

RURAL COMMODITIES WRAP

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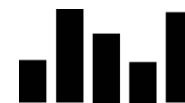
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PRICE UPDATE: NAB'S RURAL COMMODITIES INDEX

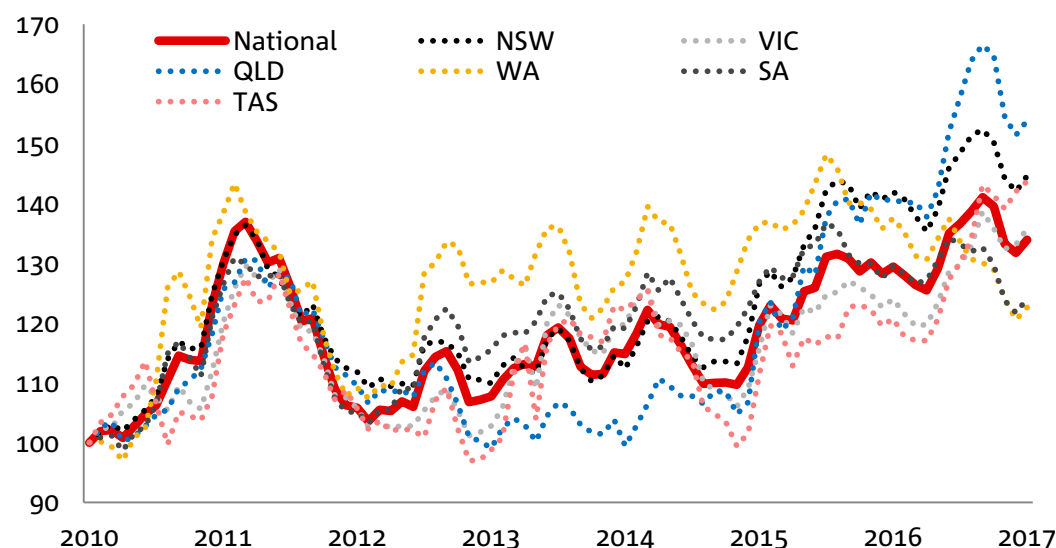


Q4 2016 saw a sustained drop in the price of many agricultural commodities, with the NAB Rural Commodities Index down 1.1% in October, 4.5% in November and 1.1% in December. January 2017 brought an upturn however, the NAB Rural Commodities Index was up 1.4% in AUD terms for the month. The recovery was driven foremost by a stellar jump in lamb prices (up 17.1%), but higher prices for sugar (up 7.5%) and beef (up 1.5%) also contributed to the increase.

NAB's Rural Commodities Index includes 28 commodities and is weighted according to the gross value of production of each industry.

NAB RURAL COMMODITIES INDEX AND STATE INDICATORS

Index value, 2010 = 100



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

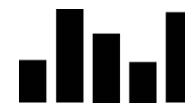
This year, we have expanded the index to include separate state level indices. Queensland has been the strongest performer since late 2015, reflecting the state's outsized share of Australia's cattle industry and the extraordinary run of saleyard cattle prices. Grain-heavy Western Australia outperformed other states from 2012 to 2015 but poor grain prices saw it sink to its lowest level since 2012 by the end of 2016. In January 2017, the national index stood at an index value of 133.6 (January 2010 = 100), New South Wales at 144.3 (+1.6%), Victoria at 135.7 (+1.9%), Queensland at 153.9 (+1.6%), Western Australia at 121.7 (+1.0%), South Australia at 123.6 (+1.6%) and Tasmania at 143.7 (+1.2%).

MONTHLY AUD PRICE CHANGES – SELECTED COMMODITIES

Monthly average price change

	December 2016	January 2017	February 2017 (to date)
Wheat	▼ 4.2%	▼ 0.5%	▲ 0.1%
Beef	▼ 2.0%	▲ 1.5%	▲ 1.3%
Dairy	▲ 10.4%	▼ 1.1%	▼ 5.6%
Lamb	▼ 5.0%	▲ 17.1%	▲ 6.5%
Wool	▲ 2.9%	▲ 3.3%	▲ 2.4%
Sugar	▼ 7.2%	▲ 7.5%	▼ 2.5%
Cotton	▲ 3.4%	▲ 2.0%	▲ 0.7%

OUTLOOK FOR THE COMING YEAR



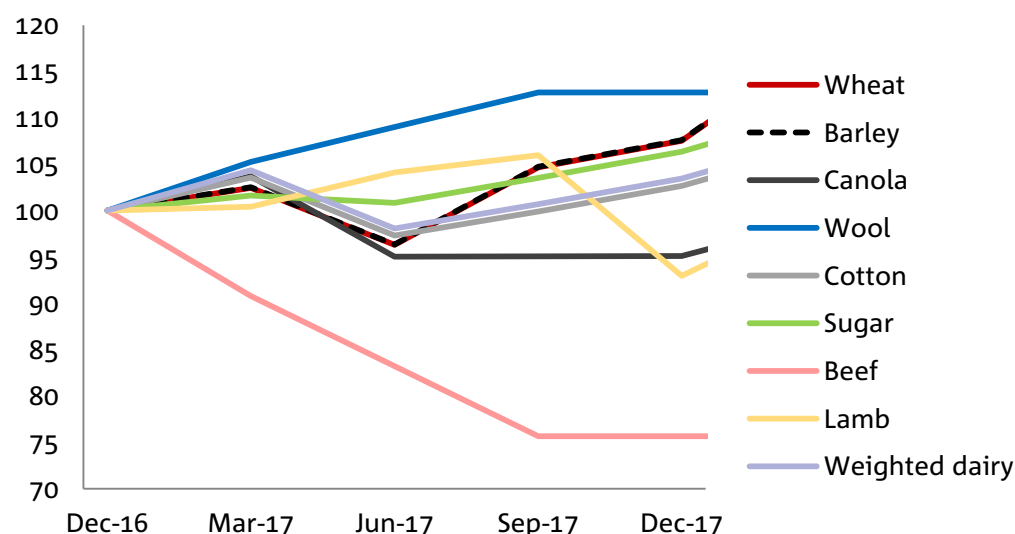
Prices

The outlook for the coming year is highly dependent on the course of the Australian dollar. This week, we revised up our AUD forecasts for the first half of 2017, although we still expect the AUD to fall to 70 US cents at the end of 2017, providing some upside towards the end of the year.

We expect cattle prices to fall further in 2017. While we have already seen some price contraction in saleyard prices, restocker interest could slow rapidly if dry conditions persist as major export markets show a generally subdued pricing outlook. Our forecasts point to the EYCI falling to 500 AUc/kg in the September quarter 2017. This is an approximately 30% contraction from peak.

INDEX OF PRICE FORECASTS FOR RURAL COMMODITIES

AUD index value, December quarter 2016 = 100



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

Production

The outlook for production is somewhat mixed. While winter crops had a generally spectacular season, with a record 35 million tonnes of wheat harvested, the drier outlook for the coming year is likely to see downward pressure in the 2017-18 season.

Major proteins all show lower production for 2016-17, with beef, lamb and mutton and dairy all falling. While lower beef and sheepmeat production reflects the need to rebuild herds and flocks following a previous period of elevated slaughter, we see low prices being the primary driver for lower milk production. Without further upside in farmgate prices, it is likely that production in the dairy sector will continue to lag.

ABARES PRODUCTION OUTLOOK

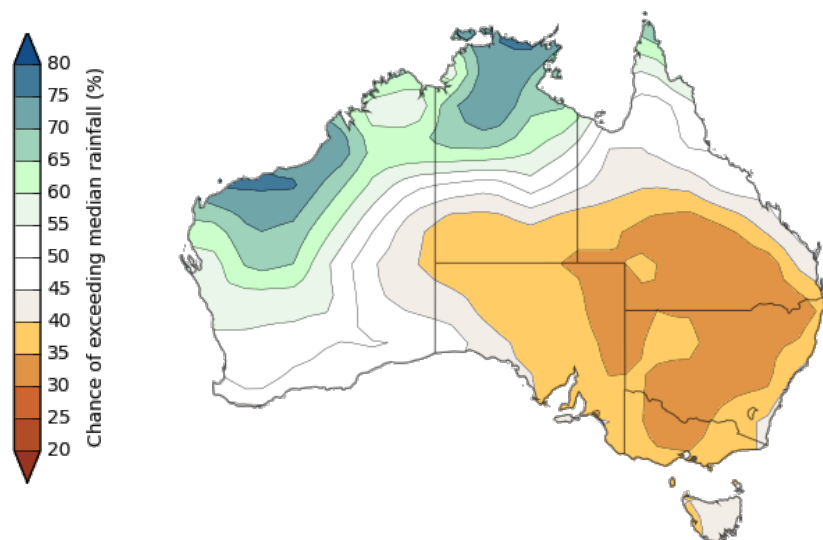
Financial year production estimates, Australia

	2015-16	2016-17	% change
Wheat (million tonnes)	24.2	35.1	▲ 45.4%
Beef (kt)	2,344	2,140	▼ 8.7%
Dairy (milk, billion litres)	9.54	9.0	▼ 5.7%
Lamb and mutton (kt)	390	358	▼ 8.1%
Wool	417	411	▼ 1.4%
Sugar (kt)	4,920	5,100	▲ 3.7%
Cotton (lint, kt)	629	1,029	▲ 63.6%



THREE MONTH RAINFALL OUTLOOK

February to April 2016

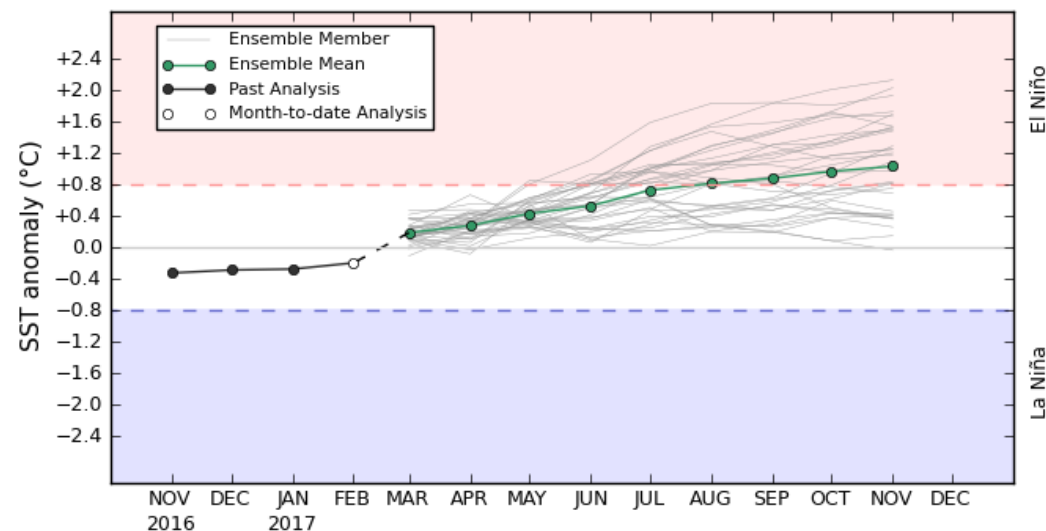


Summer has brought extremely volatile conditions to Australia's cropping districts. While much of eastern Australia has baked in an extraordinary heatwave, Western Australia has suffered substantial flooding.

The Bureau of Meteorology's three month outlook points to early autumn having a re-run of 2016, with a dry to very dry start to the wheat season in the east but prospects of a good break in the west.

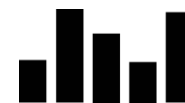
BOM POAMA MODEL LONG-RANGE EL NIÑO OUTLOOK

Monthly mean NINO 3.4 – 12 February 2017

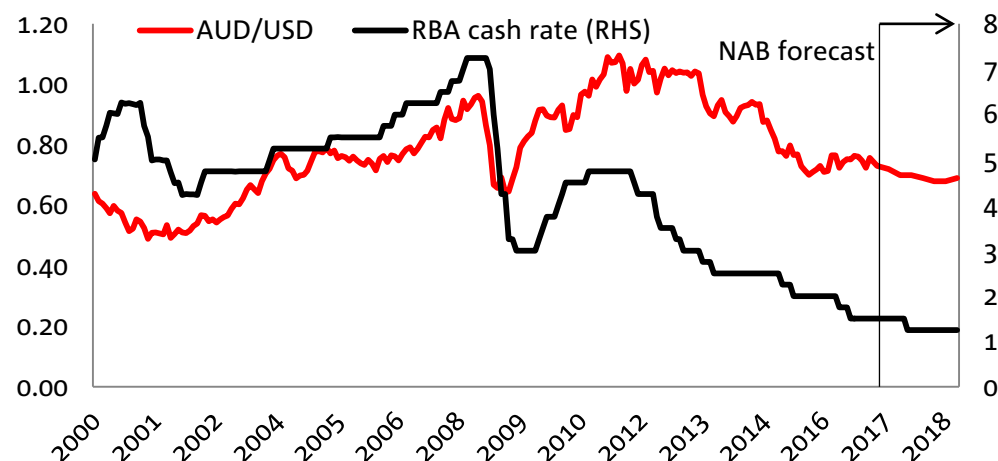


More concerning is the Bureau's long range El Niño outlook for this year. 2016 saw a late break in the east but the very wet winter and spring was consistent with the near La Niña conditions recorded throughout the year. This year, the Bureau's outlook is very different, with an El Niño event projected to hit this winter. While these projections naturally carry a degree of uncertainty, El Niño events tend to bring hotter and drier conditions on average to eastern and northern Australia.

EXCHANGE RATES AND INTEREST RATES



EXCHANGE AND INTEREST RATES INC. QUARTERLY FORECASTS



This week we revised up our outlook for the US dollar for the first half of this year.

The AUD has continued to defy predictions – including our own – for its imminent descent from the high to the low 0.70s. Alongside the inability of the USD to recapture almost any of the ground it lost in January, the global economy, commodity prices and risk appetite have all been travelling on a higher plane than we envisaged when reaffirming our AUD forecasts earlier in the year.

We retain our 0.70 end-2017 forecast and still contend we can spend some time slightly below there in 2018. A resumption of USD strength, weaker commodity prices and less buoyant risk appetite are all implicit in this view.

Solid economic momentum in the near-term will likely keep the RBA on the sidelines through most of 2017. However we expect a pull-back in economic growth in 2018, as the contributions from LNG exports, temporarily higher commodity prices and residential construction fade, while household consumption remains constrained by weak labour income growth and elevated levels of household debt.

Current RBA optimism is expected to fade about the outlook later in 2017, with monetary policy easing in late 2017 necessary to prevent a rise in unemployment and inflation undershooting again in 2018. We have removed our mid-year rate cuts, and now expect one 25bp cut to the cash rate in November 2017, taking it down to 1.25%.

NAB FX STRATEGY TARGETS

	2017Q1	2017Q2	2017Q3	2017Q4
AUD/USD	0.77	0.75	0.73	0.70
NZD/USD	0.72	0.71	0.70	0.67
USD/JPY	112	114	116	118
EUR/USD	1.05	1.05	1.04	1.04
USD/CNY	6.90	6.92	7.05	7.04
AUD TWI	65.7	64.5	63.4	61.1

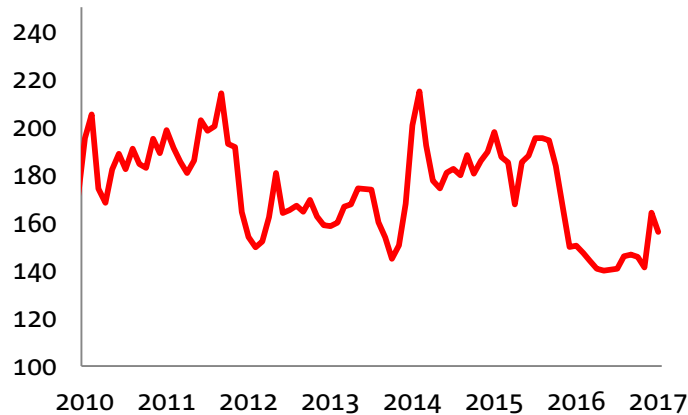
Source: NAB

FARM INPUT PRICES



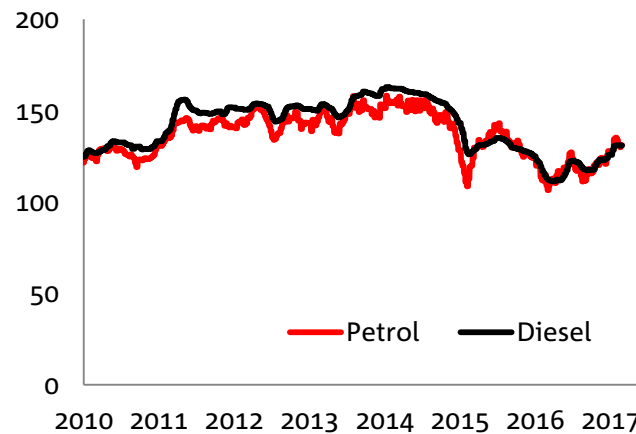
NAB FERTILISER INDEX

AUD index



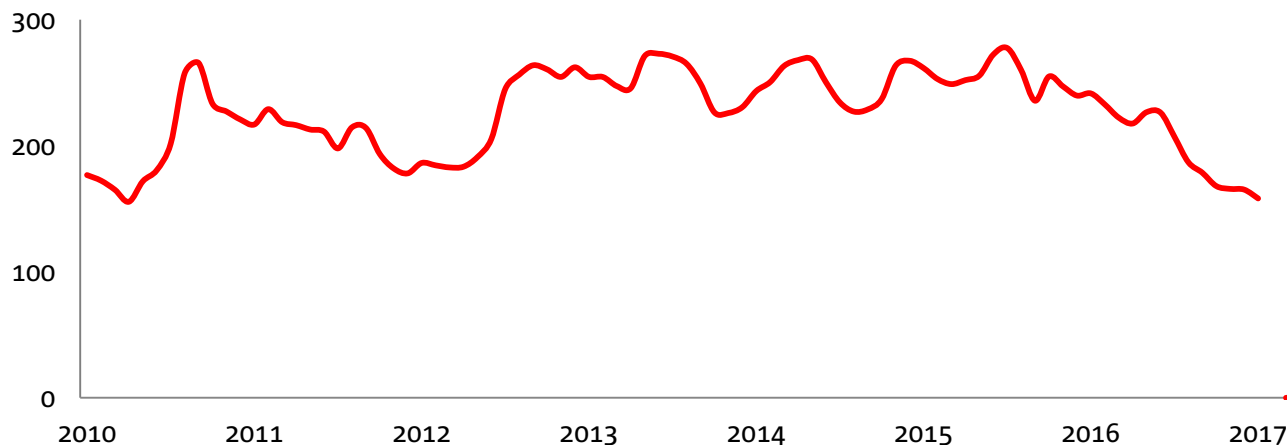
NATIONAL AVERAGE FUEL PRICES

AUc/litre



NAB WEIGHTED FEED GRAIN PRICE INDEX

AUD/tonne



Source: Bloomberg, Profarmer and NAB Group Economics

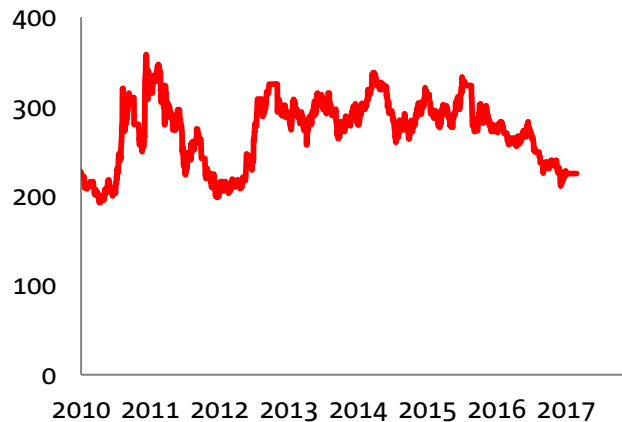
Feed prices remain very low in the wake of a bumper grain and hay season across eastern Australia. NAB's weighted feedgrain price index currently stands at its lowest level since early 2010 and we see little upside in global grain markets this year amid exceedingly strong supply. Domestically, the combination of a record grain harvest and quality downgrades in some areas ensures that there will be ample feed grain for some time to come. NAB's index includes feed wheat, barley, oats and sorghum. Three quarters of the indicator is made up of feed wheat and barley.

Fuel and fertiliser prices present something of a mixed picture. Fuel prices continue to rise since their nadir in March last year. Most recent data show national petrol prices averaging 131.1c/litre and diesel averaging 130.8c/litre. The NAB fertiliser index jumped 16.2% in December on higher US natural gas prices but retreated 4.9% in January, largely reflecting a higher AUD. While we expect the factors (notably cold weather) pressuring US gas prices to mitigate over the coming months, the upward trend in oil prices suggests that fertiliser will become more expensive for farmers in 2017.



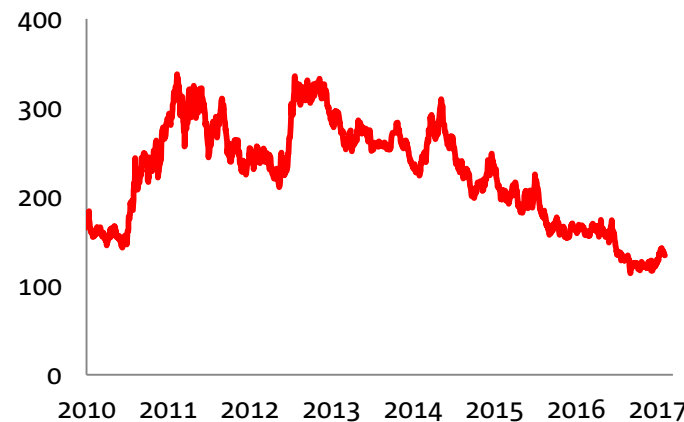
GENERIC 1ST MILLING WHEAT

Eastern Australia, AUD/tonne



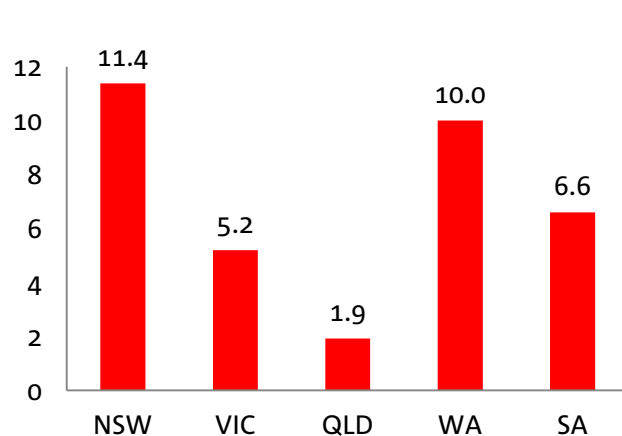
CBOT SOFT RED WINTER WHEAT

USD/tonne



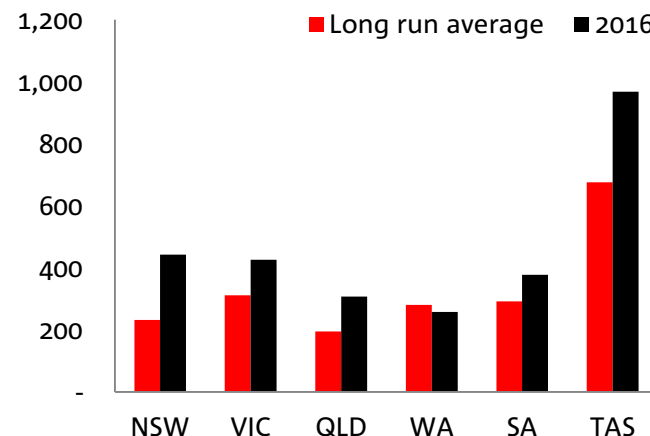
WHEAT PRODUCTION BY STATE

ABARES February 2017 estimates



SEASONAL RAINFALL IN WHEAT REGIONS

Total average rainfall April-September, mm



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

Prices

Prices remain generally moribund. The world is awash with wheat and inventories remain extensive, despite the USDA downgrading global carryover stocks by 4.7 million tonnes this month. While we note yield downgrades in parts of the Black Sea and lower US winter wheat plantings, it remains unlikely that USD prices will rise significantly this year. Our forecast is for Australian wheat prices to increase around 12% in AUD terms by the end of calendar year 2017, although AUD strength in the first half of the year will probably see prices fall in Q2. If the AUD does not fall, there is unlikely to be much upside for local prices.

Production

Harvest of the 2016-17 winter crop has now essentially drawn to a close and all signs point to an unprecedented crop. ABARES' latest estimates put the wheat crop at over 35 million tonnes, more than 5 million tonnes higher than the previous record of 29.9 million tonnes, set in 2011-12. Massive yields were driven by a much wetter than average winter and spring in eastern Australia. Western Australia saw a perfect start to the season but a much drier winter with elevated frosts. Nonetheless the west still managed to produce an above average crop.

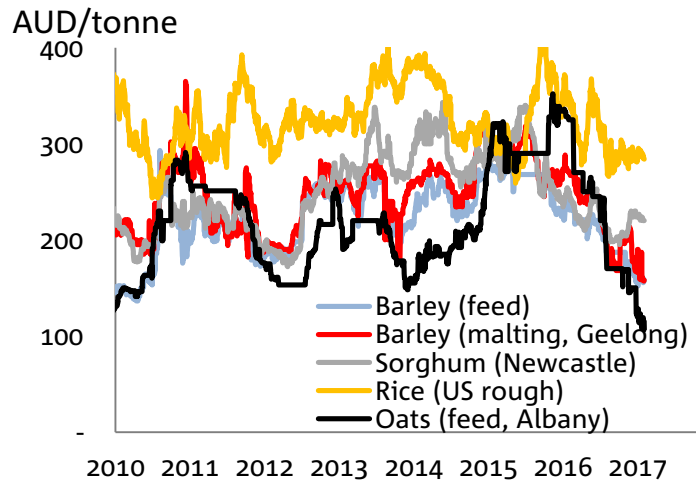
For more information see our [January Grain Harvest Update](#).



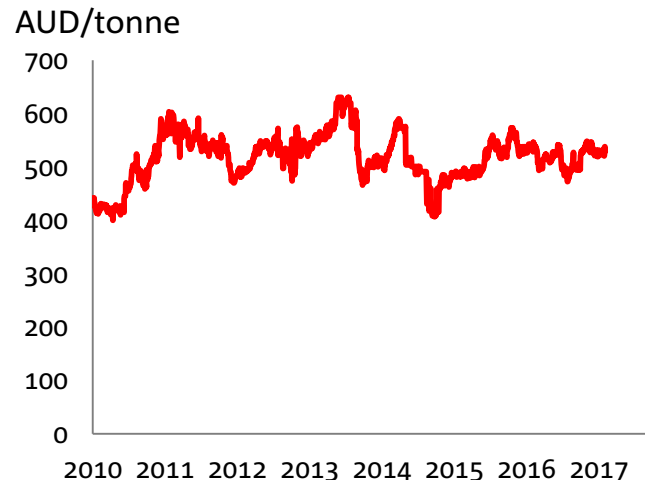
OTHER BROADACRE CROPS



SELECTED COARSE GRAINS



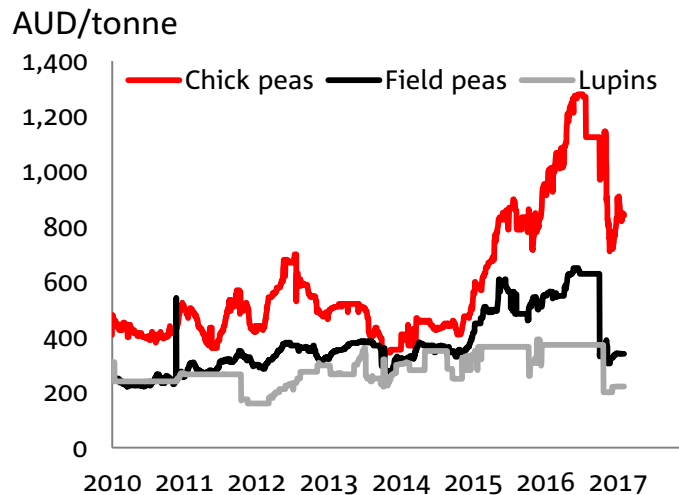
CANOLA, NEWCASTLE NSW



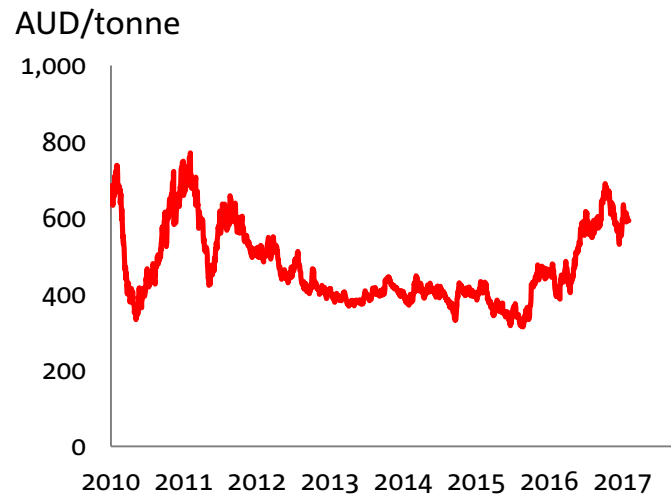
Prices for most coarse grains remain mired in the same situation as wheat. Strong global supply has seen prices tumble and the outlook is broadly similar to wheat for the coming year. Canola remains a stand-out, with prices holding up very well. The price premium for canola is likely to see higher Australian plantings this year.

Last year we noted our concerns around the then extraordinary chick pea prices, which had exceeded AUD1,200/tonne following two poor Indian monsoon seasons. But with the return of more favourable conditions to India prices have receded to the AUD800 range. We expect further downside for chick pea prices in the coming year, although they are likely to remain more expensive than alternative crops.

SELECTED PULSES



ICE NO.11 SUGAR



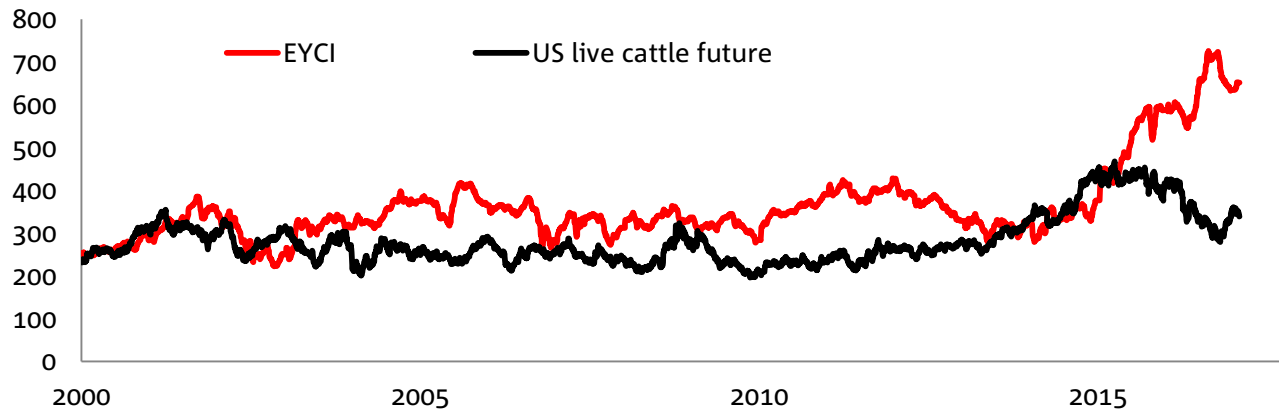
Sugar continues to perform. AUD prices reached the highest in half a decade late last year and although there has been some retreat growers will be pleased with the improved returns. Production is expected to be moderately higher this year.

Source: Bloomberg, Profarmer and NAB Group Economics



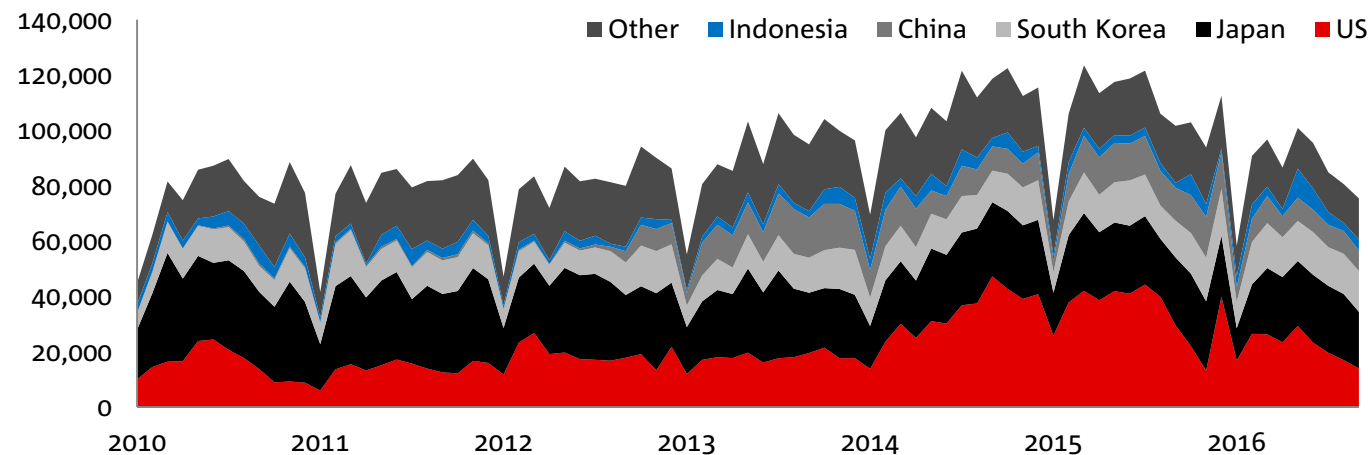
EASTERN YOUNG CATTLE INDICATOR AND US CATTLE FUTURES

AUc/kg



MONTHLY AUSTRALIAN BEEF EXPORTS

Tonnes swt



Source: Meat and Livestock Australia and NAB Group Economics

The Australian cattle industry enjoyed a stellar two year run of rising prices, with the Eastern Young Cattle Indicator smashing records to reach 725 AUc/kg in August last year, all the more exceptional given that the indicator had not exceeded 428 AUc/kg before 2015.

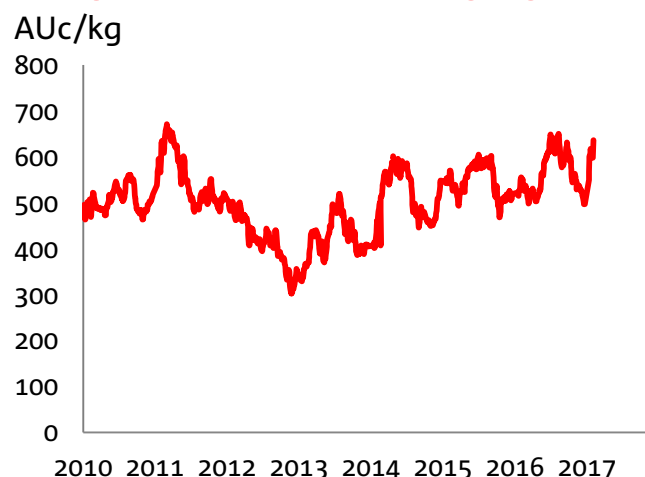
The initial phase of this boom was caused squarely by US demand for imported beef in response to domestic US supply constraints following high corn prices and drought in 2011. However, these factors have since dissipated and it has been our view for some time that the international beef outlook is now much weaker than in 2014 and 2015. US drought conditions are now much more localised and corn cheap and plentiful. Further, there is likely to be much more competition in the US imported beef market in the coming years as South American producers become more competitive.

We have already seen some price contraction – the EYCI is now under 622 AUc/kg and that restocker interest could slow rapidly if dry conditions persist. Our forecasts point to the EYCI falling to 500 AUc/kg in the September quarter 2017. This is an approximately 30% contraction from peak, although remains above the range of prices prior to 2015.

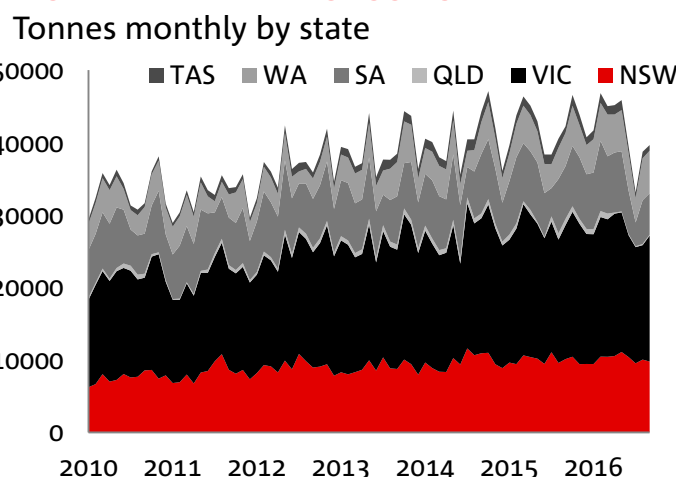
LAMB, PORK AND POULTRY



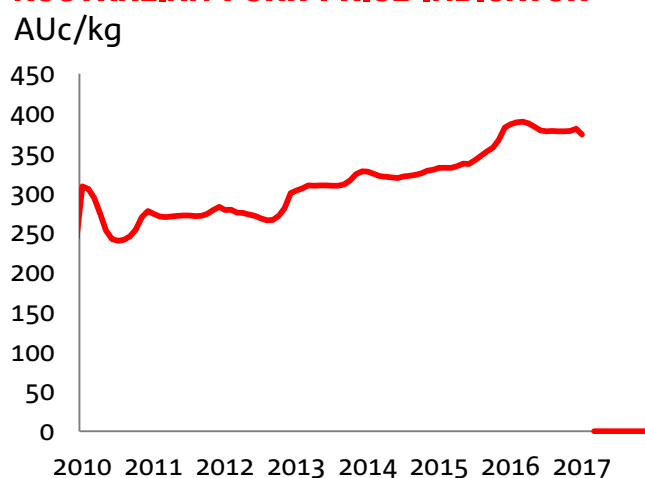
NATIONAL TRADE LAMB INDICATOR



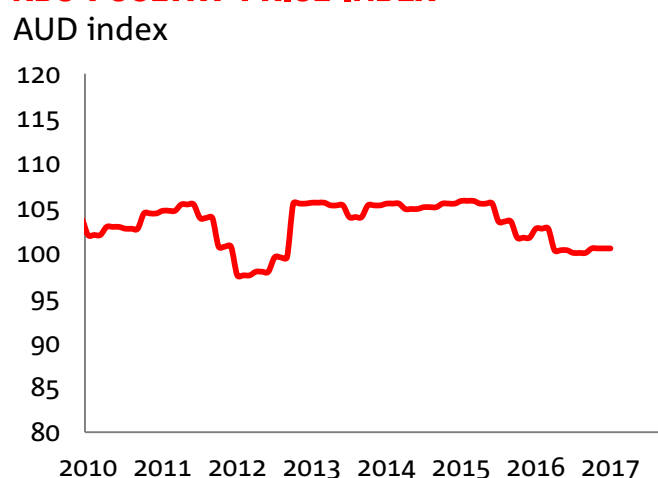
MONTHLY LAMB PRODUCTION



AUSTRALIAN PORK PRICE INDICATOR



ABS POULTRY PRICE INDEX



Lamb prices have surged in the new year, with the seasonal run-up coming in early summer rather than the usual autumn-winter. Constrained supply has been a major driver of improved prices, although the very hot and dry conditions in much of New South Wales (combined with a drier outlook) may make flock rebuilding less enticing. Nonetheless, lamb and mutton producers should be very pleased with the trajectory of prices this summer. We expect stable to moderately higher prices this year, continuing the good run since 2013. Export markets for lamb are reasonably diversified, with the US and China accounting for a substantial volume. However, the Middle East remains a very important market, particularly for mutton and live sheep.

In contrast, wholesale pork prices (measured as an average of buyer and seller prices for eastern seaboard 60.1-75kg animals) have provided little excitement over the past six months. While prices fell 1.9% in January, the second half of 2016 saw monthly price changes of less than 1%.

Retail poultry prices have remained reasonably stable since late 2012, with a small downward trend since mid-2015. These prices will see chicken continue to cement its place as Australia's most consumed meat. National retail prices rose 0.5% in the December quarter 2016.

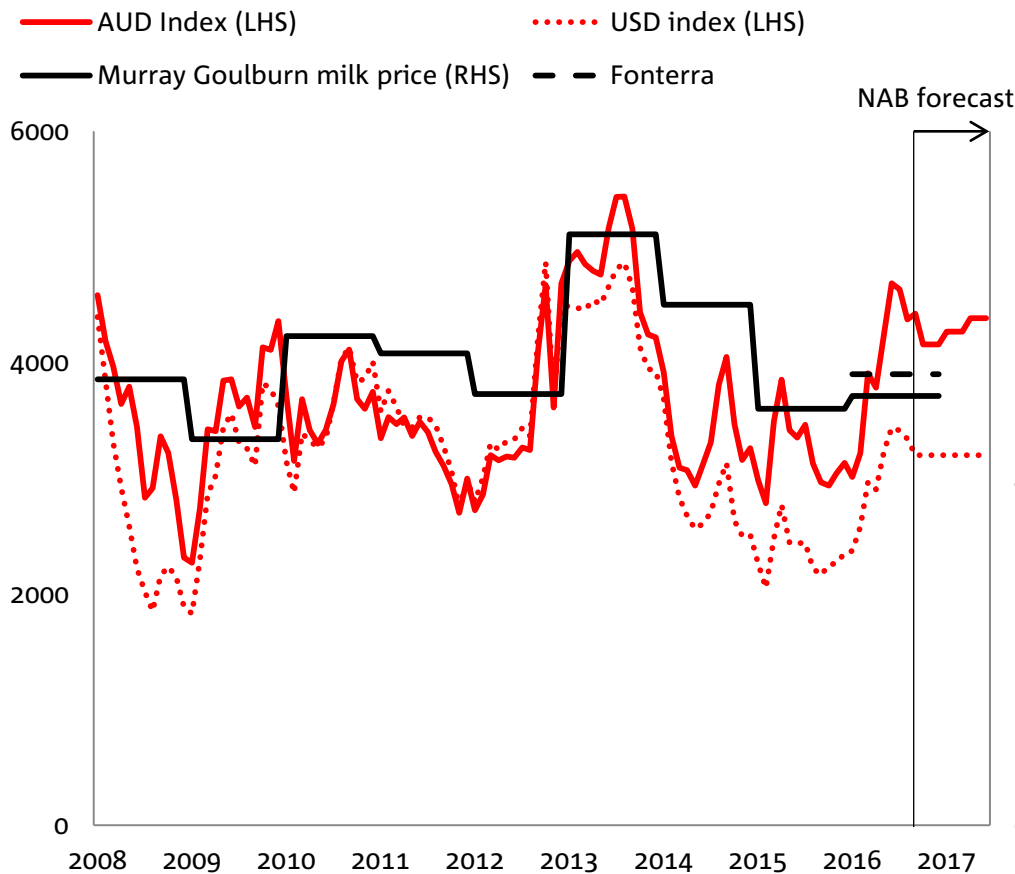
Source: Meat and Livestock Australia, Australian Pork, Australian Bureau of Statistics and NAB Group Economics



NAB WEIGHTED DAIRY EXPORT PRICE INDICATOR

\$/tonne (export price, LHS)

AUD/kg milk solids (farm gate price RHS)



Source: Australian Bureau of Statistics, Global Dairy Trade, Dairy Australia, Fonterra, Murray Goulburn, ABC 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

2016 was a very tough year for many Australian dairy producers, with farmers beginning the year amid extremely dry conditions in key dairy regions and steep cuts to farmgate prices. However, since the middle of 2016, we have seen steady improvements in both global prices and local seasonal conditions.

8 Global Dairy Trade auction results began to pick up in July last year. NAB's weighted dairy export price indicator now shows AUD denominated dairy prices close to their highest level since March 2014. Data showing falling milk deliveries in New Zealand and the European Union has been a key driver of the recovery. December production for New Zealand – the world's largest dairy exporter – was down 2.7% year on year. The United States remains an outlier as cheap feed corn continues to underpin lower input costs.

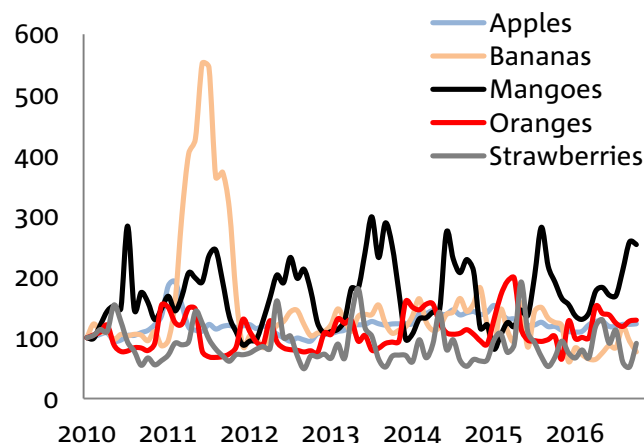
4 It is fair to say that the speed of this recovery exceeded our expectations, and we note that export prices are now around one-quarter above the long run average level from 2010 to 2016. NAB's indicator fell 1.1% in January and 5.6% in February following two months of 10%+ gains.

2 Australian milk production plunged last year, with December deliveries down 4.5% year on year. Seasonal production to date is off 8.5%. The ongoing impact of lower farmgate prices is clearly a major factor in lower Australian production. While the rally in international markets should see some further upside at farmgate, this is largely yet to materialise and won't be helped by AUD strength in the first half of the year. Absent further increases at farmgate, it is unlikely that production will recover this season. However, the industry finds itself in something of a catch-22, as falling milk deliveries are denting processor revenue, impeding their ability to offer the higher prices needed to boost raw milk production.



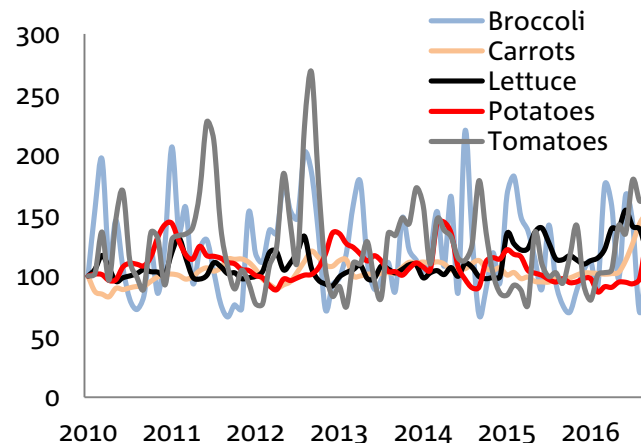
WHOLESALE FRUIT PRICES

AUD index, Sydney and Melbourne



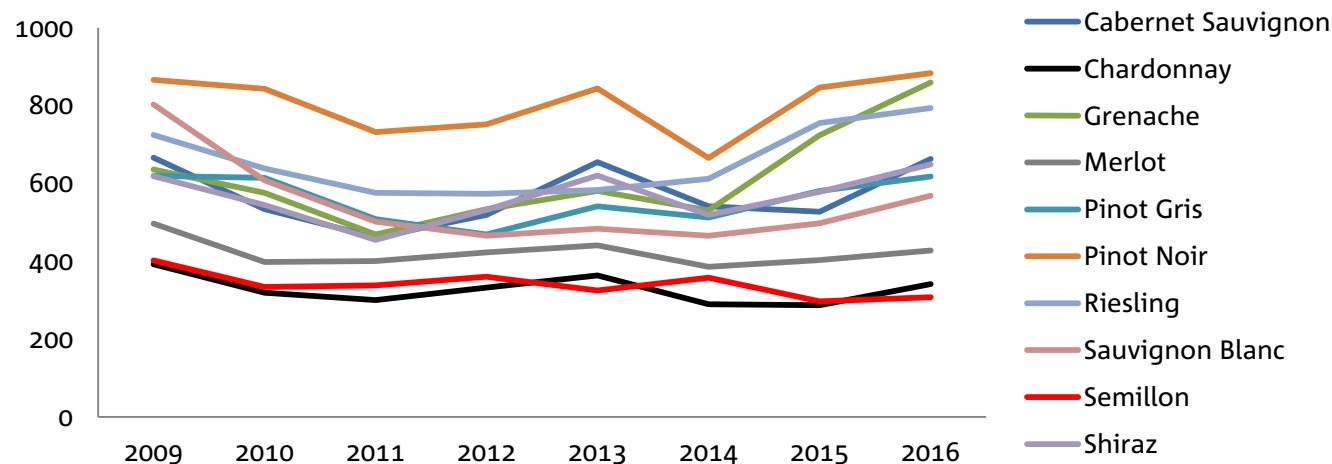
WHOLESALE VEGETABLE PRICES

AUD index, Sydney and Melbourne



NAB WEIGHTED WINE GRAPE PRICES

AUD/tonne



Source: Ausmarket Consultants, Wine Australia and NAB Group Economics

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

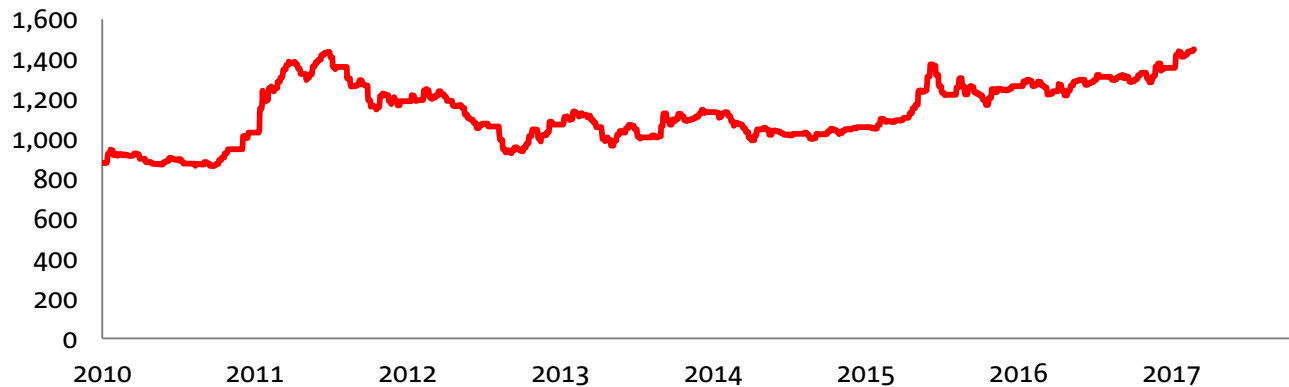
Wholesale fruit and vegetable prices were mixed in January. Fruit prices were up 2.9% to an index value of 104.2 (January 2010 = 100). Vegetables fell 1.1% to an index value of 134.5 (January 2010 = 100). While fruit and vegetable prices show strong seasonal volatility, the trend since the beginning of the index in 2010 shows very little growth in wholesale prices, a concerning trend for producers.

Wine Australia's 2016 Price Dispersion Report, 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

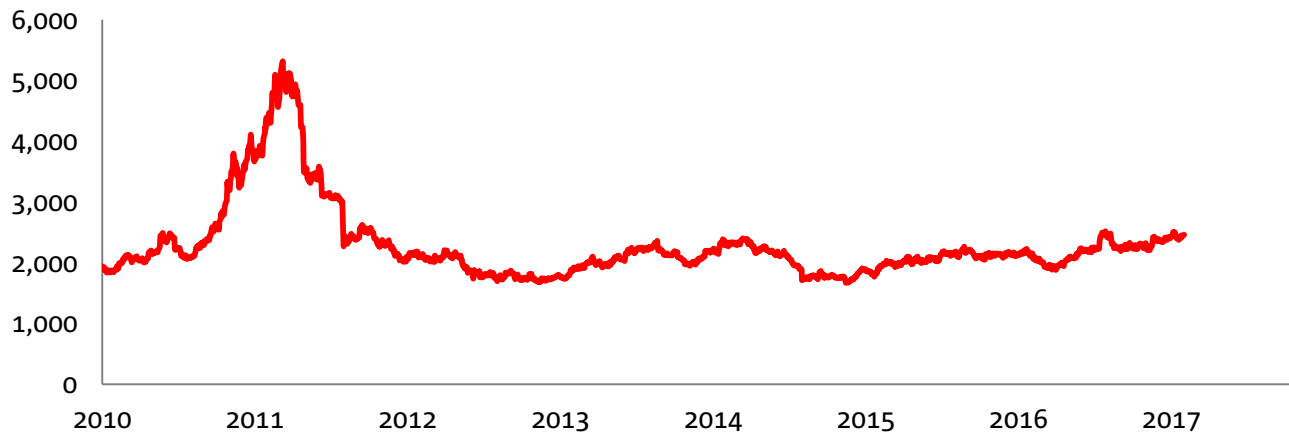
AUc/kg



The wool market is currently enjoying some of the best conditions in years following a return of confidence to the industry last year after several years of unfavourable prices. The price upturn enjoyed by wool producers has continued despite recent USD weakness (wool is quite sensitive to movements in the dollar), and our expectations of a lower AUD this year points to further upside. The Eastern Market Indicator rose 3.3% in January after rising 2.9% in December. We forecast that prices will increase 6.9% in 2016-17.

COTLOOK A INDEX

AUD/tonne



Cotton prices have trended moderately higher, up 2.0% in January and 0.7% in February. However, the major story for Australian cotton is the rapid expansion in cotton production this season, as plantings stretch as far south as the Victorian border on plentiful irrigation water availability. ABARES forecasts cotton lint production to increase 63.6% in 2016-17.

Source: Bloomberg and NAB Group Economics