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Economic Report

Rural Commodities Wrap

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- **Global growth remains at a moderate sub-trend pace and it's expected to pick up to slightly below trend in 2014.**
- **However, NAB business conditions remain weak and forward indicators deteriorated slightly. There are still no signs of a recovery in non-mining investment with trade-exposed industries still struggling with the continuing strength of the AUD.**
- **It's our view that economic activity will remain soft over coming quarters and current economic optimism will fade, prompting the RBA to lower the cash rate again in May (previously February) to 2.25%.**

The markets are continuing to watch the US Fed to assess when it's likely to start winding back its asset purchases. This is dependent on the labour market improving and inflation moving back towards its 2% goal (currently 1¼% yoy). We see that this process of tapering will begin next March and finish in the second half of next year. The Fed have also stated that a Fed funds rate of zero to ¼% is "appropriate" while the jobless rate is above 6½%, inflation is below 2½% and inflation expectations remain under control. We are of the view that the Fed will not start lifting its target funds rate until September quarter 2015.

Other central banks are also signalling that their policy rates will stay low for quite some time. The European Central Bank has just cut its policy rate to 25 bps and said it's likely to keep its rates at current or even lower levels for "an extended period of time". The Bank of Japan intends to keep its rates near zero and to continue buying large amounts of assets until inflation reaches its 2% target, which is forecast to occur in fiscal year 2015.

Economic growth continues to be spread very unevenly across the globe with big disparities in performance remaining between key advanced and emerging economies. Industrial growth in the advanced economies in August was low at 0.2% yoy compared to 4% yoy in the emerging economies. The first half of 2013 saw a narrowing in the growth gap between emerging and advanced economy growth with the former slowing and the latter picking up. However, advanced economy industrial output hit a soft patch around mid-year from which it might now be emerging. Global growth continues at a moderate sub-trend pace and it's expected to pick up slightly below trend in 2014.

In Australia, business and consumer confidence both weakened in October but remain elevated by the standards of the past two years or longer. Low interest rates continue to work slowly through the economy, evident in the recent rallies in the housing and equity markets. The improvement in household wealth implied by higher asset prices should contribute to stronger consumer demand. Broadly, there's still little evidence that business investment outside the mining sector is likely to pick up strongly any time soon. We have left our GDP growth forecasts broadly intact this month. We still expect quarterly growth to soften to 0.4% in Q3, before strengthening to 0.6% in Q4, yielding 2.3% in 2013. Meanwhile, unemployment is expected to rise to just below 6% before the end of this year, before peaking at a touch above 6½% in mid-2014. We see economic activity remaining soft over coming quarters and current economic optimism will fade, prompting the RBA to lower the cash rate again in May (previously February) to 2.25%.

2013/14 Estimates, Rural Prices & Production

Commodity	Production	Price
Wheat	12.3%	-16.0%
Beef	2.5%	-4.8%
Dairy	1.6%	25.0%
Lamb	-3.1%	12.9%
Wool	-1.4%	3.4%
Sugar	-1.2%	-1.3%
Cotton	-1.2%	11.5%
Oil	-	0.3%

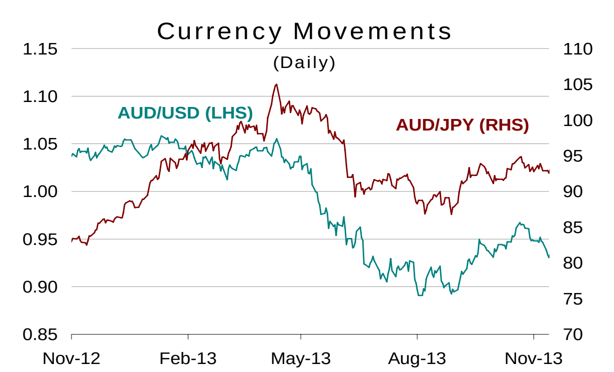
Source: NAB Group Economics
These forecasts represent year-on-year average changes in Australian production and corresponding AUD prices between 2012/13 and 2013/14 financial years

October saw domestic livestock prices continued their downward trend from a seasonally high turnoff and worsening of dry conditions in the north. Meanwhile, wool prices have lifted on the back of renewed buying interest stemming from China, India and Europe, but the strength of the AUD in the month has dampened upward price potential somewhat. For globally traded commodities, grains markets strengthened significantly in the month due to deteriorating production prospects in South American countries and China from unfavourable weather conditions, which in turn looked to divert substantial import demand to US production instead, but the overall outlook remains bearish in anticipation of a global bumper crop. Global dairy commodity prices fell for the second consecutive month on the seasonal uptick in Oceanian supply but remained historically elevated. Meanwhile, sugar prices have been jolted upwards by the news of a major fire destroying one of the world's largest sugar export terminals in Brazil. Cotton prices, on the other hand, have been weighed by weakening Chinese demand.

Currency Movements

The AUD through October was in thrall to the fortunes of the USD, in the most part. With the US shutdown beginning on 1 October, the USD moved lower, buoying the AUD. This was helped by the less dovish interpretation of the RBA's post-meeting statement. Through the month, data and central bank policy considerations further lifted the AUD. The RBA minutes confirmed policy remained data dependent but also that the Board were comfortably on hold for now. The improving Chinese economic data (Q3 GDP acceleration) also helped mid-month. As the US came to a temporary fiscal solution, easing risk aversion, there was a final rally to a month peak of 0.9758. The AUD then began to depreciate. The initial move was triggered by concerns surrounding bad debts in China, followed by rising Chinese yields and concerns over policy/liquidity tightening measures in Australia's largest trading partner. Following this, RBA Governor Stevens upped the volume on AUD rhetoric, noting that he expected the currency to be "materially lower" at some point. We ended the month with the US dollar on the rise following some weak EU inflation data and strong US (Chicago) Purchasing Manager Index data indicating the pace of industrial activity, and following a US Federal Open Market Committee meeting that has not shut the door on the notion of Fed tapering as early as December, albeit still seen unlikely. The AUD rose 1.34% against the USD in the month, with a peak at 0.9758 and a low, early in October at 0.9289. On a trade-weighted basis, the AUD was up by 1.36%. We are now forecasting that the AUD will stay relatively elevated to average 0.95 in the December quarter before moderating gradually to 0.86 by the end of 2014.

The AUD gained further momentum in October

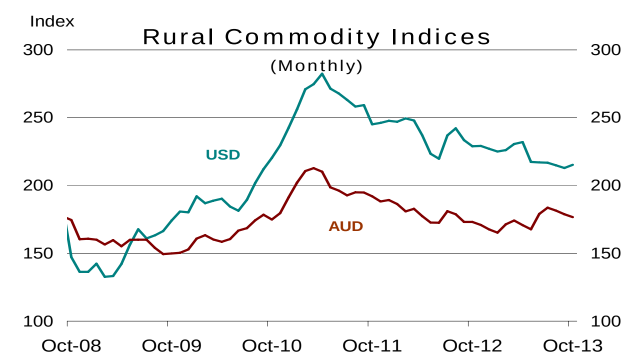


Source: Datastream

NAB Rural Commodity Index

In October, the NAB Rural Commodity Index in AUD terms fell for the third consecutive month by 1.2 %, largely attributable to the sustained loss of momentum in the prices for lamb and beef, accompanied by a gentle fall in dairy prices plus a notable rise in the exchange rate (2.4%). Conversely, the index rose by 1.1% in USD terms. After recording significant declines in August and September, lamb continued to lead the pack in losses in October again to fall by around 9% in AUD terms. It was followed by beef (-3%), cotton (-1%) and dairy (-0.2%). These were partly offset by rises in sugar (+11%), wheat (+5%) and wool (+3%). Looking forward, the risks to the outlook are largely balanced. While the declines in livestock prices may moderate as supplies tighten, dairy and cotton prices are tipped to fall further from their current levels as the seasonal supply increases for the former while the latter continues be weighed down by weakening Chinese demand. This is expected to be partially offset by the likely depreciation of the AUD from its October level.

Rural Commodity Index fell marginally In AUD terms

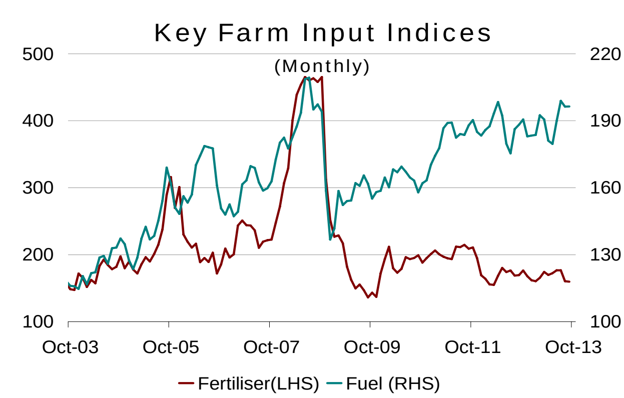


Source: Bloomberg, NAB Economics

NAB Farm Input Indices

The global fertiliser market was mixed in October but was overall lower on a notable fall in Diammonium Phosphate (DAP) and a significantly stronger exchange rate. In AUD terms, DAP fell for the fourth consecutive month to be 11% lower, driven largely by increased export availability from China and weaker demand from India due to a heavily depreciated rupee. This is followed by marginal falls in urea (-1%) and natural gas (-1%), which rose in USD but more than offset by the effect of an appreciated AUD. Sluggish global demand and an overhang of global inventories have kept a lid on fertiliser prices, further exacerbated by strong export supplies from China induced by its low export tax window for DAP and urea, which has spanned from July to mid-October. Meanwhile, the oil price index fell by 2% in the month from its highs in the third quarter but remained historically elevated.

Fertiliser prices remained subdued but petrol prices still reflect Middle East crisis premium



Source: Bloomberg, NAB Economics

NAB Weighted Feed Grains Price

Feed grain prices fell further in October as the harvest season of grains officially started across major cropping regions and the exceptional conditions In WA and SA are bolstering prospects of a strong crop outcome this year. The Albany and Esperance regions in WA were reported to be especially promising. As a result, NAB's Feed Grains Price Index continued its downward trend since July to fall by 1% in the month. In its latest commodities report, ABARES has forecast Australian coarse grains production to rise by 12% in 2013–14 to 11.7 million tonnes.

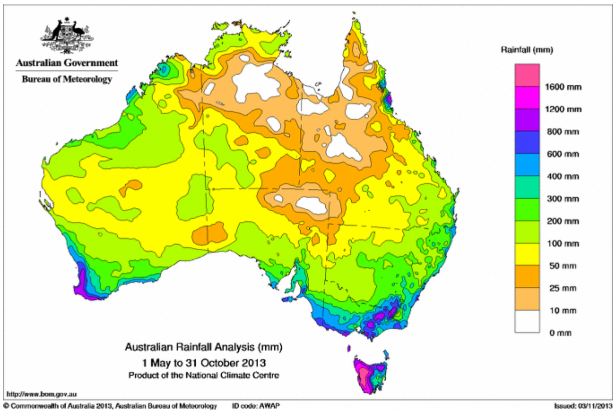
In Focus – Agricultural Commodities Outlook 2013-14

- **In the near-term, global grain markets will remain bearish despite signs of demand recovery from major global consumers. Meanwhile, prices of proteins and dairy are expected to fare better, with livestock herds declining around the world, such as the US, Mexico and Australia, at a time when global demand growth has accelerated in pace.**
- **Within Australia, the "North-South" divide in climatic conditions, with decent rainfalls in the southern regions and prolonged dry conditions in the north, will be the main determinant of production outlook for crops and livestock in 2013-14.**
- **Within Australia, the export outlook for the different commodities in 2013-14 is likely to be highly variable, with dairy, lamb and live exports expected to be the top performers while softs of cotton and sugar are likely to fare the worst.**

Global and Domestic Commodity Prices in 2013

As the end of 2013 is approaching, it's a great time to reflect back on some of the key events that took place in the agricultural sector this year, and anticipate some of the opportunities and risks that might arise for the remainder of 2013-14.

Rainfall has been unevenly distributed across the country during the critical crop development months



Source: BOM

2013 kicked off with a soft note, with the development of drought conditions in the second half of 2013 halting the run of two consecutive wet years of 2010-11 and 2011-12 which witnessed record harvests in the latter year. At the turn of 2013, cattle prices were on a downward slippery slope while lamb prices had only started to turn the corner after hitting their weakest levels recorded since mid-2008 in November 2012. At that time, Australia was not the only country plagued by widespread dry conditions; so did our trans-Tasman neighbour, and many major crop growing regions around the world, such as the US (which experienced its worst drought in more than 50 years), Europe and parts of South America. As such, prices of globally traded commodities for crops, i.e. wheat, corn and dairy soared to historically elevated levels due to pessimistic production forecasts. Prices for cotton and wool were also relatively robust, but they were more driven by the strength in underlying demand by emerging countries. In particular, the purchases by the Chinese government to restock its national cotton strategic reserves had a direct impact on maintaining global cotton prices above 80 US cents per pound.

As the year wore on, it became increasingly apparent that the long-anticipated improvement in weather conditions was not going to occur evenly across Australia, with major parts in northern and central Australia experiencing significant rain deficiencies and poor top-level soil moisture, even up till today. Meanwhile, coastal and southern regions of Victoria, South Australia, Tasmania and wheat growing regions in Western Australia have received the much needed late-autumn early winter break which provided the critical levels of sub-soil moisture required for the germination of the newly planted winter crops. Meanwhile, the relentless dryness in the mainly cattle rearing regions in the north kept slaughter rates of livestock up, pressuring on prices. On a positive note, the sharp rise in production didn't morph into an excessive oversupply of red meat in the domestic retail markets, as it was readily absorbed by protein export demand by emerging economies, mainly China and parts of the Middle East. Exports to these countries have surged at a phenomenal rate in the past year, and total monthly beef exports have broken previous set records in May and July. Meanwhile, lamb exports have surged to their highest level on record in October.

The pattern of sustained strength of this demand even during a time of a historically high Australian dollar, were attributable to a number of factors: favourable pricing of Australian proteins, tight domestic supplies in importing countries, and in the case of China, supply shortages were exacerbated by the more serious efforts by its government in clamping down of "gray" channels of beef and poultry imports from Southeast Asian countries. However, providing a layer of underlying support has been the well-recognised narrative of rapidly expanding of population and rising average incomes of consumers in emerging economies. That said, live exports suffered the opposite fate, continuing to fall for the third consecutive year in 2012-13, mainly from the progressive reductions in the live imports quota in Indonesia.

As the year progressed, the US and South Brazil and Argentina, which are ranked amongst the top grain producers in the world, also experienced enhanced weather conditions that boosted crop yields. The so-called 2012-13 North American Drought, which peaked during northern hemisphere summer of 2012 afflicting more than 80% of the country, experienced some relief when major winter rain events broke a three-year pattern of drought in much of the Southeastern US and eventually most of the eastern half of the country, but conditions worsened in parts of the western regions.

Along with the improvements in weather conditions, more optimistic crop production prospects have emerged. The projected rise of US corn production to its largest on record, accompanied by strong soybean production in Brazil and a general global recovery in wheat production stemming predominantly from the Black Sea, have culminated in the prospects of a grain glut in the 2014 marketing year which have duly depressed global grain prices and contributed to moderating global food prices from May to September, the longest streak of food price declines since 2009. In terms of other crops, expected record sugar production in Brazil, aided by significantly devalued currency due to rising US bond yields, hence an appreciating USD in the second and third quarter this year, have also seen sugar prices plunging to levels not seen since 2010, but they have recently rebounded on the news of a major fire at one of the world's largest sugar warehousing ports in Brazil.

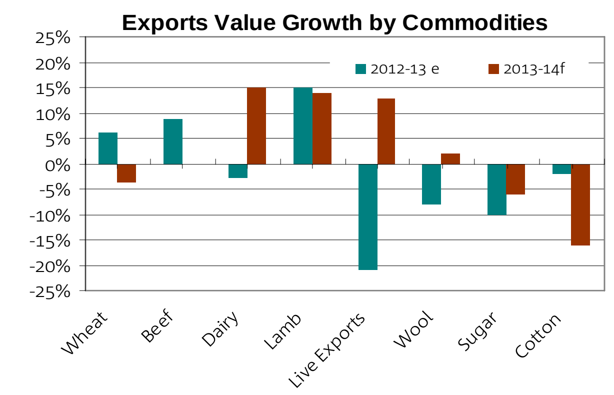
In the near-term, global grain markets will remain bearish despite signs of demand recovery from major global consumers. Meanwhile, prices of proteins and dairy are expected to fare better, with livestock herds declining around the world, such as the US, Mexico and Australia, at a time when global demand growth has accelerated.

Australian Agricultural Production and Exports Outlook in 2013-14

Despite the recent decline in global rural commodity prices overall, supply-side responses in terms of cut-backs in planned production are thus far limited in Australia. Rather, it's the "North-South Divide" that has characterised the distribution of rainfall in this country since winter that is playing a big role in shaping the Australian agricultural production outlook for 2013-14

The production outlook for winter crops is looking generally favourable, despite some variations in growing regions. The below-average winter rainfall in parts of New South Wales, Southern Queensland and northern Western Australia have rendered lower yields of wheat and coarse grains, but they have been offset by higher plantings and yields in Victoria, South Australia and Western Australia where weather conditions have been more favoured by the Rain God. NAB now expects that Australia wheat production will reach 24.7 million metric tonnes (mmt) in 2013-14, 0.3 mmt lower than our early September forecast to take into account the damage incurred by the severe frosts across Victoria and New South Wales in mid-October. However, wheat and barley crop conditions have been exceptional in WA this year, with the lack of rain from May to July compensated by a soft finish in September and October. As grains harvests are now well underway in WA , CBH, one of Australia's leading organisations specialising in the supply chain of grains from storage, transportation to processing, was reported by the agricultural website The Land to have received the largest ever amount of grain for October within the state at 779,952 tonnes, surpassing the past record of 622,000 tonnes. According to CBH, many growers are expected to average around four tonnes of wheat and barley a hectare and we have tipped for wheat production for the state to reach 9mmt this financial year. Overall, WA, VIC and SA are expected to contribute to around 72% of overall production this year. Similarly, coarse grains production is expected to experience an uptick of similar magnitude, to be just below 12mmt, driven by growth in barley, sorghum and barley which is expected to outweigh falls in triticale and maize.

Export outlook is largely mixed across commodities



Source: ABARES, NAB Economics

The combination of elevated global grains prices and low production in 2012-13 has resulted in a significant rundown of domestic stocks of grains due to exports, which made up about 88% of total production last financial year for wheat and coarse grains combined. Consequently, Australian wheat basis (the excess of local to foreign price) has strengthened significantly since early April this year, with domestic wheat futures prices having risen by 12% since then to be currently around AUD $280 per tonne for new deliveries in January, compared to an 8% fall in the international futures market. As such, a significant degree of stock replenishment is likely to take place in the financial year at the expense of exports, although the Australian wheat basis will diminish gradually as stocks get rebuilt over time. At this stage, it's quite challenging to provide an accurate projection of Australian exports for the year, which will be contingent on restocking intentions, overseas demand and the trajectory for Australian basis. ABARES has recently forecast a 4% fall in export earnings in 2013-14, reflecting projected falls of 10% in export volumes and 12% in global prices, partly offset by the effect of a falling AUD. Exporting prospects for coarse grains are expected to be weaker, reflecting sharper falls in global malting and feed barley prices and reduced shipments.

Production prospects for softs remain resilient, albeit being slightly below that of last year. Plentiful supply of irrigation water resources and commodity prices which are above historical average have maintained the momentum of plantings. For sugar, harvesting conditions were overall encouraging; pointing to average or above sugar content yields, however, there has been some damage to sugarcane plantings due to floods earlier this year and the Yellow Canopy Syndrome disease in the region of Herbert. Meanwhile, total cotton production is expected to fall marginally from 2012-13 levels, but dryland cotton planting is forecast to have gained acreage from 23, 000 hectares in 2012–13 to 40,000 hectares in 2013 –14 at the expense of sorghum production according to ABARES' latest commodities report, largely a result of more optimistic gross margins.

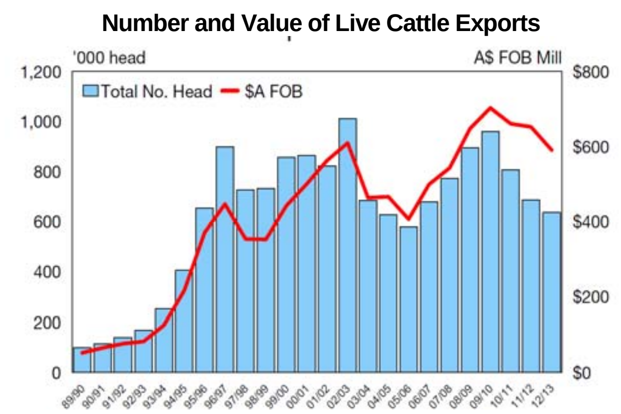
Export volumes of sugar for 2013-14 are expected to stay largely unchanged from 2012-13, but earnings will be moderately diminished predominantly due to weaker global prices (-11%). However, cotton exports volume will be slashed in the order of around 20% from diminished exportable supplies as well as stiffer competition from the US and India. Cotton prices are likely to rise moderately in AUD terms (NAB forecast 11.5%) in 2013-14 from a higher year-average world price and lower exchange rate, although this assumption is highly vulnerable to the possibility that the Chinese government may release its cotton reserves in large quantities which will have a detrimental effect on prices. Put together, the value of cotton exports will be around 9%.

For livestock, it's clear that the overall supply projection for the remainder of the financial year will need be balanced between the normal seasonal conditions outlook for southern producers, as opposed to the tough conditions that are plaguing northern producers. The worsening rain deficiency projections in parts of the north will contribute to sustained high turnoff (albeit not as high as March – July levels) and pressure on livestock prices. Therefore for Northern Australia, the market outlook for late 2013 and 2014 will be primarily contingent on the timing of the arrival of the wet season. Nonetheless, the expected continued rise in northern production will be partly offset by the south, where a reasonably wet start to winter has stoked restocker demand in anticipation of pasture regrowth, thereby restricting supply growth in the coming months and exerting upward pressure on cattle prices in the coming months. However, the overall 2013-14 average price is forecast to be 5% lower than 2012-13 average.

To illustrate the steady influx of cattle throughput for the year, average weekly slaughter for the first nine months of the calendar year has been 13% higher relative to the same period last year, at 140,972 head, according to the Meat and Livestock Association. As such, overall 2013-14 beef and veal production volumes are still expected to outperform 2012-13 by 2.5% with a higher slaughter rate only partly offset by lower average carcass weight. Exports volumes are expected to be even more resilient, rising by 5%, supported by continued demand from China and Southeast Asian countries, including Indonesia which has recently abandoned the quota system.

For lamb, the highest slaughter rate in around 40 years in 2012-13 (around 21.1 million head) has reduced the breeding flock going into 2013-14, coupled with lower lambing percentages as sub-optimal seasonal conditions in 2012–13 resulted in lower ewe joining rates. A falling herd size is expected to put downward pressure on lamb production in 2013-14, forecast to contract by around 3%. However, the volume of lamb exports is expected to hold up better, rising by 1%, aided by a weaker exchange rate and sustained demand from the Middle East, China and the US. Tighter domestic and global supplies will see lamb prices average higher 13% in 2012-13.

Number and value of live cattle exports have been falling since 2010-11 but are tipped to grow in 2013-14



Source: MLA

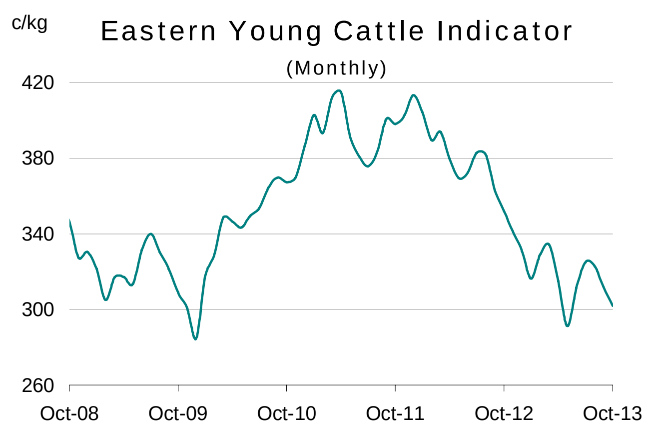
In the realm of live exports, which has undergone a tumultuous period in the last couple of years from the progressive reductions in the quota of imports by Indonesia, there was a significant turn of events in September. The Indonesian government has announced that it would suspend its quota system which restricts cattle imports from countries such as Australia in preference for a reference price mechanism, where imports of beef products and live cattle to the many feedlots in the country to be fattened and slaughtered will be allowed as long as the domestic consumer price exceeds the benchmark of 76,000 rupiah (currently around AUD$7.00) per kilo, while imports will be curtailed once the consumer price falls below 5% of the benchmark. In light of this and rising import demand for sheep in the Middle East, ABARES has forecast for live exports volume to increase by 7% in 2013-14, driven by 15% in cattle and 5% in live sheep, amounting to a close to 13% rise in overall export value. Having said that, downside risks might arise from the declining number and quality of cattle stocks from a prolonged period of drought, which raise the question as to Northern producers will be able to meet Indonesian demand should the number of import permits be raised substantially.

According to Australian Wool Innovation Limited, the sharp rise in sheep turn-off in 2012-13 -- which has reduced season-opening sheep numbers for 2013-14 – combined with an expected reduction in average fleece weight resulting from the dry seasonal conditions that were experienced in many wool growing regions in the first half of 2013, will result in marginally lower wool production in 2013-14 of 1.4%. Meanwhile, a tighter supply, accompanied by a recovery in demand from Europe and China and an assumed lower exchange rate will provide some support to wool prices in the financial year, with NAB forecasting an average of around 1080 AUc/kg, to be about 3.4% higher than the previous year.

Finally, conditions in the dairy sector appear to be more promising than industry average in 2013-14, with production expected to be marginally higher (+2%) from a return of more favourable weather conditions, stronger exports and higher farmgate prices, despite production to-date in the current marketing year is still moderately lower than last season. Robust demand for dairy commodities from emerging Asian economies, especially China, and the Russian Federation, as well as a sharp lift in export prices (+25%) due to elevated global dairy commodity prices and a depreciation in the AUD, are expected to induce a lift in the total value of exports by around 15%, with a lower export volume (due to diversion to the local market) offset by higher prices.

Key Commodity Prices

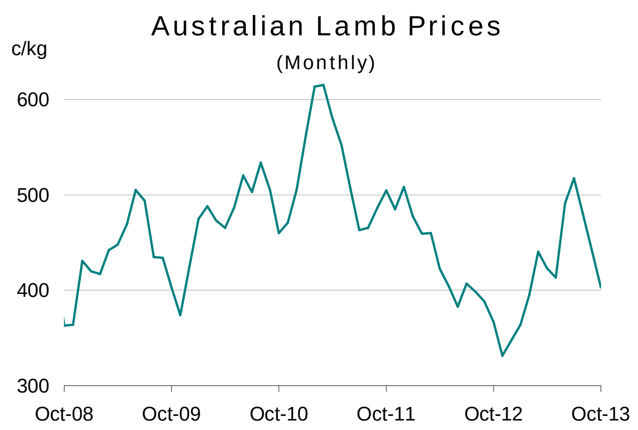
Cattle prices fell in October but exports continued to surge to near-record levels



Source: MLA

Cattle prices fell for the third consecutive month in October in monthly average terms, largely driven by a surge in seasonal supply and low restocker demand. Majority of cattle producing states of Queensland, New South Wales and South Australia received below-average rainfalls in the month, and above-average temperatures, with NSW being the hardest hit. As a result, there has been downward pressure on feed availability which is in turn reflected in the ordinary quality of cattle presented at saleyards and easing prices. In contrast, conditions were more favourable in Victoria in the month, buoying decent levels of restocker activity. Despite the AUD continuing to strengthen to average around US$0.95 in the month, beef and veal exports soared past 100,000 tonnes in October to be just shying away from July's record high. The largest contribution has stemmed from Indonesia, to which exports have doubled in the month compared to the same time last year to 5275 tonnes swt. This is in turn driven by the disbandment of the quota import system by the Indonesian government to a reference price mechanism, reportedly due to escalated domestic beef prices from a critical supply shortage. In the first week of November, the long-awaited rains in Queensland have helped to lift producer sentiment and contributed to a slight rebound in prices.

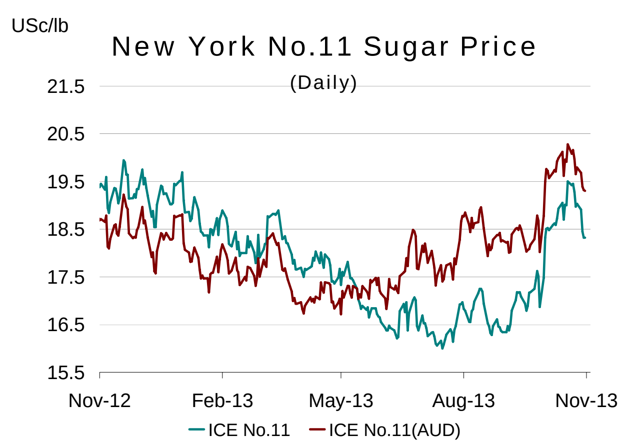
Lamb exports set a new monthly record in October



Source: MLA

Similar to the trend in beef prices, heavy lamb prices fell for the third consecutive month in October to average around 440 AUc per kilo. A combination of a greater lamb numbers in the past year, higher traditional spring turnoff and deteriorating conditions in western and northern NSW has underpinned high processing numbers. This has in turn fuelled the highest monthly lamb export volume in history, reaching 20,825 tonnes which is about 12% more than the same time last year. Contributing the most to the year-on-year growth for the month is China, which demanded close to 1300 tonnes more of lamb compared to last October and once again set a new monthly record, with the previous one set only in September. The Middle East continues to account for the biggest share of the market at around 25%, followed closely by China and the US, which stand for around 24% and 20% respectively. There are some signs of strengthening in US demand recently, with exports to the country demostrating strong lifts in September and October relative to the same months in 2012. Looking forward, it is unlikely that the current pace of exports can be sustained, with lamb supply and quality already showing signs of easing.

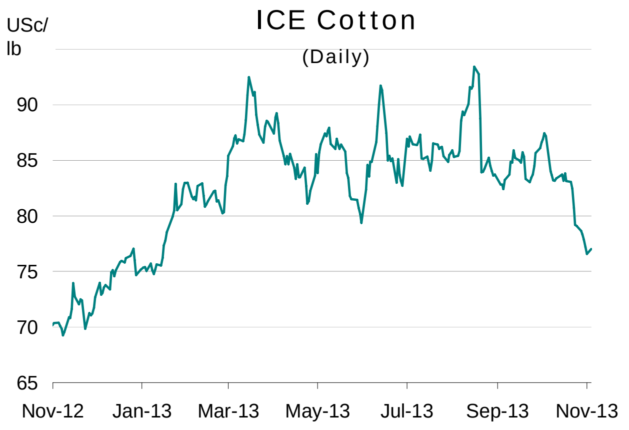
Global sugar prices surged on a major fire destroying stocks at one of the world's largest export terminals



Source: Bloomberg

Global sugar prices continued to build on the momentum in September and enjoyed a rare sharp upswing in the 3rd week of October to reach the highest levels in more than a year, after a fire broke out one of the world's sugar export terminal in Brazil and destroyed warehouses full of the sweetener. It has been estimated that around 180,000 metric tonnes of sugar was destroyed in the process, equivalent to the sugar content of 7.5 billion 1.55-ounce Hershey's milk chocolate bars. This has resulted in sugar prices lifting by 2.2% bringing the advance to 20% in the two months leading to the peak. Meanwhile, indicators of rising demand suggest that surplus for 2013-14 will not be as excessive as previously feared while a stronger Brazilian real has also trimmed some incentive for exports. Furthermore, sugarcane harvests in the centre South of Brazil were also reported to have been hampered by heavy rains which occurred in September and early October, which has prompted the Brazilian Sugar Cane Industry Association, or Unica, to trim its forecast for the harvest in Brazil's main sugar-producing region by 0.4% to 587 million metric tonnes this season.

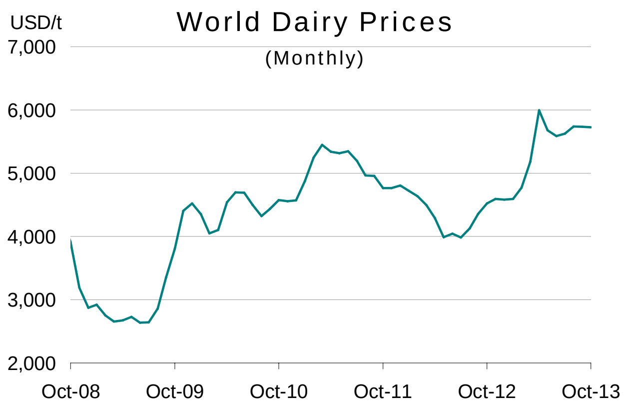
Cotton prices slumped on reports of better than expected 2013 global harvests and slowing Chinese demand



Source: Bloomberg

Cotton prices followed a sharp downward trajectory in October and early November, in the longest losing streak for the commodity since at least 1980. The ICE#11 index fell 11% over October to be 2% lower in monthly average terms, predominantly due to larger than expected 2013 harvest. The best monsoon season in India in six years has helped to lift the country from drought conditions last year and is expected to boost its cotton crop to record levels. Similarly, favourable weather conditions have also supported cotton production and quality in Greece and the US, while increased plantings in Brazil are likely to drive a 22% improvement in production in the country this year. Looming over the already comfortable production prospects is the record amount of cotton inventory held by the Chinese government. The restocking cycle that commenced late last year has supported cotton prices beyond 80USc for the last nine months. However, the pace of this purchase has slowed considerably in recent months, pointing to the possibility that the government may start to release some of its reserves later this year or in 2014, which will only serve to dampen prices further. According to the International Cotton Advisory Committee, China is expected to account for 55% of the 20.8 million tonnes of the world's ending stock in 2013-14, of which levels are 12% above that of last year.

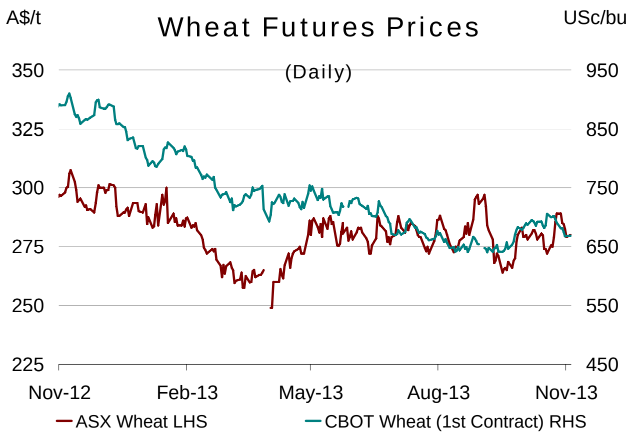
World dairy prices stayed resilient on voracious Chinese demand despite a seasonal recovery in Oceanian supply



Source: Bloomberg

Global dairy prices have eased marginally in the month to still maintain at historically elevated levels, supported by an insatiable demand by China despite more product shipments from New Zealand. Projections by Agrifax suggest that China will need 400,000 tonnes additional whole milk power this calendar year compared to 2012, and the forecast growth of 8% in New Zealand milk production this year will only equate to half of this additional demand even if all of it is diverted to China. Against this backdrop, the seasonal uptick in Oceanian supply, which usually peaks in October or November, is only likely to exert very modest downward pressure in the coming months. Production in Australia in the first quarter of the 2013-14 has been relatively lacklustre, as output across six states trailed behind last season by 3.8%. While the season's peak is now over, better returns from higher farmgate milk prices are expected to maintain production momentum in the later part of the season. Farmgate prices are expected to be around 42-45 cents per litre for manufacturing milk and above $6/kg for milk solids.

Domestic wheat basis strengthened on concerns of potentially widespread frost damage in Victoria and NSW



Source: Bloomberg

Global wheat prices continued their upward momentum in October, with the Chicago Board of Trade (CBOT) first-contract futures rising by 5% in monthly average terms. Contributing to this has been the reported poor crop conditions in South America, with the worst drought in 50 years in Argentina, South America's largest wheat exporter, adversely eroding production prospects. There have also been reported severe crop losses due to frost in Brazil and Paraguay. This helped to form the market's view that there will be a sizeable amount of South American import demand diverted to US production, which is likely to gain further support from China, where wheat imports are expected to reach the highest in years from a poor quality harvest that sent local prices soaring. In Australia, wheat prices rose substantially on news of severe frosts causing large-scale damage to wheat crops in parts of New South Wales and northern Victoria. At this stage the total damage is yet to be quantified but overall Australian wheat production is expected to lift by 12% to 24.7mmt this year, predominantly driven by a notable production improvement in WA.

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