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agribusiness

Economic Report

Rural Commodities Wrap

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- **Global equity and commodity markets weakened in January on growing concerns of the slowdown in emerging economies. Energy prices improved towards the end of the month but the prices of metals and agricultural commodities remain muted overall.**
- **In Australia, NAB business surveys are showing business conditions to be at their highest level in 3 years, holding out hope that a turning point may be near. We have moved our forecast of another interest rate cut by the RBA this year from May to November, given RBA's move to a neutral stance for now.**

Global commodities markets were off to a subdued start in the first half of January, as weak crude oil prices, due to high inventory levels in the US and a disappointing Chinse Purchasing Managers Index (PMI) result, which is an indicator of the pace of industrial production growth, raised concerns about wider demand conditions. The "risk-on" rallies which have dominated major equity markets around the world for much of last year also appeared to have lost some steam in January, largely driven by major sell-offs of risky assets in emerging economies on worries about their economic slowdown. Energy prices leapt towards the end of January and continue to maintain their strength into February on the back of a surge in demand from extreme freezing conditions in the US, but the spill-over effects onto global metals and agricultural commodities prices were more limited.

Across developed economies, business surveys taken at the end of 2013 were consistent with continued moderate growth, although there was a slight dip in confidence in several countries. The main hurdle to get over now is the April increase in Japanese indirect taxes. Judging by past events, this will pull spending and activity into late 2013 and early 2014 but then create a softer period in consumer spending after the tax rise. The US Fed has started gradually "tapering" back its asset purchases and we expect that to continue through the remainder of the year. The Fed funds rate is unlikely to increase until well into 2015, even though the US jobless rate is falling close to levels the Fed requires to review its near zero interest rate policy. The European Central Bank (ECB) has said it will keep Euro-zone interest rates at or below their current low levels for as long as is needed to support recovery. This decision reflects the Euro-zone's combination of very low growth in prices, money and credit alongside high unemployment. The Bank of Japan is also running a very accommodative policy aimed at getting inflation up to 2%.

Mixed conditions continue to prevail across the main emerging market economies. Chinese GDP growth slowed modestly in the final quarter of 2013 (from 7.8% yoy to 7.7% yoy), a result that lined up with the easing trend seen in the central bank's main business survey and in partial indicators of activity like industrial output and fixed investment spending.

2013/14 Estimates, Rural Prices & Production

Commodity	Production	Price
Wheat	17.0%	-15.5%
Beef	3.1%	-6.6%
Dairy	-2.7%	38.4%
Lamb	-1.1%	12.0%
Wool	-2.0%	5.5%
Sugar	-1.2%	1.4%
Cotton	-2.7%	16.5%
Oil	-	1.0%

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, more positive economic indicators, including NAB business conditions reaching their highest level in three years, hold out hope that a turning point may be near. Improving asset prices and a depreciating AUD may help bolster consumer spending and exports. Stronger housing approvals may also be supportive in the near term. There are also signs that household risk appetite is increasing. However, the labour market is expected to remain weak because of structural adjustment associated with the decline in labour-intensive mining investment. The combination of better near term conditions (albeit they may not be maintained) and, especially, the unexpectedly strong Q4 underlying inflation print has caused us to move our next rate cut call from May to November. We do not expect a rate hike until late 2015.

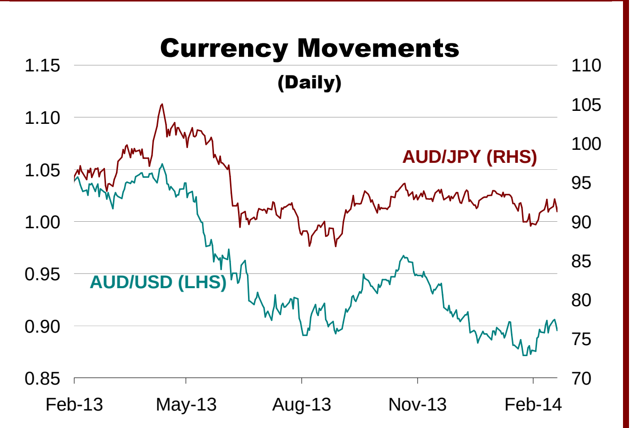
In January, major commodity prices in Australia were mixed. Beef prices fell but lamb prices recorded a rise. Wool prices managed to maintain momentum in the January and February auctions so far, fuelled by renewed interests by major European buyers for high-quality wool and sustained strength in Chinese demand. Meanwhile, domestic grain markets continued to defy global price trends on strong domestic feedstock demand stemming from drought-stricken northern Australian. Global dairy prices have also benefited from a voracious Chinese demand for infant formula despite strong output levels in New Zealand. For softs, cotton has held up on improving global textile demand, while sugar languished further to record lows on the concerns of an oversupply of subsidised exports from India in an already record-high global stock environment.

Currency Movements

The AUD has experienced somewhat of a rollercoaster in the past few weeks from a low of 0.8730 to a high of 0.9067. Much of the rally has been on the change in view of the AUD from the RBA. While the RBA have moved to a neutral stance, from a mild dovish bias on interest rates, the big change was their view on the AUD. In December, when the AUD/USD was at 0.91, the RBA had noted that the AUD/USD was "uncomfortably high". Into the February meeting the AUD was 0.8750, above the 0.85 cents that Governor Stevens had previously implied was fair value, but all references to the AUD being "high," were removed. The AUD is now range-trading near our quarter end forecast of 0.89, below the levels indicated by the present value models.

More mixed recent US data may mean greater volatility in the USD and the AUD. However, with the US Fed members consistent in their mantra of steady "tapering", we are likely to see the USD move higher over time. The risks of a blow up in emerging market remain, as the US Fed persists with tapering. On the upside, if US data stay weak post-weather, we may see the AUD higher than presently forecast. NAB's forecasts remain largely unchanged from last month, as we expect the AUD to moderate further to reach 84 US cents by the December quarter 2014.

The AUD picked up recently on changed RBA rhetoric

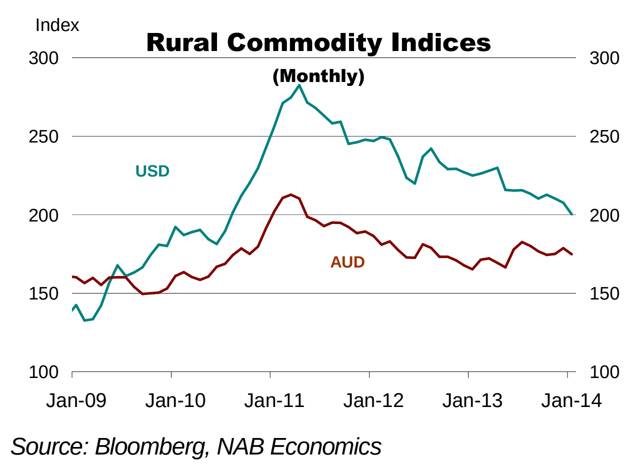


Source: Datastream

NAB Rural Commodity Index

In January, the NAB Rural Commodity Index in AUD terms fell modestly by 2% despite a 1.3% fall in the AUD which would have a supportive effect. Contributing to the overall lower index in AUD terms had been the notable falls in the prices of beef (-11%), US hard winter wheat (-5%) and sugar (-4.5%). These have more than offset increases recorded in barley (+6.5%), lamb (+6%), cotton (+5%), dairy (+4%) and wool (+1%). The near-term outlook for the index is mixed. Australian protein prices are skewed to the downside from a high slaughter rate before the expected tightening from reduced herd sizes would take place. Global grain prices are likely to be range-bound at low levels as the markets have mostly priced in the surge in global production, while demand conditions remain robust. Meanwhile, dairy prices are expected to stay elevated for some time until the northern hemisphere spring flush starts kicking in around May, whereas sugar and cotton prices are expected to moderate from their current levels from oversupply.

Rural Commodity Index fell marginally In AUD terms



Source: Bloomberg, NAB Economics

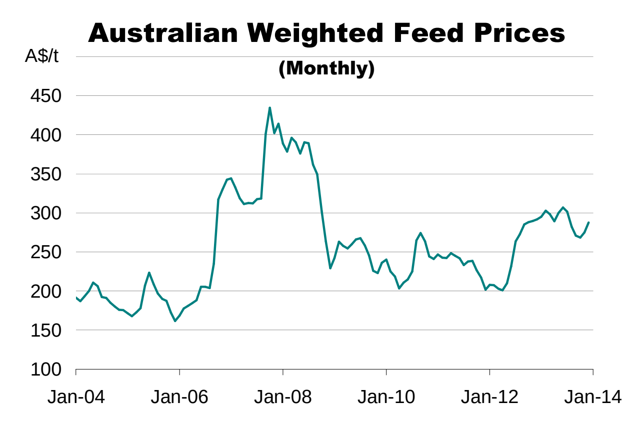
NAB Farm Input Indices

In January, the global fertiliser market continued its strong pace, with across the board rises for urea, Diammonium phosphates and natural gas. Prices of natural gas, which is a key input into urea production, soared in Europe and US on excessive heating demand and created shortages in the pipeline. This in turn has a temporary effect on the supply of urea but prices stay soft overall. Meanwhile DAP prices are showing signs of recovery as low prices spurred some degree of opportunistic buying, especially from Brazil. The low price environment for fertilisers should benefit Australian farmers ahead of the winter cropping season, which is likely to experience an increase in application rates. Meanwhile, local petrol prices have risen by 1% in the month largely reflecting a holiday period premium.

NAB Weighted Feed Grains Price

Domestic feed grain prices continued to rise in January despite a completed bumper Australian grain harvest. In the southern states, exports are exceeding exporters' ability to execute orders. Meanwhile, the northern market paints a picture of strong feedstock demand with limited annual production resulting in trades regularly executed well above published prices. The incoming crop of sorghum may offer some relief to farmers struggling to secure feed supplies as they have been reported to have suffered from poorer quality due to the lack of rain, hence will not be fit for the export market.

Feed prices picked up pace on strong northern feedstock and export demand



Source: ABARES, NAB Economics

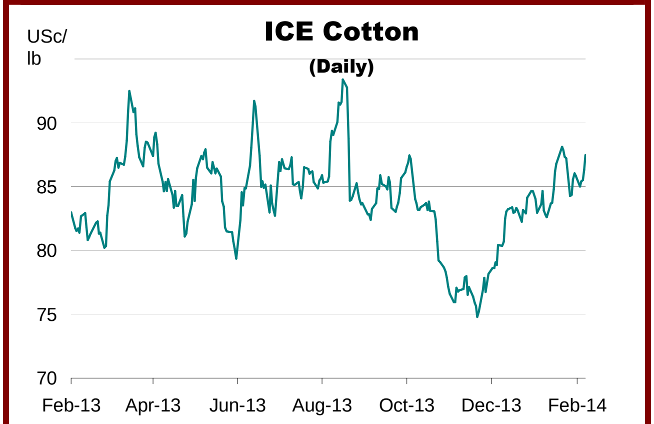
In Focus – Cotton

- **With world cotton production expected to exceed consumption for the fourth consecutive year, the world's cotton stocks-to-use ratio is forecast to reach an all time high of 89% this financial year, up from 84% in 2012-13.**
- **Australian cotton lint production is expected to fall by 2.5% in 2013-14 to 975,000 tonnes. A recovery in cotton prices in AUD terms largely due to forecast depreciation in the exchange rate, as well as plentiful supplies of irrigation water; are expected to have supported plantings to some extent, but constituted mainly of irrigated cotton. Due to a very dry spring and low moisture profile, dryland cotton plantings are minimal this year.**

Recent Price Movements

2013 calendar year was a reasonably solid year for average cotton prices, above historically average levels and around 5% higher than of 2012 level. While prices are now around just slightly more than one-third of the peak in early 2011 (clearly an outlier fuelled by panic-buying by mills around the world in response to supply shortage in major producing countries) in the past year the market has been characterised by rather steady conditions with limited volatility in prices. In 2013, the average standard deviation in cotton prices was around 4 US cents, compared to 9 US cents in 2012 and 40 US cents in 2011. This is mostly underpinned by the stable import demand patterns by China, as it embarked on the second year of implementing a provisional strategic cotton reserve policy and setting a price floor above the world price in a bid to protect its farmers, stabilise the domestic cotton market and encourage agricultural production. In doing so, China has emerged an increasingly formidable market force in the cotton industry. It added 11 million tonnes of cotton to its national reserve over the two-year stockpiling program, accounting for close to 60% of the world's ending stocks in 2012-13.

Cotton prices



Source: Bloomberg

The planned shift by the Chinese government from setting a price floor towards offering direct subsidies to growers this year looms as a downside risk to prices. The question is not whether or not prices will fall given that it is a foregone conclusion, but more critically, by how much and in what fashion. There are concerns in the market that there could be a disorderly unravelling of prices when the Chinese government decides to dispose of its cotton inventory in a sudden and large-scale manner, which will undoubtedly unsettle the commodities markets and trigger rippling effects onto producer countries such as the US, India, Egypt and Australia, as well as textile manufacturers, exporters and consumers. That said, the possibility of a hard-landing in prices appears remote at present, as the Chinese government is more likely to undertake a measured and gradual liquidation process to achieve basic returns for its stocks and avoid roiling the market (further discussed on the next page). According to the Intercontinental Exchange (ICE) Cotton No.2 Futures benchmark, cotton prices have been hovering around the 85 US cents mark in January and February, having rebounded from recent lows of around 75 US cents when news emerged of larger-than-expected harvests from India and better-than-expected production prospects in the US and Brazil. The recent strength in the index has been due to the spike in seasonal demand by major textile producing countries such as Turkey and Vietnam as new season cotton became available. The stockpiling policy by the Chinese government has left cotton stocks in other countries artificially tight, with these countries accounting about two-thirds of the world's cotton consumption and holding only about 40% of the carryover stocks. As a result, there was a build-up in pent-up demand in these countries, which seek to be satisfied when new stocks come onto the market.

The Cotlook 'A' Index, which is an alternative cotton price index based on the quotations in the East Asian region (including Bangkok, Hong King, Singapore, Malaysia, Taiwan and China) is still perched above 90 US cents per pound. Looking ahead, the average cotton price for 2014 is likely to be moderately lower than 2013, driven by slower Chinese demand and potentially a staggered release of stocks by its government from its strategic reserves, as well as higher stocks-to-use ratio as world production continues to outstrip consumption for the fourth consecutive year. We expect Cotlook 'A' prices to average 88 cents this year, compared to 90 cents last year.

World cotton production to fall further in 2013-14

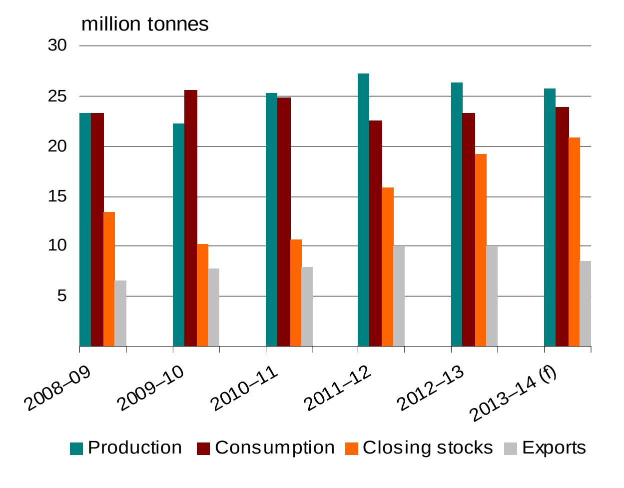
According to the International Cotton Advisory Committee (ICAC), the world's leading international commodity body for cotton and cotton textiles, world cotton production is forecast to decline to 25.7 million tonnes, a fall of 4% from 2012-13 and 8% below peak production of 28 million tonnes in 2011-12.

This reflects lower yields and smaller plantings due to dry conditions in the US, the world's largest exporter and third largest producer after China and India, and as farmers switch to alternative crops, such as maize and soybeans, to take advantage of their more favourable prices. Based on the latest December quarter crop report by Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES), dry seasonal conditions in the US are estimated to have caused the abandonment rate (the area planted but not harvested because of poor yields) to rise to 24% in 2013–14, close to doubling the ten-year historical average. As a result, US cotton production this financial year is likely to decline by around a quarter to around 2.8 million tonnes.

In China, cotton plantings in 2013-14 have fallen by approximately 5.5% as farmers responded to lower returns from rising production costs. In particular, labour costs increasingly constrained factor to farm profitability, despite the government's guarantee on prices of around RMB 20,400 a tonne (equivalent to 150 US cents per pound). Combined with slightly lower yield, overall production is expected to decrease by around 6% to be around 7.2 million tonnes. Meanwhile, cotton production in India is expected rise by 10% to reach a record of 6.3 million tonnes this financial year, a reflection of both an increase in yield (8%) and plantings (2%). This is attributable to a favourable monsoon season which delivered sufficient rains during the critical growth period from June to September.

Overall in 2013-14, the expected lower production in the US, China, Turkey and Uzbekistan are expected to offset forecast production increases in India, Brazil and Pakistan.

Global Cotton Balance Sheet



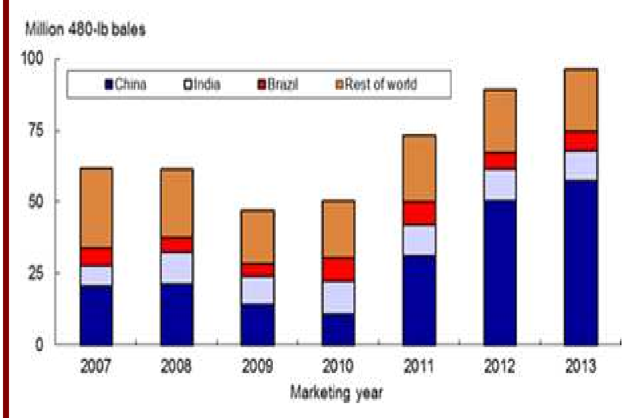
Source: ABARES

Modest global consumption growth in 2013-14

After recording the first growth in three years in 2012-13, world mill consumption of cotton is projected by the ICAC to go up by 1% this season to 23.6 million tonnes, further adding to the evidence that a turnaround in the textile sector globally is currently underway. This is in turn underpinned by a synchronised recovery in major developed countries in the second half of last year, spearheaded by improved conditions in the US, UK, Japan and Euro-zone, implying stronger world demand for manufactured apparel which indirectly feeds into higher cotton consumption by top-spinning countries such as China, India and Pakistan. NAB expects global growth to accelerate to 3.5% in 2014 from 3.0% in 2013, before picking up to 3.7% in 2015.

Apart from China, all major spinning countries are expected to contribute to rising mill use in 2013-14. Leading the recovery are India and Pakistan with forecast mill use growth of 6% to 5.2 million tonnes and 2.7 million tonnes respectively, both beneficiaries of rising Chinese yarn imports in recent years. Elevated domestic cotton prices due to the Chinese government's price support mechanisms have spurred Chinese textile manufacturers to rely progressively more on imported semi-finished yarn rather than using raw cotton. Some cotton mills have resorted to shifting production overseas to secure cheaper raw materials, even going as far afield as the US. Vietnam, with its proximity to China, openness to the global cotton market, as well as a trade agreement between the two countries for duty-free yarn exports, has emerged as a favourite relocation destination for Chinese textile and yarning businesses. Correspondingly, cotton mill use in China has declined considerably over the last few years, but recently showed signs of stabilisation at around 36 million bales (8.2 million tonnes). Partly encouraged by the cost advantage, China imported an estimated 8.3 million (raw-cotton equivalent) bales or 1.9 million tonnes in the form of yarn in 2012-13, and this is expected to surpass 10-million bale equivalents (2.3 million tonnes) of raw fibre this financial year. Nonetheless, relatively low prices for alternative fibres, particularly polyester, are expected to provide strong competition for cotton, thereby constraining future consumption growth.

Global Cotton Ending Stocks

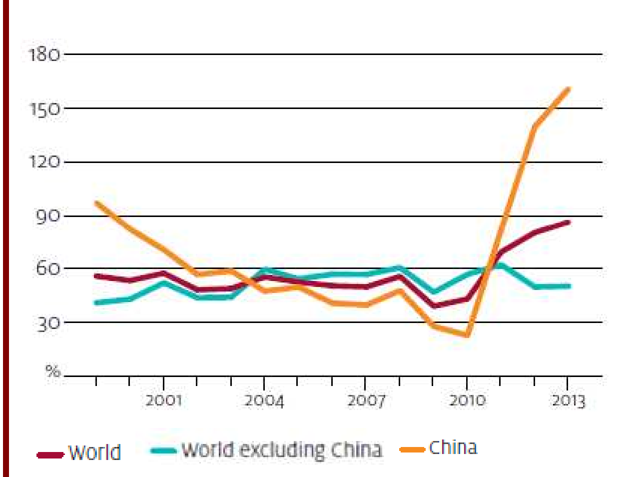


Source: USDA

Record world stocks in 2013-14, but the Chinese government will look to slowly deplete its inventory

With world cotton production expected to exceed consumption for the fourth consecutive year, the world's cotton stocks-to-use ratio is forecast to reach an all time high of 89% this financial year, up from 84% in 2012-13. As mentioned earlier, China's cotton stocks hoarding practice has caused a sharp imbalance in the distribution of stocks across regions, one that is heavily skewed towards itself and leaves the rest of the world with a disproportionately low share of inventory. Currently, China's stocks-to-use ratio is projected by ABARES to reach 161% this financial year, which implies it can be self-sufficient for more than 18 months without any production or trade, while the ratio for the world (excluding China) is forecast to decline to 51 per cent, the lowest level since 2010–11.

Global Cotton Stocks-to-Use Ratios



Source: ABARES

Obviously, this trend is unsustainable in the long-run, with Chinese imports already showing signs of slowing down as it transitions towards the trial of direct subsidies option. The official confirmation of the shift from stockpiling to direct subsidy to commence in 2014 was first announced by the government in January. This move has been anticipated by market players for a while. The stockpiling policy was only intended to be a temporary stop-gap emergency solution by the government to prevent a crash in cotton prices after Chinese supplies surged in response to the record prices in late 2010. Furthermore, it has failed to encourage the predicted increase in domestic production. According to a senior representative of the China Cotton Association, the move towards direct subsidies is an important step to free the cotton market from some of the distortionary forces which have adversely affected the competitive edge of downstream cotton spinners and textile manufacturers, while still providing some form of income protection for farmers. The trial will focus on the western province of Xinjiang, which accounts around 60% of total Chinese cotton production.

That said, the policy document lacked specific details on timing, as well as on the structure and size of subsidies. This caused some uncertainty in the near-term outlook of the global market, with some participants warning that if that if the cotton subsidies coverage was not far-reaching enough to cover regions beyond Xinjiang, it could actually have the opposite effect of limiting production in these other regions and encouraging imports.

Given that the subsidy program is still in the trial phase, we don't believe that the Chinese government will conduct any "dumping" of stocks from its strategic reserve in any hurried sense. The government should understand that any sudden, massive release of stocks will cause a sudden dip in prices that will offset the production incentives offered by the subsidy. We believe that it will instead release stocks in a systematic manner to manage downward price pressures for as long as the direct subsidy trial is in place, to assure downstream players that it is committed to progressively subject the raw cotton market to market mechanisms and bring domestic prices lower, while maintaining incentives farmers to continue production.

Trade to slow in 2013-14 from subdued Chinese import demand

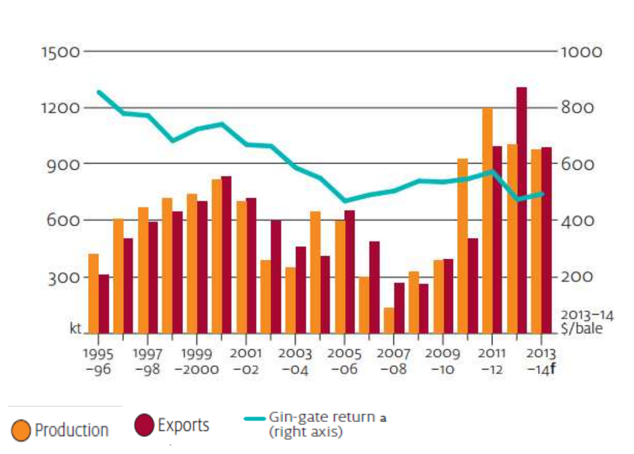
In recent years, global cotton trade has been largely propped up by China's cotton import demand. Against the backdrop of the imminent end of the Chinese stockpiling program, Chinese import demand is anticipated by the USDA to slow sharply this season, to be down by 46% from 2012-13. As such, world trade in cotton is likely to decline this year, to be around 38.5 million bales (8.7 billion tonnes), which represents a 16% reduction from the previous year.

In 2013/14, China is forecast to import only 11 million bales (2.5 billion tonnes) of raw cotton, contributing to a global import share of consumption of about 35%; compared to 43% in the two years prior. Should these trends persist, global cotton trade—including that of Australia's—may be constrained unless global cotton consumption expands substantially.

Outlook for Australian cotton: higher prices keep production elevated. Exports to slow

Based on the latest ABARES forecasts, Australian cotton lint production is expected to fall by 2.5% in 2013-14 to 975,000 tonnes, but nevertheless still a reasonably robust outcome. A recovery in cotton prices in AUD terms largely due to forecast depreciation in the exchange rate, as well as plentiful supplies of irrigation water are likely to spur production of irrigated cotton. However, due to a very dry spring and low moisture profile, dryland cotton plantings are minimal. Higher summer temperatures have also impacted on the yields of some farms in Queensland, but the quality of fibre this year is reported to be good overall.

Australian Cotton Production, Exports and Return



Source: ABARES

The return to Australian cotton growers at the gin-gate is expected to rise by 4% to $493 a bale (227 kgs) of lint. Although this pales in comparison to the average of $545 a bale (in 2013-14 dollars) in the decade to 2011-12, it is still more favourable than the prices of alternative crops.

After hitting a record of 1.3 million tonnes in 2012-13, Australian cotton exports are likely to ease to 987, 000 tonnes in 2013–14, reflecting lower production in this and last financial year, further weighed down by slowing Chinese import demand. Because almost all of Australian cotton production is exported and the harvest is March to June, Australian cotton production in one season is exported across two financial years. If realised, Australia will be the third largest raw cotton exporter in 2013-14, trailing only the US and India. The AUD is forecast to track lower in 2014 as the USD gains strength from its domestic recovery and a switch in investors' appetite back towards developed countries, which will offer exporters further relief. NAB expects the AUD to edge down to 84 US cents by the December quarter 2014.

Comments from the Field

Local SunWater storages are reported to have been all but fully utilised at this time. Large amount of the local irrigation area cotton will achieve almost full yields with some producers reducing their areas/yields due to lack of water. Minimal inflows into the local storages have resulted in producers being very considered with acreages taken through to picking. Reductions in overall yields may be offset with excellent growing season conditions and overall cotton quality not expected to suffer. Some larger farms and local corporations are known to have started with on-farm water storages at capacity and are expected to achieve full yields. **Luke Sheedy (Agribusiness Manager), St George, Qld**

Little to no dryland cotton was planted for the season, while irrigated cotton crops are progressing well into the final stages of the growing season with water use being very high given hot summer across the various valleys and no in-crop rain. Some growers are finishing the growing window 1 to 2 waterings short but this is minimal with the major concern now being little to no water carried over for the next season. Growers are anticipating yield to be average to above average and good quality fibre produced. Prices on offer being seen in the market inclusive of strong seed prices are supporting growers' confidence. Growing costs have been in line with budgets with some variances being seen in fuel and labour given additional waterings. **Shane Dowton (Regional Agribusiness Manager), Northern NSW**

At this stage of the season, our irrigated growers are carefully managing water on hand to try and ensure water will be sufficient to complete last watering. In some cases, some area has been reduced as a result of insufficient water on hand. Dryland crop planting area was very low as no rain was received within the planting window. Any dryland crops on hand now are not expected to yield well. **Jason Lipp (Regional Agribusiness Manager), Darling Downs, QLD**

Darling Downs cotton growing area commenced their season with ample supply of irrigation storage and bore water, which saw an irrigated cotton planting acreage similar to previous seasons. Dryland cotton planting acreage was reduced substantially, given the lack of planting rainfall and higher competing grain prices. Growing conditions have been far from ideal, however higher summer temperatures have benefited plant growth, at the expense of additional irrigation usage and reduced sub-soil moisture levels. Without the assistance of substantial in-crop rainfalls to replenish irrigation water and assist optimum dryland growing period, yields are expected to be reduced by 25% to 30%. This will be offset somewhat by the lower AUD which is assisting to maintain cotton values around $500 per bale. **Gavin Pontin (Senior Agribusiness Manager), Dalby, QLD**

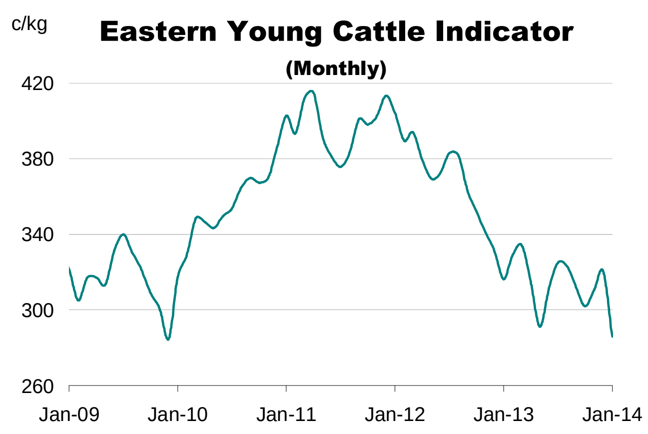
This season's cotton crop in the Riverina got off to a much slower start due to very mild temperatures; however re-plantings were similar to the previous year. In fact until the 16th December, the cotton plants almost looked stunted until we finally saw temperatures around the 40 degree mark. Since then we have had a much hotter and drier conditions which helped the cotton plants thrive. Water usage is on par with the last two seasons, however the temporary water market has been consistently at around $80-$90 per meg compared with $30-$40 per meg last year, although there was a small spike in the market last year around January at $100 per meg.

All crops at this stage have been cut out and will require at least 2 further waterings prior to defoliation. Rains of 1-2 inches over the weekend will help here. Like last year, growers are confident of increased yields this season (10 plus bales per hectare or 4 per acre), due to the hotter growing season at the back end. Prices had been quite low at planting time, but have started to increase since Christmas ($500 plus per bale) since the Northern growers have had water allocations cut. Growers are optimistic that prices may even hit $520 per bale, for that production not locked in. Many are looking for opportunities to forward sell for future years as cotton prices spike.

The Whitton Cotton Gin has now been operating for two seasons and has managed to process approx 160,000 bales each year. However the timeframe for 2013 was 4 months processing wise as opposed to nearly 8 months in 2012. As a result of the higher temporary water prices (nearly double last year), the amount of cotton being grown is expected to double as growers try and get the best return per meg of water. High ginning costs at the Whitton Gin ($85 per bale compared with $65 / bale of other gins), has also created competition for ginning with a new Gin to be built at Hay by Auscott and another proposed Gin currently seeking funding to be near Carrathool. **James Shelton (Agribusiness Manager), Griffith, NSW**

Key Commodity Prices

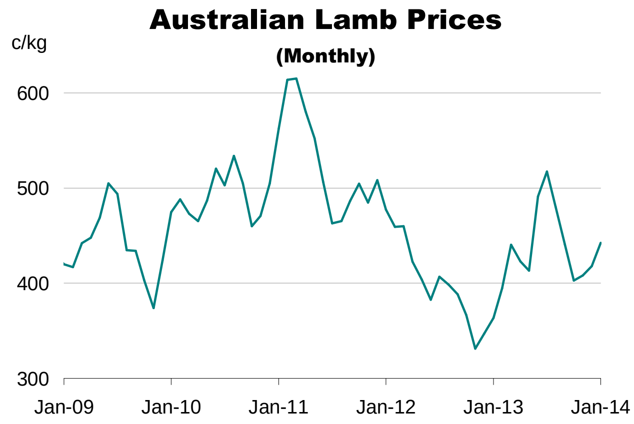
Cattle prices continued to be weighed down by drought conditions in northern NSW and Queensland



Source: MLA

In the first month of 2014, there had been very little change in the factors that affected cattle prices before the trading hiatus towards the end of last year. Major cattle rearing regions of Queensland and northern NSW have yet to experience any respite from the relentless grip of dry conditions, after missing out on the heavy monsoon rainfalls which drenched the northern most regions of the continent. This has resulted in sustained, near-record slaughter rates which translated into strong throughputs. More recently in the second week of February, slaughter rates reached unchartered territory in eastern states as seasonal conditions deteriorated. However, prices demonstrated some signs of picking up. According to the Meat and Livestock Association (MLA), Australian beef and veal exports during January reached 64,642 tonnes swt – easily the highest January volume on record, when the previous January records were closer to 55,000 tonnes swt in 2013 and 2007. January is typically the slowest month of the year but this year has proven to be an anomaly, underpinned by strong Chinese and Korean demand ahead of an early Lunar New Year celebration. In the near-term, there is not likely to be any significant upside price impetus, with prices likely to hover around the 300 AUc/kg mark, as throughput has yet to show any signs of moderation.

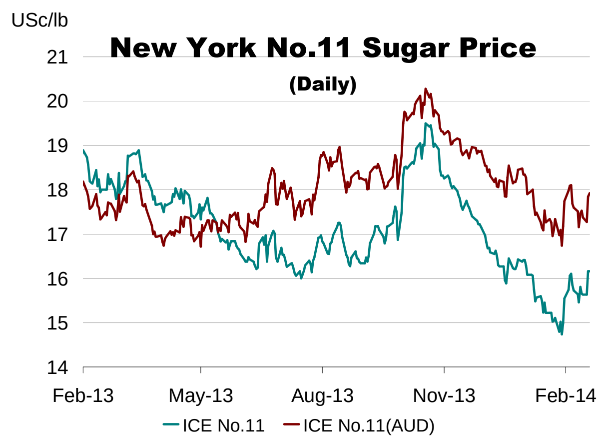
January lamb exports benefited strongly from the Chinese New Year factor as well



Source: MLA

Contrary to the trend of cattle prices in January, heavy lamb prices fared better to rise by 6% in the month, but still well below the 2013 peak of 518 AUc/kg achieved in July. Similar to the trends in beef exports, lamb exports kicked off the year on a high, with shipments in January reaching 16,828 tonnes swt, 11% higher than the same period last year to be the largest January volume on record. Again, the early celebration of Lunar New Year could have been a factor, with exports to China up by 5% y-o-y in the month and Hong Kong almost doubling its intake of Australian lamb over the same period. Meanwhile, shipments to the US and Middle East also held up remarkably well. While both countries only recorded a 2% rise in January relative to a year ago, their Australian lamb intake volumes represent increases of 46% and 70% above the countries' five-year averages respectively. Encouragingly, there are now signs that demand conditions in Europe are improving.Looking ahead, reduced breeding stock from sustained high turnoff rates will lead to fewer lambs available for slaughter in the second half of 2013-14, which suggests lower export volumes.

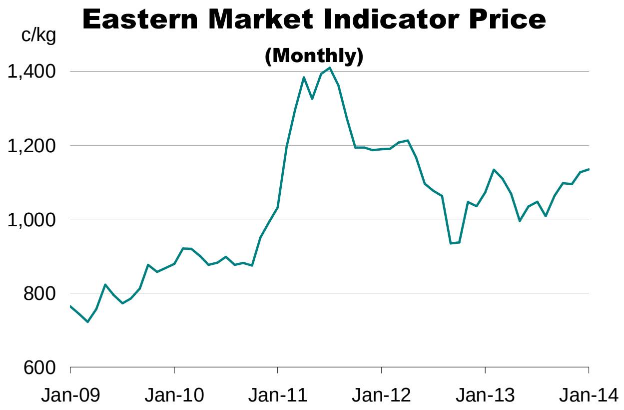
Subsidised Indian sugar exports will bear further downward pressures on global prices



Source: Bloomberg

Sugar is still deeply entrenched in a bear market as global production is expected to outstrip consumption for the fourth consecutive year, culminating in the largest global ending stocks on record at an estimated 43.4 million tonnes in the season ending September. Contributing partly to the 6% decline in the monthly average price of sugar had been the news that the Indian government was considering offering subsidies to sugar exporters amid a domestic glut. These were eventually approved early this week. According to Reuters, the Indian government will provide 3,333 rupees ($54) a metric tonne for exports in February and March and will review the amount in April. It is estimated the Indian government will subsidise as much as 4 million tonnes of sugar in the next two years, which constitutes further downward pressures on prices in an already sluggish market and distorts global trade patterns. Sugar prices reversed their downward trend in early February upon the news of a severe heat-wave and drought affecting key growing areas in the Southeast of Brazil which will affect crop outcomes; however this effect has proven to be short-lived.

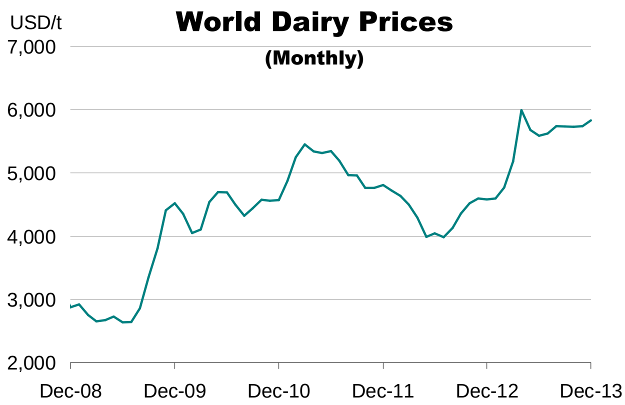
Wool prices stronger on renewed interests from European buyers



Source: Datastream

In January, wool prices were generally resilient, rising by 1% in monthly-average terms. This is largely driven by reduced offerings at auctions in the second half of the month, with the last auction week shortened to only two trading days due to the Australia Day public holiday and Lunar New Year holiday overseas. Combined with a reinvigorated purchasing activity by major European buyers, especially the Italians, increased competition at the auctions helped to keep prices buoyant. Effects of the continuous drought on the quality and composition of wool produced have also become apparent, with a significant reduction in the available types broader than 20 micron and a large increase in wools finer than 19 micron. Despite that, high quality top-making and spinners' styles Superfine Merino wool have managed to widen their price premiums to average styles, assisted by competition by top makers from China and Europe looking to ensure quality, as well as some orders stemming from India. More recently, a large offering and an appreciation in the AUD in the first auction week of February was greeted with a lukewarm response by buyers, while the large available volumes of finer than 20 micron wools in the coming weeks are also likely to exert some downward price pressures on prices.

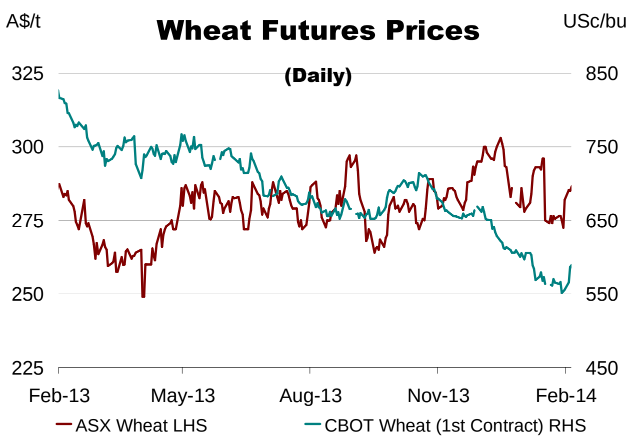
World dairy commodity prices show no signs of slowing down on robust Chinese demand



Source: Bloomberg

Global dairy prices showed no signs of letting up in January, and after trading at historically elevated levels since March last year, it represents a period of unsurpassed duration of sustained high prices. Strong demand for dairy exports, especially in the form of baby formula by China due to the lack of domestic production, is main factor which is keeping prices high. China's purchasing pattern has also been influenced by the free trade agreement signed with New Zealand, which allows a portion of imports to enter the Chinese market at a lower tariff rate. The quota for the lower-tariff imports typically gets exhausted at the beginning of the year which is associated with seasonally high volumes in the first quarter of each year. Meanwhile, global milk production has yet to be able to catch up with demand, despite strong milk flows stemming from NZ. Milk production in Australia and California has been constrained by extreme dry and hot weather, with drought conditions in the latter unlikely to be broken this winter in the US. In Australia, 2013-14 marketing year-to-date production by December tracked around 3% below that of 2012-13, but there is a possibility of further narrowing of the gap in the coming months as more normal weather conditions return.

Domestic wheat basis propped by Northern drought-induced demand despite a slump in global prices



Source: Bloomberg

Australian wheat basis has held up remarkably well in January and first half of February, despite the recent bumper crop outcome from the 2013-14 harvest season and as global wheat prices slumped to their lowest point in three and a half years at the end of January on the back of record global production. The latest crop report by ABARES showed that Australian 2013-14 wheat production rose by 20% 2012-13 to 27 million tonnes, while barley production rose to 9.5 million tonnes (28%). A dire feed grains shortage in the northern part of Australia as drought-embattled cattle farmers are forced to send their herds to feedlots before slaughter have continued to exert considerable pressure on grain prices in the region, and the spread between grain prices in northern, western and southern Australia continues to exceed $60 a tonne. Together with a low carryover stock from the previous year, strong domestic demand has diverted further available stocks from exports. Meanwhile, global wheat prices has been revived slightly in the beginning of February on stronger than expected global demand and lower a lower inventory level in the US than previous forecast by the USDA.

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