

RURAL COMMODITIES WRAP

JULY-AUGUST 2016

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Important Notice

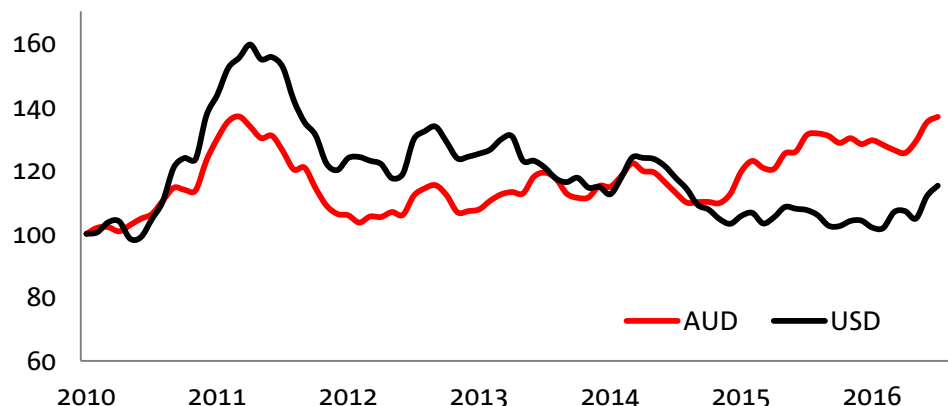
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RECENT RURAL COMMODITY PRICE MOVEMENTS

NAB RURAL COMMODITIES INDEX

Index value, January 2010 = 100



MONTHLY AUD PRICE CHANGES – SELECTED COMMODITIES

	May 2016	June 2016	July 2016
Wheat	▲ 2.9%	▲ 1.9%	▼ 6.3%
Beef	▲ 2.0%	▲ 9.3%	▲ 6.4%
Dairy	▲ 3.7%	▲ 2.9%	▼ 2.0%
Lamb	▲ 8.8%	▲ 10.2%	▲ 1.8%
Wool	▲ 3.1%	▲ 0.2%	▲ 2.1%
Sugar	▲ 16.9%	▲ 14.2%	▲ 0.3%
Cotton	▲ 6.6%	▲ 3.9%	▲ 7.5%
Index	▲ 3.0%	▲ 4.6%	▲ 1.3%

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

Overall, the outlook for Australian agriculture remains generally very robust, with a mostly very favourable season and good prices for many (but not all) commodities. Winter has been kind to most producers so far, particularly those in broadacre cropping and livestock industries. This month, we upgrade our Australian 2016-17 wheat production forecast to 27.2 million tonnes. The outlook for spring rainfall is generally favourable, presenting further upside overall.

Prices remain generally favourable, although dairy remains under pressure and the outlook for wheat continues to deteriorate, reflecting very favourable global supply. Overall, the NAB Rural Commodities Index was up 4.6% in June and 1.3% in July in AUD terms. In USD terms, the index rose 6.7% in June and 3.0% in July. This strength is underpinned by strong cattle and lamb prices.

With Q2 inflation printing low, but not extremely so, eyes are turned to Tuesday's RBA board meeting. The outcome is likely to be a close call, although the CPI result does not in our opinion demand a further adjustment.

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.

PRICE, PRODUCTION AND EXPORT FORECASTS

Our expectations for prices in the coming year are underpinned by our forecasts for a generally lower AUD, tracking in the high 60s-low70s range in late 2016 and 2017. This is likely to support local prices somewhat through challenging international conditions for grains and dairy.

Cattle prices are likely to come under some pressure in 2017 in response to higher US supply and improved South American access, although we note that good rainfall in Australia is pushing restocker demand higher (and prices with it). Dairy is likely to continue to feel the pressure on farmgate milk prices. We have further downgraded our wheat price forecasts due to ample global supply.

Our outlook for agricultural production is highly reliant on the climate outlook. The Bureau of Meteorology is still on La Niña watch, but recent data show the likelihood of La Niña lessening. Nonetheless, the season has been generally very favourable so far and the three month outlook continues to forecast above average rainfall for eastern Australia and neutral conditions in Western Australia.

The table below outlines our latest outlook for production, prices and the value of exports. These estimates are contingent on estimates for production and export volumes, prevailing global prices and NAB's foreign exchange outlook.

PRODUCTION, PRICE AND EXPORT FORECASTS (AUD)

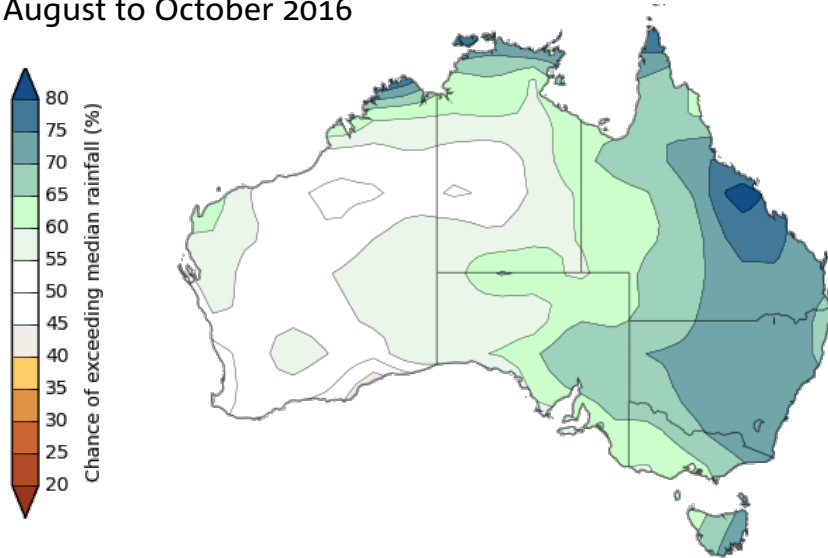
	Production change		Price change		Export value change	
	2015-16	2016-17	2015-16	2016-17	2015-16	2016-17
Wheat	▲ 1.9%	▲ 12.6%	▼ 2.7%	▼ 1.5%	▼ 2.6%	▲ 14.2%
Beef	▼ 11.4%	▼ 3.9%	▲ 43.8%	▲ 1.6%	▲ 3.7%	▼ 4.2%
Dairy	▼ 1.0%	▼ 0.9%	▼ 5.0%	▲ 0.6%	▼ 5.9%	▼ 0.3%
Lamb and mutton	▼ 3.1%	▼ 5.2%	▲ 4.7%	▲ 0.1%	▼ 0.9%	▼ 7.6%
Wool	▼ 6.2%	▲ 0.5%	▲ 14.4%	▲ 6.8%	▲ 7.3%	▲ 8.5%
Sugar	▲ 5.0%	▲ 5.9%	▲ 13.1%	▲ 25.2%	▲ 18.3%	▲ 30.4%
Cotton	▲ 12.1%	▲ 41.0%	▲ 11.2%	▲ 4.4%	▼ 13.6%	▲ 27.5%

Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Australian Bureau of Statistics, Bloomberg and Profarmer.

CLIMATE OUTLOOK

THREE MONTH RAINFALL OUTLOOK

August to October 2016



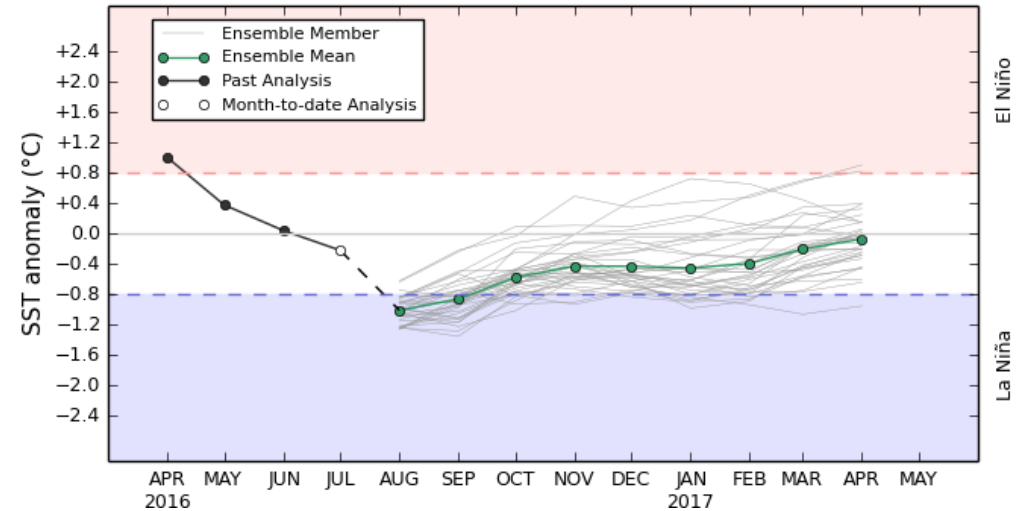
The Bureau of Meteorology (BoM) three month rainfall outlook to September points to generally average to well above average rainfall across eastern Australia. However, Western Australia is expected to see more neutral conditions.

This outlook points to good grain growing conditions well into spring, although the very strong rainfall outlook across the east coast increases risk of waterlogging for crops and Western Australia risks a somewhat weaker finish to the grain season. Rainfall has also boosted sentiment in livestock industries, with cattle and lamb prices ticking higher.

Source: Bureau of Meteorology

BOM POAMA MODEL LONG-RANGE EL NINO OUTLOOK

Monthly mean NINO 34 – 17 July 2016



The Bureau of Meteorology's long range outlook for El Niño points to broadly neutral conditions for the remainder of the year and into early 2017. While the BoM remains on La Niña watch (placing the chance of a La Niña event at around 50%), recent data suggest that is less likely to develop this year.

ECONOMIC UPDATE

NAB AUSTRALIAN ECONOMIC FORECASTS

Per cent change financial year on year

	2015 -16	2016 -17	2017- 18
Real GDP	3.0	2.7	3.0
Private consumption	2.9	2.4	2.5
Unemployment rate (year end)	5.7	5.6	5.7
Consumer Price Index (core)	1.7	1.9	1.8
RBA cash rate (year end)	1.75	1.75	2.0

NAB GLOBAL ECONOMIC FORECASTS

Per cent change calendar year on year

	2016	2017	2018
United States	1.8	2.1	1.9
Euro-zone	1.9	1.3	1.5
Japan	0.5	0.6	0.6
China	6.7	6.5	6.3
India	7.7	7.7	7.5
Emerging East Asia	3.5	3.6	3.4
World GDP	2.8	3.0	3.1

Source: NAB Group Economics

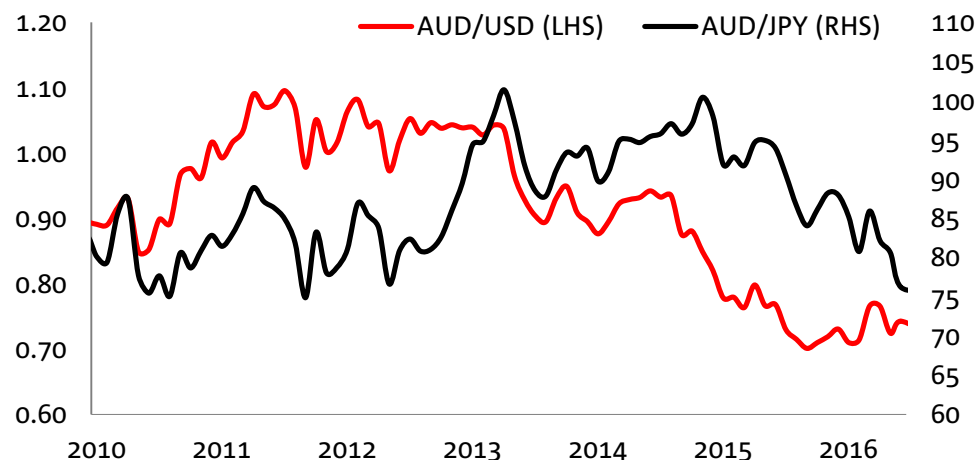
For more detail, see our [Global and Australian Forecasts](#)

Brexit, the latest in a series of shocks to global financial markets, leads up to shave our global growth forecasts by 10 to 20 bps in 2016 and 2017. Annual global growth should average around 3% over the forecast horizon, a lacklustre performance that falls well below its long run trend. China, India and the US remain key drivers of growth with softer conditions across Japan and the rest of E Asia, Latin America and W Europe. With little evidence of inflation pressures central banks can keep interest rates very low by historical standards. The global trading environment for Australian business looks set to remain subdued but the degree of global softness should be kept in perspective – this is a long flat period for growth as the global economy recovers from the GFC, it is not a recession.

Australian real GDP continues to be supported by solid non-mining activity and strong growth in the volume of LNG and services exports. Consistently above-average business conditions in non-mining appear to supporting business confidence (despite Brexit), which is encouraging as we enter a period of political uncertainty. The divergence between mining sectors and geographies is increasingly stark however, with low commodity prices to be an enduring feature. Our real GDP forecasts are 2.9% for both 2016 and 2017 and to 2.5% in 2018. The unemployment rate eases to just above 5½% in coming quarters, then holds steady before drifting up to 5.8% in 2018. Meanwhile, low wages growth and weak commodity prices are consistent with a subdued inflation outlook and are a testing combination for government revenue, as evidenced by S&P placing Australia's AAA credit rating on negative outlook.

EXCHANGE RATES AND INTEREST RATES

MONTHLY EXCHANGE RATE MOVEMENTS



The decline in volatility back to near post-GFC lows has driven the AUD/USD recovery from 0.73 to around 0.76. Our 0.72 end of September forecast for the AUD is under some pressure and the bigger near term risk is for a retest of the 2016 year-to-date high of 0.7835.

The Q2 CPI produced another relatively low quarterly inflation outcome, but perhaps importantly, did not reproduce the very low Q1 CPI result. We consider that while a further rate cut will be considered at Tuesday's RBA meeting - and while the outcome is likely to be a close call - the Q2 CPI does not demand a further adjustment. This is especially so with non-mining GDP above trend, business conditions above average, and reasonable employment growth outcomes. It is also unclear whether a further cut would effectively stimulate higher inflation in a number of sectors.

NAB FX STRATEGY TARGETS

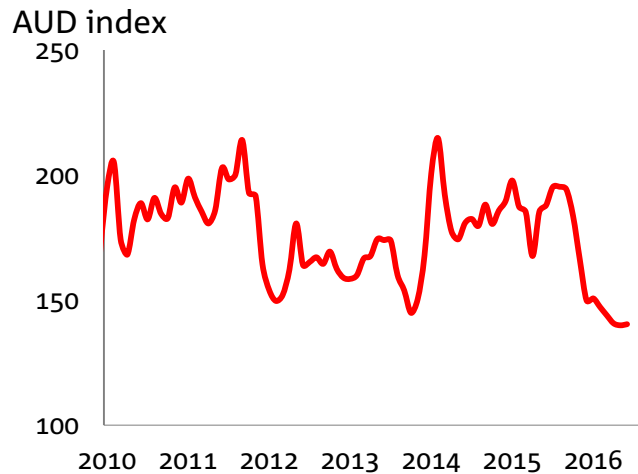
	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2
AUD/USD	0.72	0.70	0.69	0.69	0.69	0.70	0.71	0.72
NZD/USD	0.68	0.66	0.66	0.65	0.66	0.68	0.69	0.70
USD/JPY	105	105	103	103	102	101	100	99
EUR/USD	1.08	1.06	1.05	1.05	1.06	1.07	1.08	1.09
USD/CNY	6.73	6.80	6.78	6.76	6.74	6.73	6.72	6.70

Source: NAB

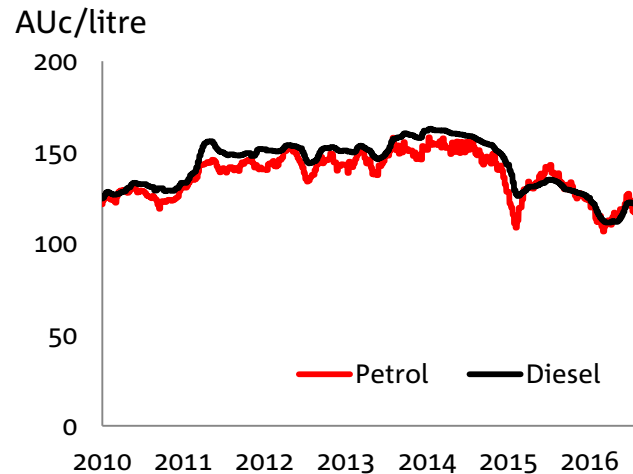
FARM INPUT PRICES



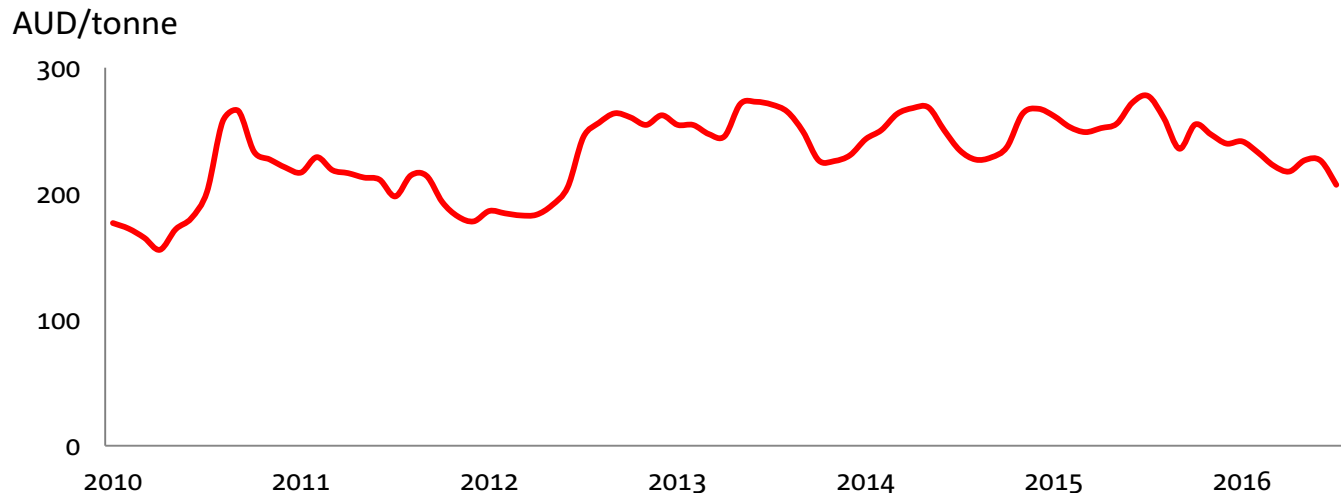
NAB FERTILISER INDEX



NATIONAL AVERAGE FUEL PRICES



NAB WEIGHTED FEED GRAIN PRICE INDEX



Global fertiliser prices have levelled off, with the NAB Fertiliser Index up 0.3% in June and 0.2% in July in AUD terms as cheaper urea and DAP offset gains in natural gas. However, our forecasts for a lower AUD presents a moderate upside risk for fertiliser prices into 2017, noting that prices have fallen substantially this year. The index is comprised of natural gas, urea and DAP.

National average petrol prices were up again in June, with petrol 6.3% higher and diesel 6.2% higher. However July (to date) brought cheaper petrol (down 3.9%) and more steady diesel (up 1.0%).

Weighted feed grain prices were steady in June (off 0.1%) but collapsed 8.5% in July. We have downgraded our AUD grain price forecasts this month and note that pressure continues to be on the downside.

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.

Source: Bloomberg, Australian Institute of Petroleum, Profarmer and NAB Group Economics

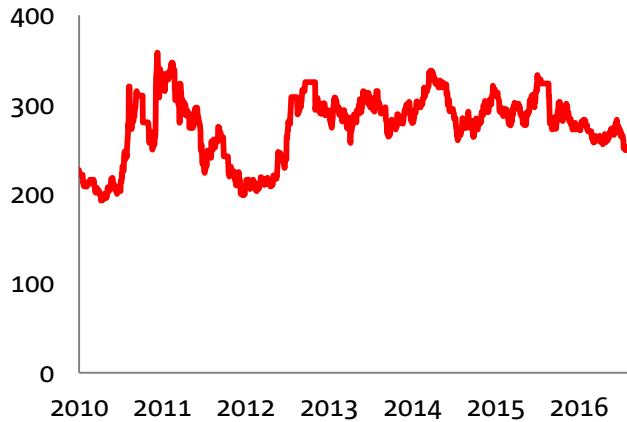


WHEAT



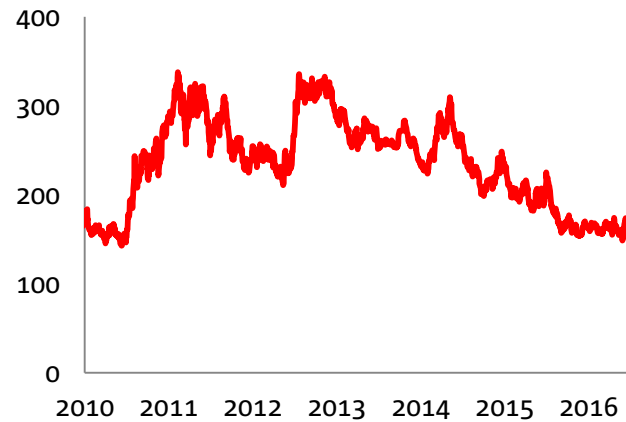
GENERIC 1ST MILLING WHEAT

Eastern Australia, AUD/tonne



CBOT HARD RED WINTER WHEAT

USD/tonne



NAB CENTRAL CASE AUSTRALIAN WHEAT PRODUCTION OUTLOOK

Million tonnes (production), tonnes/hectare (yield)

	NSW	VIC	QLD	WA	SA	TAS	AUS
Production	8.6	3.3	1.5	9.1	4.8	<0.1	27.2
Yield	2.5	2.2	2.0	1.8	2.4	4.0	2.1

Prices

The steady downward trend in wheat prices was interrupted in the last two months due to supply concerns, particularly spilling over from soy and corn. However, global wheat supply remains buoyant and downward price pressure has returned and USD prices are now the lowest in a decade.

We have further downgraded our outlook for wheat prices, noting that the USDA continues to forecast strong global supply. Generic 1st Eastern Australian milling wheat was up 1.9% (AUD) in June but fell sharply in July – down 6.3%.

Production

This month we have revised up our central case estimate for the 2016-17 Australian wheat crop to 27.2 million tonnes from 26.1 million tonnes in May. This is based on wetter than average conditions in New South Wales more than offsetting a small downgrade to forecast Western Australian production.

Our forecasts are based on rainfall to date and average rainfall in major cropping areas for the rest of the season. Our high case estimate, based on 20% above average winter and early spring rainfall, points to a national harvest of 27.8 million tonnes.

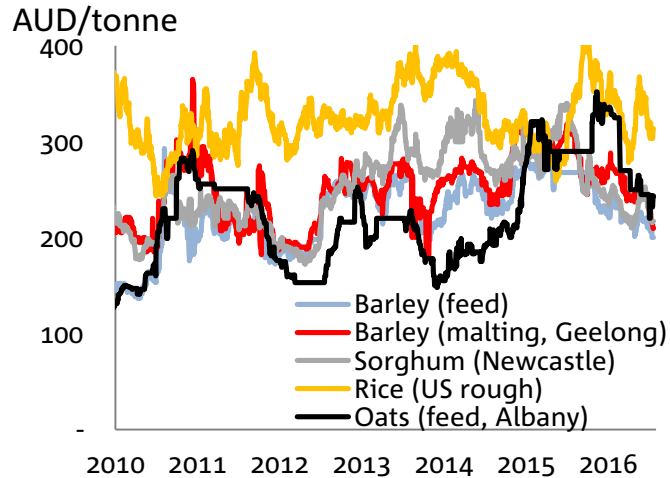
Source: Bloomberg, Profarmer, USDA, Bureau of Meteorology, ABARES, Australian Bureau of Statistics and NAB Group Economics



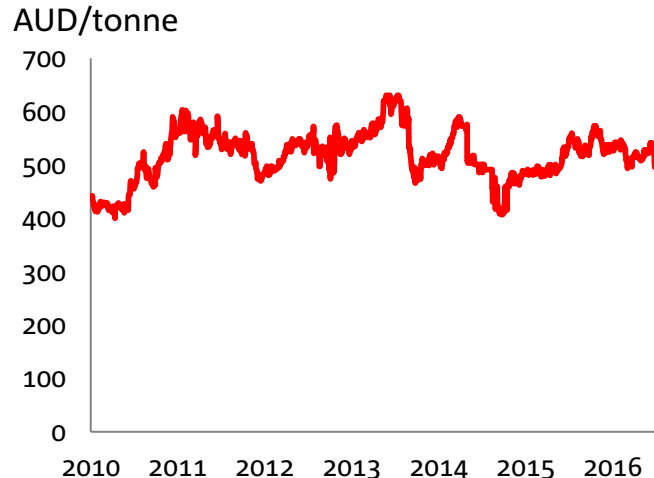
OTHER BROADACRE CROPS



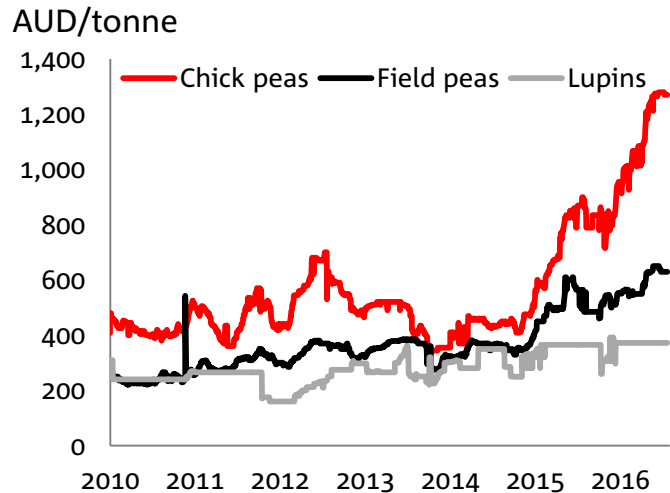
SELECTED COARSE GRAINS



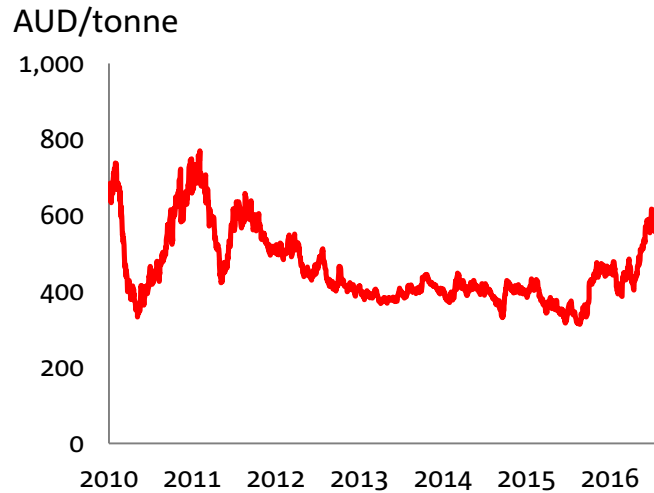
CANOLA, NEWCASTLE NSW



SELECTED PULSES



ICE NO.11 SUGAR



Source: Bloomberg, Profarmer and NAB Group Economics

Australian coarse grain prices have mostly followed broad trends set by wheat this year, reflecting a dependence on movements in the AUD. Sorghum (Newcastle) was off 9.4% in July while barley (feed, generic) fell 6.3%. Rice and oats were 7.9% and 7.7% lower in AUD terms. Domestic canola was off 7.0% in AUD terms in July.

Our July In Focus report on pulses presents a very favourable outlook for Australian pulses production this season based on very good weather conditions. We are, however, substantially more circumspect when it comes to the outlook for prices. This is particularly the case for pulses predominantly destined for India, such as chick peas and lentils.

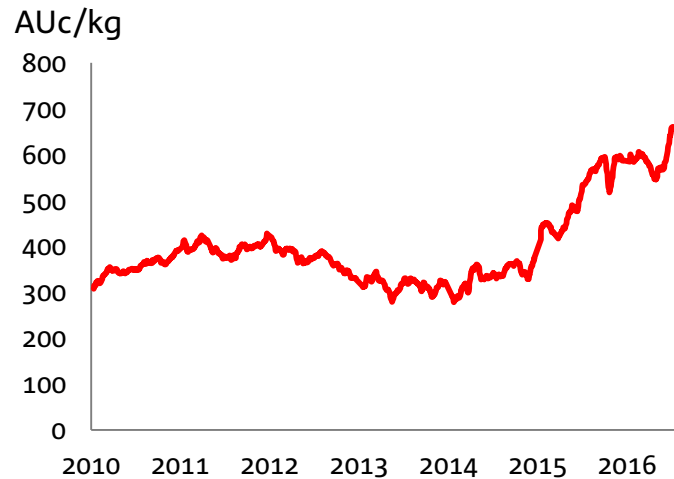
Global sugar prices are surging amid global supply shortfall concerns, with good growing conditions in Brazil not sufficiently offsetting risks elsewhere. Demand remains broadly favourable.

ICE no.11 sugar surged 14.2%(AUD) in June, after rising 16.9% (AUD) in May. Exuberance was tempered in July with prices only up 0.3%. While prices have been volatile this year, we continue to expect higher prices, noting supply issues and improving global demand.

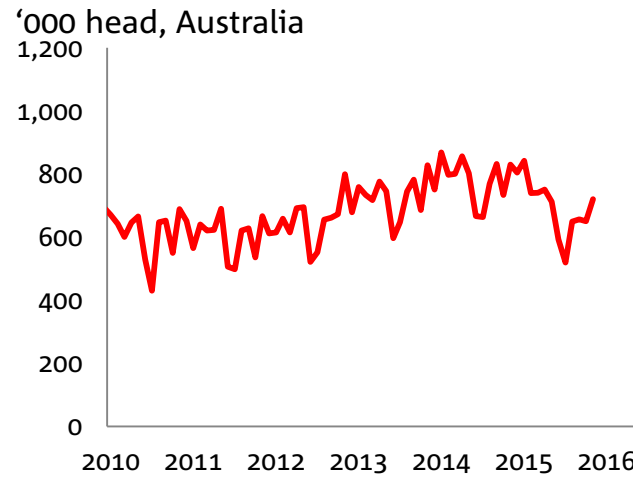




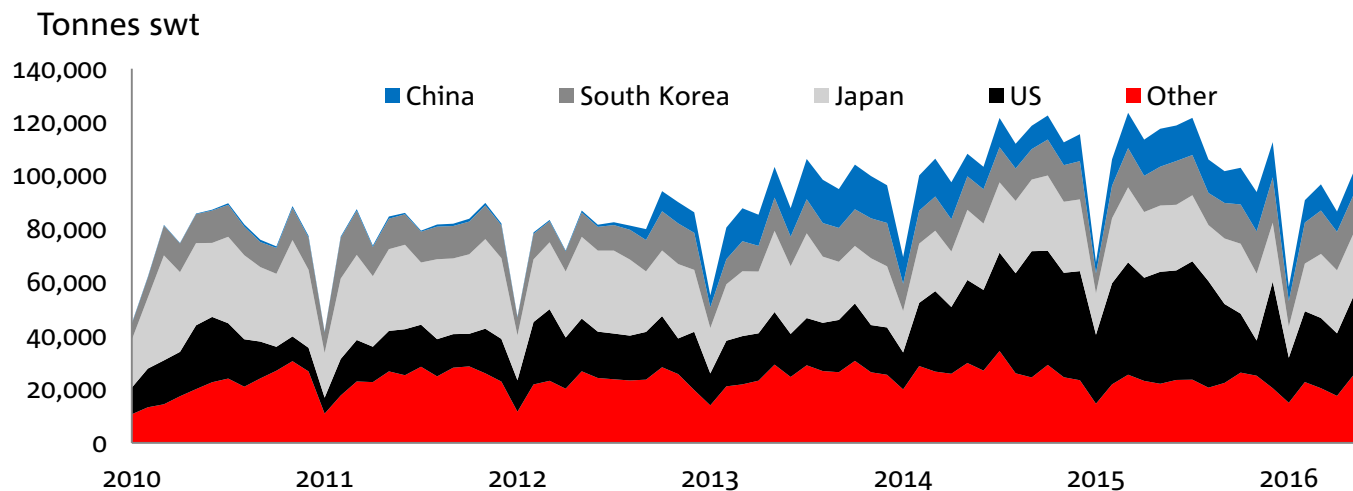
EASTERN YOUNG CATTLE INDICATOR



MONTHLY CATTLE SLAUGHTER



MONTHLY AUSTRALIAN BEEF EXPORTS



Source: Meat and Livestock Australia and NAB Group Economics

Cattle prices continue to surge on strong winter rainfall. The last three years saw well above average cattle slaughter, depleting herds and leaving producers scrambling to restock with the weather now much more favourable for pasture growth.

The Eastern Young Cattle indicator rose 9.3% in June and 6.4% in July. The indicator now stands at a record 673.5AUc/kg.

We expect that cattle prices will remain high for the rest of 2016, although the prospect of further upside may prove somewhat optimistic.

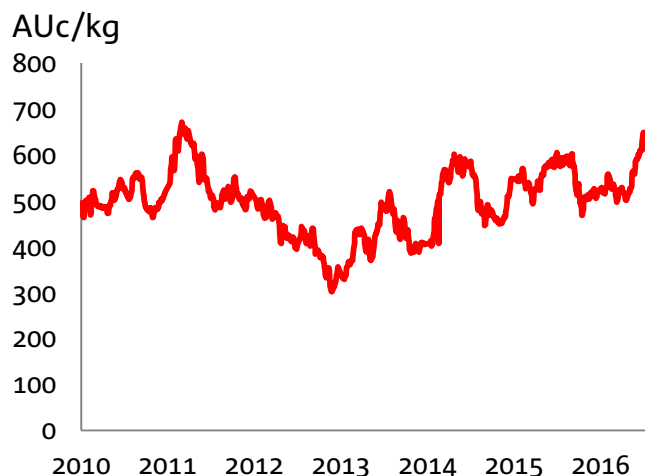
However, signs from the US market (our largest export market) are less encouraging for prices looking into next year. US imported beef indicators are now down 15-20% in AUD terms from their September 2015 peak with improved domestic cattle supply providing more competition. The USDA this month raised its US beef production forecast, now expecting US production to increase 5.3% this year and a further 3.4% in 2017.

This will keep export prices under pressure, further compounded by increasing competitiveness from South America in key east and south-east Asian markets.

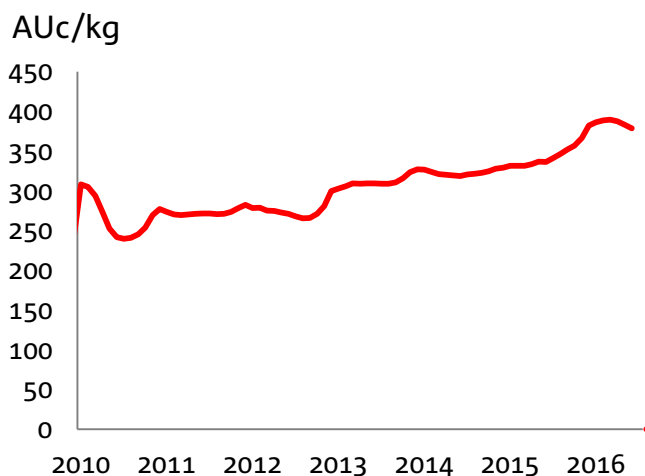
LAMB, PORK AND POULTRY



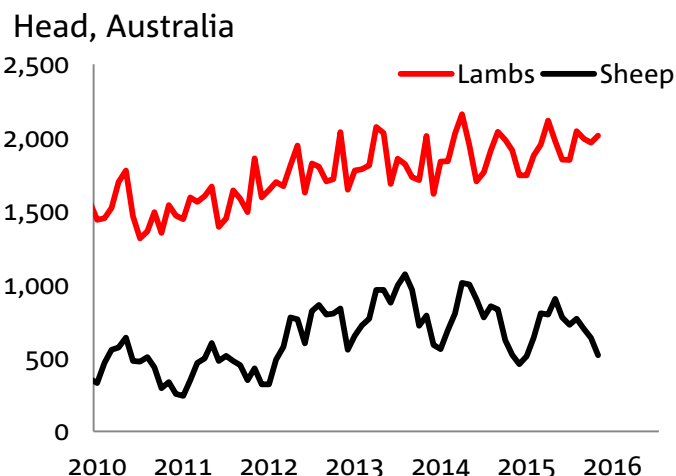
NATIONAL TRADE LAMB INDICATOR



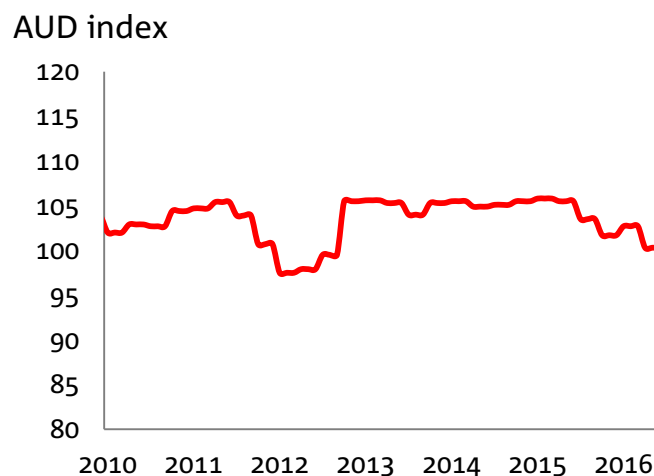
AUSTRALIAN PORK PRICE INDICATOR



MONTHLY SHEEP AND LAMB SLAUGHTER



ABS POULTRY PRICE INDEX



Our forecasts for lamb continue to reflect moderately higher prices this year. Indeed, the Eastern States Trade Lamb Indicator has been trending upwards since 2013, albeit with strong seasonal variation reflecting the usual spring lamb flush. The National Trade Lamb Indicator was up 10.2% in June, reflecting good rainfall across Eastern Australia. Prices in July were up a more modest 1.8%.

Production and exports have been elevated amid dry conditions over the past two years, but these levels were not sustainable and we see lamb and mutton production falling more than 5% in 2016-17.

Overall we forecast the value of exports to fall 7.6% in 2016-17 amid lower export volumes.

Australian wholesale pork prices (measured as an average of buyer and seller prices for eastern seaboard 60.1-75kg animals) continued to fall in June and July, off 1.2% and 0.3% respectively. While the industry generally sees relatively little volatility in prices, the sustained upward trend since mid-2015 looks to have peaked for now.

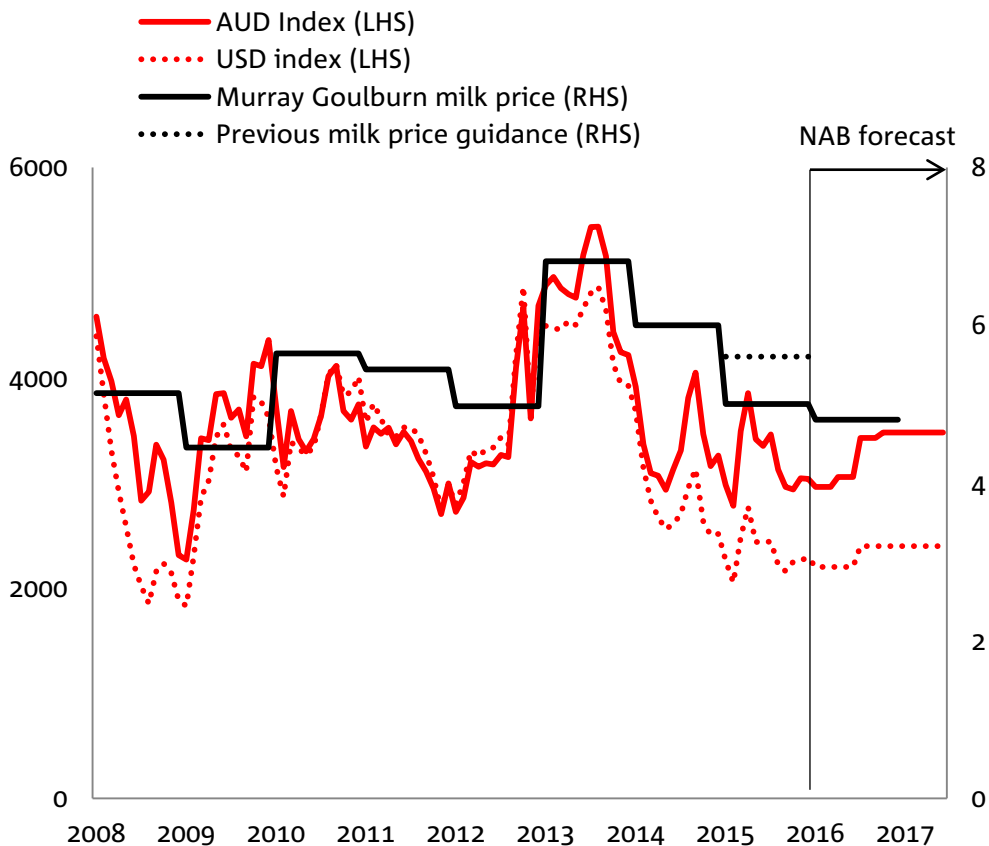
While we do not collect wholesale poultry price data, retail prices have remained reasonably stable since late 2012. However, national retail prices fell 2.3% in the June quarter 2016.

Source: Meat and Livestock Australia, Australian Pork, Australian Bureau of Statistics and NAB Group Economics



NAB WEIGHTED DAIRY EXPORT PRICE INDICATOR

\$/tonne (export price, LHS)
AUD/kg milk solids (farm gate price RHS)



NAB's Australian weighted dairy export indicator recorded a 2.9% increase in June to AUD3,131.99/tonne, the second straight month of improvement but still well below the February 2014 high of AUD5,436/tonne. July results were off 2.0% in AUD terms to AUD3,083.47/tonne.

The low prices reflect a number of factors, including:

- lower Chinese milk powder demand;
- the removal of EU dairy quotas (and associated higher production);
- the ongoing impact of the Russian dairy embargo; and
- buoyant US domestic supply.

We do not expect a marked improvement in the above areas in the coming year and as a result expect international prices to remain low for the foreseeable future. However, the low prices may see lower European supply, limiting further downside pressure and further depreciation in the AUD could provide some upside.

The expectation that low international prices will continue is reflected in opening farmgate prices for the 2016-17 season. Murray Goulburn's headline opening price is \$4.80/kg milk solids, although with Milk Supply Support Package repayments the price could be as low as \$4.31/kg milk solids for some producers. This is below the cost of production for the average dairy farmer in many regions.

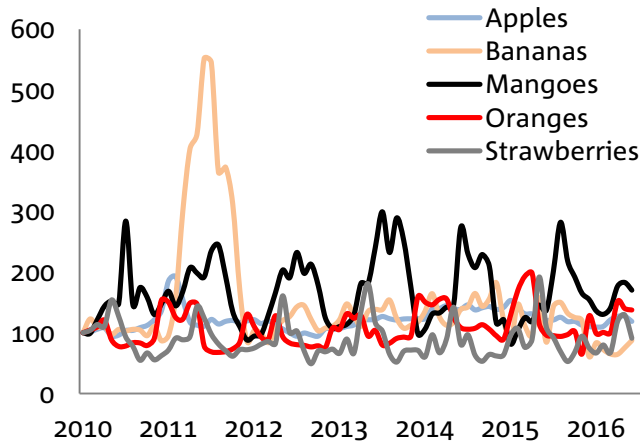
Source: Australian Bureau of Statistics, Global Dairy Trade, Dairy Australia, Fonterra, Murray Goulburn and NAB Group Economics

Note: chart shows Murray Goulburn farmgate prices (upper range for revised 2015-16 price) except 2008-09 which shows Dairy Australia's reported Victorian average value



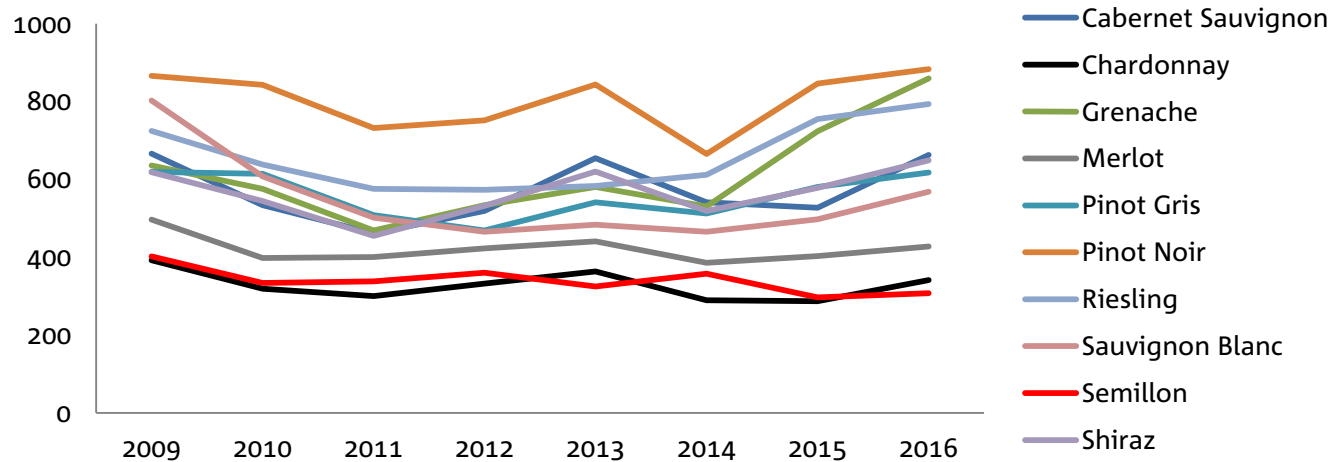
WHOLESALE FRUIT PRICES

AUD index, Sydney and Melbourne



NAB WEIGHTED WINE GRAPE PRICES

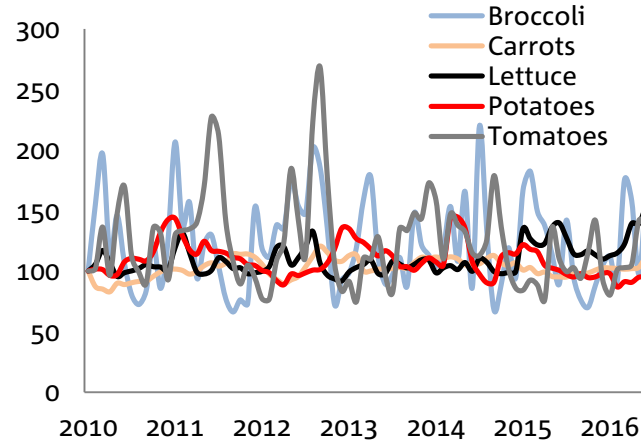
AUD/tonne



Source: Ausmarket Consultants, Wine Australia and NAB Group Economics

WHOLESALE VEGETABLE PRICES

AUD index, Sydney and Melbourne



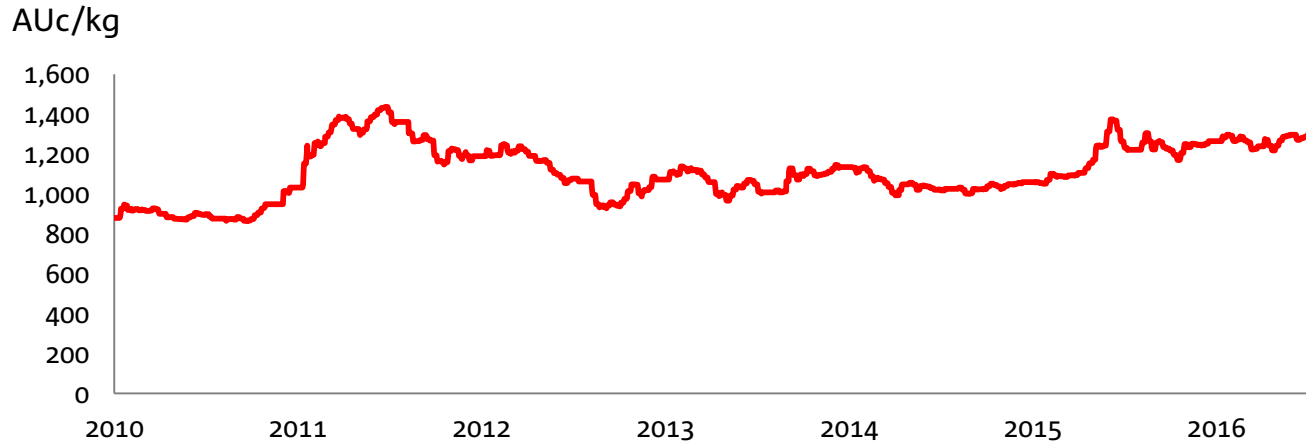
We produce wholesale price indices for fruit and vegetables, based on data from the Melbourne and Sydney wholesale markets.

Wholesale fruit and vegetable prices were divergent in June and July, largely reflecting their highly seasonal nature. Fruit prices fell 5.3% in June and 0.2% in July to an index value of 118.6 (January 2010 =100). Vegetables surged 9.8% in June and 5.1% in July to an index value of 137.6 (January 2010 =100).

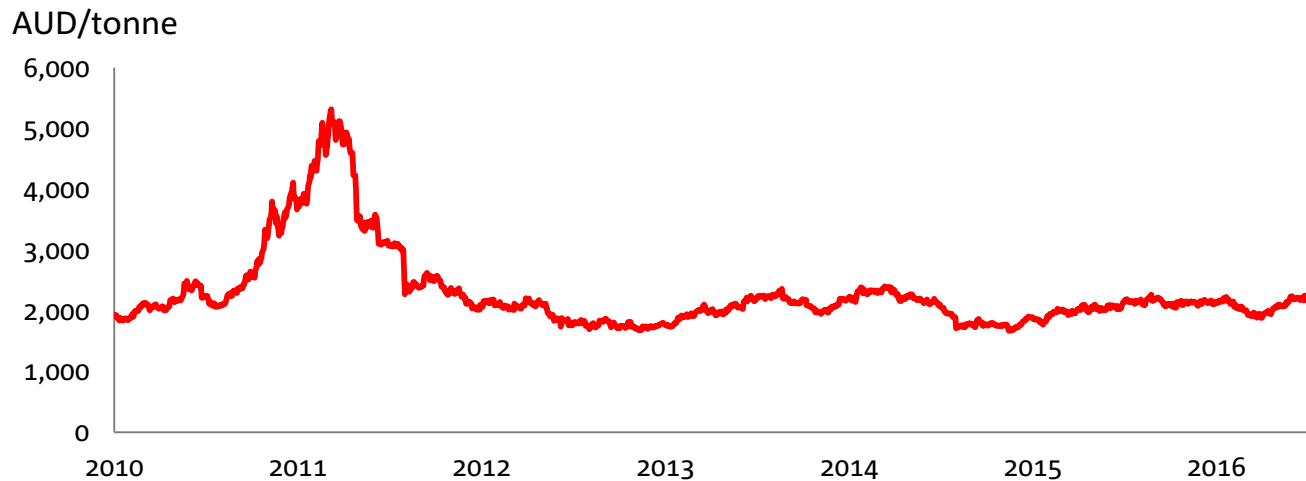
Wine Australia's 2016 Price Dispersion Report, released this month, shows further strengthening in wine grape prices in the 2016 vintage, reflecting the rewards of a lower AUD. Overall, wine grape prices for major varieties were higher to much higher. Cabernet Sauvignon was a standout performer, up 26% from last season. Chardonnay and Grenache also grew strongly, both up 19% in volume weighted terms.



WOOL – EASTERN MARKET INDICATOR



COTLOOK A INDEX



Source: Bloomberg and NAB Group Economics

After several years of unfavourable prices, wool producers continue to enjoy a moderate upturn since last year, with the Eastern Market Indicator steady in June and up 2.1% in July. While the AUD strength has been something of a brake on price upside (wool is quite sensitive to movements in the dollar) any move downward in the AUD provides an upside to price. Overall, we forecast that prices will increase 6.8% in 2016-17.

The higher prices are forecast to offset lower production in 2015-16 and spur some increase in production in 2016-17. We forecast the value of Australian wool exports to increase 8.5% 2016-17.

Global cotton prices continue to strengthen. Cotlook A was up 3.9% (AUD) in June and 7.5% in July.