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The Japanese Beef Market and Australian Competition

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Report Highlights:

This report combines the perspectives of AgTokyo and AgCanberra on the Japanese beef market. Further information can be found in the recent GAIN reports JA5053 and AS5027. The eventual resumption of North American beef into the Japanese market will have a profound effect. The market has not recovered to 2001 levels due to prolonged high prices and limited availability of preferred cuts and Australia has moved aggressively to fill the void left by the ban on US imports. The resumption of North American beef trade may risk triggering of the safeguard.

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SUMMARY:

The eventual resumption of North American beef into the Japanese market will have a profound effect. Beef supplies in Japan continue to be below 2003 volumes. Consumption has not recovered due to prolonged high prices and limited availability of preferred cuts. The resumption of North American beef trade may risk triggering of the safeguard.

Australia has increased its exports to Japan as well as its feedlot capacity, and cattle on feed numbers are expected to continue to increase. Australian exports to destinations other than the Japan, the U.S. and Korea have fallen. A large portion of Australian beef is imported into Japan on a full-set basis, which in 2005 resulted in a surplus for some less popular cuts such as round. The surplus may also begin to affect the domestic market in 2006 as round cuts are unpopular among consumers whose general preference runs to cuts such as chuck, short plate, short rib, and loins.

These surpluses show that one of the U.S. beef industry's strongest marketing advantages was its ability to provide large quantities of specific grain fed cuts to meet the particular market preferences of Japan. Japanese trade contacts suggest U.S. companies should focus on supplying specific cuts such as short plate and other items for beef bowl and grilling and avoid full or semi-full sets. Industry sources are not expecting large quantities of these types of cuts to be available initially in 2006 despite the expected reopening of Japanese market to US beef. US supplies are expected to be somewhat limited by the requirement limiting exports to animals 20 months of age or younger,

JAPANESE MARKET SITUATION

In 2004, Japan's total beef supply dropped 14% from the preceding year to 1.268 million metric tons (MMT), largely due to a 24% drop in imports to 645,000 MT as a result of the detection of BSE in the U.S. Australia and New Zealand increased exports but were only partially able to make up the US volume. This beef supply deficit is expected to remain a problem in the future with projections of 11% below (1,311 MMT) in 2005 compared to 2003 level.

Australia and New Zealand are expected to maintain the majority of the beef import market through 2005. According to Meat Livestock Australia (MLA) statistics, Australia boosted its grain fed beef exports (chilled and frozen combined) to Japan for January – July 2005 by 22 % (113,561 MT PWE). This accounted for a 46% share of total shipments and a 5% share increase compared to the previous year.

Total beef imports, including prepared and processed products, for 2005 are forecast to increase 12% from a year ago to 721,000 MT (up 11% for beef at 685,000 and up 29% for prepared and processed products at 36,000 MT). Australia is expected to capture 90% of this market with New Zealand accounting for 9%. Of the prepared and processed products category, the two major suppliers are China and Australia, with China projected to nearly double the volume at 10,000 MT.

Market prices, particularly at the wholesale level, soared in 2004, but appeared to have begun cooling down after reaching a peak during the first half of 2005. The average price of representative imported cuts, for Aussie full set/short grain fed (chilled, boneless) was 5% lower at 855 yen per kilogram for the first half 2005 compared to the same period last year, while the price for full set/grass fed (chilled) was also 4% lower at 722 yen per kilogram. Prices for Australian grass fed trimmings (frozen – mainly for hamburger patties), which are used for ground beef, rose 2% to 434 yen per kilogram.

On the retail front, prices continue to rise. Retail beef prices have remained high for the first half with domestic cuts such as sirloin (from dairy breeds) reaching a record high price of over 700 yen (\$6.36) per 100 grams. In comparison, Aussie chilled sirloin (grain fed) is sold at about 400 yen (\$3.63) per 100 grams at retail. The high prices are forcing the average consumer to either buy less expensive cuts or eat beef less frequently.

After a drop in 2004, total domestic beef consumption started bouncing back in 2005 and is projected to increase 4% from last year's level to 1.221 MMT, mainly reflecting increased imports. During the first half

of 2005, despite high market prices, a modest increase was evident in the household sector partly helped by increased availability and sales of Aussie chilled grain fed cuts. However, there has been some sluggishness reported in the food service and prepared food businesses due to the lack of availability of specific cuts and high prices.

Domestic Beef Production Forecast to Decline in 2005 - 2006

Japanese cattle inventories are expected to continue their gradual, but continuous decline to 2.7 million head in 2005 allowing for a slow increase of imports in the future. Also, the reduced number of calves born in 2004 – 2005, particularly dairy calves (Holstein steers, and F1 cross breed steers and heifers) will likely lower the total slaughter for beef in CY 2005, CY 2006.

2006 Import Demand Hinges on Import Resumption of U.S. and Canadian Beef

Specific import restrictions for U.S. beef will not be known until after the Food Safety Commission (FSC) review is completed. However, Japanese importers are aware that the supply of US beef will be dependent on the following measures: 1) the number of animals that can meet the 20 months of age or younger requirement of the Export Verification program (EV), 2) demand from other Asian countries as additional bans are lifted, and 3) cost of imports based on the potential implementation of the beef safeguard (SG) as well as the current foreign exchange situation.

Assuming that U.S. and Canadian beef are being imported, there is a good chance that total beef imports (generic) for April – June 2006 will exceed the trigger levels resulting the SG from August 1, 2006 for both chilled and frozen beef though March 31, 2007. An artificial tariff hike from 38.5% to 50% (bound duty), if imposed, will likely hamper the recovery of beef consumption and hurt the retail and food service sectors as well as consumers.

AUSTRALIAN SITUATION

Australian beef exporters are wary of the possibility of a significant reduction in demand and prices for beef in 2006, with expectations of resumption in trade of U.S. and Canadian beef to North Asian markets. The industry now anticipates a larger price impact than previously forecast in part because the U.S.-Japanese beef import protocol will likely include U.S. beef from USDA A40 grade cattle. The industry is also watching the Korean market to see if cattle less than 30 months of age (per OIE guidelines) will be accepted, rather than beef from cattle less than 21 months. Trade sources report both Japan and Korea are reducing stocks in anticipation of the re-entry of North American beef.

According to Meat and Livestock Australia (MLA), the Australian beef and cattle industry is more vulnerable to a major price decline now than at any time in the past 3 decades. Australia's current record beef and cattle prices are currently dependent on four major markets (domestic, Japan, Korea and the U.S.), which account for 95 percent of Australian production. Any decline in demand in these markets will have a resounding impact on Australian prices.

Australian exports to other markets have fallen over the past couple years, particularly to traditional markets such as South East Asia, Hong Kong and China. Australian trade sources report significant inroads have been made by South American, Chinese and New Zealand beef exporters in a number of markets including Taiwan, Hong Kong, the Philippines, Indonesia and the Middle East. Further, exports to more minor markets are expected to remain low over the next few years.

Expansion of Cattle on Feed Expected to Continue: In Australia, both national feedlot capacity and numbers of cattle on feed reached record levels this year, and further increases are likely over the next few years. The feedlot sector expansion has been driven by growth in the Japanese market and in domestic demand for grainfed beef, both for export and from the domestic retail and foodservice sectors. Feedlot capacity now exceeds 1 million cattle, and further growth is expected over the next few years. The expansion in lotfeeding assisted the industry through the recent prolonged drought and was also encouraged by reduced grain prices over the past couple years. Grainfed cattle now account for about one third of beef production in Australia.

Australian exports to Japan were up significantly in 2005, with grainfed exports continuing to make gains. Trade in fullsets and all major cuts rose, with the sharpest expansion in brisket and manufacturing beef. MLA reports manufacturing beef trade benefited from increased hamburger sales, as Japanese consumers shifted from alternative fast foods such as bento boxes and gyudon. Further, grainfed trimmings proved to be a substitute for U.S. brisket in gyudon.

Australian Marketing Efforts in Japan:

MLA reports 2004 Nielson research on consumer perceptions of Australian beef in Japan indicate that Australian beef has a strong overall safety image, however, there is low recognition for testing, identification and traceability. The Australian industry believes it is important for Australian beef to be recognized for these attributes in order to differentiate itself from American beef in the Japanese market. Although Nielson research indicated that Australian beef had distinguished itself from U.S. product in safety aspects, it has not in terms of key taste and texture attributes.

JAPANESE MARKET FORECAST:

Japanese Investment in Australia

The Japanese import sector contacts suggest that Australia and New Zealand may have difficulty expanding their exports largely due to the limit in facilities for producing grain-fed cattle as well as their practice of full-set based trade (boneless).

Japanese beef import companies have had substantial business ties and investments in feedlots and meat packing business in both Australia and New Zealand for the past several decades. Because of these investments, these Japanese companies have the ability to adjust production and export decisions based on the cost operation in Australia and the price and availability of U.S. cuts under the EV program. One company, the largest Japanese meat packer, acquires roughly half of its current supply of Aussie beef from an operation it owns with the remainder coming from other slaughter plants. The company operation includes a feeding facility and a slaughter plant that harvests 600,000 head annually. Reportedly, the plant is not operating at full capacity but further expansion is not expected due to the high cost of feeder calves as well as uncertainty of the future demand for Australian beef once US beef returns to the market. (NOTE: Japanese importers are expecting that the return of U.S. and Canadian beef will cool down the feeder calf prices in Australia which could also affect their production decisions).

The company's feed lot operation typically buys 18 month-old grass-fed calves and then feeds them out for 4 – 6 months. Presently about 50% of the beef produced by the slaughter plant is then exported to Japan and the rest marketed to other Asian and Middle East markets. Prior to the ban on U.S. beef, only 35% of the production was destined for Japan and the company is prepared to adjust its export destinations based on market demand in Asia as well as the price and supply of US and Australian beef.

Japan Demands Specific Cuts:

A large portion of Australian beef is imported on a full-set basis, which in 2005 resulted in a surplus for some less popular cuts such as round. The surplus may also begin to affect the domestic market in 2006 as round cuts are unpopular among consumers whose general preference runs to cuts such as chuck, short plate, short rib, and loins.

These surpluses show that one of the U.S. beef industry's strongest marketing advantages was its ability to provide large quantities of specific grain fed cuts to meet the particular market preferences of Japan. Restaurants featuring offal variety meat (including tongues, intestines, hanging tender, skirt meat etc.) and short plate and short rib continue to suffer financially with many going out of business. This market is expected to remain important once U.S. beef trade resumes based on comments from importers who have expressed interested in buying specific grain fed cuts from U.S., rather than a full set or a semi-full set (a set without round cuts) once the trade resumes.

Australian expectations for export demand for its grainfed beef to remain strong in the coming years in Japan and Korea. MLA predicts the A40 USDA grade cut-off for U.S. exports to Japan is likely to restrict the ability of the U.S. to produce marbled beef to compete with medium- to long-fed Australian product. However, Australia does recognize that the resumption of U.S. trade is expected to have a negative impact on Australian sales of short-fed beef, particularly forequarter cuts, such as brisket, blade, chuck roll and short rib which are used in the food service sector.

Importer Demands:

Strategy wise, Japanese trade contacts suggest that U.S. companies should focus on supplying specific cuts such as short plate and other items for beef bowl and grilling and avoid full or semi-full sets. The US is expected to quickly regain its market within the restaurant sector, particularly among the beef bowl and barbecue restaurants who are desperate for additional beef supplies. The requirement of limiting exports to animals 20 months of age or younger is expected to severely limit the availability of specific cuts, at least until the industry has time to increase the number of animals with verifiable age. In the meantime, USMEF is distributing information on alternative cuts, which should help alleviate the demand for limited U.S. supplies.

Prior to the import ban in 2003, the majority of U.S. supplied cuts were used in the food service sector. [Note: the Japanese food service industry has repeatedly petitioned the government to raise the cut off age for testing of cattle to 30 months or younger in order to facilitate trade.] Retailers, particularly the major supermarkets, must restore confidence in US beef among its consumers before they will be able to fully resume sales. As a result, the retail sector is expected to require additional assurances from exporters, such as information on traceability or feeding and slaughter methods. Even before the 2003 import ban on U.S. beef, many importers favored Australian grain fed beef (particularly steaks and other high quality cuts) due its lower price and good image with consumers. Retailers did prefer U.S. beef for grilled (yakimiku) items such as sliced short plate or boneless short rib pack.

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