

INDONESIA AUSTRALIA RED MEAT & CATTLE PARTNERSHIP



Joint State of the Industry Report 2019

Introduction

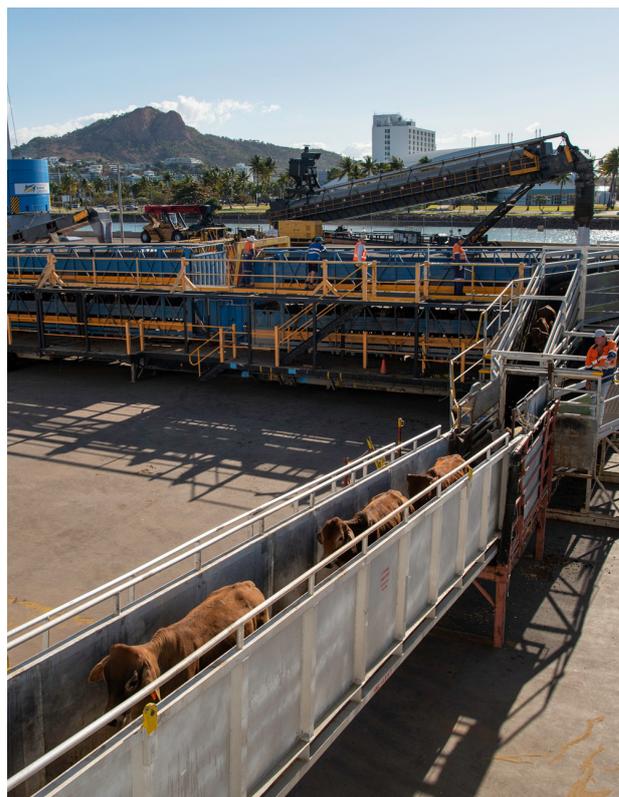
Indonesia and Australia enjoy a unique business partnership with respect to the cattle and beef trade. Feeder cattle produced in northern Australia are fattened and processed in Indonesian feedlots and abattoirs, a supply chain that has functioned successfully for over three decades. The market is underpinned by northern Australia's ability to efficiently produce feeder cattle, and Indonesia's ability to fatten and process these cattle at relatively low cost. Australia also exports to Indonesia significant quantities of fresh and frozen beef, and trim and offal. These raw materials are used to manufacture bakso balls, rendang and other staple foods, providing a protein source as well as employment for many Indonesians.

This Joint State of the Industry Report provides a 2019 snapshot of this red meat and cattle trade. The report covers Australian production and export and Indonesian feedlots and processing, key elements of supply chain, and includes an examination of factors that affected investment, trade and consumption in 2019.

Key messages

The assessment of the bilateral trade in 2019 provided three key messages.

- Export sales of Australian feeder cattle remained strong through 2019, resulting from the moderately low value of the Australian dollar against the currencies of trading partners and the ongoing drought across much of northern Australia that necessitated destocking.



Cattle being loaded from trucks in Darwin onto a ship bound for Indonesia.

- Indonesian feedlots faced significant challenges throughout the year due to increasing production costs, steady beef prices, and the import of low-cost Indian buffalo meat (IBM) and Brazilian beef. Some relief was derived from the relative weakness of the Australian dollar against the Indonesian rupiah and comparatively low cattle prices in northern Australia.
- There are substantial trade growth opportunities presented by strong and enduring sectoral relationships across both countries, a rapidly expanding Indonesian beef market, and the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA) that will eliminate many tariff and quota requirements and provide a framework for stronger economic cooperation.

Australian herd in destocking phase

Drought and flood significantly impacted Australian production in 2019, which was the hottest and driest year on record in northern Australia (Figure 1). Many producers struggled with feed and water availability leading to widespread destocking and low cattle prices. The slaughter of female cattle reached new highs.

In contrast, at the start of 2019 parts of Queensland suffered extreme flooding resulting in a devastating loss of some 600,000 cattle. Northern Queensland was however able to provide a steady supply of quality feeder and slaughter cattle with live exports of cattle from Townsville almost matching those from Darwin.

By the end of 2019 the cattle herd in Australia had been reduced to its lowest levels since 1995 due to challenging environmental conditions experienced over the previous two years (Figure 2).

This period of contraction is now likely to be followed by a rebuilding phase, following good rains in large parts of northern Queensland at the start of 2020. Competition for a reduced supply of livestock will however likely lead to increases in cattle and beef prices.

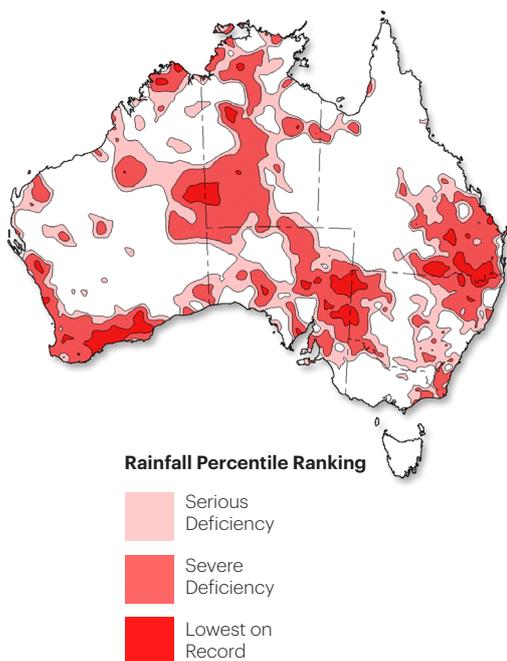
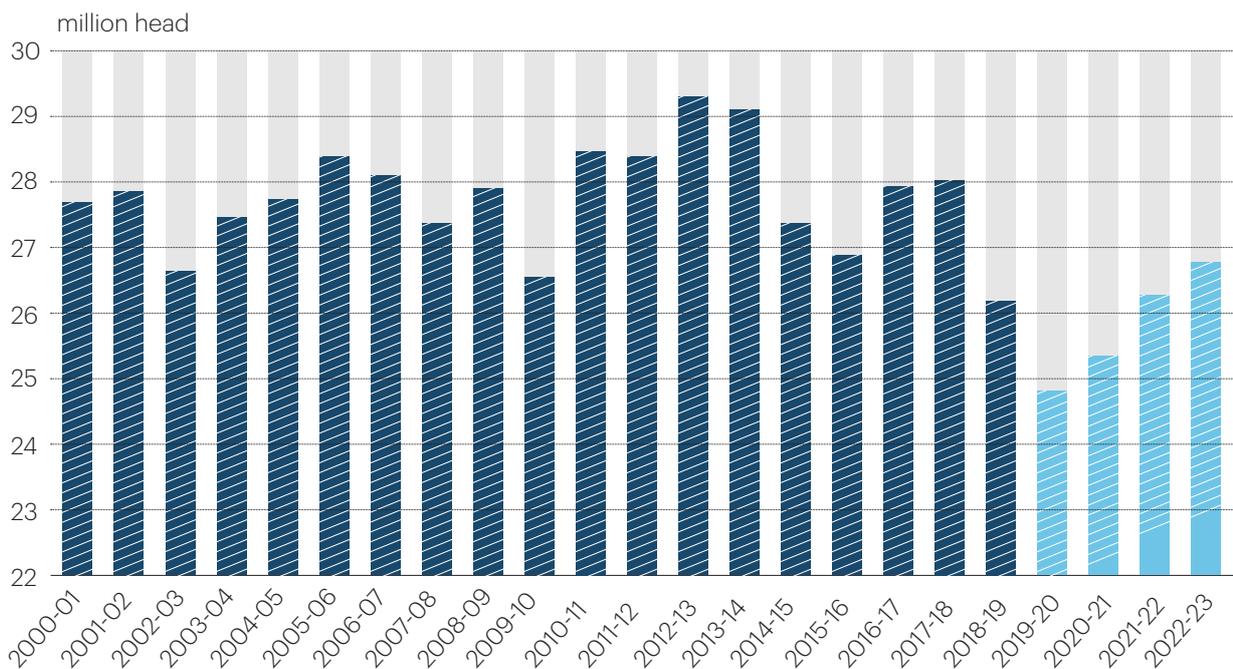


Figure 1: Rainfall deficiencies in Australia from April 2018 to March 2020

Figure 2: Australian national cattle herd population over the past 20 years and future projections

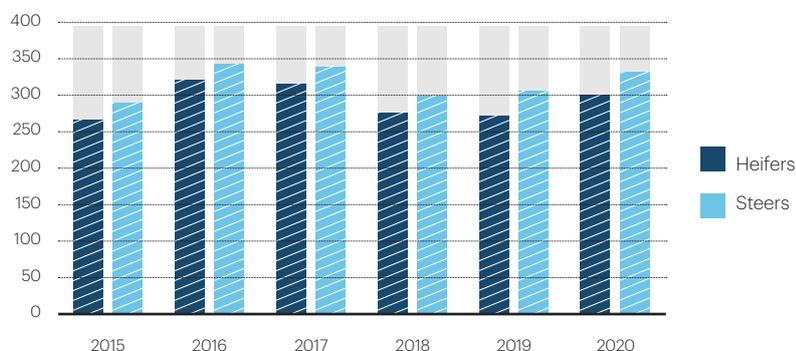


Source: ABS, MLA estimates

Australian cattle prices remained low

Australian cattle prices in 2019 remained at relatively low levels driven by widespread destocking (Figure 3). The Eastern Young Cattle Indicator (EYCI) was at AU cents 385.25/kg carcass weight in March 2019, its lowest point since December 2014.¹ The live export price for feeder steers to Indonesia (ex-Darwin) dropped to around AUD2.80 a kilogram liveweight in May 2019, down from AUD3.25 a kilogram in December 2018. The Australian dollar also depreciated against the Rupiah by over 5%.² All drove strong live cattle export numbers in 2019.

Figure 3: Annual Cattle Price Trends – Export Darwin to Indonesia (Aust' cents / kg liveweight)



Brahman cross cattle, the cattle breed exported to Indonesia from Australia.

Australia – world's largest beef exporter (by dollar value)

In 2019 Australia became the world's large beef exporter by dollar value with exports generating A\$10.8 billion. Australia also became the second largest beef exporter by volume after Brazil, followed by India and the US. These results, delivered during very challenging environmental conditions, were largely due to a favourable US dollar exchange rate (averaging \$USD 0.69 to AUD1.00) for exporters and a significant spike in the regional demand for beef after African Swine Fever decimated the pork industry in China. This protein deficit was filled, in part, by beef imports from Australia. In 2019 Australia's beef exports to China grew by 85%.

1 The EYCI is an estimate of value based on carcass weight/kg. Data from Cattle market wrap: December 2019 MLA

2 The dollar continued to fall in early 2020 due to overall weak commodity prices, unprecedented extreme climatic events in Australia and uncertainty over trade with China due in part to the outbreak of Coronavirus (COVID-19).

Australian live cattle exports to Indonesia increased, boxed beef stable

Australia exported cattle to 20 countries, mostly in South East Asia, with Indonesia its main market. Approximately 75% of Indonesian imports of live cattle and boxed beef are supplied by Australian firms.

In 2019 Australia shipped to Indonesia approximately AUD 690 million worth of live cattle (676,433 head – Figure 4), AUD 274 million of frozen beef, AUD 48 million of chilled beef and AUD 106 million of beef offal. With a combined total of AUD 1.12 billion this represented the fifth most valuable market for the Australian red meat industry and the first for live cattle with over 50% of the export market.

The main shipments originated from Darwin and Townsville (Figure 5). The prolonged drought conditions in many pastoral areas saw a decrease in shipments from Darwin³ and an increase from Townsville⁴ due to good rains in northern Queensland in early 2019.

2019 also saw a review of the Australian Standards for the Export of Livestock (ASEL) that recommended more pen space on

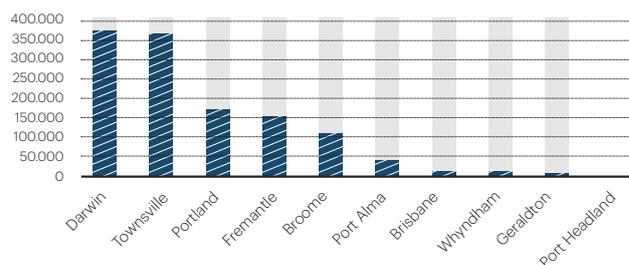


Figure 5. Cattle exports from Australian ports in 2019 to all destinations including Indonesia

livestock ships⁵. If regulated as planned in late 2020, a ship carrying cattle of 300 to 350kgs live weight from Darwin to Indonesia would require an increase in pen space of around 5% and could increase shipping costs by 5-17%.

Indonesian feedlots focusing on efficiency to improve profitability

Five to six years ago it was possible to make reasonable profits by importing live Australian cattle and fattening them in Indonesian feedlots. The circumstances in 2019 are much more challenging. A combination of factors, including rising costs, lower beef market prices and competition from frozen IBM and other imported frozen beef has placed significant financial pressure on Indonesian feedlots. Input costs are rising around 3% per year whilst

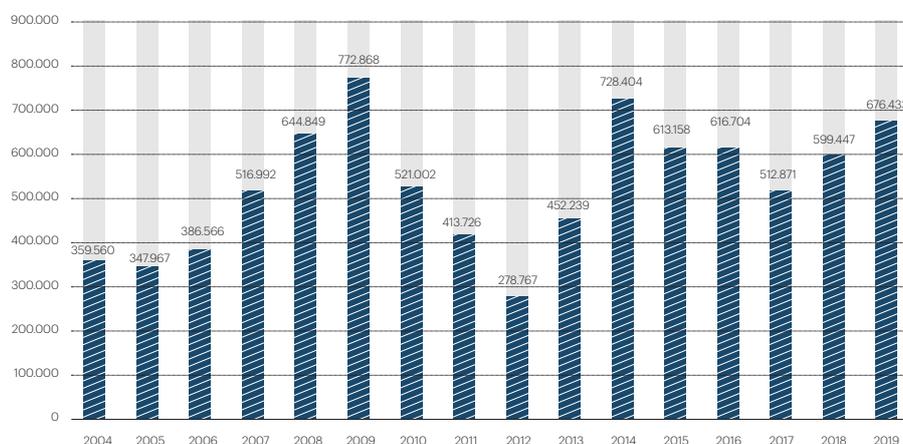


Figure 4: Total cattle exports from Australian ports 2019

3 416,942 in 2018 to 373,836 in 2019

4 257,751 in 2018 to 364,046 in 2019

5 This will vary according to a range of factors including the length of the voyage and the weight of the livestock.

beef prices have been stable for the past four years (IDR 110 -120,000 per kg – Figure 6) and consumers now have access to IBM sold at IDR 80-100,000 per kg.

Imported frozen beef penetrated most markets across Indonesia and during the second half of 2019 feed prices increased substantially due to drought and inflation⁶. Many regional feedlot operators just broke even – some only made profits on offcuts and offal and many closed. One local feedlot operator indicated that local market prices varied between IDR 39,000 and IDR 41,500 kg cwt in January 2020 and that they had to sell at this price due to their poor bargaining position and inability to access other markets. Whilst feeder cattle imports were strong in 2019, the closure of feedlots may negatively impact the live cattle trade in 2020.

Feedlots near major urban centres, such as Jakarta, that were more efficient and had more control over their local supply chain, marketing and sales, were slightly more profitable than their more remote counterparts. However, some industry members stated that increasing land prices close to urban centres were resulting in the closure of feedlots for other



Cattle being fed in Lampung, Indonesia

more profitable uses. Adding further pressure on the industry, reduced profits have slowed feedlot infrastructure maintenance.

Active members of GAPUSPINDO, the Indonesian Beef Cattle Business Association, decreased from 42 in 2017 to 26 in 2019. Despite this reduction, the number of live cattle imported during 2019 increased from 2018 levels. Usually around 150-200,000 cattle are in feedlot stock yards at any point in time, with a target of around 240,000 prior to the Muslim religious festivals of Idul Fitri and Idul Adha, to avoid price spikes. In 2019 many feedlots took advantage of the lower Australian cattle prices and in some instances became overstocked.

The Indonesian industry adds approximately AUD 550 of value per head to imported

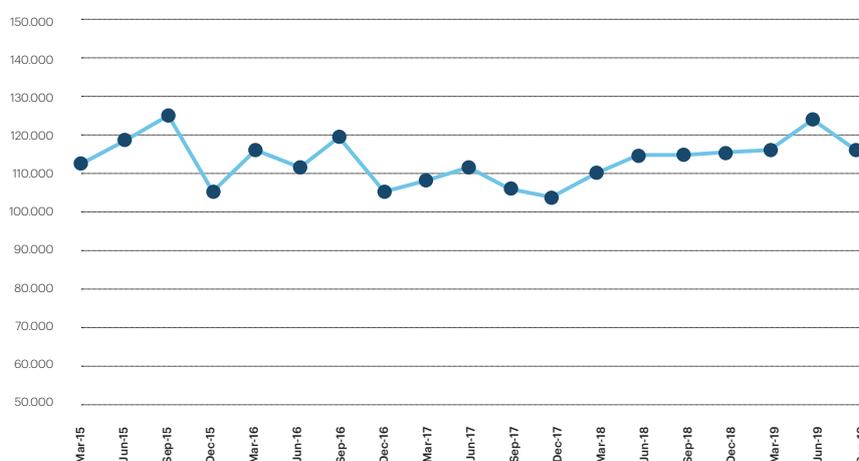


Figure 6: Wet Market price of fresh beef Rp per Kg – Source MLA statistics

⁶ About 99% of feedlot feed is sourced locally. Vitamin and mineral supplements are primarily imported.

Australian cattle, through fattening and processing, which equates to AUD 370 million to the Indonesian economy, and employs over 100,000 Indonesians in the feed, logistics, fattening, processing and selling sectors.

If feedlots are to remain profitable they will need to reduce production costs, particularly if the Australian dollar strengthens against the Indonesian rupiah, live cattle prices increase, and input costs such as for feed, health and transport continue to rise, whilst market prices remain stable. To maintain parity with costs, Indonesian processors believe that retail beef prices need to be at or above IDR 140,000 per kg, a price usually only reached during the Indonesian religious periods of Idul Fitri and Idul Adha when demand is high.

Breeder importation policy presented unique challenges for feedlot operators

In 2017 the Indonesian Government implemented a policy that required importers to import one breeder for every 5 feeders, equating to 16.7% of total live cattle imported.⁷ Importers had two years to fill their quota, which would be subject to audit. Those importers who failed to meet the quota would have their permits suspended for 12 months.

In 2019 the Indonesian Government revised the policy to one that required feedlot operators to assign five per cent of each feeder cattle consignment for breeding purposes. Many operators were examining the feasibility of breeding cattle under oil palm or working with surrounding smallholder farmers to comply

⁷ Following the implementation of the policy in October 2016 Australia exported approximately 42,000 breeders into Indonesia over a 2 year period or 2.4% of total shipments.



Integrated cattle breeding and palm oil operation in Kalimantan.

with the policy. If the policy is fully enacted approximately 30,000 breeders would need to be imported from Australia every year.

Processing volume decreased

In 2019 Indonesian abattoirs continued to benefit from low labour costs. The cost of processing and packaging feedlot-finished Australian cattle in a modern, Category 2 Indonesian abattoir was approximately AUD 98 per head compared to AUD 282 per head in Australia. Many of the larger Exporter Supply Chain Assurance System (ESCAS) approved abattoirs did however see a decrease of approximately 40% in processing following the introduction of IBM in 2016-17 (Figure 7). This decrease may however have also been due to higher Australian prices in 2018 and the corresponding decrease in live cattle imports.

In some regional abattoirs slaughtermen got paid in trimmings and offal rather than cash. This created an incentive for the abattoirs to process local smaller cattle rather than larger Australian cattle because of the proportionally higher volume of trimmings, a consideration if Australian cattle are to be shipped to regional locations for fattening and processing.



ESCAS approved abattoir in Bogor Indonesia.

Indian meat imports kept beef prices low

In Indonesia, local beef production, predominantly by smallholder farmers breeding *Bos javanicus* cattle, supplies approximately 45% of the local demand. The remainder is supplied through imports of live cattle and boxed beef from an increasingly diverse range of markets, as indicated in Figure 7, with Australia contributing around 75%.

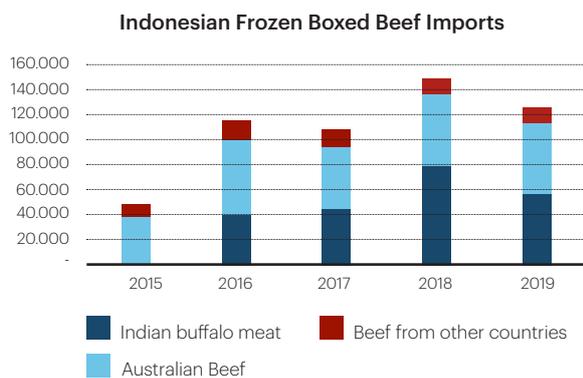


Figure 7: Importation of beef (frozen) from all sources between 2015-2019.

Approximately 90,000 tonnes of IBM will be imported in 2019-20, which represents approximately 40-50% of current beef imports. The government reference price for frozen IBM was set at IDR 80,000 per kg in 2019 although some IBM was also mixed with local or imported beef and sold at higher prices in traditional

markets. Brazil has also gained market access and was permitted to ship 50,000 tonnes as of mid-2019⁸, although less than 10% of the allocation was ultimately imported. Brazilian meat was priced at around IDR 100,000 per kilo. Fresh beef retailed in wet markets at IDR 100-120,000 per kg.

The Centre for International Economics modelling indicates that the introduction of Brazilian beef will have modest impacts on Australian beef and cattle shipments⁹. The medium to long-term impact of IBM imports is still unknown, however beef market growth from a rapidly growing Indonesian middle class will likely minimise the impact of IBM on the fresh beef market. Its introduction has also likely expanded the beef consumer market with more now able to afford red meat.

IA-CEPA presents substantial growth opportunities

The IA-CEPA was signed in 2019 and ratified by the Australian Parliament in December 2019 and by the Indonesian Parliament the second quarter of 2020. The trade agreement creates a framework for closer economic engagement and will build on existing multilateral and regional agreements including the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA) both of which saw Indonesia liberalise several livestock and red meat tariff lines.

It is likely the following IA-CEPA measures will significantly benefit the bilateral red meat and cattle trade.

⁸ Only 3,500 tonnes had been imported by December 2019.

⁹ Commissioned by the Meat and Livestock Association



Australian Brahm-cross feeder cattle being unloaded in Indonesia after sea transport.

- A quota for 575,000 head of live male cattle, with a 0% in-quota tariff, which will grow by 4% per annum over five years to 700,000 head.
- Live cattle import permits to be issued automatically on an annual basis and without seasonal restrictions, with a review to be conducted after five years to consider future increases in the quota above 700,000 head.
- A 0% tariff on female live cattle and no quota or import permit restrictions.
- Boxed beef and frozen offal exports not currently benefiting from 0% tariffs secured under existing agreements will have a 0% or 2.5% tariff (down from 5%) with all products to be reduced to 0% over five years.

Immediate outlook for the bilateral trade

Growth opportunities for the bilateral red meat and cattle trade are substantial. Strong and enduring Australian and Indonesian government and industry relationships are ideally placed to leverage the unique complementarities of the two industries, the rapidly expanding Indonesian beef market, and very importantly, IA-CEPA, that will eliminate many tariff and quota requirements. Key predictions for the bilateral trade for 2020/2021 are outlined below.

- After a prolonged drought and devastating bushfires through to early January 2020, recent rains in many parts of rural Australia will see a focus on restocking, with supplies beginning to tighten and cattle prices to increase.

- Internationally, demand in Vietnam and elsewhere in Southeast Asia will see ongoing competition for live export cattle, although Indonesia will remain Australia's main live cattle trading partner. The ratification of IA-CEPA should encourage ongoing trade but probably at slightly lower levels than seen in 2019. The introduction of new ASEL shipping regulations may offset any benefits of the 5% tariff reduction under IA-CEPA.
- Demand for quality beef in Indonesia will continue to rise as the middle class in Indonesia continues to grow. Conservative estimates indicate annual growth of 10% for beef products. The introduction of cheaper alternatives, such as IBM, will broaden the consumption base enabling a greater number of Indonesians to consume red meat.
- The delineation between the different meat market segments is expected to become more distinct. Beef from locally processed cattle, whether imported feeders or local cattle, will continue to command a 'fresh' premium. If large volumes of IBM are imported as planned in 2020, this may become a more mainstream affordable option.
- Imports of frozen beef from Brazil and other countries, combined with ongoing imports of IBM are likely to have a negative impact on Australian exports to Indonesia, the feedlot industry in Indonesia, and local cattle production and processing. The industry will need to evolve and become more efficient in order to compete.
- A reduction in the local processing of cattle due to frozen IBM and other beef importation will reduce the availability of cheap offal, a large component of the Indonesian market. The call for this demand to be met through importation is likely to continue.

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