more give, less take

agribusiness

Economic Report

Rural Commodities Wrap

Vyanne Lai, NAB Agribusiness Economist

July 2013

- **Global equity markets have come under downward pressure, but the latest data on activity is slightly more positive. Business sentiment about current conditions has picked up in advanced economies and growth in global industrial output is faster.**
- **The soft outlook for China continues to weigh on the Australian resources sector and places significant downside risks to our exchange rate forecasts.**
- **The domestic sector weakened further in June. The latest NAB survey reported the weakest reading for business conditions for more than four years.**

There was previously a disconnect between sluggish global growth and the big rise in equity values, rationalised by a flood of central bank liquidity boosting investor appetite for higher yielding assets and risk. Recently this has reversed with G7 equity markets falling at a time when there are some brighter signs for their growth outlook. This reflects the fear that there will be less central bank liquidity injected to support asset values as the economic situation improves. The withdrawal of central bank stimulus from global economic activity should be a long and gradual affair – the US Federal Reserve's likely timetable would not see an end to quantitative easing (QE) until next year with no rate rises until 2015 and the Japanese central bank has ramped up its stimulus.

Less buoyant equity markets would be in line with the generally weak trend evident in global commodity markets through the last year, the latter being far more in accordance with the sub-trend pace of global economic growth that has led to only sluggish growth in commodity demand. Nonetheless, the latest data on activity is slightly more positive. Business sentiment about current conditions has picked up in advanced economies and growth in global industrial output is faster.

Across the advanced economies, the US remains one of the best performing with moderate expansion continuing, but partial data suggest that growth could have slowed in the June quarter. There are also signs of improved conditions in the previously weak Japanese and UK economies. The performance of the Japanese economy is attracting particularly close attention as investors assess the impact of "Abenomics" – the combination of monetary and fiscal easing plus reform intended to end deflation and boost growth.

2013-14 Estimates, Rural Prices & Production

Commodity	Production	Price
Wheat	16.7%	-24.8%
Beef	3.0%	4.5%
Dairy	1.6%	5.7%
Lamb	-7.1%	8.6%
Wool	-3.3%	5.1%
Sugar	4.7%	-12.5%
Cotton	3.0%	6.5%
Oil	-	-4.0%

Source: NAB Group Economics
These forecasts represent year-on-year average changes in Australian production and corresponding AUD prices between 2012-13 and 2013-14 financial years

The three big emerging market economies of China, India and Brazil are still driving most of the 3% global growth forecast for 2013 but they too have experienced a slowdown. There is clear evidence of a major slowdown in Chinese exports but domestic market oriented measures of demand such as fixed investment or retail sales still show solid growth.

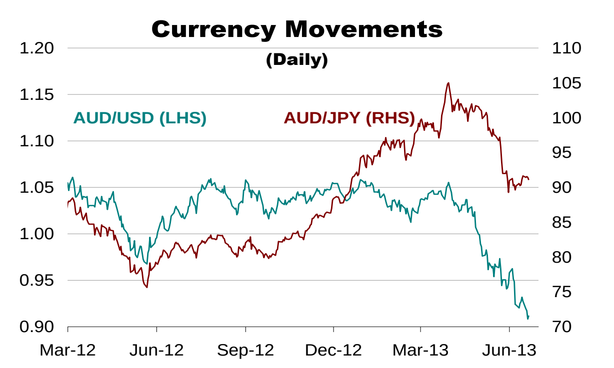
The Australian economy appeared to weaken further in June in the face of the combined effects of softness in Chinese growth and minerals commodity prices, volatility in financial markets and weaker domestic partials, including our own survey. The latest NAB survey reported the weakest reading for business conditions for more than four years. We have left GDP growth unchanged at 2.3% in 2013 and 2.8% in 2014 but with greater downside risk to the outlook. Unemployment rate is still expected to exceed 6% by the end of this year. Domestic weaknesses, softness in China and financial volatility have encouraged us to bring our next expected rate cut forward to the next meeting on 6 August (previously November). We expect the bias to easing to continue beyond August.

In June, the prices of livestock have jumped significantly, with the short seasonal supply and the much awaited rains keeping price and confidence buoyant. Wool prices firmed moderately on a tight supply and some renewed interests from major buyers. Wheat prices retreated after recording a sharp rise last month but remain elevated. Excess global surplus continues to plague sugar prices while cotton prices stayed largely unchanged. Meanwhile, dairy prices continued to ease from their record highs in April. This month, wine is our commodity in focus.

Currency Movements

The AUD's relentless move lower from May was halted over the past few weeks, as it ranged from 0.8999 to 0.9345 against the USD. The underlying picture, if anything, has worsened, but the prior universal negativity brought about a brief reprieve before the slide resumed last Friday. The information flow over the past few weeks has supported the softer AUD outlook. Concerns regarding China's economic growth have increased. The market is expecting the State- sanctioned 7.5% q/q, but the risks are fractionally to the downside. Meanwhile, as Chinese interest rates remain elevated and the currency modestly strengthens, the prospects for further economic rebalancing increase. While this is long term positive for China, it remains an AUD negative. The International Monetary Market (IMM) positioning data highlights the extent to which the AUD is out of favour. As at 2 July, 'speculative' traders held a record short AUD against the USD, at -70.5k contracts. This equated to a third of all reported IMM speculative USD longs; a huge proportion considering that in the spot market, the AUD accounts for only 7.6% of all currency trades. Given such extreme positioning, it is perhaps not surprising the AUD saw a recovery in the past week. Data released for 9 July showed a small reduction in shorts and continued reduction in extreme positioning is likely to allow for AUD to trade lower over time. While we continue to monitor the downside risks to the AUD, there have been no further revisions to NAB's exchange rate forecasts since the last wrap. NAB is forecasting the USD/AUD rate to fall to 0.88 by the end of 2013, 0.85 by mid-2014 and 0.83 by the end of 2014.

The relentless slide in AUD has moderated but significant downside risks remain

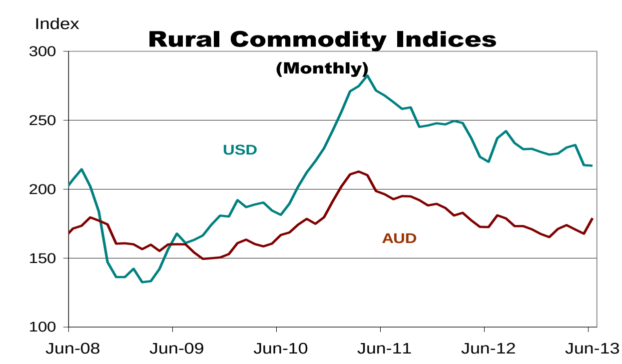


Source: Datastream

NAB Rural Commodity Index

In June, sharp rallies in domestic livestock products and a further notable depreciation in the AUD saw a 6.7% rise in the NAB Rural Commodity Index in AUD terms in the month, but when converted into USD terms, turns into a marginal decline of 0.2%. Leading the rise of the AUD index in the month were marked lifts in beef (+7%), wool (+4%) and lamb (+19%), aided by a combination of factors: the arrival of the much awaited rains boosting farmers' confidence and a seasonally tight supply during winter months. After a sizeable reversal of dairy prices last month, the easing has slowed to just 2% this month while sugar continued its relentless fall (-3%). Wheat undid some of the price gains from last month as the global market continues to seek direction between a tight old crop market and a bumper new crop in 2013-14. Cotton and barley prices were largely unchanged in the month. Looking ahead, livestock prices which are expected to rise further will provide some support to the rural commodity index but this will be rationalised by an exceptional year of grains and oilseeds harvests.

Rural commodity prices in AUD terms rebounded on stronger livestock prices but weaker in USD terms



Source: Bloomberg, NAB Economics

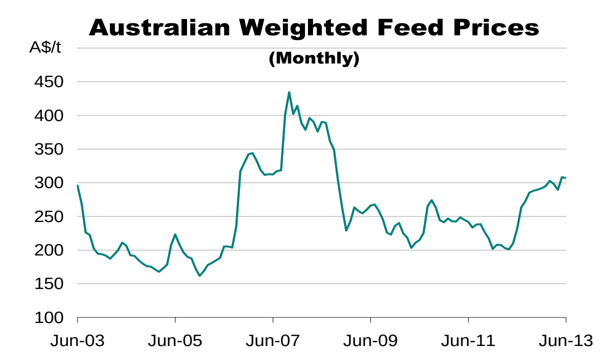
NAB Farm Input Indices

A weakening AUD is serving to more than offset the benefits of falling fertiliser input prices. Over the past month, global Diammonium Phosphate prices have fallen further to USD 472/tonne while urea prices have dipped to USD 315/tonne. Natural gas is also softer at USD 3.8/million Btu. Despite the falls in global prices, the overall NAB Fertiliser Index actually rose by 3% in the month from a 6.5% fall in the currency. The previously expected acceleration in fertiliser usage intensity associated with spring planting programs in the Northern Hemisphere did not eventuate from the delayed arrival of warmer conditions and now the most ideal application window has passed. Meanwhile, supply side remains loose with a high urea inventory and the imminent uptick in Chinese fertiliser exports in the current quarter from the lowering of export taxes. So far, the spikes in global oil indices due to the escalated tensions in the Middle East and a weaker AUD have not translated into higher domestic petrol prices, presumably due to the generous margins maintained by oil companies to start with, but we expect the effects of higher oil prices to flow through to the index in the coming months.

NAB Weighted Feed Grains Price

Feed grain prices have retreated marginally by 0.5% but remain elevated by recent historical comparisons. Similar to the situation in the global grains market, current prices are supported by a restricted inventory of old crops feed wheat, oats and sorghum while the new winter crops, which have been recently sowed and expected to yield a significantly higher output this year, will serve to dampen feed prices in the medium term.

Feed grain prices remain elevated from tight inventories



Source: ABARES, NAB Economics

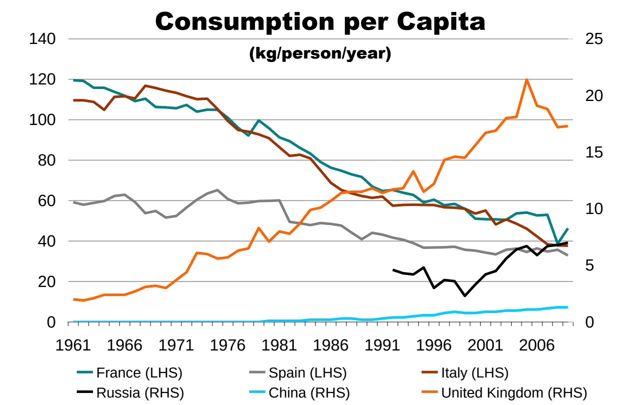
In Focus – Wine

- **Over the medium term, the continued rise in per capita consumption levels in New World countries is expected to be the key driver of growth in global wine consumption.**
- **In terms of global wine exports, Old World producers of France, Italy, and Spain continue to dominate. However, a number of New World producers such as the US, Argentina and South Africa are quickly gaining market share. The unit values of exports from the New World producers are improving as well.**
- **While the Australian wine industry continues to be challenged by stiff import competition, an oversupply and strong retail market dominance by the Woolworths and Westfarmers duopoly, the recently depreciated AUD has lifted industry confidence and is likely to provide some relief to export competitiveness.**
- **The Australian 2013 vintage is shaping up to be above average with yields and quality of wines (still at the early stage of their production) reported to be superior compared to the past few years.**

Global wine consumption losing traction as beers and spirits gain popularity…

Through the 2000s, numerous commodities saw sharp increases in demand and corresponding price rises, largely driven by rapidly growing demand and rising incomes in emerging countries. However, wine, which is typically thought of as a discretionary item that is associated with enhanced income and social status, defied the trend to see its consumption remaining broadly flat. Somewhat surprisingly, wine consumption levels have only been increasing roughly in line with population growth, with the per capita consumption by the biggest consumer counties declining markedly over several decades. Much of this loss can be attributed to the rising popularity of beer and spirits which have become much more differentiated and superior in quality, with the artisanal appeal of craft beers gaining strong momentum.

Wine consumption falling in key markets



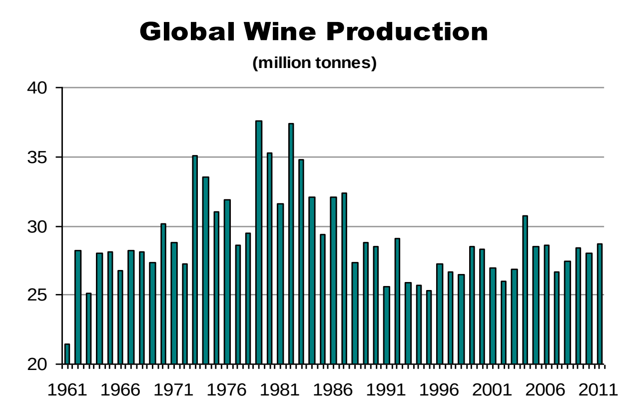
Source: UN FAO, NAB Economics

That said, significant variations exist in the wine consumption patterns across different regions in the world. While per capita consumption in the traditional Old World countries, such as Portugal, France, Italy and Spain, has declined, a number of new markets have opened up. In particular, New World countries such as the US, China, Russia and the United Kingdom have witnessed substantial increases in their per capita consumption, largely offsetting the declines plaguing the Old World countries. Over the medium term, we expect continued rises in per capita consumption levels in New World countries to be the key drivers of growth in global wine consumption. In 2011, the US surpassed France as the largest consumer of wine by gross volume and consumption is set to grow by 12% between 2013 and 2016 as consumer acceptance of wine grows. Similarly, China is set to become the second largest wine-consuming country by 2016 with wine sales forecasted to growth by 50% between 2013 and 2016. However, in terms of per capita consumption, major New World countries still lag considerably behind Old world countries. The US sits at 21st place and China doesn't even feature in the top 25 per capita consumption. In our view, the key question from such markets is whether further income growth spurs further increases in per capita consumption. Rising incomes offer no guarantee that wine consumption will rise in tandem as the alcohol market is highly competitive and increasingly, brand marketing is the key to success of a particular alcoholic product. For instance, Chinese per capita consumption is at the high end of the range in Asia, behind Japan but yet ahead of more developed South Korea. Overall global consumption is forecast to grow by 5% between 2012 and 2016.

Global production gradually recovering from glut…

After a sharp fall in global wine production in 2007, global wine production is gradually recovering despite falls in consumption across key consuming regions. Between 2006 and 2011, global wine production grew 7.7%, largely reflective of the efforts by New World countries, while the production in Old World countries faltered. The fall in Old World production was in part due to the European Union's intervention to address the glut caused by overproduction in the 2000s. In addition to providing free wine storage, the EU conducted several rounds of crisis distillation. New World countries such as Australia and the US have also seen declines in production amid actions to reduce vineyard acreage to address oversupply.

Global wine production rising moderately after a recent low in 2007

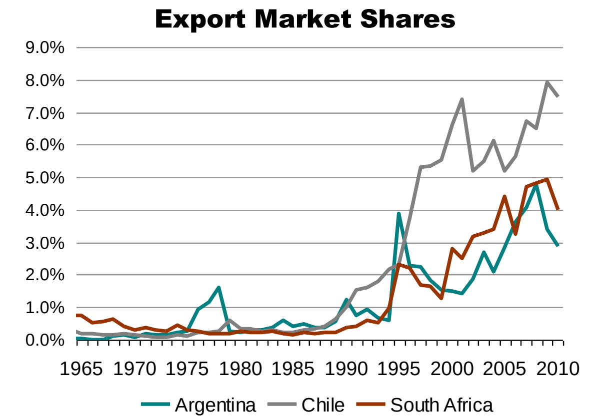


Source: UN FAO, NAB Economics

Despite their stars no longer shining as brightly as before, the Old World producers of France, Italy, and Spain continue to exert dominance in global wine exports. In more recent years, however, the US, Argentina and South Africa have quickly gained global market share while Chile has regained the ground lost in the early 2000s. Further more, these countries are also enjoying improving unit value as well. Between 2000 and 2010, global wine trade has increased by 66%, driven by a strong rise in imports by Germany (43%), the United Kingdom (up 41%), the United States (up 109%), France (up 34%) and Russia (up

327%). Of these, the UK is considered to be one of the most important export markets as it is characterised by high consumption and little to no domestic production.

South American and South African Exports



Source: UN FAO, NAB Economics

Australian wine industry outlook

Mounting competition from the other New World producers has challenged the Australian wine industry on both the domestic and export market fronts.

The export market is driven by bulk exports...

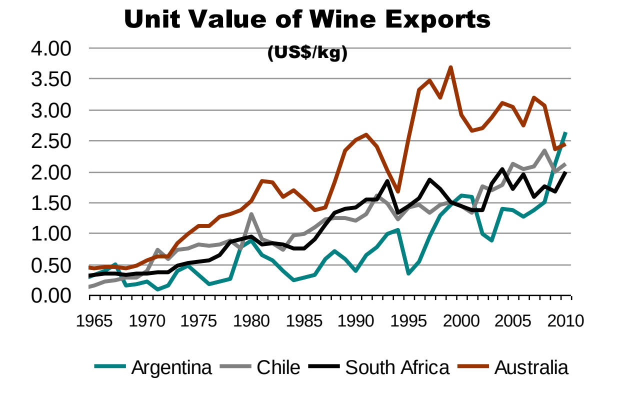
On the export front, despite being the fourth largest wine exporter by volume in the world, the competitiveness of Australian wine has weakened considerably in recent years. The rise of New World exports has impinged considerably on the market share of Australian exports, especially at the lower price points in the market, which resulted in the significant erosion of the unit values of Australian wines in the past five years. To exacerbate the matter, the strong Australian dollar and global economic downturn have further undermined the demand for Australian wines.

Export markets are vital to Australian producers, contributing to 63% of total wine disposals. Moreover, in 2011, the industry accounted for 5.2% of Australia's total agricultural exports, making it the country's 18th largest exporting industry. By value, top wine export destinations are the US, UK, Canada, China and New Zealand. Growth in export revenue is dependent on the further opening up of emerging New World export markets such as Ireland, Canada, Germany, China, India, South Korea, and Japan. However, there will be a saturation of focus and effort on these markets by most wine producing countries.

Driven by the strong Australian dollar, on-going alcohol tax increases, the new tax on carbon emissions affecting key inputs of wine production (e.g. bottles), and growing presence of buyers-own brands with UK in particular, the number of Australian exporters choosing to send wine in bulk to then bottle in-market rather than in Australia has increased significantly over the past few years. In 2012, the volume of bulk wine exports increased by 9% to 373 million litres. In 2013 to-date, almost 80% of Australian wine shipped to the UK is in bulk containers. The vast majority of bulk wine exports (92%) was exported between the A$0.50 to A$1.50 per litre, whereby the A$1.00 to A$1.50 per litre segment was the primary driver of overall growth in wine export volume (exports up 26% to 115 million litres).

In terms of country breakdown, the overall value of Australian wine exports to the UK has fallen despite recovery in volume of wine exports. In contrast, bulk wine exports to China saw a decline by 65% to 8 million litres in 2012.

Australian prices under pressure



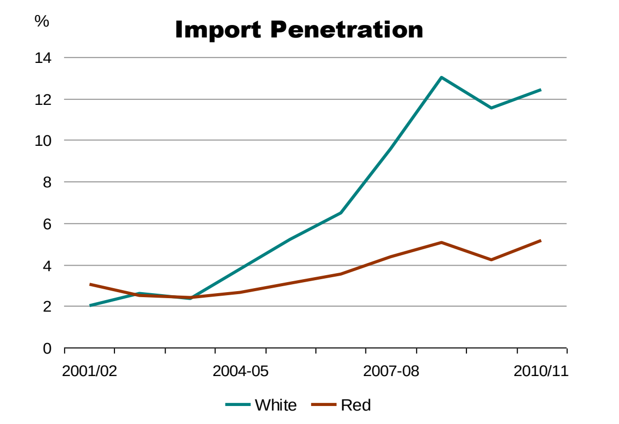
Source: UN FAO, NAB Economics

Australian export volumes picked up 3% y-o-y in 2012, but fell 2% in value according to Wine Australia. Australian wine prices continue to be under pressure as value per litre decreased 4% over the year. The decline was attributed to bulk wine sales offsetting falling bottled wine exports. Conditions within Australia's key trading partners proved to be quite challenging for value of exports through 2012. Though volume of exports to top four destinations were mostly positive (with exports to the UK up 3%, the US up 9%, Canada down 4% and China up 7%), value of exports fell for all destinations with the exception of China (UK down 2%, US down 5%, Canada down 8%, and China up 19%). With consumer confidence in most of these markets either weak or tentative, export value growth is likely to remain tepid in the near term.

Within the domestic market, Australian wine producers are also not offered much reprieve: falling wine sales, higher import penetration and a glut continue to hamper prices and returns. In 2012, total Australian wine sales fell 2% according the Australian Bureau of Statistics. Furthermore, Australian wines have fallen victim to further regulatory burden and changing consumer preferences: stricter regulations imposed on excessive alcohol consumption and increasingly health-conscious overseas drinkers now prefer lighter wines to full-bodied Australian Shiraz and Chardonnay. In response, Australian wine exporters have been increasing exports of lower alcoholic content wines for all wine types — from sparkling to Rosé, reds to whites. Even though total Australian exports declined in the past 5 years, none of the major export destinations recorded a decline for lighter Australian wines. In many markets, lighter wine types take up a significant portion of total Australian wine imports. These countries include New Zealand (42%), South Korea (64%), United Arab Emirates (27%), France (26%), the UK (17%), and Singapore (16%).

Domestic sales are also feeling the burden of the Wine Equalisation Tax (WET), which is tax of 29% of the wholesale price and is independent of the alcohol content of the wine and fruit based alcohol products. This favours the production of cheaper, higher alcoholic content wine, and production based on volume and not value. As a result, the tax has insidiously worsened the glut that is taking place at the moment. Many wineries are also complaining that the current WET system, which offers full rebate to wineries and anyone who converts grapes into wine by a contract winemaker for the first AUD$1million sales, is causing some serious competitive issues for smaller wine producers. In particular, retailers could ask growers with surplus fruit to have it made into wine by a contract processor, for which some growers were prepared not to be paid as long as they received the WET rebate once the fruit was processed, bottled and sold. The retailers were therefore obtaining wine at below the cost of production because they were paying only for the winemaking, not the grapes.

Imports continue to gain market share



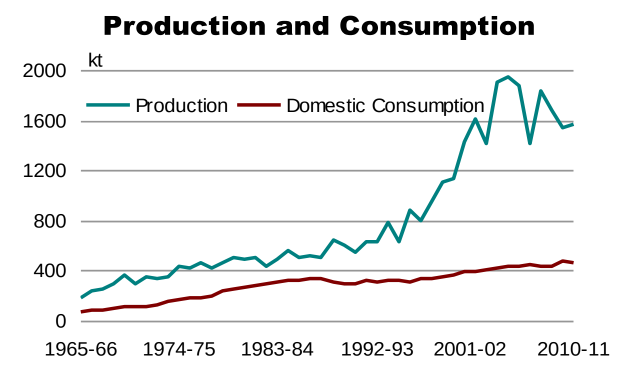
Source: ABS, NAB Economics

The high AUD also appears to be taking its toll on the domestic market, especially for Australian white wines which are subject to formidable competition from New Zealand. In 2012, sales of Australian white wine within the domestic market fell 2%. In contrast, sales of imported white wines were up 20.1%. Most notably, New Zealand Sauvignon Blancs have become increasingly popular within the Australian market in recent years. Last year, 8 of the top 10 selling white wines in Australia were NZ Marlborough Sauvignon Blanc. Australian red wines are also experiencing foreign pressures but to a lesser extent. In 2012, imports of red wine and rosé increased by a 19.4%, while Australian red wine sales were down 0.8%. That said, imported reds and Rosé still account for a relatively small share of the domestic market at 6.7%.

In addition, a more significant challenge for domestic wine producer is the market power of Wesfarmers and Woolworths who control over 60% of the Australian liquor retailing market. The supermarket duopoly has exploited its market power to reduce shelf space for branded products and pushed their own label wines. In fact, Woolworths reported that own-brand wine sales were the biggest growth area in its liquor retailing business. The growing market power of the supermarket giants is expected to continue undercutting branded products, depressing prices, and undermining producers' profitability.

Further adding to the woes facing Australia's wine sector is the ongoing oversupply of wine grapes, even though wine grape production has eased from the highs of 2004-05. Wine grape overproduction has resulted in the accumulation of wine inventories of approximately 1.7 billion litres currently. However, this is still a significant improvement from the 2.4 billion litres in 2006, which have been run down mostly in the form of bulk exports in the under $0.50 per litre bracket between 2009 and 2010.

Australian wine market still oversupplied



Source: ABARES

Looking ahead, recent trends in the wine trade suggest that Australian exports are likely to remain under pressure, especially from cheaper South American wines in the budget range, while quality wines are also not likely to get much impetus from a weak consumer sector in Europe. Domestically, wine sales in Australia are likely to be further challenged by an increase in market share of imports. Nonetheless, some hope has arisen from a notably depreciated AUD, which is expected to fall further, that it will offer some relief to Australian export competitiveness. Furthermore, the Australia 2013 vintage is reported to be shaping up to be an above average year. The drier conditions during the last summer and autumn have helped to reduce disease risk and improve grape quality, although some varieties did not survive the dryness which culminated in an overall lower annual wine grape production. A weaker production in the year, aided further by improved exports prospects from a lower AUD, has lifted expectations of a further amelioration in the wine glut and a boost to prices and profit margins.

Comments from the field

The 2013 vintage for the SA wine industry was of mixed results. There were regions that recorded substantial yield reductions and others that achieved average results. However, the overriding position was that wine quality was very good and some instances exceptional. The expected total Australian crush for the 2013 vintage is circa 1.8 million tonnes which for many within the industry is an unexpectedly high number. Despite the large Australian crush, demand for wine has increased substantially, especially for cool climate A & B grade wines. The previous position of an oversupply of bulk wine has been reduced substantially to a point where end users are entering medium-term supply agreements to shore up future volumes as there are concerns over future supply to feed brands. Prices generally have increased on a per litre basis and back to the grower and this may improve further with a weakening Australian dollar.
Stephen Stegmeyer, Senior Agribusiness Manager, Adelaide, SA

The 2012-13 vintage in the Riverina was the most successful for many years. Prices have increased slightly, especially for reds which had been most affected by the previous two years of wet weather at vintage. There were some early fears of sunburn and heat stress that damaged the earliest white varieties, cutting yields by up to 50%. However, the grapes seemed to recover fairly quickly after the start of vintage and were better in quality and yield than they had been for a few years. Average prices were around the $300 to $350 per tonne mark, and recent drop in Aussie dollar has lifted expectations that the wine grape glut might start to disappear faster than previously thought as exports become more competitive. A new

freight terminal close to Griffith is also expected to assist exports from the Riverina with a larger and faster capacity benefiting all local wineries as well as other industries.
Eamon Burke, Agribusiness Manager, Griffith, NSW

Superstition says that 13 is an unlucky number, however 2013 is looking to be a fortunate year for the Clare Valley. The yields and quality of the Riesling produced this year is considered to be a standout, proving why this variety is the flagship for the Clare Valley region. Both minimum and maximum temperature for December, January and February were near average. However, the rainfall for September to February was only two thirds of the average. These seasonal conditions helped reduce the disease risk over the summer months. Not all grape varieties survived the summer months as well as the Riesling and Shiraz, other varieties only achieved average to less than average yields and quality. Increasing water efficiency will continue to be a focus for growers in this region as the increasing cost of water places pressure on margins.
Anna E Milne, Agribusiness Manager, Clare, SA

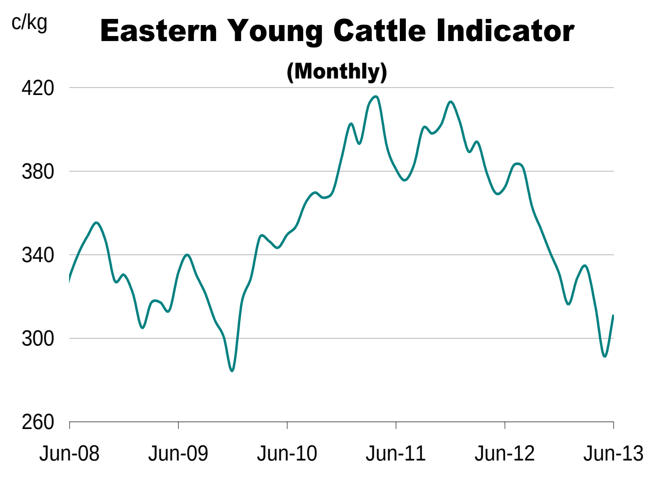
Tasmanian wine continues to show strong growth in the domestic market. Vintage on both a volume and quality basis was the best in a number of years due predominantly to a dry harvesting period. Poor yields from 2012 vintage will see a shortage of Tasmanian wine in the market which should allow higher margins to be maintained. Dollar coming back is opening up new markets not before realised for Tasmanian wine product.
Hugh Robertson, Agribusiness Manager, Launceston, TAS

The Hunter had a good quantity and quality wine for the 2013 vintage. If anything the whites were better than the reds. As is often the case, there were some challenges with the weather but the majority of vineyards managed to get the grapes off prior to. It is obviously very early in the 2014 vintage but they had good rain, so they seem to be happy with moisture and nutrient levels. In Orange, vineyards that have early maturing grapes had a good 2013 vintage, although most had some frost damage from early in the 2013 vintage, reducing yields. The later maturing grapes were affected by some east-coast lows that brought rain in March. We won't really know about the 2014 vintage until after winter but they had 100ml rain in June and 100ml in July which has set them up well. The increased bulk wine prices have increased sentiment for most growers going forward.
George Hardy, Agribusiness Manager, Sydney, NSW

Vintage for 2013 was a mixed bag for the Margaret River Wine Region, with yields down on the 2012 year but quality generally very high. White varieties saw yields return to average levels, particularly for Sauvignon Blanc and Semillon, however there are reports of yields being down 30 – 40% for Chardonnay due to high winds during flowering. Weather conditions in the lead up to harvest were ideal for white varieties with very high quality wines resulting at this early stage. Red varieties saw yields also at average levels, weather conditions for the early part of the red vintage were very favourable but some late heavy rain will potentially impact quality. Overall, most wineries are very happy with the quality of white wines but also remain upbeat with the reds despite the late rain. The lower yields across the region have once again raised the question about the supply/demand dynamics within the industry. Since the completion of vintage bulk, wine prices have doubled to be over $3.00 per litre, which has triggered a lot of bulk wine sales to assist cashflow. Prices for fruit increased slightly at vintage, however large wineries are already discussing contract extensions or new 3 – 5 year contracts from suppliers. Whilst economic conditions are making the sales environment tough, the increase in bulk wine prices for the first time in many years and discussions about contract extensions from large wineries is seeing an increased level of confidence that has not been seen for many years.
Chris Omodei, Agribusiness Manager, Bunbury, WA

Key Commodity Prices

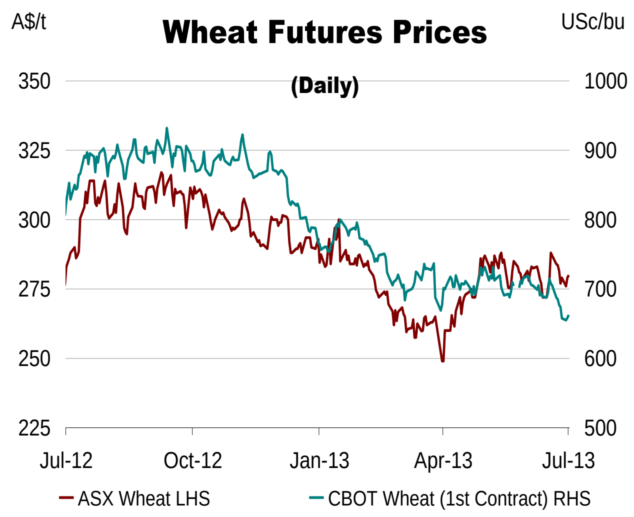
Cattle prices turning the corner in June after reaching three-year monthly low in May



Source: MLA

Cattle prices are enjoying a tractable recovery as average to above average rainfall recorded across most of the country during May and June boosted restockers' confidence. Reflecting a seasonally low stock during the winter months, the Eastern Young Cattle Indicator (EYCI) is currently above 330c/kg in daily terms, compared to the recent low of around 280c/kg mid-May, which amounts to an 18% rise in less than two months. After surging past 100,000 tonnes swt for the first time on record in May, Australian beef and veal exports remained resilient in June despite the recent price rally. While June's outcome was around 7% lower than May's result, it surpassed the value of the same period last year by 8% which is considered to be a strong outcome nonetheless. Driving the resilience had been the somewhat surprising sustained high exports to China, which surged notably since the second half of 2012 and have exceeded 10,000 tonnes swt for the fifth consecutive months. Beef and veal exports to China in June are more than twelve fold higher compared to June last year which is a phenomenal rise. Exports to Korea and the Middle East also held up in the month.

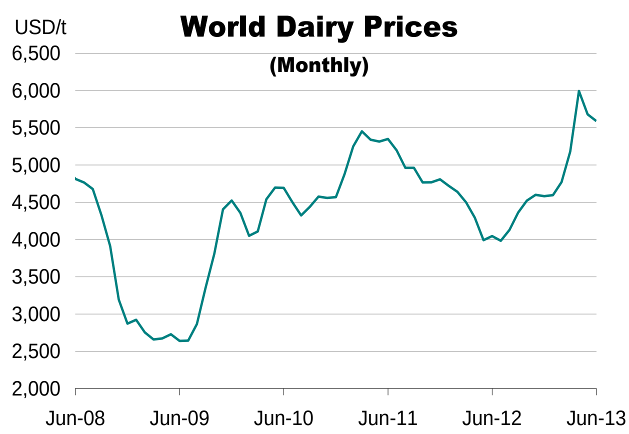
Domestic wheat prices continue to hold up on old crop tightness and poorer new crop prospects



Source: NAB, ABARES

Domestic wheat prices held up relatively better than the world benchmark price as indicated by Chicago Board of Trade (CBOT) in June. The sustained dry conditions in Western Australia have spurred speculation that conditions for the newly planted winter crop are worsening, which helped lend support to the prices of new Western Australia wheat crop values in the first week of July. Influencing the movements in the CBOT benchmark had been the most recent annual report on crop acreage by the US Department of Agriculture (USDA) which projected higher than expected US corn acreage of 97.4 million acres, the highest since 1936. This has in turn resulted in an increase in production estimates for new crop corn which weighed heavily on both corn and wheat futures markets. In contrast to weak new-crop markets, the current old crop tightness continues to provide some support to prices for immediate delivery. Potentially offering support in the near-term are also some recent market developments, including the Japanese government looking to resume wheat imports from the US in August, and downgrades to Russian new crop output forecasts.

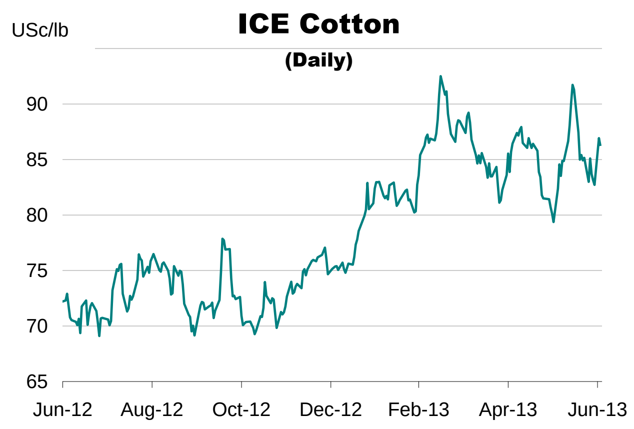
Global dairy prices moderated further in June from a record high in April but remain elevated



Source: NZX

Global dairy commodity prices continued to ease in June, however they remain elevated in historical terms. In the northern hemisphere, milk production levels are growing but remain varied across Europe. Weather conditions have stabilised in the region following periods of wet and hot weather with milk supply volumes approaching the levels the same time last year. Meanwhile, internal demand in the region is robust with milk processors mostly able to absorb the supply but strong dairy prices have impeded export growth somewhat. In Australia, milk production trends are flat at the start (July 1) of the new production season. A flurry of opening milk prices for the 2013-14 have been announced by major processors and they are mostly significantly above than those for the 2012-13 season. The offering of higher farmgate prices by processors reflects the heightened competition for milk in a tight supply environment and boosted confidence for stronger export demand this year, underpinned by a more favourable exchange rate. Given this, we expect the average export dairy prices to rise by 2% in 13-14.

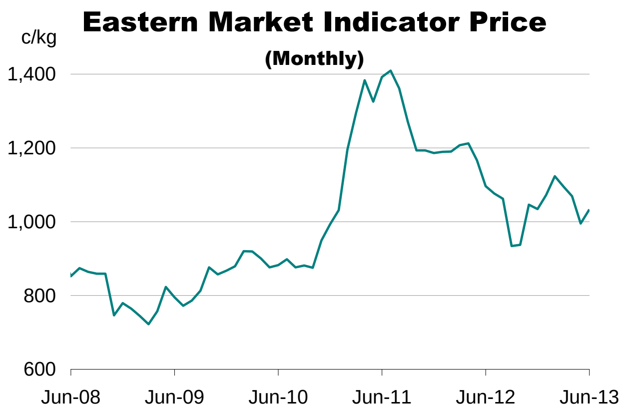
Cotton prices consolidated in June on heat-related new crop yield fears



Source: Bloomberg

Cotton prices maintained their momentum in June as the persistent drought conditions in Texas, the largest cotton-growing state in the US, are increasingly hurting new crop prospects. Cotton prices surged to their highest point in close to three months in the second week of June when the USDA cut its output forecast by 900,000 bales for the 2013-14 year to 13.5 million bales as a result of a projected increase in abandonment rate due to drought conditions. At the same time, the USDA has trimmed its projection for stockpiles and exports for the year, citing the strength of Chinese export demand having reduced carry-over stock into 2013-14 which can be made available for other consuming countries. This in turn has caused in a severe global imbalance where the ending stocks in China in 2013-14 are expected to be significantly higher than the rest of the world. Hence a more sluggish export demand anticipated for China is likely to be offset partly by stronger demand from other major textile producers such as Pakistan, India and Vietnam. In our first official reading of cotton prices for the year, we expect global cotton prices to average higher by 3% in 2013-14 to around 90 US cents per pound.

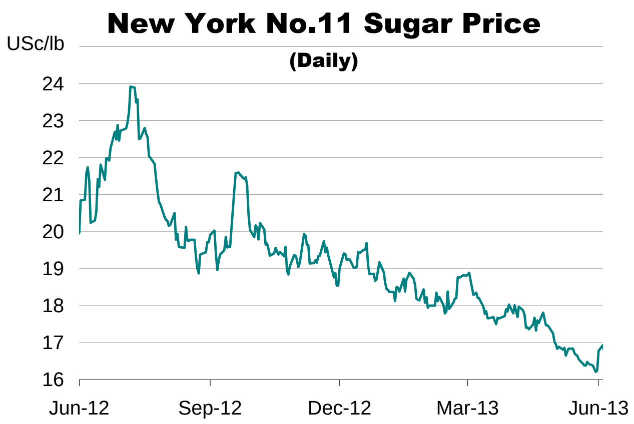
Wool firmed moderately on a seasonally tight supply



Source: Bloomberg

The Eastern Market Indicator (EMI) firmed in June in monthly average terms from a seasonally tight supply during winter months and some renewed interest from major buyers such as China and India. Nonetheless, the first auction of the 2013-14 selling year was reported to be a disappointment, with a higher than expected offering weighing on the prices of all fleece types, presumably in reaction to the higher prices the month before. Even in June when we saw a broad-based rise across fleece types, the compression of prices in the Merino fleece segment continues to narrow, albeit at levels which should still be profitable for producers of fine and medium Merino, according to Australian Wool Innovation. The volatile AUD/USD exchange rate continues to cause uncertainty in the forward market, with exporters finding it difficult to lock in businesses, particularly in the Merino fleece categories. Orders are streaming in a sporadic manner, mainly concentrated in low quantities on a just-in-time shipment basis to minimise currency risks. For 13-14, we expect wool prices to rise by 5% to be around 1090 cents/kg.

Sugar prices on a relentless slide on a sharply depreciated Brazilian real



Source: Bloomberg

The merciless slide in sugar prices showed little reprieve in June and the first two weeks of July. It spiked up momentarily in late June on the news that the production of the sweetener in Brazil's main producing region was delayed by rains and a growing diversion of sugar cane supply into ethanol production. While the expected record crop of sugar canes in Brazil and the resultant lift in sugar production had been the single most bearish factor in the market in the past 9 months, the sharp depreciation in the currency of the country, the real, against the US dollar in recent months has emerged to be another bearish force to be reckoned with. Sugar futures have tumbled to a three-year low in the first week of July on speculation that a weak real will spur sales from the country further which is already the world's largest sugar exporter. In the second quarter, the real weakened by 9.4% against the US dollar, while the global sugar surplus in 2012-13 crop year (October to September) is expected to hit a record high of 10 million tonnes. As such, sugar prices are likely to remain at very subdued levels around the 16 to 17 US cents per pound mark for the remainder of the crop year.

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