Economic Report

Rural Commodities Wrap – November 2014

Phin Ziebell, NAB Agribusiness Economist

Photo: Rachel Campbell

agribusiness

Key points

- 2014 has shaped up as a mixed year for many producers. In southern areas, the best autumn break in years was followed by generally poor late winter and spring rain, cutting wheat yields and denting spring pasture growth for beef, lamb and dairy farmers. In the north, ongoing drought continues to affect the beef industry, with persistent discounting and higher turnoff. Prices were mixed, with international grain and dairy falling considerably, and lamb giving up most of its gains, but beef performing well and wool showing signs of stabilisation.

- The global economic outlook is one of contrasts, while global growth remains moderate and sub-trend, there are large variations between key economies. We also see mixed data locally: while business conditions generally improved in October, there are reasons to be cautious. Business confidence is moderate, income remains under pressure and job security is still an issue.

- The Australia-China Free Trade Agreement (ChAFTA), announced this month, includes significant reductions Chinese tariffs applied to a number of Australian agricultural imports. Dairy and beef are winners under the agreement, but wool and cotton, which make up more than 40% of Australian agricultural exports to China, are not likely to see any great benefits from the deal. For more information on the agreement, see our Special Feature.

Contents

Harvesting wheat at Blyth, SA. Photo by John Coppi, CSIRO
http://www.scienceimage.csiro.au/image/4485/harvesting-wheat-at-blyth-in-the-mid-north-of-south-australia-1986-/

Economic Update

For a detailed analysis of Australian and global economic trends see our [Global and Australian forecasts]() and [Australia and the world on two pages]().

Global Economy

Global growth remains moderate and sub-trend with big variations between key economies. China and North America represent around one-third of global GDP but they currently account for around half of global growth. By contrast, Japan and the Euro-zone are the main drags on the global economy, accounting for one-sixth of world output but contributing very little to global growth. Low interest rates, less fiscal retrenchment, lower oil prices and a gradual recovery in investment in India should produce an acceleration in global growth from this year's 3% to 3.4% in 2015. Although the US and UK upturns look solid, the emerging market economies continue to drive around three-quarters of the increase in global output in 2014 with China and India contributing around half, but that share should trend down.

Domestic Economy

Business conditions improved sharply in October except in transport and wholesale. While this may point to a strong start to Q4, there are reasons to be cautious: business confidence is moderate, income remains under pressure and job security is still an issue. Our GDP forecast is up slightly for 2015 (3.0%) while our 2016 forecast is 3.3% and unemployment is still expected to peak at around 6.5%.

Interest Rates

The RBA kept the cash rate at 2.50% in November, as expected and unchanged for 15 months. We still expect no change in the cash rate until the end of 2015. While there are tentative signs of an improvement in household spending, they do not yet signal a sustained change in household and business conditions. In the absence of any major surprises, the cash rate is unlikely to rise until late next year as monetary policy commences its return journey to normality.

Table 1: NAB Global Economic Forecasts

% change year on year	2014	2015	2016
China	7.3	7.0	6.8
US	2.2	3.0	2.8
Euro zone	0.7	0.9	1.1
Emerging Asia	3.8	4.0	4.2
Japan	0.5	1.2	1.0
Middle East	2.7	3.2	3.0
Advanced economies	1.7	2.2	2.1
Emerging economies	4.7	5.1	5.4
World GDP	3.0	3.4	3.5

Source: NAB Group Economics

Table 2: NAB Australian Economic Forecast

% change year on year	2014	2015	2016
GDP growth	3.1	3.0	3.3
Private consumption	2.4	2.6	2.7
Unemployment rate	6.3	6.0	5.8
Consumer Price Index (core)	2.2	2.2	2.7

Source: NAB Group Economics

Table 3: NAB Interest Rate Forecast

	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
RBA Cash Rate	2.5	2.5	2.5	2.5	2.5	3.0

Source: NAB

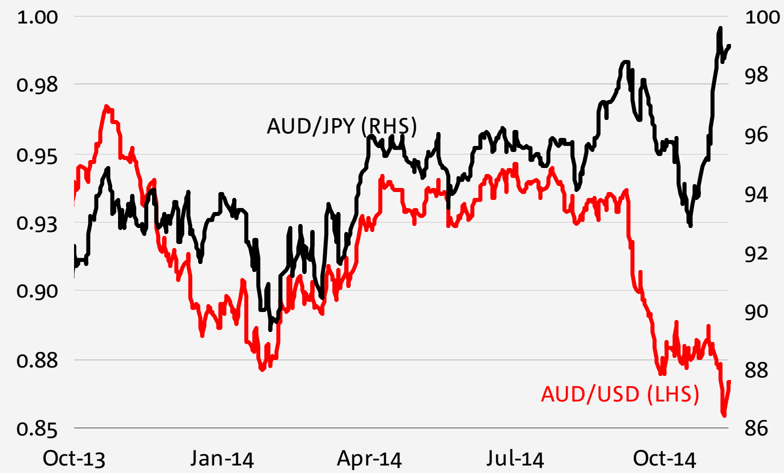
Exchange Rates

The AUD has fallen considerably over the last three months, now trading well below 90 US cents. The lower AUD has been driven in large part by an appreciating USD, combined with a falling terms of trade, and more recently, an unexpected decision by the Bank of Japan to further ease policy.

In response, we have revised our AUD/USD forecasts lower. The speed with which the USD/JPY run-up has broadened out into a more generalised bout of USD appreciation means that many of the levels we expected to be achieved in 2015 are now being realised much sooner. The RBA still regards the AUD "above most estimates of its fundamental value, particularly given the further declines in key commodity prices in recent months."

On balance, we tentatively expect that the AUD could end the year around 85-86 US cents, but note that the risk is skewed towards a break below 85 US cents in a continued strong USD environment. We have also revised our low for the AUD from 80 US cents to 78 US cents, expected in 2016.

Figure 1: Daily currency movements



Source: Bloomberg

Table 4: NAB FX Strategy Targets

		2014 Q4	2015 Q1	2015 Q2	2015 Q3
Australian Dollar	AUD/USD	0.86	0.84	0.83	0.82
New Zealand Dollar	NZD/USD	0.76	0.74	0.73	0.71
Japanese yen	USD/JPY	115	117	120	122
Euro	EUR/USD	1.22	1.18	1.14	1.13
British Pound	GBP/USD	1.58	1.54	1.52	1.50
Swiss Franc	USD/CHF	1.02	1.06	1.11	1.12
Chinese New Yuan	USD/CNY	6.15	6.12	6.10	6.08
Canadian Dollar	USD/CAD	1.15	1.15	1.14	1.12

Source: NAB

Photo: Rachel Campbell

Climatic Conditions

2014 year to date

Climatic conditions in 2014 have been mixed to unfavourable for many producers. Wheat growers have experienced a patchy season in many areas, with a good autumn and early winter break followed by below average rainfall in parts of the Western Australian wheatbelt and much of Victoria, but better conditions in South Australia and southern New South Wales.

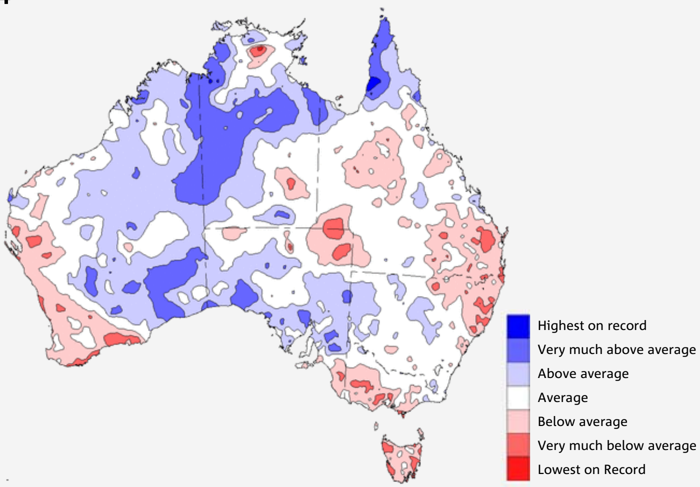
Ongoing dryness in southern and western Queensland and northern New South Wales has made conditions difficult for the beef producers in these areas, with signs of discounting amid drought-induced destocking. Dairy producers have fared somewhat better, although dry spring conditions in much of Victoria have seen poorer pasture growth.

Outlook

The Bureau of Meteorology's (BoM) rainfall outlook for November 2014 to January 2015 forecasts well below average rainfall for much of the continent. Rainfall deficiencies are likely to be most severe in Queensland, northern Victoria, south western New South Wales and the Northern Territory. South western Western Australia and Tasmania are expected to receive close to average rainfall. The BoM has become more concerned El Niño and has upgraded its tracker from watch to alert level. BoM now forecasts an at least 70% chance of El Niño occurring.

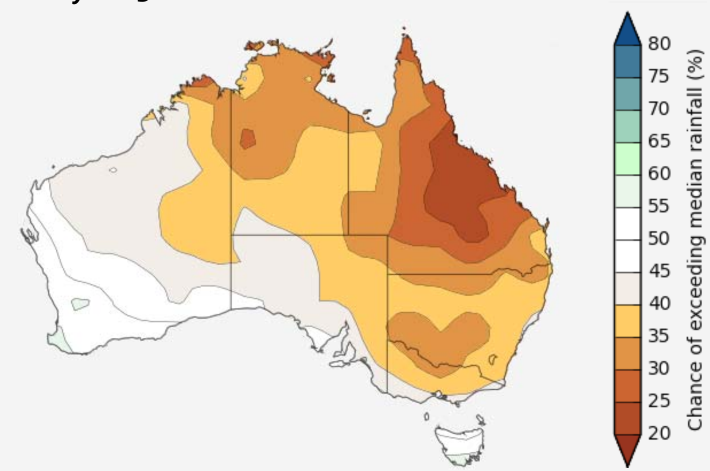
The BoM forecasts above average temperatures for November 2014 to January 2015 across almost all of Australia. Central and Western Queensland, northern parts of the Northern Territory, as well as parts of East Gippsland Tasmania are forecast to see the highest variation from median seasonal temperatures. Above average temperatures are likely to cause higher evaporation rates and compound the effects of forecast below average rainfall.

Figure 2: Australian rainfall deciles – January to September 2014



Source: Bureau of Meteorology

Figure 3: Australian rainfall outlook – November 2014 to January 2015



Source: Bureau of Meteorology

Production Outlook

Overall, we have kept our 2014-15 production outlook in line with our forecasts from last month, while we have made minor adjustments to our price outlook in line with updated exchange rate forecasts.

The outlook for winter grains remains mixed as disappointing winter and spring rainfall across most grain regions, combined with reports of frost damage, weighs on yields.

The outlook for protein is likewise mixed. While Queensland cattle producers enjoyed reasonable rain in August and September, October rainfall was underwhelming and the coming wet season is looking increasingly challenging. Dairy producers, particularly in Victoria, have experienced below average spring rains and now face the prospect of higher hay and feed grain dependence.

Table 5: NAB Commodity Price and Production Growth Forecasts (%) for 2014-15

	Production	Price (AUD)
Wheat	-10.3	-8.8
Beef	-3.4	7.7
Dairy	1.9	-12.7
Lamb	-3.6	-2.4
Wool	-5.0	-4.6
Sugar	5.0	-10.8
Cotton	-34.8	-12.4

Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Bloomberg and Thomson Datastream. These forecasts represent year-on-year average changes in Australian production and corresponding AUD prices between 2013-14 and 2014-15 financial years

Canola and wheat near Cowra, NSW. Photo by Carl Davies, CSIRO http://www.scienceimage.csiro.au/image/3497/truck-on-highway-rural-nsw/

NAB Rural Indices

NAB Rural Commodities Index

The NAB Rural Commodities Index was down only 0.6% (AUD) in October as a falling AUD offset the effects of falling international commodity prices.

In USD terms, the index was off a more substantial 3.7%, falling for a sixth straight month.

NAB Farm Input Prices

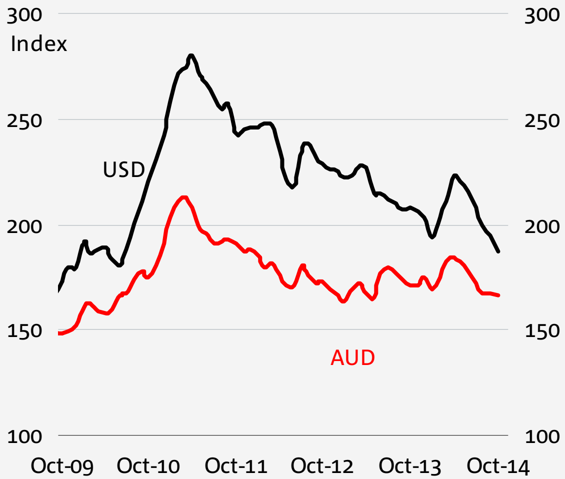
Fertiliser prices were steady in October as lower international DAP, urea and natural gas prices were offset by a falling AUD. NAB's Fertiliser Index recorded no change for the month (AUD).

Fuel prices were slightly higher in October (144.5 AUc/l, up from 142.3 AUc/l in September) as falling oil prices were offset by the lower AUD.

NAB Weighted Feed Grain Prices

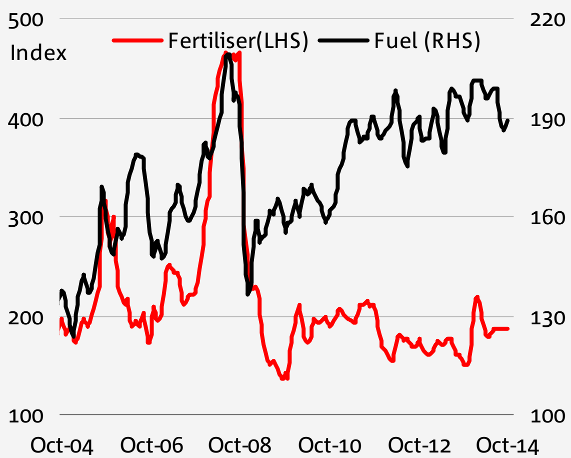
NAB's Weighted Feed Grain index fell 1.9% in October as lower barley, oats, sorghum, maize and triticale prices offset an increase in the local price of feed wheat. While major international benchmarks for grains are trending generally lower, a falling AUD, combined with a dry spring across much of Australia (and associated mixed hay season) could see upward pressure on feed prices coming into summer.

Figure 4: NAB Rural Commodities Index



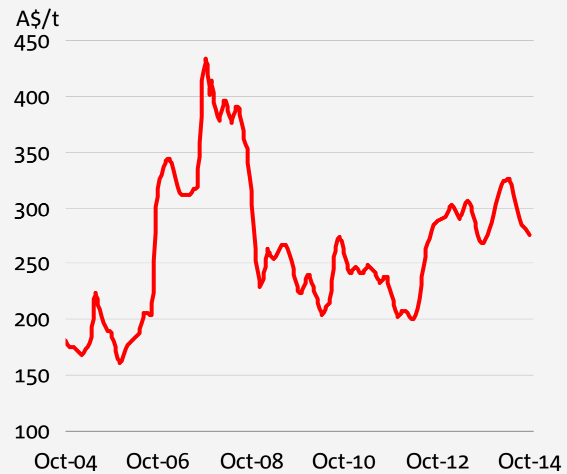
Source: NAB Group Economics, ABARES, Meat and Livestock Australia, The World Bank, Bloomberg and Thomson Datastream

Figure 5: NAB Farm Input Price Index



Source: ABARES, BNZ, RACQ and NAB Group Economics

Figure 6: NAB Weighted Feed Prices



Source: ABARES and NAB Group Economics

Wheat

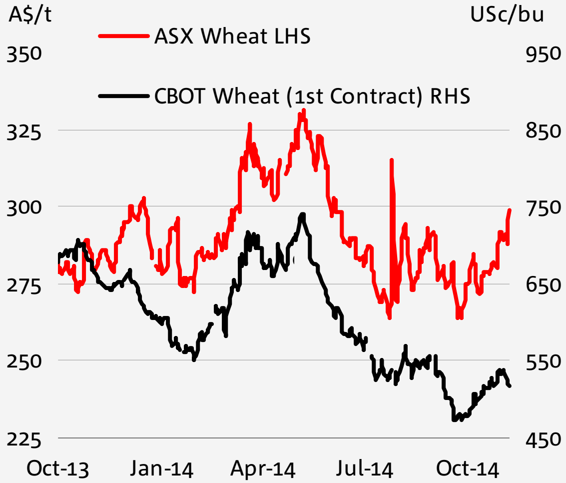
International wheat prices have recovered somewhat from their September lows but are still well down on their May 2014 peak. Prices have trended upwards partly in response to a move by the United States Department of Agriculture to lower its estimate for 2014-15 wheat production by 1.3 million tonnes, as well as cold weather in the US. If the US experiences an unseasonably cold winter, Hard Red Winter wheat yields may be reduced.

While we were initially optimistic about the 2014-15 Australian wheat season due to favourable autumn and early winter conditions, a dry late winter and spring in many areas cut into yields. Wheat growers saw below average winter rainfall in parts of the Western Australian wheatbelt as well as much of South Australia, northern Victoria and Southern New South Wales, combined with mixed spring conditions)especially in parts of the Mallee and Wimmera).

Lower forecast domestic production, combined with a falling AUD and mixed hay cutting season, has lent some support to Australian wheat prices since late September.

Disappointing spring pasture growth in many areas will likely see higher local feed grain demand coming into summer, further lending support to local price premiums.

Figure 7: Australian and international wheat futures



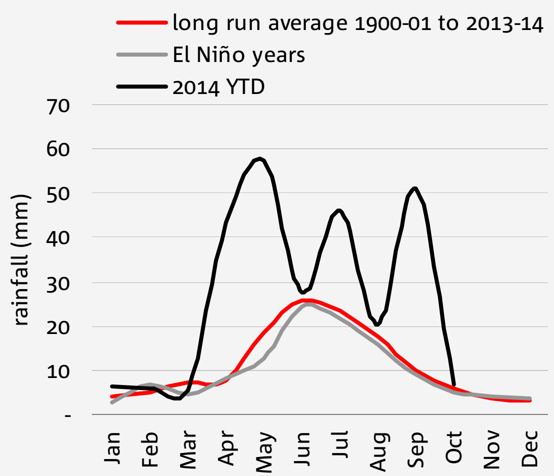
Source: Bloomberg

Wheat yields in the Wimmera-Mallee

After a promising start, the season has now deteriorated to the point where we are now faced with a below average result. The fact that we have not had a meaningful rain event since July, has being the major influencer. Subsequently, yields are well below average – if farmers can generate between 35-50% of their original budget forecast that would be considered a good result. Crop performance has been patchy throughout the Wimmera and Mallee, with variable rainfall over the season and some areas affected by frost.

Brad Sudholz
Senior Agribusiness Manager
Horsham, Victoria

Figure 8: Rainfall in the Western Australian Wheatbelt



Source: Bureau of Meteorology and NAB Group Economics

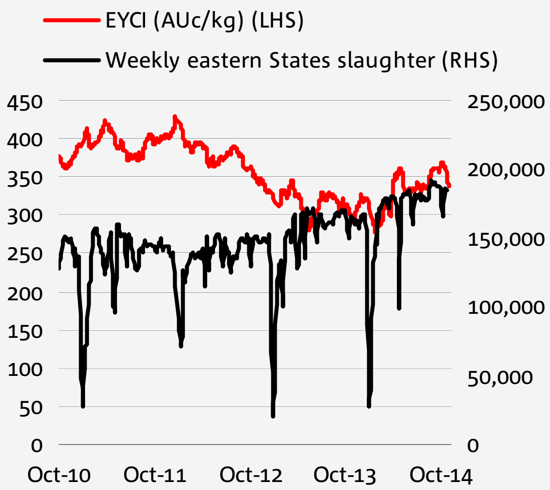
Beef

Beef prices eased in September, with the Eastern Young Cattle Indicator (EYCI) falling 1.2% to average 356 AUc/kg in the first monthly fall since June. Discounting persists in northern sales owing to the ongoing drought, compounded by the BoM's latest rainfall outlook (which forecasts below average rainfall for much of Queensland from November to January). Producers are looking to a decent wet season to rebuild herds and poor rainfall would likely significantly weigh on sentiment.

2014 has been a standout year for Australian beef exports, led by 90cl hamburger beef destined for the United States. The US has increasingly looked to imports on account of drought conditions depleting the US cattle herd. With Australian slaughter elevated for much of 2014 (owing in part to drought induced destocking), Australian producers have been able to meet this demand. Elevated slaughter rates have continued throughout spring as poor pasture growth and a mixed hay season weigh on sentiment.

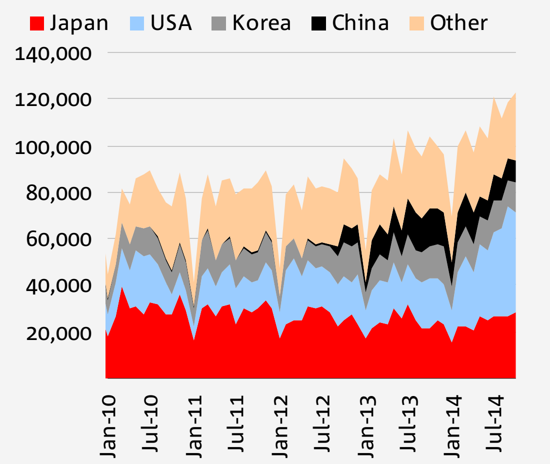
While total beef exports were higher in October, exports to the United States fell 9.6% month on month. While drought in the US has allowed Australian imports to gain a strong foothold in the market, improving United States weather, combined with lower feed grain prices points to a stronger US cattle outlook over the coming year. This may see Australian beef exports to the US come under pressure in 2015.

Figure 9: Eastern Young Cattle Indicator and slaughter



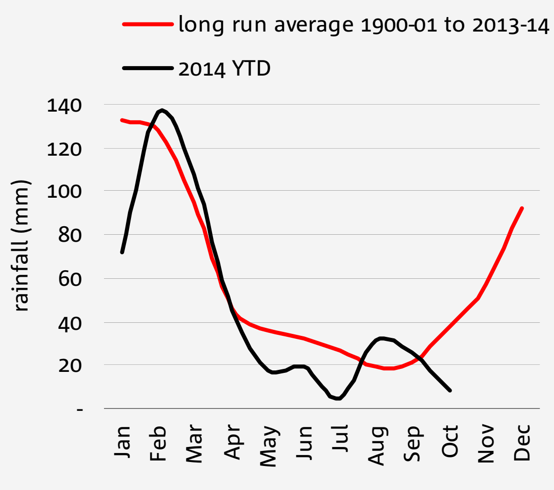
Source: Meat and Livestock Australia

Figure 10: Monthly Australian beef exports by destination (tonnes)



Source: Meat and Livestock Australia

Figure 11: Rainfall in Queensland beef regions



Source: Bureau of Meteorology and NAB Group Economics

Dairy

International dairy prices continued to fall in October, with BNZ weighted dairy prices down 13.6% to US$3,901/tonne for the month. Prices have been falling since March 2014 amid ample supply and slack demand, especially in China.

Australian farmgate prices are likely to prove somewhat more resilient however, largely on account of a falling AUD. The Weekly Times reports that while Murray Goulburn is holding its opening price of AU$6/kg milk solids (ms) and Warrnambool Cheese and Butter is hopeful of retaining AU$5.86/kg ms, Fonterra Australia is less likely to keep its opening price of AU$5.80/kg ms.

Domestic production is tracking slightly higher than last year so far but has peaked early in western Victoria and the Murray and Goulburn areas in response to dry to very dry spring conditions. Gippsland is performing on par with previous seasons and Tasmania looks to be having an above average season.

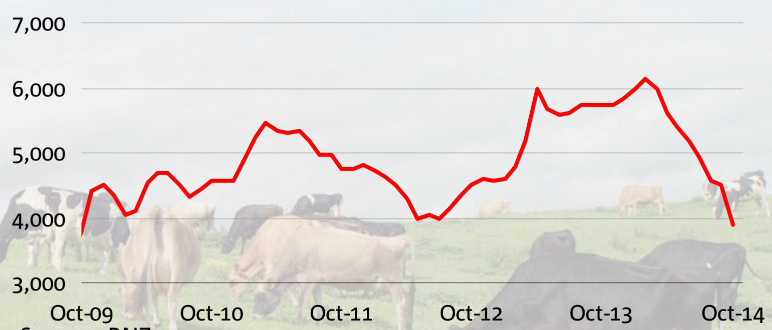
Conditions in the Goulburn and Murray catchments

The growing season has finished up rapidly in northern Victoria with a very dry spring. Along with less permanent water in the system, this is contributing to keeping temporary water prices elevated. There are significant changes to milk pricing this year with no step-ups, which while potentially reducing farm income does make budgeting easier in many ways. Northern Victorian milk production so far is above the same point last year, with increased herd sizes and the relatively mild winter season contributing to this early peak.

There has been increased focus on and some movement in supply contracts this year as producers take advantage of upfront payments for on farm capital and sustainability works.

Megan Hodge
Agribusiness Manager
Shepparton, Victoria

Figure 12: BNZ weighted global dairy price



Source: BNZ

Dairy cattle near Bemboka, NSW. Photo by Carl Davies, CSIRO http://www.scienceimage.csiro.au/tag/dairy-cattle/i/3401/dairy-cattle/

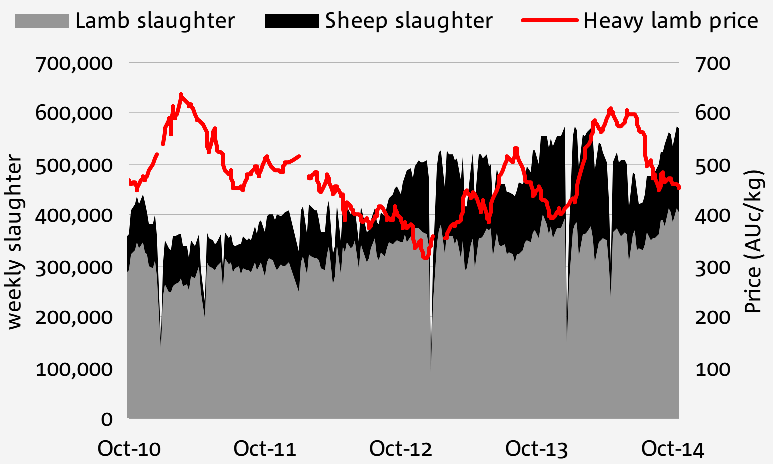
Lamb

Heavy lamb prices fell 2.3% in October to 461 AUc/kg, solidifying losses in August and September and reflecting higher seasonal supply. Prices are now lower than any point since February 2014 on a monthly average basis as a dry spring in much of the country has seen higher turnoff than usual.

Meanwhile, lamb exports continue to grow, with a record 24,202 tonnes shipped in October. Domestic consumption has lagged in recent years however, despite higher production and intensifying supermarket competition. Domestic consumption fell 6% in 2013, with 54% of Australian lamb exported. This continues a generally downward trend since 2009. Per capita consumption in 2013 fell by 8% to 9.1kg per capita from just under 10kg per capita in the previous year.

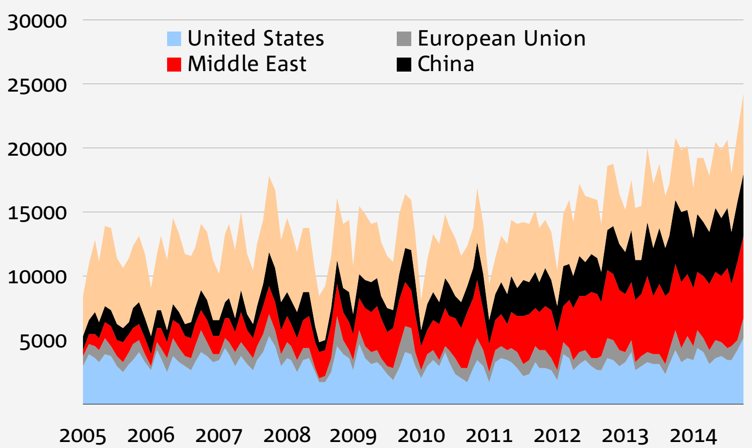
Our outlook for lamb in the coming year is clouded by unfavourable summer rainfall forecasts for most lamb production regions, combined with the ongoing effects of drought induced destocking on flocks. Overall, we expect production to decline 2.4% in 2014-15 as producers look to rebuild flocks. We forecast heavy lamb prices to fall 3.6% in 2014-15.

Figure 13: Heavy lamb prices



Source: Meat and Livestock Australia

Figure 14: Monthly Australian lamb exports by destination (tonnes)



Source: Meat and Livestock Australia

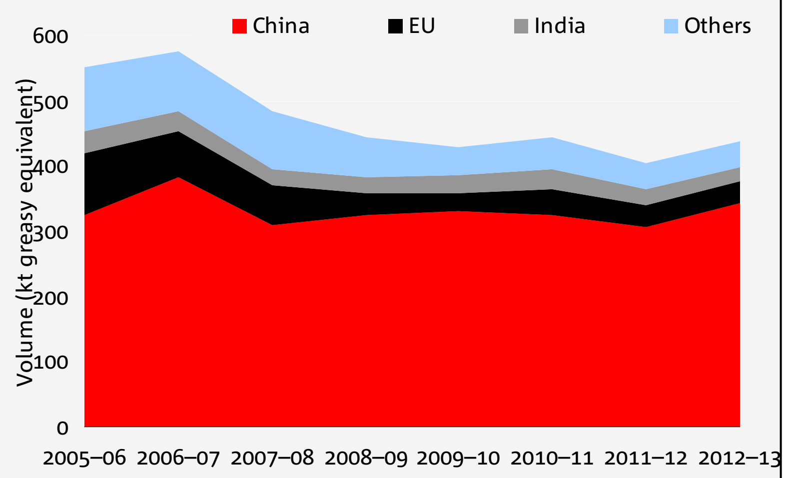
Wool

Wool prices were up 1.9% in October, with the benchmark Eastern Market Indicator averaging 1,040 AUc/kg in response to an increase in orders and lower AUD. Price movements have been small for much of the year – October marked the sixth straight month in which prices moved less than 2% month on month.

The year has nonetheless been mixed for many producers, as subdued prices continue to cut into profitability. While the industry has been facing pressure from substitute (mostly synthetic) fabrics for several decades, there has been a decline in premiums for high grade super and ultrafine grades since the Global Financial Crisis in response to lower demand for premium suiting and haute corture.

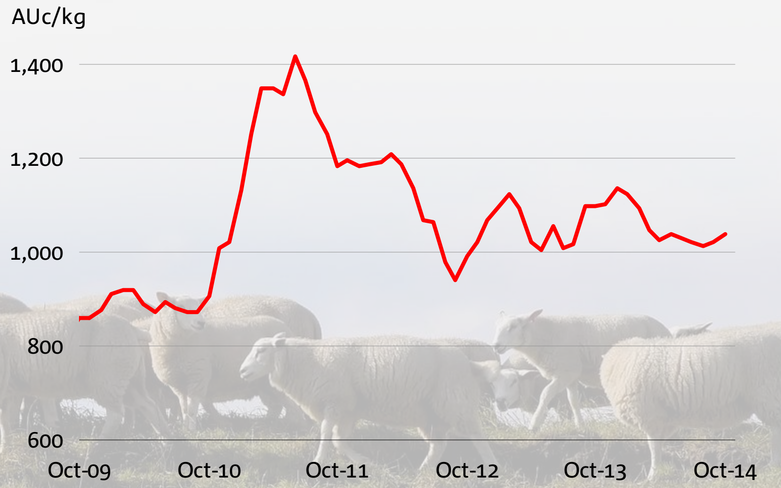
China is far and away the largest customer of Australian wool. In 2012-13, over three quarters of Australian wool exports were sent to China. Any economic uncertainty in China brings the risk of falling wool demand and lower prices. Should the cooler economic conditions experienced in China in Q3 2014 continue into Q4 2014 and 2015, reflecting the continued reluctance of Chinese policy makers to implement broad based stimulus, it is possible that wool demand will be subdued.

Figure 15: Australian wool exports by destination



Source: ABARES

Figure 16: Eastern Market Indicator



Source: DXdata

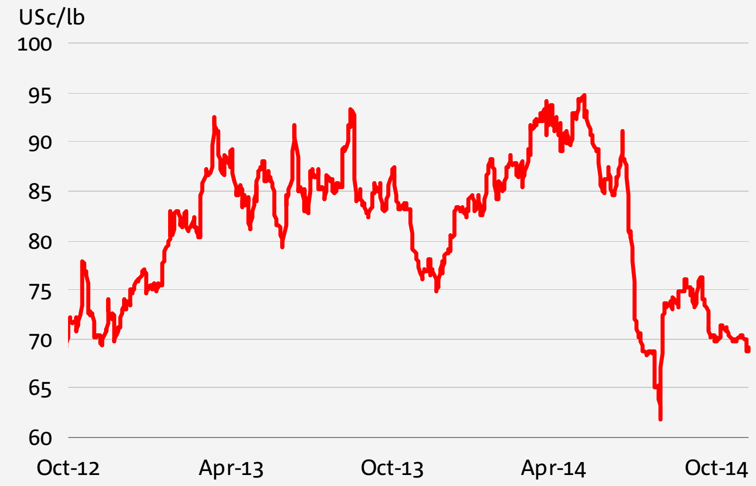
Cotton

The downward trend in cotton prices was briefly arrested in September, although prices have since fallen in October. ICE cotton first futures fell 0.9% (USD) in September to average 73.4 USc/lb for the month, and are now trading around 70 USc/lb.

Prices have been driven lower by strong global supply (in particular by a large expected US harvest) and weak demand from China. Our outlook for domestic cotton is for substantially lower planting in 2014-15 due to lower irrigation water availability.

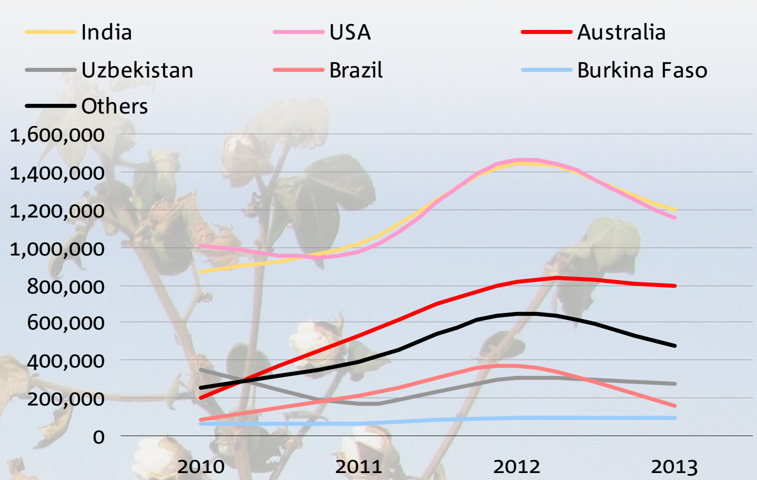
Although Cotton is one of Australia's biggest agricultural exports to China, ChAFTA has not delivered an improvement in market access. This reflects the sensitivity of the sector and China's large stockpile of cotton, accumulated due to industry support arrangements. This price support system entails over $US5 billion in subsidies annually. The regime of minimum support acquisition prices and stock accumulation is to be replaced in 2014-15 by a direct subsidy to Xinjiang farmers. Facing this high cost policy that has created a large stockpile, the Chinese will restrict cotton imports to the 894 kt specified in their WTO commitments, an unfavourable outcome for Australian cotton growers.

Figure 17: Global cotton prices



Source: Bloomberg

Figure 18: Chinese cotton imports (tonnes)



Source: UN Comtrade

Sugar

After rebounding in September, international sugar prices fell in October and increased again in November in response to ongoing mixed news over the performance of Brazil's drought ravaged sugar crop. Overall, sugar was up 12.6% (USD) for October.

In Australia, the sugar crush is wrapping up after a solid season. While low forecast rainfall may be an issue for some growers next season, but with much of Australian sugar either irrigated or grown in the wet tropics, we do not see climatic conditions as a major concern at present. Uncertainty continues over the future of Queensland Sugar Limited's (QSL) single desk for sugar exports precipitated by the decision earlier this year by Wilmar, Tully and MSF to leave the scheme from 2017. A Senate Inquiry into sugar marketing arrangements is due to report in the first half of 2015.

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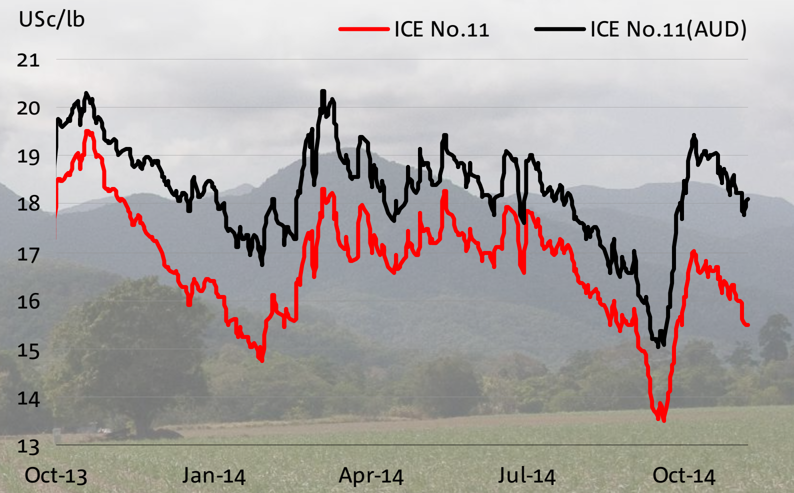
Progress of the crush in Queensland

It's been a solid year for sugar with the crush nearly finished – we expect the crush to wind up in early December for most areas.

The big story is the falling AUD, which along with the hedging strategy used by most growers, should assist in offsetting the impact of lower global sugar prices and provide a sound footing for the 2015 season.

Geoff Howard
Regional Agribusiness Manager
Townsville, Queensland

Figure 19: Global sugar prices



Source: Bloomberg

Cane train near Mossman, Queensland. Photo by David Gardiner https://flic.kr/p/arMMjM

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Photo: Mai Thai

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