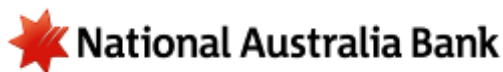


# Economic report



## Post-farmgate agribusiness survey

Vyanne Lai, NAB Agribusiness Economist

September quarter 2013

### Post-farmgate business conditions positive still

- **Post-farmgate agribusiness conditions maintained its momentum in the September quarter to remain in positive territory, with the profitability index recording its first positive reading in three years.**
- **The lack of demand has become a greater constraint to businesses' output in the September quarter relative to the June quarter.**
- **Post-farmgate agribusinesses expectations for business conditions for the next 12 months improved in the quarter, to be the highest in nearly two years.**

### Business conditions stayed resilient on favourable interest and exchange rates

Post-farmgate business conditions maintained its positive momentum into the September quarter after a turnaround in the June quarter. Aiding conditions in the quarter were a number of favourable economic and agricultural developments, such as an interest rate cut by the Reserve Bank of Australia (RBA) to 2.50% and the sustained improvements in weather conditions supporting a robust outlook for dairy and crop production, plus continued low input costs in the forms of low saleyard prices for livestock and constrained wage growth. As such, more survey respondents reported good conditions than poor in the quarter. Contributing to the positive reading of the business conditions index has been an increase in profitability component, which turned positive for the first time in three years.

Protein exports continued to grow at robust pace in the quarter, with beef exports continuing to chart new territory and reach another monthly record in July after May. In contrast to the continued downward trend in total business conditions into negative territory, post-farmgate business conditions have shown a gentle upward trajectory despite high seasonal volatility. This suggests that post-farmgate businesses might be insulated from some of the factors affecting businesses in general. Post-farmgate agribusiness confidence has improved markedly over the quarter but is still mildly negative overall, possibly reflecting the still-weak sales margins as costs rose in the quarter.

### Lack of demand still plaguing businesses

In the current economic environment where there is sufficient slack in production capacity and the labour market, as well as

a low-interest environment engineered by the RBA, supply side factors serve as relatively minor constraints on the profitability of post-farmgate businesses. The lack of demand impetus is a more problematic issue plaguing businesses at the moment, with a higher proportion of survey respondents (60% compared to 55% last quarter) citing sales and orders as a constraint on output while around half of the respondents cited demand as being the most constraining factor likely to impact on profitability over the next twelve months. The relatively lacklustre sales and order index compared to last month has been accompanied by corresponding falls in employment, capacity utilisation and forward orders.

### Medium-term expectations are still resilient

In the September quarter, post-farmgate agribusinesses have become moderately more optimistic in their expectations for business conditions for the next 12 months, to be the highest since December quarter 2011. Similarly, expectations on output gains and profitability were also quite solid, with 44% of respondents expecting an improvement in profitability in the next twelve months, marginally above the 40% for the broader economy. This is in line with the view by a higher proportion of respondents that the exchange rate will fall further within the next year, with slightly more than half believing that the exchange rate will range between 85 and 90 US cents. The overall optimistic outlook continued to foster a rosy outlook for capital expenditure plans, with the reading elevated at +25.

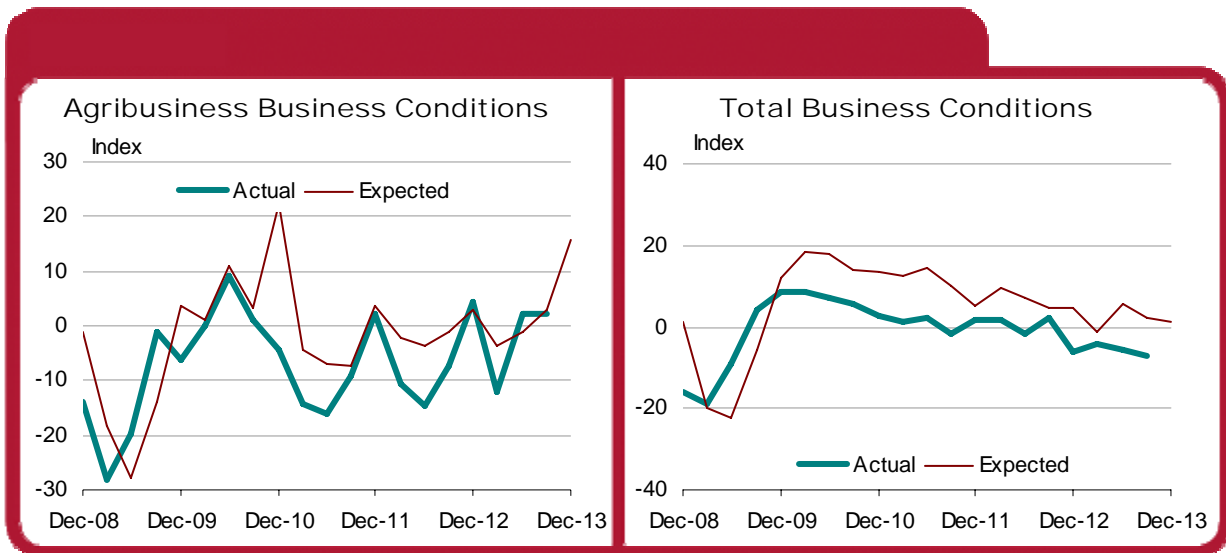
### Key Survey Indicators

Index	Q1 2013	Q2 2013	Q3 2013
Business Conditions	-12	2	2
Business Confidence	-9	-11	-4
Trading	-13	5	5
Profitability	-18	-3	4
Employment	-5	5	-2
Expected Conditions - 3 months	-1	3	16
Expected Conditions - 12 months	13	13	19
Forward Orders	-5	-3	-7
Capacity Utilisation (%)	79.4	78.9	77.7
Capex Plans (Next 12 months)	20	31	25

Source: NAB Group Economics

## Post-farmgate agribusiness conditions in line with expectations

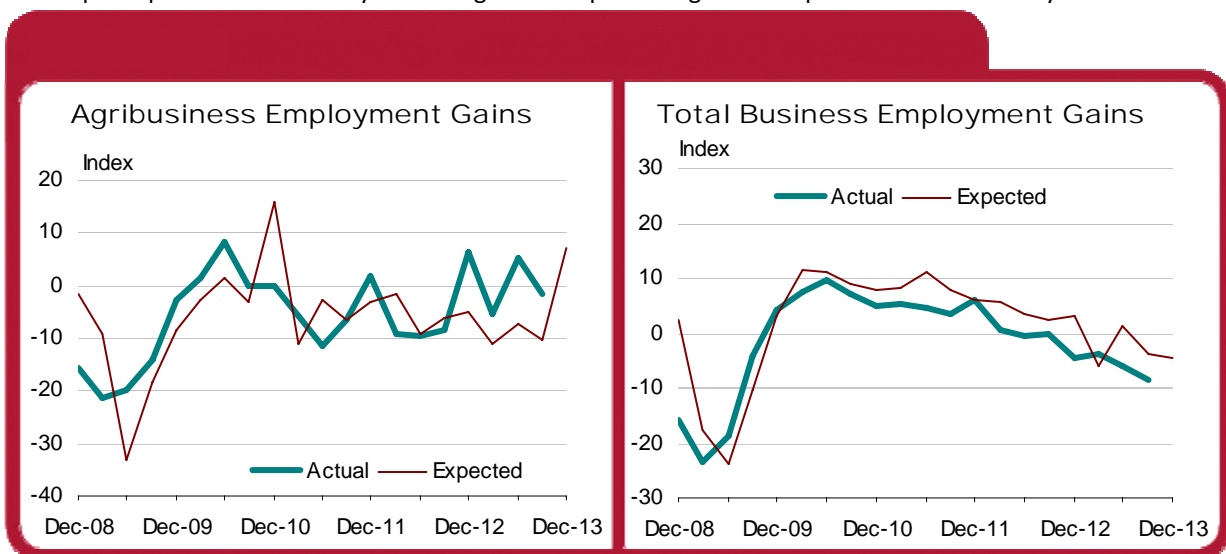
The post-farmgate agribusiness conditions index remained unchanged at +2 in the September quarter, a reading which was consistent with expectations formed three months ahead and bucked the downward trend in overall business conditions and one that is considered to be historically elevated compared to a five-year average of -7. While this series continues to exhibit volatile quarter-to-quarter movements, it has been on a gentle upward underlying trajectory since the recent low in June 2011. While a smaller share of respondents, i.e. 18% have cited good or very good conditions compared to 25% in the June quarter, there are now proportionately more respondents reporting satisfactory business conditions, from 51% last quarter to 67% this quarter. Trading and profitability conditions were the main contributors to this quarter's result, with the latter breaking into positive territory for the first time in three years. On the other hand, employment conditions have reversed some of its gain last quarter to be marginally negative. A firmer belief by respondents that the exchange rate will be lower in the near future, another rate cut in August and strong export prices and demand for proteins and dairy have invariably helped to shape more favourable perceptions of post-farmgate business conditions by survey respondents this quarter.



Source: NAB Group Economics

## Most post-farmgate businesses in holding employment pattern in the September quarter

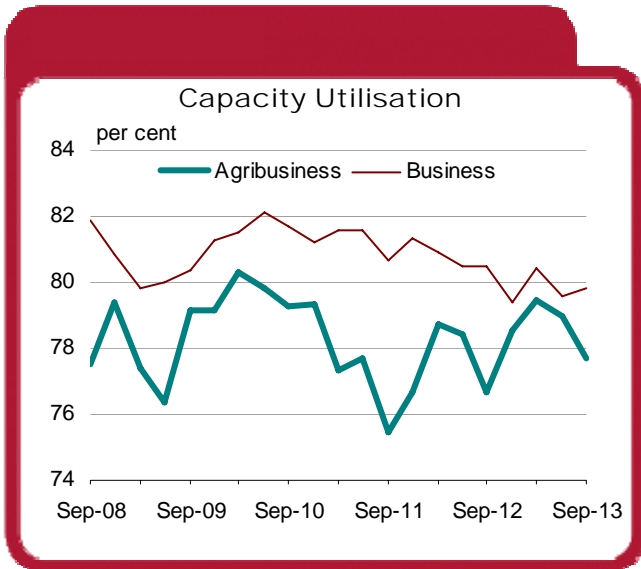
After a strong jump in the June quarter, post-farmgate agribusiness employment conditions have reversed some of its gains, but at a reading of -2, still maintained above the five-year average of -5. The survey results suggested that most post-farmgate businesses are in a holding pattern this quarter, with 81% of respondents citing no change in employment and fewer respondents reporting headcount cuts. This outcome is stronger than total business as a whole, which continued to suggest a sombre picture of the labour market, with significantly more respondents reporting job cuts than hires. There is now a more notable divergence in the three-month employment outlook between total industries and post-farmgate businesses, with the latter showing more inclination to increase employment in the coming quarter, but most of this is likely to be driven by a seasonal pick-up in business activity coinciding with the peak of agricultural production and holiday demand.



Source: NAB Group Economics

## Capacity utilisation tracked lower as inventory building slowed

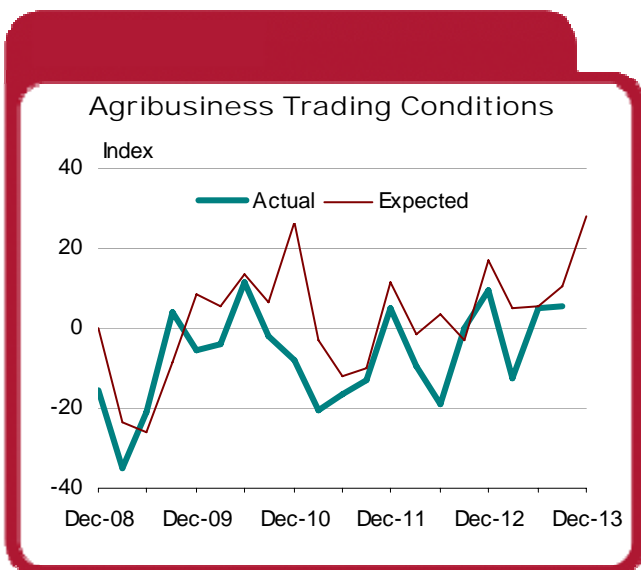
Capacity utilisation of post-farmgate businesses continued to track lower in the September quarter to be around 77.7%, slightly below the five-year average of 78.3%. This corresponds with lower forward orders and flat export sales in the quarter, which could have been adversely impacted by the volatility in AUD. While still lower than the total industry average, capacity utilisation levels of post-farmgate businesses have shown a more resilient trend than total industry average that is clearly declining, which perhaps indicates that agribusiness is better shielded from the cyclical factors affecting other parts of the economy at present, with strong demand for Australian exports of proteins, wool and dairy supporting operating activity in general. The increasing trend in capacity utilisation also favours capacity expansion in the medium-term, as indicated by this quarter's strong result for capex expectations for the next 12 months.



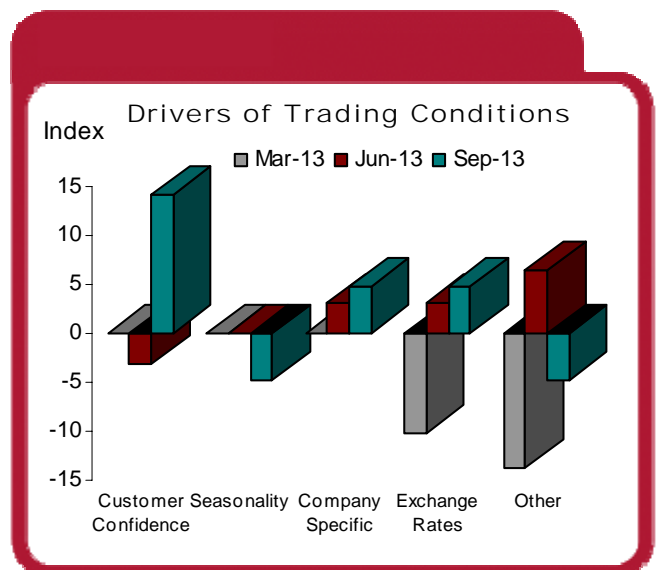
Source: NAB Group Economics

## Trading conditions robust on a rebound in customer confidence

Trading conditions within post-farmgate businesses were largely unchanged on average in the quarter, with the index at +5, although the composition of drivers was markedly different. Customer confidence featured prominently as the main contributor to trading conditions this quarter, possibly reflecting the exuberance associated with a change of government in Australia, as well as the more tangible recovery trajectory of major economies around the world. Furthermore, a lower exchange rate in the quarter has also aided trading conditions, while seasonality factors associated with lower demand and supply during winter months served as a detractor. Encouragingly, when asked about their expectations on trading conditions in the next 12 months, survey respondents were overwhelming optimistic, resulting in the highest reading since March quarter 2005.

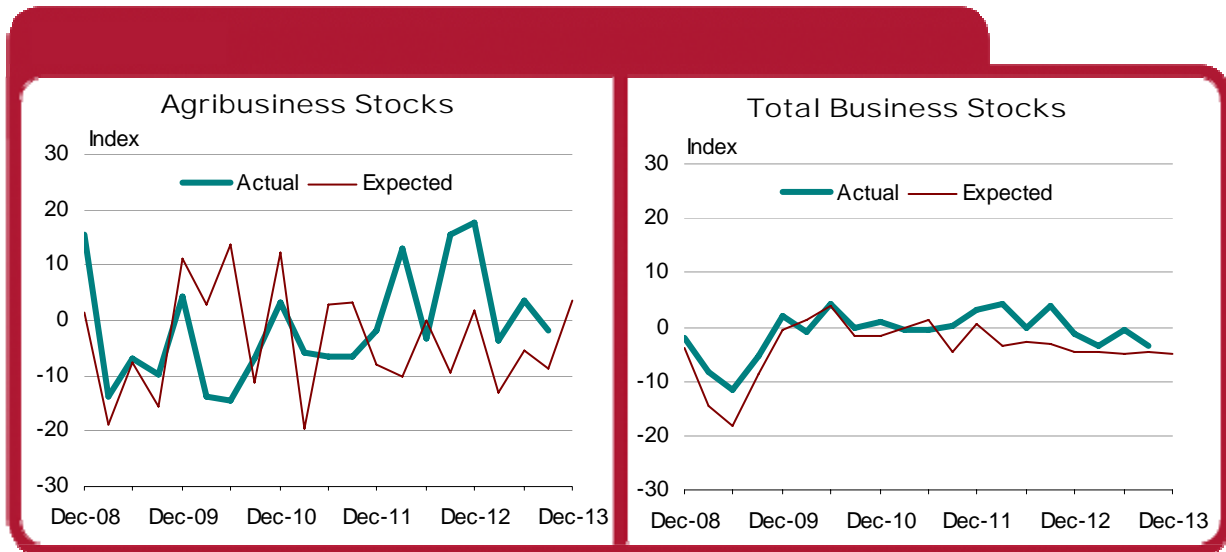


Source: NAB Group Economics



## Stocks expected to climb in the December quarter on a rise in production of major crops and dairy

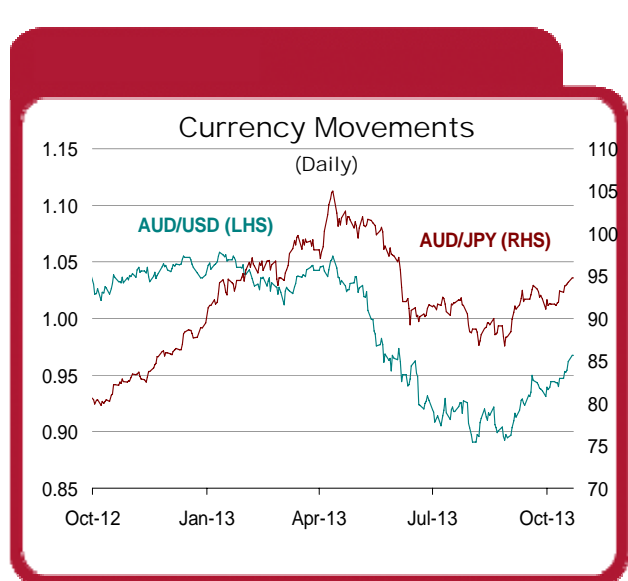
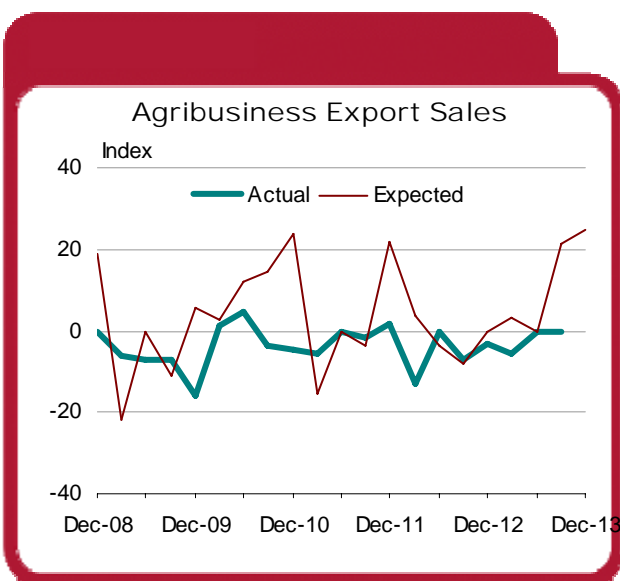
The stock levels index fell marginally in the September quarter to -2, largely reflecting a lower seasonal demand from customers during winter months, as illustrated by lower forward orders in the quarter. According to the survey results, 16% of respondents reported an increase in stock levels during the quarter relative to 18% reporting a reduction. Stocks are nonetheless expected to gain traction in the December quarter as harvests of major crops and peak production period for dairy ensue.



Source: NAB Group Economics

## Export sales stayed flat in the September quarter

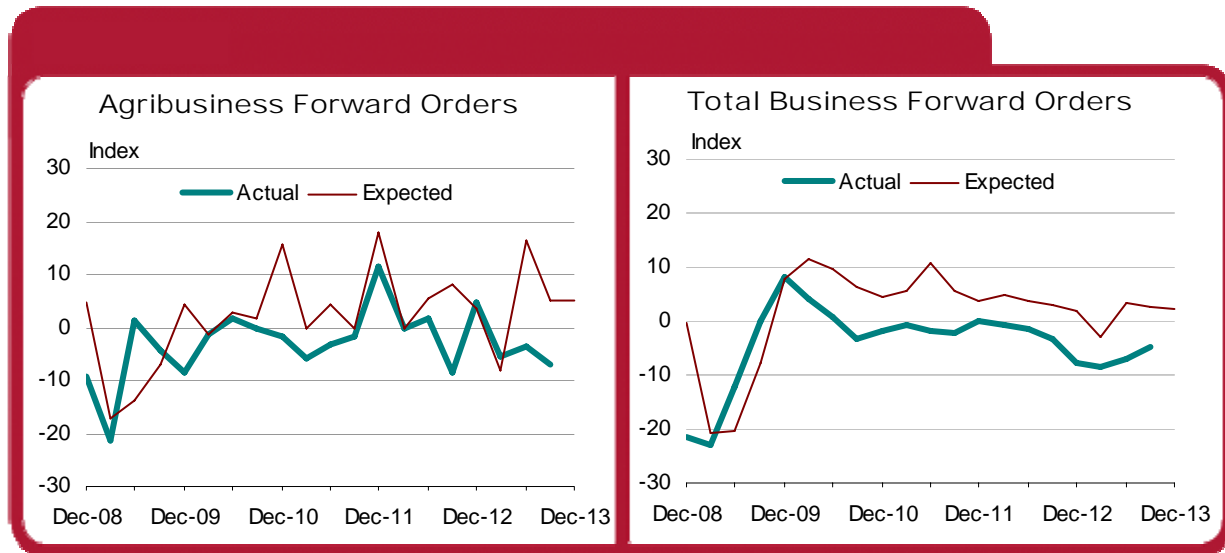
The export sales index stayed broadly unchanged at 0 in the September quarter to be significantly below market expectations made a quarter ahead. Tightness in seasonal exported supplies of dairy, grains and wool in the quarter was only partly offset by the sustained strength in lamb and beef exports, brought about by high slaughter rates as a response to a pick-up in prices in May and June. According to the survey results, an equal percentage of 17% of survey respondents reported either an increase or reduction in export sales. Echoing the sharp rises in confidence expressed in many of the other forward indicators, expectations of export sales for the upcoming quarter by survey respondents reached the highest level in close to 7 years at +25. While this is consistent with the outlook of stronger demand associated with the holiday season, an upshot in expectations for December quarters in the past have not delivered a very strong correlation with the actual outcomes. As such, we expect the export sales index to only rise marginally in December, especially in light of a recent appreciation in the AUD.



Source: NAB Group Economics, RBA

## Forward orders fell in the September quarter on AUD volatility and thin trading conditions

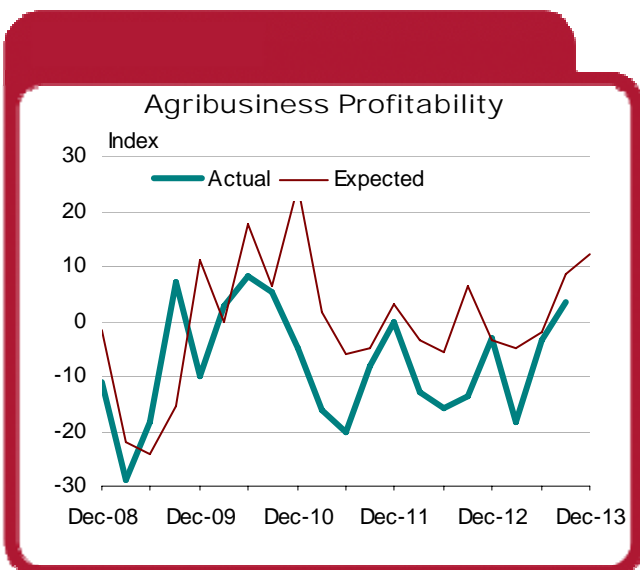
Forward orders from the customers of agribusinesses fell in the quarter, consistent with lower capacity utilisation rate and flat export sales. This is in contrast to the general trend of total business, which is experiencing an upturn after hitting a trough in December quarter last year. Based on some anecdotal evidence gathered from certain commodity sectors, such as the wool market, the heightened volatility of AUD, which fell rapidly over the course of May and June but then rose again in August and September, have caused a sense of uncertainty amongst major overseas buyers who prefer to adopt a just-in-time buying approach, instead of locking in orders in advance. Limited winter supplies during winter months for some of the commodities have also served as a constraint for the level of trading activity in some sectors. According to the survey results, a higher share of 24% of respondents reported lower forward orders compared to last quarter's 21%.



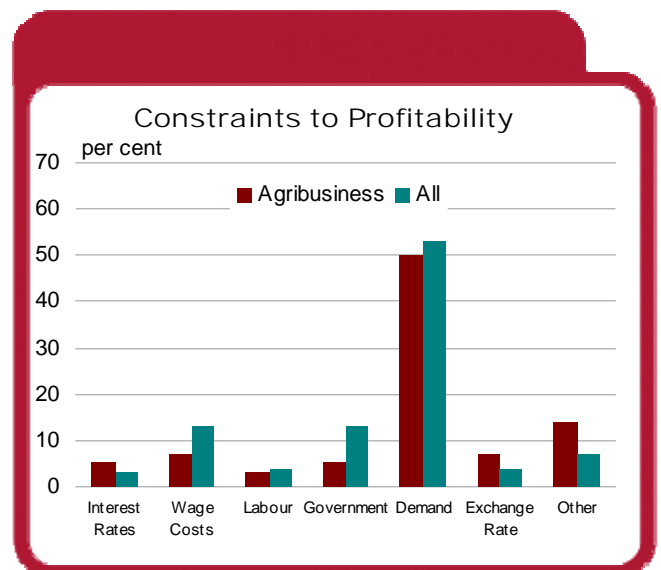
Source: NAB Group Economics

## Profitability improved on favourable supply-side conditions

The profitability index was the brightest spot in this month's survey, building on last quarter's momentum to breach into positive territory for the first time since September quarter 2010. Increasingly, supply side factors have become less of a constraint on profitability, with a high exchange rate keeping costs low for imported inputs and a loose labour market capping wage growth potentials. However, the demand side of the equation is still feeling the weight of still-weak global demand, although there are now more convincing signs that advanced economies could finally be contributing more to global growth. In the September quarter, significantly fewer respondents had cited poor or very poor profitability, although the proportion reporting good or very good profitability is also smaller. For the quarter ahead, survey respondents were significantly more optimistic, with the expectations index at +12 points.

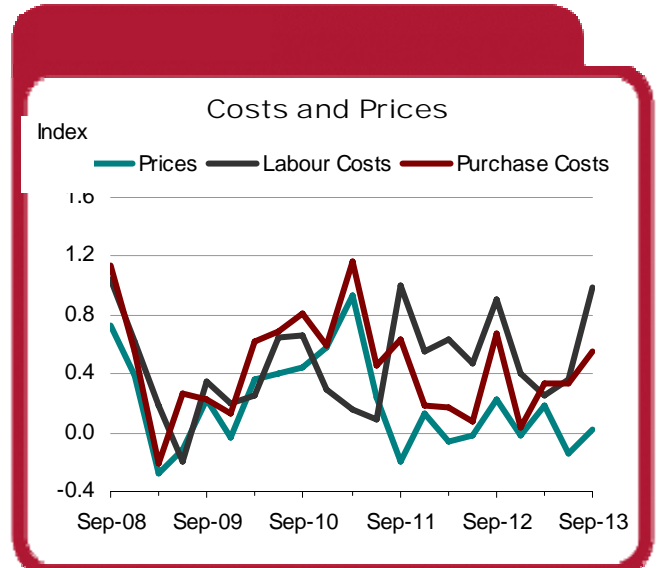
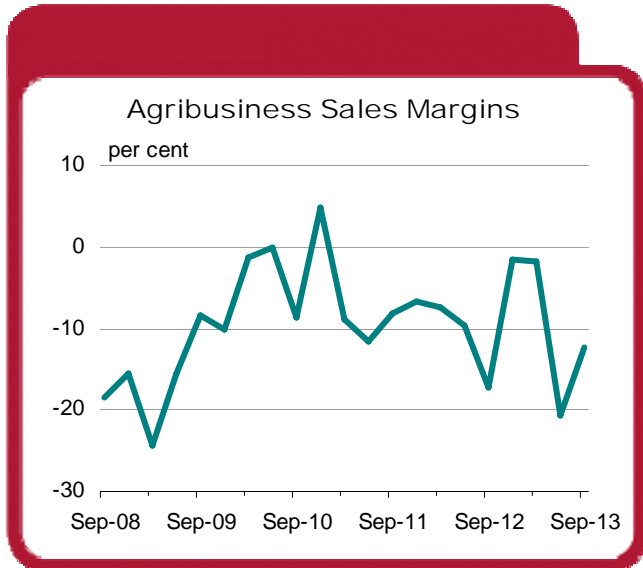


Source: NAB Group Economics



## Sales margins conditions recovered some ground in the September quarter

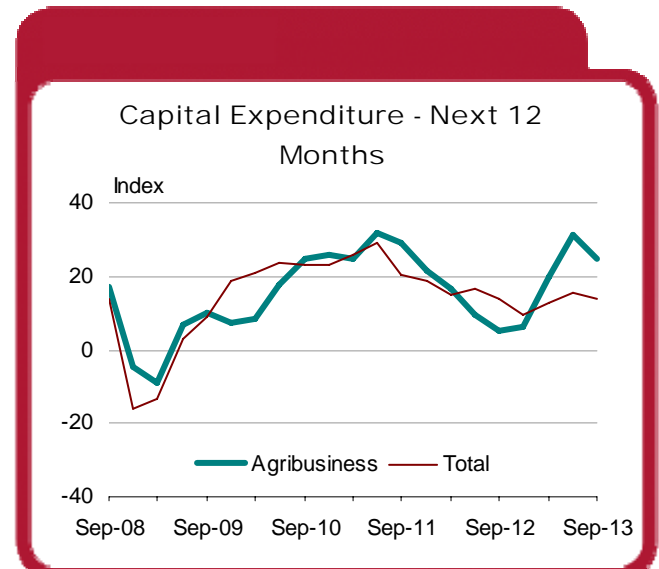
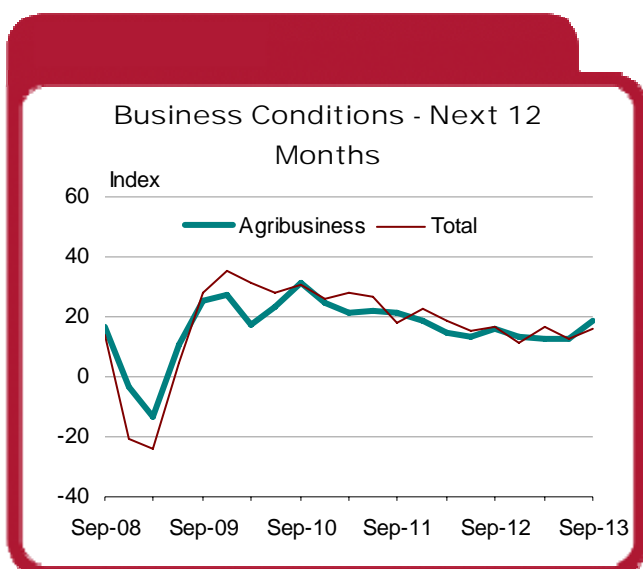
After experiencing a precipitous fall in the June quarter, sales margins conditions have clawed back some ground in the past quarter, although higher purchase and labour costs in the quarter have served to limit the magnitude of the rebound. Overall, the negative reading suggests that there were more respondents (23%) who have indicated they now have less or much less sales margins compared to those who cited the opposite (11%) on balance. The poor sales margins indicator masks the fact that turnover volumes could be high from more competitive pricing, as a consistently positive reading of the cash flow index suggests that the overall health of businesses' operations are still under no immediate threats.



Source: NAB Group Economics

## Long-term expectations picked up while capex expectations remain robust

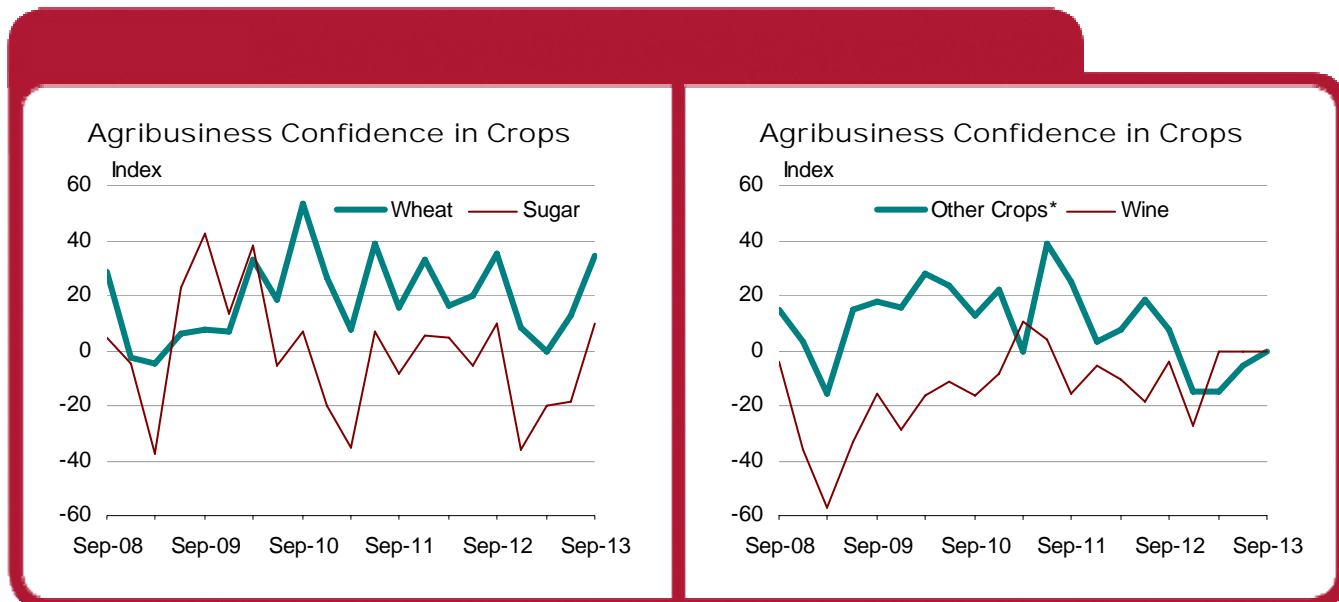
Medium-term expectations for business conditions within the post-farmgate agribusiness sector have turned the corner to reach +19 after staying unchanged at +13 for the past three quarters. This is broadly in line with the general rise in optimism in the activity outlook for post-farmgate businesses, with respondents' confidence receiving a boost possibly from the recent change of government, more upbeat economic data from major economies such as the US and China and the continuation of loose monetary settings in Australia and around the world. As such, the 12-month outlook for capital expenditure was also reasonably robust, with a softer outlook for interest rates (NAB is forecasting another rate cut by the RBA in February 2014) likely to have buoyed confidence of businesses that they are now able to borrow at lower costs for the purposes of facility upgrades.



Source: NAB Group Economics

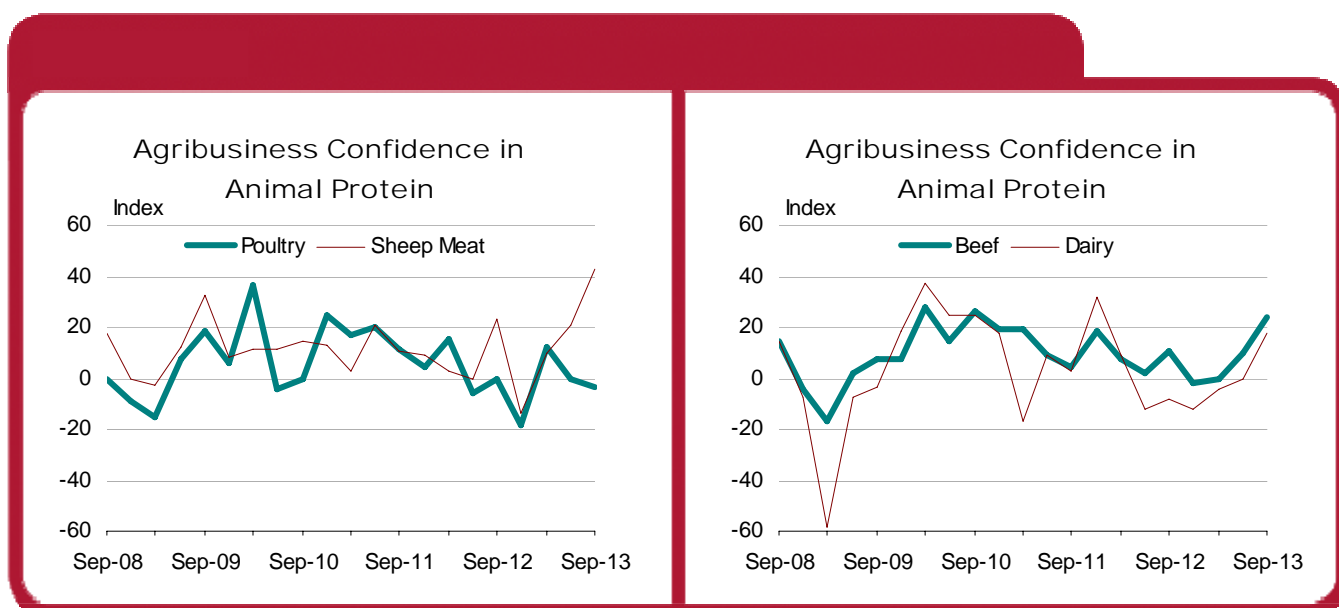
## Agribusiness confidence in commodities and other supplies

Post-farmgate agribusiness confidence in crops has improved on balance over the September quarter. Wheat continued to lead the pack in confidence after showing a strong increase last quarter, rising by a startling 22 points to +34. This is largely driven by rising domestic wheat prices relative to global values as domestic stocks continue to tighten ahead of harvest, while new crop prospects were largely positive in the quarter despite news of some potential crop damage on the east coast due to frost and persistent dryness. Confidence in sugar followed a similar trend, possibly reflecting the optimism by industry participants at the peak of cane crushing season, with some regions reporting significantly better sugar content yields compared to last year. The confidence index for wine has also picked up in the quarter as the glut facing the industry is slowly moderating.



\*Includes fruit, vegetables, fodder  
Source: NAB Group Economics

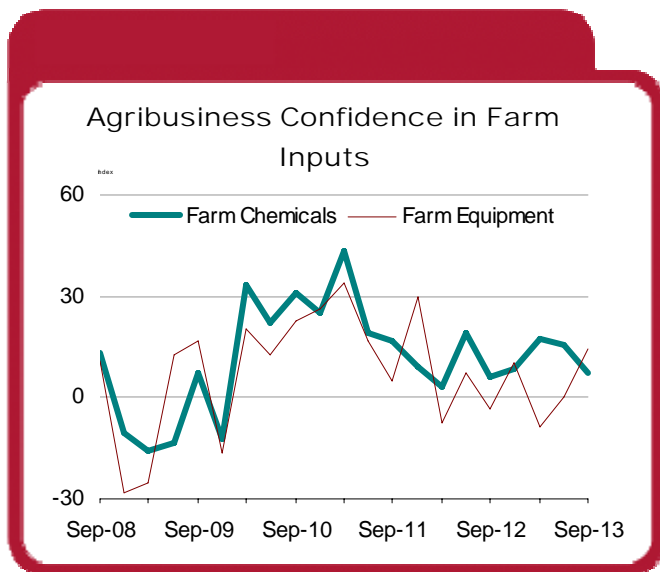
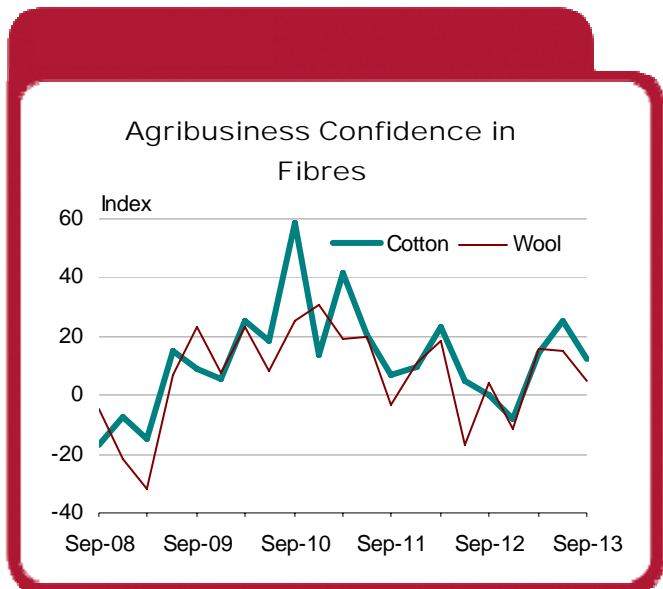
Post-farmgate agribusiness confidence levels in livestock, apart from poultry, have staged impressive increases in the quarter. Rising exports for sheepmeat and beef, combined with a lift in prices have spurred strong gains in the confidence indices of the two commodities, with the former reaching an all time high of +43. Dairy also recorded an improvement to be at +18, the highest since December quarter 2011, as processors benefited from a combination of strong commodity prices from a tight supply and a lower AUD that boosted competitiveness. Poultry was the only exception, with its confidence index falling for the second consecutive quarter, possibly reflecting the stiffer competition from a fall in beef and lamb retail prices in the past few quarters.



Source: NAB Group Economics

Confidence in fibres was broadly lower in the quarter, although the indices for cotton and wool were still decidedly positive. The index for cotton rose fell to +13 from +25 last quarter, likely attributable to some signs of slowing demand from China, where the government has undertaken an aggressive phase of inventory restocking for its strategic reserve since late last year but now appears to be reaching a plateau. Similarly, confidence in wool has also fallen by 10 points to +5, with the three-week winter recess in auction activity and a slow start to the new 2013-14 season likely to have dampened the spirits of industry participants to some extent in the quarter.

Agribusiness confidence in farm input was mixed in the quarter, with the rise in confidence for farm equipment partly offset by a fall in confidence for chemicals. The sustained low prices for fertilisers due to excess global supply continue to support confidence levels above the neutral point (at +7 in the September quarter). Confidence in farm equipment showed improvements for the second consecutive quarter in September, presumably arising from the successive rate cuts in the June and September quarter which make it more attractive to fund the borrowings for equipment purchases.



Source: NAB Group Economics



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## About the Agribusiness Survey:

The agribusiness survey is a cohort of the NAB Quarterly Business Survey which surveys approximately 900 small/medium to large sized Australian companies. The agribusiness sample is approximately 100 small/medium to large sized companies, mainly in the food manufacturing industry but also wholesaling, services, and a small number of firms in other sectors. Gundabluery Research Pty Ltd mainly conducts the survey over a two-week period in the final month of each quarter. To ensure the highest possible accuracy, respondents to the survey are chosen at random from those firms with 40 or more employees.

## Definitions

Business confidence is a measure of respondent's expectations of business conditions in their industry for the upcoming quarter. Business conditions are a simple average of trading, profitability and employment indices, reported by respondents for their company. The trading, profitability and other indices are calculated by taking the difference between the percentage of respondents nominating good or very good, or a rise and those nominating poor or very poor, or a fall. For example, if 25 per cent of respondents state that trading levels are good or very good and 10 per cent state these levels to be poor or very poor, the corresponding index of trading performance would be 15. The Capacity Utilisation Rate measures the degree to which an industry is operating at or below full capacity level. The full capacity rate is defined as the maximum desirable level of output given existing capital equipment. The Capacity Utilisation Rate is calculated as the average of respondents' capacity utilisation for the quarter. The cost and price change indices are the average of respondent's estimates of past and expected cost and price movements.

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