SEVEN KEY DRIVERS
OF THE AUSTRALIAN DAIRY INDUSTRY

Global supply
Situation: Positive
Outlook: Positive
Milk production has slowed in the four key exporting regions this spring, supporting commodity prices. Wet weather has weighed on milk flows in the southern hemisphere, while higher feed costs and culling have impeded growth in the United States (US) and Europe. For now, global supply is expected to remain fairly tight, at least until the northern hemisphere spring commences.

Australian market
Situation: Positive
Outlook: Positive
Consumer confidence continues to improve as Australians enjoy newfound freedoms. Shoppers are spending more money through foodservice venues, while retail demand for dairy remains strong. Retail sales of yellow spreads and milk have stabilised from the panic-buying highs of 2020 but remain above 2019 levels.

Global demand
Situation: Positive
Outlook: Positive
Global demand for dairy has improved as more countries re-emerge from lockdowns. Freight remains a constant challenge and has seen some buyers rush to place additional orders to ensure supply. While this is currently supporting commodity prices, growing inventories may dampen demand once product movement improves.

Inputs
Situation: Neutral
Outlook: Neutral
Above average rain has created challenges for the grain harvest and fodder conservation this spring. While hay and temporary irrigation prices are subdued, the cost of grain and fertiliser has increased. Access and availability of labour, as well as machinery and suitable parts, also remains a challenge.

Australian production
Situation: Neutral
Outlook: Neutral
Wet weather and cold fronts have impacted per-cow yields this spring. Other factors including labour shortages, firm beef and land values, and business diversification also weigh on milk production. As such, any increase in Australia’s national milk pool is looking increasingly unlikely this season, despite otherwise profitable conditions.

Global economy
Situation: Negative
Outlook: Negative
While the global economy continues to recover, many challenges remain and the International Monetary Fund has downgraded its economic growth forecast for 2021. Ongoing lockdowns in key regions, including some provinces in China, are weighing on the recovery, while surging energy costs and supply chain pressures further undermine short-term outlooks.

Exchange rates
Situation: Neutral
Outlook: Neutral
The Australian dollar ($AUD) has remained relatively stable against the US dollar ($USD) this spring, around $AUD/$USD 0.73. Given rising inflation pressures, several analysts forecast the US Federal Reserve will increase rates in 2022. If realised, this is likely to strengthen the $USD against other major currencies.
When it rains, it pours - in a land of extremes, this expression seems especially apt. Following a year of close to record returns, conditions remain supportive for farm profitability.

Global dairy markets are contributing to this promising outlook, as commodity prices continue to rise. Additionally, as most Australian COVID-19 restrictions ease ahead of summer, consumers are taking advantage of newfound freedoms, further buoying the domestic market. At the same time, rain has dominated forecasts this spring and more is set to come. While this has been positive for dam levels and pasture growth in some regions it has created some challenges as wet weather plays havoc with harvests and weighs on per-cow yields this year.

Since the start of the season, commodity prices for most dairy products have been trending upwards and are now trading above five-year averages. Global demand for dairy has increased as countries re-emerge from lockdowns. Sales to southeast Asia and the Middle East and North Africa (MENA) region have particularly picked up, outweighing more muted interest from China in recent months. Nevertheless, in the past 12 months to August, global dairy exports to Greater China have surged 27%.

Supply chain bottlenecks continue to add complexity and costs to freight, however these issues have also served to boost dairy sales from Australian exporters. At present, US exporters are especially struggling to ship product overseas due to port congestion. In some instances, this has prompted orders from Australian suppliers, to fill gaps at short notice.

Weaker global supply growth has also been a driving factor. Cold and wet weather has impacted pasture growth and weighed on milk production in New Zealand, with volumes to October down 3.3% compared to last year (on a tonnage basis).

Although seasonal conditions have improved and milk flows are projected to partially recover this summer, local analysts forecast an overall drop of 0.2% this season. In Europe, milk production is also lagging. Surging feed and energy costs are hurting margins and impeding growth in several countries.

In the US, following months of expansion, the dairy herd is now contracting. Higher feed prices have prompted substantial cuts to the national herd and as a result, the US reported its first drop in milk production since May 2020 this October. With global dairy supply expected to remain fairly tight, at least until the northern hemisphere spring, market fundamentals look well supported going forward.

Back home, the end of lockdowns in Victoria and New South Wales (NSW) has been a welcome change and consumer confidence has edged upwards. Shoppers have returned in force as the economy re-opened, and Dairy Australia’s foodservice index show that café and restaurant spending has recovered since last year. Takeaway products are also growing in popularity and retail demand for dairy remains strong. While retail spending has stabilised from the panic-buying peak of 2020, sales of yellow spreads and milk continue to outpace 2019 volumes. In value terms, retail milk sales continue to rise and the recent upwards price adjustment of private label milk by the major retailers is likely to fuel this momentum. As people are gearing up to eat and drink their way through the Christmas period, domestic dairy demand looks set to stay firm.

While dairy market dynamics remain supportive, seasonal conditions have created several challenges this spring.

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1 Dairy Australia calculation based in part on data reported by NielsenIQ through its Homescan Service for the total milk, cheese, yellow spreads, and yoghurt categories to 10 Oct 2021, for the Total Australia market, according to the NielsenIQ standard product hierarchy. Copyright © 2021, Nielsen Consumer LLC.
Above average rain, storms and cold fronts have weighed on per-cow yields, caused flooding in some regions and disrupted harvest proceedings. This has particularly been the case in Victoria, Tasmania and Western Australia (WA), where silage making efforts have been delayed or abandoned due to ground conditions. Less hay is projected to be made this year but with significant amounts left in store (albeit some weather damaged) and plentiful pasture growth, the cost of purchased fodder remains subdued. Wet weather has also replenished water storage sites and the cost of temporary irrigation water has continued to fall in northern Victoria and southern NSW.

Other costs, including energy and labour, have risen this spring with fertiliser and grain prices surging. A global shortage of fertilisers, combined with some countries limiting exports, will restrict supply for the foreseeable future. International pressures are also impacting Australia’s grain prices. Nevertheless, a significant amount of grain is being harvested and as wet weather has worsened the quality of some crops, even more may be made available for the domestic market. While higher prices will increase farmers input costs this season, a generally higher farmgate milk price is expected to insulate against rising prices.

Last year proved to be one of the most profitable in recent times, as most dairy regions reported their highest average returns since 2013/14, according to the Dairy Farm Monitor Project (DFMP). Gippsland and Tasmania were the only exceptions, where returns were the second best over this period, while in Queensland and NSW return on assets was the highest in a over decade. This helped improve the health of many farm businesses and several factors, including strong market fundamentals and lower fodder and water costs, suggest this momentum can be maintained.

Another factor likely to underpin farm profit expectations is Australia’s stagnant milk pool. Milk production to October was down 2.9% compared to 2020/21, and production growth this season is now looking increasingly unlikely. This has further intensified competition for milk amongst processors as evidenced by the latest milk price step-ups issued by Saputo Dairy Australia and Fonterra Australia. This competition for milk supplies bodes well for the season ahead and is likely to underpin farm profitability.

From a regional perspective, Queensland’s milk pool is well placed for growth this year. Generally favourable seasonal conditions, a relatively high farmgate milk price and reasonable access to affordable feed continue to buoy sentiment in the state. NSW milk production is also forecast to increase, given the significant amount of affordable high quality feed available and a growing milking herd. Meanwhile, farmers in northern Victoria are enjoying a good season and with plenty of water available, many have increased feed and irrigation reserves. This is expected to boost per-cow yields in the region.

Drier weather in South Australia (SA) created concern about fodder prospects, however, improved moisture in October boosted the outlook and increased supplementary feeding may deliver a slight uptick in production this year. In comparison, wet and cold weather has weighed on milk volumes in western Victoria, Gippsland and Tasmania. Some farmers have chosen to let cows back onto paddocks intended for silage, and given poorer quality and weather damaged feed, per-cow yields have fallen. Likewise, fodder production has been delayed in WA due to heavy rain. Cold weather has hindered pasture growth and a delayed harvest has seen farmers engage in less supplementary feeding, impacting milk production.

While weather forecast suggests more rain this summer, many factors appear quite supportive for the dairy industry heading into 2022. Muted global supply growth combined with robust demand continue to underpin commodity prices and locally sales of dairy products remain strong. As Australia’s national milk pool is unlikely to grow this season, strong competition for milk is also expected to remain a feature of the processing landscape going forward. All in all, while we can expect more overcast days ahead, the outlook for farmgate profitability appears much brighter.
MILK PRODUCTION

WET WEATHER WOES

With generally higher farmgate milk prices, plentiful pasture growth and some lower input costs, the scene was set for modest milk production growth this season. While conditions remain supportive for farmgate profitability, this is yet to translate to an increase in Australia’s national milk pool.

Production has steadily declined during the first four months of the year, lagging behind 2020/21 volumes by 2.9% this October. Seasonal conditions have contributed to this sluggish start, but with summer quickly approaching, will warmer temperatures pivot the current production trajectory?

This winter proved to be the wettest since 2016, with above average rain in many dairy regions. Heavy rain fell across Victoria, Queensland, southern South Australia (SA), inland New South Wales (NSW), parts of Tasmania and Western Australia (WA). Spring was also wetter than average in much of eastern Australia; alongside flooding and waterlogged paddocks, several storms resulted in cooler temperatures in southeastern parts of the country.

In late November, the Bureau of Meteorology announced that a La Niña had formed in the tropical Pacific and as such, forecasts a wet summer ahead. Above average rain is predicted for much of eastern Australia, and in combination with already very wet soils, this has heightened the risk of widespread flooding. All in all, it seems as though the rain will continue to fall.

So far, wet weather has supported pasture growth and many farmers are yet to start irrigating. Cows continue to graze on paddocks, however feed quality has been poor in some parts of the country.

This has especially been the case in Tasmania and Victoria. Several cold fronts have dented per-cow production and as a result cow-yields are down in southern Australia this season.

Seasonal conditions have also created a ‘silage divide’ between northern and southern Australia. Warmer temperatures and relatively favourable weather have allowed for a significant amount of silage to be produced in Queensland. While less silage has been made in NSW this season, plenty remains in store and the region is well stocked for the year ahead. A lot of good quality silage has also been produced in northern Victoria. Many farmers in this region are actively working to bolster supplies and with plenty of affordable irrigation water available, the region is well placed to further boost feed reserves. In comparison, silage production is behind schedule in Gippsland, western Victoria, Tasmania and WA, with many farmers unable to make silage between rainfall events. As a result, some farmers have let cows back onto designated paddocks, aiming to produce pasture hay instead once the rain abates.
Less hay is anticipated to be produced this season, as rain continues to interrupt harvesting and fodder will require significant drying time before baling, due to the damp ground.

There is already an abundance of weather damaged product available, but it will be difficult to source good quality cereal hay in some regions. Nevertheless, with a significant amount of fodder in store and plentiful pasture growth the cost of purchased hay remains subdued.

On the flip side, Australia is on track to produce the second largest wheat harvest on record. The wet winter has seen the cropping season off to a great start in WA and some northern regions and yield prospects are strong. However, more rain at this point risks impacting the quality of the grain. According to industry sources, worsening quality is most likely to present challenges for export markets and could see greater volumes discounted on the domestic market this year. Despite significant local production, the cost of wheat remains elevated. Droughts in the northern hemisphere and less exportable products from other regions, have seen global grain prices surge. As international values look set to remain firm, local price pressures are likely to continue into next year.

Other input costs have also risen this spring, with fertiliser prices especially surging. A global shortage combined with strong demand and skyrocketing shipping costs have seen Australian prices increase. The recent energy crisis in Europe and China is likely to further constrain fertiliser and roundup supply, as plants are forced to shut production. Additionally, new rules in China and Russia aimed to restrict fertiliser exports will also tighten supplies.

As a result, prices are expected to remain high for the foreseeable future.

In addition to mother nature, labour shortages remain a recurrent feature of the production slow down. The shortage of farm workers in Australia has resulted in severe competition between agricultural industries to secure staff. This is pushing up labour costs at a time when finding staff remains challenging. While the re-opening of international borders may provide some relief next year, several farmers have for now chosen to diversify away from dairy or reduce stocking rates to navigate this issue.

At the same time, beef prices continue to rise, making culling more attractive. According to saleyard data, the average carcass value has jumped 25% since the start of this season. With prices reaching new records, many farmers continue to make the choice to cull, taking advantage of strong returns. Data indicates that culling has increased 39% since the start of 2021/22, compared to the year prior. This will delay any rebuild of the national dairy herd.
While 2020/21 proved to be one of the most profitable seasons in recent times, according to data from the DFMP, 9% of farmers chose to leave the industry. Firm land values and record beef values are key drivers behind this elevated rate of exits, and industry contacts suggest more farms have sold this year. This will present challenges for the dairy industry long-term.

Many factors, including a higher farmgate milk price and pasture growth, support ongoing profitability this season and farmer sentiment remains strong. Nevertheless, milk production growth is yet to eventuate. Wet and cold weather, especially in southern Australia, has impeded milk flows to-date. Additionally, labour shortages present ongoing challenges, while strong returns for other agricultural products and firm land and beef prices continue to drive culling and farm exits. These factors are negating otherwise profitable conditions and as such, growth in Australia’s national milk pool in 2021/22 is now looking increasingly unlikely, despite warmer days ahead.

SO WHAT?

Following a year of close to record returns, the performance of many dairy farm businesses is stronger than ever. In the past, profitable conditions have usually resulted in an increase in milk production, however this year it has not been the case. Wet and cold weather present a challenge to growth, while ongoing farm exits and culling continue to weigh on the rebuild of the national herd. During a season with otherwise profitable conditions, it is important to distinguish between a stagnant milk pool and overall farm business health.
The 2020/21 season proved profitable across most dairy regions in Australia. In Victoria, dairy farmers reported the most substantial returns since 2013/14. This was primarily due to relatively strong farmgate milk prices, favourable seasonal conditions and lower input costs.

In 2021/22 farmgate milk prices appear to be around 7% higher on average compared to last year. In several dairy regions, seasonal conditions have been reasonably kind so far, albeit in others it has been too wet. This, combined with solid cattle prices, is likely to see considerable income on many dairy farms. However, climbing input costs may be shrinking the profit margin many hoped to again see this season.

The input costs that are likely to have the most significant influence on margins are grain and fertiliser prices. At the time of writing, nitrogen-based fertilisers had roughly doubled in price since the start of 2021, while grain prices increased around $66 per tonne since last season, despite significant local supply. There is also no indication that these inputs prices have finished their upwards trajectory. Other costs such as chemicals, fuel and labour have also increased, however, they alone are not likely to significantly affect the profitability of many farms this year.

Using last year’s average of all farms involved in the DFMP in Victoria, adjustments have been made to costs and income settings, to assess the net impact on profitability in 2021/22. This exercise assumes that seasonal conditions, cow numbers and milk production remain constant and the way the farm is managed stays the same. For example, the level of concentrate feeding and tonnes of fertiliser applied are unchanged. In reality, most farm managers will adjust input usage to suit changing conditions.

The significant changes made to the budget for 2021/22 are:
- Milk price increased by 7% ($6.87 kg MS to $7.35 kg MS)
- Livestock sales income increased by 5%
- Electricity price increased by 5%
- Fertiliser costs increased by 90%
- Purchased water prices decreased by 40%
- Purchased fodder and fodder harvesting costs have not been changed
- Purchased concentrates increased by $66 per tonne of dry matter
- Pasture improvement costs increased by $5,000 due to higher chemical costs
- Fuel prices increased by 20 cents/litre
- All overhead costs, including labour but excluding repairs and maintenance, have been increased by 5%

The results show that income has increased by $107,501 (6.7%) while costs have increased by $142,028 (10%) or a decrease in net cashflow of $34,527 (19%).
## Table 1 Victorian DFMP ‘average’

<table>
<thead>
<tr>
<th>Farm Business Summary</th>
<th>2020/21 Actual</th>
<th>2021/22 Predicted</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Physical Parameters</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Usable Area</td>
<td>ha</td>
<td>278</td>
</tr>
<tr>
<td>Milking Area</td>
<td>ha</td>
<td>278</td>
</tr>
<tr>
<td>Cows Milked</td>
<td>Number</td>
<td>373</td>
</tr>
<tr>
<td>Annual Stocking Rate</td>
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<td>1.3</td>
</tr>
<tr>
<td>Milk Production - Litres</td>
<td>Total Litres</td>
<td>2,657,030</td>
</tr>
<tr>
<td>Milk Production - Kg Milksolids</td>
<td>Total Milksolids</td>
<td>206,153</td>
</tr>
<tr>
<td>Homegrown Feed - Milking Area</td>
<td>t DM / Milking ha</td>
<td>7.9</td>
</tr>
<tr>
<td>Homegrown Feed - Usable Area</td>
<td>t DM / Usable ha</td>
<td>7.9</td>
</tr>
<tr>
<td>Proportion of Homegrown Feed</td>
<td>% of Diet</td>
<td>71%</td>
</tr>
<tr>
<td>Cows per Labour Unit</td>
<td></td>
<td>104</td>
</tr>
<tr>
<td><strong>Cash</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Milk Income</td>
<td>$</td>
<td>1,415,465</td>
</tr>
<tr>
<td>Total Farm Cash Income</td>
<td>$</td>
<td>1,590,549</td>
</tr>
<tr>
<td>Total Farm Working Expenses</td>
<td>$</td>
<td>1,074,334</td>
</tr>
<tr>
<td>Farm Operating Cash Surplus</td>
<td>$</td>
<td>516,215</td>
</tr>
<tr>
<td>Finance Costs (Interest &amp; Lease)</td>
<td>$</td>
<td>92,086</td>
</tr>
<tr>
<td>Net Farm Cash Flow Before Tax and Drawings</td>
<td>$</td>
<td>177,731</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Farm Gross Income</td>
<td>$</td>
<td>1,590,549</td>
</tr>
<tr>
<td>Total Variable Costs</td>
<td>$</td>
<td>773,832</td>
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<tr>
<td>Total Overhead Costs</td>
<td>$</td>
<td>467,965</td>
</tr>
<tr>
<td>Cost of Production (includes inventory changes)</td>
<td>$</td>
<td>1,241,797</td>
</tr>
<tr>
<td>Total Costs</td>
<td>$</td>
<td>1,241,797</td>
</tr>
<tr>
<td>Earnings Before Interest and Tax (EBIT)</td>
<td>$</td>
<td>348,752</td>
</tr>
<tr>
<td>Finance Costs (Interest &amp; Lease)</td>
<td>$</td>
<td>92,086</td>
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<tr>
<td>Net Farm Income</td>
<td>$</td>
<td>256,666</td>
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<tr>
<td><strong>Wealth</strong></td>
<td></td>
<td></td>
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<tr>
<td>Return on Total Assets (ROTA)</td>
<td>%</td>
<td>5.1%</td>
</tr>
<tr>
<td>Equity as % of Owned Assets</td>
<td>%</td>
<td>73.0%</td>
</tr>
<tr>
<td>Return on Equity (ROE)</td>
<td>%</td>
<td>6.0%</td>
</tr>
<tr>
<td>Change in Net Worth</td>
<td>$</td>
<td>139,770</td>
</tr>
</tbody>
</table>
All things being equal, except for changes to key input and output prices, returns for the average farm are expected to ease in 2021/22 as a result of higher input costs. Nevertheless, a robust profit is still likely. On top of this, most dairy regions will not experience the same seasonal conditions and many will tinker with their management to adapt to changes in circumstances.

Tinkering can become a double edged sword. In a year where key inputs costs are high, the response most managers will consider is to reduce input usage. In 2021/22 the two inputs many farmers will consider cutting are concentrates and fertiliser. This will be carefully balanced against not wanting to diminish these inputs to the extent that the output value is reduced by more than the value of the inputs. For example, if taking out a kilogram of concentrate saves $0.45 but milk production decreases by 0.075 kg Milk Solids (MS) which would be sold for $7.00 kg MS, this would result in income being reduced by $0.52 to save $0.45 or lowering profit by $0.07. For most farms, it will involve some experimentation to determine how much (if any) concentrate can be taken out of the diet without altering incomes by more than the cost saved. This will likely be different for each farm, and for some, the optimal result will reduce production — weighing on industry growth even during an otherwise favourable season. Similar considerations apply to fertiliser use, which will be a focal point for managers balancing rising costs against incomes.

**SO WHAT?**

Generally higher farmgate milk and cattle prices will help to absorb a significant increase in critical inputs this season. As long as seasonal conditions remain favourable, returns on most dairy farms should be similar to 2020/21. With higher input and output prices, farmers will be giving careful consideration to input levels in trying to maximise returns. This is a complex balance as care needs to be given so that cutting inputs does not reduce income by more than the costs saved. For some farmers, the most profitable settings will mean lower milk production. This is likely to weigh on overall growth prospects this season.
MARKET DASHBOARD

Commodity prices

Figure A1 Key dairy commodity price indicators

Source: Dairy Australia

Figure A2 Dairy fat and protein — pricing relative to substitutes

Source: Dairy Australia, Oil World

Global supply and demand

Figure A3 Milk production year-on-year changes

Source: AHDB, Dairy Australia, DCANZ, Eurostat, USDA

Australian market

Figure A5 Australian retail sales

Source: Dairy Australia calculation based in part on data reported by NielsenIQ through its Homescan Service for the total milk, cheese, yellow spreads, and yoghurt categories to 12 Jun 2021 and 10 Oct 2021, for the Total Australia market, according to the NielsenIQ standard product hierarchy. Copyright © 2021, Nielsen Consumer LLC.

Exports to key markets

Source: Dairy Australia, TDM. Data represents 12-months to August 2021.
### Fertiliser

<table>
<thead>
<tr>
<th>Urea (granular Black Sea)</th>
<th>DAP (US Gulf)</th>
<th>MOP (granular Vancouver)</th>
</tr>
</thead>
<tbody>
<tr>
<td>613 US$/t</td>
<td>673 US$/t</td>
<td>221 US$/t</td>
</tr>
<tr>
<td>↑ +150% LY</td>
<td>↑ +88% LY</td>
<td>↑ +9% LY</td>
</tr>
<tr>
<td>↑ +89% 5Y</td>
<td>↑ +64% 5Y</td>
<td>↓ -1% 5Y</td>
</tr>
</tbody>
</table>

Price is October 2021 average, compared to the October 2020 average (LY) and 5-year (5Y) October average.

Source: World Bank

### Cows

**Cull cows**
- 740 c/kg
- ↑ +30% LY
- ↑ +60% 5Y
- 72,638 head
- ↑ +8% LY
- ↓ -2% 5Y

**Dairy cattle exports**
- 85,981 head
- ↓ -7% LY
- ↑ +11% 5Y

Price is October 2021 average, compared to October 2020 (LY) and 5-year (5Y) average. Number of head is last 12 months (cull cows to October 2021, dairy cattle exports to September 2021) compared to year earlier (LY) and 5-year (5Y) average.

Source: NERS, ABS

### Water

**Northern Victoria**
- 101 $/ML
- ↓ -46% LY
- ↓ -60% 5Y
- 2,408,923 ML
- ↑ +7% LY
- ↑ +5% 5Y
- 14,087

**Murray Irrigation System**
- 80 $/ML
- ↓ -51% LY
- 169,048 ML
- ↑ +25% LY
- ↑ +22% 5Y

**Monthly average (12 months)**
- 111 $/ML
- 200,744
- 111 $/ML
- 14,087

Price of water traded is October 2021 average compared to October last year (LY) and 5-year (5Y) average. Volume of water is 12 month total, to October 2021, and compared to same period last year (LY) and last 5 year (5Y) average. Monthly average is the average price and volume over the past 12 months to October. Northern Victoria prices are averaged from three key trade zones, details can be found in the monthly Production Inputs Monitor report: dairyaustralia.com.au/industry-statistics/industry-reports/production-inputs-monitor

Source: Victorian Water Register, Murray Irrigation Ltd.

For ongoing information and updates on farm inputs, readers can subscribe to Dairy Australia’s weekly Hay and Grain Reports, or the monthly Production Inputs Monitor, found on the Dairy Australia website dairyaustralia.com.au/industry-statistics/industry-reports/production-inputs-monitor

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