Dairy Australia
Your Levy at Work

Dairy 2013
Situation and Outlook

February Update

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About this report

The Situation & Outlook process is designed to provide the Australian dairy industry and its stakeholders with an overview of the entire industry supply chain – from dairy farm inputs to consumer markets.

This is the second update released for the 2012/13 season, following the September 2012 Situation & Outlook update report. Previous Situation & Outlook reports can be downloaded from the market situation and outlook page at www.dairyaustralia.com.au.

The report has been compiled with input from industry organisations and dairy companies, as well as a range of information sources.

This updated report:

- Summarises the operating conditions facing the Australian dairy industry supply chain, and ultimately affecting the profitability of dairy farms; and
- Provides a brief overview of the current industry status and the situation and outlook for the key drivers of the Australian dairy industry.

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Australian dairy supply chain in February 2013

Deterioration of production conditions across most regions.

Water available in irrigation regions, but production margins are being squeezed.

Late season milk price step-ups slowed by persistently high Australian dollar.

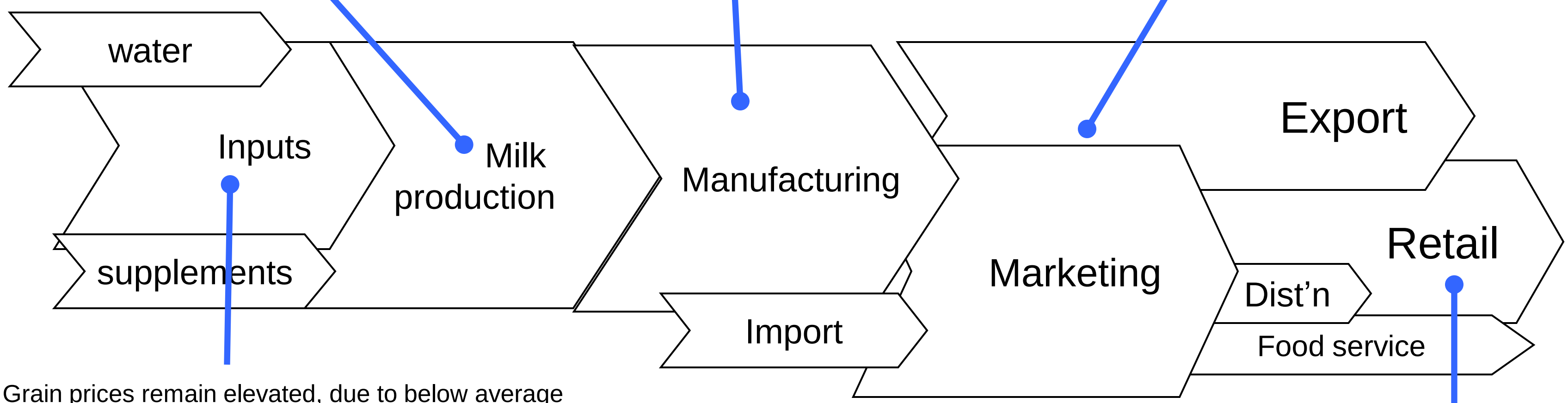
The strong Australian dollar continues to constrain exporter returns and reduce international competitiveness.

Further step-ups depend on where the AUD is against manufacturer budget expectations

US supply contracted less than expected following drought, but milk production growth has slowed.

Australian and EU production conditions have deteriorated, while NZ milk production remains strong.

International demand is steady, but buyers remain cautious in current economic environment.



Grain prices remain elevated, due to below average crop yields and strong export market demand.

Seasonally low purchasing and weaker market sentiment have kept fertilizer prices in check.

Lower cull cow prices and challenges facing the export heifer sector, despite a strong year for shipments.

Cautious consumers, but confidence is building – growth in non grocery/foodservice sales continues.

Total supermarket retail fresh white milk sales volume up 2.7%, branded sales volume increased 15.0%.

Key driver outlook

	Global economy	Global demand	Australian market	Global supply	Inputs	Exchange rates
Status						
Major discussion points	•Positive signs for global economic recovery coming out of China and the US, but Euro area situation remains key concern. •Smooth leadership transition in China – economic growth around 8%. •Emerging market economies continue to outperform developed market economies and drive world growth.	•Economic unrest maintaining uncertainty. •Buyers holding adequate stocks and cautious outlook on procurement. •Demand for dairy proteins and infant formula still strong. •Long term growth still expected from China and India as incomes grow.	•Supermarket milk discounting extended to petrol and convenience stores. •Mixed wholesale performance for major dairy categories, but some prices firmer. • Food service sector experiencing higher rates of growth in sales turnover than supermarkets. •Consumer sentiment improving but constrained by uncertainty over house prices/jobs.	•US drought yet to break. Conditions could remain tough in lead up to peak. •Wet conditions in Europe combining with high input prices constraining growth. •Deteriorating Australian production conditions. •NZ milk production strong, but conditions slowing production growth.	•Grain prices remain elevated. •Water allocations remain high. •Fertilizer prices moderating. •Lower cull-cow prices and a sluggish heifer market.	• Australian dollar remains attractive to foreign investors, holding it above parity. •Australia's big four banks forecast the AUD between 100-107 US cents by mid-2013. •AUD correction expected in the second half 2013. • European exporters less competitive as Euro appreciates against USD.

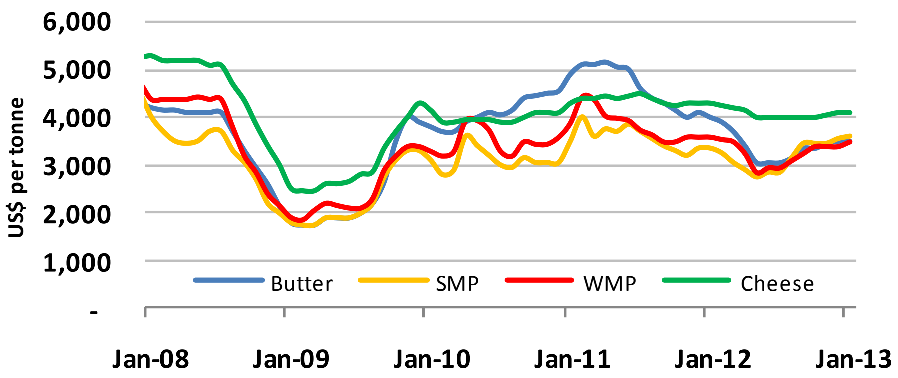
Operating conditions or key driver status:

Positive Steady Negative

The Australian dairy industry in February 2013

- Milk price and higher feed and energy costs have been the major concerns during the 2012/13 season. **Southern export region farmers are facing a 8-10% price drop. Northern domestic producers also face negative price signals and some are now also coping with flood impacts.**
- **Australian milk production is up 0.5% (28m litres) for the six months to December, to 5.3bn litres.** However, production during December actually decreased 1.3% compared to December 2011.
- **Increasingly difficult seasonal conditions have prompted Dairy Australia to lower its milk production forecast for the 2012/13 season to 9.5bn litres**, up just 0.2% on last season.
- International commodity prices have improved since September and the Australian dollar has largely been stable. While the many different payment systems make a definitive forecast difficult, a range of around **$4.90 – $5.10 per kgMS** or **36-38 c/L** for southern farm gate prices is likely.
- Many companies have forward-sold manufactured product, locking in US dollar prices, **the primary downside risk to this payout forecast remains a higher Australian dollar (AUD).**
- Major Australian banks are forecasting the AUD to be 100 – 107 US cents by mid-2013, but expectations diverge heading toward the end of 2013 when the forecast range is 99 – 108 US cents.
- A stronger US economic recovery, or a significant drop in the value of mining exports, are the factors that could send the AUD lower.
- **The IMF revised its global economic forecast down 0.2% because of ongoing uncertainty over Europe.** But developing economies are expected to grow 5.5% in 2013 – a positive for dairy demand.
- **An economic recovery appears to be underway in the United States.** Consumer confidence and spending is increasing slowly. This is also supporting export-dependent developing economies.

Fig 1 – Indicative international dairy commodity prices



- Despite challenging economic conditions and an increase in commodity prices, **global demand has remained steady.** Global dairy exports to China increased 26% in 2012, to over 1,350,000t.
- Chinese consumer spending is expected to grow 8.5% in 2013, demand for infant formula is strong and young consumers are driving cheese consumption.
- Australian consumers remain cautious, but confidence has improved slightly in early 2013. Although average wholesale prices for some key dairy product categories firmed slightly over the December quarter and total sales volumes were broadly stable, average per litre supermarket retail fresh white milk prices are down.
- Major supermarkets are extending $1-per-litre milk to petrol and convenience outlets. Changes to retailers' fresh milk sourcing arrangements may also be on the horizon.
- On the supply side, the US drought is yet to break and poor weather is slowing EU production growth. If poor conditions continue, the northern hemisphere production peak will suffer.

Margin squeeze – The space between short and long-term trends

- The drop in milk prices this season, combined with a sharp rise in feed and electricity costs has significantly increased cash flow pressure for dairy farmers across Australia.
- At the moment there is a margin-squeeze between long term demand growth and short term volatility associated with exchange rates, production conditions and input prices.
- To put some context around the current situation, we have used western Victoria to highlight these issues.
- Western Victorian farmers in general entered the 2012/13 season on the back foot. A wet and short 2011 spring limited fodder conservation. This was followed by dry summer conditions, which meant that many farmers in the region had run down fodder reserves by early autumn.
- As a result of these difficult conditions, cost of production – as measured by the DPIV's Farm Monitor program – jumped 12% in 2011/12 for western Victorian participants, placing them well above other Victorian regions.
- Another disappointing spring in 2012 has added to the pressure for farmers dealing with an even greater than usual cash flow challenge in the current season.
- This situation has been exacerbated in western Victoria by a supply spike in agricultural land, as some vendors have been forced to meet the market, at prices reportedly 20-25% below the 2008 peak. This has undermined asset values across the region, which were previously boosted by Managed Investment Schemes and interest from New Zealand dairy investors.
- For farms with high debt levels, declining asset values have also constrained access to working capital from banks, prompting delayed payment terms to existing creditors or increased use of third party lines of credit.
- The current situation highlights how equity levels can amplify vulnerability to short term margin volatility and cash flow pressures.

Fig 2 – Victorian average farm debt

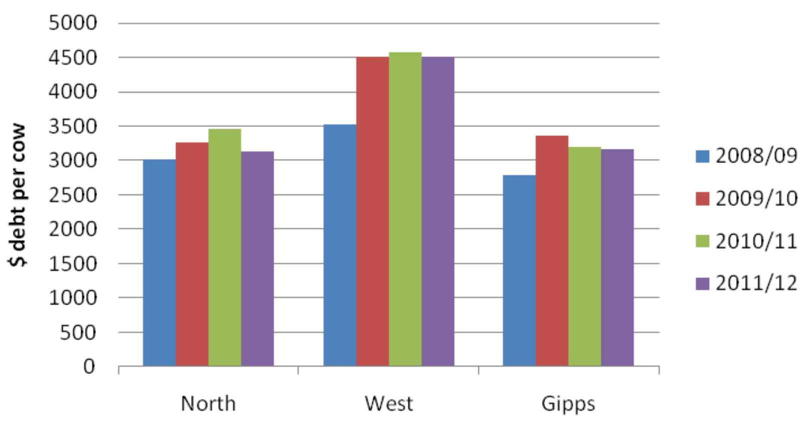
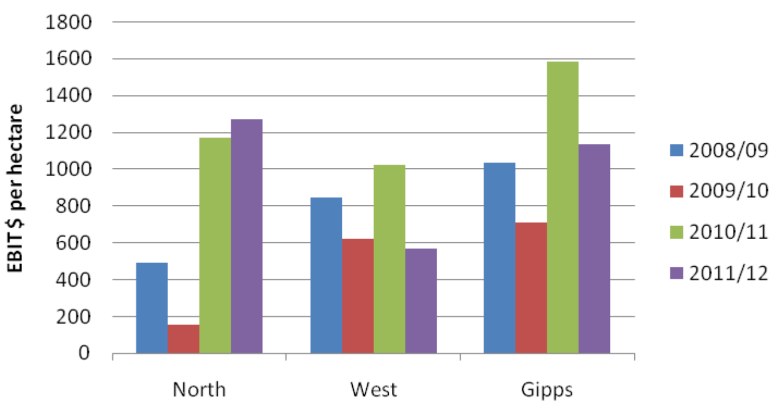


Fig 3 – Earnings before interest and tax

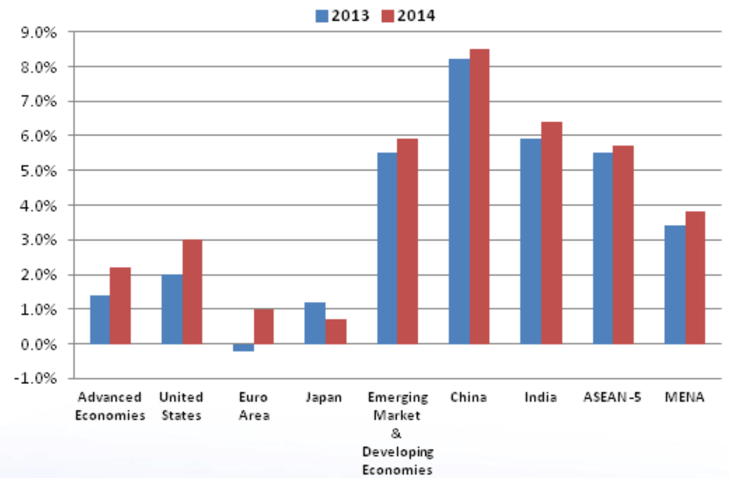


Source: DPIV Farm Monitor

Global economy

- The **IMF has revised its global economic growth forecasts downwards by 0.2%** largely reflecting the **ongoing uncertainty** over Europe, which has affected emerging market economies as developed markets purchase less export product.
- Growth in **emerging markets and developing economies will continue to support global growth,** surpassing that of the advanced economies to register 5.5% in 2013.
- Signs of economic recovery are emerging from China and the United States, but the **situation in Europe and the wider global economic recovery remains fragile.**
- Despite the European Commission reporting improved sentiment among consumers and most sectors (except retail), **Eurozone unemployment hovers around 12%.** However**,** unemployment in Greece and Spain is approaching 27%.
- Much of the Euro area is experiencing ongoing recession. **European analysts suggest the Euro crisis is yet to reduce milk consumption, but indications of 'shifting-down' in value are emerging.**
- **There are signs of a US recovery;** rising consumer spending, improved housing prices, positive employment data and business investment. The IMF's forecast for US growth is unchanged at around 2%, but lifting above trend later in 2013.
- Ongoing conflict in parts of the Middle East and North Africa continues to pose challenges for economic growth and stability.
- Economic recovery has also encouraged rising oil prices. Though the global benchmark Brent price has hit USD$115/bbl, **OPEC expects the price to hold around USD$110/bbl through 2013** as supplier countries respond with increased output.
- **India is entering 2013 with improved business sentiment, and lower inflation.** The IMF and other analysts are forecasting growth to lift closer to 6.0%
- **China's economic performance has improved in recent months**. Industrial production, consumer sentiment and retail sales showed positive growth in the last quarter of 2012.
- Government infrastructure spending on top of a recovery in housing prices and construction activity is expected to further support continued economic growth.
- **Chinese consumer spending is forecast to grow 8.5% in 2013** assisted by tax cuts. A Bloomberg survey of economists suggested China's growth will lift from 7.7% in 2012 to 8.1% in 2013.
- Japanese **Prime Minister Abe has announced a new stimulus package**; the Bank of Japan has set a 2% inflation target (Japanese inflation peaked over the last decade at 1.37% in 2008). This has **resulted in a weaker Yen, negatively impacting Japanese importers.**
- Japan has also seen a slowdown in exports to the US, Europe and China, and its trade deficit tripling, and is likely to see slower growth over 2013.

Fig 4 – 2013 and 2014 GDP projections

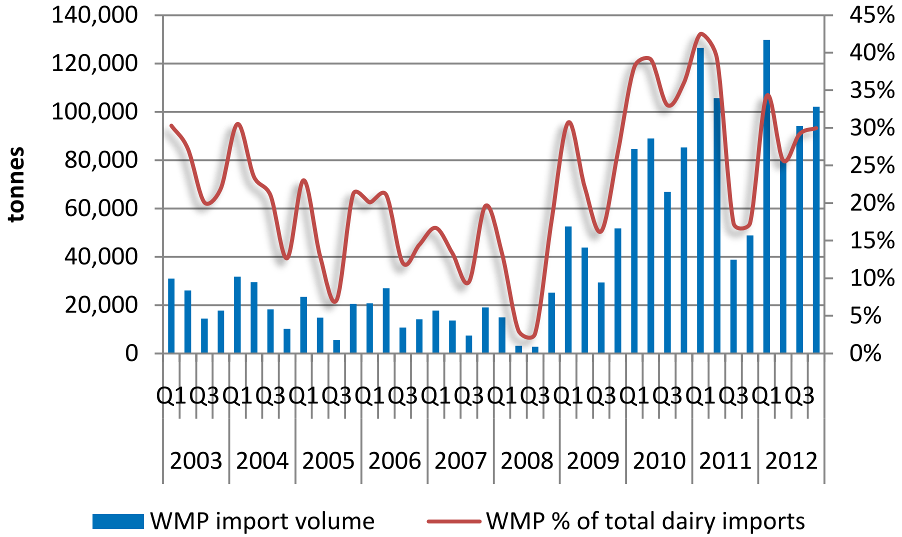


(Source: IMF WEO Update, January 2013)

Global demand

- Despite the **challenging economic environment and tightening supply** from many regions pushing up commodity prices, **global demand has remained steady.**
- Difficult production conditions in Australia, EU and United States, offset by a good season in New Zealand have increased buyer uncertainty. **Buyers are focused on filling short−term requirements and waiting to see how prices develop.**
- **Global dairy export trade volumes** for the nine months to September 2012 **rose 6% on the corresponding period in 2011**, to 8.75 million tonnes. Trade in SMP and butter jumped almost 10%, cheese increased 5%, while WMP was flat.
- **Holiday season demand supported commodity prices in the last months of 2012**. US food service consumption increased marginally, but remains sensitive to economic developments.
- Recovering property prices are supporting US consumer confidence – Gallup tracking (early Jan) indicates **consumer spending is up 24%** (to US$84/day) compared to Jan 2012. Advance buying for Easter/Passover should also support US prices.
- **European demand has been mixed** due to poor weather disrupting usual summer consumption patterns. Demand growth has generally paused in light of the current economic situation.
- Total **Russian dairy imports are down 5%** for Jan-Nov 2012, primarily lower SMP, WMP, cheese and butter purchases. However, infant formula and milk imports rose by 25% and 13% respectively.
- Disposable incomes in Brazil have been challenged by a modest economic slow down but the IMF is still forecasting 3.5% growth in 2013. Brazilian **dairy consumption growth continues to outpace local production,** and imports during 2012 increased 8% to an estimated 220,700t.
- The **Indian Dairy Association, expects local demand to rise 29% over the next five years.** Indian milk production is not expected to keep pace with this rate of demand growth.

Fig 5: China Qtly WMP Imports



- **Chinese dairy imports for 2012, were more than 1,350,000t, up 26% on 2011.** Smooth Chinese leadership transition (to Xi Jinping and Li Keqiang) and plans to significantly lift domestic consumption will support ongoing demand.
- **Younger Chinese consumers are driving cheese consumption growth** with imports up 36% in 2012. WMP and SMP imports are increased 27% and 29% on 2011 respectively. Demand for infant formula is still strong – there are more than one million internet searches for 'milk powder/formula' per day, up 31% on Q3, 2011 backed by a 17% increase in infant formula imports in 2012.
- **South East Asian dairy imports have been mixed** during the first nine months of 2012. Malaysian and Thai imports are up, but Indonesian and Singapore import volumes have decreased.
- Increased imports by Iran, Iraq and the UAE have not offset the 18% decrease in Saudi Arabian dairy imports. **Total Middle Eastern dairy imports decreased 6% in 2012**. **African dairy imports** have also slowed (down 10%) in the face of rising commodity prices.

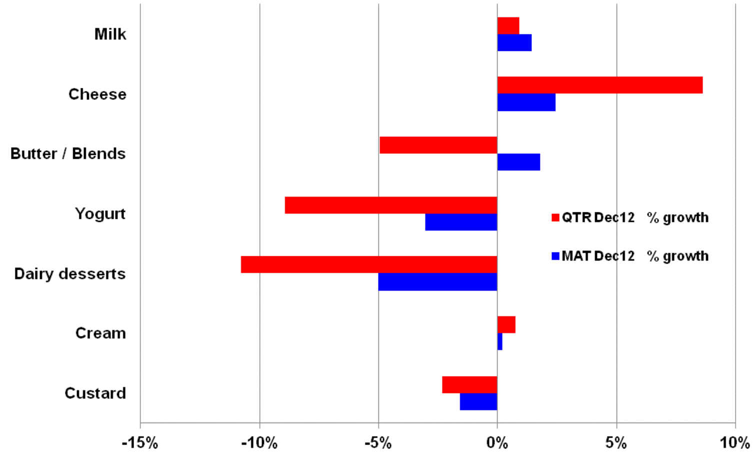
Australian market

– Employment remains relatively steady and **consumer confidence has shown slight improvement in early 2013**, but the outlook for business conditions this year is expected to remain challenging.

– Performance in key categories in the domestic dairy market has been mixed; **wholesale volumes over the December 2012 quarter lifted above the annual trend for cheese and cream**, but **declined for other products against the annual trend.**

– Average **wholesale prices firmed over Q4 2012** for most key categories, with prices above those of Q4 2011.

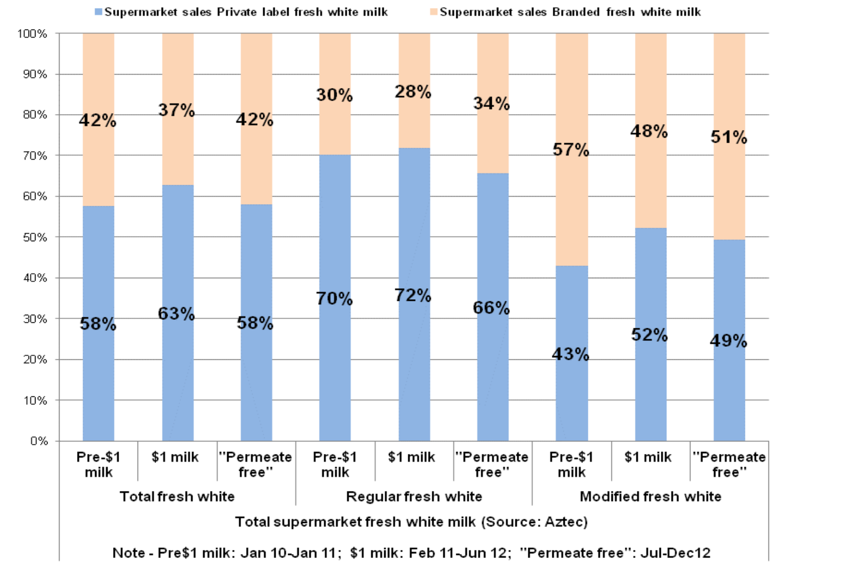
Fig 6 - Domestic sales by dairy category (% volume change on LY)



– **Supermarket majors have extended $1-per-litre milk discounting to petrol and convenience (P&C) outlets.** Total milk sales through the majors' P&C are estimated at 3.0% of the total fresh milk market: 11.0% of total flavoured milk and 2.8% of fresh white milk sales.

– ABS data suggests that overall retail sales growth has slowed, but food service sales outpaced growth in supermarket turnover in Q4 2012 compared to Q4 2011.

Fig 7 - % vol supermarket share - 'milk price wars' & 'permeate free'



– **Aztec supermarket scan data to December shows branded milk has recovered supermarket sales share,** to close to pre $1-per-litre milk campaign levels. This has coincided with the introduction of branded permeate-free product lines and increased promotional activity. But increased sales volumes have not offset the decline in the average fresh white milk supermarket retail price. The introduction of private label permeate-free products will probably influence price trends in coming months. Interest in greater provenance is also likely to have some bearing on new supply and marketing arrangements for fresh drinking milk.

– Processors have bought some supermarket volume share with heavy promotional expense. **Average branded per litre supermarket retail prices are down, notably in the higher priced modified milks sub-segment,** where average per litre price is **down nationally 2%,** lower in NSW (down 7%) and Victoria (down 4%).

– **Aztec data also shows that both major processors have experienced persistent declines in the total dollar value** of their supermarket fresh white milk sales over the last 5 years (based on 12 months to mid-January).

Global supply

Europe

– **EU-27 milk production to October 2012** grew just under **1% on the same period in 2011.** Production has been slowing since July, with October production decreasing 1.7% relative to October 2011. **Growth is now expected to come in at 1% for both 2012 and 2013.**

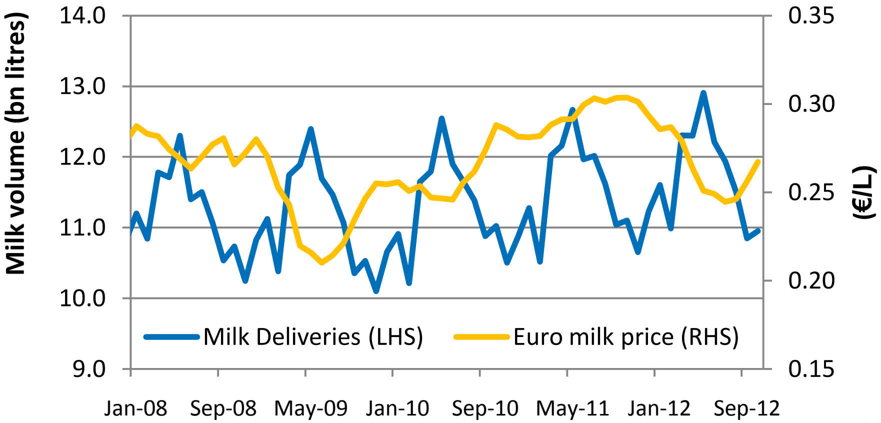
– **Cost pressures are constraining EU production**, with high grain prices and shortages of quality fodder in some areas. Poor weather has compounded the effects of global feed price increases.

– **Milk production for France and Germany was 20bn and 25bn litres to October** - 0% and 1% growth respectively.

– Growth in Eastern European countries continues. Poland and Hungary in particular, both increased over 7%. However, in October some Romanian producers were forced to stop milk deliveries due to a failure to meet EU quality standards.

– EU farmgate prices regained ground in late 2012, but remain lower than previous years. The **November weighted average price of €28/100kg (35 c/L AUD)** is around 9% lower than Nov 2011.

Fig 8 - Average EU 27 milk price and milk deliveries



United States

– US milk production has proved surprisingly resilient despite ongoing drought and poor production margins, **growing 1.8% to around 91 billion litres for the 2012 calendar year.** December data shows **growth of 1.6% for the month.**

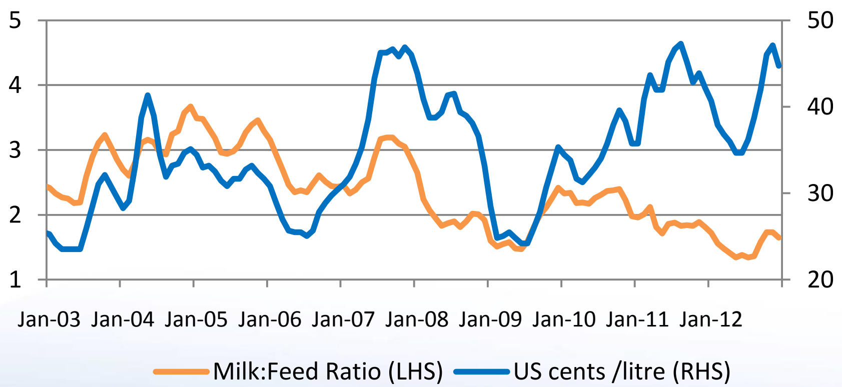
– **The US herd contracted significantly during 2012, decreasing to** 9.2 million cows at December (10,000 cows less than December 2011). Despite high beef prices, around **half the cows from Californian farms exiting the industry are being sold to other farmers,** both locally and interstate, whose financial position is more sound – retaining cows and supporting production.

– **US production patterns are shifting in favour of eastern and mid-western states** with better access to feed supplies. California and neighbouring southwestern states are lagging as higher geared farms are forced to rationalise.

– **A shortage of fodder, and poor nutritive value of the available feed is the key impediment facing US farmers** at present. **This issue is compounded by the high price of corn,** and may decrease cow yields as the season progresses.

– **The USDA's forecast is for 0.3% growth in calendar year 2013.**

Fig 9 - US milk:feed ratio and average US milk price



Global supply

Australia

- **Australian milk production is up 0.5% in the six months to December 2012** - at 5.3 billion litres. The rate of growth has slowed over the course of the season, and production during **December decreased 1.3%** compared to the same month in 2011.
- Difficult seasonal conditions continue to put pressure on fodder production and feed budgets have been trimmed due to tight farm margins. With southern farmgate milk pricing 8-10% lower than last year, and higher feed and energy costs, farmer profitability and production has been significantly impacted in 2013.
- Consequently, **DA's current forecast milk production is for growth of around 0.2% to 9.5 billion litres** for 2012/13.
- If autumn conditions are favourable with improved farmgate cash flow and/or the structural shift to winter production continues, there is some upside potential to the current forecast.

New Zealand

- **Milk production in the 2012/13 season to November is up 7% on last year.** At 2.8 billion litres, **production for the month of November was up 8%** on the same month in 2012.
- Despite useful rainfall at the start of January and flooding on the west coast, **many New Zealand dairying areas are currently experiencing dry conditions, which are limiting pasture growth.**
- North Island rainfall during January was down 20% on average and hot weather has reduced soil moisture and flattened production growth.
- In the South Island, conditions vary significantly by region, but overall dairy production is holding above last season.
- **Growth is expected to moderate for the balance of the season, but still produce 3-5% production growth to over 20bn litres.**

South America

- **A number of major dairy regions in South America have been affected by weather extremes** - drought followed by excessive rain. This combined with higher grain, labour and energy costs is expected to hamper milk production in early 2013, before an expected recovery later in the year.
- Four successive months of negative growth have seen milk production in **Argentina** slow markedly, with November output 7% below November 2011. Year-to-date production **is 2% above the same period in 2011** at 6.9 billion litres. Supply growth has outpaced domestic demand and exports of products such as WMP have risen. With per capita demand steady, **Argentina's exportable surplus is expected to remain around current levels in 2013**.
- The **Brazilian dairy industry has also been faced with the cost:price squeeze,** and local production is often undercut by imports from Argentina and Uruguay. Brazilian domestic demand continues to increase faster than production, which is forecast to grow by **3-3.5% in 2013**.
- **While milk production in Uruguay grew rapidly in the first half of calendar year 2012,** challenging production conditions have slowed full year growth expectations to around 7% (total 2 billion litres).

China and India

- **Chinese dairy product output increased 6.5% year on year** in December, as investment in large scale dairy farm projects continued, while **India's monsoon season rainfall recovered from early deficiencies** to reach 92% of its long-term average, easing pressure on grain yields and fodder availability.

Inputs

Feed grains

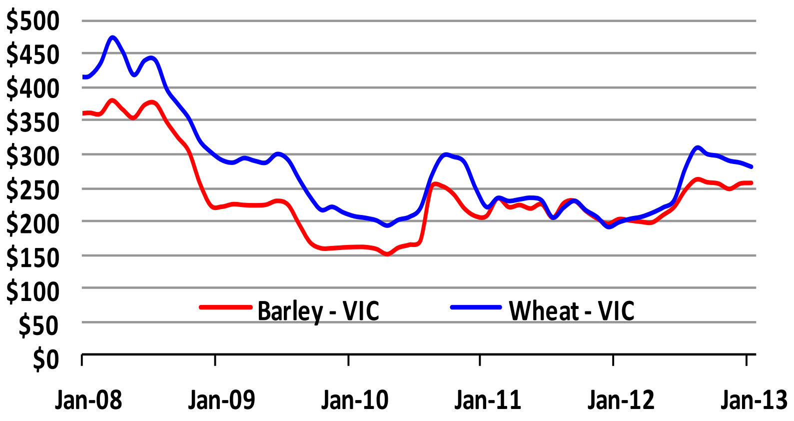
– **Global grain prices remain elevated** with a dry outlook in the US, winter kill in the Black Sea region and excessive rain in the lead up to UK spring plantings continuing to drive uncertainty around supply.

– **Corn stocks around the world will remain stretched until at least the South American harvest** from mid-February – and more likely through to the second half of 2013 when the US crop begins to be harvested.

– **Feed wheat demand remains strong,** as high corn prices mean production economics continue to favour the inclusion of wheat in rations. In particular, US feed wheat use during 2012/13 is widely expected to reach its highest level since 1998/99.

– Despite easing slightly since their peak in August, local feed grain prices remain high, with **Melbourne-delivered feed wheat prices 46% above the same time last year - $288/tonne** at the end of January. Barley has risen less sharply, **up 30% to $260/tonne**.

Fig 10 - Feed grain prices (AUD/tonne)



– The 2012/13 Australian winter crop harvest is largely complete, with anecdotal evidence suggesting that crops have exceeded yield expectations in many areas.

– The ABARES *December Crop Report* estimated that **the total 2012/13 Australian winter crop would reach 35.1m tonnes** – a dip of 23% on last year's 45.6m tonne record. This level of production would be 9% below the five year average to 2011/12.

– The **wheat crop** is **forecast to reach 22.0m tonnes**; while the **barley harvest** is expected to be **around 6.9m tonnes**.

– Dry conditions through harvest meant **a much smaller proportion of quality downgrades than the past two summers,** while strong overseas demand continues to push up local prices. **Forward booking of export shipments suggests that grain marketers are anxious to take advantage of strong export prices** on offer, contributing to a tight domestic supply situation through 2013.

Hay

– **Strong demand through 2012 has significantly run down national hay stocks.** Demand is likely to remain robust until the autumn break and follow up rains enable pasture reestablishment while soil temperatures remain conducive to growth.

– While hay prices are noticeably higher than this time last year, good **conditions for haymaking mean that quality is also excellent.** Straw quality has also been high in eastern states, and **presents a viable fodder option for many dairy producers this year.**

– **The export market is shaping up as a significant competitor for hay supplies** this season, thanks to healthy demand from Asian markets, the high quality of product available, and export prices around $10-$30/t higher than last year. Early season data to **December shows hay exports are down 2% compared to the same period in 2011/12 in volume terms, totalling 348,000 tonnes.** With new season hay entering the market from November, exports are expected to accelerate in coming months.

Inputs

Fertiliser

- Rabobank reports subdued demand and slow trading for most fertilisers during late 2012, as **seasonally low purchasing and weaker market sentiment kept prices in check.**
- Good supplies pushed phosphate prices down during Q3 2012 and by December 2012 were trading 16% lower than December 2011. For the same period, Urea and Potash prices fell 17%, and rose 13% respectively.
- **Urea prices are expected to remain firm** due to strong northern hemisphere demand – especially if US soil moisture improves. South American buyers are also expected to remain active. Phosphate prices are forecast to remain steady over the next few months.
- Strong inventories are likely to see potash ease slightly, despite firm demand in some regions from farmers keen to capitalise on favourable crop economics.
- **Australian fertiliser distributors are encouraging retailers to forward order estimated requirements** in an attempt to avoid repeats of past years that have seen importers caught with high priced, unsold stock – or retailers left short.

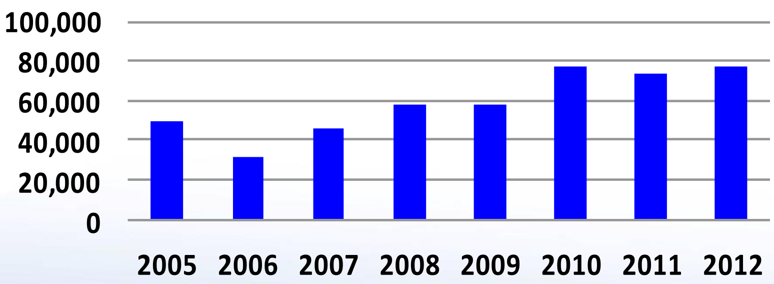
Water

- **All northern Victorian irrigation systems are at 100% High Reliability Water Shares (HRWS).** Allocations against Low Reliability Water Shares (LRWS) are 94% for the Campaspe system and 100% for the Broken system.
- GMW considers LRWS allocations for the Murray, Goulburn and Loddon systems to be ‘unlikely’ this season. Water is now being reserved for the 2013/14 season in the Murray system.
- Allocations for southern NSW and Gippsland irrigation systems are also at 100%.
- With increased demand this season, temporary water prices are at two year highs, although still far short of previous dry years at **$40 to $45 per mega litre**.
- According to the Bureau of Meteorology (BOM), **El Nino-Southern Oscillation (ENSO) indicators in the tropical Pacific remain at neutral levels,** and are likely to remain so into the southern hemisphere autumn. This suggests a neutral the three month rainfall outlook, and close to average rainfall for the season.

Cows

- **Cull cow sales in the seven months to the end of January were 6% below the same period last year,** as lower prices (down 22% on average) offset the incentive to cull stock in the current environment of lower milk production margins.
- **Live dairy cattle exports increased 4% to 77,092** in the twelve months to Dec 2012 – with a strong fourth quarter more than offsetting significantly lower volumes in the early months of the year.
- Recently, a large number of planned export shipments have fallen through, with outcomes linked to behind the scenes procedural and political complications – including the Chinese leadership transition. Consequently, large numbers of **heifers originally destined for export will now be sold locally, depressing local dairy livestock market in coming months**.
- Assuming a successful resolution of these issues and those surrounding pedigree requirements for export livestock, ongoing demand for dairy cows in China is expected to see a **gradual recovery in heifer export prospects** over the next 12 months.

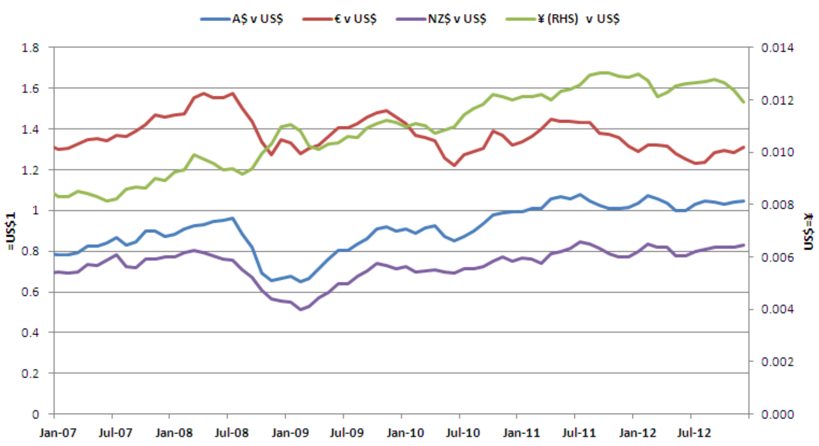
Fig 10 - Dairy cattle export volumes – number of head



Exchange rates

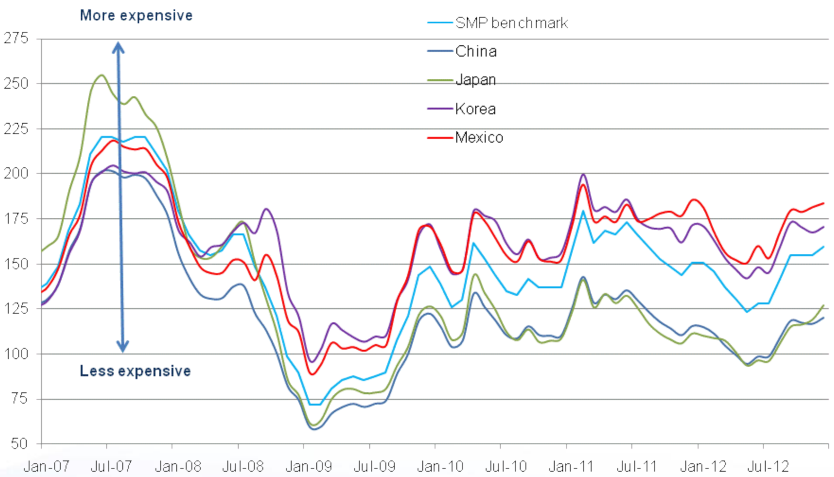
- Tentative recovery in the US, renewed growth in China and continuing uncertainty in Europe suggests a 'fragile' global economic situation - despite Euro appreciation against the USD.
- The **Euro has gained against the US dollar (USD) and the Yen for six consecutive months** as currency market participants' optimism about the worst of the Euro crisis having passed outweighs negative sentiment. Yet ongoing uncertainty may still put downward pressure on the Euro in 2013.
- Fears over 'currency wars' are increasing as policies with currency devaluing effects are implemented by some nations.
- **The stronger Euro against USD and Yen will reduce some of the currency advantage** European traders have used during 2012 – leveling the playing field in key dairy markets like Japan.
- **Australia continues to enjoy higher credit ratings and interest rates, attracting investors looking for safety and better returns. This is supporting the AUD despite falling coal and iron ore prices.**

Fig 11 - Exchange rates vs. USD



- Australia's big four banks have a **forecast range for the Australian dollar (AUD) of 100-107 US cents by mid-2013.**
- This forecast AUD range widens to **99-108 US cents by the end of 2013.** This is broadly in-line with a Bloomberg survey of 46 financial institutions expecting ranges of the AUD of 90-110 US cents by mid-2013 but **greater economic uncertainty pushes the range wider to 85-112 US cents by the end of 2013.**
- While the AUD has tracked close to 105 US cents in recent months, a **growing number of currency analysts believe the AUD will depreciate against the USD over the course of 2013** as the US recovery strengthens; if iron ore prices drop, and if the RBA announces further rate cuts.
- **SMP import affordability in key export markets declined over the second half of 2012**, as the upward trending SMP prices offset the relatively stronger currencies of importing countries.

Fig 12 - Import affordability index. Feb 2005 = 100



International Trade Policy Update

– This **section outlines the current status of international trade agreements and negotiations in place, or under way,** in order to grow export volumes and **improve returns to farmers by saving around $250 million per year paid in tariff duties alone.**

Completed Agreements:

– **Australia has seven Free Trade Agreements currently in force**: with New Zealand, Singapore, Thailand, Malaysia, the USA, Chile and the regional agreement AANZFTA (ASEAN, Australia, New Zealand Free Trade Agreement) with the Association of Southeast Asian Nations (ASEAN) and New Zealand.

– **The Malaysia Australia Free Trade Agreement (MAFTA) entered into force on 1st January 2013.** The main benefits for Australian dairy are new country specific quotas (CSQ) for liquid milk and improved trade documentation rules. The new Country Specific Quotas for liquid milk include annual growth rates of up to 9% per annum, and for the first time (for a sub-component of the new quota) the right to export liquid milk that is not end-use restricted, such as retail packaged fresh and UHT milk lines.

Current Negotiations:

– **Australia is a World Trade Organisation (WTO) participant, and is also engaged in nine FTA negotiations** - five bilateral FTA negotiations: with China, Japan, Republic of Korea (ROK), India and Indonesia; and four regional FTA negotiations: the Trans-Pacific Partnership Agreement (TPP), the Gulf Cooperation Council (GCC), the Pacific Trade and Economic Agreement (PACER Plus), and the Regional Comprehensive Economic Partnership Agreement (RCEP).

Multilateral Negotiations: (involving many participants)

– **WTO Doha Round** The Doha Development Round is the current trade-negotiation round of the WTO which commenced in Nov 2001. In July 2008 negotiations broke down after failing to reach a compromise on agricultural import rules. During 2012 Australia and several other WTO partners explored alternatives (‘new pathways’) for agreement on issues by a subset of members, but little outcome has emerged to date.

Regional Negotiations: (involving more than two countries, sometimes also referred to as plurilateral negotiations)

– **Gulf Cooperation Council (GCC)** Negotiations with the Gulf Cooperation Council comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, commenced in July 2007. Australia is one of a number of countries negotiating FTAs with the GCC, however, the Council has paused its trade negotiations with all partners pending a review of its trade agreement policy. There is no indication that negotiations with the Gulf Cooperation Council are likely to move ahead significantly in the near future.

– **Trans-Pacific Partnership (TPP)** The fifteenth round of the TPP Agreement negotiations took place in Auckland New Zealand, from 3rd – 12th December 2012. For the first time Canada and Mexico joined the negotiations along with the existing participants: Australia, New Zealand, USA, Vietnam, Malaysia, Singapore, Brunei, Chile, and Peru. Japan is still considering if it will formally seek membership. Department of Foreign Affairs and Trade (DFAT) negotiators hope to conclude negotiations by the end of 2013, but this may be an optimistic timeframe. The next round of TPP negotiations will be held in Singapore from 4th to 13th March 2013.

– **PACER Plus** Negotiations were launched at the Pacific Islands Forum Leaders August 2009. Participants are: Australia, Cook Islands, Federated States of Micronesia, Kiribati, Nauru, New Zealand, Niue, Palau, Papua New Guinea, Republic of Marshall Islands, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Australia's primary objective is to promote the economic development of Forum Island Countries through greater regional trade and economic integration.

– **RCEP (Regional Comprehensive Economic Partnership)** RCEP is an ASEAN-centred proposal for a regional free trade area, which initially includes the ten ASEAN member states and those countries which have existing FTAs with ASEAN – Australia, China, India, Japan, ROK and New Zealand. RCEP negotiations were initiated in the margins of the East Asia Summit in November 2012.

International Trade Policy Update (cont.)

Bilateral Negotiations: (involving two countries)

- **China** FTA negotiations with China commenced in 2005. It appears unlikely that a final resolution will be achieved soon. The latest negotiation round (the 18th) was held in Canberra in March 2012. The major hurdles are non-agricultural issues. The Australian Government is aware of the commercial advantage that the New Zealand dairy industry has due to its completed FTA with China. China is also currently interested in progressing trade agreement discussions with other countries such as Japan, Korea, and ASEAN.
- **Japan** Negotiations commenced in April 2007. Bilateral interest is high with inter-sessional discussions taking place between negotiating rounds. The recent change of Government in Japan does not appear to have hindered the ongoing negotiations.
- **Korea** Negotiations commenced in March 2009 and were almost complete in late 2011 before stalling. A key factor appears to be ISDS (Investor State Dispute Settlement). Unless the FTA with Korea is progressed, the phasing of tariff preferences for EU and US suppliers under their FTAs will put Australian exporters increasingly behind our competitors. It is hoped that newly elected President Park Geun-hye will agree to progressing FTA negotiations with Australia.
- **India** Negotiations commenced May 2011. The fourth round of negotiations was held in New Delhi in November 2012. Consensus is that this negotiation will be a long and difficult process. There are significant political and industry groups within India who are against increased market access for food products. Australian negotiations are behind the EU and NZ who are also negotiating FTAs with India.
- **Indonesia** The Indonesia - Australia Comprehensive Economic Partnership Agreement negotiations commenced in Jakarta in September 2012. These are still at an early stage, with little progress evident in the broad economic partnership agreement.
- For more information on these agreements please visit the DFAT FTA website: www.dfat.gov.au/fta

Fig 13 – Trade Event Summary

Trade Event	Completion Outlook	Potential benefit to Australian Industry
WTO Doha round	Unlikely in short term	Very significant, multi product and multi market
GCC – Australia	Challenging/ unlikely in short term	Major access improvement to demand market
Trans Pacific Partnership	Target is end 2013	Significant benefits for multiple dairy products and markets
PACER plus	Likely, end 2013 – 2014	Niche product and market
RCEP	Likely, 2014 +	Advantage against EU and USA, lineball with NZ
China FTA	Unlikely in short term. Non agriculture issues.	Resolve current trade disadvantage with NZ
Japan FTA	New momentum, potentially by end 2013	Our biggest customer, significant dairy benefit
Korea	Stalled by non-agriculture issues	Significant benefit to price sensitive customer
Indonesia	Initial phase Long timeframe	Major opportunities for rapidly growing dairy market
India	Initial phase Long timeframe	Significant opportunity, multiple products