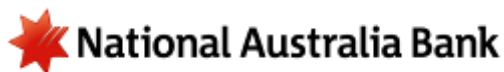


Economic report



Post-farmgate agribusiness survey

Vyanne Lai, NAB Agribusiness Economist

December quarter 2012

Post-farmgate business conditions surged

- **Post-farmgate agribusiness conditions lifted considerably in the December quarter to be moderately positive after three consecutive quarters of decline.**
- **Customer demand, availability of suitable labour and government policy and regulation to act as constraints.**
- **Medium-term expectations improved, translating into more bullish capital expenditure plans.**

Business conditions improved notably

After three consecutive quarters of recording negative results, the post-farmgate agribusiness conditions index has finally “crossed the line” into positive territory. This suggests that, on balance, more survey respondents reported good conditions than poor. Driving the result were increases across the three key components that make up the index: employment, trading and profitability, with the sharpest turnaround in employment conditions.

The overall improvement in conditions is consistent with improved confidence in agribusiness markets on the heels of the continuing rally in global equity markets and more positive news from some of Australia’s major trading partners (the US and China in particular). Export volumes have risen solidly in some markets such as lamb and beef as dry conditions have forced herd reductions, and this is likely to have helped meat processors.

Despite the improvement in conditions, agribusiness confidence remains deep in negative territory following a minor improvement of 3 points to -13, possibly reflecting weak expectations about orders, high and rising crop prices and adverse sentiment in poultry and sheepmeat.

Conditions improved but demand, suitable labour and government policies still cited as constraints

Consistent with the broader economy, sluggish demand continues to weigh on the post-farmgate agribusiness industry. According to the survey results, 56 per cent of survey respondents cited sales and orders as a constraint on output while 47 per cent of respondents cited demand as being the most constraining factor likely to impact on

profitability over the next twelve months. Availability of suitable labour also appears to be a major concern, albeit showing signs of alleviation, with 40 per cent of respondents citing it as a constraint on output while 6 per cent of respondents considered it to be the most constraining factor on profitability over the next twelve months. Also weighing on industry players’ minds are potential changes in government policies and regulations, which have become increasingly imminent closer to the federal elections, with 10 per cent of survey respondents regarding it as the most constraining factor on profitability in the coming twelve months.

Medium-term expectations remain robust

Post-farmgate agribusiness expectations for business conditions for the next 12 months remain positively resilient. 26 per cent of the respondents expect output or sales to increase moderately with 18 per cent expecting a significant increase. Similarly, expectations on profitability were also quite solid, with 37 per cent of respondents expecting an improvement in the next twelve months, marginally above the 36 per cent for the broader economy.

The largely optimistic outlook in conditions has translated into more bullish plans in terms of capital expenditure and expectations around forward orders.

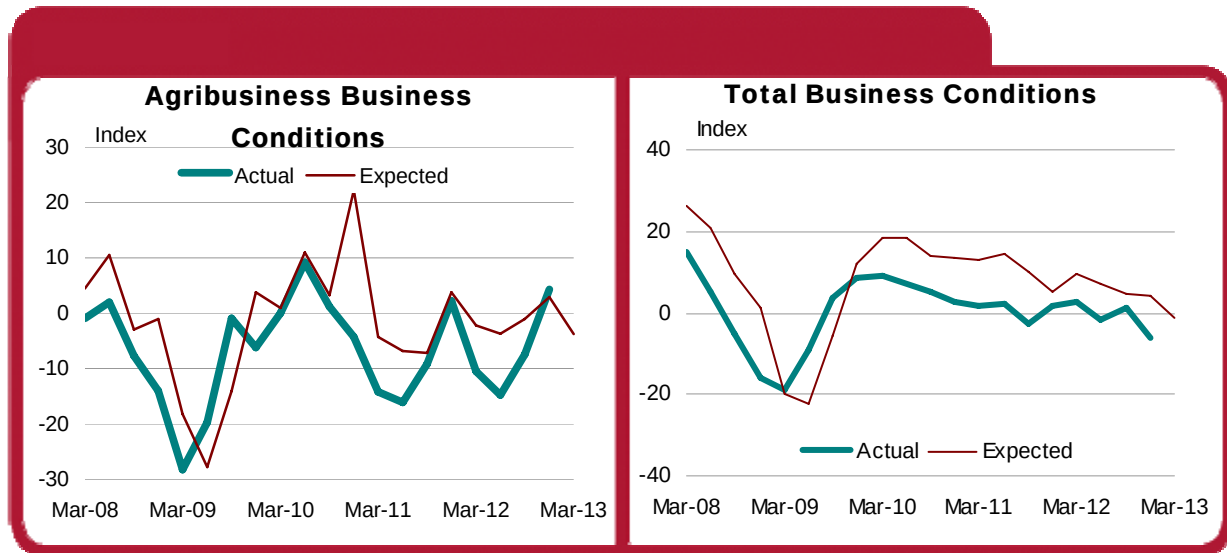
Key Survey Indicators

	Q2	Q3	Q4
Index	2012	2012	2012
Business Conditions	-15	-7	4
Business Confidence	-6	-16	-13
Trading	-19	0	10
Profitability	-16	-14	-3
Employment	-10	-9	6
Expected Conditions - 3 months	-1	3	-4
Expected Conditions - 12 months	13	16	13
Forward Orders	2	-9	5
Capacity Utilisation (%)	78.4	76.7	78.5
Capex Plans (Next 12 months)	10	5	6

Source: NAB Group Economics

Post-farmgate agribusiness conditions improved starkly

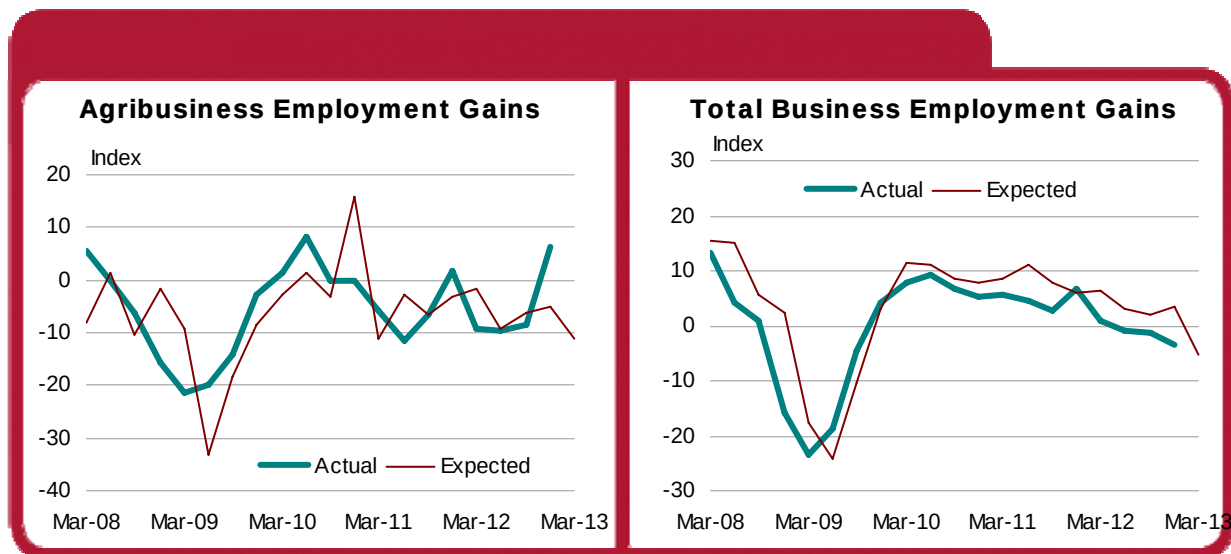
Post-farmgate agribusiness conditions have marched into positive territory in the December quarter. This means that, on balance, conditions were perceived by survey respondents as good or very good, relative to a negative result in September quarter which implied poor or very poor conditions reported on balance. Helping to drive the index were solid improvements in the employment and trading conditions indexes, which have climbed 15 and 10 points respectively, significantly higher than the levels six months ago. Concerns around profitability appeared to have notably ameliorated over the quarter as well, with a greater number of respondents reporting favourable conditions. However, expectations for the next three months are more pessimistic at -4 points, largely reflecting weakness in expected employment conditions.



Source: NAB Group Economics

Post-farmgate employment the main contributor to improved agribusiness conditions

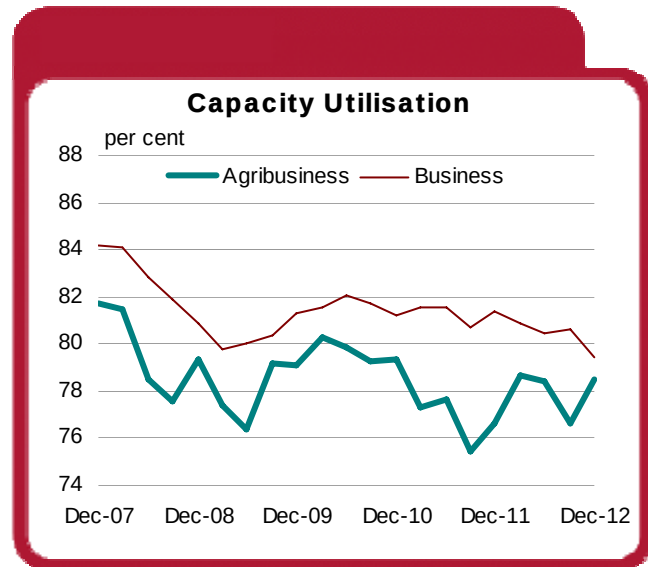
Employment conditions rose above expectations to record its first positive reading since a year ago, providing tentative suggestions that the labour constraint experienced by post-farmgate business might be ameliorating. The survey results showed that on balance, there are more respondents reporting an increase in hiring in the quarter compared to those which contracted their staff numbers. This is compared to the further worsening of employment conditions of total businesses as a whole. The three-month outlook is more cautious, however, with 79 per cent of respondents indicating that they are inclined to keep their employee numbers unchanged.



Source: NAB Group Economics

Capacity utilisation returned to long-run average

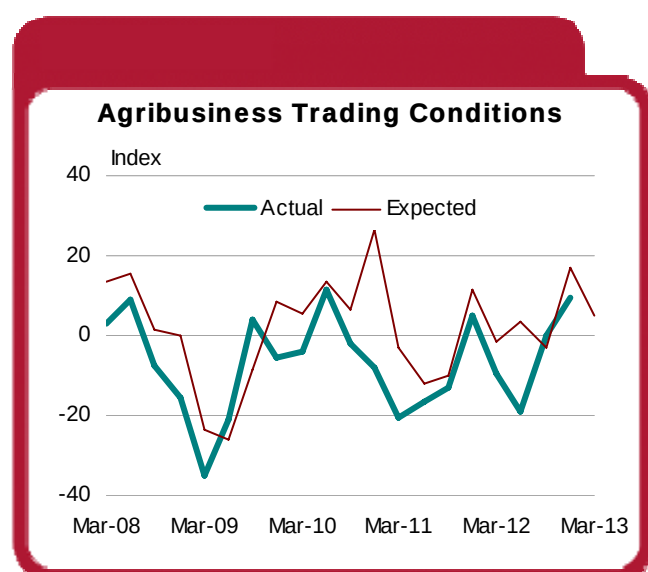
In line with improved forward orders (see below), capacity utilisation has ticked up in the December quarter to be at its long-term trend of 78.5 per cent. This is unsurprising considering that production and exports of processed meats were reported to be relatively strong in the quarter, assisted in particular by increased shipments to China ahead of the Lunar New Year. After discounting the impact of seasonality, improved fundamentals such as stronger demand from overseas importers and a lift in global confidence are likely to provide a support layer for production, hence capacity utilisation, in the medium term.



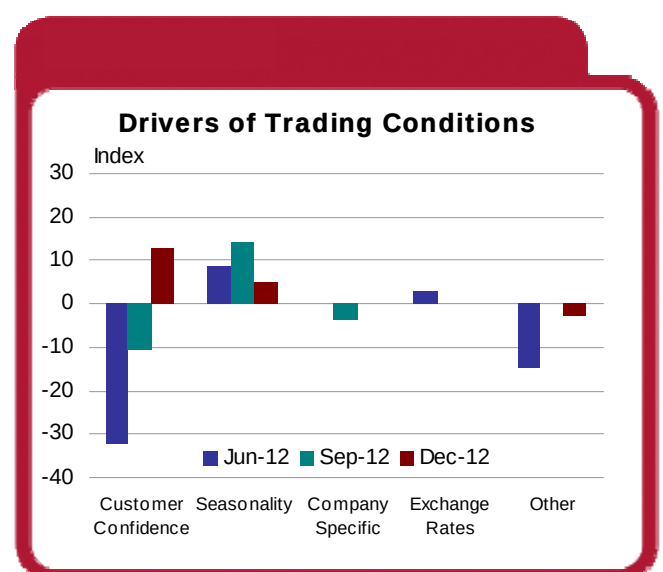
Source: NAB Group Economics

Trading conditions bounced back on improved consumer confidence

Trading conditions continued to leap forward in the December quarter, lifting from the neutral point of 0 to +10, the best reading since September quarter 2011. Consumer confidence was a major contributor in the quarter, largely reflecting a flow-through of a more upbeat global growth outlook, led by the economic recovery in the US. These results have likely been skewed, however, by wheat processors in the sample, who would have benefited from higher exports prices as global inventories diminished, leaving Australia and North America to account for the bulk of world exports. Dry conditions across Australia have also increased supply of livestock at saleyards, pushing prices lower, of which meat processors are major beneficiaries in terms of lower input costs.

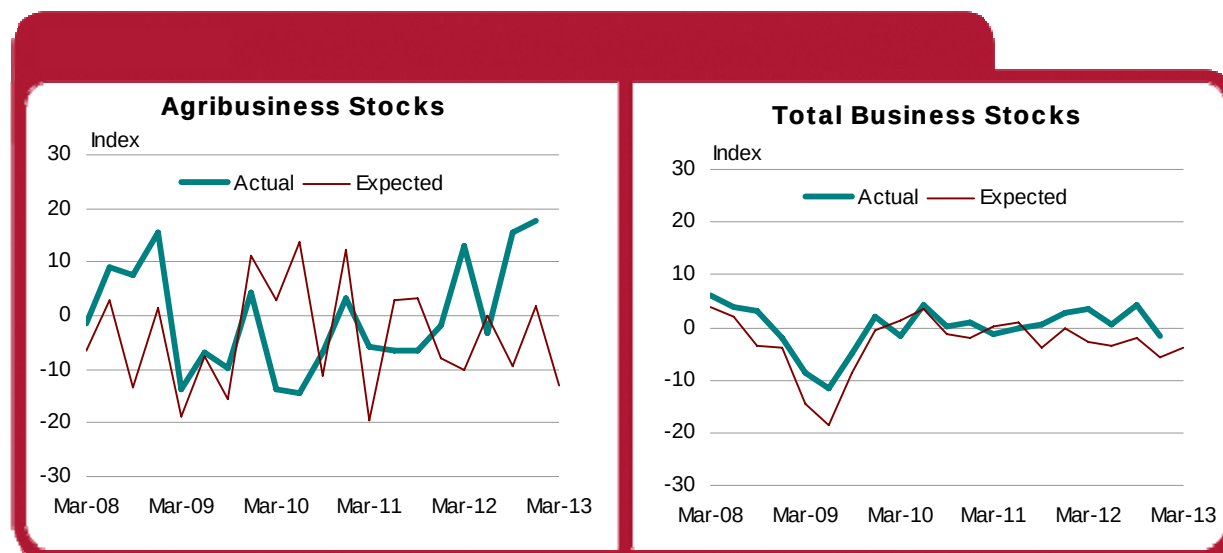


Source: NAB Group Economics



Stocks edged up further along with a higher intensity of production

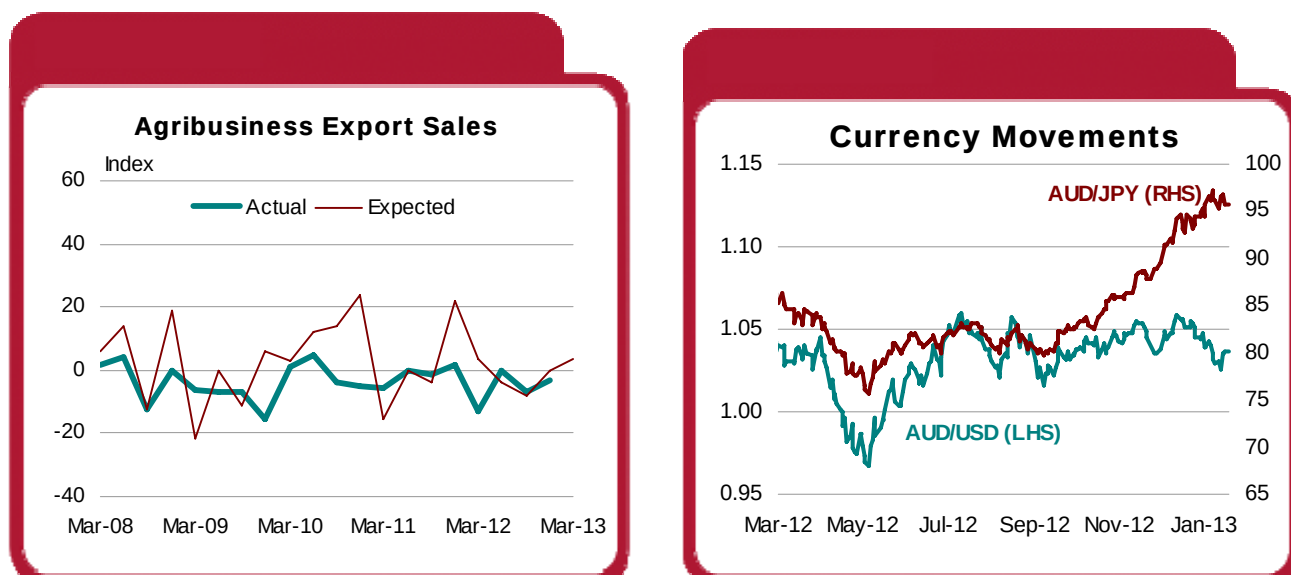
Consistent with a hike in capacity utilisation signalling an expansion in production, agribusiness stocks index in the December quarter increased by 2 points to +18 points, significantly above the expectations of just +2 points from a quarter earlier. According to the survey results, 38 per cent of respondents reported an increase in stock levels during the quarter relative to 16 per cent reporting a fall. When asked about future stock levels, respondents were much more pessimistic with the expectations index for March sitting at -13 points, which suggests that this is likely to be a phase of inventory rebuilding by businesses in response to more favourable cost conditions, after which a period of destocking will ensue.



Source: NAB Group Economics

Export sales remained subdued in December

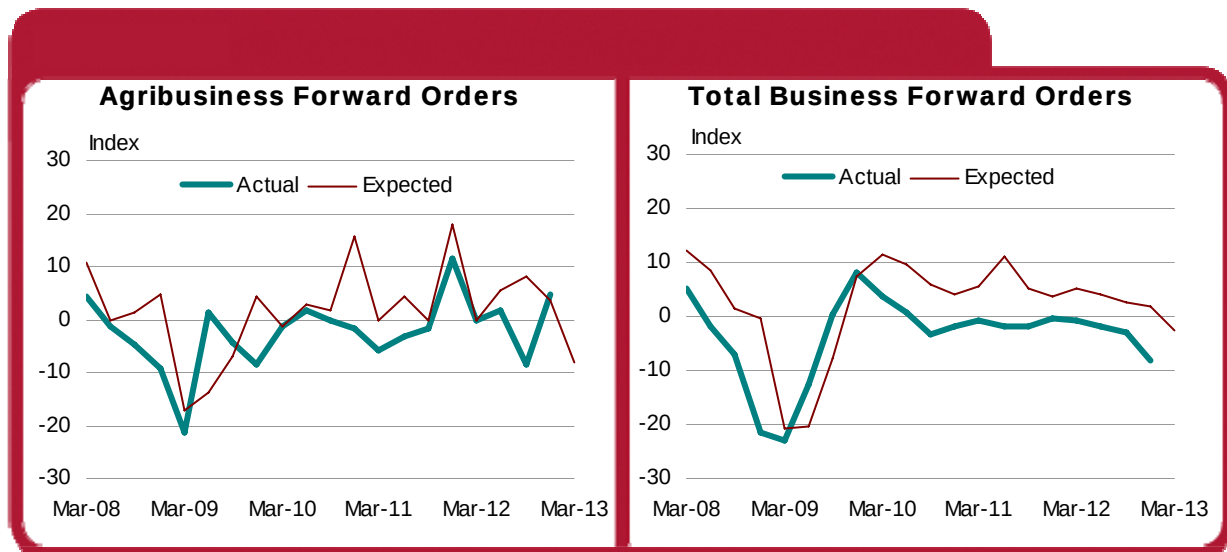
The stubbornly high AUD, although showing signs of moderation lately, is still weighing on export sales conditions, with the index still mired in negative territory at -3 points. According to the survey results, just 12 per cent of survey respondents reported an increase in export sales in the quarter while 19 per cent reported a decline. When asked about the quarter ahead, survey respondents were mildly optimistic on balance, with the expectations index for March up at +3 points.



Source: NAB Group Economics, RBA

Forward orders rebounded

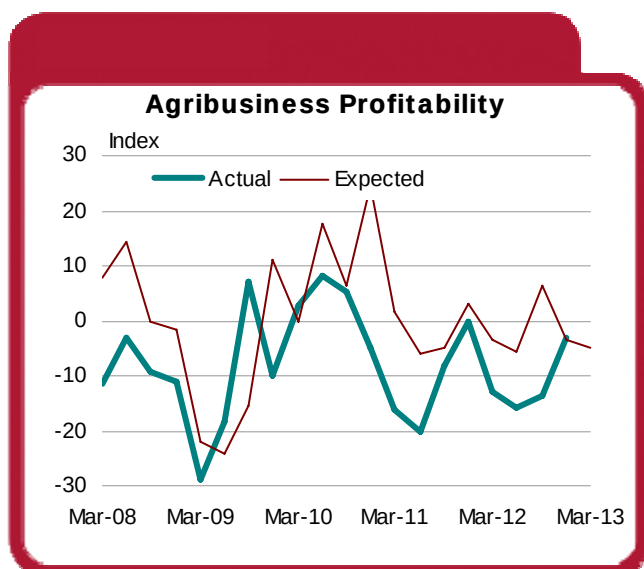
Forward orders from the customers of agribusinesses were up significantly in the quarter, with the index rising by 14 points to +5 points, perhaps reflecting the fact that customers taking advantage of low commodity prices for some major agricultural commodities. According to the survey results, 22 per cent of respondents reported an increase in forward orders while 13 per cent reported a fall. Survey respondents were more pessimistic for the March quarter, with the expectations index at -8 points, suggesting that on balance forward orders should fall in the next quarter.



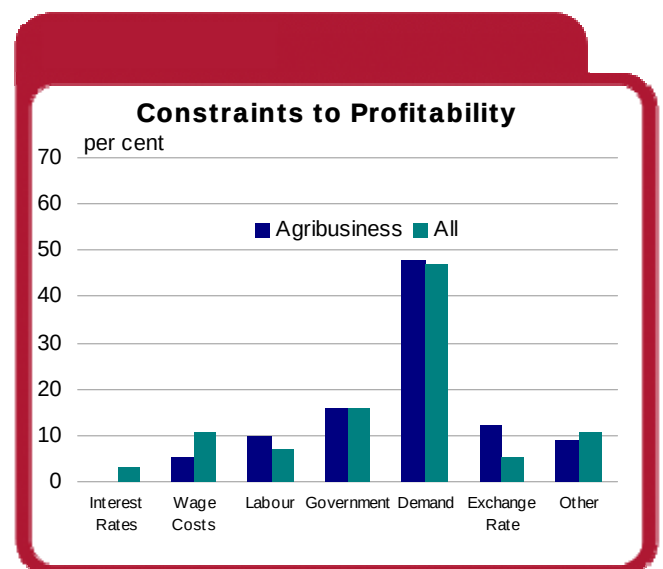
Source: NAB Group Economics

Profitability remains very much subdued

Lower input costs have helped stretch sales margins for a higher proportion of businesses this quarter, with post-farmgate agribusiness profitability ticking up, but remaining subdued overall still, up by 11 points to -3 points. According to the survey results, 30 per cent of respondents reported poor to very poor profitability while 29 per cent reported good to very good profitability. For the quarter ahead, survey respondents were a little more pessimistic, with the expectations index at -5 points. Consistent with the broader economy, demand conditions remain the key constraint to profitability. According to the survey, 47 per cent of respondents cited demand to be the most constraining factor on profitability over the coming twelve months.

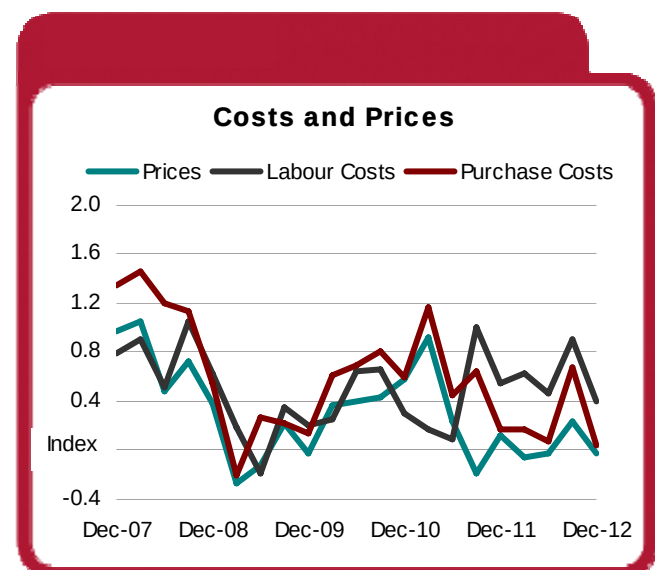


Source: NAB Group Economics

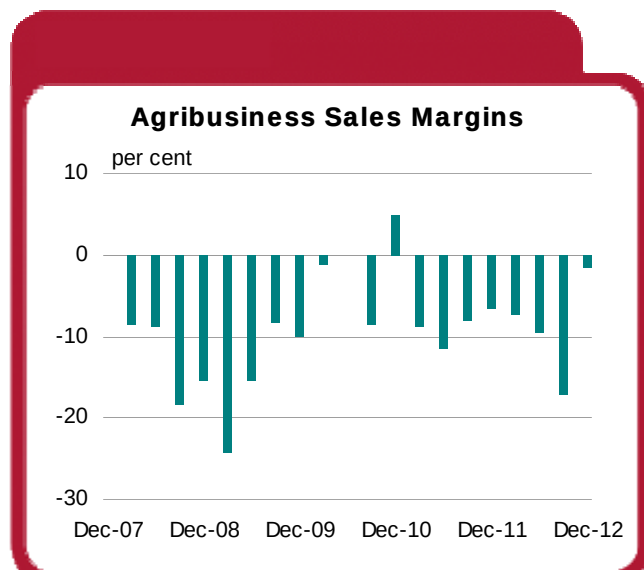


Sales margins improved in the December quarter

Sales margins enjoyed some reprieve in the December quarter, with an increased number of post-farmgate businesses reporting more favourable results. Prices of products fell marginally in the quarter, but they were more than offset by sharp falls in labour and purchase costs. The index rose to -2 points, the highest since December 2010. According to the survey results, 22 per cent of respondents reported an increase in sales margins compared to 24 per cent reporting a fall.

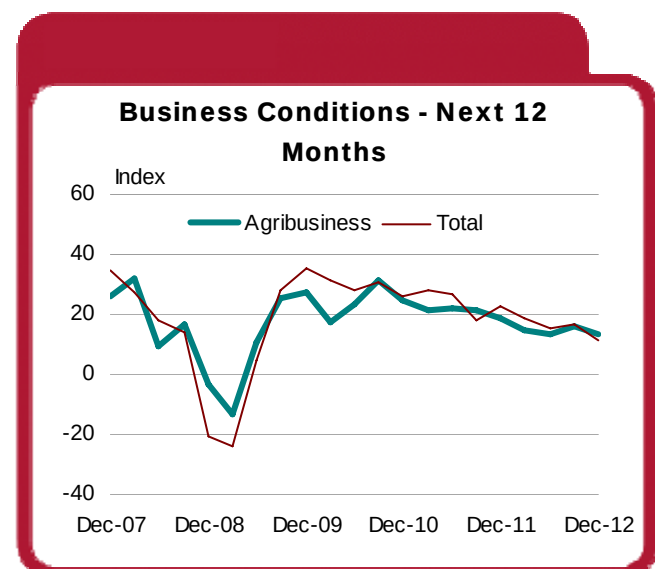


Source: NAB Group Economics

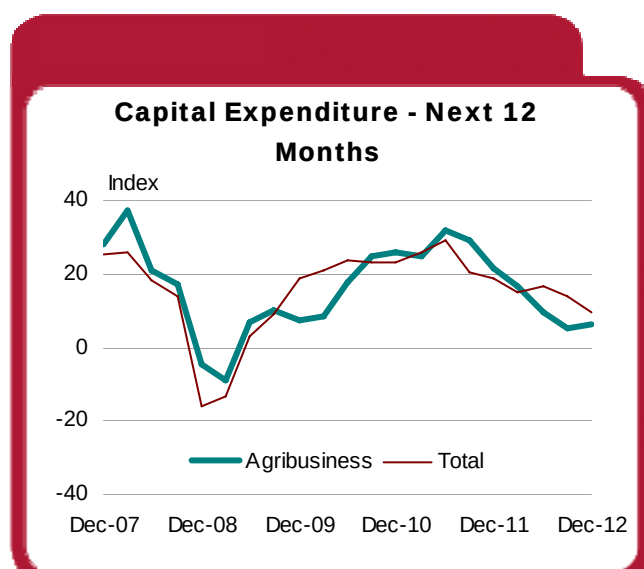


Long-term expectations softened but capex plans improved modestly

Medium term expectations within the post-farmgate agribusiness sector followed a similar trend to that of total businesses in December quarter, with the index for expected business conditions over the next twelve months moderating to +13 points. Interestingly, despite the fall in long-term expectations index, the index for expected capital expenditure over the next twelve months edged up marginally, after five consecutive quarterly falls.



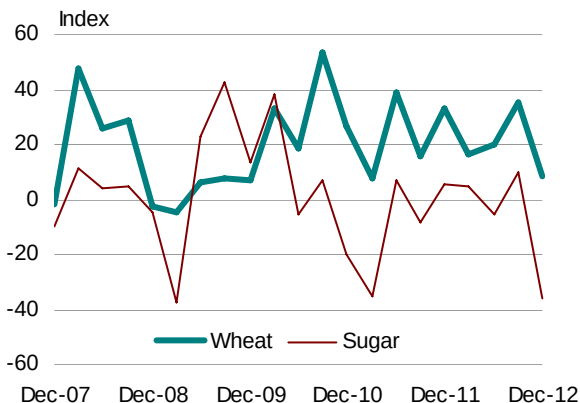
Source: NAB Group Economics



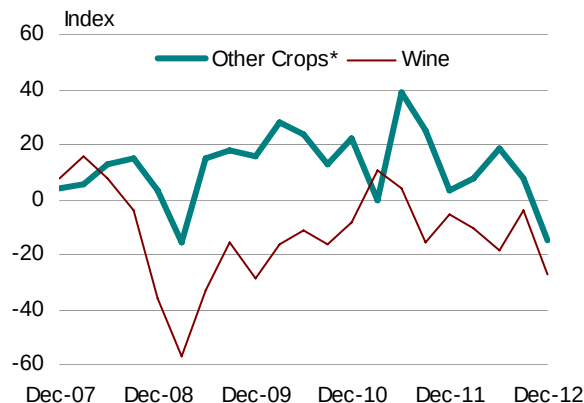
Agribusiness confidence in commodities and other supplies

Post-farmgate agribusiness confidence in crops had broadly deteriorated over the December quarter. Confidence in sugar was down significantly, with the index dropping to -36 points in the quarter from +10 points in the September quarter. This is perhaps not surprising against the backdrop of recent sharp falls in sugar futures prices due to surplus global production. Wheat fell sharply in the quarter as well to +9 points, likely due to the stabilising of wheat prices at high levels from rapid rallies leading to the December quarter. Echoing the falls in confidence were also other crops and wine. The confidence for other crops is the poorest result since March quarter 2009, and the first negative result since then.

Agribusiness Confidence in Crops



Agribusiness Confidence in Crops



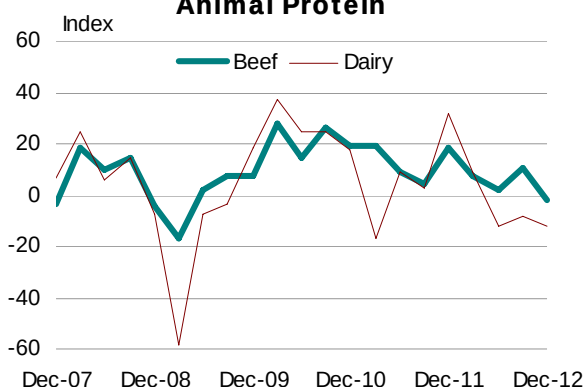
*Includes fruit, vegetables, fodder

Source: NAB Group Economics

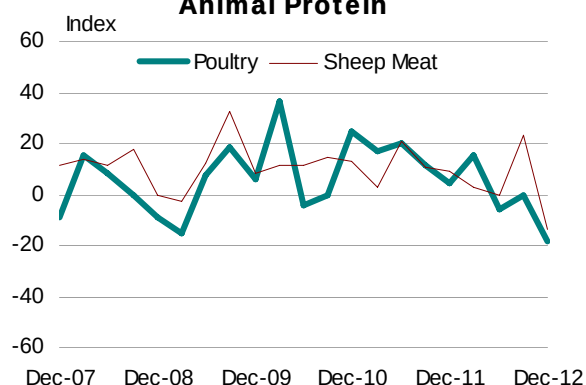
Unwinding some of the rises evident in the September quarter, post-farmgate agribusiness confidence in animal proteins was down across the board in the December quarter to all being in the negative territory. More than reversing last quarter's gain was sheep meat, which was down significantly with the index falling by 37 points in the quarter and hitting its lowest level since the start of the series in December 2006. This comes off as slightly surprising in the context of falling saleyard prices of sheep meat and robust export sales during the quarter hence could be just a function of the inherent volatility in the survey data. Similarly, confidence in poultry was also down notably, down by 18 points from being neutral to also be the lowest since the start of the series. The falls in confidence in beef and dairy were less severe, by 5 and 12 points to be at -2 and -13 points respectively.

Barring high volatility in the series, poultry meat, and to a lesser extent sheep meat, seem to be on a down trajectory in confidence levels, while beef is holding up relatively well. Rising costs of feed, which are borne by the poultry meat processors, are a contributing cause to declining confidence within the sector, while a generally strong export demand for Australian lamb and beef have helped to provide an underlying layer of support for confidence in those products. Confidence in dairy is the most volatile of all, but has also seen a sharp fall since December 2011, partly reflecting the recovery in dairy prices at farm gates.

Agribusiness Confidence in Animal Protein



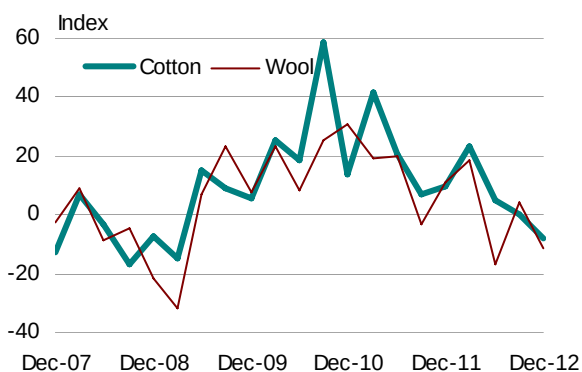
Agribusiness Confidence in Animal Protein



Source: NAB Group Economics

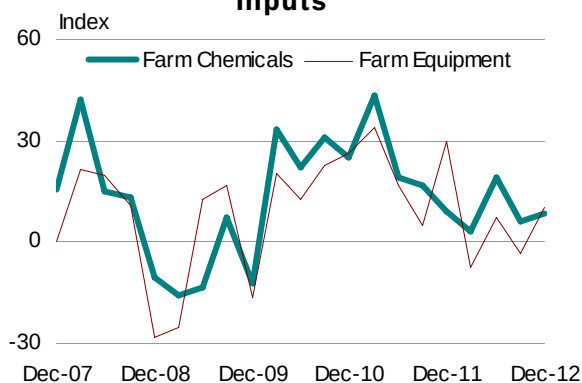
Confidence in fibres was broadly lower in the quarter, with indices for cotton and wool having now fallen into negative territory. This is consistent with the increases in the price of raw cotton and wool at farmgates recently, driven by the strong demand from China. The index for cotton fell 8 points from the neutral point while wool recorded a fall of 16 points to -12 points. Agribusiness confidence in farm input was broadly positive in the quarter, with increases in the confidence indices for both farm chemicals and farm equipment, settling at +8.3 and +10 points, respectively. The former is likely to reflect the current low prices of fertiliser inputs such as natural gas, urea and Diammonium Phosphate (DAP) while a sustained high AUD has helped to keep the purchasing costs of farm equipments, mostly imported, in check.

Agribusiness Confidence in Fibres



Source: NAB Group Economics

Agribusiness Confidence in Farm Inputs



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About the Agribusiness Survey:

The agribusiness survey is a cohort of the NAB Quarterly Business Survey which surveys approximately 900 small/medium to large sized Australian companies. The agribusiness sample is approximately 100 small/medium to large sized companies, mainly in the food manufacturing industry but also wholesaling, services, and a small number of firms in other sectors. Gundabluuey Research Pty Ltd mainly conducts the survey over a two-week period in the final month of each quarter. To ensure the highest possible accuracy, respondents to the survey are chosen at random from those firms with 40 or more employees.

Definitions

Business confidence is a measure of respondent's expectations of business conditions in their industry for the upcoming quarter. Business conditions are a simple average of trading, profitability and employment indices, reported by respondents for their company. The trading, profitability and other indices are calculated by taking the difference between the percentage of respondents nominating good or very good, or a rise and those nominating poor or very poor, or a fall. For example, if 25 per cent of respondents state that trading levels are good or very good and 10 per cent state these levels to be poor or very poor, the corresponding index of trading performance would be 15. The Capacity Utilisation Rate measures the degree to which an industry is operating at or below full capacity level. The full capacity rate is defined as the maximum desirable level of output given existing capital equipment. The Capacity Utilisation Rate is calculated as the average of respondents' capacity utilisation for the quarter. The cost and price change indices are the average of respondent's estimates of past and expected cost and price movements.

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