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Economic Report

Rural Commodities Wrap

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August 2013

- **Global equity markets recovered earlier losses as it became clear that central banks would not rapidly turn off their monetary easing, although we still expect the US Federal Reserve to start tapering in the coming few weeks.**
- **The long awaited rotation of global growth towards a greater contribution from big advanced economies may finally be under way as business survey and industrial output data shows growth picking up.**
- **The domestic sector weakened further in July, with business conditions unchanged at the lowest level in four years.**

Global equity markets recovered earlier losses as it became clear that central banks would not rapidly turn off their monetary easing and forward looking markets priced-in an expected upturn in global growth. Central bank statements reinforcing their guidance that interest rates should stay low for a long time yet across the big advanced economies has supported financial markets. This means that markets worry less about an imminent withdrawal of the central bank liquidity that has fuelled higher asset prices around the world. That reassurance provided the market confidence needed to sustain risk appetite and move equity prices back to their previous highs. Our assessment is that the US Federal Reserve starts 'tapering' (winding back asset purchases) later this year and that phase ends in mid-2014, but will not begin to lift its policy rate or start running-down its assets until the second half of 2015.

The last few months have finally brought some early evidence that things could be getting better and a rotation of global economic expansion towards a greater contribution from the big advanced economies has begun. This reflects the passing of prolonged periods of economic weakness in Western Europe, the stimulus coming from Abenomics to Japanese demand while, in the background, a moderate US recovery continues. Second quarter trends in GDP for the US and UK have been reasonably positive, partial data for Japan suggests continued growth and even some of the recent economic indicators in the recession-hit Euro-zone are looking less negative with the ECB seeing a "stabilisation in economic activity at low levels". The most marked evidence of improving economic conditions comes in the business surveys where the latest monthly purchasing manager surveys show a solid improvement across the US, UK and Euro-zone. In contrast, the growth performance of the large emerging market economies has been disappointing. Chinese growth slipped from double-digit levels in 2010 to 7.5% yoy in June 2013 and quarterly growth in the second quarter was running at 1.7%, below the 7% yoy figure mentioned as a minimum acceptable growth outcome by senior Chinese leaders. India has also slowed markedly with growth halving from around 10% in the first half of 2010 to around 5% yoy in early 2013.

2013-14 Estimates, Rural Prices & Production		
Commodity	**Production**	**Price**
Wheat	16.7%	-24.8%
Beef	1.5%	4.5%
Dairy	1.6%	5.7%
Lamb	-7.1%	8.6%
Wool	-3.3%	5.1%
Sugar	4.7%	-12.5%
Cotton	3.0%	6.5%
Oil	-	-4%

Source: NAB Group Economics

These forecasts represent year-on-year average changes in Australian production and corresponding AUD prices between 2012-13 and 2013-14financial years

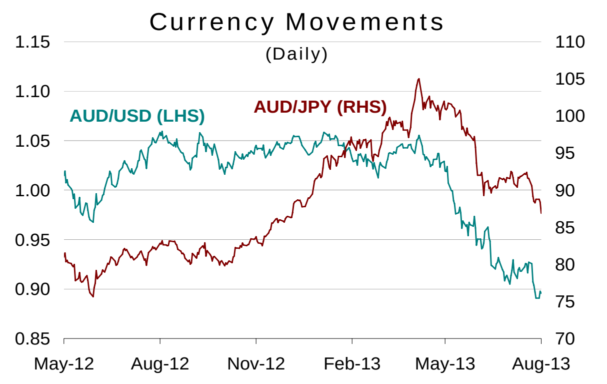
The Australian economy appeared to weaken further in July, with domestic demand possibly continuing to contract. Business conditions reported in the latest NAB survey remain unchanged at their lowest level in four years. Overall our GDP growth path remains broadly unchanged from a month ago but at the margin is a touch lower – especially in the out years. We see growth softening to 2.2% in 2013, before rising to a still below-trend rate of 2.6% in 2014. Consistent with this, the unemployment rate is expected to exceed 6% before the end of this year, before rising to 6½% or a touch higher by late 2014. Given the above, we expect the RBA to cut again before year's end – probably in November on the back of continuing low core inflation and a weaker labour market.

In July, the prices of livestock continued their momentum in June to record remarkable growth. Wool prices firmed moderately on an anticipated tight supply before the annual three-week trading recess. Dairy prices reversed their falling trend to grow marginally in the month from strengthening demand and are likely to track significantly higher from the recent New Zealand milk scare. Global wheat prices retreated further in the month as the expectations of a bumper crop this year has been reinforced by favourable seasonal conditions. Meanwhile sugar prices jumped on a frost scare in Brazil while cotton prices stayed largely unchanged. This month, beef is our commodity in focus.

Currency Movements

AUD/USD has rallied from 0.8850 to above 0.9200 in the second week of August despite the latest RBA rate cut and evidence from the latest Statement on Monetary Policy that an easing bias persists. Yet the moves are consistent with a softer USD and a rise in AUD 'fair value' as US rates ease back, volatility indicators decline and metals prices lift off their recent floor. Stronger data from China is also helping. We last revised our AUD forecasts in June, lowering our end-2013 estimate for the AUD/USD rate to 0.88 and to 0.83 for end 2014. While still in essence a US dollar call, back then our view was that the RBA easing cycle was likely to be complete with a move down in the cash rate to 2.5% and with a tightening cycle potentially commencing late in 2014. We now envisage at least one further rate cut in this cycle (to 2.25%) with risk skewed to an even lower cycle end-point – a view supported by the economic projections contained in the new RBA Statement of Monetary Policy - and with no tightening expected before 2015 at the earliest. This is part of the justification for now forecasting a somewhat deeper and faster AUD depreciation path. We now envisage an end-2013 rate at 0.86, and a move down to the 80 cent level by the end of 2014. However, between now and then we see a higher upside risk, perhaps to the 93 cents area. Recent easing in US bond yields, a pickup in industrial metals prices off their recent lows and a fall-back in market volatility have all served to lift our short term 'fair' value estimates for the AUD. These currently stand in the 0.92-0.94 area, having been down near 90 cents a month or so ago. So while we continue to expect that US bond yields and the USD will push back higher if the Fed does proceed to commence tapering its QE3 bond buying programme on September 19 and deliver our new 0.88 end-September forecast for the remainder of this month, we see more upside than downside risk from current spot levels.

The AUD moderated further in July in monthly terms but has recently rebounded from strong China data

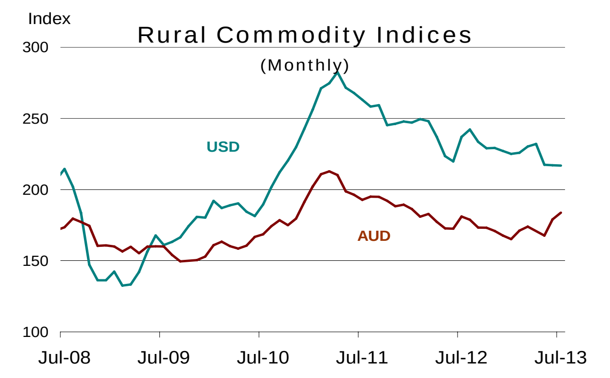


Source: Datastream

NAB Rural Commodity Index

In July, the continued momentum in domestic livestock products and a further depreciation in the AUD, albeit not as markedly as in June, saw a 2.6% rise in the NAB Rural Commodity Index in AUD terms in the month and a corresponding marginal decline of 0.1% in USD terms. Contributing to the rise of the AUD index in the month was a broad-based rise in commodity prices except wheat, with strong lifts in the prices of livestock (cattle rose by 4%, lamb by 5% and wool by 1%) and dairy (+ 3%). Despite cotton prices staying unchanged and sugar having fallen in USD, cotton and sugar recorded a marginal rise of 2% and 1% in the month after being converted into AUD as the currency depreciated by more than an offsetting 2.6% in the month. Looking ahead, a further easing in the AUD and the sustained strength in dairy and livestock product prices will provide supplementary support to the Rural Commodity Index but this will be rationalised by depressed oilseeds and grains prices from a bumper crop year.

Rural Commodity Index rose in AUD terms

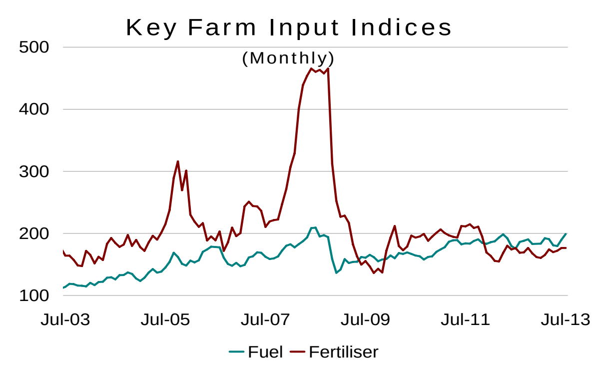


Source: Bloomberg, NAB Economics

NAB Farm Input Indices

Over the past month, the global fertiliser market was mixed but still remained at relatively low levels, with Diammonium Phosphate (DAP) and natural gas prices tracking lower to USD 457/tonne and USD 3.8/million Btu respectively, while urea prices have risen marginally to USD 327/tonne but remained 16% lower than the same time last year. China's low export tax window for DAP and urea, which commenced on 16 May and 1 July respectively and will run through to mid to late October, portend a flood of nutrients supply into global markets, keeping prices low during this period. As a result of the weakening of AUD in the month, however, the overall NAB Fertiliser Index actually rose by 3% in the month. Overall, the demand for fertilisers has been subdued as the previously expected acceleration in fertiliser usage intensity associated with spring planting programs in the Northern Hemisphere did not eventuate from the delayed arrival of warmer conditions. Meanwhile, the fuel price index has ticked higher by 5% in the month from escalated tensions in the Middle East.

Key farm input prices remain subdued



Source: Bloomberg, NAB Economics

NAB Weighted Feed Grains Price

Feed grain prices have retreated marginally by 1.6% but remain elevated by recent historical comparisons. Current prices are supported by a restricted domestic inventory of old crops feed wheat, oats and sorghum. Meanwhile new crop prices (futures) have risen moderately as a weaker AUD in the month more than offset the slide in global prices, causing the Australian basis to rise considerably.

In Focus – Beef

- **In July, EYCI continued to build on the recovery evident in June, with prices lifting by 4.4% in monthly average terms. We expect the EYCI to average 4.5% higher in 2013-14.**
- **Australian cattle herd appears to have peaked at 28.5 million head as of June 2011, with a high drought-related slaughter rate putting a halt to stock rebuilding.**
- **Australian beef production in 2013-14 to grow marginally by 1.5%, with a slower slaughter rate offset by increased carcass weight.**
- **Australian beef exports broke the record of exceeding 1 million tonnes in 2012-13, driven by exceptional growth in China and the Middle East. Export outlook remains robust from strong demand and a devalued AUD.**

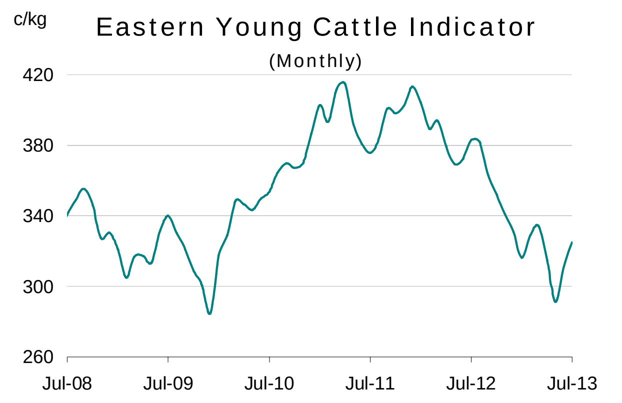
2012-13 has been a challenging year for cattle farmers. Drought conditions which affected pastures across most parts of the country since mid last year have reduced feed availability significantly, prompting a high slaughter rate and culminating in a precipitous fall in saleyard prices of around 24% between August 2012 and May 2013. The consistent reductions in the live exports quota to Indonesia by its government since 2010, which gained traction after the five-week suspension by the Australian government in June 2011 following evidence of animal welfare abuses in some Indonesian abattoirs, have also played a part in increasing the supply of cattle for the domestic market, weighing further on prices. In May this year, average to above average rainfalls recorded across the country broke the dry spell officially and offered a glimmer of hope to cattle farmers that perhaps their bad luck has finally run out. Restockers' confidence rose, coupled by a seasonally tight supply, meant prices finally turned the corner after falling steadily through most of autumn. Given the low prices, beef and veal exports have performed exceptionally, supported by the rapid rise of emerging markets of China and the Middle East. A more certain recovery trajectory in a number of advanced economies such as the US, Japan and UK, aided by the long-awaited depreciation in the AUD, also provided further impetus to exports.

On balance, we think that the outlook for the cattle industry is looking rosier compared to the first half of the year, albeit from a low base. It is likely to continue to benefit from ongoing urbanisation in developing economies and dwindling cattle numbers in key exporters.

Australian cattle prices turning the corner on decent rains while national cattle throughput continues at a robust pace

Dry conditions for the most part of 2012-13 have resulted in a large influx of cattle from northern and western Queensland which saw cattle prices, indicated by the Eastern Young Cattle Indicator (EYCI), track steadily lower, only to bottom out during autumn when the southern and northern peak turnoff periods combined. The subsequent wet start to winter in the southern states was greeted enthusiastically by livestock farmers, buoying confidence and prices as more producers are now inclined to hold on to stocks while waiting for pasture to regenerate during spring. That said, production conditions continue to be highly challenging for producers across northern Australia, who are still experiencing drought-like conditions and are likely to maintain high turnoff rates (though not as high as from March to July) and pressure on livestock prices, according to the Meat and Livestock Association (MLA). In July, EYCI continued to build on the recovery evident in June, with prices lifting by 4.4% in month average terms after rising by 7% in June. Apart from the rains, helping to sustain prices in recent months has been the increase in export demand for beef by countries such as China and the Middle East, spurred by a devaluing AUD and low prices in general. Prices through August so far have shown more fluctuations due to the inconsistent quality offered through most saleyards partly due to the high slaughter rate since last year, suggesting that supply has perhaps breached further into the trade-offs between quality and quantity. Total national cattle throughput in July lifted 29% compared to June and 12% year-on-year, as cattle turnoff continued to increase across the majority of states.

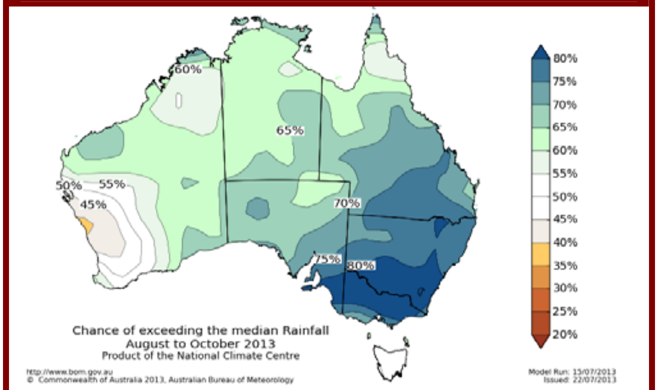
Australian cattle prices recovering



Source: MLA

In the near-term, the balance of risks suggests that the price outlook for cattle for the remainder of the year is positive, despite the obvious divergence in conditions between the north and south. The seasonal outlook for the next three months by the Bureau of Meteorology which indicates average to above average rainfall for most of mainland Australia, including Queensland, should support prices in the near-term as restocker activity gains pace. Furthermore, processors are also likely to demand more manufacturing beef to satisfy what appears to be an insatiable export demand at the moment, squeezed further by the thinning supply of suitable lines for slaughter. The fundamental trend of a falling AUD is also benefiting the outlook as Australian exports become more attractive, especially in an environment of intensifying competition from the US in key markets like Japan. The AUD is now forecast to remain below parity for the foreseeable forecast period, as commodity prices fall and the USD strengthens on the back of a gradually recovering economy. As a result, we have forecast the EYCI to average around 356 c/kg in 2012-13, around 4.5% higher than 2012-13 levels on average.

Wetter-than-normal rainfall likely to boost pasture growth

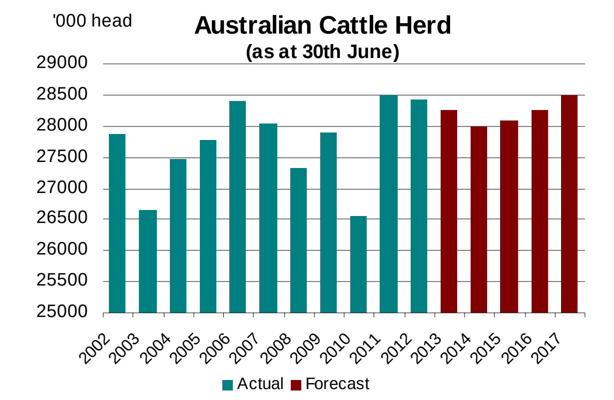


Source: BOM

Outlook for Australian Beef Production

The two consecutive years leading up to mid-2012, which turned out to be one of the wettest periods on record across most states in Australia, with the exception of WA, had driven producers to enter a period of intense herd rebuilding efforts which culminated in a very low turnoff rate in that period. As a result, the Australian cattle herd expanded by almost 2.0 million head from 2010 to 2011 and maintained at high levels in 2012. While the MLA has previously forecast the cattle herd to continue to grow in 2013, the onslaught of the drought and historically high slaughter levels throughout 2012-13 has derailed its predicted course with the Australian herd as at 30 June 2013 estimated at 28.25 million head, down 0.6% from the year before. In particular, the high slaughtering of female cattle in the year marked the end of producers' herd rebuilding intentions. It now appears that the Australian cattle herd peaked at around 28.5 million head, as at June 2011.

Australian cattle herd peaked in 2011



Source: ABS, MLA

With a hugely expanded herd size over the last couple of years and the impact of poor conditions, cattle slaughter was always expected to be higher than the previous year. Nonetheless, the severity of the drought, particularly in northern Australia, has effectively pulled forward slaughter numbers from the second half of 2013. This implies that numbers for the second half of the year are forecast to be below year ago levels, with the relatively more favourable seasonal outlook likely to encourage some stock retention. In its recently released mid-year update MLA has revised up its 2013 slaughter number to 7.725 million head, representing a 5.1% annual increase. This is further confirmed by official ABS slaughter statistics, which reported an additional 465,000 head of cattle have been processed between January and May, totalling 3.336 million head – the largest five month start to a calendar year since 2007.

Perhaps not surprisingly, the high slaughter rate had inadvertently affected the quality of carcasses. This is accompanied by reduced average carcass weight associated with a sharp increase in female slaughter at a forecast average weight of 278kg/head in 2013, albeit compared to the record high of 287.4kg/head recorded in 2012. Taking into account the offsetting developments of a higher adult cattle slaughter rate (+5.1%) and reduced carcass weights (-3.3%), MLA has estimated beef and veal production in 2013 to total around 2.2 million tonnes cwt – up 1.7% year-on-year. Looking ahead, while the slaughter rate in the upcoming spring season might moderate somewhat from some degree of stock retention, it is expected to pick up in the first half of 2014, with the significantly weaker AUD providing a strong impetus for export demand. Average carcass weight is also expected to increase marginally. As such, we expect beef production in 2013-14 to grow marginally by 1.5%.

Australian Beef Export Performance Strong

Despite the challenges imposed on beef exports – a stubbornly high AUD until recently, a still-weak global economic outlook and changing trade policies in key export markets – Australian beef exporters continue to perform solidly. In 2012-13, Australian beef and veal exports in volume terms increased 6.9% to a record 1.01 million tonnes (shipped weight), reflecting greater domestic supply and increased demand from a number of emerging markets. A decline in domestic beef sale volume in 2012-13 has resulted in the share of exports as a percentage of total production to rise to 67%.

While Japan, the US and Korea continue to dominate the top three spots in terms of destination by volumes, their combined shares have steadily declined over the years, from accounting for about 90% in 2005-06 to just 69% in 2012-13, with the emerging markets catching up very quickly. The prominent rise of China and the Middle East as major export destinations of Australian beef since late last year has witnessed the setting of a number of new records in the year to date: from the all-time monthly record volume of beef exported in May (103,208 tonnes swt) which was subsequently broken by July's result (106,184 tonnes swt) and Australian beef exports exceeded 1 million tonnes swt for the 2012-13 fiscal year. The uptick in volume was partly supported by lower prices overall, which means that the value of exports would have probably grown by less than that of volume, but would still have proven to be a boost to export income in general.

Traditional markets slowly losing shares to emerging markets

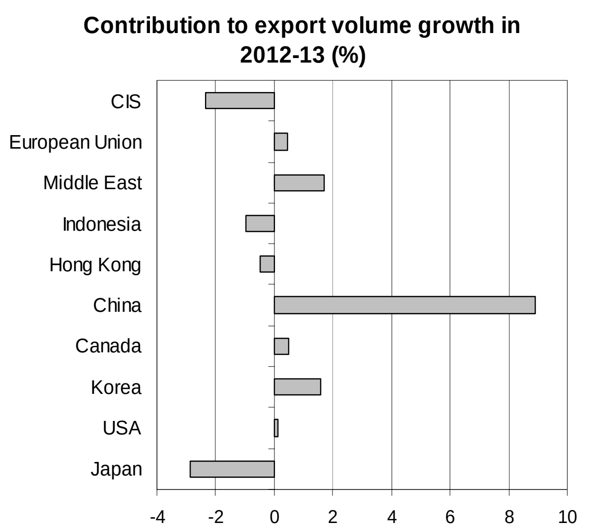
Source: MLA

Broadly speaking, the outlook for Australian beef exports remains very positive, with total volume of exports in 2012-13 already reaching a record high. While in the past, export performance had proven resilient even when the exchange rate exceeded parity (with USD), per unit value of exports was lower as importing countries altered the composition of the cuts they demanded. Nonetheless, the weakening exchange rate should result in the partial return of competitiveness of Australian beef in the premium market thus supporting value growth. Overall, we expect volume exports to increase marginally by 2% in 2013-14. By region, we expect that exports to China, the Middle East, the US and Korea are likely to be the key pillars to growth. In contrast, Japan and Indonesia are likely to remain very challenging markets to operate in.

Outlook in Key Export Markets

While **Japan** remains the top export destination for Australian beef, it has become an increasingly tough market especially in light of recent changes in import policies by the Japanese government favouring American and Canadian beef. In 2012-13, Australian beef exports to Japan experienced a broad-based decline of 8.3% in both frozen and chilled beef and detracted 2.8 percentage points from export growth. Its share as a total of Australian beef exports has been falling gradually since 2010-11, but the fall from accounting for 34% of total exports in 2011-12 to just 29% in 2012-13 makes it the biggest negative contributor to growth in that year. In February 2013, Japan's Ministry of Health, Labour and Welfare amended the age restriction for US and Canadian beef, from the then under 21 months to under 31 months, improving the access of US beef to Japan significantly at the expense of Australian beef for which import requirements remain unchanged. This, combined with increased demand for brisket from China, saw a 22% year-on-year reduction in Australian brisket shipments to Japan in the first six months of 2013. A softer yen against the AUD as a result of the Japanese government's policy stimulus has also served as a dampening factor by making Australian exports more expensive. Weaker market access relative to the US, as well as diversion of demand to emerging economies suggest that Australian exports to Japan are likely to contract moderately in 2013-14.

China, the Middle East and Korea driving export growth



Source: MLA, NAB Economics

Being the second largest 'traditional' export market for Australia, **the US** has been relatively resilient in 2012-13 to grow by 1%. Lower domestic beef production in the US in the year as a result of fewer cows being slaughtered (-2%) has increased US beef imports from Australia and New Zealand. Having said that, export volumes by Australia in the second half of the financial year was significantly lower compared to the first half and the same period last year (-15% year-on-year) as stiffer competition emerged from drought-stricken New Zealand which experienced a high turnoff rate, thereby exerting downward pressure on US import prices. Most of the fall was due to manufacturing beef, with some Australian exporters preferring to redirect them to other countries such as China, Korea and Saudi Arabia where average export returns were higher. Despite this, the US is likely to be a very lucrative market in the medium term. With domestic production expected to fall further this year, the US will rely on increasing volumes of imports over the coming year, with USDA forecasts suggesting that US imports of beef are expected to increase almost 8% in 2013. This bodes well for Australian exports, especially when competitive supplies are thinning – New Zealand will have smaller export capacity from the large cull earlier while Canadian herd has contracted substantially from drought-induced lack of feed. As such, Australian beef exports to the US in 2013-14 are expected to pick up relatively strongly by around 5%.

Australian exports have fared relatively well in **Korea** in 2012-13 to rise by 12% to reach close to 138,000 tonnes, albeit still significantly lower than the 157,000 tonnes recorded in 2006-07. This largely reflects the competitive pricing of Australian frozen beef in the Korean import market. According to ABARES, the landed price of Australian frozen and chilled beef averaged 16% and 6% less respectively than the equivalent beef from the United States in the first 10 months of 2012-13. This is in spite of Australia facing a number of headwinds in the market, including efforts by the Korean government to maintain a desired level of cattle and pig numbers, encouraging an increase in domestic supply. In order for all these excess supplies to be absorbed, discounts and other forms of promotional campaigns were held at supermarkets, thereby increasing the competition for imported meats. Furthermore, US beef imports received a second tariff cut from the Korean authorities in January 2013, which allowed them to enjoy around 5.2% of price advantage over Australian beef. Despite this, imported beef from the US actually fell in the first five months of 2013 even though the levels of Korean beef imports were the fourth highest on record, largely as a result of the escalation of the competition for US products with Japan following the loosening of import protocols by the Japanese government. In the near-term, Australian beef trade to Korea is likely to remain stable, stemming from the current competitive prices of Australian beef and the imminent lessening of import competition from the US (Australia and the US comprise 85% of total Korean beef imports) due to the expected fall in its beef production. However, given that the US is going to enjoy further step downs in its tariff rates by 2.6% each year until zero in 2026, while there have not been any announced cuts to the Australian beef tariff of 40%, the tariff divergence will eventually eat into the competitiveness of Australian beef exports.

After an unprecedented surge in late 2012, beef exports to **China** have maintained a strong pace to be the largest positive contributor to growth in 2012-13. Australian beef and veal exports to China during the first half of 2013 reached 62,421 tonnes swt, 20 times the 3,048 tonnes swt exported over the same period in 2012. Contributing to this phenomenal rise in exports have been the efforts by the Chinese government in cracking down on illegal meat trade, such as buffalo from India and beef from Vietnam, thereby increasing the formal trade link with Australia. Correspondingly, Chinese beef imports during the first five months of 2013 reached the highest volume on record, at 100,867 tonnes swt, compared to just 8,185 tonnes swt during the corresponding period in 2012, with imports from Australia accounting for close to half of the total during the period, cementing its position as the largest supplier. While frozen manufacturing beef still makes up the largest proportion of exports to China, more recently there had been a gradual shift in the composition of exports up the value scale, with an increasing demand for chilled beef from retailers, high-end restaurants and hotels. This bodes well for the overall growth outlook in unit value of Australian exports, as the Chinese consumers become more willing and able to pay a premium for high-quality Australian beef. While the summer months tend to be seasonally slow for Chinese beef demand, we expect the strength in shipments to China to be maintained in the near term, supported by underlying fundamentals of a rapidly rising middle class in China who are likely to incorporate more proteins into their diet, as well as a weaker AUD favouring export competitiveness.

Australian beef exports to **the Middle East** have been at a healthy pace for some time, having recorded consistent yearly growth since 2005. The recent surge is largely attributable to the Saudi Arabia's bans on US and Brazilian beef, after two separate cases of atypical *Bovine spongiform encephalopathy* (*BSE*) were reported in California and Brazil's state of Parana in April 2012 and December 2012 respectively. The bans are currently still in place, thus benefiting Australian exports. Apart from Saudi Arabia, exports to Iran and Kuwait in the first half of 2013 have also been robust. As a result, Australian beef exports to the Middle East grew by 51% in 2012-13, making it the second largest contributor to export growth after China. Provided that Saudi Arabia's ban on Brazilian beef is maintained, Australian beef and veal exports to the Middle East are forecast to rise by around 4% to 50,000 tonnes in 2013-14.

Live Cattle Exports

According to ABARES, Australian exports of cattle for feeder and slaughter purposes are estimated to have declined by 17% in 2012–13 to 480,000 head, largely reflecting falls in cattle exports to Indonesia, Egypt and the Middle East. Exports to Indonesia in 2012–13 are estimated at 265,000 head, a decline of 110,000 head (29%) from exports in 2011–12, and significantly lower than the quota of 520,000 head in 2011. The decline in quota largely reflects the Indonesian Government's pursuit of its agenda to be 90% self-sufficient in beef production by 2014, although anecdotal evidence based on media reports suggest a lack of success. This has led to some moderate upward revisions in the import quota for Australian cattle by the Indonesian government in recent months to meet rising domestic demand and keep a lid on soaring prices. In 2012–13, only 55% of feeder and slaughter cattle exports from Australia are estimated to have gone to Indonesia, compared with 83% in 2008–09.

Other live export markets have held up relatively better, with exports to Malaysia, the Philippines and Japan charting strong growth in the first five months of 2013, albeit from a low base.

In 2013-14, ABARES has forecast a further 2% reduction in the number of live cattle exports for feeder and slaughter purposes to 470,000 head, indicating further tightening of import restrictions in Indonesia. However, exports to other markets in North Africa, the Middle East and South-East Asia are forecast to increase.

Comments from the field

Beef is certainly in the news. Record production coupled with exports headline. While a dry season in north and western Queensland has increased supply and impacted prices, I believe this has a limited life span. The positives: we are not seeing any build up of processed product. Additional supply into Indonesia, falling dollar, a reasonable season in Southern Australia, the likelihood of a normal or better season in north and western Queensland, US and China markets plus others all point to a greater return in the ensuing 12 months and beyond.
Greg Roberts, Regional Agribusiness Manager, Rockhampton, QLD

Cattle prices in the Northern Territory are still depressed as live export numbers to our largest market, Indonesia are limited. There has been some relaxation of Indonesian import permits recently with a number brought forward and issued earlier than planned, and weight restrictions lifted for 25,000 head of heavy cattle in July/August to meet demands post Ramadan. Dry conditions persist with hope of an early wet season. A number of cattle stations are on the market with few sales being completed.
Gavin Kruger, Senior Agribusiness Manager, Darwin

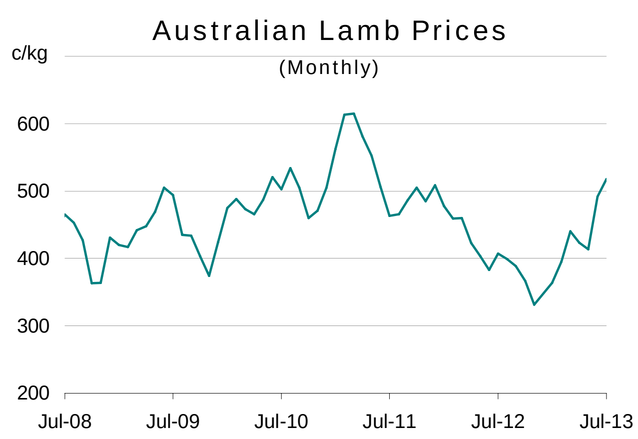
The cattle market has suffered from an oversupply for much of the year which has impacted on farmgate prices. However, recent shortages in the market have seen prices rise, although this is considered to be more of a seasonal influence rather than a clear sign to a sustained strengthening market. An interesting development within this market has been the re-emergence of the F1 (Angus/Wagyu) weaner which continues to attract a premium on a forward sales contract basis. Recent contracts have seen prices range between $750 and $900 per head (heifers and steers) at weaning weights of 250kg. Demand for this product remains strong. Annual commercial bull sales have commenced and are usually a very good indication of confidence (given it is a good indicator as to joining number). Sales to date have been well back on last year (and the previous year) with high pass-in rates (25/30%) which have resulted in much lower average sales prices (probably around 30%). This would indicate that female joining numbers are likely to be back this year.
Ian O'Callaghan, Regional Agribusiness Manager, New England and North Coast NSW

The northwest Queensland region livestock industry has over recent months been dictated by the continued dry conditions. The Cloncurry, Richmond, McKinlay and Flinders shires are all drought declared and with no relief in sight for the near future. Graziers have reduced stock numbers and where found have agisted breeding stock with intention of bringing them back when the season improves. In the Gulf, there are properties which weren't affected by the December/January fires that have grass coverage. However, water has become an issue, as dams begin to dry up in areas. On the positive, recent cattle sales have seen the prices lift from their lows but are still below the pre dry prices. The news of increased allocation for live cattle exports to Indonesia has been welcomed. The property market has seen property sales in Julia Creek area, however most focus has been further south around Barcaldine/Aramac area where good bodies of grass exist.
Phil Hudson, Agribusiness Manager, Cloncurry, Qld

Northern graziers are facing a tough period as drought conditions take hold in many areas, with some receiving less than one third of their average annual rainfall over the past 12 months. Those producers that have had to offload unfinished cattle due to the season have also had to endure the current depressed prices, whilst those that have grass are holding off on selling and hoping for an early break to the season. Recent announcements of increased numbers to Indonesia are welcomed and should see further demand via the Townsville Port facility.
Brian O'Grady, Senior Agribusiness Manager, Townsville, Qld

Key Commodity Prices

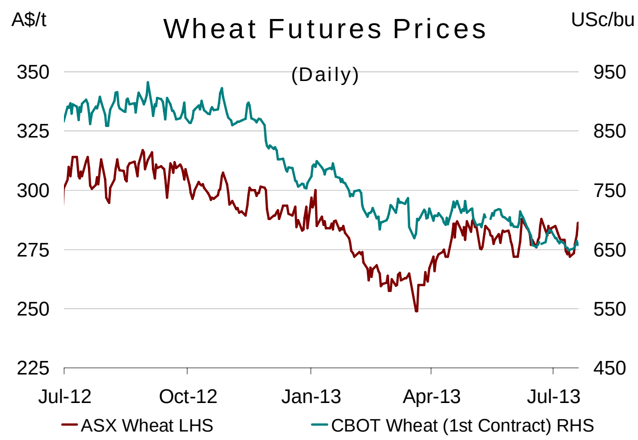
Heavy lamb prices rose further in July on strong export demand



Source: MLA

Lamb prices continued to improve in July, albeit at a slower rate than in June. Contributing to this has been average rainfall across the majority of the country, accompanied by very mild winter temperatures, which have helped pasture regeneration, particularly across parts of the southern states. Meanwhile, processors jostled to secure adequate supply before an anticipated winter-induced tightening of markets by continually lifting their over-the-hook prices, which spilled over to the physical markets. Driving processor demand has in turn seen a lift in exports, spurred higher by the significantly softer AUD since June. In July, lamb exports rose 9% in the month to be 17% higher year-on-year, supported by exceptional growth in exports to China and the Middle East. In 2012-13, total lamb export volumes reached record highs, largely due to early drought conditions encouraging a high turnoff and subsequently, slaughter rate. As a result, lamb quality has been very mixed with supplies made up of more light weight, poor conditioned lambs and heavy weights close to teething. The record high slaughter rate in 2012-13 suggests that opening lamb numbers in 2013-14 will be smaller, implying a smaller production.

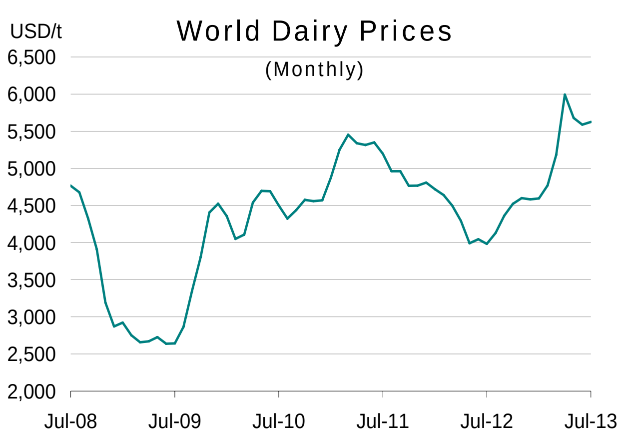
Domestic wheat prices remained firm on tight old crop markets situation



Source: NAB, Bloomberg

Domestic wheat prices continued to show remarkable resilience in July on strong demand and a tight stock situation. Cropping conditions in the east coast and south of Australia remain favourable with above to above-average rainfall received, while conditions in Western Australia have been relatively drier. Also supporting the domestic basis has been the considerable decline in the AUD when global prices, indicated by the Chicago Board of Trade (CBOT), have trended lower in terms of monthly average. A balmy growing season in the US Midwest, which was one of the worst hit regions by the drought last year, has reinforced the expectations of a US bumper harvest this year. While a recovered Black Sea winter harvest from last year's drought is also going to add to what is shaping up to be a substantial global supply pool in the 2013-14 season, thereby exerting downward pressure on prices. Nonetheless, the strength in export demand for wheat has offered an underlay of support to prices. Japan bought nearly 90,000 tonnes of US western white wheat in a tender on 1 August, marking the first purchase of the variety by its top buyer after the discovery of a genetically modified version of the grain in Oregon. Weekly export data from the US and EU also shows strong volumes exported in the last couple of weeks.

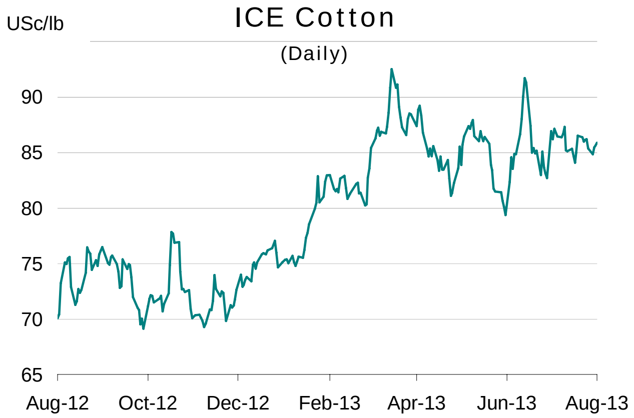
Global dairy prices stayed resilient in July and a recent milk scare in New Zealand is likely to see higher prices



Source: NZX

Dairy commodity markets have held up considerably well during July. Prices have firmed due to a surge in demand that has come ahead of the seasonal increase in supply from the Southern Hemisphere, with buyers who abstained from purchases when prices sky-rocketed a few months ago now re-entering the market. Milk production in the Northern Hemisphere is finally picking up relative to the same time last year, but the season's peak is over, which limits the availability of milk to be processed into commodities suitable for export markets. The 2013-14 production season for New Zealand (NZ) has just started, with pastures and cows being generally in good condition but supplementary feed reserves are low on some farms. Therefore a reasonable but not spectacular start to the season is expected. More recently, revelations by Fonterra, the largest dairy company in NZ, that its exports could contain toxic bacteria that might lead to botulism have sent shock waves across Asia, particularly in China where officials announced a recall of potentially tainted powdered milk and a further temporary ban on dairy imports from NZ. This is likely to lead to a rise in dairy prices.

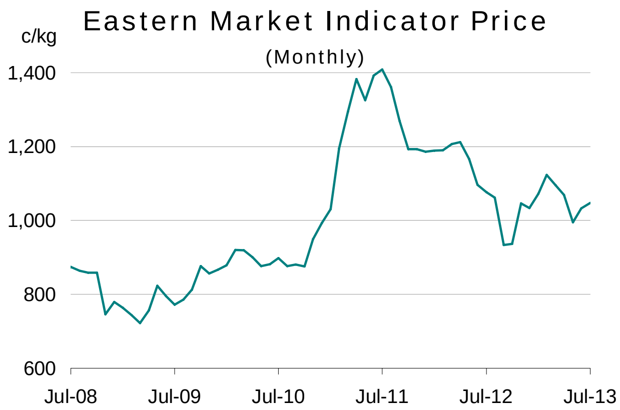
Cotton prices tracked sideways as worries on slow new crop development are offset by slowing Chinese demand



Source: Bloomberg

Cotton prices largely tracked sideways in July, with the expectations of a tight US crop supply in the new crop year that begins on 1 August, offset by worries of slowing economic growth in China, resulting in reduced demand from the world's top textile market. Underpinning the tight new crop expectations has been slow crop development due to the earlier drought conditions experienced by the largest cotton-growing state of Texas, of which 68% of the new crop is currently rated fair to very poor by the US Department of Agriculture in its latest crop progress report. Certified stocks totalled about 252,000 bales by the end of the month - the lowest level since February and down steeply from over 600,000 bales at the start of the month. The big drop was largely expected following the largest July ICE delivery in at least five years of 147 million pounds. On the other hand, speculation that China will produce more of the fibre in the new crop year than previously forecast and an upward revision to global output by USDA, served to influence prices in the opposite direction. In Australia, a wetter-than-normal end to winter and start to spring for most parts of the country suggests that reservoir levels will remain high, implying plenty of irrigable supplies for cotton during the growing season.

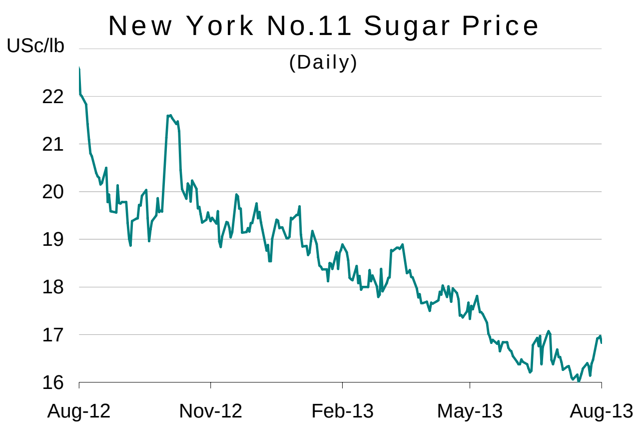
Wool firmed moderately prior to annual three-week recess



Source: Bloomberg

The first half of July marked the first two sale weeks of the new wool marketing season before the annual three-week recess starting from 15 July to 2 Aug. Within the two weeks, the Eastern Market Indicator (EMI) firmed marginally. The long-suffering superfine Merino improved notably in the second week. However, given the narrow premium gap between the superfine and medium fleece, the superfine fleece will have to outperform medium fleece for a few more sales for the status quo in price premium to be re-established. In what appeared to be a counterintuitive phenomenon, the abrupt but short-lived lift in the exchange rate to 93 US cents during the second week of July, has spurred some keen competition between the large buyers of China and India in terms of forward orders. This might've been triggered by buyers' insecurity that the exchange rate might strengthen further during a time when supply might be short just prior to the temporary hiatus. It's expected that demand will build up sizeably after the three weeks from the lack of access to markets and a seasonal low production period in China.

Sugar enjoyed a late-in-the-month rebound from frost scare in South America



Source: Bloomberg

Sugar prices fell to their lowest point in more than three years at US 16 cents in mid-July, due to favourable weather assisting the Brazilian Centre South crush as the sugar cane harvests approached its peak. A sharply depreciated Brazilian real against the USD has also encouraged producers to sell the dollar-denominated commodity to alleviate currency loss. Closer to the end of the month, sugar prices enjoyed a sharp rebound to reach a four-week high in New York on speculation demand may be higher than forecast, at the same time that a frost scare threatened to cut output from southern Brazil sizeably. A Chinese government policy to stockpile local sweetener has resulted in elevated domestic prices relative to international prices which prompted more buying. The current low sugar prices, which are below production costs in many countries, are likely to lead to a slowdown in production in the new marketing year starting 1 October, which will narrow this season's global surplus of 11.2 million tonnes.

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