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Report Highlights:

Prospects for Indonesian dairy imports continue to remain strong. Despite high fuel prices, consumer awareness of the health benefits of dairy products and industry success producing retail dairy products to meet decreased consumer purchasing power have increased overall total dairy product consumption by 10 percent in 2006. However, Indonesian fresh milk production is expected to slightly decrease 2 percent in 2007 mostly due to the lack of lactating dairy cattle. Whey imports are forecast to reach record levels in 2007.

Includes PSD Changes: Yes
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SITUATION AND OUTLOOK

The Indonesian dairy industry is expected to continue its robust growth. Despite a 126 percent increase in fuel prices, consumption is expected to grow due to growing awareness of the health benefits of milk and successful producer response to decrease consumer purchasing power with smaller package sizes and new, less costly products. Changes in the outlook in the near term are not likely given population growth and low per capita consumption when compared to the region.

Imports of dairy products will also continue to grow as lack of investment and incentive to improve in local milk production continues. Prospects for U.S. dairy, which currently holds about 20 percent market share, are good since the quality and price of U.S. and Oceania nonfat dry milk and whole milk powder are competitive. Most users buy on price. Changes in EU policy regarding dairy subsidies should open further prospects. U.S. whey dominates the Indonesian market and potential prospects for whey imports remain strong.

The Indonesian economy is expected to improve in 2006. Economic growth is estimated to be at 5.8 percent, inflation at 8.0 percent, and the currency exchange is expected to remain stable at Rp. 9,100 – 9,300 to US\$1. Recent natural disasters have had negligible impact on the industry or outlook.

PRODUCTION

The Indonesian dairy industry is forecast to grow at least 15 percent annually but competition will remain fierce with the entry of new products and new players. Yet the 2006 domestic milk production is estimated to be stagnant and marginally decline by 2 percent to 47 TMT in 2007 due to lack of improvement in production practices among dairy farmers.

Indonesia does not produce enough fluid milk to meet domestic demand. Estimates are that it produces 25 percent of needed milk. In the past, fresh milk production was used as raw material for whole milk powder (WMP). Now, it is combined with nonfat dry milk (NDM) to produce full cream liquid and powder milk. Domestic WMP production is expected to slow down in 2007. No NDM is produced in Indonesia, and domestic demand is fully met from imports.

Indonesian milk production is sourced from about 320,000 dairy cattle. Around 20,000 dairy cows need to be replaced this year since they are no longer producing milk. The lack of funds will likely make this effort impossible. Milk production per cow ranges from 10 to 15 liters/day. The quality of milk produced also remains low. On average, total plate count (TPC, i.e. bacteria content) is 500,000 – 1 million per ml, total solids (TS) is 12 percent, total fat per ml is 3 percent, and total protein per ml is 3 percent.

Drought caused by the El Niño weather pattern has hit Indonesia again this year since June 2006. The drought this year is expected to last longer than the one last year, which will drop the availability and the quality of grass for feed and will reduce fresh milk production by 7 percent in the short term. Production is expected to recover when the rainy season starts around the end of November 2006.

In contrast to the small scale and inefficient milk production units, large and efficient companies dominate the milk-processing sector. The five largest companies account for 78 percent of market share. The largest companies form the Indonesian Milk Processing Industry (IPS), an association consisting of 11 members, most of whom are located on the island of Java. Yet there is room for newly emerging companies in Indonesia. When the May

2006 earthquake in the Yogyakarta and Klaten area of central Java damaged their facilities, one of the major producers was forced to temporarily move production to Australia. Yet no significant impact was felt in the market as other dairy producers immediately filled the demand.

Since 1995 GoI, in cooperation with dairy cooperatives, has been implementing its White Revolution movement, which aims to increase milk production through farmer education. However, the result of this program remains discouraging. Poor quality dairy cattle, poor feed and feeding management systems, farmer's difficulty in finding commercial loans from banks, inadequate on farm and off farm management, lack of extension officers, low level of farmer education, and lack of technology continue to hamper growth of Indonesian fresh milk production.

Currently, about 241,800 people are involved in on-farm fresh milk production. The domestic fresh milk production chain starts with backyard dairy farmers who deliver their milk to primary cooperatives. The primary cooperative will cool the milk in a cooling system before sending it to the Union of Indonesian Dairy Cooperatives (GKSI). The Indonesian milk processing industry (IPS) will buy the milk through GKSI at a price depending on the bacteria content and total solids in the milk. After deducting the transportation and cooling cost, GKSI will hand over the cash to farmers. In this system, farmers have a very low bargaining position as the price they receive is set by GKSI and IPS. Therefore, there is no incentive for farmers to improve feed practices and thus increase production.

CONSUMPTION

Total Indonesian dairy product consumption is forecast to increase by 10 percent in 2006 and forecasted to continue growing through 2007.

Three types of consumer products dominate the market: powdered milk (full cream milk, skim milk, and formulas for infants, children, weight gain and loss, diabetics, pregnant and lactating women, and other health purposes); sweetened condensed milk; and liquid ready-to-drink milk (fresh milk, sterilized, pasteurized, UHT, and homogenized dairy milk).

Liquid ready-to-drink milk accounts for 20 percent of total market share and is the fastest growing segment. It is retailed in packages convenient for travel such as in children's school lunchboxes, is affordable, and has a longer shelf life. Currently, there are a few brands of infant formula and formula for pregnant and lactating women that can also be found in liquid form. Powdered milk has the strongest market share of 40 percent because housewives prefer its use at home. Sweetened condensed milk (SCM), used for puddings, bread spread, and toppings, takes the remaining share.

In October 2005, GoI increased fuel prices by an average of 126 percent. The increased prices affected both the industry and consumers. Consumer purchasing power was so depressed that consumers were forced to use more of their income on basic needs such as food, education, and health.

Most of the industry reported that the fuel price hike increased industry production costs by 6 to 10 percent, including costs of manufacturing, storage and transportation, with some companies reporting increases as high as 15 percent. However they could not pass the increased production costs to the consumer because the increased fuel prices decreased consumer purchasing power. So instead of increasing the retail prices, the industry used other measures to decrease retail prices, such as decreasing package sizes and using cheaper products in formulations. UHT liquid milk is sold in smaller packages (150 ml – 200

ml brick packs, plastic bottles and pillow packs) with 9-month shelf life without refrigeration at retail price ranges from Rp. 1,500/pack to Rp. 2,000/pack (US\$ 0.16/pack to US\$ 0.22/pack at an exchange rate of Rp. 9,100/US\$1, as of September 2006). Instead of using only NDM, the industry is now combining NDM and whey powder or using only whey powder to produce a new product called creamer to replace popular sweetened condensed milk in a 390-gram can or 45-gram sachet. Creamers do not contain the same amount of protein and are normally used for coffee. However, most consumers do not distinguish creamer from SCM and use it as an affordable replacement.

The successful Susu Peduli and Susu Sekolah programs sponsored by USDA in 1999 to 2003 have left a strong impression in the minds of Indonesian milk producers motivating them to market their products in rural areas. The programs also increased awareness of the health benefits of milk among consumers in rural communities. The breakthrough in production and marketing combined with higher consumer health awareness and aggressive promotion campaigns have successfully increased consumption. Currently, Indonesian per capita milk consumption has grown to 7 – 7.5 liters per year, which is still lower than other countries in the region such as Malaysia, which has annual per capita milk consumption of 21 liters and Thailand, which has annual per capita consumption of 24 liters. Consumption is also expected to increase as the total population of about 220 million people grows by 1.4 percent annually.

TRADE

Indonesian imports of WMP are estimated to be relatively stagnant at 27 TMT in 2006 and 2007 due to high prices on the international market and industry preference to use NDM and anhydrous milk fat, because they tend to have a longer shelf life, a slightly lower price, and are easier to combine with other dairy products. Indonesian imports of NDM in 2007 are forecasted to increase 5 percent to 147,000 tons compared to 140,000 tons in 2006. Indonesian imports of whey powder are forecasted to be 35,000 tons, which represents more than a 20 percent increase in 2007 compared to 2006.

Given the long historical presence in Indonesia's dairy market and geographical advantages, Oceania (Australia and New Zealand) has been enjoying the largest share of dairy product exports to Indonesia while the United States accounts for about 20 percent market share. However, prospects for U.S. dairy products will remain bright, as the price and quality of U.S. dairy products are competitive. Furthermore, the United States can take advantage of the EU policy to reduce the export subsidy for their dairy products that has reduced their competitiveness. The two largest dairy processors in Indonesia are European-based companies that source out their raw material of WMP, NDM, and whey powder from their home office. Some predict that a large dairy farm being established in China will become a source of milk in the future.

High international demand for whey has increased the Indonesian landed price of whey to US\$1,000/ton in September 2006 compared US\$700/ton in September last year. The United States continues to be the dominant supplier of whey to Indonesia followed by the EU and Oceania though some end users report that U.S. whey is inclined to cake faster, resulting in a shorter shelf life, and has more yellowish color compared to whey from other suppliers. U.S. presence in the Indonesian dairy market is the success story of several U.S. Dairy Export Council (USDEC) programs to promote the quality and use of U.S. dairy products. USDEC recently held a program to promote the use of U.S. whey powder for sport and nutritious food and drink products that will likely result in a new record for use of U.S. whey powder. Whey powder is now not only used as ingredients in feed but also in infant formula and muscle building food and beverages.

STOCKS

Stocks held by the private sector are pipeline supplies. Importers reported that their stock of whey is decreasing due to high demand. The industry has been purchasing whey powder at higher than usual prices due to the high demand.

The ending stocks of NDM is estimated to decrease to 12,000 tons in 2006 due to the strong demand from the local dairy industry, tight supplies in exporting countries, and high prices in the international market.

PRICES

| Product | Price - ID Rupiah | Price - U.S. Dollars (Rp. 9,100/US\$1 as of 9/1/06) |
|------------------------------------------------------------------------------|--------------------|--------------------------------------------------------|
| Local Fresh Milk Grade 1 (Farm Gate - 12% TS, 0-250,000/ml TPC) | Rp. 2,548.67/liter | \$0.28/liter |
| Local Fresh Milk Grade 3 (Farm Gate - 12% TS, 500,000-1 mil/liter TPC) | 2,283.19/liter | \$0.25/liter |
| Whole Milk Powder | | \$2,150/ton |
| Nonfat Dry Milk | | \$2,200/ton |
| Whey (CNF) | | \$1,100/ton |

Source: Union of Indonesian Milk Cooperatives and traders.

Currently, Indonesian importers are finding WMP prices are less than NDM. Normally, the price of WMP is higher than NDM. However, WMP prices have lowered with an increase in stocks. Lower prices for the by-products for NDM production have decreased to the point where it is not profitable for producers to separate the NDM and fat.

POLICY

A 5 percent import duty and 10 percent Value Added Tax (VAT) are currently applied to NDM and WMP Indonesia imports. During September 2006, the House of Representative, Min. of Trade and Min. of Finance agreed to eliminate the 10 percent VAT on several agricultural products including milk. This policy has been long awaited by the Indonesian agricultural sector and is expected to lower the production cost of producing agricultural finished products within the country. However, official regulations have not been released and there are no indications they will be released in the near future.

PSD: DAIRY, DRY WHOLE MILK POWDER

| PSD Table | | | | | | |
|-----------------------------|------------------------------|--------------------|---------------------|--------------------|---------------------|--------------------|
| Country | Indonesia | | | | | |
| Commodity | Dairy, Dry Whole Milk Powder | | | | (1000 MT) | |
| | 2005 | Revised | 2006 | Estimate | 2007 | Forecast |
| | USDA Official [Old] | Post Estimate[New] | USDA Official [Old] | Post Estimate[New] | USDA Official [Old] | Post Estimate[New] |
| Market Year Begin | | 01/2005 | | 01/2006 | | 01/2007 |
| Beginning Stocks | 6 | 6 | 4 | 4 | 4 | 5 |
| Production | 48 | 48 | 50 | 48 | 0 | 47 |
| Intra EC Imports | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Imports | 26 | 26 | 31 | 27 | 0 | 27 |
| TOTAL Imports | 26 | 26 | 31 | 27 | 0 | 27 |
| TOTAL SUPPLY | 80 | 80 | 85 | 79 | 4 | 79 |
| Intra EC Exports | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Exports | 1 | 1 | 1 | 0 | 0 | 0 |
| TOTAL Exports | 1 | 1 | 1 | 0 | 0 | 0 |
| Human Dom. Consumption | 75 | 75 | 80 | 74 | 0 | 75 |
| Other Use, Losses | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Dom. Consumption | 75 | 75 | 80 | 74 | 0 | 75 |
| TOTAL Use | 76 | 76 | 81 | 74 | 0 | 75 |
| Ending Stocks | 4 | 4 | 4 | 5 | 0 | 4 |
| TOTAL DISTRIBUTION | 80 | 80 | 85 | 79 | 0 | 79 |
| Calendar Yr. Imp. from U.S. | 0 | 0 | 0 | 0 | 0 | 0 |
| Calendar Yr. Exp. to U.S. | 0 | 0 | 0 | 0 | 0 | 0 |

Note: Not Official USDA Data

PSD: DAIRY, MILK, NON FAT DRY

| PSD Table | | | | | | |
|-----------------------------|-------------------------|--------------------|---------------------|--------------------|---------------------|--------------------|
| Country | Indonesia | | | | | |
| Commodity | Dairy, Milk, Nonfat Dry | | | | (1000 MT) | |
| | 2005 | Revised | 2006 | Estimate | 2007 | Forecast |
| | USDA Official [Old] | Post Estimate[New] | USDA Official [Old] | Post Estimate[New] | USDA Official [Old] | Post Estimate[New] |
| Market Year Begin | | 01/2005 | | 01/2006 | | 01/2007 |
| Beginning Stocks | 10 | 10 | 14 | 14 | 9 | 12 |
| Production | 0 | 0 | 0 | 0 | 0 | 0 |
| Intra EC Imports | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Imports | 135 | 135 | 135 | 140 | 0 | 147 |
| TOTAL Imports | 135 | 135 | 135 | 140 | 0 | 147 |
| TOTAL SUPPLY | 145 | 145 | 149 | 154 | 9 | 159 |
| Intra EC Exports | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Exports | 10 | 10 | 20 | 10 | 0 | 5 |
| TOTAL Exports | 10 | 10 | 20 | 10 | 0 | 5 |
| Human Dom. Consumption | 121 | 121 | 120 | 132 | 0 | 145 |
| Other Use, Losses | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Dom. Consumption | 121 | 121 | 120 | 132 | 0 | 145 |
| TOTAL Use | 131 | 131 | 140 | 142 | 0 | 150 |
| Ending Stocks | 14 | 14 | 9 | 12 | 0 | 9 |
| TOTAL DISTRIBUTION | 145 | 145 | 149 | 154 | 0 | 159 |
| Calendar Yr. Imp. from U.S. | 0 | 23 | 0 | 26 | 0 | 28 |
| Calendar Yr. Exp. to U.S. | 0 | 0 | 0 | 0 | 0 | 0 |

Note: Not Official USDA Data

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