Dairy Situation and Outlook

June 2017

Dairy Australia
Your Levy at Work

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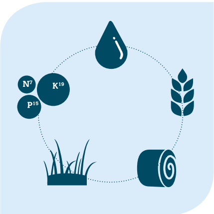
Contents

Dairy Situation and Outlook – June 2017

Six key drivers of the Australian Dairy Industry

Inputs



Situation: ▲
Outlook: ■

The start of calendar 2017 has been unseasonably warm and wet in most of the country with summer rainfall around 49% above average. Grain and hay markets remain subdued, and fertiliser in general remains much cheaper than a year ago. Most irrigation systems are expected to receive a high seasonal determination in 2017/18.

Global supply

Situation: ■
Outlook: ■

Globally, improved margins have arrested the fall in milk production in most exporting regions, and whilst supply growth remains limited, a responsive farm sector means any gains from further commodity price increases would likely be fought over.

Global economy

Situation: ■
Outlook: ▲

According to the IMF, global economic growth faces a slightly more optimistic outlook as a result of higher projected growth rates in the US, increasing global investment and improved commodity prices, a result of supply restriction and increased demand.

Australian market

Situation: ■
Outlook: ■

Supermarket sales volumes showed growth in all dairy categories. Milk sales have been particularly strong, and the sales value of the category grew almost 7%. Value growth is under pressure in other categories - particularly cheese and yoghurt and dairy desserts.

Global demand

Situation: ▲
Outlook: ■

Demand for exports continues to grow, though lower average prices have dampened total US dollar values over the past 12 months. A recovery in demand from Greater China accounts for around 30% of volume growth over this period, while Southeast Asia has also seen growth.

Exchange rates

Situation: ■
Outlook: ▲

The median consensus forecast is for the AUD to depreciate slightly against the USD for the remainder of the year, as a result of the Federal Reserve further increasing interest rates and expectations that the new US government will lower corporate tax rates.

▲ Positive ■ Neutral ▼ Negative

Executive summary

- **The industry continues to deal with profitability, trust and confidence issues, though underlying confidence of farmers in their own business and its future remains robust.**
- **Despite ongoing downside risk, the international market is more balanced than a year ago and domestic sales growth is strong – albeit with continued pressure on value.**
- **Improved farmgate pricing for most regions, and continuing input cost relief look set to deliver modest growth in milk volumes in the season ahead.**

Many farmers across a number of regions continue to struggle financially and the wider industry is facing ongoing frustration and distrust in parts of the supply chain. Together with difficult seasonal conditions for many in spring, this has impacted farmer confidence and not surprisingly, milk production has fallen sharply this season. Notwithstanding the ongoing challenges, the broader market provides grounds for cautious optimism about the season ahead. Costs for major inputs remain contained, and current milk price forecasts suggest at least some upside to 2016/17 levels.

Globally, dairy markets are in relatively neutral territory, with sufficient demand to absorb northern hemisphere spring production without major price disruption. Sentiment is far from bullish, and key exporting regions all stand ready to compete for any price upside, but the market is currently well balanced. In Australia, the domestic market has continued its steady volume growth, although some categories are experiencing slower value growth amidst ongoing unit price pressure.

Farmer confidence has suffered as a combination of seasonal and pricing pressures depressed profitability over the past 12 to 18 months. The shock and anger generated by the 2015/16 step-downs, as well as the protracted period of enquiry and pursuit of remedy are also reflected in this year's results for Dairy Australia's National Dairy Farmer Survey. Nationally, 53% of respondents to the February/March survey felt positive about the future of the dairy industry, representing a significant drop from the 2016 result of 67%. Many of the hardest hit were southern regions, with significant declines in WestVic Dairy, GippsDairy, DairyNSW and DairyTas.

Key themes to emerge from the survey included confirmation that trust in processors has been damaged (27% of farmers either have, or would like to change processor), and profitability is at a three year low (45% of farmers anticipate making a profit in 2016/17). Management strategies have varied widely in response to the issues of the past year – especially in northern and western Victoria, and Tasmania. Despite the current challenges, one third of farmers expect to grow their herd size in the next 12 months and close to two thirds (63%) anticipate their production to increase in the next three years.

Input costs are a more immediate bright spot. Record international production, and strong harvests in Australia have kept grain prices contained. There has been little change to the hay market in the last few months; with subdued demand, ample supply and low prices. Despite some upward pressure on phosphate prices, fertiliser in general remains much cheaper than a year ago, with potash and nitrogen indicators trading around 20% below year-ago levels. Most irrigation systems are expected to receive a high seasonal determination in 2017/18, and temporary water prices ended the 2016/17 season well below the $100/ML mark.

Elevated culling rates (40% above average) have persisted in 2016/17, but the rate has slowed since October 2016. Heavy culling in 2016/17 is, together with reduced confidence, likely to constrain Australian milk production in 2017/18. Assuming current indications of improved farmgate milk prices and a continuation of favourable weather and input prices are borne out, milk production growth of between 2% and 3% is forecast for the coming season, implying a total of over nine billion litres.

For the current season, Australian milk production has continued to close the gap with 2015/16, and is likely to reach 8.95 billion litres; about 7.5% below last season. Cash flow remains a significant issue for farmers directly exposed to export markets, despite some relief in the form of lower feed costs and modest

The end of a difficult 2016/17, and potential for better operating conditions in 2017/18 offer hope that rebuilding of confidence and relationships along the dairy supply chain will accompany better profitability.

milk price increases. In Western Australia, the balance between milk supply and processor requirements remains an issue while in Queensland and northern New South Wales, pressure on farmgate prices threatens profitability.

Internationally, improved margins have arrested the fall in milk production in most exporting regions. Whilst supply growth remains limited, a responsive farm sector means any gains from further commodity price increases would likely be fought over. European milk production is stabilising after nine months of modest falls, while US milk supply continues to expand (up around 2%). Milk production expectations in New Zealand have ebbed and flowed this season, but intakes will likely finish only slightly (1 to 2%) lower than 2015/16.

Demand for exports continues to grow, with the volume of dairy products traded over the twelve months to February increasing by 3.8%. A recovery in demand from Greater China accounts for around 30% of this, while southeast Asia has also seen growth. Tonnages exported to the Middle East and North Africa, as well as Japan have eased slightly. Lower average prices across the 12 months have been reflected in a 4.6% decrease in overall US dollar traded value.

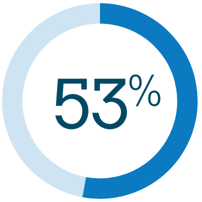
Price pressure is also a feature of the Australian domestic market, though supermarket sales volumes continued to grow strongly for most key dairy categories. Milk sales have been particularly robust, especially in fresh white full cream and flavoured milk, while dairy spreads saw continued (albeit moderating) growth. Both of these categories have seen value grow faster than volume, as consumers ‘trade up’ to branded products at higher price points. Cheese and yoghurt have also seen increased volumes, but value growth has lagged as discounting pressure mounts and consumers seek out ‘value’ offerings.

Pressure has also been felt post-farmgate, with Murray Goulburn announcing the closure of its Rochester, Kiewa (both northern Victoria) and Edith Creek (Tasmania) plants and scrapping its Milk Supplier Support Package (MSSP). Fonterra has announced changes to its loan schemes, comprising reimbursement of interest payments made on its loan scheme by current and retired suppliers, and a $0.40/kg MS additional payment above its base 2017/18 farmgate milk price. The company's rebuilt Stanhope cheese plant will commence production in the new season. Parmalat resolved an industrial dispute concerning its Echuca plant, but remains in arbitration with the Queensland collective bargaining group Premium, over proposed changes to milk pricing. Saputo completed its takeover of Warrnambool Cheese and Butter in late February, and Bega Cheese sold one of its four spray driers at Tatura, and Derrimut infant formula canning facility to Mead Johnson Nutrition.

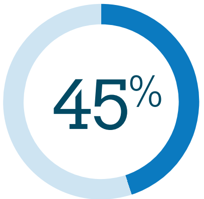
The end of a difficult 2016/17 season, and the potential for better operating conditions in 2017/18 offer hope that the rebuilding of relationships and confidence along the dairy supply chain will accompany better profitability. With a number of inquiries and industry led initiatives either concluded, or close to delivering outcomes, there is widespread appetite to apply the lessons of recent challenges and take the industry forward. Consumer support at home, and a balanced market internationally, provide a promising backdrop to getting this done.

National Dairy Farmer Survey (NDFS) 2017

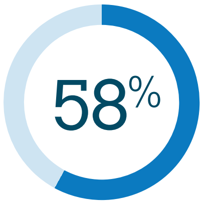
National results at a glance as at February/March 2017



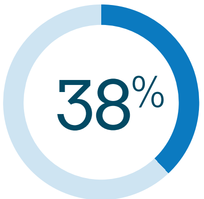
Farmers positive about industry future
(2016: 67%)



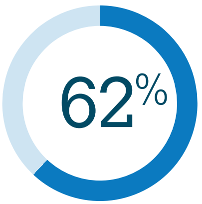
Anticipated profit in 2016/17
(2015/16: 64%)



Positive about future of OWN business



Intended to invest in the next 12 months
(2016: 49%)



Made operating profit in 2015/16
(2014/15: 80%)

The NDFS was conducted during February and March 2017 amongst 1,000 dairy farmers nationally. At the time of the survey, 53% of respondents felt positive about the future of the dairy industry following very challenging pricing and seasonal conditions experienced since May 2016. This represented a significant drop in sentiment from 2016 survey results where 67% of farmers were positive about the industry future. The decline in positivity was widespread but particularly apparent in WestVic Dairy, Gipps Dairy, Dairy NSW and Dairy Tas regions and in general, amongst small herd sizes (<150 cows).

This response is unsurprising considering the strong historical correlation between milk price and sentiment. Statistical analysis suggests that prices account for more than 80% of the variability in farmer positivity about the future of the dairy industry. Climate or seasonal conditions and input costs tend to be the next most dominant drivers of sentiment but show a much lower correlation than price.

Survey data highlights key impacts of the 2016/17 season. These are discussed in the themes below.

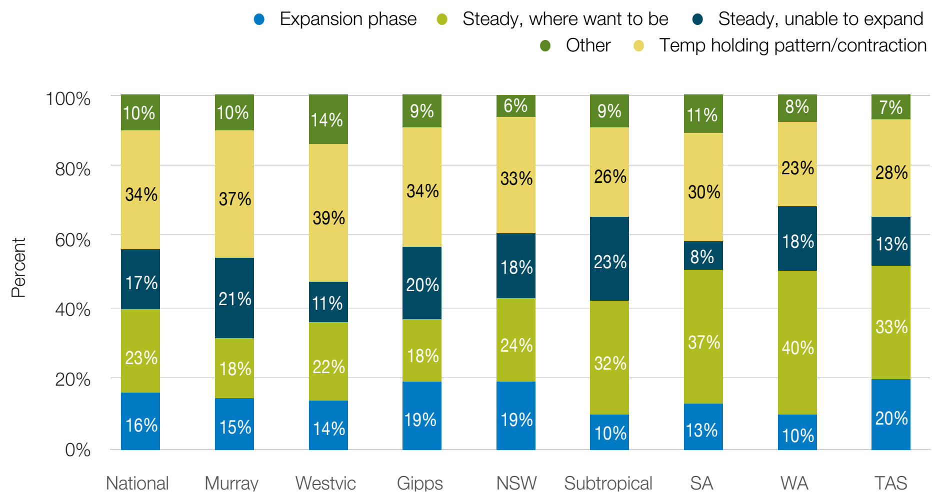
Theme 1: Trust in processors has taken a knock.

In the past 12 months, 11% of respondents changed the processor they supply and a further 17% would like to change supplier – 9% are considering it and 8% would like to change but are unable to. Farms with herds greater than 700 cows were most likely to have changed processor or to be considering a change. In general however, most farmers tend to be loyal to their processors historically and 61% have remained with one processor for the past 10 years.

Milk price is predictably the primary reason for changing or considering changing processor, however 21% also expressed concerns with processor management and the treatment of farmers, 12% were concerned about the 'clawback' and 8% lack trust in their company and feel they have not been honest.

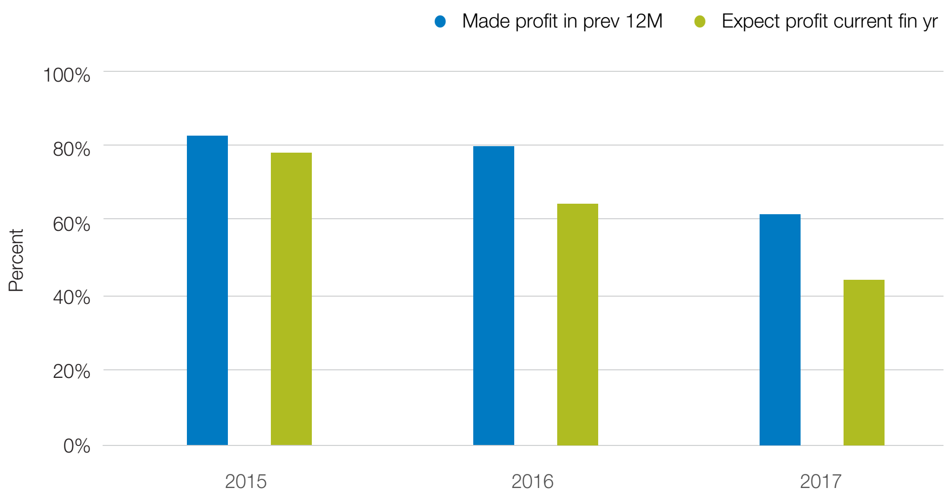
With additional seasonal challenges also faced in the past 12 months, many farmers are reporting uncertainty, with a third nationally stating they are in a temporary holding pattern or contracting phase. This is most prevalent in the Murray Dairy and WestVic Dairy regions. However, for many the impact of the last 12 months seems to be seen as a short term setback with close to two thirds believing their production will increase in the years ahead.

Figure 1 Enterprise phase



Source: National Dairy Farmer Survey 2017

Figure 2 Profitability



Source: National Dairy Farmer Survey 2017

There has been a corresponding decline in the proportion of farmers in an expansion phase (16% in 2017 compared with 26% in 2016) as well as those being 'steady' (63% in 2016 to 40% in 2017). The drop in farmers in an expansion phase is widespread across all dairying regions while the decline in those who are in a happy and steady position is most significant in the Victorian regions.

Given challenges experienced in the industry over the last 12 months, its unsurprising that significantly fewer farmers are encouraging their family or employees to stay in the industry (especially in Victoria and New South Wales) and significantly more farmers having only negative things to say about the industry whether it be to family, other farmers, service providers or their local communities. This corresponds to 16% of all respondents saying they are making plans to leave the industry.

Theme 2: Profitability is under severe pressure

The proportion of farmers making an operating profit has declined consecutively over the past 3 years. In the 2013/14 and 2014/15 financial years, 80% of farmers nationally reported operating profits. In 2015/16, 62% reported a profit and for 2016/17, only 45% are anticipating a profit.

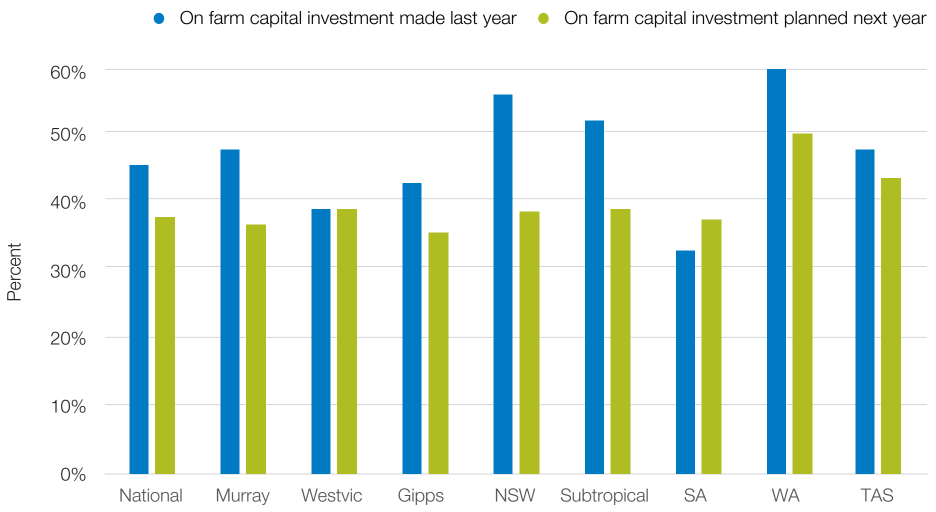
Data from the latest survey, however, suggests farmers are used to dealing with seasonal challenges and variability in market conditions. The majority (60%) report that they were prepared to make on-farm changes to deal with the challenges they face. These changes were primarily related to purchasing and conserving feed, making adjustments to herd size and closer monitoring of costs to cope with current conditions.

Not only is the proportion of farmers making a profit lower, but survey data suggests profit levels have also been declining over time. Latest data indicates that 70% of farmers are expecting 2016/17 profits to be lower than the average of the past 5 years. Farmers in Murray Dairy, Gipps Dairy, Dairy NSW, Dairy SA and Western Dairy are most likely to be expecting lower profits this current financial year.

Generally speaking, farms with herds of more than 500 cows are most likely to make a profit in 2016/17 but similar to farmers nationally, a high percentage are expecting profit levels to be lower than the 5 year average.

One of the noticeable consequences of this decline in profitability is lower intentions to make capital investments. This typically trends with levels of profitability and confidence in the future of the industry. Compared to 2014/15 when 59% made capital investments on farm, significantly fewer farms made investments last financial year (46%) or intend making investments in the next 12 month (38%). Western Dairy and Dairy Tas are the dairying regions most likely to invest in the year ahead – for Western Australia this is most likely to be in machinery and in Tasmania, irrigation plant.

Figure 3 Capital investments



Source: National Dairy Farmer Survey 2016–2017

Figure 4 Farm management changes

Source: National Dairy Farmer Survey 2017

Theme 3: Farmers have responded in a variety of ways to the 'industry crisis'

Farmers across the board have made changes to their farm management in response to the challenging conditions over the past 12 months. This was most apparent in the Murray Dairy, WestVic Dairy and Dairy Tas regions.

Adjustments to debt, herd size and supplementary feed were the top three changes made:

- Nearly half (46%) of all respondents obtained a new loan or extended their debt while 30% have refinanced or deferred debt. This was significantly higher in the Murray Dairy region where 56% obtained new loans for extended debt and 45% refinanced or deferred debt.
- 38% decreased their herd size while 26% increased their cow numbers, possibly taking advantage of stock availability. Farmers in Victoria, South Australia and Tasmania were most likely to have reduced stocking rates.
- 30% decreased their level of supplementary feeding, partly helped by improvements in seasonal conditions, while 17% increased supplementary feeding as costs came down significantly. Increases in supplementary feeding were most evident in Dairy NSW and Western Dairy.

The National Dairy Farmer Survey was conducted in February and March 2017 amongst 1,000 dairy farmers across eight dairying regions. Respondents are recruited randomly and are interviewed by telephone. Results presented are based on survey data which is weighted to represent the structure of the Australian dairy industry.

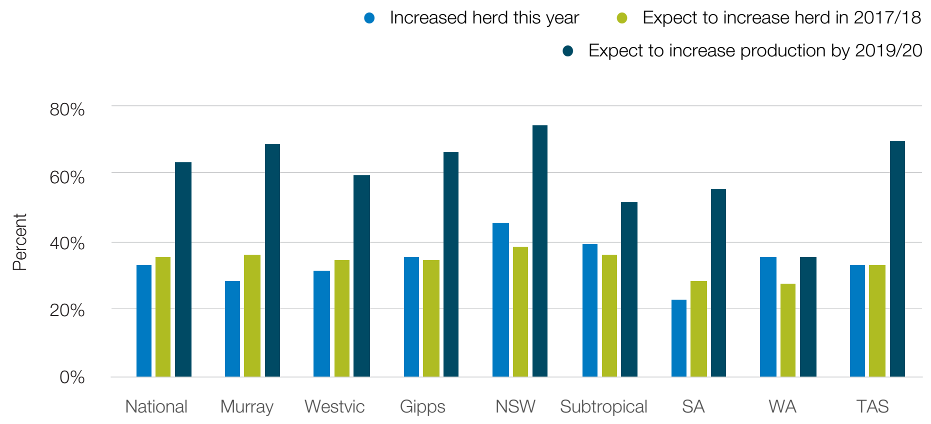
Theme 4: There is a silver lining

Despite recent falls in average herd sizes, especially in Murray Dairy and WestVic Dairy regions, overall a third of farmers expect an increase in their herd in the next 12 months and close to two thirds (63%) anticipate their production to increase in the next 3 years. This optimism is widespread with the exception of the Western Dairy region.

Production intentions for 2019/20 vary significantly by herd size with 50% of small farms (<150 cows) expecting growth compared to 73% of 'xx-large' farms (>700 cows).

In terms of general views of the industry, many respondents expressed the opinion that the dairy industry is cyclical and ups and downs are to be expected. The majority (72%) still believe there are opportunities for the industry and given the strong correlation with sentiment and farmgate milk prices, it can be anticipated that confidence will rise as prices improve. Furthermore, those who trust their own business models and feel like they are prepared to deal with both the good and the bad tend to be more confident in the industry. That said, the relationship with their processor and prices paid continue to have a significant influence on their overall outlook for their businesses.

Figure 5 Herd and production expectation



Source: National Dairy Farmer Survey 2017

Figure 6 Positive about industry vs own business

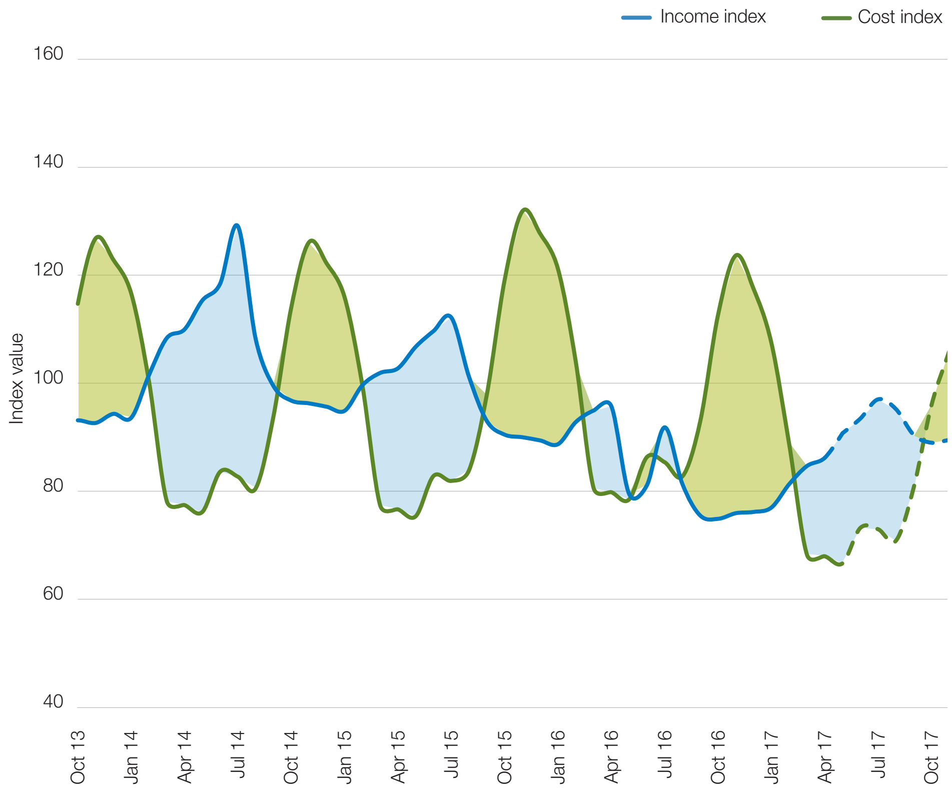
Source: National Dairy Farmer Survey 2017

Export region weighted cost and income indices

The weighted cost and income indices consider the near-term outlook and highlight the net impact of market changes. The latest update suggests:

- Whilst income has been tight for many farmers in 2016/17, the resumption of a more 'normal' cash flow pattern has provided some level of respite compared to 2015/16.
- Lower costs for key inputs have been the main contributor to the 'breathing space' in margins, though significant differences in milk pricing means the experience varies widely.
- Early indications suggest that 2017/18 farmgate prices will be around 10% higher, and with input costs likely to remain close to current levels, the index outlook anticipates a better profitability outcome for farmers in southern regions.

Figure 7 Export region weighted cost and income indices



Source: Dairy Industry Farm Monitor Project, Dairy Australia analysis

Inputs

Fertiliser

Urea (granular Middle East)

179 US$/t

▼ –23% LY
▼ – 44% 5Y

DAP (US Gulf)

360 US$/t

▼ –45% LY
▼ –60% 5Y

MOP (granular Vancouver)

214 US$/t

▼ –35% LY
▼ –59% 5Y

Price is April 2017 average, compared to the 2016 April average (LY) and 5-year (5Y) April average.

Source: Bloomberg

Water and weather

Northern Victoria

96 $/ML

▼ – 53% LY
▼ – 10% 5Y

1,838,667 ML

▼ – 5% LY
▲ +9% 5Y

Murray Irrigation System

62 $/ML

▼ – 72% LY
▼ – 30% 5Y

165,336 ML

▲ +42% LY
▼ – 8% 5Y

Price of water traded is 12 month average and volume of water is 12 month total, both to April 2017, and compared to year earlier (LY) and last 5 years (5Y).

Source: Victorian Water Register, Murray Irrigation Ltd

Cows

Cull cows

460 c/kg

▲ +13% LY
▲ +29% 5Y

106,363 head

▲ +1.5% LY
▲ +40% 5Y

Dairy cattle exports

66,345 head

▼ – 12% LY
▼ – 17% 5Y

Price is April 2017 average, compared to April last year (LY) and 5-year (5Y) averages. Number of head is last 12 months (cull cows to April, dairy cattle exports to April 2017) compared to year earlier (LY) and 5-year (5Y) averages.

Source: NLRS, ABS

Most irrigation systems are predicted to receive a high seasonal determination at the first announcement in 2017/18.

Weather

The start of 2017 has been unseasonably warm and wet in most of the country as summer rainfall tracked about 49% above average. As the eastern parts of the Pacific Ocean heat up, the Bureau of Meteorology has issued an El Niño watch, signalling a 50% risk of El Niño for winter. El Niño is associated with lower rainfall and warmer temperatures in Australia for the subsequent season. The central and eastern parts of the Indian Ocean are cooling, increasing the likelihood of dry conditions in Australia.

During summer, rainfall in western parts of the country tracked well above average, while the eastern part received below average rainfall. Some areas in Western Australia recorded the highest summer rainfall in history and Northern Territory and South Australia also received above average totals. Cyclone Debbie brought heavy rain and flooding to Queensland and New South Wales in late March resulting in serious flooding; despite this, most of eastern region received below average rainfall. The wet conditions extended into April for southern regions, while both western and eastern parts of the country were drier than average.

The average temperature tracked above long term benchmarks for most of the summer. Eastern Australia experienced both warmer days and nights with New South Wales recording the hottest summer on record while north-western parts had cooler than average days. The hot summer temperatures extended into autumn for the majority of the country. The BoM forecasts a warmer and drier winter than usual. Below average rainfall and higher day and night temperatures is to be expected in most parts of the country.

Water

The mild 2016 summer and heavy rainfall have led to high dam storage levels. Dartmouth, Hume and Eildon dams are sitting at 78%, 60% and 66% respectively, all well above last year's level. Despite declining water storage levels in all major dams, the latest seasonal outlook suggests a year with good water accessibility. Most irrigation systems are predicted to receive a high seasonal determination at the first announcement in 2017/18.

Temporary water trade levels remain elevated and the persistence of above average rainfall during summer maintained pressure on prices of temporary water in northern Victoria and southern New South Wales. In northern Victoria, average prices dropped from $50/ML in February, to $45/ML in March, to $42/ML in April. April marks the seventh consecutive month with price declines in northern Victoria. This is an 83% decrease in price from the same period last year and as a result the water trade market has been highly active. More than 267,000 megalitres were traded during April 2017, an increase of 125% to previous year.

Zone 6 (Hume to Barmah) continues to experience the biggest increase in water trade volumes, in March it was up 428% on previous year.

Water trades in the Murray Irrigation Area continue to track well above previous levels and have more than doubled compared to the previous year for the 12 months to March 2017. Over 24,000 megalitres were traded, a slight decrease from March but still 55% higher than this time last year. The price is significantly lower than last year, down 86%, to $34/ML in April. This is the lowest water prices have been in the last five years in the area.

Fertiliser

The fertiliser industry continues to struggle with overcapacity, oversupply, supply competition and bearish demand, keeping the market under pressure. Prices remain well below their long run levels with some fertilizers being the lowest on record. Potash (MOP) and nitrogen (urea) are down 23% and 21% respectively from last year, while the phosphate (DAP) market has recovered somewhat and prices are up 8% on previous year.

The global supply of potash remains elevated thanks to increased competition in the industry. As a response to the low prices and subdued demand, producers are trying to adjust their production to counteract the growing supply, with some of the major players temporarily halting production in various plants. The industry is forecasting increased demand later during the year from major importers in Asia, China and India, on the back of favourable weather conditions, however the prevailing oversupply is putting pressure on the market.

World demand for phosphates (including DAP) decreased in early 2017 as major importers withdrew from the market, resulting in large stockpiles globally. Demand is forecast to grow in the second half of the year as India looks to increase imports. China has cut its production by almost 50% following government inspections of production plants. The cuts have resulted in a significant export drop, as producers focus on internal market demand. The decrease in production combined with a slight lift in demand might lead to a general lift in the market.

The urea market has seen a lift during the start of 2017 as demand increased from Europe, the United States and South America. As a result of a permanent reduction in Chinese urea production, global supply has decreased which is providing some support for slightly higher prices. During the second half of the year new plants in the United States are projected to increase supply, which might yet reverse the current trend.

Cull cows

Elevated culling rates have persisted in 2016/17 as cull cow numbers track 40% above the five year average. In the 12 months to April, 106,363 cows were culled, compared to 94,602 last year. However, since October 2016 the number of dairy cows sold to slaughter has decreased on a monthly basis, suggesting a potential cow cull slow-down.

Cull cow prices continue to track well above the five-year average of 357c/kg and during the 12 months leading up to April prices increased a further 11% to average 457c/kg. After seven months of consecutive monthly price decreases, cattle prices started to increase again in March, following the widespread autumn break and lower yardings. The Meat and Livestock Australia Industry Projection for 2017 predicts higher beef prices will persist for most of the calendar year.

Supporting this, beef exports in 2016/17 are predicted to be the fifth highest recorded in Australia, however trends vary by destination market. The United States herd has started to rebuild after a period of liquidation, resulting in a 27% decrease in Australian beef exports to the US during the first quarter of 2017. Increasing US supply has added to export competition in Korea, resulting in a 21% decrease in Australian exports to that market. At the same time exports to Japan and China have increased on a year-to-year basis with Japan currently being Australia's biggest market for beef exports.

Hay

There has been little change to the Australian hay market in the last few months as demand remains low and supply high. Hay trading is down in most of the country as farmers have enough pasture and home-grown fodder to continue to sit out the market; some farmers are even looking to cover their own feed requirements for the remainder of the year.

Recent rainfall has continued to support pasture growth, adding to the lack of urgency to buy hay. With higher yields this season, storage sheds are close to full, leaving a lot of hay unprotected from rain. Weather damage has created a wide range, and poorer quality hay overall.

Northern Australia

A slight pick-up in the market has been noticed in the north as dry conditions have almost depleted the local supply of hay and buyers are beginning to seek product from southern regions. Demand is still lower than previous years, however supply pressures could result in price increases over the next months.

Cull cow prices continue to track well above the five-year average of 357c/kg and during the 12 months leading up to April prices increased a further 11%.

There has been little change to the Australian hay market in the last few months as demand remains low and supply high.

Rainfall following the recent cyclone has improved the feed situation for farmers not affected by flooding however the full impact of the cyclone and its effect on fodder demand is yet to be realised.

Southern Australia

In southern regions there is an oversupply of hay, following the favourable growing conditions during last season. Many farmers have enough feed in sheds and grass in paddocks to sit out the market for the time being. The overall quality of hay in the region is well down from previous years with hay in paddocks having been badly damaged by rain.

In southern regions a lift in demand is becoming increasingly unlikely following the arrival of the autumn break.

Western Australia

Hay trading in the west is slow, mirroring the general trend for the season, with only small volumes being traded. Large quantities of export quality feed are not utilised by exporters and overflowing onto the domestic market, keeping prices low.

The quality in the region is generally better than the rest of the country, however recent rains have caused some damage to exposed product.

Grain

The world supply of grain (wheat and coarse grains) during 2016/17 is forecast to reach a new record level at 2.6 billion tonnes, increasing 5% from the previous year. The *USDA's April World Agricultural Supply and Demand Estimate* report anticipates an increase of 1.7 million tonnes. Lower domestic consumption, especially in Europe, has resulted in higher carry-over stock than predicted, the primary reason for the revision. This year marks the fourth consecutive year with record global production resulting in large stockpiles globally.

Australia, the United States and Russia all reported record breaking yields during 2016/17. US wheat production is forecast to break a near 30 year record; having been estimated at 63 million tonnes, an increase of 12% from the previous year. Wet conditions in parts of the US are causing crop disease concerns, but overall the outlook for 2016/17 has improved. The large output is putting pressure on prices and the large degree of wheat short-futures positions suggests the market isn't expecting any issues with the new crop production. World grain production is projected to decrease slightly in 2017/18 following a minor reduction in forecast wheat output. Despite this decrease 2017/18 output is still likely to be amongst the largest ever as a result of the growing stockpiles and carryover crop.

The trend of record breaking yields carries over to the coarse grain market. The production of coarse grains is projected to reach 1.4 billion tonnes, an increase of 0.5% from previous year. Maize output accounts for most of the increase, despite the decrease in production in the United States, as Brazil and Argentina both have increased production. South Africa's maize output has also increased from last year's drought affected levels.

ABARES' February crop report predicts the 2016/17 summer wheat crop at 4.2 million tonnes, up 12% to previous year. This is a result of favourable weather conditions and good availability of irrigation water. As the winter wheat crop increased 45% to previous years, wheat prices have come down with the ASX Jan 2018 reflecting this trend, falling 12% since last year. Barley and canola production have increased, 56% and 41% respectively, both breaking previous Australian yield records and adding pressure to grain prices.

For ongoing information and updates on farm inputs, subscribe to Dairy Australia's monthly Production Inputs Monitor, or the weekly Hay and Grain Report, found on the Dairy Australia website at dairyaustralia.com.au/Markets-and-statistics/Farm-inputs-and-costs.aspx.

The 'Grain and Hay Report' provides a comprehensive overview of the market and indicative pricing by dairying region, and is published most weeks.

The Production Inputs Monitor provides statistics and commentary for grain, hay, fertiliser, weather, water and cull cows on a monthly basis.

Grain and hay prices

Australian dairy regions
Grain and hay

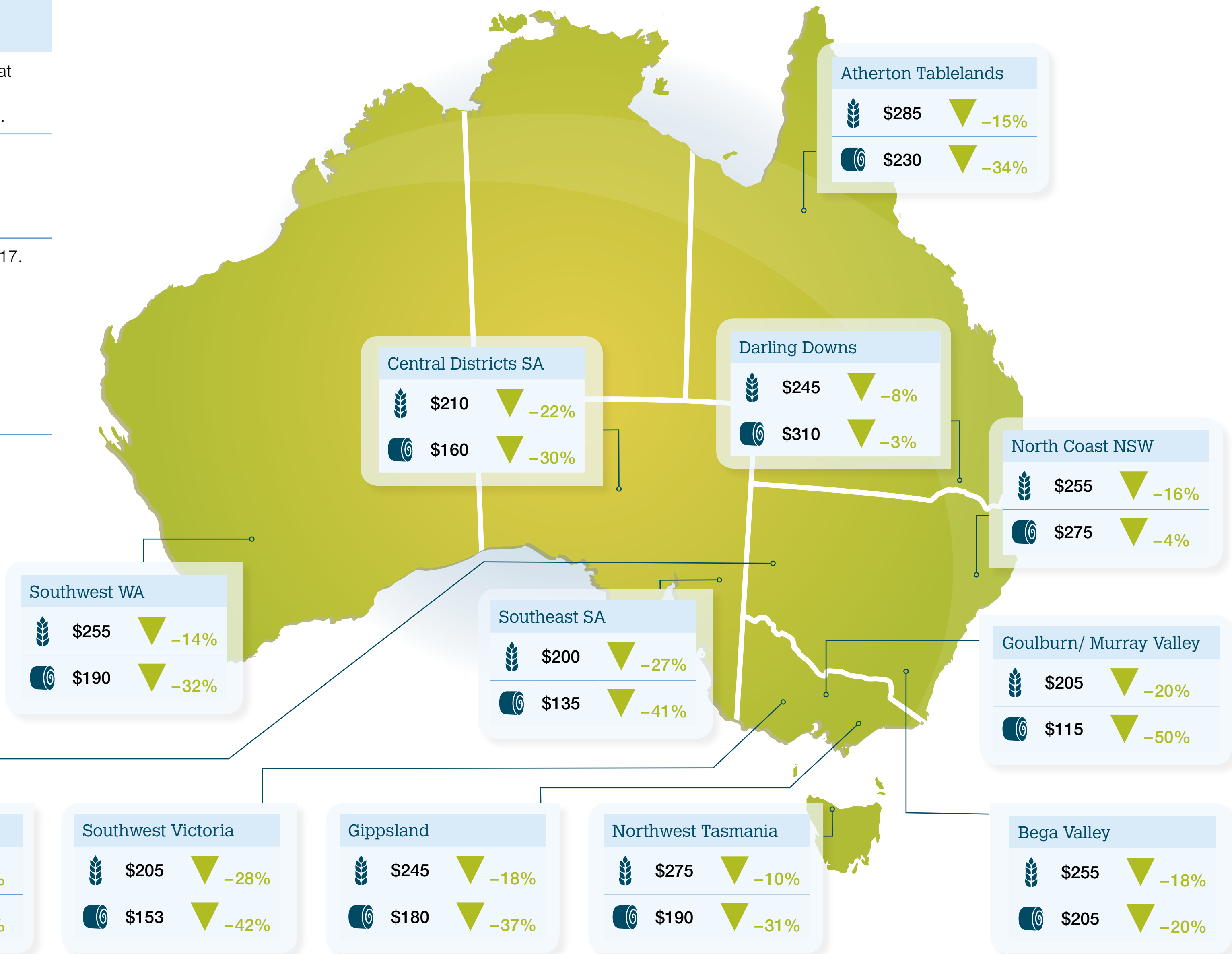
The relevant stockfeed wheat available in a region (ASW, AGP, SFW1 or FED1).

Shedded cereal hay: mid-range product without weather damage, of good quality and colour.

Prices are estimates in $/tonne at April 2017. Compared tp equivalent date April 2016. GST exclusive but including delivery and (for grain) an allowance for storage and marketing costs.

Percentage price change compares to the equivalent date 2016.

Source: AFIA, Lachstock Consulting



The Australian market

Milk

Total supermarket milk sales volumes grew by 3.5% to 1,389 million litres over the 12 months to April, while the category's sales value grew 6.7% to almost $2,200 million. Fresh white milk grew strongly, up 3.9% in volume to 1,077 million litres, and 8.2% in terms of value. The strong growth in the sales value of the fresh white milk segment is due mainly to increased sales of higher-priced branded milk, which retailed at an average price of $1.88/L, compared to $1.04/L for private label milk. Within the fresh white milk category, the market share of company branded milk (by volume) has fallen slowly since June 2016, with supermarkets' private label fresh white milk regaining ground, as shown in figure 9.

The market share of branded fresh white milk was 34% in April 2016, before rapidly increasing and peaking at 49% in early June. Since then, branded milk's market share has fallen, and now sits at 42% in March, which is still around 8% higher than in the period prior to the 'Milked Dry' segment on The Project. The cumulative effect of this increased market share has been to lift total sales of branded milk in the 12 months to April by over 28% to 461.5 million litres, compared to 359.5 million litres in the previous period.

Within the fresh white milk segment, volumes of full cream milk have grown by 10.2% to 683 million litres. This increased consumption of full cream milk reflects not only consumption growth in the segment, but also the effect of consumers transitioning across from fresh modified low fat and no fat milk varieties, sales volumes of which declined by 5.5% to 393.5 million litres.

Sales volumes of UHT milk have continued to fall, easing by 2.7% to 185.6 million litres in the 12 months to April, 2017. Interestingly, company branded UHT milk declined by 4.3% to 118.5 million litres, while private label UHT sales volumes remained more-or-less steady, up 0.2% to 52.6 million litres. Lactose-free milk sales volumes present a bright-spot for UHT milk sales, with company branded UHT milk sales volumes growing by 8.7%, and contributed significantly to total sales value of the UHT category by retailing at a premium to ordinary white UHT milk.

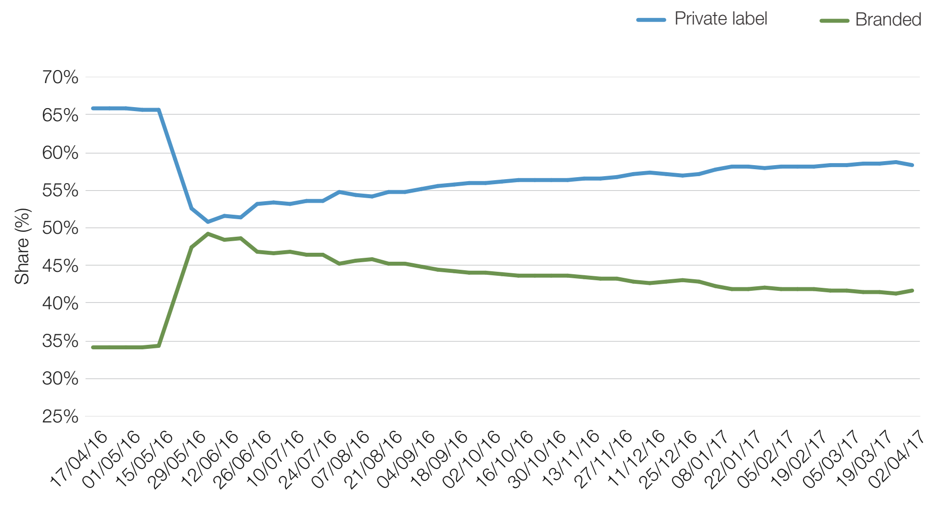
Flavoured milk sales continue to grow strongly with volumes sold in the 12 months to April growing by 9.6% to 134.1 million litres, whilst the sales value of the category grew by 6.7% to $475.9 million, making a significant contribution to the overall sales value of the milk category. Meanwhile, total non-dairy milk sales volumes grew by 12.9% to 93 million litres, whilst the sales value of dairy alternatives totalled $238.9 million, an increase of 12.4%.

Figure 8 Australian market (As of 2/4/17)

	Milk (As of 2/4/17)	Cheese (As of 1/1/17)	Dairy spreads (As of 2/4/17)	Yoghurts and snacks (As of 1/1/17)
Volume	(m. litres) 1,389	(kt) 143.9	(kt) 48.6	(kt) 208.6
Year-on-year growth	+3.5%	+2.9%	+3.4%	+1.0%
Retail value ($ m)	2,200	2,166	450	1,427
Year-on-year growth	+6.7%	+1.2%	+5.5%	–0.9%

Source: IRI
Note: Available data is taken from differing periods; milk and dairy spreads from MAT 2/4/2017; cheese and yoghurt and snacks from MAT 1/1/2017.

Figure 9 Company branded vs P/L fresh white milk share of supermarket sales



Source: IRI

Cheese

Supermarket sales volumes of cheese grew by 2.9% over the 2016 calendar year, whilst the overall value of supermarket cheese sales grew by 1.2%. Within the cheese category, sales of deli-section cheese have increased 5.0% in terms of volume, to 22,767 tonnes, and the value of deli cheese grew 3.7% in terms of value to $569 million. Within the chilled cheese segment, sales volumes grew 2.5% to 121,400 tonnes, whilst sales values grew by 0.3% to $1.6 billion. Although volume and value for both chilled cheese and deli cheese grew, average prices for these segments continued to ease, with average chilled cheese prices decreasing by 2.1% and those of deli cheese by 1.2%.

Within the chilled cheese category, this weakness in per kilogram prices is borne out by a number of trends. The first is the ongoing trend towards larger cheese packsizes, with the 650–999g and 1–1.49kg packsizes showing continued growth. As shown by the table below, these packsizes have a much lower per kilogram price, and have grown considerably at the expense of smaller, higher-priced units. This may also explain household survey data reported by Roy Morgan, showing lower frequency of household cheese purchases, even as sales volumes have continued to grow.

A second, related point, is that cooking and ingredient cheese sales account for most of volume growth. This segment includes shredded mozzarella and pizza cheese, often sold in larger bags, and has grown its share of the cheese market, with greater prevalence of discounting and the promotion of cheaper brands. Whilst higher margin segments such as snacking, sliced and entertaining cheeses have also grown significantly, the total volumes of these segments remain too small to offset value erosion in larger segments such as block and ingredient cheese.

Figure 10 Supermarket chilled cheese sales

Packsize	Share of market	Price	Price growth	Volume '000 (t)	Volume growth
100–199g	5.2%	$29.71	–2.5%	7.0	12.7%
200–299g	21.7%	$17.95	–1.0%	25.4	–0.8%
400–649g	45.3%	$11.66	–1.9%	52.0	–2.9%
650–999g	9.9%	$9.62	–6.6%	14.5	23.5%
1.0–1.49kg	17.1%	$7.87	–3.3%	21.3	5.2%

Yoghurts

The yoghurts and dairy desserts category has seen a slight growth in volumes over the 2016 calendar year, with growth in overall volumes of 1% from 206,600 tonnes to 208,600 tonnes. However, the total sales value of the category eased slightly, falling 0.9% to $1,427 million. Within the category, yoghurt sales grew by 2.2%, underpinned by continued growth traditional and natural yoghurts, with sales volumes over 2016 up 10.8% compared to 2015. In turn, this growth helped offset the continued decline in sweetened yoghurts, which fell by 5.2%, as consumer attitudes towards added sugar content continue to change. In value terms, sales of traditional yoghurts increased 5.7%, or less than volume growth. This was due to a 4.6% fall in the average price of the traditional segment. Average prices for sweetened yoghurts also declined, but by less, from $5.51/kg to $5.44/kg.

Yoghurt snacks and dairy desserts continued to perform poorly overall, with the exception of full fat yoghurt snacks. Often aimed at children as a school lunch item or a snack, and sold in single serve foil pouches as well as more traditional multipacks, this segment grew by 1.8%. Otherwise, most other products within this group, such as custards, mousses and more indulgent yoghurts, saw continued declines in sales volumes.

Spreads

Total dairy spreads grew 3.4% in volume, to 48,630 tonnes, and 4.5% in value to $450.3 million, in the 12 months to April 2017. Butter sales increased 4.2% by volume to 26,190 tonnes, and total sales value increased by 4.7% to $224.5 million, with average price for butter growing by $0.20/kg to $8.57/kg over the period. Within the butter category, company branded butter sales grew by 9.6% to 13,360 tonnes, while private label butter sales declined by 0.9% to 12,830 tonnes. Unsalted butter sales volumes grew by 11.4% to 6,230 tonnes, whilst salted butter sales volumes grew by 7.3% to 17,520 tonnes. Whilst unsalted butter remains the smaller subsegment within the butter category, it has consistently grown at a faster rate than salted butter over the past 5 years, and points to the importance of cooking and baking in driving demand for butter. The strong growth in sales of 500g butter blocks (+5.6%), also points to the increased preference for butter in cooking.

Economic settings

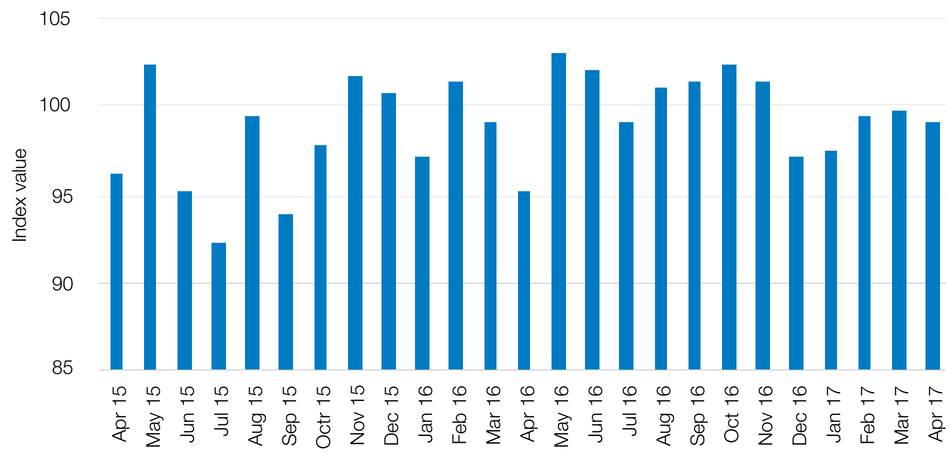
The Westpac-Melbourne Institute Consumer Sentiment Index has improved over the last three months, rising from 97.4 in January 2017 to 99.7 in March before easing to 99.0 in April. However, this result marks the fifth consecutive month that pessimists have outnumbered optimists. Notwithstanding this, it seems that lower consumer confidence levels have not negatively impacted Australians' appreciation of eating out.

Dairy Australia's Food Service Index shows continued growth in the food service sector, with turnover growing by 4.3% in the 12 months to February. The index reflects year-on-year growth in revenue in the takeaway, cafe, restaurant and catering services businesses. Half year growth in turnover was stronger, with revenue growing 5.1% in the six months to February 2017. The Takeaway Food sector has shown significant increases, with revenue growing 7.6% in the last 12 months, and even more strongly in the last 6 months, up 9.9%. The Cafe and Restaurant sector's growth remains positive at 1.7%, while supermarket sales remain steady, growing by 2.4% over the 12 months to February.

The All Groups CPI for the March quarter sits at 111.2, having gained 0.5% points since the December 2016 quarter. Annual inflation remains low, at 2.1% for the 12 months to March, but appears to have accelerated from the December quarter 2016. The March results were broadly in line with the RBA's expectations, and while stronger than the previous quarter, do not appear to have changed the RBA's outlook on the timing of any interest rate rises. The most significant increases for the quarter were in automotive fuel (+5.7%) and electricity (+2.5%). Meanwhile fruit (-6.7%) was the largest single category decline. Within the headline CPI figures, the food and non-alcoholic beverages category grew slightly over the 12 month period, from 105.6 in the quarter to September to 106.2 in the quarter to December 2016. Over the last year, the food and non-alcoholic beverages category has increased 2.1%, from 103.8 to 106.0. Meanwhile over the same period dairy sub-group price levels declined by 1.9%, with decreases to prices in the cheese subgroup (-2.9%) and the ice cream and other dairy categories (-3.1%), whilst the milk sub-group was more-or-less stable (+0.1%).

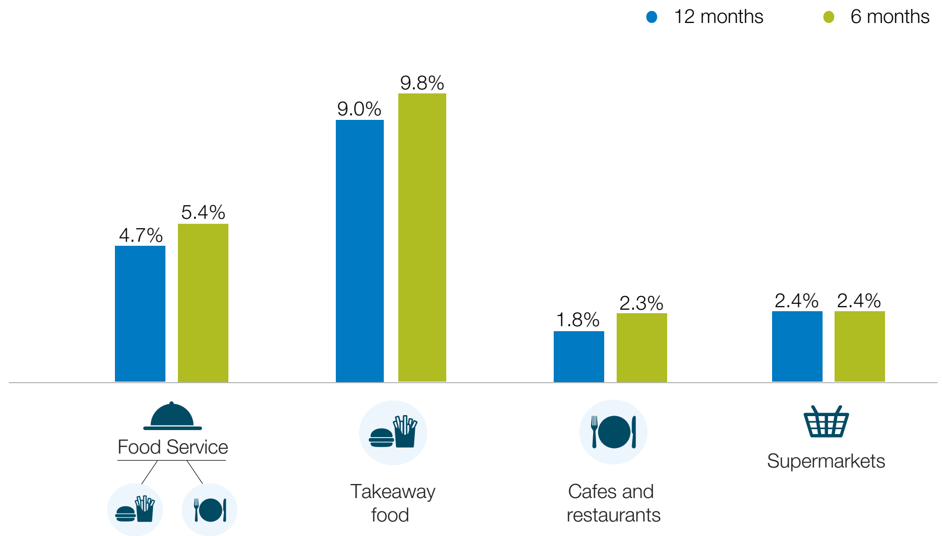
The inflation reported refers to headline inflation, while underlying inflation (which excludes more volatile and seasonal items) remains much weaker. Ongoing weakness in the Australian labour market, with higher unemployment and under-employment is an ongoing concern for the RBA. While Australia has enjoyed an unexpectedly large trade surplus in February, and strong growth in national income due to higher commodity prices, the net effect of these weaknesses in inflation and labour market will likely influence the RBA to delay any rates rises until at least late 2017.

Figure 11 Australian consumer confidence



Source: www.tradingeconomics.com, Westpac Banking Corporation, Melbourne Institute

Figure 12 DA Food Service Index (YoY turnover growth to February 2016)



Source: Dairy Australia, ABS

Global economy and exchange rates

The projection of 3.1% global economic growth in 2016 remains unchanged in the latest (April) update to the World Economic Outlook (WEO) from the International Monetary fund (IMF). Growth is forecast to increase to 3.5% in 2017 and 3.6% in 2018, an upwards revision of 0.1% following a slightly more optimistic economic outlook. This is a result of higher projected growth rates in the United States, which are driving growth in developed countries, increasing global investments and improved commodity prices, a result of supply restriction and increased demand. The ultra-low inflation rates in some advanced economies have started to rise following the recovery in commodity prices.

While growth rates in advanced economies may be improving, they remain subdued and sensitive to protectionism and inward-looking policies. Higher growth rates in emerging markets are driving global growth, with the improvement in the Chinese economy and commodity prices contributing to this development. Large inequalities exist between emerging markets and a slowdown in growth, for some countries, is predicted following deteriorated trade terms. Globalisation and international trade is perceived far more positively in developing nations compared to advanced economies and the risk of increased trade barriers and potential trade wars is posing a threat to global economic growth.

Following the recovery in commodity prices the Australian dollar has appreciated slightly against the US dollar, to 0.76 AUD/USD, during the first quarter of the year, impacting the cost-competiveness of Australian exports. The median consensus forecast is for the AUD to depreciate slightly against the USD for the remainder of the year, to 0.74 AUD/USD. The strengthened US dollar is a result of the Federal Reserve further increasing interest rates and the general market consensus that the new government will decrease corporate tax rates. This will likely improve Australia's competiveness against the US for the remainder of the year. Forecasts continue to predict the New Zealand dollar to depreciate against the USD during the year, down to 0.68 NZD/USD. The euro bucks the trend as it is projected to appreciate against the USD, predicting an exchange rate of 1.08 EUR/USD by the end of the year, an increase to previous predictions. This may be a result of slightly higher inflation rates in Europe and improved economic growth prospects for the area.

Global supply and demand overview

Growth in demand is mixed, but positive overall. However, lower average prices have kept US dollar values depressed.

United States

At-capacity US cheese plants are generating plenty of whey for export, while a buoyant fat market is keeping the protein coming.

Export volume trends

Total volume change:

▲ 4%

Significant product shifts

- ▲ Whey powder (17%)
- ▲ SMP/NDM (2%)
- ▼ Lactose (–2%)
- ▼ Cheese (–6%)

European Union

With less milk, and Intervention the channel of choice for many SMP manufacturers, European tonnages fell. A long awaited recovery in cheese volumes is apparent.

Export volume trends

Total volume change:

▼ – 3%

Significant product shifts

- ▲ Liquid milk (+10%)
- ▲ Cheese (+6%)
- ▼ WMP (–17%)
- ▼ SMP (–18%)

Russia

The embargo looks set to continue in the medium term, but shipments from other suppliers - including NZ - have led to growth in the small volume of reported Russian imports.

Import volume trends

Total volume change:

▲ +37%

Significant market shifts

- ▲ New Zealand (+170%)
- ▲ South America (+42%)
- ▼ European Union (– 8%)
- ▼ East Asia (– 24%)

South East Asia

Lower powder volumes have been offset by increased demand for other products, while Indonesia and the Philippines have been the growth engines at the market level.

Import volume trends

Total volume change:

▲ +2%

Significant market shifts

- ▲ North America (+7%)
- ▲ Australia (+7%)
- ▲ European Union (+6%)
- ▼ New Zealand (–7%)

Middle East

New Zealand and the EU continue to tussle over the region, while economic and political challenges keep downward pressure on overall demand.

Import volume trends

Total volume change:

▼ – 2%

Significant market shifts

- ▲ New Zealand (+4%)
- ▼ European Union (–6%)
- ▼ North America (– 9%)
- ▼ Australia (– 26%)

Mexico

Despite political uncertainty, the US is growing its share of the Mexican market for now. Overall SMP/NDM demand was lower, however.

Import volume trends

Total volume change:

▲ +4%

Significant market shifts

- ▲ North America (+5%)
- ▼ South America (–41%)
- ▼ European Union (–1%)
- ▲ New Zealand (+12%)

Greater China

Chinese imports continue to grow, albeit at a more moderate pace with highly varied trends amongst products and suppliers.

Import volume trends

Total volume change:

▲ +3%

Significant market shifts

- ▲ Australia (+18%)
- ▲ North America (+14%)
- ▲ New Zealand (8%)
- ▼ European Union (–7%)

Japan

A recovery in domestic production together with softer demand, has better balanced the internal market, reducing imports.

Import volume trends

Total volume change:

▼ – 3%

Significant market shifts

- ▲ European Union (+5%)
- ▼ North America (–7%)
- ▼ New Zealand (– 7%)
- ▼ Australia (–11%)

Australia

Despite a significant drop in milk production through the period, Australian exports increased slightly in tonnage terms, driven by a limited recovery in WMP volumes and continued growth in liquid milk.

Export volume trends

Total volume change:

▲ +3%

Significant product shifts

- ▲ WMP (+13%)
- ▲ Liquid milk (+12%)
- ▼ Cheese (–3%)
- ▼ SMP (– 19%)

New Zealand

New Zealand continues to pursue the liquid milk market, whilst constrained milk supplies kept overall export growth flat.

Export volume trends

Total volume change:

0%

Significant product shifts

- ▲ Liquid milk (+27%)
- ▲ Cheese (0%)
- ▼ SMP (–1%)
- ▼ WMP (–4%)

Changes 12 months to February
Source: GTIS, Dairy Australia

Four largest exporters

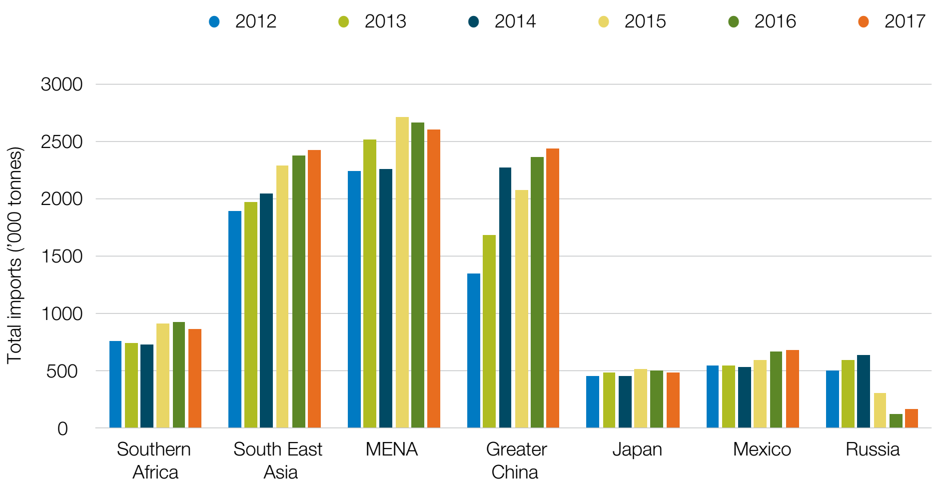
Global demand

Overview

The volume of dairy products traded over the past twelve months to the end of February 2017 rose by 3.8%, with a recovery in demand from Greater China accounting for around 30% of the growth in global dairy trade volumes. Total dairy export volumes to Southeast Asia grew by 2.3%, whilst tonnages exported to the Middle East and North Africa and Japan eased slightly. The value of global exports was down by US$1.7 billion, or 4.6%, compared to the same time last year, with falls across all major markets except Greater China and the Russian Federation, reflecting the lower global prices for key dairy commodities.

Australian dairy exports to the rest of the world in the 12 months to February grew 2.9%, totalling 729,000 tonnes. Significant growth in export volumes of Whey Powder (+62% to 48,000 tonnes), Liquid Milk (+12% to 182,000 tonnes) and WMP (+14% to 68,000 tonnes) served to offset a significant fall in SMP export volumes (-18.6% to 158,000 tonnes). Other export categories experienced smaller movements, with cheese easing (-2.4%, 168,000 tonnes), while Condensed Milk exports grew (+46.4% to 32,000 tonnes).

Figure 13 Exports to key demand markets (twelve months to February)



Source: Dairy Australia, GTIS

Despite lower prevailing world dairy prices, the value of Australian exports grew by 2.2% to US$1,936 million. The value of Australia's SMP exports fell 23.1% to US$333 million compared to US$433 million in the prior 12 month period, while the value of cheese exports fell by 4.3% to US$618 million. This was offset by the extraordinary growth in the value of Australian infant formula, which totalled 24,000 tonnes, but worth US$309 million. The value of Australian WMP exports also increased by 13.3%, to US$216 million.

Greater China

Global dairy exports to Greater China (PRC, Macau and Hong Kong) grew by 3.1% in volume terms over the 12 months to the end of February 2017, totalling over 2.43 million tonnes. Total value grew by 0.5% to almost $US 7,329 million. Importantly, this weaker sales value growth, and potential erosion of category value appears to be occurring in several important categories for Australia. Demand for milk powder was mixed; WMP import volumes grew 3.2% on the same period 12 months ago 446,000 tonnes, with the value of WMP exports to China growing 16.4% to over US$1.75 billion. Meanwhile imports of SMP declined significantly, down 17.1% to slightly over 206,000 tonnes, with the value of SMP exports falling 22%.

Sales volumes of liquid milk rose 10.6%, to almost 647,000 tonnes with large increases in volumes of milk from the European Union, however, the value of this category grew by only 6%, suggesting a decline in unit value. Infant formula remains the highest value single category of exports to this market, despite a fall of 6.4% in the 12 months to February, to around $US2.43 billion, compared to US$2.6 billion in the previous period.

Australian export volumes grew by 17.8%, from around 153,000 tonnes to almost 180,000 tonnes while the value Australian exports increased by over 45% year-on-year, from $US426 million to almost $US617 million over the last 12 months to February. This strong growth in the value of Australian exports was led by infant formula (+101.2% to US$283 million), with WMP growing 96%, from US$41 million to US$80 million. The value of Australian cheese exports also grew strongly, up by 20% to US$89 million. Meanwhile, the value of Australian liquid milk exported to China over the last 12 months fell by 7.1%, to US$69 million, despite volumes being up by 2% to 79,000 tonnes.

Japan

Total dairy exports to Japan from all suppliers declined by 3.1% in the 12 months to February, totalling 481,000 tonnes, compared to 497,000 tonnes in the previous period. The value of dairy exports to Japan fell by 12.1%, from US$1,874 million to US$1,647 million. Export volumes of cheese to Japan fell by 4.7%, from 240,000 tonnes to 229,000 tonnes, with the value of the category declining by 10.6%, from US$1,081 million to US$966 million. Export volumes of SMP fell by 24.8%, from 36,000 tonnes to 27,000 tonnes in the 12 months to February, 2017, while the value of SMP exports declined proportionately more, falling 39.3% to US$57 million. Exports of lactose to Japan grew from 68,000 tonnes to 75,000 tonnes, and value growing 10.1% to US$64 million.

Over the 12 months to February 2017 the volume of Australian exports fell by 11.2%, from 107,000 tonnes to 95,000 tonnes. The largest decline was in the cheese category, which fell by 9,800 tonnes or 10.5%, from 93,300 tonnes to 83,500 tonnes. Over the same period, the value of Australian exports fell 15.8% from US$362 million to US$305 million. Australian fresh cheese exports fell by 10,000 tonnes, which was only partially offset by an increase in exports of cheddar cheese. These declines in Australian cheese exports to Japan occurred mainly in July, August and September 2016, with volumes increasing strongly in November and December. Australian SMP export volumes also fell strongly, declining by 77% from 5,100 tonnes to 1,200 tonnes. The value of Australian SMP exports fell from US$13 million to US$2.7 million. Australian SMP exports to Japan are typically quite volatile, since access to the Japanese market for SMP is subject to available import quota space, allocated on an annual basis by the Japanese government.

Southeast Asia

The volume of global dairy exports to Southeast Asia increased by 2.3% in the 12 months to the end of February, from 2,370,000 tonnes to 2,424,000 tonnes. Notable volume increases were in casein (+63.7% to 60,000 tonnes) and whey powder (+9.0% to 404,000 tonnes). Cheese volumes also grew strongly, up 9.2% from 101,000 tonnes to 110,000 tonnes. On the other hand, volumes of milk powder exported to Southeast Asia declined, with volumes of SMP eased 5% to 633,000 tonnes, while WMP volumes fell 17.1% to 269,000 tonnes. Exports to most major markets in Southeast Asia actually declined in the 12 months to the end of February, with only significant volume growth in the Indonesian and Philippine markets offsetting the weakness in other markets. The value of dairy exports declined by 9.0% over the same 12 month period, with the impact of milk powders, particularly SMP, bringing down the value of exports.

Exports to Malaysia fell by 2.7% with lower volumes of WMP (down 15.8% to 74,000 tonnes) the chief cause. Exports to Singapore were likewise down slightly, declining 1.6%, with reduced volumes of SMP partially offset by a significant increase in the volume of ice cream exports, up from 12,600 tonnes to 33,200 tonnes. Exports to Thailand fell 2.8%, weighed down by SMP and WMP exports, which fell 24.8% and 10.7% respectively. Exports of casein to Thailand grew by 88.8% to 38,000 tonnes, after growing 303.7% in the prior 12 month period. Export volumes to Vietnam fell 4.1%, with 50.2% growth in whey powder to 65,000 tonnes unable to outweigh the declines in SMP and WMP export volumes. Meanwhile, exports to the Philippines grew by 8.3%, from 462,000 to 500,000 tonnes, lifted by growth in the liquid milk and SMP categories. Exports to Indonesia grew by 14.1%, from 416,000 tonnes to 475,000 tonnes, lifted by strong increases in SMP, whey powder, lactose and ice cream.

Amongst the major exporters to Southeast Asia, increased US exports of SMP to the region have come at the expense of SMP from the EU and Australia. The US also saw strong growth in exports of lactose and whey powder, with its total volume of exports to the region growing 6.8%. The EU saw strong growth in casein and whey powder, which served to offset reduced volumes of SMP, and lifted total EU export volumes to the region by 6%. New Zealand's exports to Southeast Asia were particularly affected by the weakness in milk powders, with reduced volumes in SMP and especially WMP leading to a 7.2% fall overall.

Australian export volumes to Southeast Asia grew by 7.1%, from 259,000 tonnes to 277,000 tonnes. Large increases in liquid milk (+26.3% to 78,000 tonnes), whey powder (+117.4% to 27,000 tonnes) and WMP (+34.8% to 23,000 tonnes) served to offset an 18,000 tonne decline in the volumes of SMP exported to the region. Despite strong growth in the value of these same export categories, the total value of Australian exports to Southeast Asia fell by 5.4%, to US$539 million, compared to US$570 million in the previous 12 month period. Australian export volumes grew most strongly in Indonesia and Vietnam, up 12% and 14%, while export volumes to the Philippines eased 6%. Singapore remains Australia's largest export market in Southeast Asia, with Australian exports to Singapore totalling almost 86,000 tonnes.

Mexico

Dairy exports to Mexico in the 12 months to February 2017 grew 3.7%, totalling almost 687,000 tonnes. The overall value of exports to Mexican declined slightly, falling by 1.4% to US$1,674 million. Butter oil imports grew from 39,000 to 53,000 tonnes, WMP imports grew from 17,000 tonnes to 46,000 tonnes, while SMP imports fell by 9% from 295,000 to almost 268,000 tonnes. Exports of whey powder remained largely stable, down 1.8% to 44,500 tonnes, while exports of cheese were up 1.3%, to 117,000 tonnes.

Middle East & North Africa

Volumes of dairy exported to the Middle East and North Africa were down over the 12 months to the end of February, falling 2.2% from 2,656,000 tonnes to 2,597,000. Exports of butter fell 15.7% from 207,000 tonnes to 174,000 tonnes, condensed milk volumes fell by 15.2% to 184,000 tonnes and those of WMP fell 5% to 548,000 tonnes. Volumes of liquid milk exported to the MENA region grew 46.2%, to over 180,000 tonnes. Export volumes to Saudi Arabia fell 14% to 353,000 tonnes, whilst volumes to Egypt fell 11% to 242,000 tonnes over the same period. Export volumes to Algeria grew 8% to over 418,000 tonnes, due mostly to significant growth in shipments of SMP from New Zealand and the US and displacing SMP from the European Union. Export volumes from the European Union to the MENA region as a whole fell 6%, totalling 1,059,000 tonnes, while New Zealand's export volumes increased 4% to 645,000 tonnes. US share of the MENA export market continues to fall, with volumes totalling 69,000 tonnes.

Australia's dairy export volumes to the Middle East and North Africa fell by 26%, from 48,000 tonnes to almost 36,000 tonnes in the 12 months to February 2017. The value of Australian exports fell by proportionately more, down 31% to US$92 million. The most significant declines were in the SMP and cheese categories, the values of which fell by 40% and 21%, to US$37 million and US$30 million respectively.

Russia

Dairy exports to Russia have increased 37.9%, from 119,000 tonnes to 163,000 tonnes. Russian embargoes remain in place on dairy imports from United States, European Union, Australia, Canada and Norway. Russian trade embargoes will remain in place until at least the end of 2017, when the enabling legislation is slated to expire. Whilst there has been some speculation about the end of these embargoes, and global political developments may yet see this happen, the expiration of this legislation is meant to signal a review and likely a renewal of trade restrictions, rather than an end to the embargoes. In order to meet demand for dairy, Russia has looked to increase its own agricultural self-sufficiency,and has sought supply from smaller global dairy exporters such as Argentina, Uruguay and Belarus. New Zealand, which is not technically subject to agricultural trade embargoes has also increased its direct exports to Russia, which grew 170% to 33,000 tonnes.

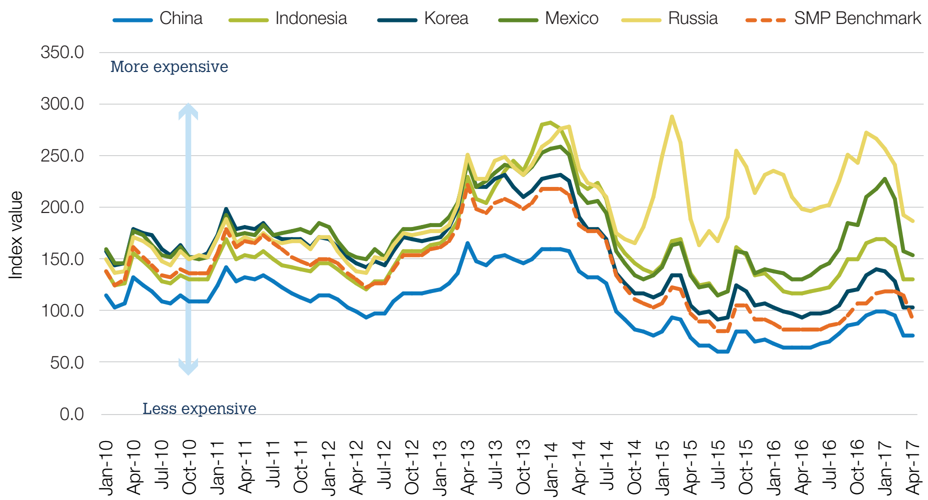
Global affordability

Dairy Australia's Affordability Index measures changes in global commodity prices, adjusted for currency impacts, to track affordability for local consumers. An increase in the index reflects worsening affordability for importing countries, and indicates a potential slowdown in import volumes, particularly to price sensitive markets.

Since December 2016 the Affordability Index has fallen 21.2%, from 116.9 to 92.1 in April 2017. Aside from declines in SMP prices since December 2016, this improved affordability of dairy commodities is due to local currencies of major importing countries strengthening against the US dollar.

Despite ongoing speculation about future global political and economic policy directions, and ongoing volatility in global exchange rates, most major importing countries' currencies have appreciated against the US dollar, making dairy imports relatively more affordable. The Korean Won has appreciated by 4.5% since December 2016, the Mexican Peso 9.5% and the Russian Rouble 9.8%. Combined with lower prevailing world prices for SMP, this has meant that local currency denominated prices for buyers in Korea, Mexico and Russia have declined by 26.0%, 29.4% and 29.6% respectively since December 2016, which should support continued growth of import volumes in these markets.

Figure 14 Dairy affordability



Source: Dairy Australia, Bloomberg

Mexico, the United States and NAFTA – Opportunity or challenge for Australian dairy?

'Why are you treating your best customer like this?' media reports quoted Mexican dairy industry officials asking their US counterparts when visiting Mexico in March 2017.

During the presidential election, Donald Trump made sure the world knew his stance on the North American Free Trade Agreement, NAFTA, calling it 'the worse trade-deal in history' and pledging to immediately renegotiate if elected. NAFTA has been contentious since commencement in 1994, but is the world's largest free trade area in terms of gross domestic product, the trade between United States and Mexico is estimated at $580 billion. Since the initiation of the agreement US dairy trade with Mexico has increased 558% to $1.2 billion. Around 15% of dairy produced in United States is exported and Mexico is the largest market, accounting for 39% of exports. Dairy from the United States totals 70% of Mexico's dairy imports and 50% of this consists of SMP. Mexico imports almost 250,000 tonnes of SMP yearly from the United States.

Since taking office president Trump has produced a steady stream of trade proposals in which everything from a 35% import tariff on Mexican products, to a border wall tax and threats to revoke the entire deal have been on the table. The policy roller coaster took another turn in late April as the three NAFTA parties agreed to commence trade talks to restructure the agreement. Following the last months of turmoil caused by regular trade threats and political stand-offs, the Mexican-US trade relationship has been damaged and dairy producers are left trying to salvage the $1.2 billion relationship. With reports of the Mexican agricultural minister flying around the world sourcing new trade partners, representatives of the US dairy industry are flying to Mexico to prove their commitment.

The Mexican dairy market has been expanding for the last three years, and imports increased 3.7% to 662,000 tonnes for the 12 months to February 2017. During this period Australia exported 813 tonnes to Mexico, the majority being butter oil - merely 0.1% of total imports. In January and February 2017, Mexico increased imports of European SMP by 122%, up to 4,000 tonnes, according to the EU Milk Market Observatory. This is only a fraction, 9%, compared to the SMP imported from US for the same period, however it is a significant increase to previous years. During the same period Mexico increased their SMP imports from the US by 1.4%, to 45,000 tonnes. The European Union and Mexico have stepped up their commitment to a joint free trade agreement scheduling several negotiations for this year. This could lead to more liberalised dairy trade between the countries. Mexico has also approached major dairy-exporter New Zealand as a potential new partner, providing yet another twist in this trade saga. Mexico might prove to be a new opportunity for Australian dairy exporters, especially if TPP talks continue without the United States. However, with the large stockpiles of SMP in Europe and uncertainty surrounding NAFTA talks, this is likely going to be a limited opportunity and take time to eventuate.

As the future of dairy trade between Mexico and the United States remains unknown, SMP prices in the United States are feeling the strain. Milk production growth in United States has resulted in large inventories. If Mexico decreases US dairy imports, even slightly, US production will most likely be diverted into other destinations at discounted prices, increasing competition in Australia's traditional markets. Any change to existing trade patterns will increase the risk of disrupting Australian trade in the global marketplace, potentially posing a challenge to match any opportunity.

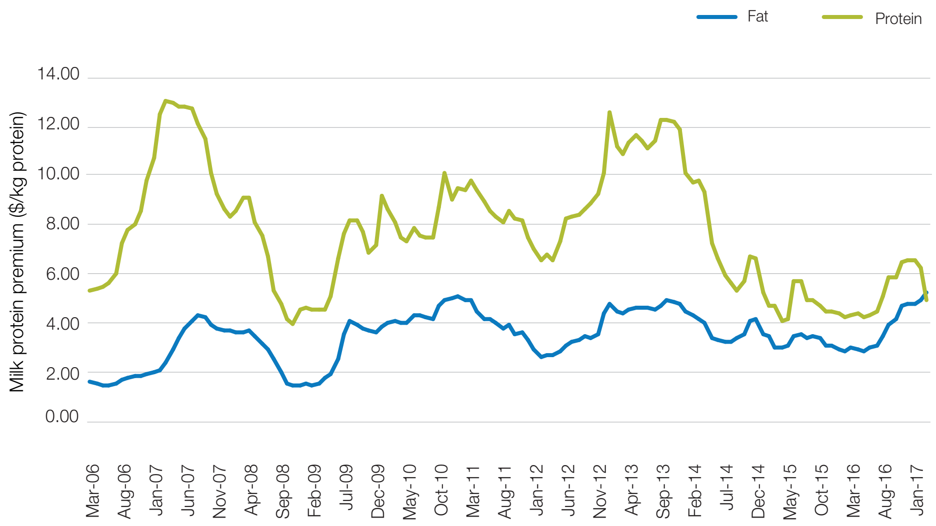
Dairy price premiums and substitutes

Premiums for dairy fats and proteins have shown significantly divergent trends since December 2016, with premiums for butterfat rising strongly, whilst protein premiums have weakened. The butterfat premium is measured as the difference in US$/kg prices between palm oil substitutes and dairy fats. Many food and ingredient manufacturers will typically alter the proportions of dairy fats and cheaper vegetable oils, substituting as the relative prices change, as reflected by the dairy premiums. Butterfat premiums for March 2017 were $5.23/kg, the highest level at any time over the past 12 years that Dairy Australia has tracked these premiums. These record high butterfat premiums are due primarily to higher world butter prices rather than noted weakness in oilseed prices. These high butter prices, which have outperformed those of other dairy commodity groups over the last six months appear to be due to strong and growing demand for butter. Lower expected palm oil prices over the second quarter of 2017 may see butterfat premiums increase further, thus placing some downward pressure on demand for butter in lower value applications.

For dairy protein, world SMP prices have eased in the three months to March 2017, particularly since February, from US$2,650/tonne to US$2,050/tonne, which dragged down milk protein prices by 22.7% over the same period. This weakness in SMP commodities translated to a 25.4% fall in dairy protein premiums, from US$6.60/kg to US$4.92/kg, around 35% below average protein premiums. Soy protein prices have remained fairly constant over the last six months, however weaker demand for soymeal suggests prices over the medium term may ease. However, with April prices close to 12 year lows, SMP prices face limited downside risk and a lower range to fall. This suggests that protein premiums may find some support, with global SMP at or near its floor prices, and unlikely to be affected by lower prices for competing vegetable protein substitutes.

Historically, fat and protein premiums have moved together, with protein commanding a significantly greater premium than fat. However, as shown by the graph above, the range between fat and protein premiums has narrowed considerably over the last three years, and since December 2016 the co-movement between the two has completely broken down. As of March 2017, fat premiums are now larger than those of protein for the first time in the series' history. While extraordinary factors such as the large EU SMP stockpile have also contributed to these outcomes, these developments point to the trend of growing demand for fat. This may have wider structural implications around how processors select product mixes and processing streams, and potentially drive greater weighting of fat content in farmgate milk pricing.

Figure 15 Dairy price premium vs palm/soy substitutes



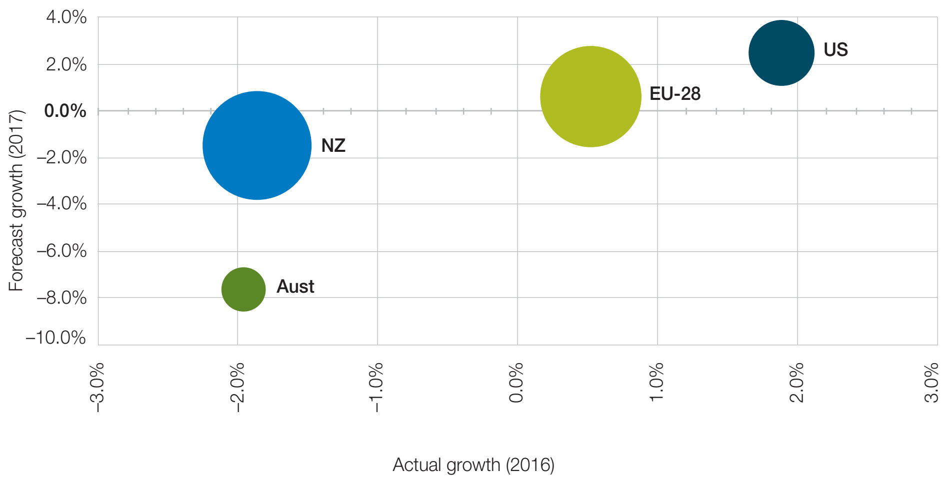
Source: Dairy Australia, Oil World

Global supply

Overview

Improved margins have arrested the fall in milk production in most exporting regions, and whilst supply growth remains limited, a responsive farm sector means any gains from further commodity price increases would likely be fought over.

Figure 16 Actual and forecast milk production growth – four largest exporters



Note: Size of bubble represents share of global dairy exports.
Data covers production seasons for Aust and NZ, calendar years for US and EU.

Source: USDA, DCANZ, Eurostat, Dairy Australia

Figure 17 Farmgate price movements – four largest exporters

Change in indicative farmgate price	NZ	EU-28	US	Australia
Compared to last report (Feb 2017)	0%	▲ 3%	▼ −6%	▲ 1%
Compared to prior year (Jun 2016)	▲ 54%	▲ 40%	▲ 17%	▼ −8%

Figure 17 Market trends – four largest exporters

Source: GTIS, Dairy Australia

European Union

European milk production is stabilising in year-on-year terms, after nine months of modest falls. February intakes fell only 1.2% once adjusted for the leap year, as the European Commission's milk production reduction program fell short of its full volume reduction target. The effectiveness of the €150 million scheme has been questioned, with suggestions that it merely compensated farmers for production decisions they had already made. Nonetheless, a recovery in commodity prices has been celebrated, and many farmers saw commensurate increases at the farm gate.

The lead-up to the northern hemisphere spring peak put an end to the recovery, exerting significant downward pressure on prices, however the market appears to be handling the seasonal inflow of milk relatively smoothly. The intervention storage scheme has reopened for the new season, and at the time of writing, around 7,000 tonnes of SMP had been accepted. Flows into intervention have resembled more of a trickle than a torrent, and indications suggest the program is only supporting the lower end of the SMP market, rather than the entire complex. Even so, it is expected that the 109,000 tonne ceiling will be reached by June. Any growth in stored product is a headache for the European Commission, which has so far failed to sell more than 40 tonnes of its 350,000 tonne stockpile, over at least eight tender rounds. While the Commission has been holding out for higher prices, offer values have actually declined over respective tender rounds, as the product ages.

On farm, colder weather in April may have slowed milk production, but on the basis of current margins the EU will soon be producing more than the same time last year. Much of this growth is expected to be in the second half of the year, and so far, Italy, Poland, France and the UK have been the main contributors in absolute volume terms. Looking at year-on-year percentage changes for these major producers, only Italy (+4 %) and Poland (+5%) are tracking above 2016 levels in the February data. Smaller producers in Eastern Europe, including Cyprus, Bulgaria and Romania also saw noteworthy recoveries (up 17%, 5% and 3% respectively) after falling heavily in 2016. The European Commission expects that milk production across the 28 member states will grow by 0.6% in 2017. Increases in per-cow production are considered likely to offset any fall in the herd size, including through the Dutch herd reduction program.

United States

US milk supply continues to expand, and local analysts have reported milk being dumped in at least four states and regions during April, with manufacturing capacity insufficient to deal with volumes collected. In the last five years, US milk production has only posted negative year-on-year growth for six individual months (out of 60), and only one of these months has been in the last three years. March data shows 1.6% year-on-year growth in milk volumes for that month, in part due to there being 0.5% (15,000 head) more cows in the national herd. Whilst herd expansion is only part of the story, the USDA is forecasting that there will be another 25,000 cows producing milk by the end of the year; farmers remain in expansion mode. With the revenue over feed costs calculation returning more than the 'rule of thumb' expansionary US$7.50/cwt for the ninth consecutive month in March, such forecasts seem well founded.

Most of the recent growth is concentrated in the southwestern states (Texas, Arizona, and New Mexico). Of the two biggest producing states, California continues to trail (down nearly 3% for March) while Wisconsin added a further 1.5% to its milk production volume, compared to March last year.

Relatively warm weather through winter also helped support milk production, though late April saw a pattern of cold and wet weather move across many US states. Whilst this is likely to have had at least some impact on milk production, grain crops are the key concern. Planting has been delayed across much of the corn belt, and winter wheat that was nearing harvest is at risk of damage from frost and snow. Grain futures are already seeing price increases, and if sustained, this could curtail the ongoing period of expansionary margins.

At this stage, the USDA expects national milk production to grow by 2.5%, compared to 2016, implying a total of around 99 billion litres.

Outside the farm gate, domestic demand looks increasingly unlikely to match the growth rates of recent years, (and inventories are already swollen, with the exception of butter) suggesting that exports will re-emerge as a focus for the US industry in the months ahead. Given the rapid retreat from global markets when returns were more attractive at home, together with recent political developments, this is unlikely to be a smooth process. One market where US dairy exports have suffered a reversal is Canada, amidst a flare up in cross border trade tensions brought on by the Canadian introduction of a cheaper class of milk to displace milk protein ingredient imports. Whilst the Mexican market was looking shaky for US suppliers, in recent weeks demand has picked up. Questions remain over US trading relationships going forward, and this may yet create waves if US suppliers need to find alternative markets for product.

New Zealand

Milk production expectations in New Zealand have ebbed and flowed this season, as a wet spring gave way to a robust shoulder period, followed by widespread flooding in April. Year on year growth in milk intakes of 9% for March pulled the season to date difference back to around 1% below the equivalent period in 2015/16, and was primarily the result of favourable weather conditions boosting pasture availability. Cyclones Debbie and Cook brought flooding to most of the North Island and some areas of the South Island, and while overall damage is likely to be light, it's likely that many cows will be dried off earlier than planned. This may increase the full season drop in milk production, but not significantly. For the season to May, a fall of around 1% is likely, compared to the 2015/16 total.

With the high likelihood that the current season will finish on a good price, and favourable outlook for next season, a further production response is expected in New Zealand. A second season of good prices in 2017/18, would see New Zealand's farmers finally putting two years of extreme cash flow pressure behind them, and local analysts suggest confidence is increasing. That said, many farmers have significant ground to make up in rebuilding their businesses. Combined with ever-tighter environmental regulations stifling new dairy developments, this means growth in milk production is unlikely to reach the double digit rates of years past.

Australia

Australian milk production has continued to close the gap with 2015/16, with March intakes around 5% below March 2016, bringing the year to date drop to 8%. Favourable seasonal conditions have persisted across most dairy regions since late spring, though unseasonably dry periods were observed in different areas over the course of the summer. March was a dry month for many southern regions, with the exception of southwest Victoria and southeast South Australia. Much of the east coast and part of southwest Western Australia received very much above average rainfall totals, in part due to Cyclone Debbie.

Cash flow remains a significant issue for farmers directly exposed to export markets, despite some relief in the form of lower feed costs and modest milk price increases. Tensions between farmers and processors, and farmers supplying different processors, have remained a clear feature of the industry in 2016/17. The combination of financial incentive and disillusionment has also seen a far greater proportion of farmers switching processor this season.

In Western Australia, the balance between milk supply and processor requirements remains an issue, with alternatives being sought in the face of indications that more farmers may lose supply agreements. Meanwhile, in Queensland and northern New South Wales, new season farmgate prices remain in play as the relativity with lower southern region prices exerts pressure. In particular, negotiations between the bargaining group Premium and processor Parmalat have highlighted tensions around these dynamics.

The total number of registered dairy farms in Australia in 2015/16, as reported in Dairy Australia's InFocus 2016 publication was 6,102, according to the various state dairy safety authorities. According to these same authorities, as of April 2017, there were 5,810 farms across Australia, representing a 4.8% decline in total dairy farm numbers, which on average have declined by 4.1% year-on-year since deregulation.

The largest decrease occurred in Victoria, where 263 dairy farm licenses were cancelled. Some 241 of these cancellations where 'bulk cancellations', processed in August 2016, effectively an automatic biennial cancellation of licenses for farms that had ceased production for at least 6 months prior. This suggests that many of the Victorian dairy farmers that exited the industry had made the decision well before the events of April 2016 and the fall in farmgate milk prices. The total number of Victorian dairy farms now sits at 3,899, compared to 4,141 farms as of June 30th 2016 (there were also 21 new applications).

At 8% below last season, milk production for the season to March is at the edge of Dairy Australia's 6 to 8% forecast range for the full season. Based on the timely autumn break received in most regions, a slow but continued improvement to trend is likely, and the final season total is expected to fall within this range, at around 8.95 billion litres.

Australia: 2017/18 initial forecast

With farmgate prices in export regions looking likely to show modest improvement in 2017/18, a favourable outlook for most key inputs, and weak comparables, the year-on-year recovery in milk volumes is expected to continue in the new season. With significant impacts to finances, herd sizes and confidence to overcome, this recovery is expected to be slow. Wide variation exists between individual farms, due to differences in milk processor and pricing arrangements, calving patterns, farm systems, management strategies and equity levels. These have driven divergence in terms of the primary challenges faced over the past 18 months, and the response to these challenges, which in turn impacts the likelihood and ability to recover as circumstances improve.

Some regional perspectives can be derived, however. Tasmania and Gippsland have seen significant production drops in 2016/17, but overall are regarded as most likely to see a recovery in the coming season. The late autumn break in Gippsland has caused some issues, but equity is generally more robust than in other southern regions. Western Victoria and southeast South Australia are highly varied in terms of equity, and confidence is a challenge. The emergence of new players competing for milk supply may help compensate for this – depending on the degree to which these processors compete on price. Seasonal conditions are currently regarded as positive.

Northern Victoria and southern New South Wales have benefited from a good autumn break and regular follow up rainfall, and purchased feed is cheap and readily available. A high proportion of farmers are in financial difficulty however after a series of climatic challenges, coupled with milk price shocks for many, and generally lower prices this season. Heavy culling through the wet 2016 winter and spring have left some farmers unable to take advantage of the cheaper feed and expected better margins in 2017/18, and relationships with processors are highly varied. The announced closure of Murray Goulburn's Rochester and Kiewa plants has also affected confidence amidst the broader community.

Further north in New South Wales and into Queensland, some regions have been affected by flooding and Far North Queensland is dry, but seasonal conditions are generally favourable. Milk pricing will be the key issue for these regions, and with the outlook for steady or lower farmgate prices, a stable production outlook is anticipated. Attractive input costs provide some upside potential, but ongoing farm exits remain a barrier to growth. Western Australia is likely to see production stable or lower as well, with processors keen to manage intakes down to match requirements, and growth incentives close to expiry. In the absence of a cost effective solution for dealing with the current seasonal milk surplus, more farm exits are possible.

In light of these challenges, but reflecting the improving market settings and favourable seasonal outlook, Dairy Australia's initial forecast for 2017/18 milk production anticipates growth of around 2 to 3% on the expected 2016/17 total of 8.95 billion litres. This implies a forecast total of over 9 billion litres for 2017/18.

Corporate sector update

The Australian dairy industry continues to feel the effects of the events in 2016.

Responding to a 21% decline in milk supply volumes, Murray Goulburn has announced the closure of three milk processing plants, which will cost 360 jobs directly. The plants at Rochester (cheese, milk and whey powder), Kiewa (yogurt and milk beverages) and Edith Creek in Tasmania (specialty and consumer UHT beverages) will be closed to allow MG to consolidate its operating costs, with some production expected to be relocated to other sites. MG has also announced total write-down of $410 million, and a dividend suspension, whilst forecasting a season-ending farmgate milk price averaging $4.95/kg MS.

Murray Goulburn has also announced that it will scrap the Milk Supplier Support Package (MSSP), which supplemented suppliers' final milk payments to the end of the year, but required farmers to pay back money back over three years. In scrapping the MSSP, Murray Goulburn will repay remaining and retired suppliers for their MSSP payments between July and September 2016. However, MG will not make any payments to farmers who have since switched to supplying a different processor. A private class action against MG has since been dropped.

In response to MG's scrapping of the MSSP, Fonterra has also announced changes to its loan schemes. Fonterra will reimburse current and retired suppliers for the interest payments made on its loan scheme, whilst also announcing a $0.40/kg MS additional payment on its 2017/18 farmgate milk prices. Balances in excess of outstanding loans can be paid upfront to ongoing or retired suppliers at the beginning of the 2017/18 season. The upfront payment option is based on production for the 12 months to April 2017, and available if farmers have continuously supplied Fonterra since April 2016. Recommencing farmers or ongoing suppliers who elect to, will receive the payment monthly through 2017/18.

Canadian-based company Saputo has completed its takeover of Warrnambool Cheese and Butter in late February, after purchasing Lion Dairy and Drinks' remaining 10% stake in the company, at $9.05 a share. With complete ownership of WCB Saputo took action to remove WCB's listing on the ASX, which was delisted on March 9th, 2017.

On February 27th, Bega Cheese announced that it had sold one of its four milk spray driers in Tatura, as well as its Derrimut infant formula canning facility to Mead Johnson Nutrition for $200 million, receiving $180 million upon completion in April, with the balance to be paid in December. Bega will still be responsible for day-to-day operations and management of the Tatura site, having signed a 10 year service and access agreement. Bega will also supply milk for the Mead Johnson dryer.

Parmalat has resolved the industrial dispute surrounding its dairy processing plant in Echuca, after negotiating redundancy terms and pay agreements with the AMWU and ETU. Negotiations began in November, but quickly foundered, which saw workers at the yoghurt and dessert factory locked out for over two months until late March. Parmalat has also been in arbitration since January with 200 Queensland suppliers over new milk price contracts.

Policy updates

A revised National Strategy to manage Bovine Johne's Disease in cattle has resulted in changed regulatory controls and the removal of zoning, quarantine and interstate movement restrictions. There is an increased role for voluntary, industry-led programs. For dairy, this involves the use of the National Dairy Industry Accreditation Score to underpin risk-based trading and provide guidance for improving BJD status. Implementation of biosecurity plans and hygienic calf rearing are further key components of dairy industry programs. Australian Dairy Farmers have also announced a revised 2017 routine calving induction limit of 12%, compared to the 15% target of 2016. This is in line with the ADF's commitment in 2015 to phase out routine calving induction nationally, through improved herd management techniques and tools.

The 2017/18 Budget has seen changes to the 457 Visa Programme and permanent employer sponsored skilled visas that affect the dairy industry. The removal of some key occupations from the 457 visa list, increased Labour Market Testing times from 6 to 12 months and longer processing times will make it more difficult to fill some roles. Businesses with turnover of less than $10 million must make upfront payments of $1,200 for temporary skill shortage visas (the replacement for 457 category visas), and $3,000 for employees on permanent visas. Australian Dairy Farmers (ADF) has voiced concerns over the effect these changes will have on the cost and red-tape associated with hiring skilled overseas labour for dairying operations, and increase the difficulty for overseas-based dairy farmers relocating and operating a dairy farm in Australia.

ADF, the Australian Dairy Products Federation (ADPF) and the Australian Dairy Industry Council (ADIC) have developed a voluntary Dairy Industry Code of Practice for Contractual Arrangements to help ensure greater transparency and fairness in milk supply and pricing. The code sets out good practice for contracts between farmers and processors, and applies to standard form contracts between processors and farmers to ensure they comply with the new Unfair Contract Terms Law which came into effect in November 2016. The ADF believes the code will come into effect in time for the next season, and is expected to cover over 95% of milk produced in Australia but will not preclude a farmer negotiating an individual contract with a processor.

Dairy Australia remains involved in ongoing consultation on the Department of Health's voluntary Health Star Rating Scheme. The scheme is designed to inform consumer choice and improve individual and public health outcomes by ranking all foods on a ½ to 5 star scale, for easy comparison. The dairy industry has raised concerns that the scheme unduly penalises dairy foods, both in how the scores are produced and how comparisons are made.

Firstly, the scoring system used to produce a star ranking heavily penalises the saturated fat content of cheese and natural yogurt, which the dairy industry feels does not recognise recent findings regarding the risks of saturated fat, and the value of dairy foods as a complete nutritional package. This could potentially deter consumers from choosing dairy products unfairly characterised as unhealthy. Secondly, the star ranking system is only intended to facilitate comparisons within a food category group. However, there are concerns that this category-based comparison may confuse consumers, by implying for instance that a serving of 4 star cola and a serving of 4 star full cream milk were nutritionally equivalent beverages. Further, the industry believes the scheme as it currently exists does not properly reflect the Australian Dietary Guidelines, and insufficiently distinguishes between 'Core' and 'Discretionary' foods.

In international trade, there have been a number of developments. The Australian government continues to participate in the Regional Comprehensive Economic Partnership (RCEP) negotiations. Whilst the group intends to finalise discussions before the end of the year, there is some concern that the proposed agreement may lack ambition and give inadequate attention to the issue of Non-Tariff Barriers. Meanwhile, Australia is engaged in bilateral negotiations with Indonesia concerning the Comprehensive Economic Partnership Agreement (CEPA), which improve Australian access beyond the multilateral Australia-ASEAN-New Zealand FTA. Whilst Australia and Indonesia have both committed to conclude negotiations before the end of the year, negotiations may yet be derailed, following the recent decision by the Federal Government to impose countervailing duties on Indonesian paper imports.

Australia has recently launched new trade negotiations with Hong Kong, known as A-HKFTA (May 16th), and with Peru (PAFTA launched on May 24th). Finally, in an important initial step towards a proposed EU-Australia FTA, Australia and the European Union have concluded a joint scoping exercise. An essential preliminary to formal FTA negotiations, the scoping study laid out the areas that any negotiations would cover and the level of ambition of future talks.

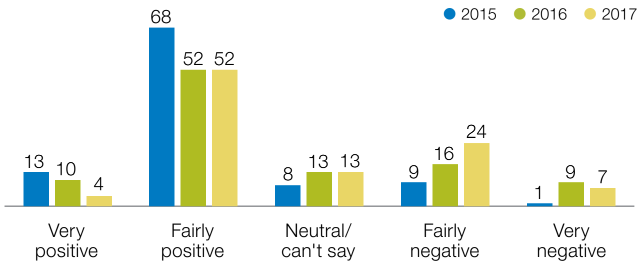
Regional NDFS results at a glance – Murray Dairy

Summary

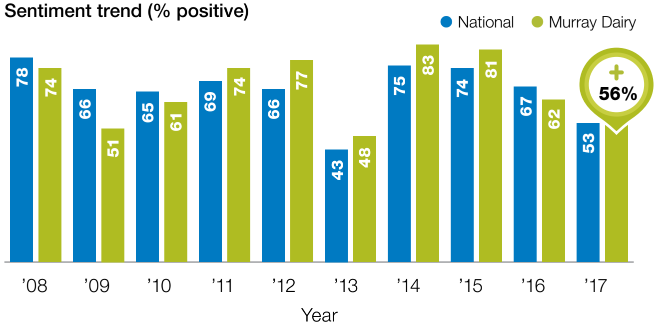
- Confidence in the industry's future has trended downwards since 2014 but is comparable with 2016 levels.
- Compared to the previous two financial years, profitability is significantly less widespread and only a quarter expect to make a profit in 2016–17, the lowest proportion nationally.
- Farmers in this region are the most likely to have extended, refinanced or deferred debt.
- Destocking has occurred on almost one third of respondent farms, the highest nationally.
- Almost two thirds anticipate production to increase by 2019-20.

Sentiment

Current sentiment (%)



Sentiment trend (% positive)



Positive drivers

Demand for dairy (14%)
Farm gate price ok (13%)
Decreased input costs (9%)

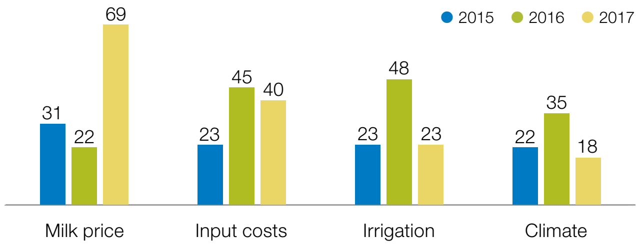
Negative drivers

Farm gate price low (35%)
Cost of production (14%)
Poorly run milk co. (13%)

Profitability and investment

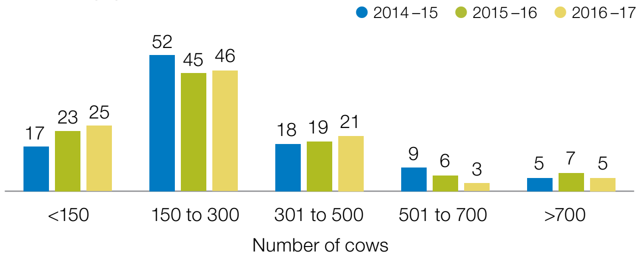
56%	Made profit 2015–16	**48%**	Invested on farm 2015–16
25%	Expect profit 2016–17	**32%**	Intend to invest 2016–17
4%	Profit higher than 5 year average	**12%**	Invest in irrigation plant
12%	Profit about same	**12%**	Invest in machinery
82%	Profit lower than 5 year average	**10%**	Invest in dairy plant

Challenges next 6 months

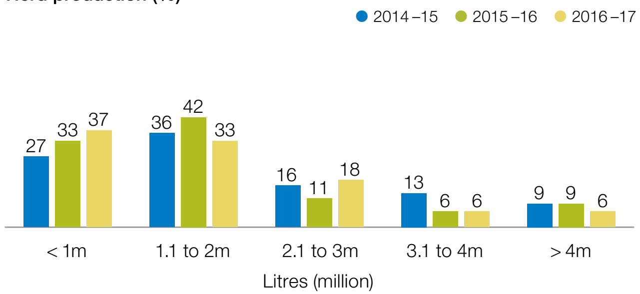


Current herd size and production

Herd size (%)

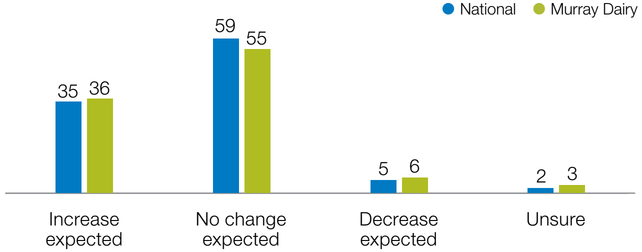


Herd production (%)

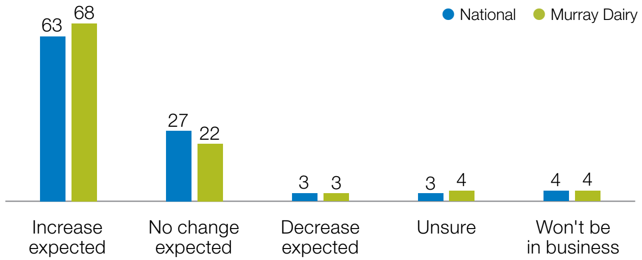


Forecast herd size and production

Anticipated change in herd size 2017–18 vs 2016–17 (%)

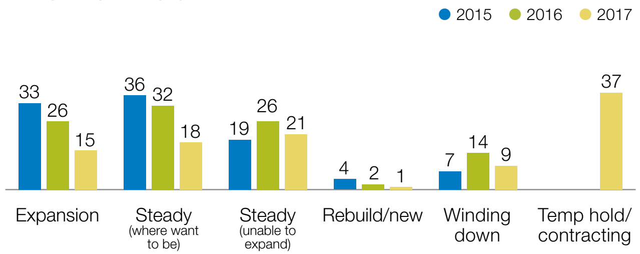


Anticipated change in production 2019–20 vs 2016–17 (%)



Regional profile

Enterprise phase (%)



The 'average' Murray Dairy farmer

71%	No change/intention to change company supplied	**68%**	Sees future opportunities for the industry
62%	Feeds moderate to high level of concentrates	**1.6t** (tonnes)	Average grain fed per cow per year
68%	Has a water security/ management plan	**53%**	Has a written annual farm budget
91%	Has **not** used DairyBase		

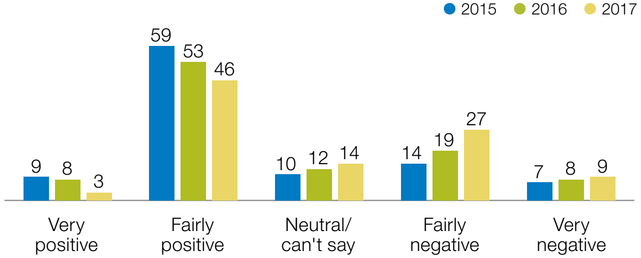
Regional NDFS results at a glance – WestVic Dairy

Summary

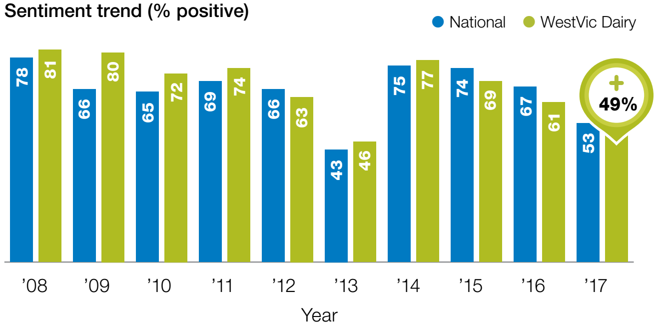
- Positivity in the industry's future decreased significantly over the past 12 months, continuing the downwards trend since 2014.
- Compared to the past two financial years, a significantly lower proportion of respondents made a profit in 2015–16 and a slightly lower proportion expect to do so in 2016–17.
- Debt has been extended, refinanced or deferred on half of respondent farms in the last 12 months.
- Capital investment is expected to occur on less than half of respondent farms in 2016–17.
- Despite falling confidence levels, almost two thirds of farms expect production will increase by 2019–20.

Sentiment

Current sentiment (%)



Sentiment trend (% positive)



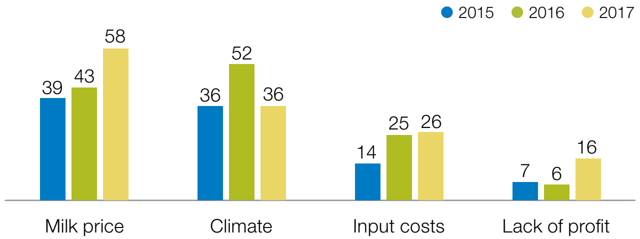
Positive drivers
- Demand for dairy (14%)
- Improved managment (14%)
- Farm gate price ok (11%)

Negative drivers
- Farm gate price low (25%)
- Poorly run milk co. (14%)
- Cost of production (8%)

Profitability and investment

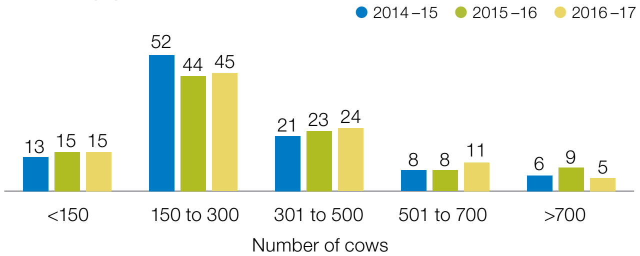
58%	Made profit 2015–16	**39%**	Invested on farm 2015–16
52%	Expect profit 2016–17	**39%**	Intend to invest 2016–17
14%	Profit higher than 5 year average	**12%**	Invest in machinery
17%	Profit about same	**12%**	Invest in dairy plant
68%	Profit lower than 5 year average	**8%**	Invest in shedding

Challenges next 6 months

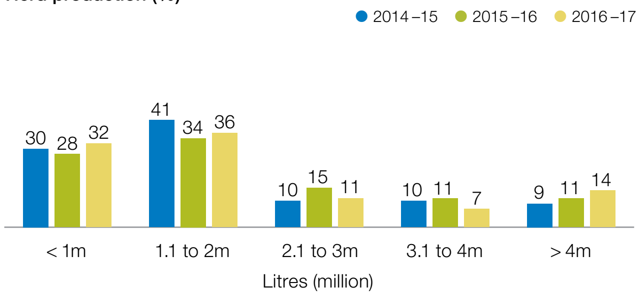


Current herd size and production

Herd size (%)

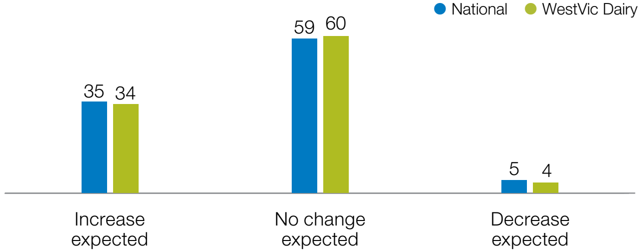


Herd production (%)

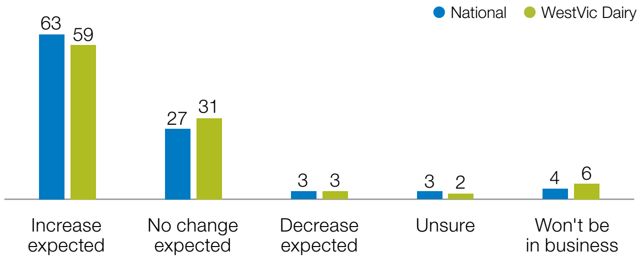


Forecast herd size and production

Anticipated change in herd size 2017–18 vs 2016–17 (%)

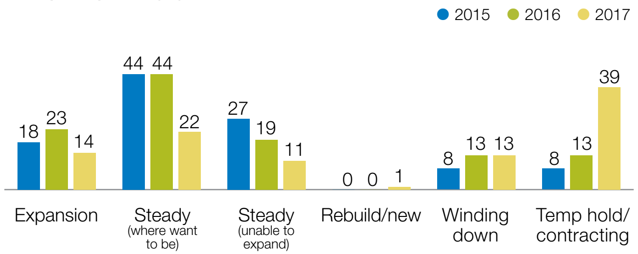


Anticipated change in production 2019–20 vs 2016–17 (%)



Regional profile

Enterprise phase (%)



The 'average' WestVic Dairy farmer

71%	No change/intention to change company supplied	**68%**	Sees future opportunities for the industry
61%	Feeds moderate to high level of concentrates	**1.5t** (tonnes)	Average grain fed per cow per year
63%	Has a water security/ management plan	**54%**	Has a written annual farm budget
84%	Has **not** used DairyBase		

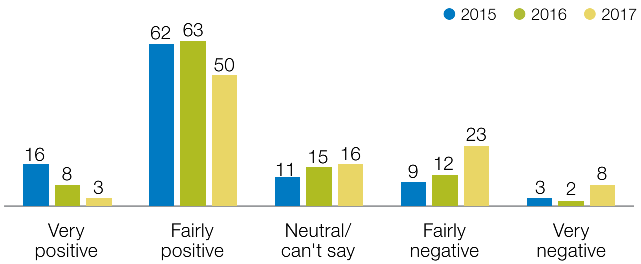
Regional NDFS results at a glance – GippsDairy

Summary

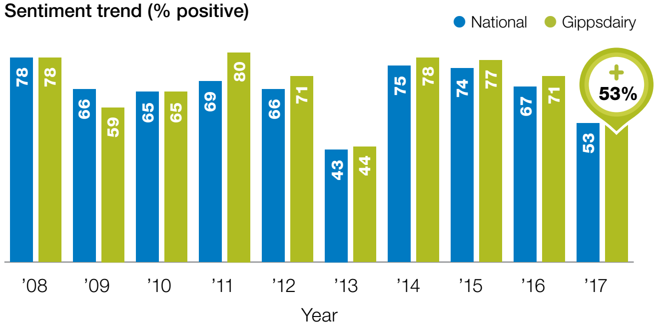
- Confidence in the industry's future is at lowest levels since 2014 and significantly down from 2016.
- Less than half of respondents expect a profit this financial year and the majority are anticipating this to be less than average of past five years.
- Capital investment has decreased significantly since 2016 and only a third are likely to invest over the next 12 months.
- More than half of GippsDairy respondents have extended, refinanced or deferred debt over the past year.
- Encouragingly, by 2019–20, two thirds of respondents expect production to increase.

Sentiment

Current sentiment (%)



Sentiment trend (% positive)



Positive drivers

- Improved managment (13%)
- Farm gate price ok (10%)
- Demand for dairy (8%)

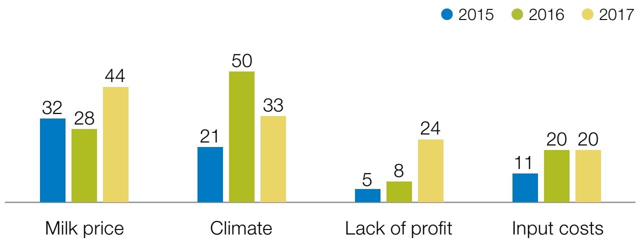
Negative drivers

- Farm gate price low (25%)
- Poorly run milk co. (14%)
- Demand for dairy (8%)

Profitability and investment

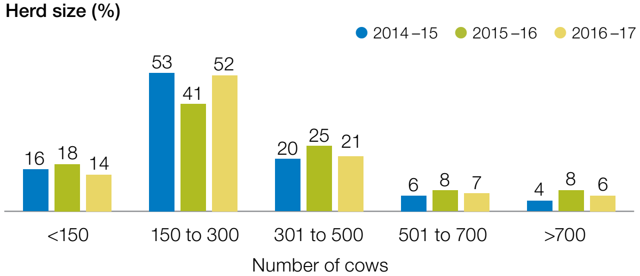
65%	Made profit 2015–16	**43%**	Invested on farm 2015–16
47%	Expect profit 2016–17	**36%**	Intend to invest 2016–17
7%	Profit higher than 5 year average	**13%**	Invest in machinery
13%	Profit about same	**10%**	Invest in dairy plant
58%	Profit lower than 5 year average	**9%**	Invest in irrigation plant

Challenges next 6 months

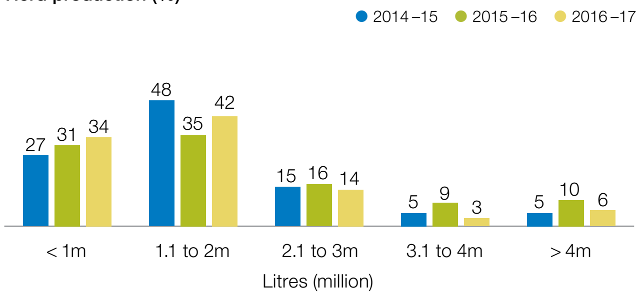


Current herd size and production

Herd size (%)

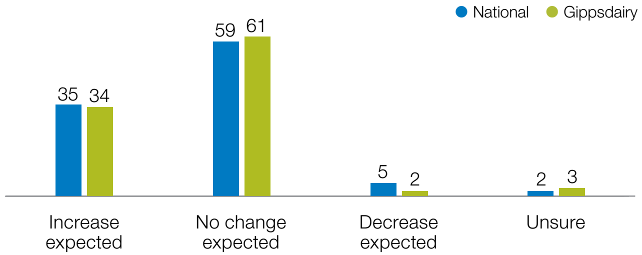


Herd production (%)

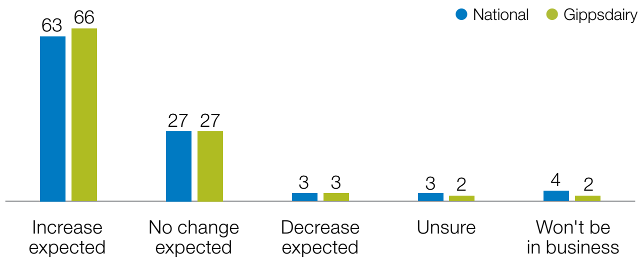


Forecast herd size and production

Anticipated change in herd size 2017–18 vs 2016–17 (%)

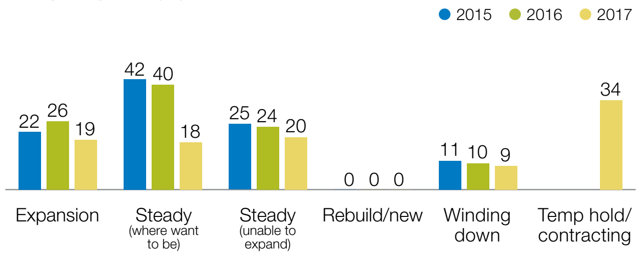


Anticipated change in production 2019–20 vs 2016–17 (%)



Regional profile

Enterprise phase (%)



The 'average' Gippsdairy farmer

68%	No change/intention to change company supplied	**80%**	Sees future opportunities for the industry
59%	Feeds moderate to high level of concentrates	**1.4t** (tonnes)	Average grain fed per cow per year
64%	Has a water security/ management plan	**51%**	Has a written annual farm budget
92%	Has **not** used DairyBase		

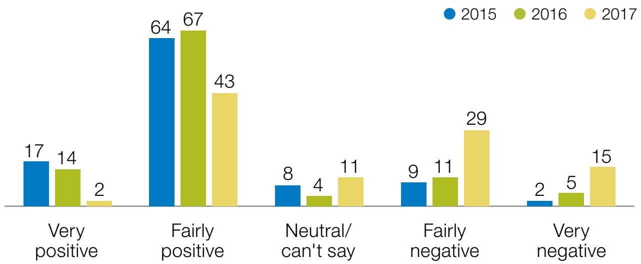
Regional NDFS results at a glance – Dairy NSW

Summary

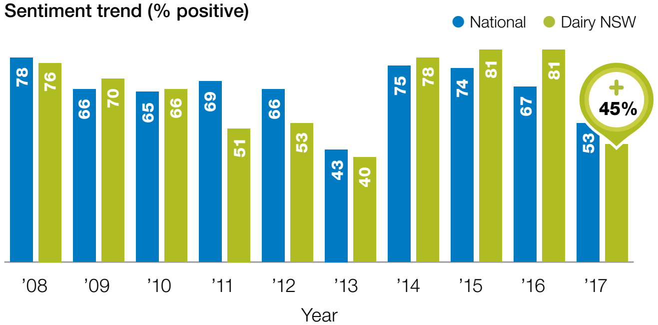
- Positivity towards the industry's future has fallen a significant 36 points, resulting in this region being the least positive nationally.
- Almost two thirds of DairyNSW farms were profitable last financial year and just over half expect to make a profit this year.
- Half of the region's respondents extended, refinanced or deferred debt in the last 12 months.
- DairyNSW respondents are the most likely nationally to expect production increases over the next three years.

Sentiment

Current sentiment (%)



Sentiment trend (% positive)



Positive drivers

- Improved managment (13%)
- Farm gate price ok (10%)
- Demand for dairy (8%)

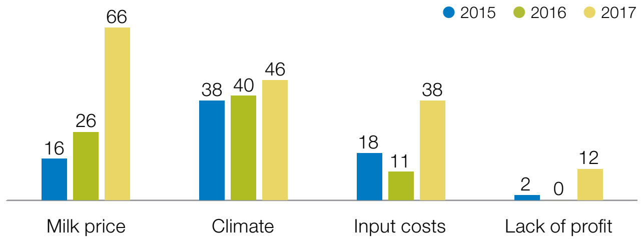
Negative drivers

- Farm gate price low (39%)
- Poorly run milk co. (14%)
- Production costs (6%)

Profitability and investment

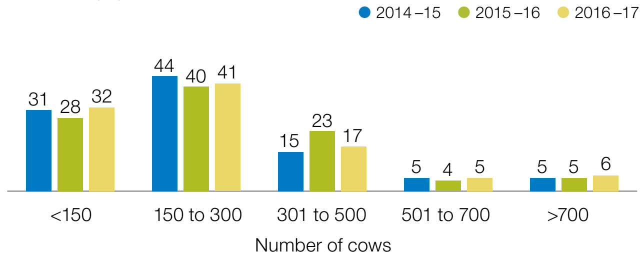
65%	Made profit 2015–16	**56%**	Invested on farm 2015–16
55%	Expect profit 2016–17	**39%**	Intend to invest 2016–17
17%	Profit higher than 5 year average	**17%**	Invest in irrigation
20%	Profit about same	**14%**	Invest in machinery
60%	Profit lower than 5 year average	**11%**	Invest in feed systems

Challenges next 6 months

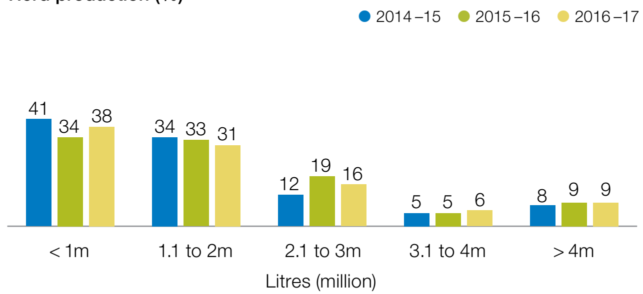


Current herd size and production

Herd size (%)

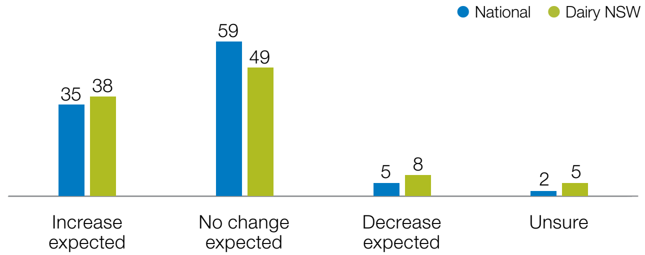


Herd production (%)

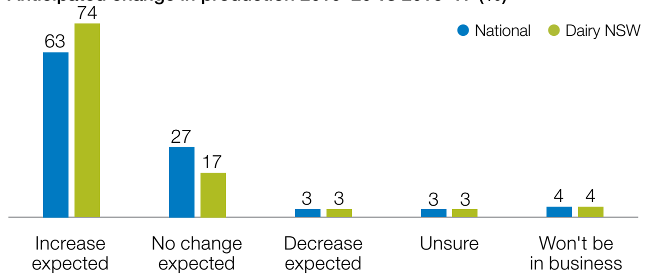


Forecast herd size and production

Anticipated change in herd size 2017–18 vs 2016–17 (%)

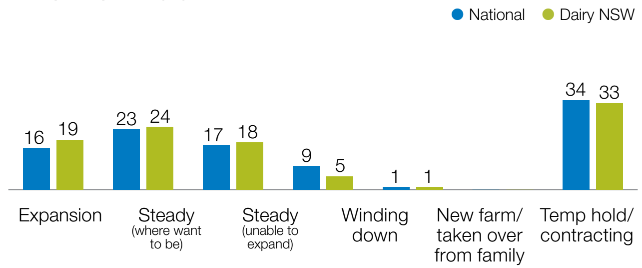


Anticipated change in production 2019–20 vs 2016–17 (%)



Regional profile

Enterprise phase (%)



The 'average' Dairy NSW farmer

75%	No change/intention to change company supplied	**64%**	Sees future opportunities for the industry
61%	Feeds moderate to high level of concentrates	**2.1t** (tonnes)	Average grain fed per cow per year
64%	Has a water security/ management plan	**45%**	Has a written annual farm budget
83%	Has **not** used DairyBase		

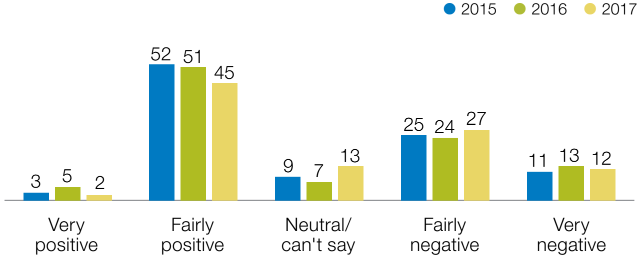
Regional NDFS results at a glance – Subtropical Dairy (SDP)

Summary

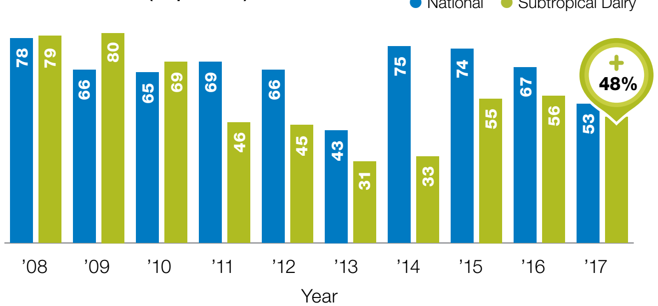
- In line with 2015 and 2016 survey results, SDP respondents are among the least likely to be positive towards the industry's future.
- Operating profits were relatively widespread last financial year but significantly fewer respondents are expecting to be profitable this financial year.
- SDP farms are the least likely to have extended, refinanced or deferred debt over the last year.

Sentiment

Current sentiment (%)



Sentiment trend (% positive)



Positive drivers

Demand for dairy (13%)

Farm gate price ok (12%)

Improved managment (12%)

Negative drivers

Farm gate price low (36%)

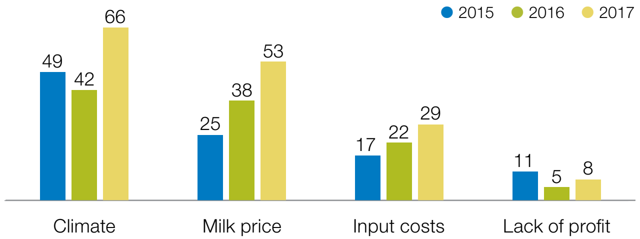
Production costs (15%)

Poorly run milk co. (8%)

Profitability and investment

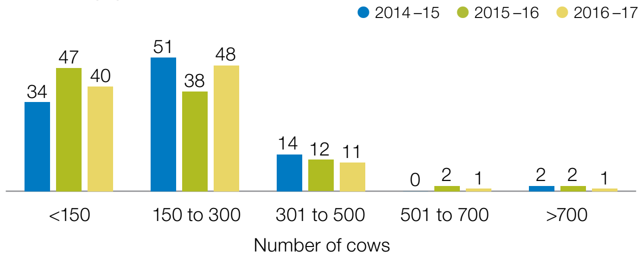
68%	Made profit 2015–16	**52%**	Invested on farm 2015–16
60%	Expect profit 2016–17	**39%**	Intend to invest 2016–17
28%	Profit higher than 5 year average	**20%**	Invest in machinery
36%	Profit about same	**13%**	Invest in irrigation plant
33%	Profit lower than 5 year average	**11%**	Invest in dairy plant

Challenges next 6 months

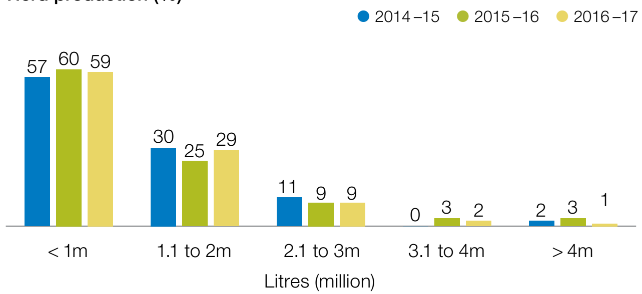


Current herd size and production

Herd size (%)

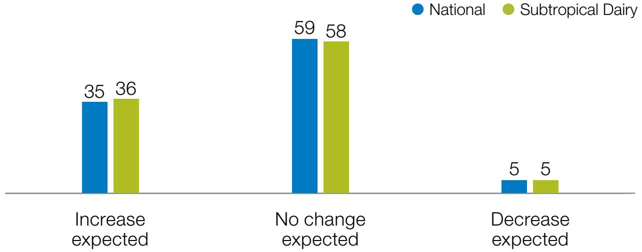


Herd production (%)

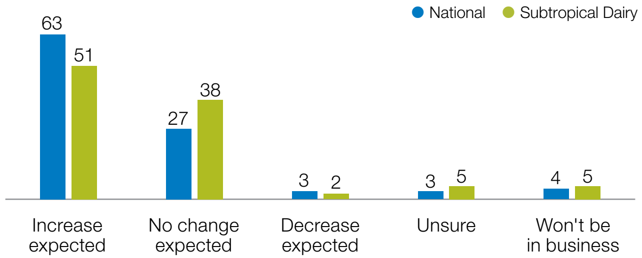


Forecast herd size and production

Anticipated change in herd size 2017–18 vs 2016–17 (%)

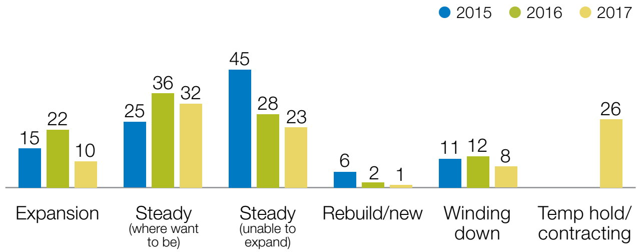


Anticipated change in production 2019–20 vs 2016–17 (%)



Regional profile

Enterprise phase (%)



The 'average' Subtropical Dairy farmer

82%	No change/intention to change company supplied	**67%**	Sees future opportunities for the industry
55%	Feeds moderate to high level of concentrates	**1.9t** (tonnes)	Average grain fed per cow per year
58%	Has a water security/ management plan	**37%**	Has a written annual farm budget
91%	Has **not** used DairyBase		

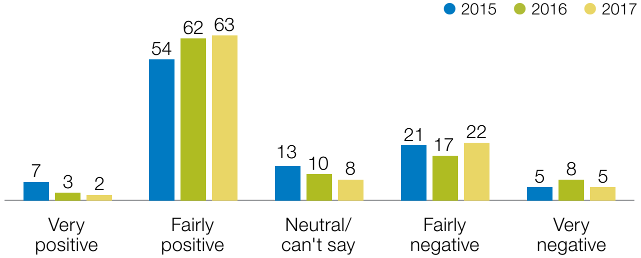
Regional NDFS results at a glance – Dairy SA

Summary

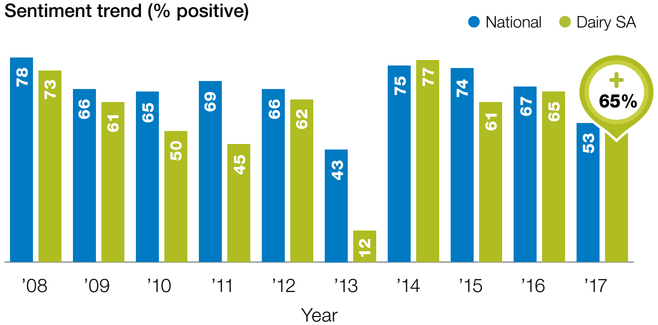
- Dairy SA was the only region not recording a drop in confidence in 2017.
- Profitability amongst the region's farms was relatively widespread in 2015–16, however significantly less expect to be profitable this financial year.
- Despite widespread profitability last financial year, on farm investment was significantly down compared to 2016, possibly due to lower than average profits.
- More than half expect production to increase by 2019–20.

Sentiment

Current sentiment (%)



Sentiment trend (% positive)



Positive drivers

Farm gate price ok (20%)
Improved managment (18%)
Demand for dairy (13%)

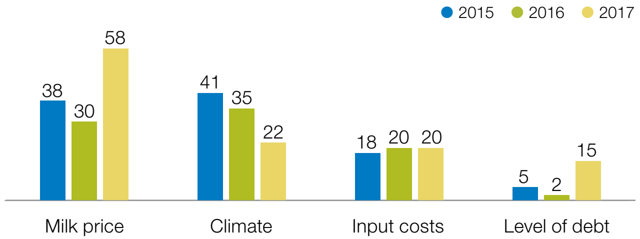
Negative drivers

Farm gate price low (28%)
Production costs (13%)
Poorly run milk co. (7%)

Profitability and investment

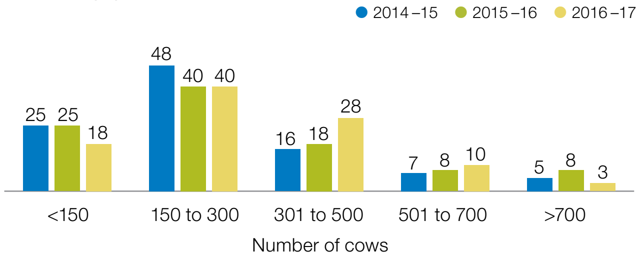
77%	Made profit 2015–16	**33%**	Invested on farm 2015–16
55%	Expect profit 2016–17	**38%**	Intend to invest 2016–17
7%	Profit higher than 5 year average	**28%**	Invest in machinery
13%	Profit about same	**18%**	Invest in irrigation plant
78%	Profit lower than 5 year average	**15%**	Invest in dairy plant

Challenges next 6 months

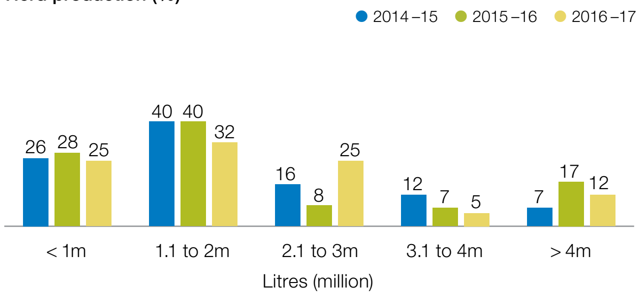


Current herd size and production

Herd size (%)

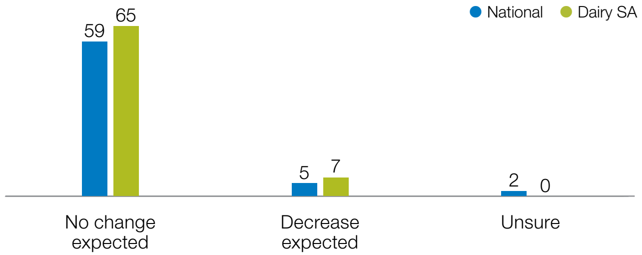


Herd production (%)

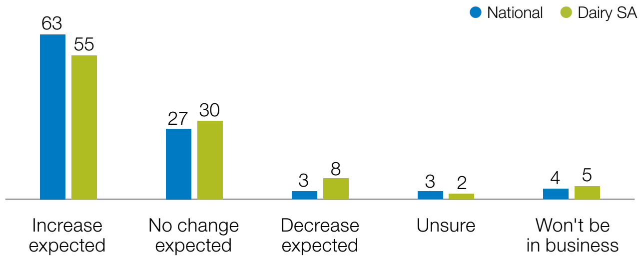


Forecast herd size and production

Anticipated change in herd size 2017–18 vs 2016–17 (%)

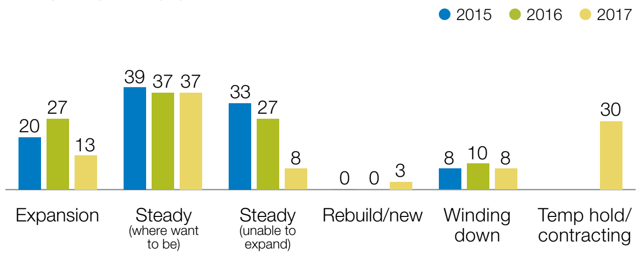


Anticipated change in production 2019–20 vs 2016–17 (%)



Regional profile

Enterprise phase (%)



The 'average' Dairy SA farmer

88%	No change/intention to change company supplied	**82%**	Sees future opportunities for the industry
78%	Feeds moderate to high level of concentrates	**1.6t** (tonnes)	Average grain fed per cow per year
68%	Has a water security/ management plan	**53%**	Has a written annual farm budget
83%	Has **not** used DairyBase		

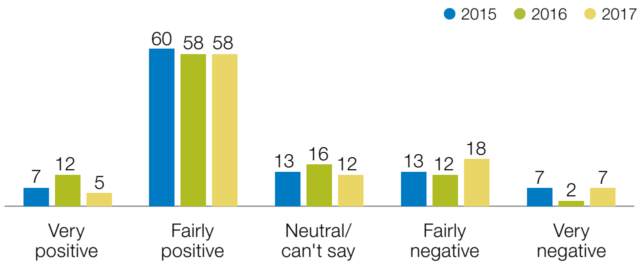
Regional NDFS results at a glance – Western Dairy

Summary

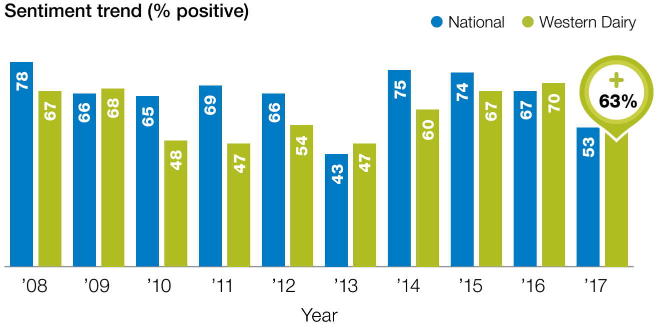
- Concerns with future contracts and low farmgate price have resulted in a slight decrease in confidence.
- In 2015–16, WA respondents were significantly more likely to have made an operating profit and a considerably greater proportion expect to do so this financial year.
- Profit is anticipated to be higher than the five year average for a larger proportion of WA respondents compared to other regions.
- Despite fairly optimistic profit expectations, only half intend to make on farm investments in next 12 months.
- In line with 2016 results, the majority of respondents expect herd sizes and production to remain the same or grow.

Sentiment

Current sentiment (%)



Sentiment trend (% positive)



Positive drivers

- Improved managment (17%)
- Current contract ok (20%)
- Demand for dairy (13%)

Negative drivers

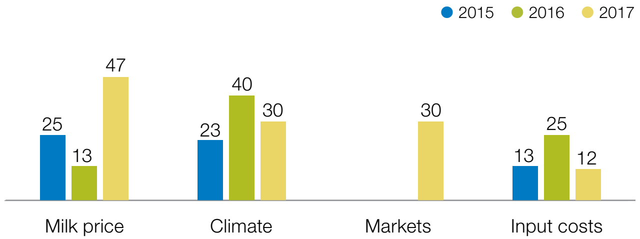
- Demand/contracts (28%)
- Farm gate price low (17%)
- Production costs (13%)

Profitability and investment

93% Made profit 2015–16
87% Expect profit 2016–17
40% Profit higher than 5 year average
27% Profit about same
33% Profit lower than 5 year average

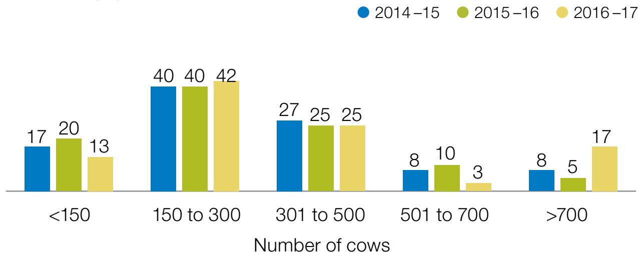
60% Invested on farm 2015–16
50% Intend to invest 2016–17
35% Invest in machinery
15% Invest in dairy plant
15% Invest in feed systems

Challenges next 6 months

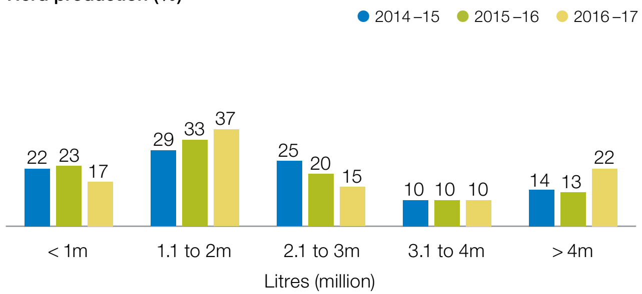


Current herd size and production

Herd size (%)

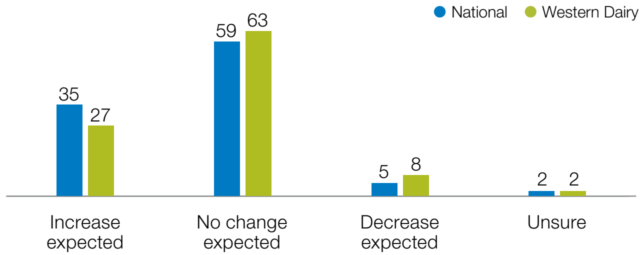


Herd production (%)

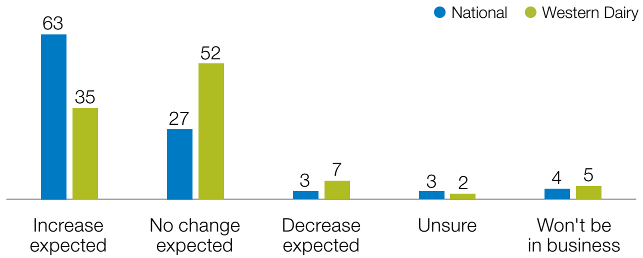


Forecast herd size and production

Anticipated change in herd size 2017–18 vs 2016–17 (%)

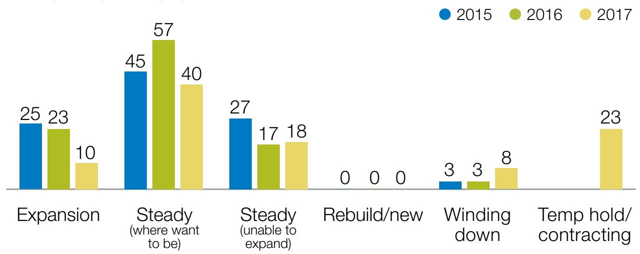


Anticipated change in production 2019–20 vs 2016–17 (%)



Regional profile

Enterprise phase (%)



The 'average' Western Dairy farmer

87% No change/intention to change company supplied
70% Feeds moderate to high level of concentrates
65% Has a water security/ management plan
82% Has **not** used DairyBase

73% Sees future opportunities for the industry
1.9t (tonnes) Average grain fed per cow per year
57% Has a written annual farm budget

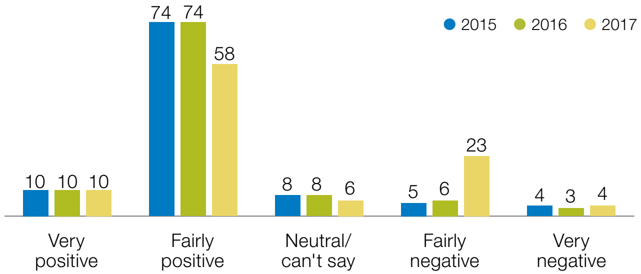
Regional NDFS results at a glance – DairyTas

Summary

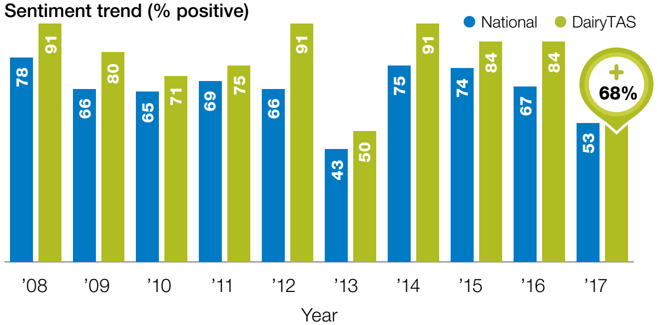
- Positivity in this region is significantly reduced compared to 2016 and a downward trend is becoming evident.
- A considerably lower proportion of the region's respondents made an operating profit last financial year than in 2016 and less than half expect to be profitable this financial year.
- Over the past 12 months more than half of the region's respondents have extended, refinanced or deferred debt.
- Significantly fewer respondents invested on farm in the last 12 months and less than half intend to invest this financial year.
- Almost three quarters of Dairy Tas respondents expect production to be greater by 2019–20.

Sentiment

Current sentiment (%)



Sentiment trend (% positive)



Positive drivers

- Demand for dairy (19%)
- Improved management (16%)
- Farm gate price ok (11%)

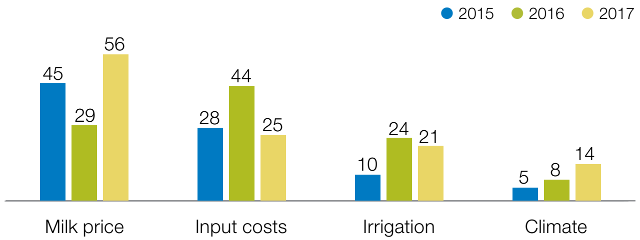
Negative drivers

- Farm gate price low (21%)
- Cost of production (9%)
- Poorly run milk co. (9%)

Profitability and investment

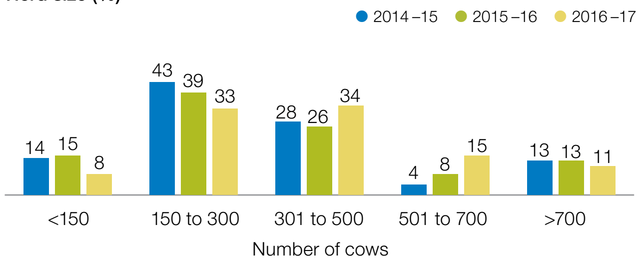
59%	Made profit 2015–16	**48%**	Invested on farm 2015–16
44%	Expect profit 2016–17	**44%**	Intend to invest 2016–17
9%	Profit higher than 5 year average	**20%**	Invest in irrigation plant
15%	Profit about same	**13%**	Invest in machinery
75%	Profit lower than 5 year average	**11%**	Invest in dairy plant

Challenges next 6 months

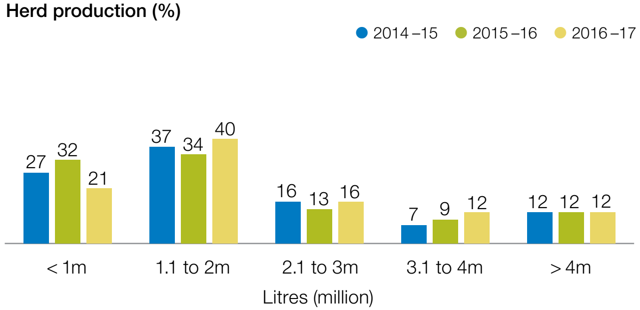


Current herd size and production

Herd size (%)

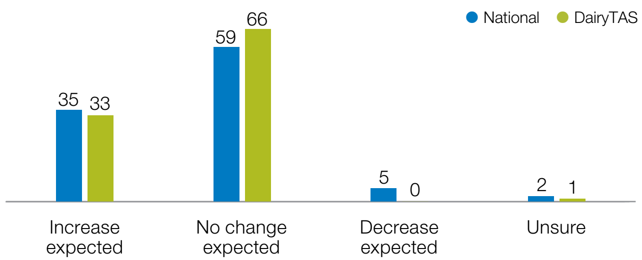


Herd production (%)

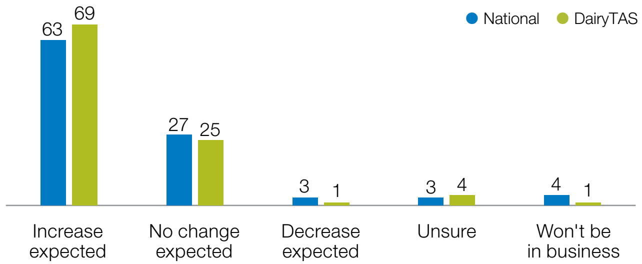


Forecast herd size and production

Anticipated change in herd size 2017–18 vs 2016–17 (%)

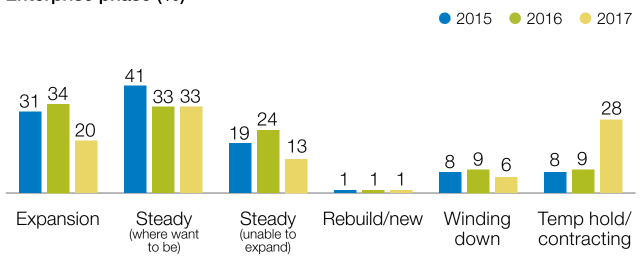


Anticipated change in production 2019–20 vs 2016–17 (%)



Regional profile

Enterprise phase (%)



The 'average' DairyTAS farmer

+25%	No change/intention to change company supplied	**84%**	Sees future opportunities for the industry
49%	Feeds moderate to high level of concentrates	**1.2t** (tonnes)	Average grain fed per cow per year
61%	Has a water security/ management plan	**70%**	Has a written annual farm budget
79%	Has **not** used DairyBase		





Dairy Australia
Your Levy at Work

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