



# Economic Report

## Rural Commodities Wrap – October 2015

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## Key points

- Agricultural prices continued to diverge in September. Most major grains fell (wheat was down almost 10% in AUD terms), as did fruit, vegetables and trade lamb (reflecting seasonal trends). However, dairy prices strongly rebounded on supply concerns. Sugar, beef and rice were also higher in AUD terms. Overall, the NAB Rural Commodities Index was off 1.5% (AUD) and 4.1% (USD).
- After dropping below 70 US cents in mid-September, the AUD since rallied and is now above 72 US cents. Overall, we see the AUD as a 65 to 75 US cent currency (on the wide) through 2016 and forecast the AUD to bottom out at 68 US cents in Q1 2016.
- Signs that the effects of El Niño are ramping up are reflected in a very hot and dry three month rainfall outlook for south-eastern Australia. However, the Bureau of Meteorology forecasts that Western Australia may enjoy decent rain and conditions are expected to be neutral in much of Queensland. This outlook is likely to put further pressure on graziers in Victoria and New South Wales coming into summer.

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## NAB Rural Commodities Index

Overall, the NAB Rural Commodities Index was off 1.5% (AUD) and 4.1% (USD). Most major grains fell (wheat was down almost 10% in AUD terms), as did fruit, vegetables and trade lamb (reflecting seasonal trends). However, dairy prices strongly rebounded on supply concerns. Sugar, beef and rice were also higher in AUD terms.

NAB's Rural Commodities Index includes 28 commodities (wheat, barley, sorghum, rice, oats, canola, chick peas, field peas, lupins, wool, cotton, sugar, wine grapes, beef, lamb, pork, poultry, dairy, apples, bananas, oranges, mangoes, strawberries, broccoli, carrots, lettuce, potatoes and tomatoes). The index is weighted annually according to the gross value of production of each industry in Australia.

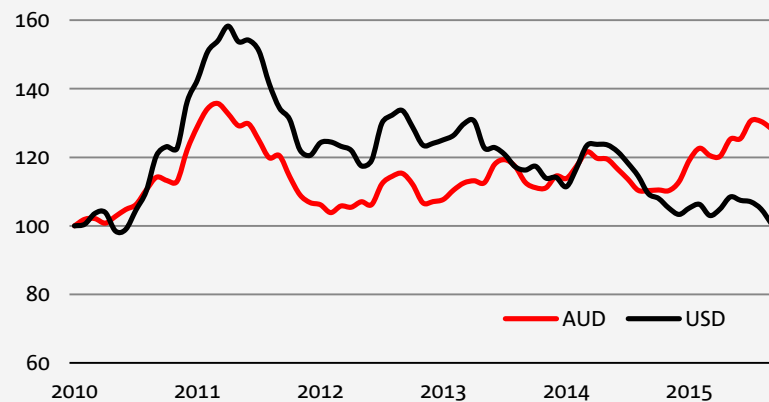
## Production and Price Outlook

Signs that the effects of El Niño are ramping up clouds the production outlook, particularly coming into summer. While we have previously highlighted the risk of El Niño to Australia's wheat crop, the later onset of El Niño now means that the major climatic risk is for graziers and summer crops. If rainfall continues to trend below average, cattle restocker interest could dissipate and herd rebuilding could be pushed back after a prolonged period of elevated slaughter.

We have adjusted our price forecasts in line with market conditions. We have held our beef price forecast track steady this month, although a continued decline in saleyard prices (as seen in early October) could see our forecasts revised lower towards the end of the year. We see further upside for dairy prices with continuing strength in Global Dairy Trade auction results, reflecting supply concerns brought on in part by El Niño.

Price and production forecasts for major commodities are shown in *Table 1*.

Figure 1: NAB Rural Commodities Index



Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Australian Pork, Ausmarket Consultants, BNZ, Australian Bureau of Statistics, Bloomberg and Profarmer. January 2010 = 100

Table 1: Price movements, production and price forecasts for major agricultural sectors

	Month on month price change (AUD)	2015-16 annual production change	2015-16 annual price change (AUD)
Wheat	▼ 9.6%	▲ 1.4%	▲ 10.9%
Beef	▲ 3.5%	▼ 8.2%	▲ 43.9%
Dairy	▲ 25.4%	▲ 0.7%	▲ 10.9%
Lamb	▼ 6.7%	▼ 1.0%	▲ 3.8%
Wool	▼ 1.2%	▼ 12.0%	▲ 10.6%
Sugar	▲ 9.6%	▲ 6.4%	▼ 2.4%
Cotton	▼ 1.0%	▲ 4.4%	▲ 16.8%

Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Bloomberg, BNZ and Profarmer. Forecasts represent year-on-year average changes.

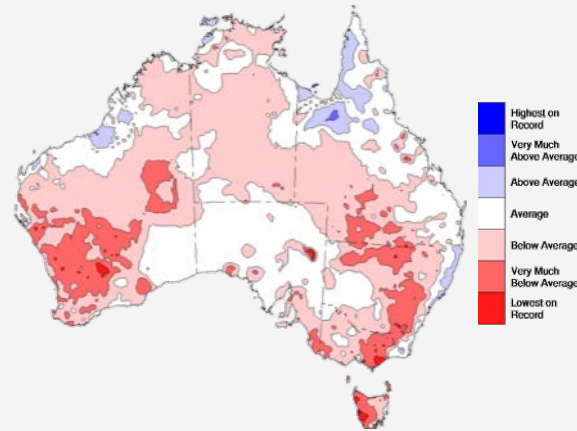
## Climatic conditions

Rainfall was below to well below average across large swathes of the continent in September, although much of coastal Queensland and New South Wales enjoyed average to above average falls, as did parts of Cape York, the Gulf Country and Pilbara. Rainfall deficiencies were especially severe in north western, central western and southern New South Wales, south west Queensland, most of Victoria as well as much of Western Australia.

Signs that the effects of El Niño are ramping up coming into summer are concerning amid already dry conditions. *Figure 3* shows the Bureau of Meteorology's Normalised Difference Vegetation Index (NDVI) anomaly for the last six months. This shows that throughout most of Australia, vegetation is less green than the long run average for the period. However, parts of New South Wales in particular, but also some areas of South Australia and south-east Queensland, are more green than average for the period.

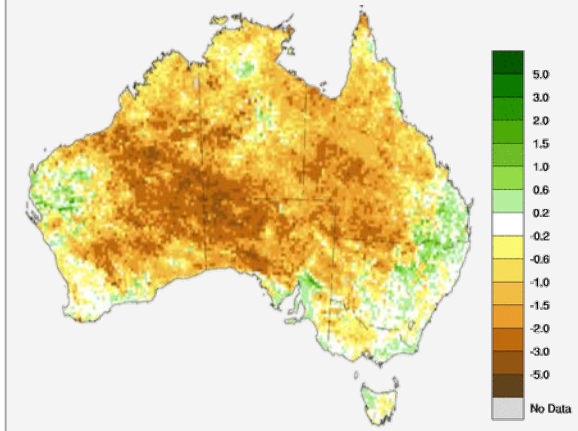
*Figure 4* shows the three-month rainfall outlook to December. The Outlook is for a hot and dry three months for south-eastern Australia, although the west may enjoy decent rain and conditions are expected to be neutral in much of Queensland.

**Figure 2: Australian rainfall deciles – September 2015**



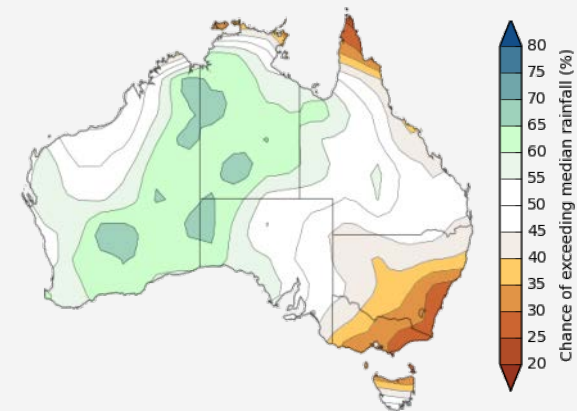
Source: Bureau of Meteorology

**Figure 3: Normalised Difference Vegetation Index Anomaly – six months to 30 September 2015**



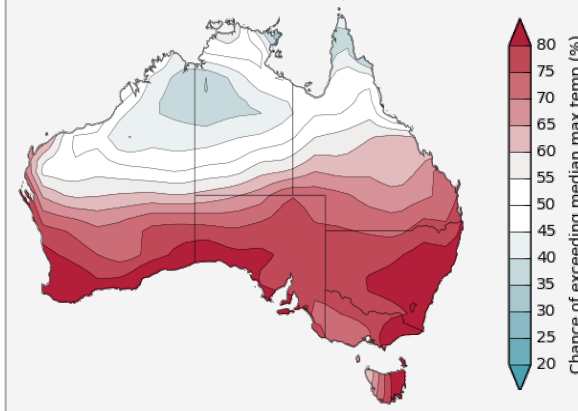
Source: Bureau of Meteorology

**Figure 4: Rainfall outlook – October to December 2015**



Source: Bureau of Meteorology

**Figure 5: Temperature outlook – October to December 2015**



Source: Bureau of Meteorology

## Economic Update

For detailed analysis of Australian and global economic trends see our [Global and Australian Forecasts](#). Below is a précis of this report.

### Global Economy

Global growth remains sluggish and below trend and, unlike the IMF, our forecasts do not envisage much pick-up in the next couple of years. Although the emerging economies are still growing much faster than the big advanced economies (around 5% versus around 2%), the focus of market attention has been shifting toward the former as falling commodity prices, the prospect of higher US interest rates, a build-up in debt and uncertainty over the pace of Chinese growth. By contrast, growth in the advanced economies picked up in mid-2015 and there is much less market focus on the problems with the Greek economy. Commodity exporting economies and their currencies have come under more pressure as sluggish global growth and the Chinese industrial slowdown lowers global commodity prices, impacting incomes and exports in some big primary producers which are heavily exposed to foreign investor sentiment.

### Domestic Economy

In Australia, the ongoing high level of business conditions and trend improvement in key leading indicators such as capacity utilisation supports our view that the gradual recovery in the non-mining economy is becoming more resilient (See latest Business Survey release). Low interest rates and the lower AUD are providing support, with strength particularly evident across services sectors of the economy, including but not limited to tourism-related activity.

### Interest Rates

There are still clear downside risks from offshore, and weak commodity prices and falling mining investment will remain a drag. However, we find it difficult to mount a case for further policy easing on purely domestic grounds and view market pricing for another 25bp cut over the coming 6 months as overly pessimistic.

**Table 2: NAB Global Economic Forecasts**

% change year on year	2015	2016	2017
China	7.1	6.9	6.5
United States	2.5	2.5	2.4
Euro zone	1.3	1.7	1.9
Emerging East Asia	3.7	3.8	4.1
Japan	0.7	1.2	1.0
Advanced economies	1.9	2.1	2.1
Emerging economies	4.8	5.0	4.9
World GDP	3.1	3.2	3.3

Source: NAB Group Economics

**Table 3: NAB Australian Economic Forecasts**

% change year on year	2015	2016	2017
GDP growth	2.3	2.7	3.3
Private consumption	2.5	2.5	2.7
Unemployment rate (year end)	6.1	5.8	5.8
Consumer Price Index (core)	2.5	2.6	2.4

Source: NAB Group Economics

**Table 4: NAB Interest Rate Forecast (end of quarter)**

	2015 Q1	2015 Q2	2015 Q3	2015 Q4
RBA Cash Rate	2.25	2.0	2.0	2.0

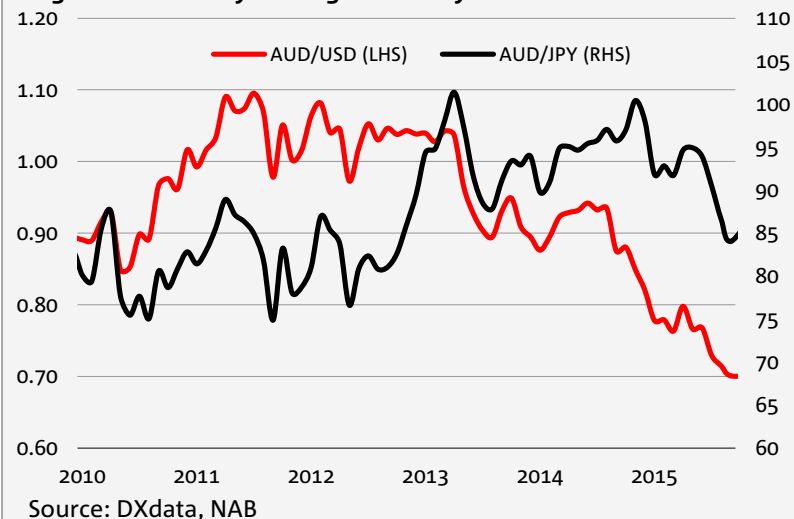
Source: NAB Group Economics

## Exchange Rates

After dropping below 70 US cents in mid-September, the AUD since rallied and is now above 72 US cents. This reflects delays to US Fed's long awaited tightening cycle amid equity market tumult in August and relatively weak US employment data in September. We see December as still the most likely month for the Fed to start lifting rates; but there is a clear risk that it might be delayed into 2016.

Overall, we see the AUD as a 65 to 75 US cent currency (on the wide) through 2016. We forecast the AUD to reach 70 US cents by the end of year before bottoming out in Q1 2016 at 68 US cents. This represents an upside for local prices and is good news for Australian agricultural producers. While the expectation for the AUD to drop to 70 US cents by year end materialised a little earlier than predicted, the recent rally reflects the dependence of the forecast track on US policy rates.

**Figure 6: Monthly average currency movements**



**Table 5: NAB FX Strategy Targets**

		2015 Q4	2016 Q1	2016 Q2	2016 Q3
Australian Dollar	AUD/USD	0.70	0.68	0.69	0.70
New Zealand Dollar	NZD/USD	0.62	0.60	0.60	0.61
Japanese yen	USD/JPY	121	122	123	124
Euro	EUR/USD	1.14	1.12	1.10	1.08
British Pound	GBP/USD	1.52	1.51	1.48	1.45
Swiss Franc	USD/CHF	0.97	1.00	1.02	1.05
Chinese New Yuan	USD/CNY	6.40	6.50	6.60	6.65
Canadian Dollar	USD/CAD	1.34	1.38	1.37	1.36

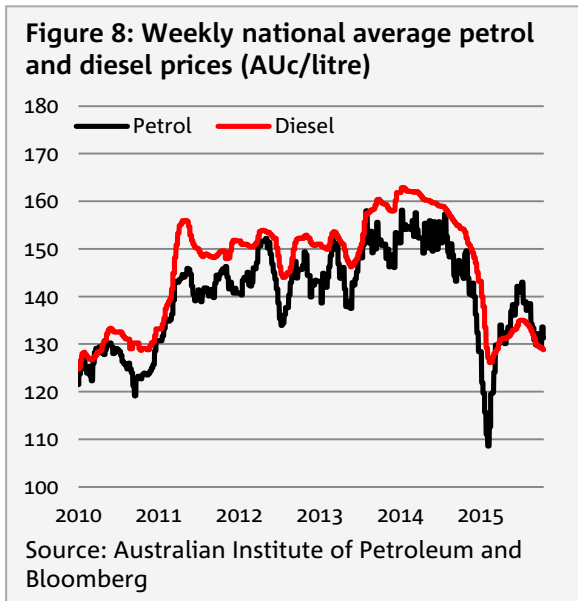
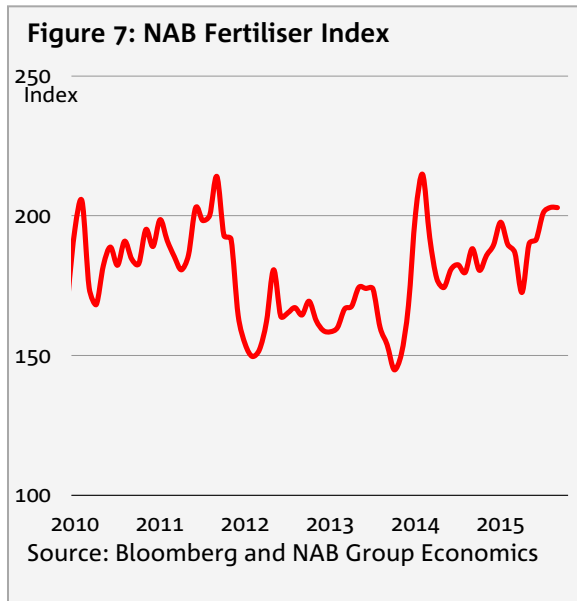
Source: NAB



## NAB Farm Input Prices

The NAB Fertiliser Index was flat in September in AUD terms as exchange rate movements offset lower natural gas and urea prices.

National average petrol prices fell 3.8% in August, while diesel prices were 2.3% lower for the month. This came as global oil prices remained relatively steady during the month. The AUD is forecast to fall in the coming months, presenting something of an upside risk for fuel prices.

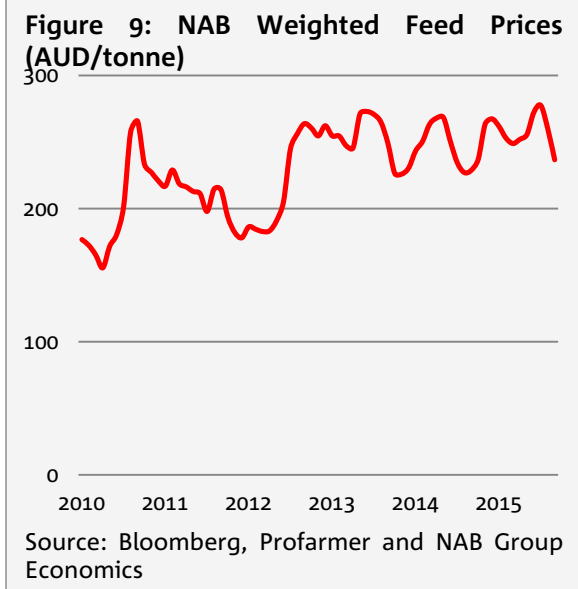


## Weighted Feed Grain Prices

Weighted feed grain prices fell again in September (down 9.4%), reflecting generally lower prices among major feed grains in domestic markets as a result of broadly favourable international supply.

The prospect of strong El Niño conditions coming into summer could see elevated domestic feed grain demand as graziers look for additional supplementary feed.

NAB's weighted feed grain price indicator includes feed wheat, barley, oats and sorghum. Three quarters of the indicator is made up of feed wheat and barley.



## Crops

### Wheat

Generic 1<sup>st</sup> Australian milling wheat prices fell again in September – down 9.6% (AUD) for the month reflecting strong supply expectations. However, adverse weather conditions in the Black Sea growing region have since elevated supply concerns and prices began to recover somewhat since early September lows. Overall, the USDA now forecasts that the 2015-16 crop will be the third consecutive record harvest.

### Coarse grains

Coarse grains generally followed wheat lower through September, although rice prices continue to rise on supply concerns associated with El Niño in East Asia as well as falling inventories worldwide. US rough rice prices were 13.0% higher in AUD terms in September.

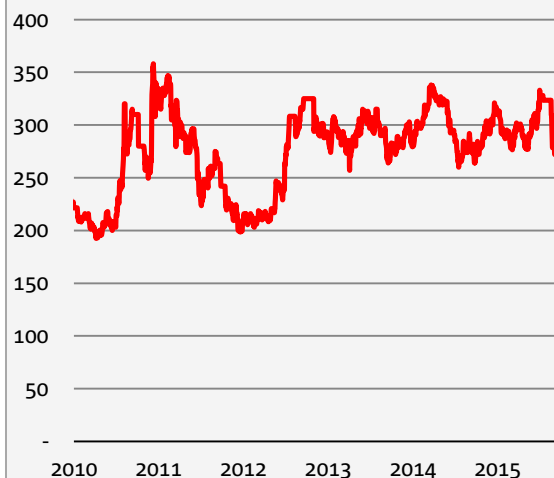
### Oilseeds

Domestic canola was stable (down 0.1% in AUD terms) in September. The Australian canola crop is likely to be lower this season based on lower plantings. ABARES estimates the area planted to canola to have fallen 13.5% this season.

### Pulses

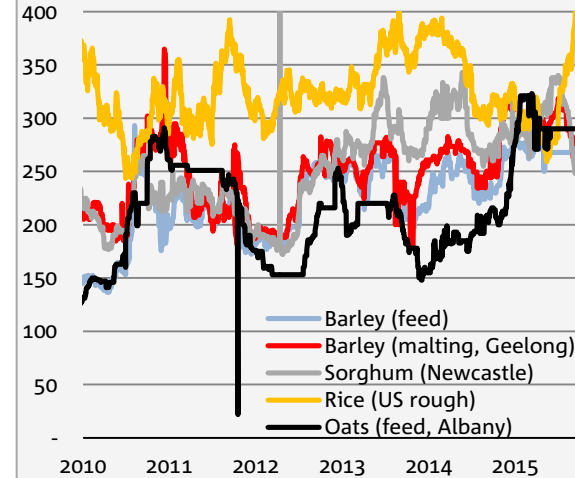
Chick peas' stellar run, which saw prices surge from less than AUD500/tonne at the end of 2014 to almost AUD900/tonne in late July this year, looks to have peaked. While chick peas (Brisbane) were up 4.1% in September, early October has seen lower prices.

**Figure 10: Generic 1<sup>st</sup> Australian milling wheat (AUD/tonne)**



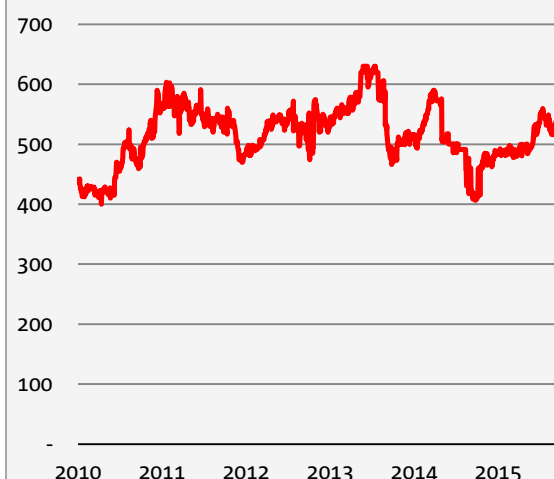
Source: Bloomberg

**Figure 11: Selected coarse grains (AUD/tonne)**



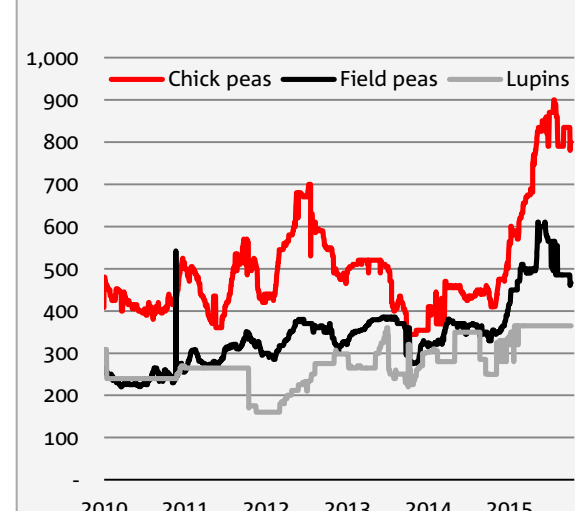
Source: Bloomberg, Profarmer

**Figure 12: Canola, Newcastle NSW (AUD/tonne)**



Source: Bloomberg, Profarmer

**Figure 13: Selected pulses (AUD/tonne)**



Source: Bloomberg, Profarmer



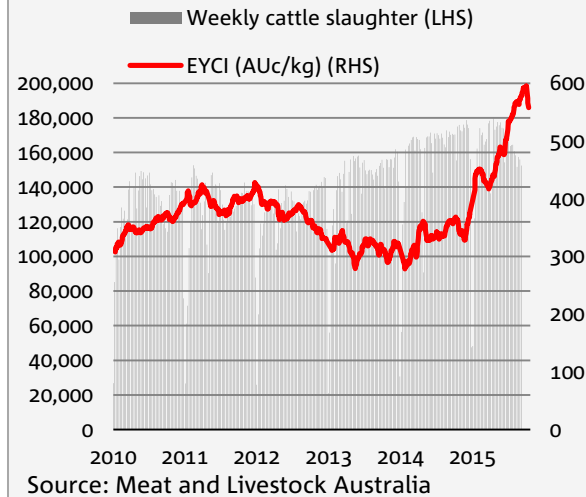
## Protein

### Beef

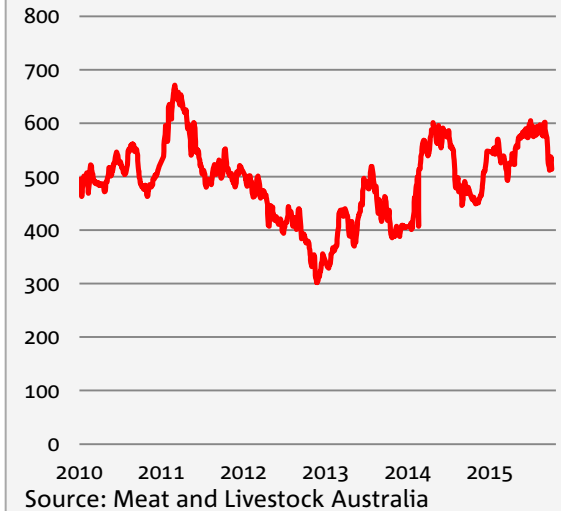
There are signs that cattle prices peaked in September, reflecting weaker US cattle prices, slower production and exports and dry weather tempering restocker interest.

While the Eastern Young Cattle Indicator (EYCI) was up 3.5% (AUD) in September, ending the month at a record 595 AUc/kg, prices have weakened in October. The EYCI is now down more than 10% since the start of October. Although we have held our beef price forecast track steady this month, a continued decline in saleyard prices could see our forecasts revised lower towards the end of the year.

**Figure 14: Eastern Young Cattle Indicator (AUc/kg)**



**Figure 15: Eastern States Trade Lamb Indicator (AUc/kg)**



### Lamb

Lamb prices fell in September (the Eastern States Trade Lamb Indicator was down 6.7% in AUD terms), however this reflects normal seasonal variation and prices remain higher than the same time last year.

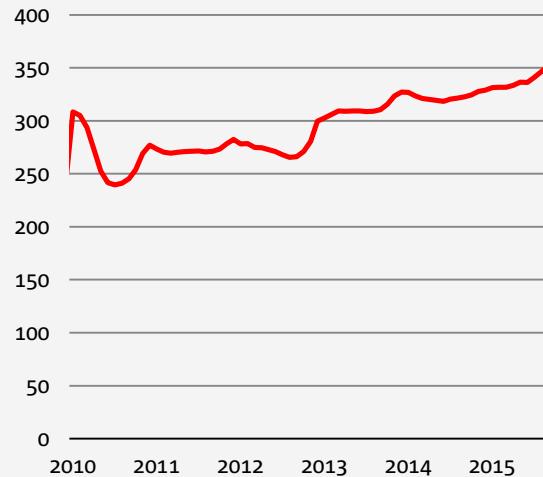
### Pork

Australian wholesale pork prices (measured as an average of buyer and seller prices for eastern seaboard 60.1-75kg animals) were up 1.6% (AUD) in September.

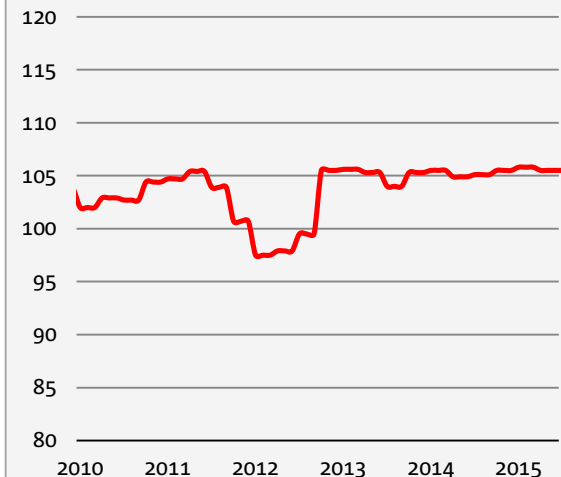
### Poultry

While we do not collect wholesale poultry price data, retail prices have remained stable since late 2012, gaining falling 0.3% in the June quarter (the most recent data available).

**Figure 16: Pork – 60.1-75kg (AUc/kg)**



**Figure 17: Poultry – Australia (ABS index)**

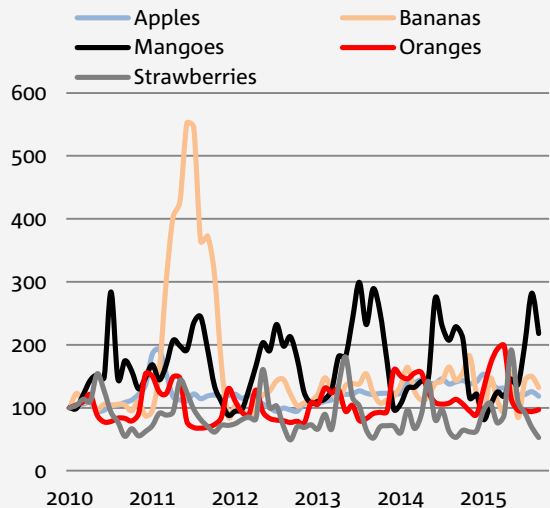


## Fruit

The NAB Fruit Price Index, based on data from the Melbourne and Sydney wholesale markets, tumbled in September, erasing its August gains and falling 13.6% in AUD terms.

The index stands at 128.6 for September 2015 (note January 2010 = 100), 9.5% lower than the same time in 2014.

**Figure 18: Wholesale market price index, selected fruit – Sydney and Melbourne**



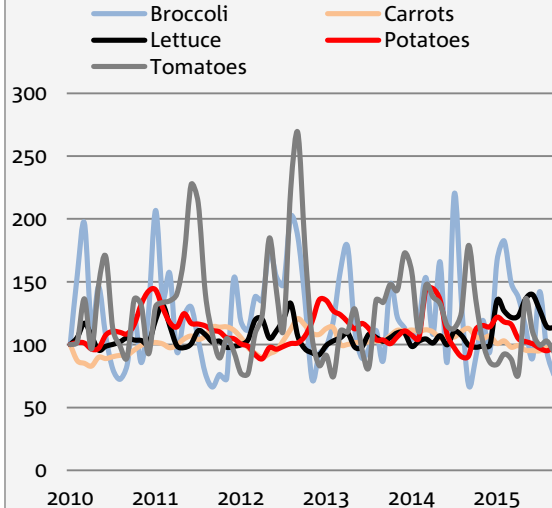
Source: Ausmarket Consultants and NAB Group Economics

## Vegetables

The NAB Vegetable Price Index, based on data from the Melbourne and Sydney wholesale markets, fell again in September, down 3.5% (AUD).

The index stands at 98.7 for August 2015 (note January 2010 = 100), 14.4% lower than the same time in 2014.

**Figure 19: Wholesale price index, selected vegetables – Sydney and Melbourne**



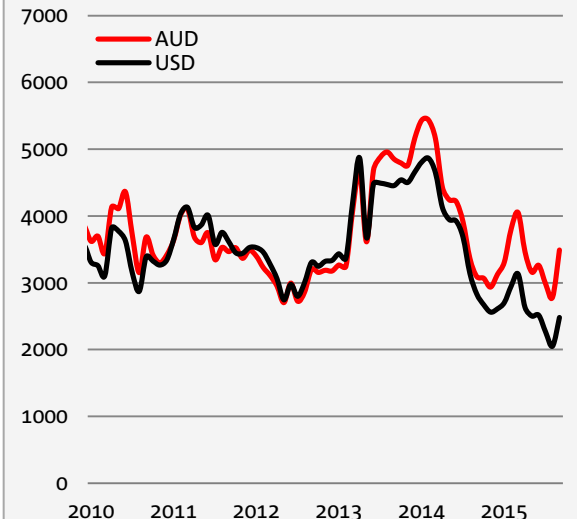
Source: Ausmarket Consultants and NAB Group Economics

## Dairy

NAB's measure of dairy export prices, based on Global Dairy Trade (GDT) auction results, is weighted by the quantity of Australian exports for whole milk powder, skim milk powder, butter and cheese.

There have been sharply higher prices at the last four GDT auctions, reflecting supply concerns in New Zealand and elsewhere due to El Niño. Overall, the indicator was up 25.4% in September in AUD terms.

**Figure 20: NAB monthly weighted dairy price indicator (\$/tonne)**



Source: Global Dairy Trade and NAB Group Economics

## Fibres

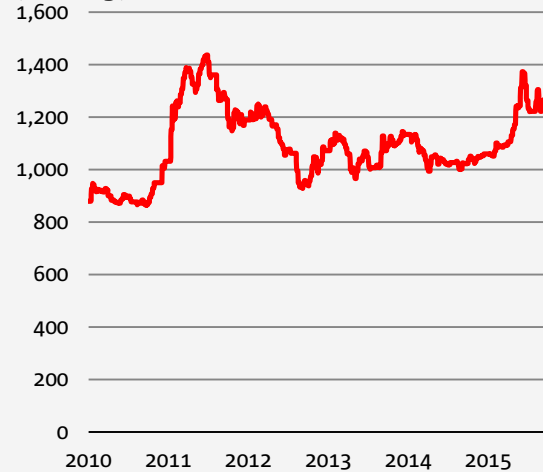
### Wool

Wool's rally peaked in mid-June with the Eastern Market Indicator approaching 1400 AUc/kg. Since then, there has been some pressure but prices remain elevated. The index was down 1.2% (AUD) in August.

### Cotton

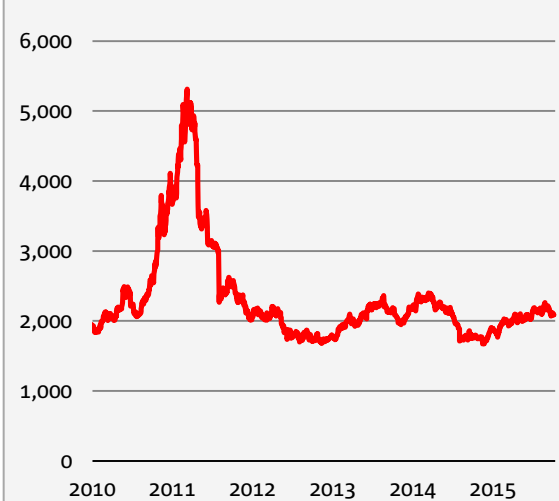
Global cotton prices were moderately lower in AUD terms in September, with Cotlook A down 1.0% (AUD). Cotton is trading above the same time last year and AUD prices have recovered from late 2014 lows.

**Figure 21: Wool - Eastern Market Indicator (AUc/kg)**



Source: Bloomberg

**Figure 22: Cotlook A cotton (AUD/tonne)**



Source: Bloomberg

## Industrial crops

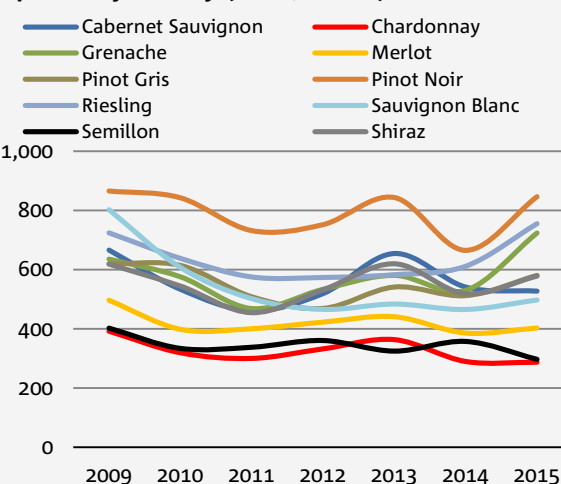
### Wine grapes

Wine Australia's 2015 Price Dispersion Report, released in July, shows a rebound in prices for several more expensive varieties. Grenache, Pinot Noir and Riesling all gained (36%, 13% and 24% respectively). However, lower priced varieties such as Chardonnay, Semillon and Merlot fared generally worse.

### Sugar

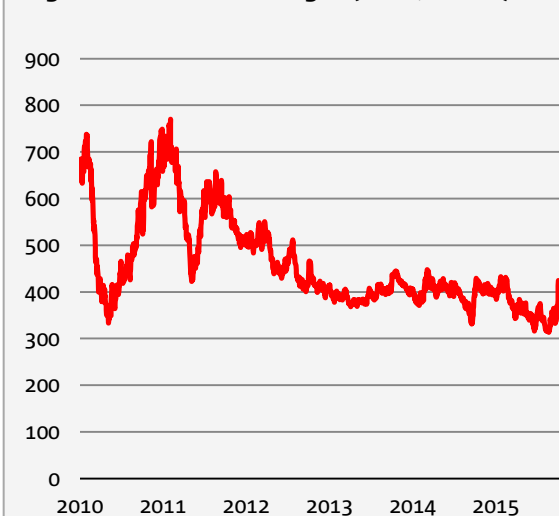
Global sugar prices rebounded in AUD terms in September, with ICE no.11 sugar up 9.6% (AUD). Lower production is the major driver of higher prices, combined with domestic policy factors in Brazil, a major sugar producer.

**Figure 23: Volume weighted wine grape prices by variety (AUD/tonne)**



Source: Wine Australia, NAB Group Economics

**Figure 24: ICE no.11 sugar (AUD/tonne)**



Source: Bloomberg

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