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Economic Report

Rural Commodities Wrap

Vyanne Lai, NAB Agribusiness Economist

June 2013

- **Global financial markets have taken a dive at the suggestions of the US Federal Reserve scaling back quantitative easing soon and the drying up of new stimulus initiatives by the Japanese government.**
- **The first half of 2013 has seen the continuation of very mixed trends across the big advanced economies and the anticipated Chinese economic acceleration has not eventuated.**
- **The weakness in Australian Gross National Expenditure suggests that the domestic economy is still mired in a soft patch with the immense impact of structural change becoming more apparent.**

Despite an uninspiring global back-drop, there was until recently a very strong run-up in global financial markets. Equity prices in the big advanced economies rose solidly between last November and mid-May and measures of market volatility were low. Since then share markets have fallen back and quite sharply in places like China, Japan, and to some extent, Australia as central banks around the world take a breather from injecting further liquidity into their economies.

Given that there is still little evidence that the long-awaited acceleration in global economic activity has commenced, the solid run-up in equity prices essentially reflected forward-looking expectations of stronger global activity and a response to the rounds of central bank policy easing which have boosted market liquidity. However, the more recent suggestions that the Chinese government is looking to rein-in credit growth, US Federal Reserve might scale back its quantitative easing (QE) program in the coming months and the lack of new policy stimulus from the Japanese government have rocked investors' confidence and sent the stock markets into disarray. Meanwhile, commodity markets remain shrouded in bearish sentiment.

The first half of 2013 has seen the continuation of very mixed trends across the big advanced economies and a synchronised turn upwards in the business cycle remains elusive. The Euro-zone remains in recession and we do not expect to see much growth there until the latter half of the year. The other advanced economies have been faring better with an upturn in Japanese activity that looks set to continue as the weaker yen boosts exports and Abenomics boosts confidence while the UK is also expected to continue growing slowly. The US has been the best performing of the big advanced economies but some of the recent partial data suggest that the pace of economic growth has slowed in the second quarter. The three big emerging market economies of China, India and Brazil are still driving around 1½ ppts of the total 3% global growth forecast for 2013 but they too have experienced a slowdown.

2012-13 Estimates, Rural Prices & Production

Commodity	Production	Price
Wheat	-29%	17%
Beef	2%	-14%
Dairy	-2.5%	4%
Lamb	4%	-14%
Wool	1%	-15%
Sugar	15%	-23%
Cotton	-7%	-15%
Oil	-29%	17%

Source: NAB Group Economics

These forecasts represent year-on-year average changes in Australian production and corresponding AUD prices between 2011-12 and 2012-13 financial years

As the year plays out, the immense impact structural change is having on the Australian economy is becoming increasingly apparent. However, the economy's ability to cushion the effects of this adjustment is becoming less certain, and poses a downside risk to near and medium-term growth prospects. GDP growth held up at a modest pace in Q1, but a second consecutive quarterly decline in gross national expenditure (GNE) paints a worrying picture of the domestic economy. While our near-term growth forecasts are broadly unchanged, the weakness in GNE combined with our expectation for mining employment to fall more quickly than previously anticipated has prompted us to lower our GDP forecasts a touch in the out years. GDP growth is expected to be 2.3% in 2013 and 2.8% in 2014 and the unemployment rate is expected to exceed 6% by the end of this year. We expect the RBA to lower the cash rate by 25 bps in November to help offset weakening labour market conditions. However, if the labour market deteriorates faster than forecast, rate cut(s) could come earlier.

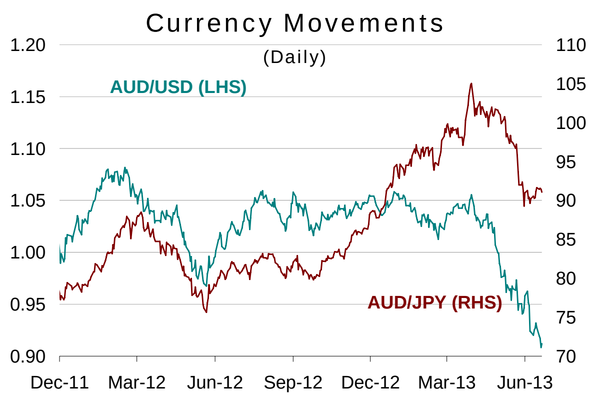
With the exceptions of wheat and cotton, the prices of most other agricultural commodities have moderated in May. The somewhat anomalous rise in wheat prices was resulted from fears of a supply shortage from delayed wheat planting in the US while cotton rallied at the end of May from opportunistic buying. Beef and lamb prices continued to trend lower, reflecting the effects of oversupply at saleyards, however they have firmed more recently as the long-awaited rains lifted confidence. Excess global surplus continues to plague sugar prices while wool prices also suffered from waning demand. Meanwhile, dairy prices have eased from their record highs in April. This month, wheat is our commodity in focus.

Currency Movements

The sharp depreciation of the AUD in May, which began as a US bond yield-led USD rally sparked by the encouragement given by Ben Bernanke to the notion that QE-tapering could begin within a few Federal Open Market Committee (FOMC) meetings, quite quickly morphed into an AUD-specific (and broader commodity currency) sell-off. This was compounded initially by the somewhat unexpected May RBA rate cut but further market volatility eroded AUD's attractiveness in carry trades. The subsequent announcement by the US Federal Reserve on 19 June which added clarity to the FOMC's intentions to taper should it see sustained improvements in the economy and fears of Chinese credit crunch sent the AUD into a tailspin and it fell to its 33-month low but it has since recovered some ground to around the USD 91 cents mark.

Our experts have revised NAB's AUD forecasts lower on 28 June, seeing the AUD/USD rate at 0.88 by the end of 2013, 0.85 by mid-2014 and 0.83 by the end of 2014. However, significant downside risks remain, as the current AUD/USD rate suggests that the currency does not yet fully reflect the extent of the rise in US bond yields, which according to our fair value model should be closer to 0.90. The exchange rate outlook remains under review and further forecast updates may be issued when appropriate.

AUD on an entrenched downward trajectory from rising US bond yields

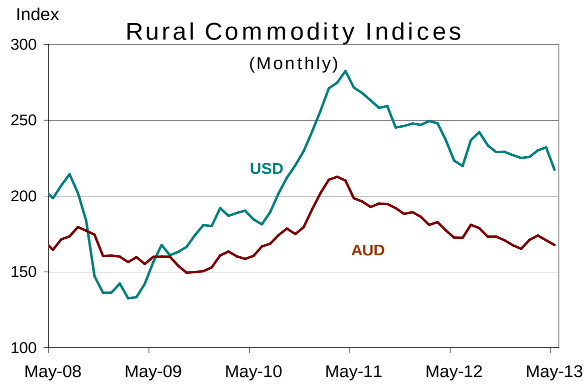


Source: Datastream

NAB Rural Commodity Index

In May, a notable depreciation in the AUD saw a 6% decline in the NAB Rural Commodity Index in USD terms in the month, converted into a more moderate 2% decline in AUD terms. Driving the index in AUD terms through the month were falls in beef (-8%) and wool (-7%), a sizeable reversal of dairy prices (-5%) from a high base in April and the continued malaise experienced by sugar prices (-4%). Wheat prices were the only standout price gainer in the month, growing by 5%. Looking ahead, moderating crop prices from a global bumper crop and the return of dairy prices closer to long-term historical average are likely to exert considerable downward pressure on the commodity indices. Counteracting some of these effects will be, however, a seasonal tightening of wool, beef and lamb supply in the winter months which will lend some price support. In the likelihood that the AUD will depreciate further against the USD in the coming months, the USD index will biased downwards relative to the AUD index.

Rural commodity prices slipped on weaker livestock and wool prices



Source: Bloomberg, NAB Economics

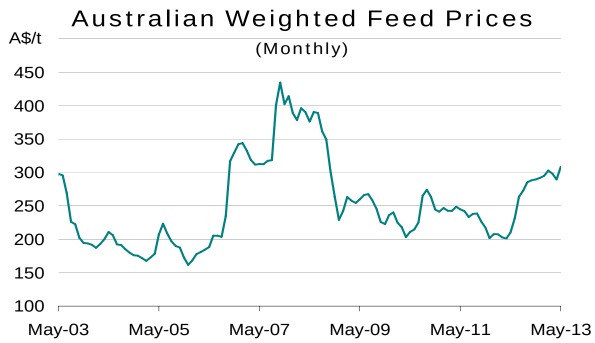
NAB Farm Input Indices

The global fertiliser market remains bearish overall despite some short-term volatility from month to month. Over the past month, global Diammonium Phosphate prices have fallen further to USD 483/tonne while urea prices have dipped to USD 343/tonne. Natural gas is also softer at USD 4.0/million Btu. Despite the falls in global prices, the overall NAB Fertiliser Index actually rose by 1% in the month as a notably weaker AUD has more than offset the benefits of global lower prices. A prolonged winter has delayed spring planting in Northern Hemisphere which resulted in shorter application window. This, accompanied by high urea inventory, has put a lid on prices. The imminent opening of a low export tax window for fertilisers by China in Q3 will also keep the supply side conditions reasonably comfortable and serve as an impetus for lower prices in the near term. Oil prices in the month are relatively unchanged, but an escalation of the Syrian civil war in June has resulted in the highest crude oil prices in at least four months which might translate into higher fuel costs temporarily.

NAB Weighted Feed Grains Price

Tight inventory levels in domestic old crops of wheat, barley and sorghum from the 2012-13 season have kept the current levels of feed grains prices elevated despite improved production prospects for grains and oilseeds globally for 2013-14. Dramatic price increases were recorded by oats and sorghum, which leaped by 20% and 15% respectively, however they only make up around a quarter of total feed grains mix. Feed wheat, which accounts for more than 40% of overall grains mix, rose by a significant 5% as well. Over the coming months, feed grains supply is likely to remain constrained until domestic winter crop production becomes more certain, which will serve to keep prices buoyant.

Feed grain prices remain elevated from tight inventories



Source: ABARES, NAB Economics

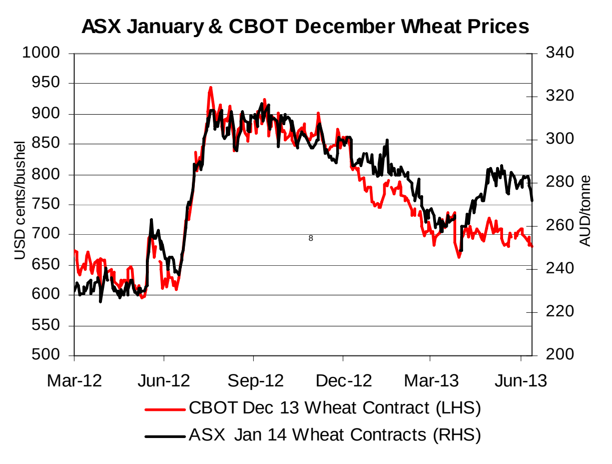
In Focus – Wheat

- **Bearish sentiment in global wheat prices is deeply entrenched from a projected bumper global grain crop in 2013-14. Australian wheat prices have been more bullish on tight domestic inventory levels.**
- **Most Australian wheat farmers have recently completed a reasonably successful winter planting program and expect average or above average yields this year.**
- **Despite a higher forecast crop for 2013-14, Australian wheat exports in the year are expected to fall from inventory building and stiffer competition from Canada and the Black Sea.**

Domestic wheat prices gaining relative to global average

Global wheat futures prices, as indicated by the Chicago Board of Trade (CBOT) indices, reached an almost four-year high in July last year from the onslaught of the worst drought in the US since the Dust Bowl in the 1930s. However, they have since fallen about 25% after entering into a bear market in January from a projected sharp recovery in global supplies from an improvement in seasonal conditions as the US and the Black Sea gradually emerge from drought conditions. The US Department of Agriculture (USDA) estimates that world wheat output will rise by 6% to 696 million metric tons in the year that began on July 1, as bigger harvests in Canada, Russia, Australia and Ukraine counter a smaller US crop.

Local wheat prices pulling ahead of global benchmark

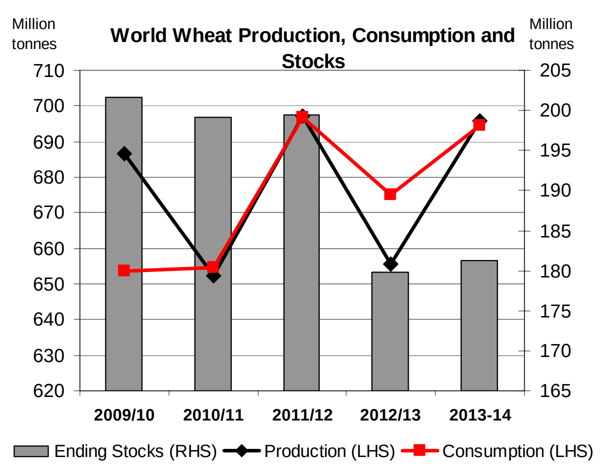


Source: Bloomberg

More recently, CBOT prices have tracked largely sideways as the grain and oilseed markets seek direction during the transition period from tight old crop stocks to upcoming new crop production. Adding to the bout of uncertainty lately has been the discovery of a rogue genetically-modified wheat strain in Oregon in late May, which led to Japan and South Korea halting imports of the soft-white wheat predominantly growing in the Northwest region of the US. A recent report by the USDA attesting that the incident is probably isolated in nature has done very little in calming farmers' nerves as they struggle with decisions of potentially switching from wheat to other crops later this year and the need to take precautionary measures against any contamination by separating out different wheat types. Apart from wheat-specific factors, some bearish sentiment surrounding the crop has been fuelled by the fact that the combined global production of competing grains and oilseeds, especially corn, is expected to hit record levels this year. This will in turn reduce the demand for wheat as a substitute in animal feed. In the US, corn production is forecast to increase by 29 per cent in 2013–14 to a record 355 million tonnes. This largely reflects a return to average yields from the drought-affected yields of 2012–13.

While Australian wheat prices tend to follow the broader trends of international prices historically, they have been pulling further ahead on strong demand and very tight domestic stocks, with the Australian wheat basis – that is the difference between local wheat prices and the international benchmark price – trading significantly above its historical average over the last nine months. Drought conditions in domestic key producing regions from winter last year to autumn this year and a strong demand induced by limited alternatives in an global environment of high grain prices, have resulted in a sharp drop in local grain inventories which helped to prop up prices. Also acting as a contributor has been some degree of stock hoarding by farmers in anticipation of a higher basis and to optimise tax planning with the commencement of the new tax year on 1 July. However, a release of stocks upon a major calendar or seasonal event will drive basis lower.

World wheat ending stock to rise from four-year low



Source: USDA

The near-term outlook for both global and domestic prices is, however, still subject to some level of uncertainty, arising from the variability in supply conditions as is usual at this time of the year. Coming into June, the northern hemisphere spring plantings are almost complete while the winter crop seeding program is also drawing to a close in the southern hemisphere. Hence the months of June and July represent a crucial development period for global crops and any changes in weather conditions can bring about heightened price volatility and wildly varying crop predictions. In the US, a slow winter harvest progress and poor conditions of harvested wheat have offered some short-term buoyancy to prices. Additionally, there are emerging data showing that spring sowings have been delayed in some parts of the country from persistent rain in the past few weeks, which have in turn stoked farmers' intentions to abandon residual acres given that the ideal seeding window has passed. In contrast, the amount of rain received throughout May into early June in Australia was the antidote to the dry conditions experienced throughout autumn, by creating a sufficient level of subsoil moisture necessary for efficient seed germination. This suggests that current high levels of domestic prices are unlikely to hold once the outcome of the new crops becomes more certain.

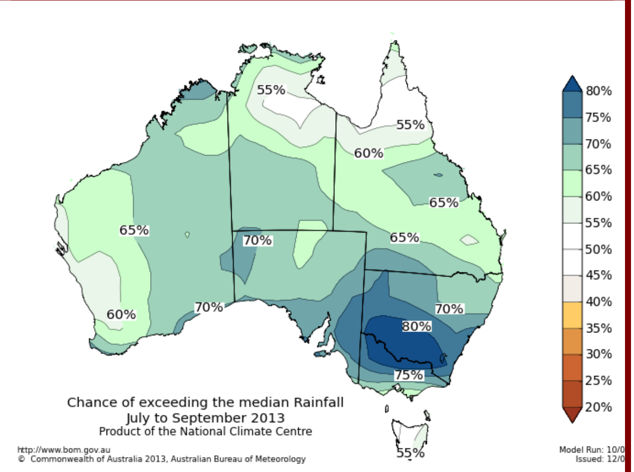
Overall, the price outlook for this season is still tilted heavily to the bearish side, as downward pressures resulting from a general solid lift in production due to improved sowing conditions is likely to overshadow any short-term volatility in prices. According to USDA numbers, we enter the 2013-14 season with carryover stocks of 180 million tonnes which is a four-year low, however as global wheat production is expected to exceed consumption marginally, there will be some rebuilding in stocks which will weigh on prices. While closing stocks for most major wheat producers are forecast to increase, stocks in India, the world's third largest wheat producer, are forecast to decline from an expected increase in domestic consumption and higher exports as the Indian Government attempts to reduce significant stockholdings following several years of above average production. Demonstrating the ingrained bearish sentiment on wheat prices had been a long-standing overall net short position in wheat futures since December last year, with the latest net short managed money exposure at 43, 000 contracts.

A positive start to Australian winter crop season …

Most Australian wheat farmers have recently completed a reasonably successful winter planting program with intelligence from within the bank suggesting that most farmers expect average or above average yields this year. A prolonged period of dryness during autumn in a number of key producing regions of Victoria and South Australia despite average rainfall forecasts has caused some anxiety amongst some farmers, most of whom have chosen to perform dry sowing during April. However, some decent rainfall May and the first couple of weeks in June proved to be the saving grace which replenished the critical subsoil moisture level and injected a much-welcomed dose of confidence amongst farmers. However, the rain came too rate for canola, which has an earlier planting window. Our experts are currently predicting an Australian wheat crop of 24 million tonnes (compared with ABARES' forecast of 25.4 million tonnes), up 14% on last season's crop but below the 2011-12 record crop.

The seasonal outlook issued by the Bureau of Meteorology for the winter period (June to September) points to a likely wetter than average winter and early spring across most of Australia. However, the timeliness, not just quantity, of the rainfall will be important for the progress of crop development. According to ABARES, a big boost in harvest is expected to arise from Western Australia, where wheat output is forecast to rise by 29% in 2013–14 to around 8.8 million tonnes, accounting for more than one-third of Australia's production. This encompasses an expected 3% increase in the area planted to wheat and higher yields. A similarly positive outlook is painted for eastern states (including South Australia), where an increase in acreage and higher expected yield is expected to lift production by 9% in the same year.

Australian rain outlook indicates wetter-than-normal winter likely

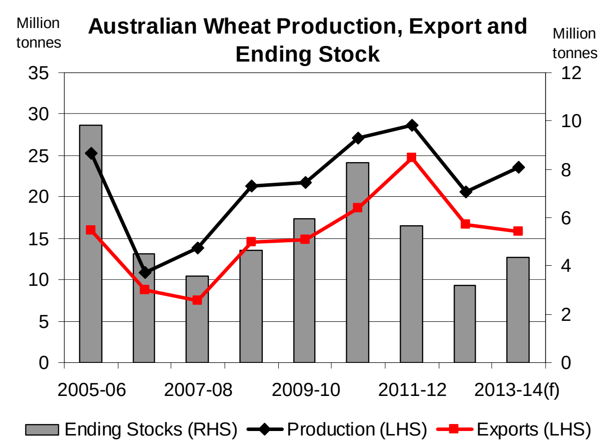


Source: Bureau of Meteorology

Wheat export earnings to decline marginally

Despite an expected increase in Australian wheat production in 2013-14, ABARES has forecast a fall in the volume of wheat exported by 9% in 2013–14 to around 19.5 million tonnes. Our experts are slightly more pessimistic to forecast exports at 15.8 million tonnes for the same year. The large draw-downs on inventories last season which have offered support to exports have resulted in an unsustainably low carry-in stock, which is expected to be replenished partly this season. Stiffer export competition is also expected to arise from the Black Sea and Canada (see "Outlook by Major Exporter" below for more details), potentially resulting in cancellations of cargoes from Australia which would have the effect of relieving some tightness in the current stock level. Consequently, export earnings are expected to fall by 4% to AUD 6.6 million, from a lower volume and also faltering world prices from a bumper global crop.

Australian wheat exports to fall despite production uptick in 2013-14



Source: NAB

That said, the financial performance of wheat farms has been resilient and a source of envy to other types of farming for some time now. Stratospheric global wheat prices, coincided with a record wheat crop in 2011-12 resulting in wheat (and other crops) farms being projected to record the highest rate of return, excluding capital appreciation, among the surveyed industries in 2012–13. However, there is substantial variation across the states. In a track record worth being worn as a badge of honour, wheat and other crops industry farms recorded the highest average rate of return among broad-acre industries in 19 of the past 20 years.

Outlook by Major Exporter

United States – According to the recent USDA Prospective Plantings Report, acreage planted to wheat in 2013 is expected to reach 56.4 million acres, up 1% on 2012. Estimated area planted to winter wheat sits at 42.0 million acres, up 2% on last year while area planted to spring wheat is estimated at 12.7 million acres, up 3% on 2013. Winter wheat harvest is currently underway but its progress is significantly slower than previous years, with a slow eventuation of warmer spring weather and frequent showers posing difficulties. The most recent USDA crop progress report revealed that US farmers had harvested a mere 20% of their winter wheat crop as of 23 June, compared to the five-year average from 2008 to 2012 at 37%. Condition of the harvested wheat was only rated as 32% “good” or “excellent”, well below the 54% a year ago. Importantly for the overall grains complex, the area planted to corn is estimated at 97.3 million acres in 2013, up slightly from last year and 6% higher than in 2011. Expected returns for corn are again historically high going into 2013. If realised, this will represent the highest planted acreage in the United States since 1936 when an estimated 102 million acres were planted. Soybeans have been crowded out slightly, down by a hair’s breadth from last year but up 3% from 2011 to 77.1 million acres.

Canada – According to Agriculture and Agri-Food Canada, producers intend to increase the seeded area in 2013-14 by 13% from 2012-13 because of good prices, low carry-in stocks and a shift out of canola. Acreage planted to spring wheat is expected to rise 14% while winter wheat acreage is forecast to increase 1%. Total Canadian wheat production is expected to increase 9% in 2013-14 to around 24.5 million tonnes as a higher harvested area is partly offset by lower yields. Exports are also forecast to be higher.

Black Sea – After a dismal season of hot and dry conditions which impacted yields severely in 2012-13, Black Sea production looks like it is going to make a comeback with a vengeance. Recent USDA Foreign Agricultural Service projections point to Russian wheat production at 54 million tonnes in 2013-14, which is 43% above last year’s production. In the Ukraine, wheat production is forecast to rise by around 24% to 19.5 million tonnes. So far wheat crops in the Russian Federation and Ukraine emerged from winter dormancy with around 90 per cent rated in satisfactory to good condition, although dry conditions for the past month or so remain. Black Sea wheat, the cheapest feed wheat by origin, is likely to dominate the Asian export market in the coming year with a number of major Asian wheat buyers already looking to switch from Indian and Australian cargoes. Australia dominated Asia's animal feed market in 2010-11 and 2011-12 based on large volumes of lower-quality wheat after wetter than normal conditions in those two years. India has been aggressively selling cargoes in 2012-13.

Argentina – Argentine wheat production is expected to experience a policy-induced production increase by around 18% in 2013-14. The Argentine government has recently announced that it will relax its restrictions on wheat exports, which were implemented last year to ensure sufficient supply to satisfy internal demand which exceeds 6 million tonnes. The increased production of wheat will help to improve the country’s crop rotation and expand its grains exports, which are currently dominated by soy. Argentina is the world’s top supplier of soymeal animal feed and soyoil, which are used to make biofuels.

European Union – In the European Union, wheat production is forecast to increase by 4% in 2013–14 to around 137 million tonnes. A return of more favourable seasonal conditions across much of the European Union is expected to result in higher average yields. The only exception is the UK, where area planted to wheat was reduced last autumn because of wet soil conditions, which are likely to cause the harvest (taking place from July to September) to plunge by 30%. There may also be effects on crop quality.

Comments from the field

Esperance district has received above average rainfall to date and majority of farmers have completed seeding for winter crops. There is a small percentage with re seeding to be competed due to water logging. Salmon Gums especially has received well above their normal average, full moisture profile is held. Above average nitrogen and chemical has been used this season to establish crops and control weeds.

Wayne Appleton – Agribusiness Manager, Esperance, WA

Seeding now completed across most of Eyre Peninsula (EP), with Upper EP finished while some seeding still remains in Lower EP. June long weekend is the benchmark period for completion of seeding with Upper EP finished prior to this. If seeding not completed by now farmers would be hoping for a mild spring, any harsh conditions such as experienced last year where no rain from September onwards would have detrimental impact on late maturing crop. Good early rains of around 55 mm mid May around Ceduna / Kimba region in Upper EP, this compared to around 40 mm on Lower EP at same time. Lower EP rainfall since caught up with current rainfalls across whole EP estimated average around 80 mm (70mm for corresponding period last year). Some farmers quoting start to season the earliest if not the best they have experienced for decades. Excellent ground moisture has created good subsoil content, but some weed issues have arisen as a result. Dry 2012 spring maintained control over these profiles and a solid production outlook. Marketing options continue to be a focus.

Steve McGuire –Agribusiness Manager, Port Lincoln, SA

The season in the Riverina started with majority of growers having to dry sow. The significant sub soil moisture our growers experienced at the beginning of the last season just wasn't there and there were many concerns about how the season would progress. We are now happy to report that most growers have now received above 75mm after sowing, with some areas reporting over 100mm. This has replaced the lack of sub-soil moisture and crops are up, experiencing warmer day time temperatures. Clients have also reported that ground temperatures have remained slightly warmer, assisting in growth rates. Overall, all reports are that this is looking like a average to above average season thus far.

Nicole Killen–Agribusiness Manager, Wagga Wagga, NSW

Generally the simmer grain harvest (for Darling Downs, southwest Queensland and northern NSW) has been completed, with later sorghum crops waiting on lower moisture levels before finalising harvest. Recent rainfall over the majority of winter cropping areas will benefit both emerging crops & assist with finalising planting in a number of areas. Large parts of northwest NSW are still waiting on additional rainfall to commence planting or create seed germination for dry planted areas. Growers by large have an air of *confidence in the season ahead, with forecasters predicting an above average winter rainfall and commodity prices benefiting from a lower AUD.*

Gavin Pontin – Senior Agribusiness Manager, Dalby, Qld

Our clients (in central Victoria) started sowing with trepidation after a very dry start, however some showers lifted spirits and the majority of crops were finished sowing in time for a good soaking rain in early June. Consequently, germination has been solid with some good early growth now visible. A good season last year has seen many clients repay working capital who are now also active in the farm management deposits market. The focus seems to be moving to all year round marketing rather than harvest sales, with significant tonnage from last season to be sold post June 30.

Megan Hodge – Agribusiness Manager, Shepparton, VIC

The winter grain production through out the mid-north of South Australia is now well and truly back on track, and while we will still be reliant on good finishing rains over the spring, recent wide spread rains across the mid-north have allowed seeding operations to really get underway, with many reporting seeding completed prior to or by the first week in June. Many through out the district commenced seeding dry back in early May, with some operators at approx 50% completion by the time the first of the opening rains were received in mid May. The rain events over the past 5-6 weeks, along with the warmer weather, has seen an excellent start to the growing season with many crops out of the ground and well into 3 to 5 leaf stage.

Michael Laidlaw – Agribusiness Manager, Clare, SA

In the Upper Great Southern area of Western Australia, seeding programme has all but been completed. It has been very good conditions year to date for the preparation and sowing programme. There were some good rainfall events prior to and during seeding. Most farming operations finished seeding earlier than in previous years, and in better conditions also. To date crops are germinating / growing well, and with good weed control.

Christopher Antonio – Senior Agribusiness Manager, Narrogin, WA

Seeding has finished in the mid-west area of Western Australia with sound moisture levels available from summer and pre-seeding solid rainfalls during May, leading to cropping programs being completed between 2-4 weeks earlier than last year and into a much better moisture profile. Establishment, in the main, has been very good with early planted canola and majority of wheat up and well positioned. June, in general, has been fairly dry with limited rainfall in most areas, although some have received decent falls over the past 10 days of up to 20mm but other areas have been under 5mm. Forward grain pricing was undertaken in November last year with either Swaps or Cash Contracts for the Dec 13 harvest above $310 by a number of Growers for up to 25% of intended Wheat production, but most are now still standing aside until they have a better view of seasonal conditions and outlook.

Rob Christoffersen– Senior Agribusiness Manager, Geraldton, WA

The Millewa and Northern Mallee have experienced above average rainfall for May, along with some follow up rainfall in the first 10 days of June. Falls have been between 30mm to 50mm in total and have given farmers a boost in confidence for a reasonable season. Most had sown crops on minimal moisture in April, based on average rainfall predictions, but until it occurred the level of uncertainty was worrying. Most are now faced with increased spraying and chemical costs,, but with further falls being forecast and a reasonable spring and finish, most will be looking forward to improved yields in comparison to 2012-13.

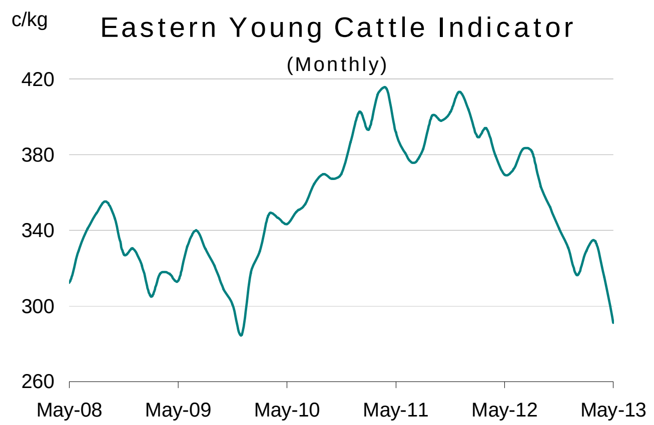
Gary Klippel– Agribusiness Manager, Mildura, VIC

The southwest slopes of NSW were dry in the lead up to the sowing of this year's crop. Much of the sowing in the area had been completed on very little moisture. A break of 13mm fell on the 14th of May with another 10mm on the 23rd of May. The main break was on the 2nd of June where 56mm of good soaking rain fell and was absorbed into the soil with minimal run off. Most farmers in the area finished their sowing operations prior to the June long weekend. Good follow up rain has also been received with the top 50-60cm of soil being quite wet and slowly joining up with sub-soil moisture. The majority of crops are now up and the outlook for this season is looking good with some farmers already starting to lock in some parcels of grain.

Ben Simmons- Agribusiness Manager, Young, NSW

Key Commodity Prices

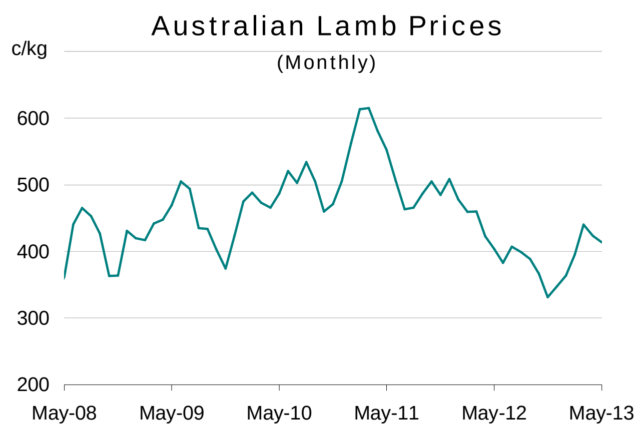
Cattle prices turning the corner in June after reaching three-year monthly low in May



Source: MLA

After reaching its lowest monthly average since December 2009 at 291 cents/kg in May, the EYCI has recovered some ground to be around 320cents/kg in the third week of June due to rain received in some key areas (not shown in chart). Average to above average rainfall was recorded across most of the country during May and early June, although not sufficient to break the drought conditions in parts of Queensland. Driven by historically high production levels and the resultant low prices, Australian beef and veal exports for May surged past 100,000 tonnes swt for the first time on record, breaking the previous monthly record set back in November 2006. Shipments to Japan (30,374 tonnes swt) and the US (19,680 tonnes swt) continue to dominate export volumes and remain relatively stable from the same time last year. Meanwhile exports to Korea were up 36% over the same period, at 12,423 tonnes swt, and although a considerable year-on-year increase (albeit when compared against a slow start) the trading environment in Korea remains tough. China's import growth continues to surprise on the upside, with exports for the month at 11, 486 tonnes compared to just 709 tonnes the same time last year.

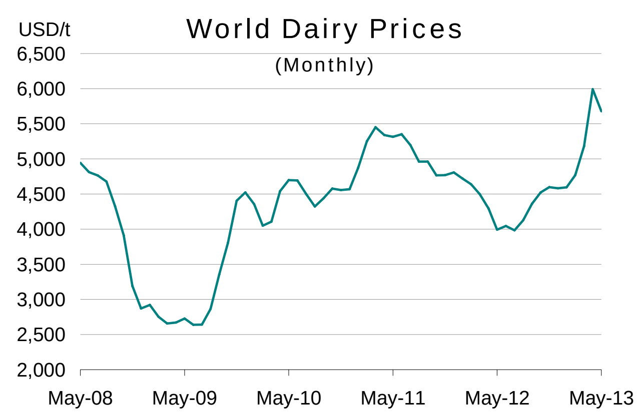
Decent rains boost lamb prices more recently



Source: MLA

The decent rainfall received by most eastern states has also resulted in improved conditions for lamb in terms of increased retentions, confidence and competition, helping to prop up lamb prices in recent weeks. Slaughter rate has remained high, with processors keen to push more volumes through in anticipation of a slowing supply during winter. As a result of dry seasonal conditions throughout much of autumn, a higher proportion of lambs slaughtered were of lighter carcass weight, resulting in a 4% reduction in national average carcass weights in April relative to the same time last year. Lambs in South Australia and Victoria yielded 6% and 3% lighter carcases respectively. Consequently, production in SA has in fact decreased year-on-year, despite a higher slaughter rate. High production levels have more generally fed into elevated levels of exports, with Australian lamb exports reaching the highest monthly volume on record in May, at 19,964 tonnes swt, breaking the previous record set in November 2012. Ranked top in terms of export destinations by volume is the Middle East, which soaked up a record 5,955 tonnes swt, up 37% on the corresponding period in 2012.

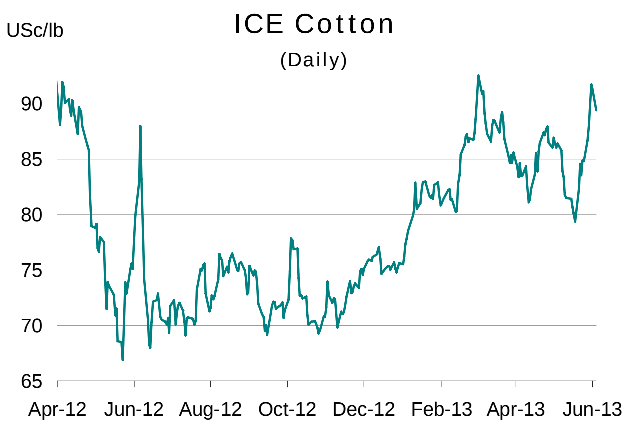
Global dairy prices moderate from record highs in April



Source: NZX

Global dairy commodity prices have eased from their record highs in April, however they remain elevated compared to the same time last year. Global stock levels are gradually depleted as the production season in the southern hemisphere draws to a close while production in the northern hemisphere has yet to gear up due to a delayed start to spring. This has helped to support prices but moderating global trading activity from buyers seeking direction in the meantime will cap the upward potential of prices. In Australia, the lack of feed availability, low milk prices (from supermarket wars) and tight cash flows have weighed on the dairy sector for some time but the payout outlook for 2013-14 is looking more positive. Murray Goulburn, Australia's biggest milk group has offered an initial price of $5.60 per kilogram milk solids to suppliers – a 24% increase on last year and the highest on record. The cooperative, which processes about a third of all milk in Australia, expects demand from key markets to continue to be strong.

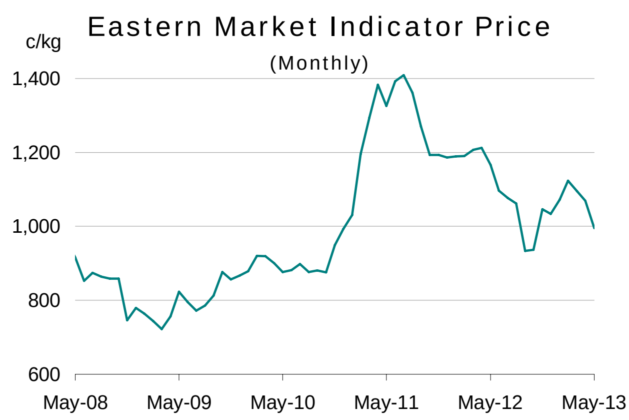
Cotton prices surged in June from opportunistic Chinese buying



Source: Bloomberg

Cotton prices have experienced extreme volatility over the past month. Following a sharp downward trend in the second half of May, ICE Cotton #2 Futures rebounded rather sharply in June. The revival was attributed to opportunistic buying after a drop of more than 8% in July futures during the losing streak in May. There has been an accumulation of pent-up demand in countries such as Pakistan and Vietnam as China's massive purchasing program in the last six months to restock its strategic reserve had diverted a substantial amount of supply away from global markets and kept prices at elevated levels. The 80-US cent level has been considered to be the resistance barrier to lure buyers back. Traders can buy ICE cotton for July delivery and sell to mills in China, the world's No. 1 textile market, at as high as $1.30 per pound. Notwithstanding the spike, supply and demand fundamentals are expected to remain lacklustre in 2013-14, with global consumption expected to be below production for the fourth consecutive year. In Australia, cotton picking is drawing to a close after a highly successful year in terms of quality and quantity of production. Yields have been exceptional at above 13 bales/ha for irrigated crop and 6 bales/ha for dryland crop.

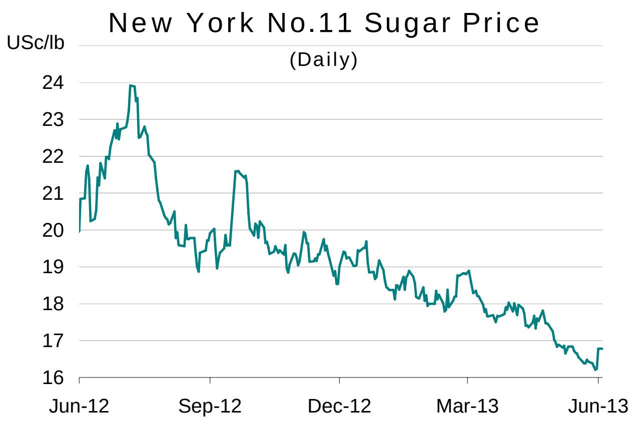
Wool fell on slowing global demand



Source: Bloomberg

The Eastern Market Indicator (EMI) weakened further in May in monthly average terms, although more recent data in June have shown some degree of firming from a seasonally tighter supply in June and July. The month of May continued to be characterised by a notable depreciation in the prices of superfine Merino fleece types of 18.5 micron and finer, partly offset by stronger performance in the medium to strong and crossbred types. A recent study by the Australian Superfine Woolgrower Association, with AWI support, confirms that the premiums paid for superfine wool have declined substantially since 2009 (post-GFC), from an average of 40% to around 11% and this trend is expected to continue as demand for superfine wool wanes. Another factor weighing on prices had een the increased volatility around the exchange rate. While the recent weakening of the AUD is a welcome development to Australian growers, buyers have become increasingly wary in their purchasing decisions in anticipation of further sharp falls in the AUD.

The slide in sugar prices continues…



Source: Bloomberg

The slide of sugar prices gathered pace in May, weighed further by a mounting global surplus largely driven by a rapid and high-quality sugarcane harvest in Brazil to-date. Drier conditions in May helped to speed up the harvesting progress and improve the recoverable sugar content in the canes, bringing prices to the lowest since November 2010. This has in the process boosted ethanol production, which sees mills already getting more than a 15% premium for producing ethanol over sugar. A stronger outlook for the demand for ethanol, supported by an expectation that the Brazilian government will announce a tax cut on the biofuel in the coming months, has helped to boost ethanol production further. However, most of this is likely to be consumed domestically rather than being exported. In its most recent quarterly report, ABARES has forecast world sugar production to increase to a record 182.2 million tonnes in 2013–14, 500 000 tonnes more than in 2012–13. The forecast increase largely reflects rises in world sugarcane plantings in recent years in response to favourable world prices, with larger sugar production in Brazil, Thailand, China and Australia only to be partially offset by lower production in Europe, the United States, India and Mexico.

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