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Economic Report

Rural Commodities Wrap

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January 2014

- **The global economy capped off 2013 on a strong note, with monthly measures of global industrial output and trade indicators picking up to finally be consistent with the more buoyant message that the advanced economy business surveys have been signalling since late 2012.**
- **However, the NAB business survey showed little improvement in domestic business conditions in November, with better trading and profitability offset by faltering employment. We still expect another interest rate cut by the RBA in May 2014, but risks remain for either an earlier cut or more than one cut should the labour market worsen.**

The global economy capped off 2013 on a strong note, with monthly measures of global industrial output and trade indicators picking up to finally come into line with the more buoyant message that the advanced economy business surveys have been signalling since late 2012. The pick-up in activity is triggering positive spill-over effects into labour markets in many countries, notably the US and UK, where both unemployment rates are falling rapidly towards central bank thresholds. The Euro zone is also set to grow in Q4, but divergences are growing, especially between the two traditional major economic powers of Germany and France, with the latter now seen to be contracting faster than Italy. Also supporting the near-term global growth outlook are the historically low policy interest rates in many big advanced economies, which are not expected to be lifted substantially anytime soon.

After the US Fed announced at their December FOMC meeting that they were commencing tapering – reducing monthly asset purchases to US$75 billion (from US$85 billion) – the response in most commodity markets was relatively muted, although the VIX index of market volatility picked-up ahead of the US Fed meeting (but remains at relatively low levels). It remains to be seen how commodity markets will respond to additional tapering over coming months – (assuming the economy continues to improve as expected) a steady winding down that will be completed by late 2014 – but the US Fed's focus on forward guidance should help to suppress market concerns, while stronger physical demand for industrial and rural commodities will help to offset softening demand from investors.

Growth has also picked up slightly in the big emerging economies. The Chinese Government's 7½% growth target for 2013 and its focus on rebalancing activity away from what have been the leading growth sectors underpin a consensus view that the economy should be cooling. However, growth picked up from 7.5% yoy to 7.8% yoy between June and September and the partial data on industrial output, investment and retail trade remains solid. Indian economic performance has repeatedly disappointed in recent years but the September GDP result was stronger, above expectations and in line with some of the partial data (but not many of the business surveys which remain weak).

2013/14 Estimates, Rural Prices & Production

Commodity	Production	Price
Wheat	17.0%	-15.9%
Beef	3.1%	-4.3%
Dairy	-2.7%	35.6%
Lamb	-1.1%	12.0%
Wool	-2.0%	4.8%
Sugar	-1.2%	2.6%
Cotton	-2.7%	16.4%
Oil	-	- 0.6%

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

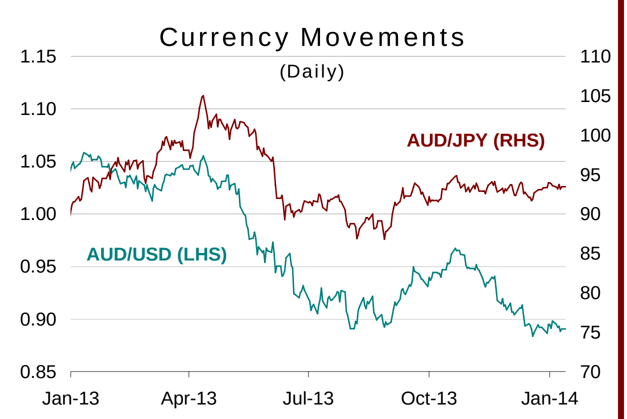
In Australia, the September quarter national accounts showed that the domestic economy continued to struggle with lower commodity prices and subdued consumer demand and business investment; although some green shoots of recovery have sprouted from the retail sector recently. NAB business conditions showed little improvement in November, with better trading and profitability offset by faltering employment. Our forecasts are broadly unchanged: GDP for 2013/14 now 2.5% (was 2.2%) and 2014/15 now 2.9% (was 2.8%), largely reflecting revisions to history. Unemployment rate still to peak at 6½% in late 2014. We still expect another cut by the RBA in May 2014 but believe that there are greater risks of either an earlier cut or more than one cut, depending on labour market outcomes.

December saw domestic livestock prices pick up modestly from a seasonal pick-up in demand, but they remained weak overall relative to a year ago. Wool prices managed to maintain momentum prior to the three-week Christmas recess in wool auctions and recent January auctions saw prices largely maintaining their ground. Meanwhile, domestic grain markets have defied global price trends to rise notably in December on strong domestic demand, especially in drought-plagued Queensland and NSW. Global dairy prices have been on a relentless demand-induced increase despite strong output levels in New Zealand. For softs, cotton has been faring better on improving global textile demand while sugar lapsed into new lows on the prospect of the largest world's ending stock on record.

Currency Movements

The AUD depreciated 2.5% in December against the USD; with a peak of 0.9168 and a trough of 0.8821. On a trade weighted basis, the AUD was down 2.0% in the month. Despite some of the Chinese economic data being better than expected, the AUD continued its slide. Much of the depreciation pressure arose from central bank action, both locally and in the US. The RBA continued its rhetoric on a lower AUD, with the statement post their December policy meeting continuing to note the AUD was “uncomfortably high” despite the decline already seen in November. This was followed up by more explicit discussion about the AUD’s value from Governor Stevens in an interview with the Australian Financial Review. Combined with a lower than expected Q3 GDP outcome, higher unemployment and deteriorating fiscal situation, the domestic pressure on AUD was lower. The US FOMC reduced its asset purchases on December 19, earlier than some expected and providing some support for the USD in its wake. More recently, the AUD has demonstrated more stability to fluctuate around the 90 US cents mark, largely a reflection of relatively quiet trading sessions at the start of the year. However, the AUD is expected to face more headwinds in the near-term, especially in light of the speeding up in the US Fed tapering and weaker Australian terms of trade from the expected falls in iron ore and LNG prices. Furthermore, NAB believes total capital expenditure is not likely to fully recover from the fading mining investment cycle. A weaker labour market as a result of this could likely prompt at least another rate cut by the RBA, weighing further on the AUD.

The AUD gained further momentum in October

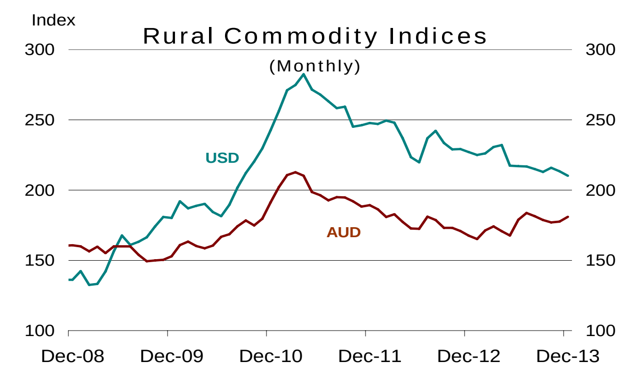


Source: Datastream

NAB Rural Commodity Index

In December, the NAB Rural Commodity Index in AUD terms rose for the second consecutive month, largely attributable to the 3.3% fall in the AUD. Conversely, the index fell by 1.4% in USD terms. Contributing to the overall higher index in AUD terms had been the strong rise in dairy prices (+5%), followed by beef (+3.2%), wool (+2.9%), lamb (+2.4%), barley (+2.0%) and cotton (+0.5%). These have more than offset large declines recorded in global crop prices: sugar (-4%) and US red hard winter wheat (-2%) from the realisation of bumper crop outcomes in the northern hemisphere as harvests there drew to a close, even after taking into account the depreciation in the AUD. In the near-term, the outlook for the index is largely mixed, with expected rises in livestock and wool prices from reduced supplies largely to be counteracted by further falls in sugar, cotton and wheat prices, as well as a falling AUD.

Rural Commodity Index fell marginally In AUD terms

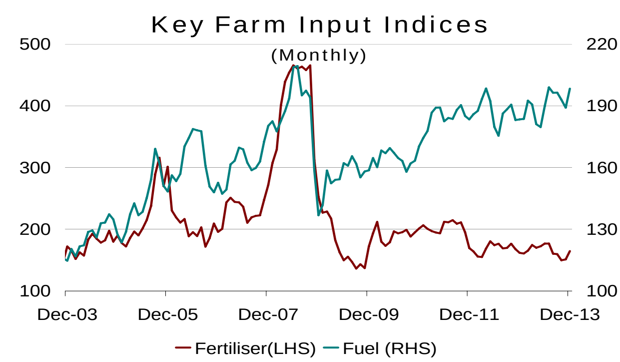


Source: Bloomberg, NAB Economics

NAB Farm Input Indices

The global fertiliser market was significantly stronger in December on a sharp pick-up in natural gas prices and a weaker exchange rate. In the US, natural gas prices have soared in the month as the continent was gripped by unusually frigid conditions, experiencing the worst cold snap in more than 20 years. On the other hand, DAP and urea prices have remained at subdued levels, with many large importers continuing to display caution when buying in large quantities, although urea appears to have held up better on speculation of limited availability out from China. Meanwhile, petrol prices continued their rising trend in December on the back of a lower exchange rate and holiday season premiums. Looking forward, global activity in the fertiliser market is likely to stay relatively soft, especially in light of potentially more supplies from China as speculation suggests that its government will replace the high-tax window from 1 November through 30 June with a flat export tax of between 10% and 15% for the full year.

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



Source: Bloomberg, NAB Economics

NAB Weighted Feed Grains Price

Domestic feed grain prices have withstood the pressure from falling global grains prices to rise strongly across the board in December. This largely reflects the effects of severe grains shortages in drought-impacted regions of northern NSW and Queensland, which have been pulling feed grains from neighbouring zones. Persistent drought conditions in Queensland have witnessed the number of cattle on grain feed rising as hay becomes increasingly unaffordable due to limited cash flows faced by farmers. As a result, NAB's Feed Grains Price Index rose by a robust 4.5% in the month.

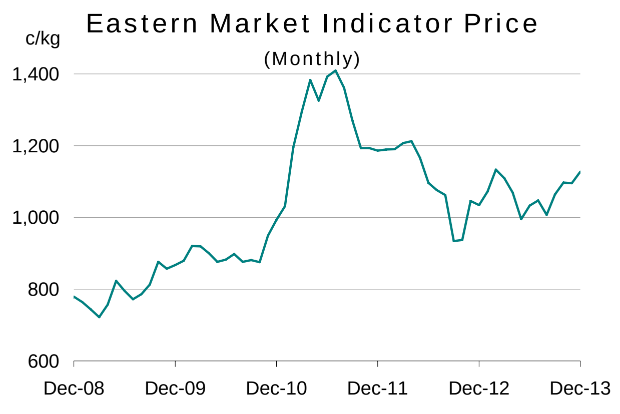
In Focus – Wool

- **Wool prices, as measured by the Eastern Market Indicator (EMI), ended 2013 on a strong note and are forecast to rise by 5% over 2013-14.**
- **Since the onset of the GFC, the price premiums paid for the higher quality, super and ultrafine fleeces compared to the lesser styles have diminished significantly, reflecting a structural change in buyer composition and their buying patterns.**
- **The Australian Wool Production and Forecasting Committee has forecast a slight easing of 2% in shorn Australian wool production volume to 345 million kg in 2013-14, reflecting smaller opening sheep numbers and lighter fleece weights from poor autumn and winter conditions in many parts of the eastern states.**

Wool prices gaining strength

Wool prices ended 2013 on a strong note after charting six consecutive weekly gains from early November to the last auctions of the calendar year in the second week of December prior to a three-week hiatus. The benchmark Eastern Market Indicator (EMI) averaged 1127 cents/kg in December, up from 1095 cents/kg in November. In year-average terms however, wool prices have fallen marginally by 2% in 2013 to around 1070 cents/kg. High sheep turnoff from drought conditions in many areas of eastern states have ensured a steady wool supply at auctions when demand conditions were relatively more erratic, partly resulting from increased volatility in the AUD which prompted buyers to adopt a more cautious, just-in-time buying approach. Buying patterns were also dominated by the more-price sensitive Chinese customers, who now lead the processing of wool finer than 19 microns and who are less willing to pay a premium for the value of the crimp effect, higher spinning performance, garment superiority and mill productivity gains, according to Australian Wool Innovation (AWI). Meanwhile, increased competition from Chinese mills and more constrained consumer spending power in the aftermath of the global financial crisis (GFC) have exerted downward pressure on the Italian milling sector which was traditionally a major premium fleece consumer.

Wool prices continue to strengthen



Source: AWI

Diminishing returns for super and ultrafine fleeces

Since the onset of the GFC, there has been a structural change in the price premiums paid for the higher quality, super and ultrafine fleeces compared to the lesser style wools, and also those paid for fleeces versus pieces. The Australian Superfine Fleece (ASF) type, which is a subset of Merino fleece, is typically considered to be the highest grade of the "spinners" types and traditionally priced for its Saxon crimping and whiteness attributes. For example, the 16.6 to 18.6 microns ASF types used to be able to attract an average 40% higher price per kilogram than that of lesser style fleece in the same diameter categories from the early 2000s to 2008, reflecting the demand for them as worsted suiting materials for premium fashion brands such as Zegna, Cerruti, and Guabello in Italy, Cheil in Korea, and Fuji Keori in Japan.

However, its fortunes faded quickly during the post-GFC period as the downturn dealt a severe blow to discretionary spending on premium fashion brands as consumers became more downbeat and cautious in their spending patterns. According to AWI, this caused a sharp, irreversible fall in the demand for the ASF types, and consequently, prices received by suppliers, with average premiums narrowing to around 9% for the period since. Helping to entrench this trend further has been the eventual departures of four of the major ASF types buyers– Itochu, Cheil, Keirnan, and Dewavrin, due to poor profitability or other unforeseen factors, and some smaller players from Italy as well. Progressively, there were more Chinese entrants in the space, such as Donghai, Tianyu and Viterra but these buyers exhibit a more price-sensitive purchasing pattern. Knit market development and blending with silk and cashmere has also helped to shift the balance toward shorter wools, and reduced the premium commanding ability of higher quality, superfine wool types.

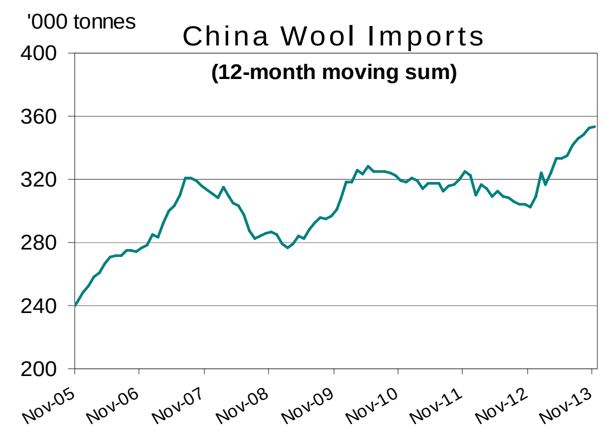
The first week of auctions in January (latest at the time of writing) reveals that the EMI has managed to hold its ground to be around 1130 cents/kg, only marginally below the prices witnessed prior to the three-week Christmas recess. This is despite a strong offering of 53,000 bales put up for sale. According to AWI, exporters are of the view that a diminished supply of merino wool will be entering the market, reinforced by the dry weather across the country.

Wool Exports

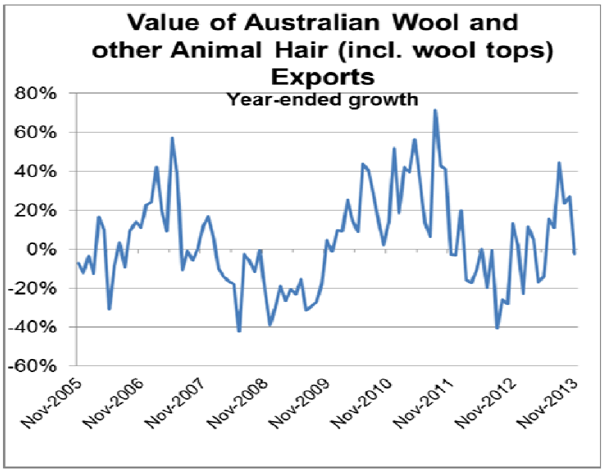
The value of Australian wool exports has been falling for the past few years after peaking in 2011. However, in the second half of 2013, there were some signs of a turnaround in the value of exports, coinciding with the acceleration in the pace of global trading activities underpinned by a synchronised economic recovery in a number of developed countries, such as the US, Japan, UK and Germany.

Australian Wool Exports

Chinese Wool Imports



Source: CEIC



Source: ABS

China, being the world's largest producer and exporter of wool apparels and textiles, continues to be the single largest market for Australian wool, accounting for over three-quarters of total Australian wool exports in 2012-13. During the year, the value of Australian wool exports to China fell by 5% despite stronger volumes (+ 12%), largely attributable to a 14% fall in export prices. This is in turn reflective of the poor demand for Chinese woollen exports by larger consumer countries of the US and European Union.

Counteracting some of the slowdown in exports has been the resilient domestic demand for woollen clothing fabric in the Chinese domestic market, with sales increasing by 6% in 2012–13. Increasingly, China is becoming a major market for finished wool products in its own right, consuming around half the wool garments it produces. According to AWI, the current rate of growth in domestic spending on apparel means China will overtake the United States as the world's largest apparel market by 2017.

Also serving as an offsetting force to China's faltering exports to the US and EU, and hence its imports of Australian wool, has been the rising prominence of South East Asia as a major producer and exporter of textiles and garments. Rapidly rising labour costs in China have rendered SEA a more cost-competitive manufacturing hub for an increasing number of manufacturing firms, including some from China.

As a result, the value of Chinese wool products exported to the region to be processed further has risen by 13% in 2012 to US$319 million, following a spike of 47% in 2011. SEA now ranks as the fourth largest export destination for Chinese wool products behind the United States, the European Union and Japan.

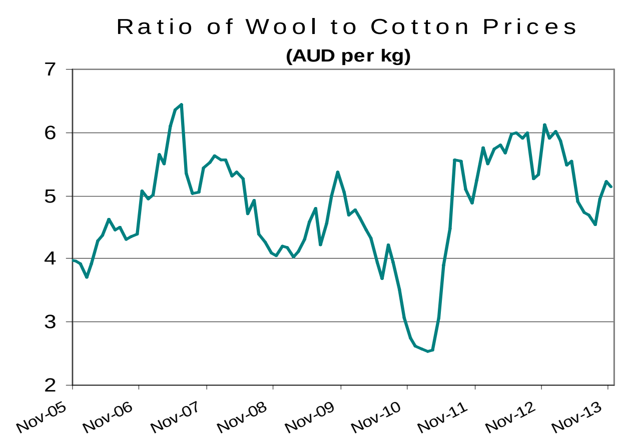
In the near-term, we believe that the momentum in the demand for Australian wool exports will continue, supported by a generally improving global economic environment as monetary policies in major countries remain at historically accommodative levels, with several major central banks in the advanced economies promising to keep interest rates low for the foreseeable future. The weakening of the AUD is also likely to provide further positive impetus to Australian wool exports. In China, economic growth is expected to continue on a path of a gradual, engineered slowdown by its government, with NAB expecting China's GDP growth to slow to 7.2% in 2014 from 2013's 7.6%. The implementation of recently announced reforms at the Third Plenary Meeting is expected to a long and arduous process, but is nevertheless proceeding in the right direction of letting market mechanisms have a bigger role in deciding resource allocation outcomes. Overall, wool imports demand from China is expected to maintain reasonably robust momentum, both from the flow-on effect of stronger demand for its manufactured woollen products from the developed world, and rapidly rising national incomes that will also spur greater discretionary retail spending on clothing within its domestic economy. In recent times, clothing sales in China have continued to expand strongly, but at a slower pace than a year ago in line with the general easing in growth there.

Clothing retail trends in the United States have also shown a strong pick-up in October and November, to be around 3% above the corresponding months a year earlier.

However, some downside risks may arise from the forecast gradual appreciation of the Chinese Renminbi (RMB) as part of the Chinese government's financial market liberalisation agenda. According to a news report by People's Daily, a mainstream online Chinese newspaper, on 8 August 2013, a 1% increase in the value of the RMB against the USD means a 6.2% profit reduction for the apparel industry, and specifically to wool textiles, a 2.2% fall in profits has been estimated.

Competing fibres

Ratio of wool to cotton prices



Source: IMF

Constituting a favourable force for wool's demand has been the moderation in the wool/cotton price ratio from its height in 2011 and 2012, following a recovery in cotton prices in late 2012 that lasted through to most of 2013. However, cotton prices are expected to fall in 2013-14, reflecting the forecast increase in the world stocks-to-use ratio to the largest on record, with China accounting for close to 60% of it. The trajectory of cotton price movements will be highly contingent on the cotton reserves policy direction of the Chinese government, with any large-scale release of stocks from its reserves likely to send prices of cotton plummeting, thereby posing some downside risks to the outlook of wool demand. There has been speculation that the Chinese government will switch from its current stockpiling policy as a means of supporting domestic prices in favour of subsidising growers of cotton and soybeans this year, which will have significant ramifications on world prices. In addition, wool continues to face significant price pressures from synthetics, prices of which have become more attractive because of lower input costs, including energy.

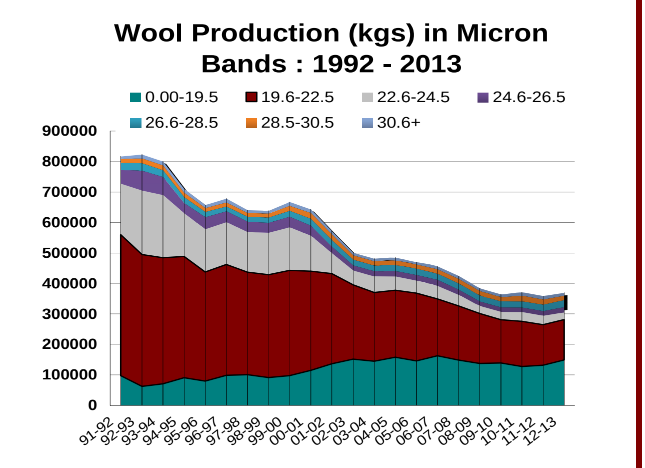
of the market observed in the auctions prior to Christmas has persisted somewhat, supported further by an increasingly positive price out look of the futures market. At the time of writing, Sydney Futures Exchange (SFE) fine wool (19 microns) active contracts were trading at 1,319 AU cents/kg.

We expect a 5% rise in the EMI price over 2013/14 to average around 1091 AUc/kg, given the stronger than expected outcomes in the December quarter and anticipated tightening of wool supplies in the second half of 2013-14. Also relevant to the price outlook has been rapidly increasing Chinese exports to SEA countries for further processing and a falling AUD. That said, potentially constraining price growth could be the continued weakness of US and EU demand for Chinese woollen exports, as well as the record global cotton inventories.

Production forecast

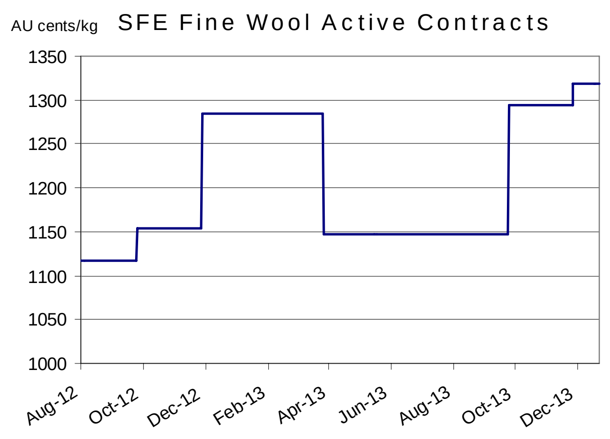
The third forecast for 2013-14 Australian wool production released by the Australian Wool Production and Forecasting Committee (AWPFC) in December has confirmed the slight easing of 2% in shorn wool volume to 345 million kg, reflecting smaller opening sheep numbers and lighter fleece weights from poor autumn and winter conditions in many parts of the eastern states. According to Australian Wool Testing Authority key test data, 46% of wool tested in the first four months of 2013–14 was less than 19.5 microns, compared with 39% during the same period last year.

Micro profile of Australian wool production



Source: AWTA

SFE Wool Futures Prices



Source: Bloomberg

By state, the largest annual declines in production are expected in drought plagued Queensland (-21.2%) and New South Wales (-4.4%), with moderate contractions also expected in the southern states of South Australia (-2%), Victoria (-1.6%) and Tasmania (-1.3%). This is only going to be partly offset by a likely increase in production in Western Australia (+2.8%).

Outlook for Prices

The return of wool auctions in the second week of January after the three-week Christmas recess was characterised by a large offering of 53,000 bales and, despite that, little change in prices. This suggests that the strength in the underlying fundamentals

Comments from the Field

Wool growers in Western Victoria are optimistic around the current wool market. With current prices for the broader microns continuing to trade well, it is hoped and expected that this continues through to the finer microns in early 2014. Good rainfall throughout the spring has greatly alleviated some concerns growers had after the dry autumn in 2013. The improvement in price for mutton has assisted confidence levels.
Nigel Cross, Agribusiness Manager, Hamilton, VIC

Wool and lamb prices are improving. Lambs were selling before Christmas about $115 per head. Spring was generally dry. Some Northern clients are reporting that they are starting run out of feed. Wool clip and lambing were down generally last 12 months due to very dry start to year. However, sentiments around prices are generally positive.
Tess Rix, Agribusiness Manager, Bendigo, VIC

Prices have been positive over the past few months, and appear to be holding well. Quality of wool has been strong, being a combination of good genetics/breeding, management and a good *winter and spring during 2013. Merino stud ram sales (selling rams for sheep/wool breeding) prices during the 2013 selling season (Spring 2013) were positive and better than previous years. I believe that this has come about with better confidence in the Merino sheep and wool industry. A number of wool growers are shearing now, in summer, extending into autumn. Sale prices for wool are anticipated to remain level with last year or better.*

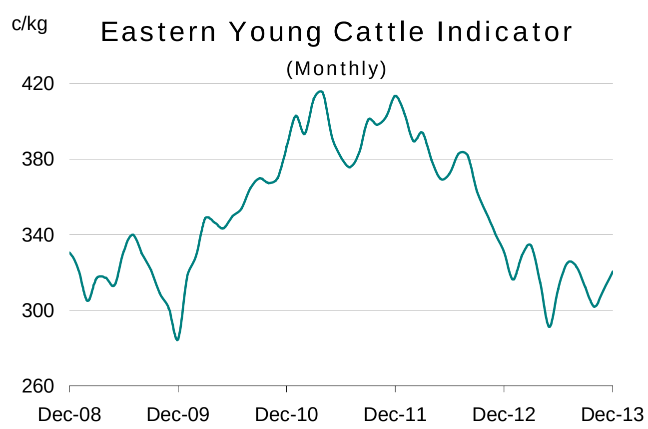
Christopher Antonio, Senior Agribusiness Manager, Narrogin, WA

The last 12 months have seen a stable trend for the wool industry, with prices reaching a stable median with less peaks and troughs in prices than those seen on historical AWEX indicator. Quality remained the key price driver with good clips continuing to sell well, particularly in the medium micron range with a strong demand from overseas buyers, while clips with high vegetable matter or low yield received heavy price reductions. Increasing running cost, less availability of shearers and an overall labour shortage in the mid-north and pastoral regions of South Australia along with the far west region of NSW have resulted in a continued percentage of wool growers transitioning into alternative sheep breeds, a large percentage of which are Dorper's. Consequently, the wool buyers are starting to see the decreased supply of wool rewarding growers with better prices as demand increases. Overall, the outlook remains positive for wool producers as the product becomes increasing recognised worldwide for its quality, comfort and durability

Brett Bonselaar, Agribusiness Manager, Jamestown/Clare SA

Key Commodity Prices

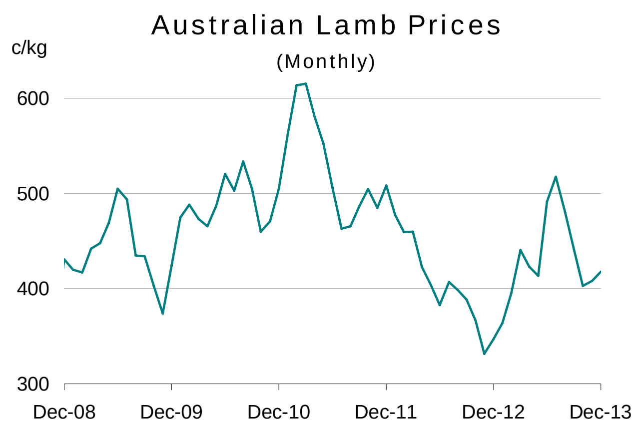
Cattle and veal exports capped off a record year



Source: MLA

In November, cattle prices halted their falling trend to rise for the first time in three months in average monthly terms. Data finishing up in mid-month due to the Christmas and New Year break suggest that the upward trend continued in the month. Nonetheless, the indicator still paled in comparison to corresponding months in the previous year, to be 9% and 3% below for November and December respectively. Slaughter rates were maintained at historically high levels due to persistently dry conditions, with virtually all additional production destined for international markets. Australian beef and veal exports during December reached 96,349 tonnes swt – the highest December volume on record, with 2013 total shipments at 1.1 million tonnes swt, exceeding the previous yearly record set in 2012 by a large margin of 14%. China proved to be a market force to be reckoned with in 2013, from accounting for just 3% of the total Australian exports in 2012 to 14% a year later, making it the third largest after Japan and the US. Growth in the Middle Eastern market and, in particular, Saudi Arabia, was also quite staggering, to almost double the 2012 volume. In contrast, significant declines were recorded in some traditionally strong markets such as Singapore and Hong Kong.

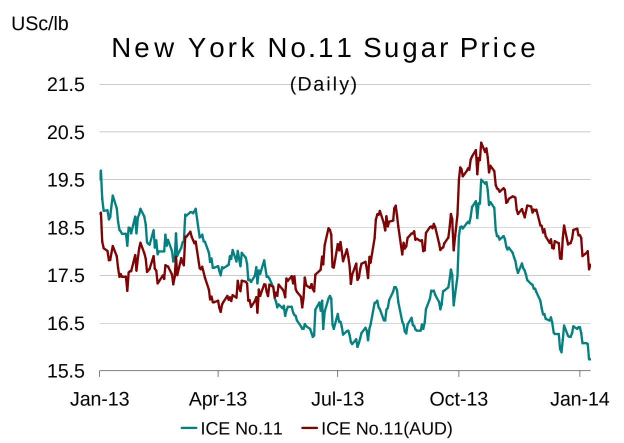
Sustained high turnoffs has also helped to set new lamb exports record in 2013



Source: MLA

Heavy lamb prices rose only by a modest 2% in December to average around 418 AUc/kg, well below the 2013 peak of 518 AUc/kg achieved in July. Dry and hot conditions have sustained high slaughter rates which, combined with strong international demand, has culminated in record lamb exports in 2013. Australian lamb exports reached 213,715 tonnes swt, exceeding the previous record set in 2012 by 13% or 25,097 tonnes swt. Similar to the trends in beef exports, China and the Middle East were the fastest growing regions in the year, to be Australia's second largest and largest lamb export markets respectively in volume terms. Lamb exports to the Middle East rose by 15% to total 59,752 tonnes swt, accounting for 28% of total exports in the year. Exports to China rose 41% year-on-year to account for 23% of the total. While the US only ranked third in export volume terms, it remained Australia's most valuable export market in 2013, consisting mainly of higher valued chilled cuts. Looking forward, sustained high lamb turnoffs in the last 12 months has resulted in reduced breeding stock which will lead to fewer lambs available for slaughter in the second half of 2013-14, which suggests lower export volumes.

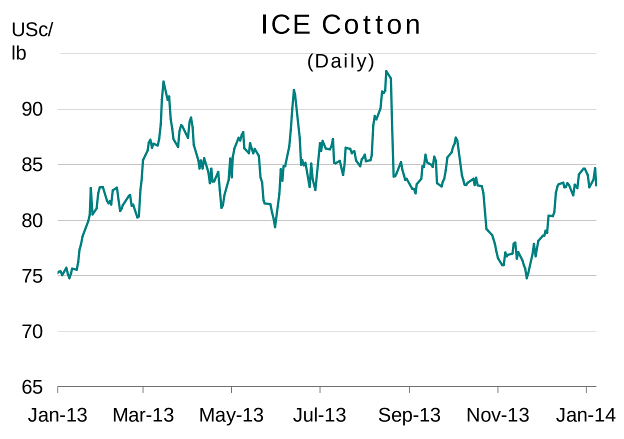
Bearish sentiments returned to global sugar markets on forecast of record world ending stocks



Source: Bloomberg

In the last two months of 2013, global sugar markets took a significant downturn as bearish sentiment returned on improving global supplies that worsened an existing glut, capping the third consecutive yearly loss and longest decline since 1992. The US Department of Agriculture has estimated that global sugar production will outstrip consumption for the fourth consecutive year, but to a smaller extent compared to the preceding surplus years, as low prices are likely to induce a greater level of global consumption and trade of the sweetener. Cumulative surpluses over the years have nevertheless culminated in the largest global ending stocks on record at an estimated 43.4 million tonnes in the season ending September, which portends very limited scope for any significant upward price movement. Global production is tipped to reach 175mt in 2013-14, to be 7.2mt in excess of consumption but marginally lower than last year, as significantly lower production in India and Russia is partly offset by growth in China and Thailand. Production in Thailand, the world's second largest sugar exporter after Brazil, is expected to hit a record of 10.9mt. Meanwhile, consumption is estimated to reach 167.4mt.

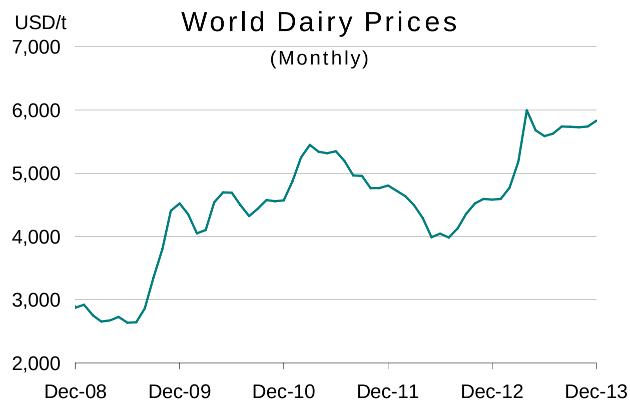
Cotton prices stronger on robust export sales and lower production in the US



Source: Bloomberg

In December, cotton prices reversed much of their fall in November on strong export sales data emerging from the US and suggestions of a tight supply situation in the country, which is the world's largest cotton exporter. On 10 December, the USDA cut its estimate for the crop's production to 13.1m bales, 25% lower from a year earlier and the smallest in four years. On the exports side, US upland export commitment rose by well over 700,000 running bales, and by 26 December sales of all cotton were equivalent to nearly 74% of USDA's projection for the season (from August to July each year). Turkey has accounted for the majority of the export commitments, overtaking China as the largest US export destination this season. Driving Turkey's insatiable import requirements has in turn been strong foreign demand for its manufactured apparel, which is expected to outpace textile output this year. Cotton prices hit a three-month high in the first week of January after a growers group in China said farmers plan to reduce the crop acreage this year. In Australia, this year's cotton crop has mostly been planted, with this season's outlook looking reasonably positive from plentiful irrigated water supplies, a lower exchange rate and resilient global demand and prices. However, due to a very dry spring and low moisture profile, dryland cotton plantings are minimal.

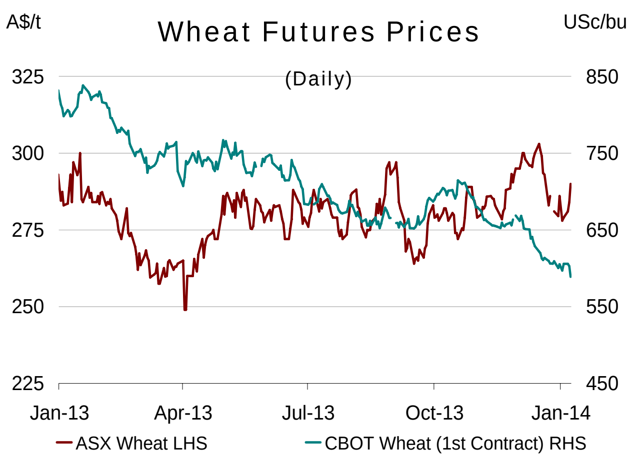
Sustained period strong global dairy prices triggered positive supply responses from Europe and New Zealand



Source: Bloomberg

Global dairy prices have remained at historically high levels despite the peak in the Oceanian production period ending, supported by a strong pent-up demand from the downturn in supplies from New Zealand, US and Europe earlier in 2013. Strong milk prices, combined with a return to more favourable seasonal conditions, are starting to prompt a positive global milk production response. In volume terms the largest response is coming from the EU markets where solid expansion is being recorded in all of the main milk producing countries, according to Agrifax. Milk production in New Zealand has maintained strong momentum, with year-to-date (to October) production to be more than 6% above last season. There is currently no indication of a repeat of last season's extreme drought. Meanwhile, total year-to-date (July to October) milk production in Australia has been disappointing despite the high opening milk prices, to be just around 4% lower than corresponding period last year. ABARES anticipates Australian milk production will decline slightly in the 2013/14 season to 9.1 billion litres, with increased production in northern Victoria likely to be offset by reduced production in western Victoria and northern NSW due to dry conditions.

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



Source: Bloomberg

The trajectories of domestic and global wheat prices have diverged notably in the past two months, with supply shortages in drought-affected areas in northern NSW and Queensland helping to keep domestic prices at elevated levels even as global wheat prices, indicated by CBOT, languished further under the weight of global bumper crops. This is also despite recently completed grains harvests in WA and SA showing exceptional grains receipts in those regions, with WA having delivered the state's largest ever grain harvest at more than 15 mt, potentially reaching closer to the 16 mt mark when the harvesting season wraps up towards the end of January. In its latest commodity report, ABARES revised its Australian wheat production forecast upwards to hit 26.2 mt in 2013-14, with significant rises in WA (+45% to 9.6mt) and South Australia (+39% to 5.2mt), and a moderate improvement in Victoria (+3% to 3.6mt) to more than offset the sharp falls in NSW (-6% to 6.7mt) and Queensland (- 21% to 1.2mt) as a result of hot and dry conditions and frost events in August and October last year.

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