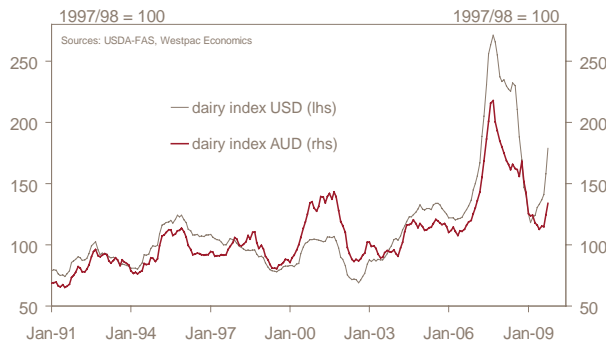


Chart 4.

**Beef export prices index \***

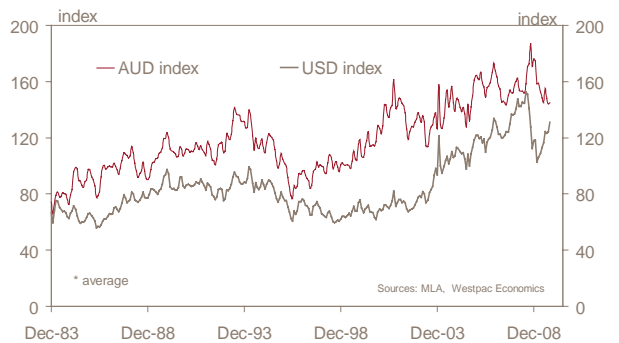


Chart 5.

**Beef prices**

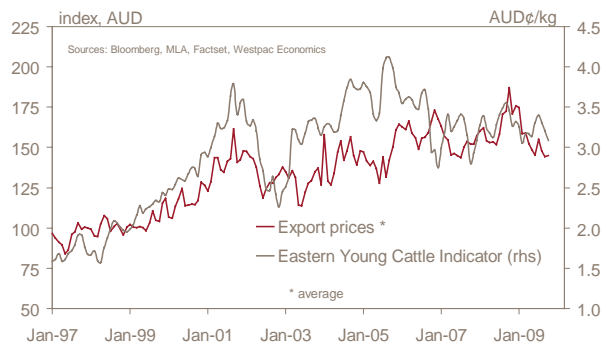
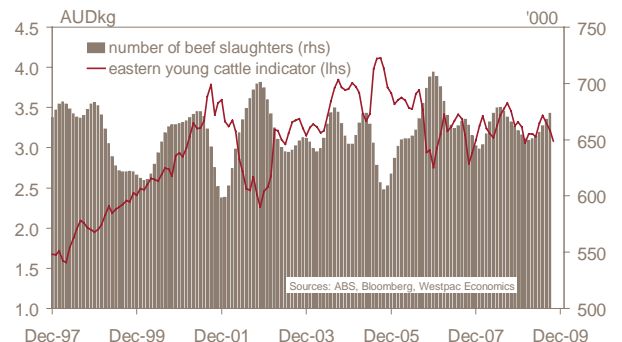


Chart 6.

**Cattle slaughtering lift**



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.