agribusiness

Economic Report

March quarter 2014

Post-farmgate Agribusiness Survey

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• Post-farmgate agribusiness conditions fell significantly in the March quarter from a 9-year high in December quarter as supportive seasonal factors dissipated. However, a sustained period of positive readings suggests that underlying fundamentals remain strong.

• Survey respondents continued to be overwhelmingly optimistic in their medium-term outlook for post-farmgate business conditions. This, combined with expectations of a prolonged period of low interest rates, has fuelled strong capital expenditure intentions for the year to come.

• Against the backdrop of a solid pace in grains and red meat exports in the March quarter, the export sales index remained comfortably in positive territory, while respondents' bullish optimism pushed the 3-month expectations index to its highest level in more than 7 years.

Business conditions and confidence moderated from 9-year high

After reaching the highest level in 9 years in the December quarter, reaching +17, the business conditions index lost most of its gains in the March quarter to finish at +4. This largely reflects the winding back of some supportive seasonal factors, but the sustained trend of positive readings for the fourth consecutive quarter suggests that overall underlying fundamentals remain robust. In conjunction with the fall in conditions, business confidence also retreated from its first positive reading since 2005 in the December quarter to be at the neutral point in the March quarter.

All three major components that make up business conditions index (trading, employment and profitability) fell in the quarter, with the profitability sub-index retreating significantly by 18 points to -2. Trading and employment conditions remain in positive territory, with trading bolstered by customer confidence.

The AUD was generally favourable for exports in the quarter as well, to be overall 3% weaker than its December quarter average. It has since shown some renewed vigour after the Reserve Bank of Australia (RBA) switched from an easing bias to a neutral stance in February.

The strong pace of protein exports showed no signs of slowing down in the quarter, with monthly beef and veal exports charting another record in March. This is despite more widespread rainfall across drought-affected regions boosting restockers' confidence and thus a higher level of stock withholding, given that most stocks for slaughter were typically booked into processors' schedules a few weeks in advance. Dairy prices also set a new record in the quarter, but appeared to have reached a turning point and are likely to fall further, largely driven by a slowdown in Chinese demand and a ramping up of supplies from the northern hemisphere. Domestic grain prices remain elevated in tandem with trends in global prices and sustained strong demand from drought-affected northern Australia.

Lack of demand still cited as a constraint to output

Given a seasonally weaker external environment in the quarter for exports and domestic consumption, it is perhaps of no surprise that a higher percentage of respondents (57%) cited sales and orders as a constraint on output, compared to 52% in the December quarter. However, fewer respondents now expect the lack of demand to be the main constraint on profitability in the next 12 months, (46% compared to 58% in the December quarter). A generally supportive macroeconomic setting has resulted in fewer concerns about the availability of suitable labour, government policy and regulation as constraining factors.

Medium-term expectations remain firm

Encouraged by a sustained improvement in fundamentals, post-farmgate agribusinesses continue to maintain an optimistic outlook in their expectations for business conditions in the next 12 months, albeit at lower levels than in the previous two quarters. Similarly, expectations about output gains and profitability also held up relatively well, with 41% and 37% of respondents respectively expecting an improvement in the next 12 months. The overall buoyant outlook of the post-farmgate agribusiness industry, combined with expectations that interest rates will remain low in the foreseeable future, has lifted 12-month-ahead capital expenditure intentions to their highest in nine months at +29.

Key Survey Indicators

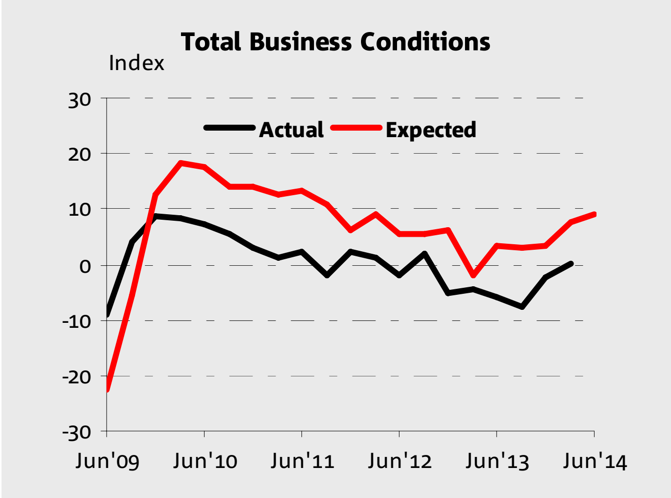
Index	Q3 2013	Q4 2013	Q1 2014
Business Conditions	2	17	4
Business Confidence	-4	6	0
Trading	5	24	13
Profitability	4	16	-2
Employment	-2	10	2
Expected Conditions - 3 months	16	10	10
Expected Conditions - 12 months	19	25	12
Forward Orders	-7	4	10
Capacity Utilisation (%)	77.7	78.4	77.2
Capex Plans (Next 12 months)	25	22	29

Source: NAB Group Economics

Post-farmgate agribusiness conditions unwound some of their December-quarter gains

The post-farmgate agribusiness conditions index has unwound some of its gains from the nine-year high in December quarter from the loss of some seasonal push, but at +4, remains significantly above the five-year average for March quarters of -6.5. The rising trend in business conditions since the second half of 2013 reflects the flow-through of the positive effects of low interest rates, a weaker AUD and looser labour market into more favourable trading, profitability and employment conditions. About 21% of respondents cited good or very good conditions, compared to just 17% at the same time last year. Trading, and to a lesser extent employment conditions, contributed positively to the last quarter's result. Underlying robust trading conditions had been a strengthening global demand for Australia's exports from developed and emerging economies alike, as well as supporting higher commodity prices and an improvement in financial market outcomes.

Meanwhile, profitability conditions have deteriorated markedly in the quarter, possibly reflecting higher purchase costs of livestock and grains at the farmgate, with the former having recorded notable gains from recent widespread rainfalls in Queensland and NSW.

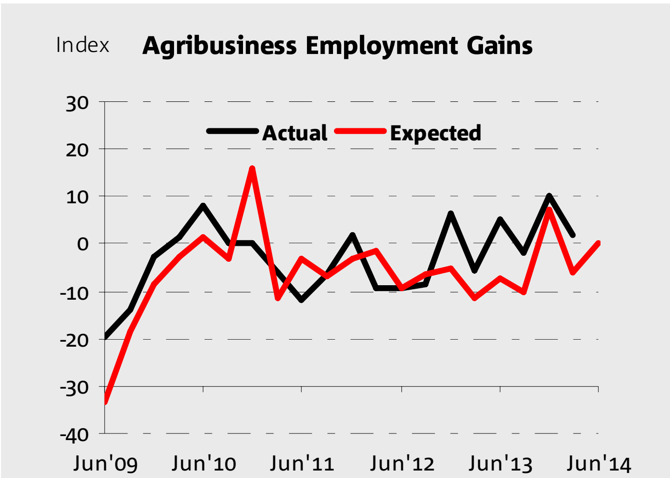


Source: NAB Group Economics

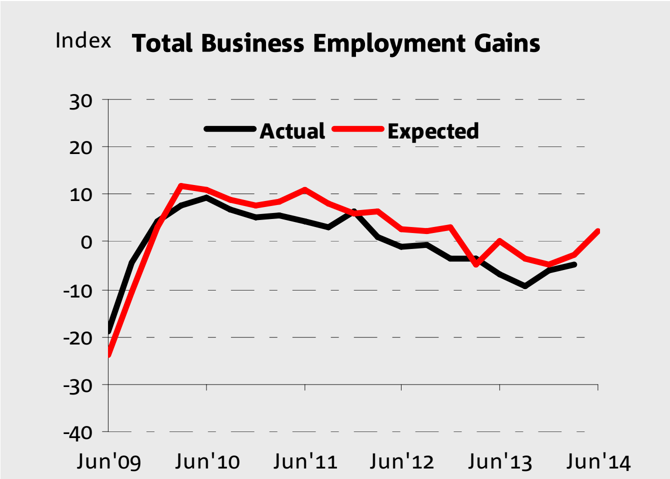
Post-farmgate businesses employment gains index positive on the back of an easing labour market

Post-farmgate agribusiness employment conditions fell in the March quarter but remained above the 5-year quarter average of -3.5. This was large a result of an easing in the seasonal demand for casual labour to meet with peak holiday requirements, but overall benign labour market conditions continued to work in employers' favour by containing wage growth and posing no significant constraints to businesses in finding suitable labour. Post-farmgate employment conditions continued to fare better relative to total business in absolute terms, although the latter has demonstrated signs of a pick-up in recent months.

For the coming 3 months, most respondents (87%) are inclined to keep their headcount unchanged given the generally slower agricultural production patterns during the winter months. This is in contrast to a further improvement in the employment conditions of total businesses.



Source: NAB Group Economics

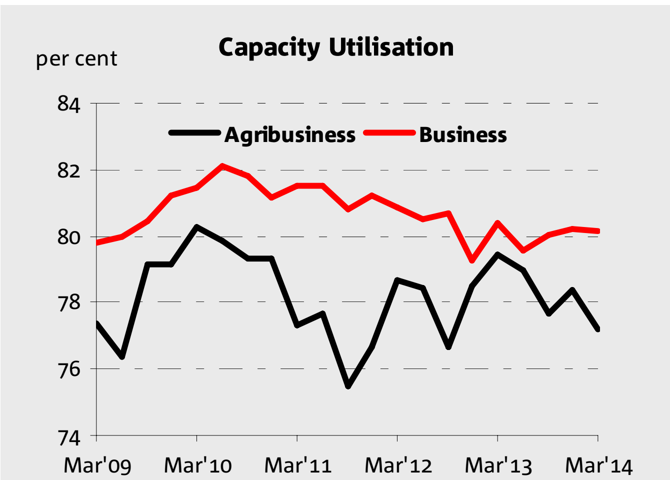


Source: NAB Group Economics

Capacity utilisation moderated to below long-term seasonal average

Capacity utilisation of post-farmgate businesses moderated in the March quarter by more than seasonal norms would suggest. At 77.2%, capacity utilisation is lower than the 5-year March quarter average of 78.2%, which is somewhat surprising given the strong readings for forward orders and export sales in the quarter. One possible explanation could be that firms chose to run-down the inventories built over the December quarter, which experienced a higher-than-normal capacity utilisation rate.

Despite showing a more resilient trend over time, capacity utilisation levels in post-farmgate businesses continued to track below the total business average, which reflects the relative need to maintain excess capacity to meet with the volatile nature of agricultural production. However, the distribution of excess capacity is highly uneven across different post-farmgate sub-sectors. Those in grain and meat processing, wine and dairy industries report high excess capacity, but it is significantly lower in the poultry processing industry due to its highly consolidated industry structure. It is expected that the latter will be the main driver of capital expenditure growth in the medium term.



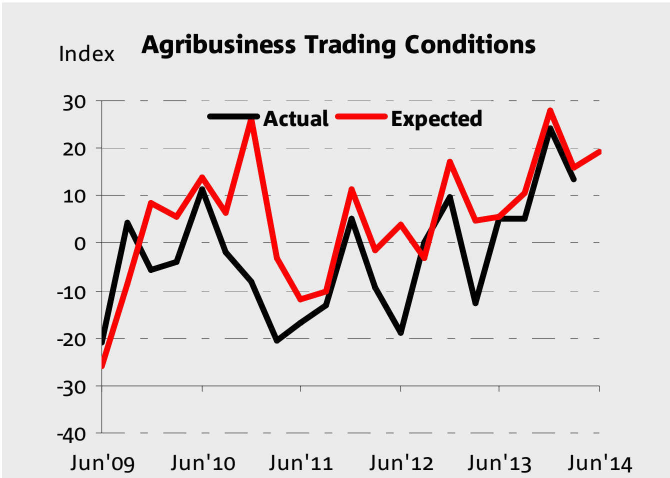
Source: NAB Group Economics

Trading conditions robust from strong customer confidence

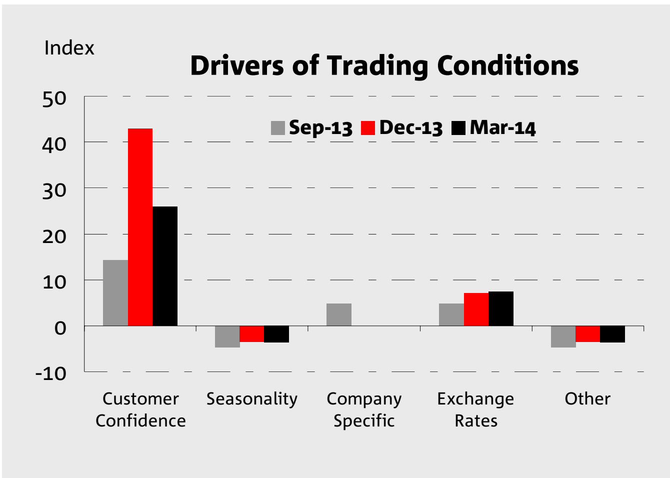
In the March quarter, trading conditions within post-farmgate businesses moderated from their record high in December quarter, but remained at historically elevated levels. Similar to the previous two quarters, customer confidence was the leading contributor to trading conditions in the March quarter, but less so compared to the December quarter.

News of a tractable recovery in advanced economies, stronger asset prices and persistently low interest rates in the global and domestic environments were likely to have buoyed confidence of customers of post-farmgate businesses. However, this would have been partly offset by growing concerns of slowing activity in China, which has seen moderating demand for commodities such as dairy and wool from the country. “Seasonality” and “other” were mild detractors for trading conditions in the quarter.

When asked about their expectations for trading conditions in the next 12 months, survey respondents remained reasonably rosy, potentially signalling further improvements in trading activity.



Source: NAB Group Economics

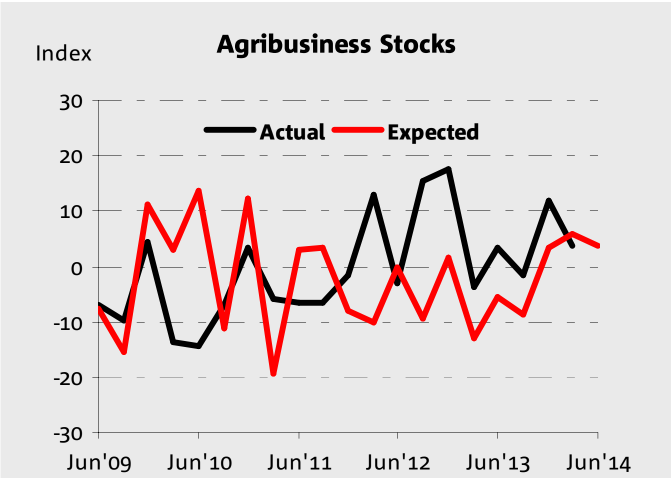


Source: NAB Group Economics

Stocks fell on cyclical inventory depletion

After firms undertook an inventory building phase in the December quarter, the agribusiness stocks index fell in March quarter, in line with seasonal behaviour and lower capacity utilisation reading in the quarter.

For the coming quarter, majority post-farmgate business respondents expected stocks to remain unchanged (52%), while 15% expected more and 12 less. Overall, the positive expected stocks reading suggests that businesses' pace of production is likely to be maintained at a resilient level in the June quarter, in line with stronger expectations for forward orders and export sales.



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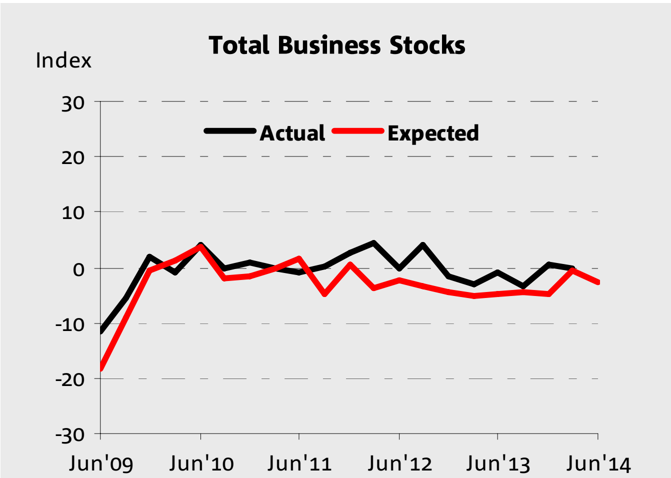
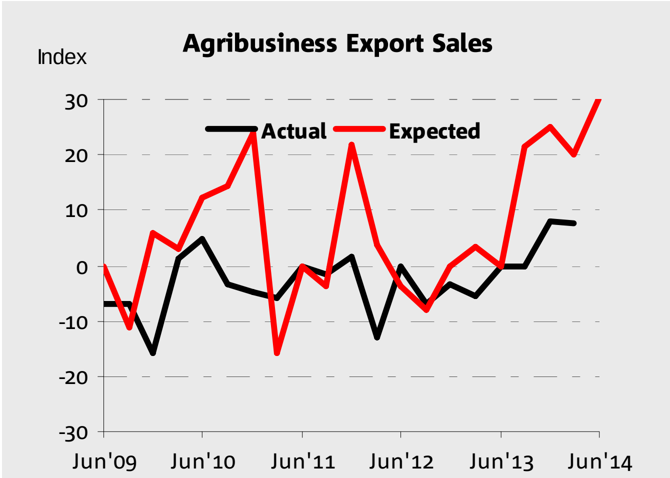


Source: NAB Group Economics

Export sales expectations index surged to the highest in more than 7 years

Against the backdrop of a solid pace in grains and red meat exports in the quarter, the export sales index remained comfortably in positive territory, but significantly below respondents' expectations from the previous quarter.

According to the survey results, 8% of respondents reported an increase in export sales, compared to 14% in the previous quarter. No respondents reported a fall in exports in the quarter. Wheat export revenues expanded strongly in the December and March quarters as Australia delivered its bumper crop, while beef and lamb exports also showed no signs of slowing on the back of record levels of slaughterings. A softer AUD also helped to support export outcomes for a range of rural commodities. Riding on a rising trend in actual export sales, respondents' 3-month outlook for exports surged to the highest level in more than 7 years at +30.



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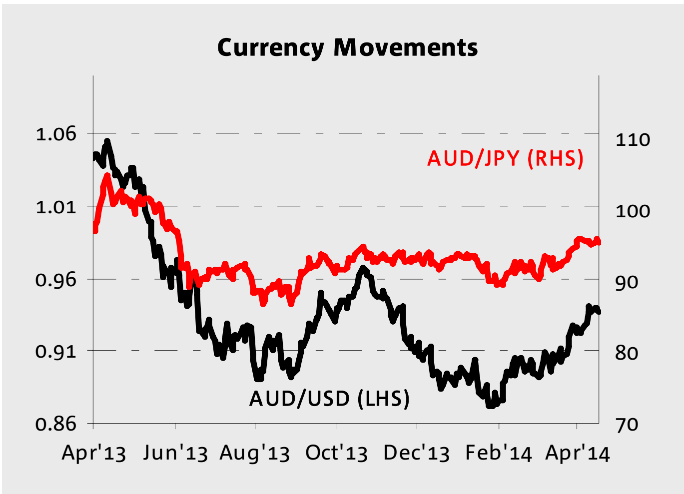
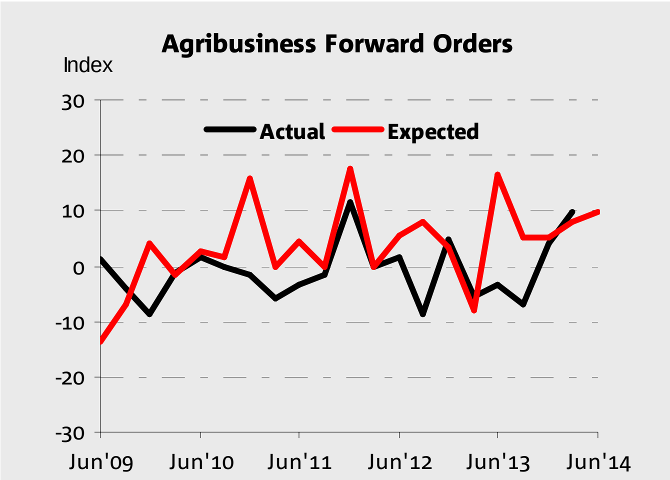


Source: NAB Group Economics

Forward orders gained pace on a softer AUD

Forward orders of post-farmgate agribusinesses gained further momentum in the March quarter, consistent with robust export sales and a weaker AUD. Relative to the December quarter, a higher share of respondents (17%) reported increased forward orders in the March quarter, while a lower share (6%) reported a fall. The figures for reported increases and falls in the December quarter were 14% and 10% respectively.

This is consistent with a rising trend in export sales, the forward orders index having fluctuated around the neutral mark for the past few years. A lower exchange rate since the second half of last year would have helped to foster some confidence in forward orders, but some buyers continued to be deterred by the strong volatility patterns and a renewed vigour in the AUD. Total business exports are on an upswing as domestic and foreign demand conditions improve.



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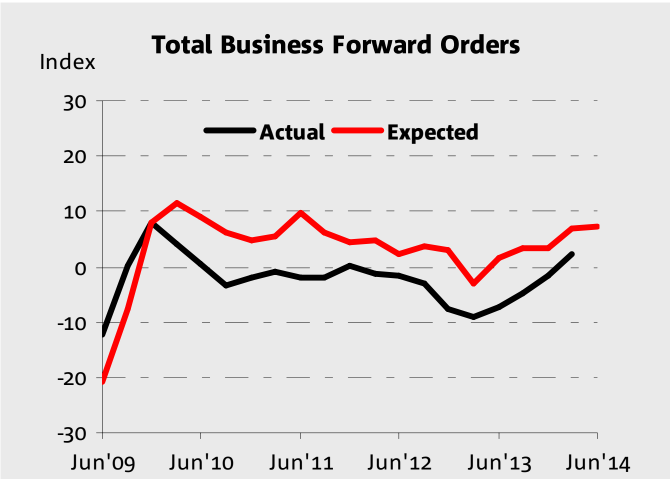


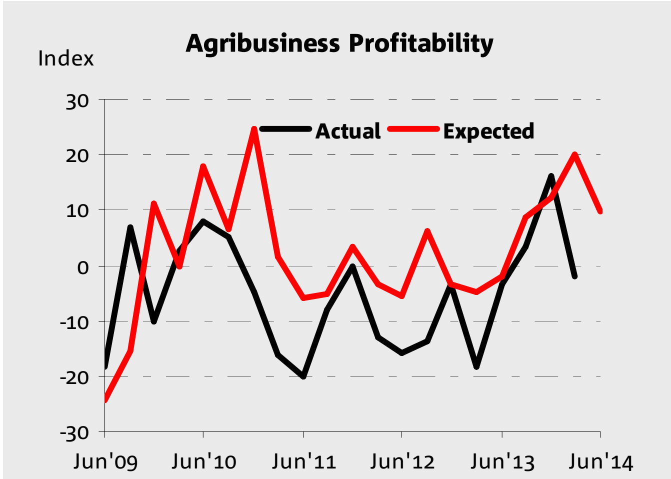
Source: NAB Group Economics

Profitability moderated from record level in the December quarter

After rising to an unprecedented level in the December quarter, the profitability index lost all of its gains in the March quarter to end up at -2, but remained significantly above the 5-year March quarter average of -9. The negative result was somewhat surprising considering the rise in sales margins to a record level in the quarter.

However, the lack of demand continued to be perceived as the dominating constraint on post-farmgate agribusiness profitability, although less so than overall businesses.

In the March quarter, 23% of respondents had cited good or very good profitability, compared to 36% in the December quarter. Meanwhile, 25% had cited poor or very poor conditions, relative to 23% in the December quarter. For the quarter ahead, survey respondents continued to maintain an overall positive profitability outlook, with the index at +10, albeit lower than the recent high of +20 in the December quarter.



Source: NAB Group Economics

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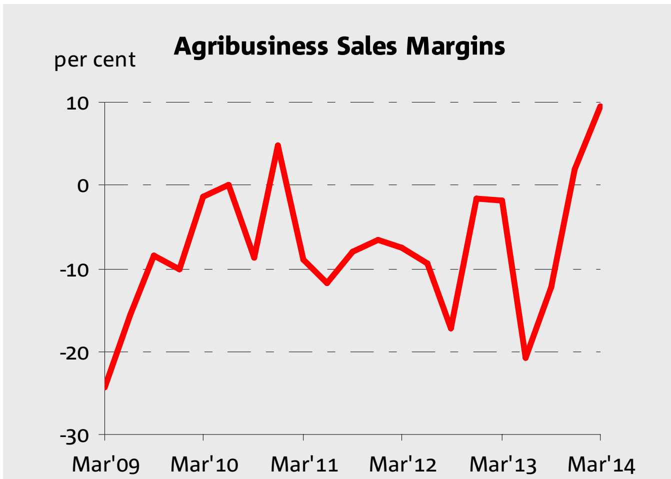
Sales margins reached unchartered territory

The sales margins conditions index built on the momentum seen in the December quarter to rise to its highest level since the start of the survey in the March quarter at +10. A sharp uptick in sales prices, combined with contained labour costs were the main contributors to the index over the period. Meanwhile, purchase costs increased in the quarter as saleyard prices of livestock were boosted by decent rains in the drought-affected regions of Queensland and NSW and grain prices continued to benefit from strong domestic demand and rallies in global prices.



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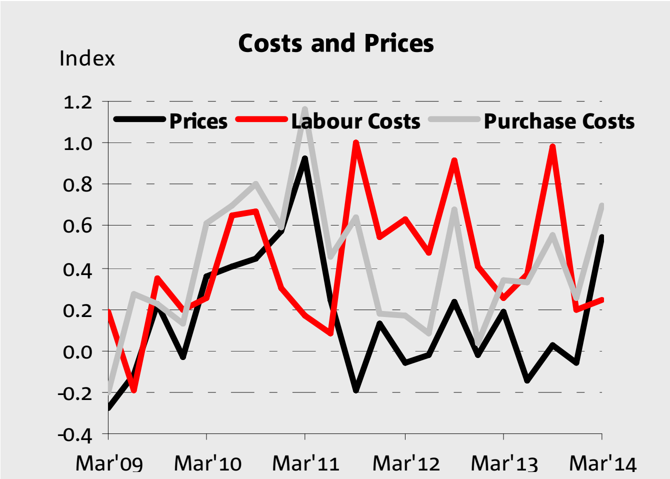
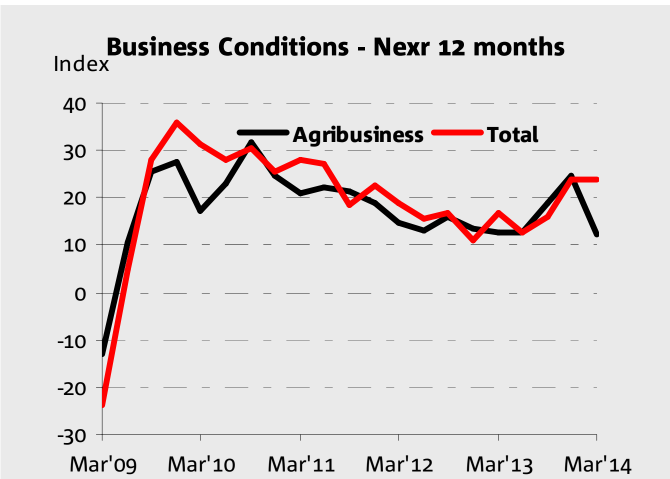


Source: NAB Group Economics

Long-term expectations of business conditions lost ground but capex expectations remained strong

Consistent with a fall in actual reported business conditions in the quarter, respondents were less upbeat in their medium-term outlook for post-farmgate agribusiness conditions. The business conditions expectations index for the next 12 months fell to +12 points from +25 points in the December quarter. In contrast, the 12-month outlook for capital expenditure fared better, rising by 7 points to +29 in the quarter, despite the RBA flagging that they are inclined to keep rates unchanged in the near-term. Most financial market participants interpreted the RBA's decision to end its easing bias and switch to a neutral stand as signalling no further cuts in interest rates.

NAB's view continues to differ from the market average by maintaining a forecast for a 25bps cut late this year on the basis of a soft outlook for the Australian economy and potential further deterioration in the labour market.



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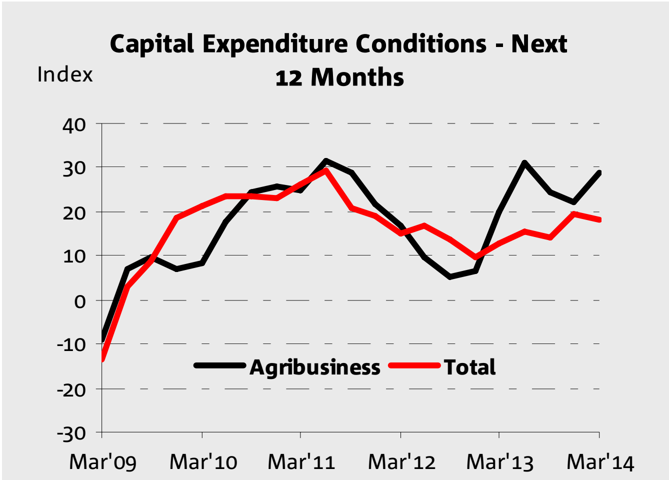
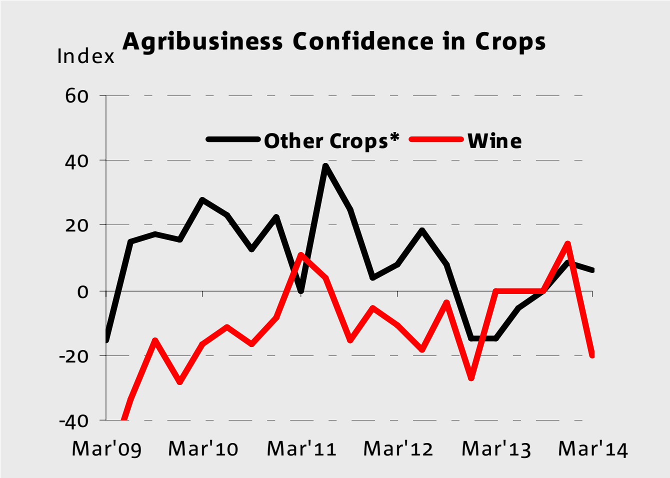


Source: NAB Group Economics

Agribusiness confidence in commodities and other supplies mostly lower

Post-farmgate agribusiness confidence in crops was broadly softer in the quarter. Confidence in wheat fell for the second consecutive quarter, but remained positive still from the strong trends in prices stemming from both domestic and global factors. However, the current situation is tempered by the poorer outlook for the coming summer crops harvest and winter crops planting, which are likely to reflect the adverse effects of the persistent drought conditions in the form of inferior quality and yields. Confidence in sugar continued its slide to be the lowest in 5 years, reflecting respondents' drawn-out disenchantment with the prolonged state of depressed sugar prices from a global oversupply. Wine confidence plummeted to -14 points in the March quarter after enjoying a rare breach into positive territory in the December quarter. Long-term structural problems in the industry, such as an oversupply of cheap and poor-quality wines and declining trend in export prices, are likely to constrain confidence in the wine industry for some time to come. However, Australian key export markets such as the US and China are set to increase their intakes of Australian wines as their per capita consumption lifts towards the international average.



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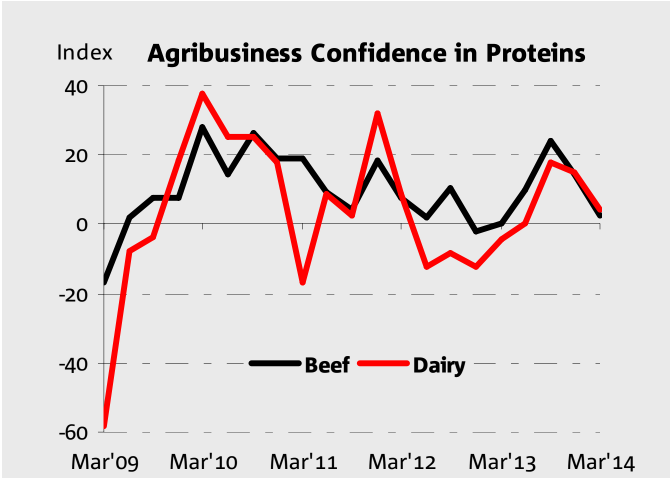

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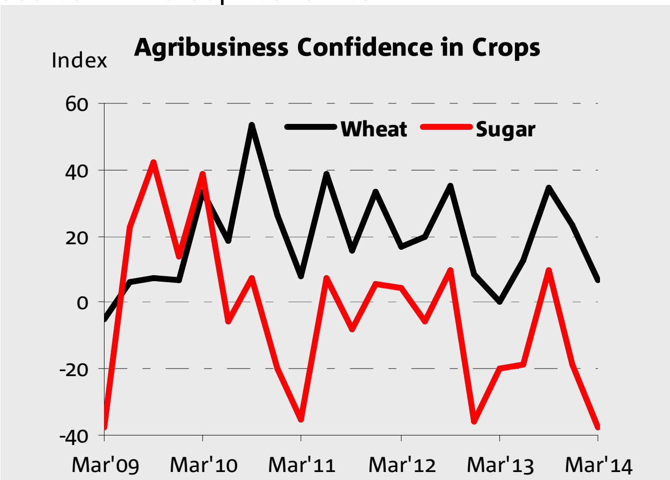

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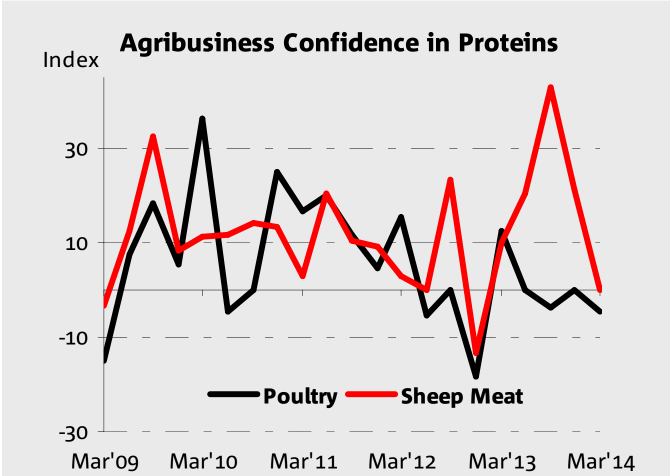


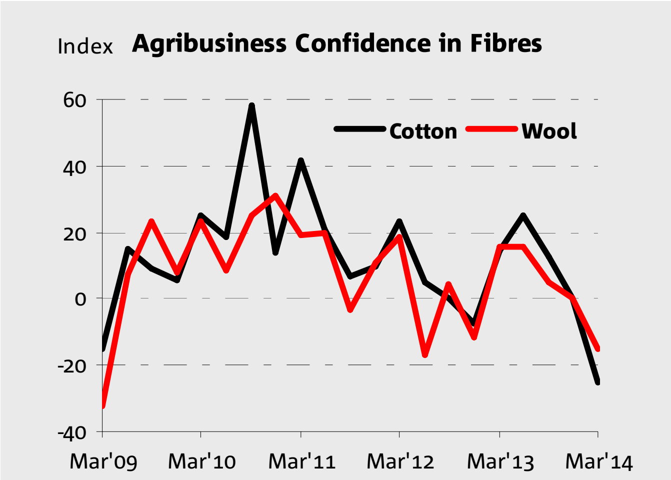
Source: NAB Group Economics

The movements in post-farmgate agribusiness confidence in livestock and proteins were also consistently lower in the quarter. Record slaughter rates of lamb and cattle which persisted into the early months of this year granted processors with plenty of supplies at competitive prices and culminated in record levels of red meat exports in March. Nonetheless, saleyard prices of livestock, which constitute input costs to processors and exporters' businesses, have shown signs of picking up recently, thus weighing on confidence. Lamb prices in particular surged by more than 20% in the quarter, probably contributing to a sharp fall in the sheep confidence index to the neutral point. Dairy confidence also turned southwards in the wake of softer global commodity prices. Meanwhile, the poultry index fell modestly to be at -4 on the back of heightened grain prices.

Confidence in wool and cotton continued on their downward trajectories in the March quarter to be both now in negative territory. The index for cotton fell for the third consecutive quarter as concerns over China's mounting stockpile, currently estimated to be around 13 million tonnes, weigh on the exporting prospects of Australia, which relies on China for 70% of its shipments.

Wool confidence was also lower on generally lacklustre auction results in the quarter due to thin export demand by major buyers from Europe and China.

Agribusiness confidence in farm inputs held up better by comparison, with both of the indices for farm chemicals and equipment confidence both rising into positive territory. The sustained low prices for fertilisers due to excess global supply continue to support confidence levels above the neutral point (at +18 in the March quarter), while a still-elevated AUD may have provided some support to farm equipment confidence by keeping imported costs in check.



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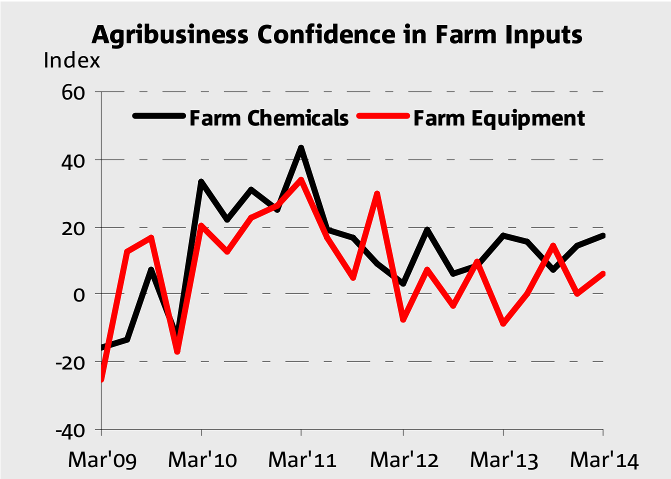

Source: NAB Group Economics

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About the Agribusiness Survey:

The agribusiness survey is a cohort of the NAB Quarterly Business Survey which surveys approximately 900 small/medium to large sized Australian companies. The agribusiness sample is approximately 100 small/medium to large sized companies, mainly in the food manufacturing industry but also wholesaling, services, and a small number of firms in other sectors. Gundabluey Research Pty Ltd mainly conducts the survey over a two-week period in the final month of each quarter. To ensure the highest possible accuracy, respondents to the survey are chosen at random from those firms with 40 or more employees.

Definitions

Business confidence is a measure of respondent's expectations of business conditions in their industry for the upcoming quarter. Business conditions are a simple average of trading, profitability and employment indices, reported by respondents for their company. The trading, profitability and other indices are calculated by taking the difference between the percentage of respondents nominating good or very good, or a rise and those nominating poor or very poor, or a fall. For example, if 25 per cent of respondents state that trading levels are good or very good and 10 per cent state these levels to be poor or very poor, the corresponding index of trading performance would be 15. The Capacity Utilisation Rate measures the degree to which an industry is operating at or below full capacity level. The full capacity rate is defined as the maximum desirable level of output given existing capital equipment. The Capacity Utilisation Rate is calculated as the average of respondents' capacity utilisation for the quarter. The cost and price change indices are the average of respondent's estimates of past and expected cost and price movements.

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