



# Economic Report

## Rural Commodities Wrap

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May 2014

- There are signs of stabilisation in the growth in the US and China: the US Fed proceeded with another US\$10 billion cut in their monthly quantitative easing program to US\$45 billion, while Chinese industrial activity gained some support from a series of targeted stimulus policies.
- NAB has revised up its forecasts of Australian GDP in 2013-14 and 2014-15 in light of a stronger expectation for Q1 due to a pick-up in exports. We have changed our rate call and now expect we are at the bottom of the cycle.

### Commodities Overview

Agricultural commodity prices were mixed in April. Saleyard cattle prices recorded a remarkable surge in the month, with the growth in lamb prices more modest for the first time since the start of the year, driven by average to above average rainfalls recorded for most regions. Cotton prices firmed on tight US inventories while wheat prices continued to benefit from drought concerns in the US and heightened tensions in Ukraine. Global dairy prices recorded their first substantial fall which signals a potential slippery slope in the coming months. Wool and sugar prices were range-bound, with the former weighed by poor trading conditions still while a supply overhang provides very little price growth impetus for the latter. This month, the poultry and pork are our commodities in focus.

### Global Outlook

Global attention in April was largely focussed on the key headline Q1 GDP numbers for the US and China, both down from the previous quarter. The unambiguous strength in the US labour market suggests its recovery is on track, despite dismal GDP growth print of 0.1% in Q1, likely weather induced to a large extent. Undeterred by the headline growth figure, the US Fed proceeded with another US\$10 billion cut in their monthly quantitative easing program to US\$45 billion. The Chinese Q1 GDP outcome of 7.4% y-o-y was above market expectations despite slowing from 7.7% in December quarter, and more recent PMIs indicate signs of stabilisation in industrial output in April as the Chinese government announced a series of targeted policy stimulus. There were some large movements in global equity markets in April, corresponding to sharp corrections in tech stocks in the US, but so far the spillover effects onto commodities have been limited. Market reactions to renewed geopolitical tensions in the Black Sea region and the subsequent fresh round of sanctions imposed on Russian business and political heavyweights were reasonably muted as well. In other advanced economies, the PMIs show recovery in Western Europe but the recent rise in Japanese consumption taxes effective 1 April has clearly hit spending. Outside Japan, other long-running national

### 2013-14 Outlook, Rural Prices & Production

Commodity	Production	Price
Wheat	20.5%	-17.0%
Beef	-2.0%	-7.6%
Dairy	-1.3%	34.5%
Lamb	-2.6%	24.8%
Wool	-3.4%	3.8%
Sugar	-1.2%	0.5%
Cotton	-6.2%	18.6%
Oil	—	+1%

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

business surveys show firms expect the moderate upturn to continue. Japanese growth should slow towards its very low long run potential rate as “Abenomics” stimulus wears off. Meanwhile, recovery in emerging market economies that dominate our export markets have experienced a bumpier road. A combination of interest rate rises to combat higher inflation, the very modest pace of growth in world trade, financial market volatility linked to expectations of eventually increasing US interest rates and political tensions have hit growth in several big economies.

### Domestic Outlook

While there had been some signs of improvements in the domestic economy, the outlook remains fragile, especially in light of the recently released “austerity” Budget. Business confidence lifted slightly in April, returning to long-run average levels after hitting a post-election low last month. The rise in confidence was a little surprising given negative rhetoric about a “tough budget”. We now expect GDP growth at 2.9% in 2013/14 (was 2.7%) and 3.1% in 2014/15 (was 3.0%). That fundamentally reflects a stronger net exports contribution in Q1. More tractable improvements in the economy, plus the RBA’s reluctance to cut further underpins our rate call change. NAB now expects no rate cut for some time, with the soonest increase pencilled in for Q4 2015. This has changed from our previous prediction of another rate cut at the end of 2014. We also see the federal budget in structural deficit for some years with fiscal restraint imposing headwinds for several years — and the extent of restraint may require further post-budget adjustments to our forecasts. We are currently expecting a fiscal contraction of around ½% per annum over the next 4 years.

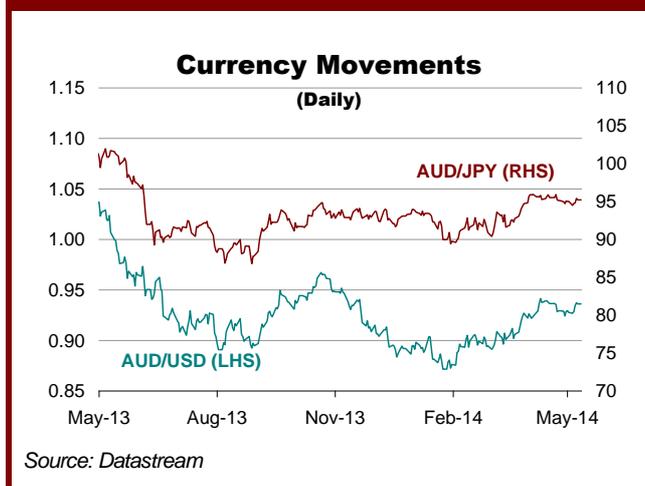
## Currency Movements

In April, the AUD gained substantial momentum to be around 5% higher on average to be close to USD 0.95, largely reflecting the failure by the USD to gain momentum despite unambiguous signs that the US recovery is still largely on track, further assisted by the extremely low volatility levels. As the AUD is a prime carry trade, the decline in market volatility provides a significant boost. Furthermore, there has been very little market-moving domestic economic news in the month. The Reserve Bank of Australia has indicated it is reasonably comfortable with the current monetary setting that balances a tentatively recovering domestic economy against the headwinds of the slowdown in mining investment, which heralds a period of relative interest rate stability. More recently, there are also signs of pick-up in the demand for AUD through the unwinding of speculative short positions, with money markets switching from net short positions at the end of April to accumulating net AUD longs over the course of May.

That said, NAB's medium-term expectations remain that the AUD will depreciate gradually against the greenback as the US monetary setting normalises from being highly accommodative at present, with the US Fed expected to commence raising the Fed funds rate in the second half of 2015. However, we now expect the recovery in USD to take place later in the year, which makes it far more difficult for the AUD to, as quickly, achieve the depreciation that we had previously anticipated to materialise.

We move our near term AUD/USD forecasts higher, with 0.90 by end-June, from 0.87 and to 0.85 by year-end. 2015 forecasts are unchanged, to gradually move down to 0.80 by December 2015.

### AUD gained momentum as asset demand rose

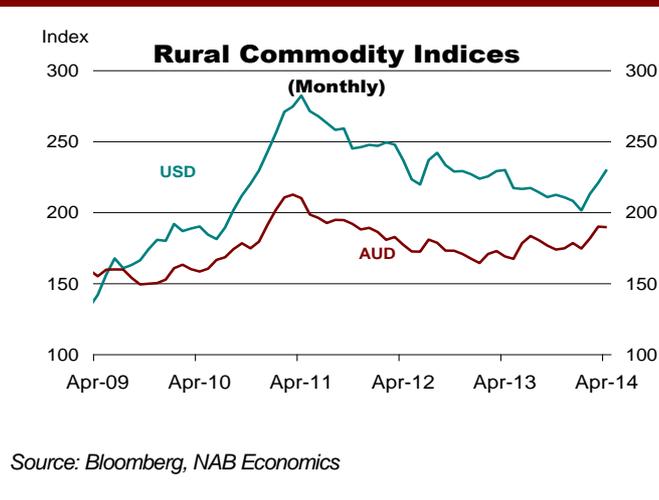


## NAB Rural Commodity Index

In April, most agriculture commodities tracked lower, but a notable 4.6% appreciation in the AUD was the main driver of the NAB Rural Commodity Index in the month. In AUD terms, the index fell marginally by 0.2%, with rises in beef (+13%) and lamb (+5%) more than outweighed by declines in dairy (-10%), sugar (-8%), barley (-8%), wool (-7%), wheat (-4%) and cotton (-2%). In contrast, the index in USD terms rose by 4.2%.

Looking forward, the risks to the index are tilted to the downside. The first substantial fall in dairy prices this month is likely to be a precursor to further declines in the coming months as supplies from the EU and the US gain pace. Softs prices are largely going to be range-bound while we expect some moderation in grain prices from their current heights. The one bright spot is likely to be livestock prices which are expected to rise further

### Rural Commodity Index in AUD terms declined modestly



from a higher degree of herd building in response to more favourable weather conditions.

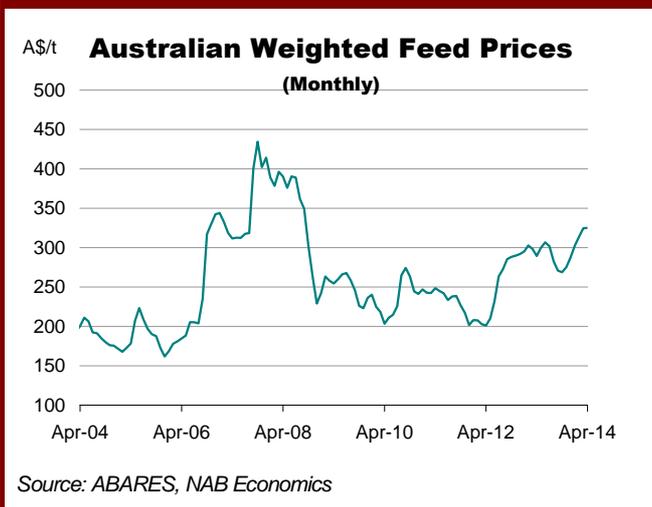
## NAB Farm Input Indices

Input prices weakened sharply in April, with broad-based falls in natural gas, Diammonium Phosphate (DAP) and urea that resulted in the NAB Weighted Fertiliser Index falling by 11%. Global DAP demand has waned substantially in Q2 from a seasonal fall in Brazilian demand due to the ongoing harvesting period, while the implementation of maximum retail price and subsidy on fertilisers in India will cap any upward momentum in import prices. Natural gas prices have fallen from their record levels in Q1 as weather conditions in the northern hemisphere moderate while urea prices continue to be weighed by a strong pace in Chinese exports. In the coming months, input prices are likely to remain contained by ample global inventories, with further downward pressures arising from a Chinese tax cut window for urea exports running from July to October.

## NAB Weighted Feed Grains Price

Continued strong domestic demand for feed supplies in northern Australia and bursts of buoyancy in global grain prices helped to support the NAB weighted feed grains price to be 0.2% higher in April, marking the fifth consecutive monthly rise. However, the modest growth rate suggests that the recent run-up in feed prices may be reaching a turning point, with reports of Australian bulk vessels unloading supplies of wheat and barley in Brisbane port, and large influx of barley expected to hit the northern market soon, which will help to provide some relief to the tight grain balance sheet in the north.

### Feed grain prices reaching a possible plateau



## In Focus – Poultry and Pork

- **Rising grain prices and greater price competition from domestic red meat posed significant challenges for poultry last year, but the industry was generally unfazed, with production and consumption rising and chicken meat retaining its status as the most consumed protein in Australia.**
- **Higher feed prices over the past year have flowed into higher chicken and pork prices in the short term, but they remain competitive with other substitutes.**
- **Things took a better turn for the Australian pork industry in 2013-14, driven by lower import competition from the US and better prices for both baconers and porkers.**

Relative to cattle and sheep, the pork and poultry industries have been less adversely impacted by the ongoing drought conditions, although they continue to bear the brunt of the indirect effects of associated high grain prices, water restrictions and stiffer competition from alternative meats of beef and lamb from heightened drought-induced slaughters.

### Australian chicken meat industry unfazed by recent drought-related challenges

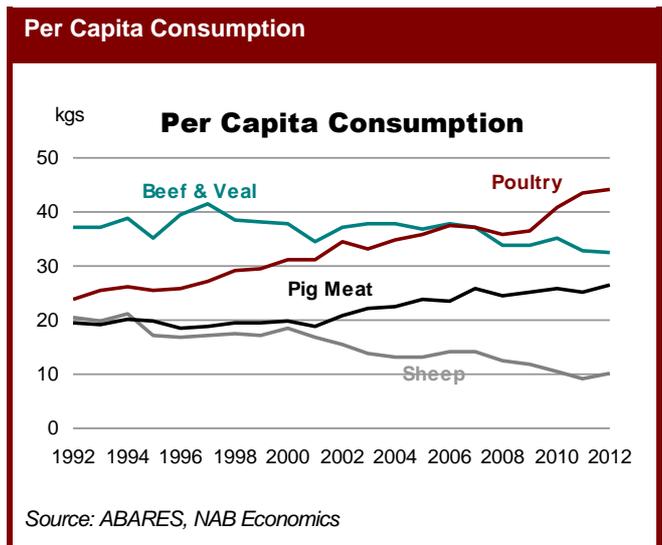
As a result of widespread drought conditions last year and this year, the chicken meat industry is faced with unusually strong competition for feed grains from other livestock, especially cattle. A sharp increase in the number of cattle offloaded onto feedlots to be fattened up before slaughter from the lack of fodder forced average feed grains prices up by around 18%. That said, the price increases borne by the large chicken processors of Ingham and Baida, which process about three quarters of all chickens in Australia, are likely to be less than this figure because the highly vertically integrated structure of the chicken industry includes large commercial feed mills that enjoy significant economies of scale and substantial bargaining power against grain handlers, potentially giving rise to more favourable price terms than smaller processors.

However, given that feed costs represent between 60 to 70% of total costs of chicken meat production in Australia with not many alternatives, rising feed grain prices still constitute a significant limiting factor on the profitability of chicken processors, especially for smaller players. Chicken prices rose correspondingly in the year, but by a more meagre 5%, as producers absorbed most of the extra costs.

The chicken meat industry has gone from strength to strength despite these challenges, underpinned to a large extent by its highly concentrated and vertically integrated structure. Under this model, processors own chicken breeding and hatching operations, feed mills and chicken processing plants and either own or contract the growing of chickens from day-old to slaughter weight, which currently takes around 5 weeks. The short birth-to-slaughter cycle was made possible by selective breeding techniques practised by chicken farmers over the last fifty years. These days, chickens only require 3.4 kilograms of feed to reach ideal slaughter weight in just 35 days, compared to 4.7 kilos of feed in 64 days in the 1970s. While improvements in meat yield was the main priority in the early days of selective breeding programs, the focus has shifted towards a broader set of outcomes, including animal welfare, reproduction, fitness, feed and sustainability etc., according to the Australian Chicken Meat Federation. The chicken meat industry, like many other commercial livestock industries, have experienced increased pressures from animal welfare groups, big retailers, and the

public in general to lift the ecological sustainability and animal welfare standards of their business practices, and in some cases, are compelled to react accordingly.

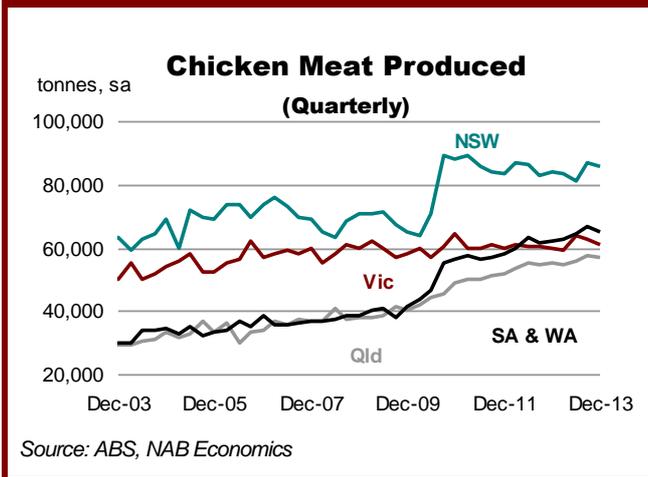
The structure of the industry, combined with selective breeding, has been driving sustained quality and efficiency gains over the years, which in turn bestowed substantial price competitiveness on chicken meat relative to meat alternatives. According to Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES), chicken meat was on average 21% cheaper than pork, and 22% and 45% cheaper than beef and lamb, respectively, over the five years to 2012-13. This trend is expected to persist over the medium term. Chicken meat also appeals to consumers due to ease of preparation and low fat content.



The combined effects of strong demand and supply-side factors spurred chicken meat production to record uninterrupted growth averaging around 4% annually over the past decade. The last financial year of 2012-13 was no exception, with production rising to 1.05 million tonnes to account for a quarter of all meat produced in Australia and the most consumed. This production growth encompasses the effects of both a rising number of chickens slaughtered and carcass weight, as changing consumer preferences for different cuts such as raw chicken breast fillets or chicken drumsticks, as well as processed chicken products, has led to demand for larger birds on average at the time of slaughter. According to ABARES, the average meat yield per bird was estimated to have increased by an average of 1% a year in the 20 years to 2012-13 to be currently around 1.9 kilos.

Production growth in NSW and Victoria continued to lag behind that of Queensland and SA and WA combined in 2013. After the production surge in 2010 and 2011 as Baiada expanded its operations in NSW, production in the state has largely followed a mild declining trend, while the chicken meat industry in Victoria has been showing signs of saturation for a number of years now. Meanwhile, Queensland and SA and WA combined are showing more consistent growth patterns, at 3% and 5% in 2013 respectively, albeit slower than previous years. Strong population growth as a result of mining activities in WA and Queensland has underpinned a sustained growth in demand in the past few years, which was generally met with positive supply responses. However, a moderating pace in mining construction activity as mining operations gradually move into export phase is likely to curb future growth potential in these states.

## Quarterly Poultry Production



Since 2008, chicken and other poultry have surpassed beef and veal as the most consumed protein in Australia to be at approximately 44.7 kilos per capita in 2013-14, 1% higher than the 44.1 kilos last financial year, to exceed total red meat (beef, veal, lamb, mutton) consumption of 41.9 kilos. This amounts to a conservative estimate of \$5.7 billion in retail spending per annum.

Chicken meat exports continue to play a relatively small role in the industry, accounting for less than 5% of all production. Close to all of exports comprise of residual by-products of frozen cuts and offal, such as feet, kidneys and livers, which are relatively unpopular in the Australian market but sought after by consumers in South East Asian and Pacific countries. ABARES forecast chicken meat exports to rise in line with production by 16% in 2013-14 to 34,000 tonnes (shipped weight) and a further 6 per cent in 2014-15 to 36,000 tonnes. Over the medium term, Australia's chicken meat exports are projected to remain at around 5% of production, increasing to 45 000 tonnes by 2018-19. Frozen cuts and offal are likely to make up most of Australia's chicken meat exports over the projection period.

Over the next five years, domestic chicken meat consumption per capita is expected to increase marginally, underpinned by growing trends in healthy eating, competitive pricing and fast foods. This, combined with resilient population growth, will drive total consumption moderately higher. Competition from red meat, which has intensified greatly over the past couple of years, will lessen along with the imminent rise in the retail prices of these substitutes as supply tightens from current drought-induced highs. Domestic poultry processing industry profitability will benefit from further consolidation amongst poultry processors and adoption of advanced technologies and systems, for example, more effective use of machinery equipment and human resource scheduling, water usage etc. However, there could be further tightening of profit margins from major supermarkets.

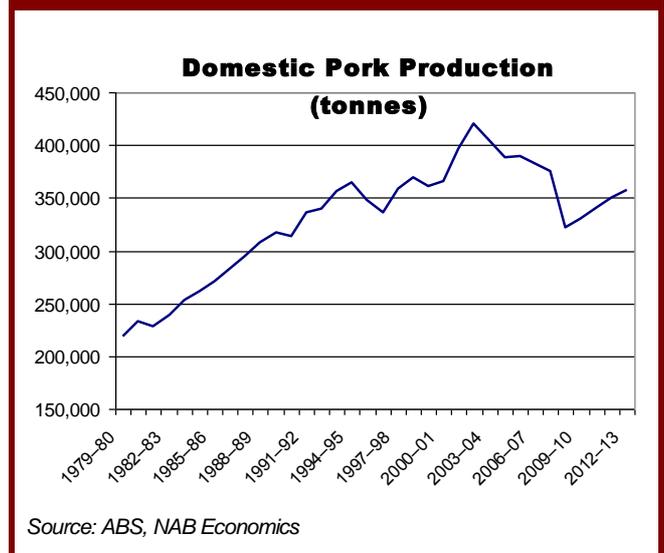
There are also increasing constraints facing poultry farmers and processors in the way they conduct their operations. Typically processing operations are chosen to be close to the metropolitan areas of capital cities for easy access to consumers and minimisation of transportation costs, but the increasing lack of suitable land allotments within proximity of existing infrastructure in Victoria, and more stringent regulations, such as the imposition of curfews on truck movements due to urban sprawl in Sydney basin, have forced some chicken farms to adjust to higher operation costs or even close down.

## Domestic pork industry grows moderately

While the domestic pork industry continues to be weighed down by some persistent structural problems, such as strong competitiveness pressures from imports and high feed prices, things took a better turn in 2013-14 relative to the previous year.

After experiencing a protracted decline between 2003 and 2008 as a result of deregulated imports, Australian pork production has been growing gradually over the last few years. In 2012-13, domestic pork production was around 357,000 tonnes, a level comparable to that of 1997-98. So far, the year-to-date data in 2013-14 suggest that this positive trend has continued, with production to March about 2% higher relative to the same period last year. At the same time, imports of pork in 2013-14 are estimated to fall by 10% this year to around 137,000 tonnes (shipped weight), largely reflecting lower imports from the US due to record pig prices. US pork prices have risen substantially in 2013 due to ongoing drought and high feed prices. Since late December 2013, US pig herd has also been plagued by the porcine epidemic diarrhoea virus, or PEDv, which is estimated to have killed 5 to 7% of the country's pigs and significantly reduced exports, according to estimates by the United States Department of Agriculture (USDA). However, pig meat imports from other major sources such as Canada and Denmark remain largely unchanged.

## Yearly Domestic Pork Production

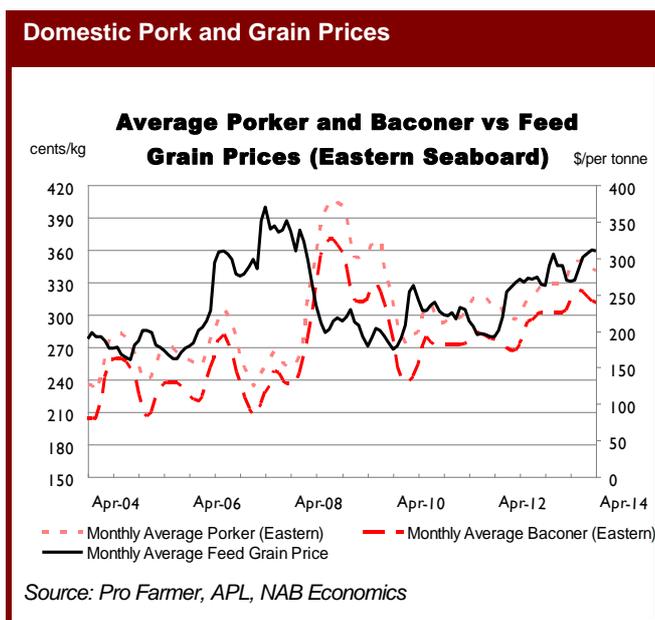


The long-term structural decline in breeding sow numbers in the past decade appears to be stabilising as well after bottoming out in 2012. A large degree of industry consolidation during this period has forced the departure of most of the least efficient operators, and those that remain are the ones with consistent long-term contracts with major retailers or exporters that could plan their sow numbers to meet demand. The voluntary commitment by the Australian pig industry to phase out gestation stalls by 2017, while expected to have some temporary effects in reducing sow numbers as farmers adjust to new feeding and husbandry practices, is unlikely to involve any significant disruption to pork production.

Over the medium term, ABARES has forecast pork production to rise to 374,000 tonnes by 2018-19. It is expected the trend of more production being directed to the fresh meat market will continue, given that the processed pork sector will remain open to competition from imports, while fresh pork imports are restricted due to biosecurity concerns.

## Pork prices on the rise due to lower supplies and higher grain prices

As a result of a tighter supply from a reduction in imports, high feed prices due to strong drought-induced demand from cattle feedlots, over-the-hook domestic pork prices rose notably in 2013. According to monthly data by Australian Pork Limited, prices for porkers and baconers averaged around 340 AUC/kg and 312 AUC/kg respective in 2013-14 to-date, which is around 9% above last year's average for both indicators. Porker-to-wheat and baconer-to-feed price ratios in the first half of 2013-14 averaged 6% and 7% higher respectively compared to the same time in 2012-13. Given that pork prices have been rising in tandem with grain prices this financial year, producers' profitability is not constrained as much as it was in 2012-13, when margins were squeezed by a combination of strong price competition and elevated grain prices.



The expected moderation in feed prices associated with an Australian bumper winter crop in 13-14 has not eventuated, especially in the northern cattle-intensive regions. There is more slack in feed markets in southern states by comparison, with farms reported to hold sufficient barley stocks. More widespread rain during the current planting season indicates further easing in prices post-sowing. Nonetheless, the overall domestic feed grain balance sheet is likely to remain tight for some time to come until new winter crop prospects become more certain, thus keeping feed grain prices elevated in the mean time.

This, combined with diminished imports from the US, will continue to support domestic pork prices in the coming months. Implications for producers' returns are less clear, as they will depend on the relative movements in feed cost and prices.

## Pig meat consumption to trend up gradually, outlook for exports positive

Presumably a reflection of higher prices in the year, Australian pork consumption per capita fell in 2013-14 to an estimated 25.7 kg/person (ABARES). In the mean time, the prices of other meat substitutes such as beef and veal have become more attractive due to high slaughter rates, which would have diverted some consumption away from pork. That said, per capita pork consumption is expected to pick up gradually over the medium term to around 27kgs/person in 2018-19, supported by its competitive price proposition relative most red meats and more

intensive marketing campaigns by industry bodies such as Australian Pork Limited.

Aided by a depreciated AUD, Australian pork export volumes showed signs of trending upwards since the second half of 2013, but overall value stayed relatively unchanged. In the 12 months to February this year, export volumes rose by 8.3% relative to the previous period to around 38,000 tonnes, relative to a 5% rise in total value to around AUD 105 million, implying a fall of 2.9% fall in per unit value of exports to around \$2.85/kg. Singapore remains Australia's biggest export destination with 28% of exports, followed by Papua New Guinea (15%) and New Zealand (14%).

In the medium term, an unprecedented rise in attention on issues such as food security, climate change and the way food is produced will offer Australia the opportunity to set the benchmark of high integrity (yet affordable) pork exports. The growth in major Asian pork consumers, such as China and Korea, is expected to be robust in the foreseeable future, even though Australian exports to these countries are relatively small at the moment. Pork exports are expected to rise gradually over time, reaching 30,000 tonnes by 2018-19, based on the latest ABARES forecasts.

## Comments from the Field

*Average feed grain prices have continued to be volatile, with key drivers in the most recent spike being forecasts of worsened US winter crop conditions and a slow start to US spring plantings. Uncertainty in early April of the stability of the Ukraine, which is a key wheat and corn exporter globally, was also a concern in the global marketplace. Domestically in the southern states, barley sales have been subdued and there is considered to be still a considerable volume of barley on farm. Given the reasonable autumn break in these states and grower confidence increases, it is expected that post sowing prices will ease. As such, average monthly baconer and porker prices in Eastern Australia have steadily increased since April 2013 (300c/kg for baconers and 330c/kg for porkers) until Jan 2014 and since then there has been a slight dip in price, according to Australian Pork Limited. April 14 average price is currently circa 315c/kg for baconers and 345c/kg for porker. - Matthew Strong, Senior Agribusiness Manager, Melbourne*

*Pig prices in WA are stable, while feed prices are staying high because grain prices are staying high despite falls on CME. Animal welfare pressure is not the worst thing facing WA pork industry, with the biggest threat being the situation that there is only one abattoir which does not give rise to sufficient competition. It is also a costly and slow process to get approvals for building new piggeries.*

*The industry is likely to continue to contract over the next 5 years, resulting in 4 to 5 big producers and a similar number of smaller producers – generally via longer term grower contracts and some takeovers of smaller producers. Production in WA has increased by 3-5% and trend is expected to continue for the next few years. There was only a small increase in sow numbers in 2012-13, however, there is still room to improve. Export market in Singapore is the key destination for WA producers and remains steady, with WA representing 47% of Australian export to Singapore. Going forward, we anticipate that there may be a reduction in imports with consumers pushing for locally sourced produce.*

*An estimated \$50 million was invested over the past five years in new housing to meet retailer's requirements for sow housing and improved production systems. Only 20% of sows are now kept in gestation stalls, (sows are in the stalls from 4 to 16 weeks depending on the management of the production unit). Therefore*

*the industry is on target to phase out this housing system pending the outcome of further research, market demand and possible changes to legislation.*

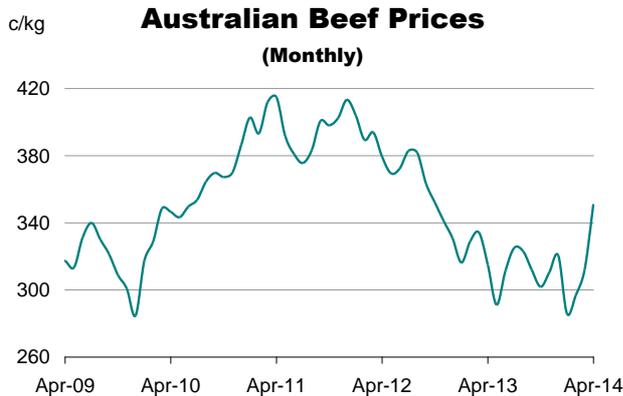
*Meanwhile, the broiler chicken industry in WA remains strong and stable, with demand for cheap protein remains and is expected to increase. It also remains self-sustaining, when eastern Australia appears to be absorbing any extra production out of SA.*

*Broiler farms are highly concentrated, with approximately 35-40 farms owned by around 30 farmers, the balance operated by Baiada/Inghams or multiple properties operated by a farm business. Chicken sheds are ageing in general, with the oldest from the 80's and the newest built in 2000 (with some extension work done in mid 2000's). It is expected that 4 to 5 farms will exit the industry over the next 5 years due to the pressure of urban sprawl.*

**Daniel Dadd, Agribusiness Manager, Perth**

# Key Commodity Prices

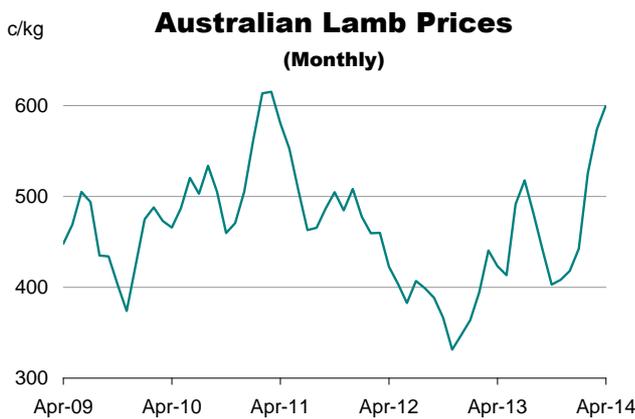
## Cattle prices surged in April



Source: MLA

Price conditions in the cattle sector continued to improve in April, supported by a decent autumn break in the southern states, continued strong beef and live cattle exports and a relatively stable exchange rate. Some patchy rain was received in Queensland but the drought-affected regions there and northern NSW continue to face hardships. The Eastern Young Indicator (EYCI) surged in April by 13%, marking the third consecutive monthly rise. Despite stronger restocker demand, slaughter rates remained at high levels in April, reflecting both the effects of the drought on feed availability as well as farmers' requirements for cash flows. As such, beef and veal exports maintained their solid pace into the month, albeit lower than the historically elevated levels in February and March, to be at levels 14% above the same time last year. Exports to Australia's top four destinations, except for Japan, were higher year-on-year, with shipments to the US and Korea notably higher due to constrained domestic supplies, while exports to China remained robust, although the Chinese government's anti-corruption measures are expected to constitute headwind to the country's food service sector.

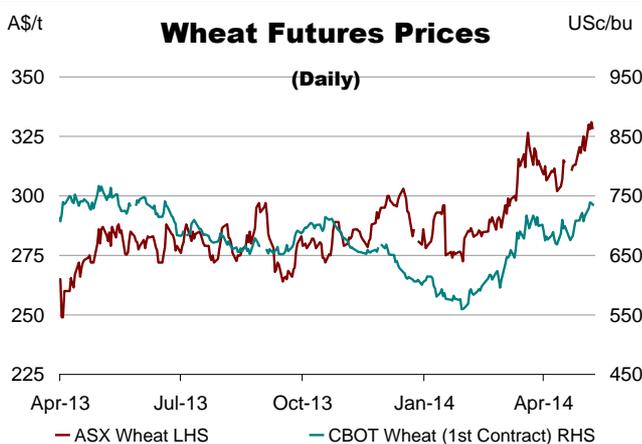
## Record lamb slaughter rates in February and March manifested in record April exports



Source: MLA

In April, heavy lamb prices rose for the sixth consecutive month to average 601AUc/kg, the highest level in more than 3 years. Lamb slaughterings showed signs of tightening in the month, driven by stronger holiday-related demand from the consecutive Easter and Anzac Day long weekends and more widespread rain in the southern states boosting restockers' demand. Consequently, eastern states' average weekly lamb slaughter, as reported by MLA's National Livestock Reporting Service, eased 2% year-on-year, to 314,699 head in the month. Record slaughter rates in February and March had flowed into sizeable export volumes to reach an April record 17,758 tonnes swt. Shipments to China, which is Australia's largest single export destination increased 32% year-on-year, to 3,098 tonnes swt, accounting for 17% of total lamb exports. The Middle East, which accounts for more than a quarter of Australian lamb exports, registered the highest monthly volume since the start of the year, at 5,056 tonnes swt, up 5% year-on-year.

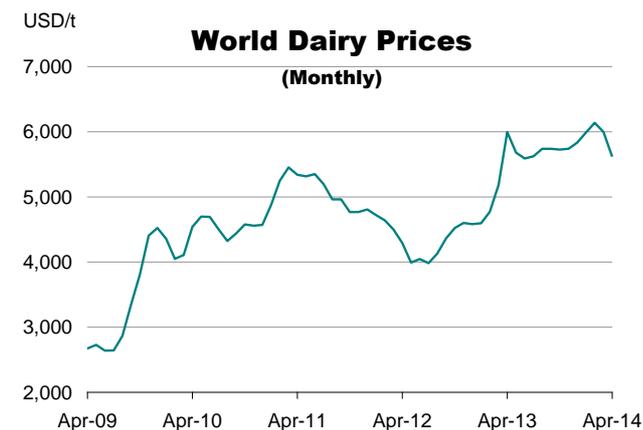
## Wheat prices tracked higher from US drought and Ukraine crisis fears



Source: Bloomberg

The remarkable global wheat price rally which commenced in late January took a breather by tracking sideways for most of April, but resumed some momentum towards the end of the month and early May. CBOT wheat index rose to its highest since June last year as persistent dry weather continues to weigh on the winter wheat crop prospects in the US and stalling spring wheat planting, while an escalation in the Ukraine crisis that spread to the main wheat exporting port of Odessa fuelled worries about grain exports from Eastern Europe. Bolstered by global price movements, futures for the new crop in Australia rose to their highest level in more than three years, further supported by a tight wheat balance sheet in northern Australia from slow grower selling. A decent autumn break in the southern states has fostered ideal conditions for wheat sowing, with central and southern NSW growers likely to enter a planting phase at full steam this month, while Victorian growers were reported to have completed around 30% to 40% of seeding, progressing with the rest at a rapid rate.

### Dairy prices gaining strength on constrained supply



Source: NZX

After a sustained period at historically elevated levels, global dairy prices reached a turning point in March in what many market commentators, including NAB, believed to herald a downward trend. Global dairy commodity prices in April fell further by 6%, with signs of softening across products and markets as Northern Hemisphere producers started to move markets. Milk flows around the world has responded to the strong price signals prior to this, with robust year-on-year growth recorded in European and Oceanian milk production (largely driven by New Zealand). This surge coincides with a slowdown in Chinese demand after a strong run-up in stock accumulation. Meanwhile Australian milk season-to-date production remains 1.4% below the same time last year, but the shortfall has narrowed over time from around 3% during the starting months when production was negatively affected by dry conditions and high feed prices. We forecast Australian dairy production to end this season marginally lower by 1.3%. The opening prices for the 2013-14 season look poised to be the highest on record,

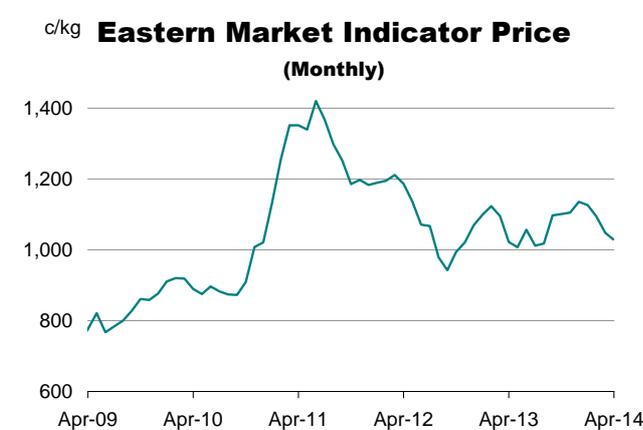
### Sugar prices eased on robust cane harvest forecasts despite drought



Source: Bloomberg

Sugar prices eased slightly in April in monthly average terms to average around USc 17.0/pound after official forecasts suggested that the overall cane harvest in Brazil is likely to hit a record in 2014-15, despite recent drought conditions. Officials estimated the Brazilian cane harvest at 671.7m tonnes, representing an annual gain of 2.0% as a higher acreage more than offsets lower yields from drought. Sugar production was expected to rise even further by 4.9% to 39.5m tonnes. However, there are downside risks to this forecast stemming from the likely development of an El Nino event later this year which could result in a Brazilian deluge that would curb cane production. Indian exports have been slower than expected due to the uncertainty associated with the subsidy. In 2014-15, global sugar production is expected to continue to outweigh consumption, with most other major producing countries, including Australia, likely to witness an increase in output. This will contribute further to the existing supply overhang which will weigh on sugar prices for some time to come.

### Wool auction conditions volatile in April while prices showed signs of stabilising



Source: Bloomberg

Australian wool auction conditions were volatile throughout April, commencing with poor conditions similar to those in the previous two months but picked up substantially in the second and third week prior to the one-week Easter hiatus. The relative stability of the AUD in the month appeared to have enticed the return of some forward interest from Chinese buyers, but their purchases continued to favour lesser styles of carbonizing, open top and crossbred wool which fetch thinner margins. Overall, the monthly price average tracked modestly lower to around AUc1030/kg but appeared to be bottoming out, partly supported by conservative weekly offerings by sellers of around mid-30,000 bales. Auction markets opened reasonably strongly the first week post-Easter break with a higher offering of 42,500 bales but heightened volatility in the past month resulted in mixed expectations amongst exporters in terms of market directions from now onwards. In the short-term, the low volumes of supply scheduled for the coming weeks suggest that there could be some upward price pressure, but the lack of longer-term price impetus in either direction indicates a period of relative stability in wool prices over the coming months.

# Contact details

## Agribusiness

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