

INDONESIA AUSTRALIA RED MEAT & CATTLE PARTNERSHIP



Joint State of the Industry Report Update: July 2020

Executive Summary

The Joint State of the Industry (JSOI) Report, to be published in January of each year, provides an assessment of the bilateral trade in live cattle and beef products between Australia and Indonesia in the previous year. The Report examines factors that affected investment, trade and consumption and covers Australian cattle production and exports, Indonesian feedlots and processing and key elements of the supply chain between the two countries.

The 2019 JSOI summarised the bilateral trade in cattle and beef in 2019 as follows:

- Export sales of Australian feeder cattle remained strong, aided by the moderately low value of the Australian dollar against the currencies of its trading partners and the ongoing drought across much of northern Australia that necessitated destocking.
- Indonesian feedlots faced significant challenges due to increasing production costs, stable 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 (AUD) against the Indonesian Rupiah (IDR) and comparatively low cattle prices in northern Australia.
- Opportunities to grow the bilateral trade were anticipated based on strong and enduring sectoral relationships across both countries, a rapidly expanding Indonesian beef market and the Indonesia- Australia Comprehensive Economic Partnership Agreement (IA-CEPA) eliminating many tariff and quota requirements.

This JSOI 2020 Update covers a very different operating environment to that experienced in 2019. The COVID-19 pandemic has created several unique challenges for Australian and Indonesian businesses along the supply chain

but has also highlighted the industry's resilience in the face of a significant crisis.

This JSOI Update: July 2020 provides the following **key messages:**

The short to medium term outlook is unpredictable. The interplay of various economic factors, all driven by the COVID-19 pandemic, will continue to place significant strain on businesses along the supply chain. Volatile AUD/Rupiah exchange rates, a significant economic contraction in Indonesia in quarter two of 2020/2021, together with a likely slow economic recovery, will see a further reduction in Indonesian consumer's purchasing power and additional increases in Indonesian feedlot and processor operating costs.

Australian feeder cattle prices increased. Drought breaking rains in the Northern Territory and Queensland in early 2020 encouraged Australian farmers to restock leading to cattle shortages. Between May and June 2020 import prices increased by 15%, compared to the same period in 2019, due to competition for a limited supply of feeder cattle and a strengthening of the Australian dollar against the Rupiah.

Australian live cattle exports to Indonesia dropped by 15% compared to the same period in 2019 as feedlot owners and traders took a 'wait and see approach' to AUD/Rupiah currency fluctuations, feeder prices and the impact from a planned import of 170,000 tonnes of IBM.

Indonesian feedlots experienced significant profit declines in 2020 due to high feeder cattle and feed prices, and increasing operational costs after the imposition of new measures to protect staff health. Some temporary relief was derived from the cancelling of the planned import of IBM and strong demand for beef during the Idul Fitri holiday period. With the recent reissue of IBM import permits, feedlot owners may need to lower their beef prices in order to maintain demand from consumers with less buying power.

Boxed beef exports remained stable. Forward boxed beef contracts made in 2019 prevented Indonesian importers cancelling orders in response to the closure of Indonesian hotels, restaurants and catering businesses. This forced some traders to freeze chilled Australian beef for delayed sale. Demand was however buoyed by substantially increased supermarket sales as consumers avoided traditional wet markets due to health concerns.

In the longer-term, growth opportunities for the bilateral red meat and cattle trade are substantial, despite the geopolitical and economic uncertainties that arose in early 2020. Strong and enduring Australian and Indonesian government and industry relationships are ideally placed to leverage the unique complementarities of the two industries, an expanding Indonesian beef market, and very importantly, IA-CEPA, that has already eliminated several tariff and quota requirements.

Joint State of the Industry Update - July 2020

This JSOI Update provides a snapshot of the Indonesian Australia red meat and cattle trade as at July 2020. The Update covers Australian production and export and Indonesian feedlots and processing, and factors that affected investment, trade and consumption. It updates the 2019 JSOI report that provided a detailed assessment of the bilateral trade in live cattle and beef products between Australia and Indonesia in 2019. The Update concludes with predictions for the bilateral trade for 2020/2021.

This 2020 JSOI Update comes at a highly unique time for the red meat and cattle trade with the COVID-19 pandemic significantly altering the operating environment for Australian and Indonesian businesses along the supply chain, generating a variety of impacts and innovative industry responses.

Australian cattle prices increased

Domestic cattle prices have risen consistently since mid-2019. Trade steers, sold in March 2019 for 486 cents per kilogram, increased to over 600 cents by July 2020. The price of export steers from Darwin increased from a low of 280 cents per kilogram in April 2019 to a high of 375 cents in March 2020 and between May and June 2020 rose by a further 15%. The higher prices were driven by scarcity and increased competition as Australia cattle farms restocked after drought breaking rains in early 2020.

Australian live cattle exports dropped whilst beef exports remained stable

Between January and June 2020 Australian live cattle exports to Indonesia were 15% lower compared to the same period in 2019. Feedlot owners withheld orders taking a 'wait and see' approach to Australian feeder cattle prices, AUD/Rupiah currency fluctuations, and the impact from a planned import of 170,000 tonnes of IBM.

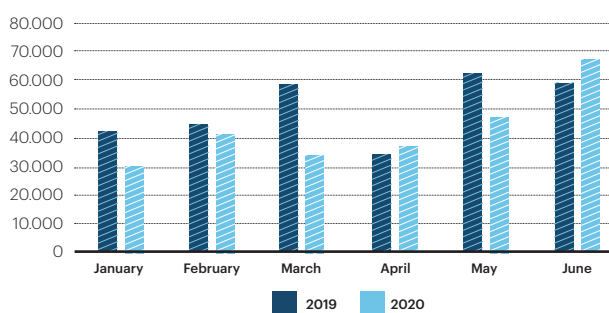


Figure 1: Live cattle imports to Indonesia for the first six months of 2019 and 2020

Australian boxed beef export volumes to Indonesia between January and June 2020 were almost identical to the same period last year - 27,988 tonnes compared to 27,997 tonnes. These exports reflected forward contracts made in 2019 which prevented Indonesian importers cancelling orders in response to the reduced demand from Indonesian hotels, restaurants

and catering businesses. Some Indonesian traders were forced to freeze chilled Australian beef for storage and delayed sale. Local demand was however buoyed by increased beef sales in supermarkets and the cancelling of the planned import of 170,000 tonnes of IBM import due to the pandemic enforced lock down in India.

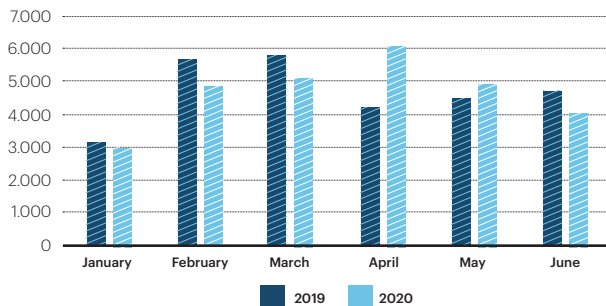


Figure 2: Boxed beef exports for the first six months of 2019 and 2020

Indonesian feedlots experienced significant profit declines

Feedlots experienced significant profit declines due to high feeder cattle prices, poor and volatile exchange rates, increasing operational costs, and the imposition of new measures to protect staff health. Between April and June domestic and internationally sourced feed and micronutrients became scarcer and transport and feed costs increased by around 15%. Beef market prices remained constant averaging around IDR110,000 per kilogram. As market prices are government controlled, feedlot owners and traders were not able to pass on their increased operational and feeder cattle costs to consumers. See Figure 3 for long term price trends.

Feedlot profits were also negatively impacted when offal prices dropped 70-80% soon after the forced closure of street vendors in April 2020. Offal and trimmings are often the main source of profit for feedlot operators, particularly in rural areas. Offal sales started to recover in June 2020 as consumers switched to cheaper protein sources.

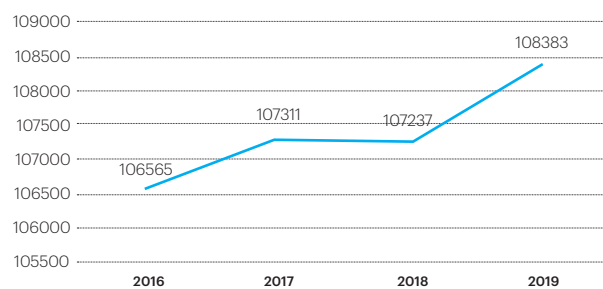


Figure 3: Average annual beef market price per kilo in Indonesia Rupiah

The importation of IBM, significantly down from 2019, is yet to have an impact on fresh beef sales. The lockdown in India prevented IBM importation between April and May, providing an opportunity for feedlots to meet the increased demand for beef during the Muslim holiday period. However, feedlots have reported an overall 30% decline in demand in 2020 compared to 2019.

The Indonesian Government has recently issued permits for the import, in 2020, of up to 170,000 tonnes of IBM and 10,000 tonnes of Brazilian beef. After importation, feedlot owners may need to lower their prices for fresh beef in order to maintain demand from consumers with less buying power.

Abattoirs reported a 15-20% decline in processing in 2020 which is in line with the reduction in imports and overall demand. Like feedlots, abattoirs have incurred additional costs and reduced productivity due to the implementation of measures to protect staff health during the pandemic.

The meat processing industry reported strong ongoing sales and product diversification in response to emerging consumer requirements, taste preferences and price points. For example, processors are now mixing beef, chicken and buffalo to produce new processed products with longer shelf lives.

Indonesian consumer demand remains strong

Demand for beef in Indonesia continues to be relatively strong despite a slowing economic environment. However, a decline in demand of around 15-20% has been experienced in regional areas, likely attributable to tourism shutdowns (domestic and international) and a significant decrease in the movement of people between regions. Hotel, restaurant and catering businesses suffered significant declines in business (60-70%), whilst supermarkets experienced increases in beef demand due to more people eating at home and consumer health concerns associated with shopping at traditional wet markets.

Online beef sales have increased by 300% with government and businesses partnering with delivery companies such as Gojek. Many traders established online meat shops and many smaller operators are now selling products through social media apps such as Facebook, Instagram and WhatsApp. The main concern for government is the emergence of an unregulated industry of small suppliers who do not meet packaging and transportation standards.

Outlook for 2020/21

Predictions for the bilateral trade for 2020/2021 are outlined below.

- The Indonesian Ministry of Finance predicts the economy could enter a recession in the third quarter of 2020/2021.¹ Indonesian consumers with reduced buying power will likely opt for cheaper forms of protein, including IBM, over more expensive beef. This could lead to a decrease in demand for fresh feedlot beef and a subsequent decline in Australian imports. Continued currency

¹ With GDP to contract 3.8% in the second quarter and shrink by a further 1% in the third quarter-

volatility and a further strengthening of the Australian dollar against the Rupiah would see sustained financial strain on Indonesian and Australian businesses along the supply chain. The industry will need to evolve and become more efficient to remain competitive.

- 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.²
- IA-CEPA will help moderate the impacts of the pandemic on struggling Australian and Indonesian businesses and will provide a framework for industry recovery. Most notably, the 5% reduction in tariffs for 575,000 steers and 0% tariff on female live cattle will, in the short to medium term, mitigate high export cattle prices. The introduction of new ASEL shipping regulations may however partially offset these benefits. Australian exporters and Indonesian importers will also benefit from relaxed tariff requirements on boxed beef and frozen offal. In the longer-term IA-CEPA provides opportunities for importing Australian feed grains into Indonesia to improve feedlot productivity, and for developing Australia-Indonesia skills partnerships that deliver targeted and industry-relevant training.

² The demand for Australian beef offal has surged in recent years with Indonesia now Australia's largest market for beef offal exports.

Information Sources

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