

agribusiness

# Economic Report



December quarter 2013

## Post-farmgate Agribusiness Survey

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- **Post-farmgate agribusiness conditions rose significantly to their highest level in 9 years in the December quarter, with across-the-board improvements in all the three components of trading, profitability and employment.**
- **The profitability index gained further momentum to reach record levels in the December quarter, consistent with better sales margins and cash flows reported by survey respondents.**
- **Despite the overall favourable macroeconomic settings of softer exchange and interest rates, lacklustre sales and orders continued to be considered as a constraint on output by a majority of respondents.**

### Business conditions and confidence surged

Improvements in post-farmgate business conditions accelerated notably in the December quarter to reach the highest level in 9 years at +17. This represents the third consecutive quarter of positive readings which suggests a rising trend in the underlying fundamentals, despite the December quarter being typically associated with favourable seasonal factors as well.

Apart from a seasonal pickup in domestic and external demand for fresh and processed foods ahead of the holiday season, a number of economic developments were generally supportive of business conditions in the quarter: the AUD fell substantially in November and December, with the RBA Governor Glenn Stevens being able to “jawbone” the currency lower with reasonable success. Over November and December, the AUD fell by 3%.

The standout feature of the December quarterly survey results is that all three components that make up the conditions index (trading, employment and profitability) recorded positive readings in the quarter, the first time in more than 3 years.

Protein exports continued to grow at a robust pace in the quarter, with beef and lamb exports capping off the

calendar year on a strong note. Commodity dairy prices also set a new record in the quarter, despite strong output growth in New Zealand, largely attributable to a voracious import appetite for processed dairy products by Chinese consumers.

Meanwhile, domestic grain prices also benefited from the AUD depreciation and supply shortage in drought-affected northern Australia. The stark pick-up in post-farmgate business conditions have finally translated into stronger confidence levels among post-farmgate businesses, with the index finally breaching into positive territory for the first time since the December quarter 2005.

### Lack of demand still cited as a constraint to output

Despite the overall favourable macroeconomic setting of softer exchange and interest rates, lacklustre sales and orders continued to be considered a constraint on output by a majority of respondents (52%), although a higher percentage of those surveyed now no longer consider sales and orders a constraint (42% in the December quarter compared to 33% in September).

The lack of demand is also weighing on respondents' expectations on profitability in the next 12 months, with 58% citing it as the most constraining factor. Since the September quarter, there are now fewer concerns about the availability of suitable labour, government policy and regulation as constraining factors.

### Medium-term expectations firming

Over the last few quarters, post-farmgate agribusinesses have become increasingly optimistic in their expectations for business conditions for the next 12 months, to reach the highest level in three years.

Similarly, expectations on output gains and profitability were also quite solid, with 44% of respondents expecting an improvement in profitability in the next 12 months, marginally above the 40% for the broader economy. The overall optimistic outlook continued to foster a rosy outlook for capital expenditure plans, with the reading elevated at +25.

## Key Survey Indicators

	Q2	Q3	Q4
Index	2013	2013	2013
Business Conditions	2	2	17
Business Confidence	-11	-4	6
Trading	5	5	24
Profitability	-3	4	16
Employment	5	-2	10
Expected Conditions - 3 months	3	16	10
Expected Conditions - 12 months	13	19	25
Forward Orders	-3	-7	4
Capacity Utilisation (%)	78.9	77.7	78.4
Capex Plans (Next 12 months)	31	25	22

Source: NAB Group Economics

### Post-farmgate agribusiness conditions surged in December quarter

The post-farmgate agribusiness conditions index staged a remarkable improvement in the December quarter, to be at the highest level in 9 years. The recent lift suggests the positive spill-over effects of sustained low interest rates, a weaker AUD and looser labour market have started to feed into more favourable trading, profitability and employment conditions.

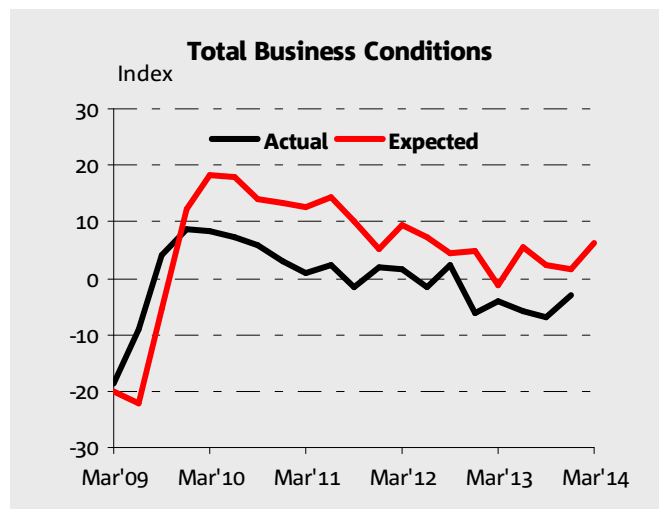
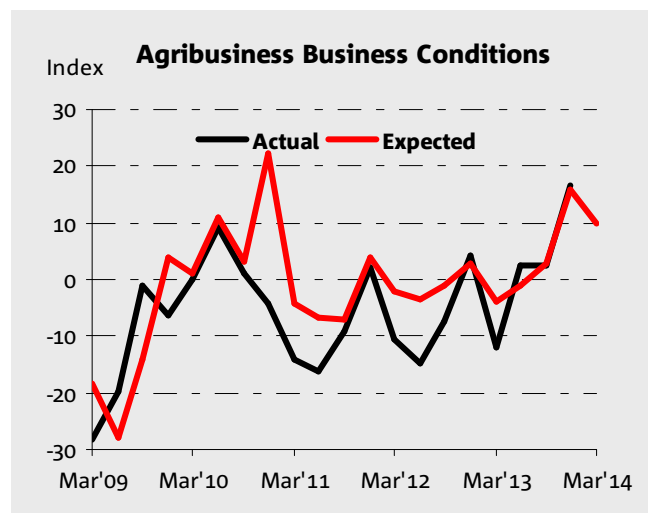
Nearly one-third of respondents cited good or very good conditions, compared to just 18% in the September quarter. Trading and profitability conditions were the main contributors to this quarter's result, with the former recording its highest reading in 9 years at +24.

Meanwhile, employment conditions also improved sharply to be at a historically elevated level. Apart from domestic and seasonal factors, a generally improving global demand for Australia's exports as developed economies start to show more sustained recovery, strong commodity prices and an improvement in financial market sentiments and outcomes have also helped to foster a more benign trading environment.

Source: NAB Group Economics

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*NAB Post-farmgate agribusiness survey – December quarter 2013*

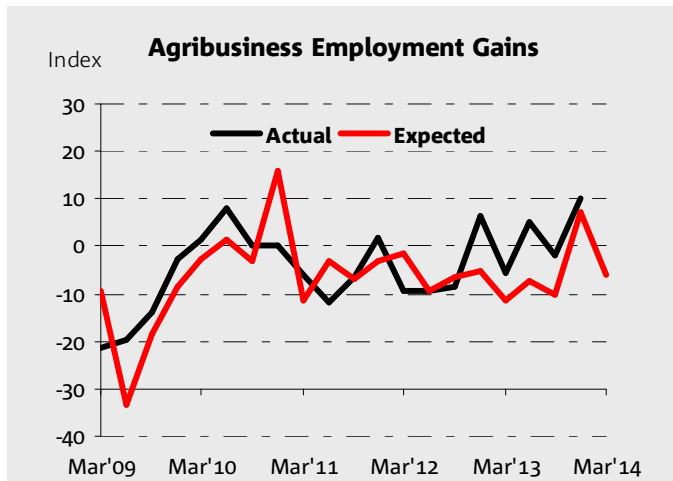


Source: NAB Group Economics

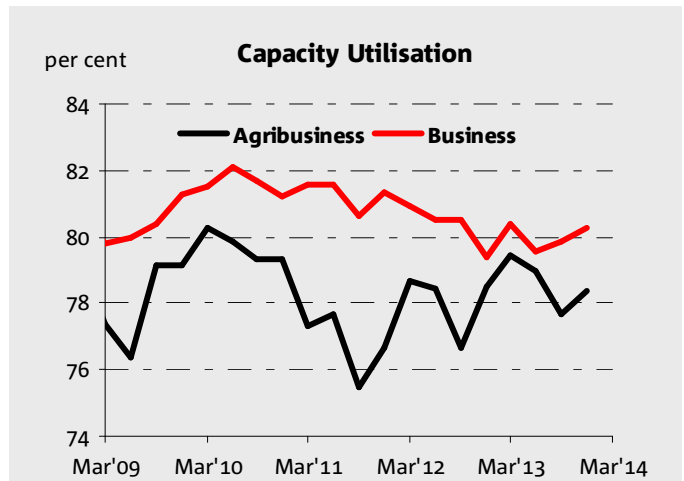
### Post-farmgate businesses employment gains on the rise

Post-farmgate agribusiness employment conditions improved notably in the December quarter to be significantly above the 5 year average of -5. The survey result possibly reflects a pick-up in seasonal requirement for labour to meet the sharp uptick in trading activity brought about by the festive season. Having said that, a softening labour market also works in employers' favour by imposing fewer constraints on obtaining suitable labour and helping to rein in wage costs. This outcome is broadly consistent with the uptick in total industry employment gains, but post-farmgate businesses continued to fare better relative to total business.

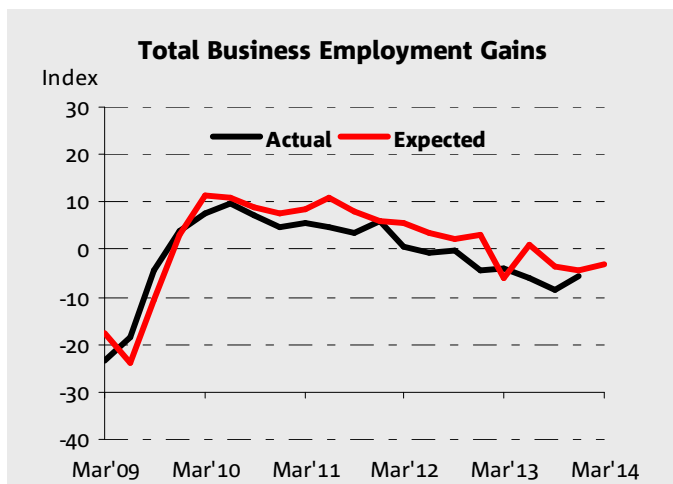
The sharp fall in three-month forward hiring expectations of post-farmgate agribusinesses suggests that businesses will be more inclined to reduce headcount or keep it unchanged in Q1, as seasonal demand for workers eases. This is in contrast to employment conditions in total businesses, which appear to be stabilising in recent months.



Source: NAB Group Economics



Source: NAB Group Economics



Source: NAB Group Economics

### Trading conditions surged on sustained improvements in customer confidence

Trading conditions within post-farmgate businesses rose sharply in the quarter to reach +24, the highest reading since the start of the survey. Similar to the September quarter, customer confidence was the leading contributor to trading conditions in the December quarter, albeit significantly more so.

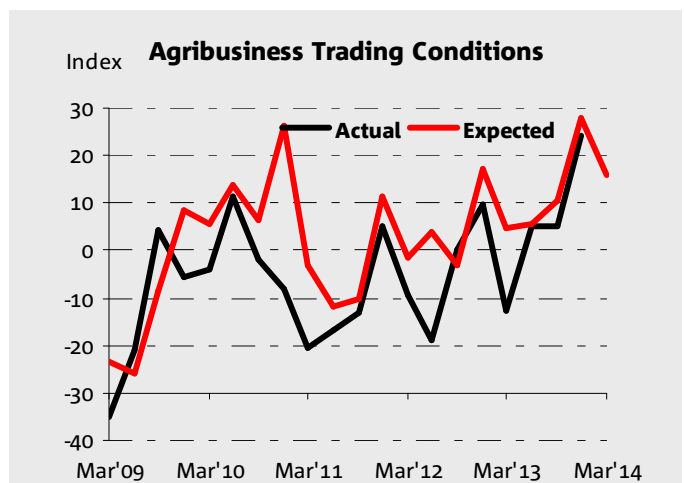
Sharp depreciation in the AUD, stronger asset prices and a sustained low-interest global environment, accompanied by generally positive economic news on Australian major trading partners are likely to have buoyed confidence of domestic and global customers alike. Meanwhile, “seasonality” and “other” were mild detractors for trading conditions in the quarter.

### Capacity utilisation tracked higher from robust exports and forward sales

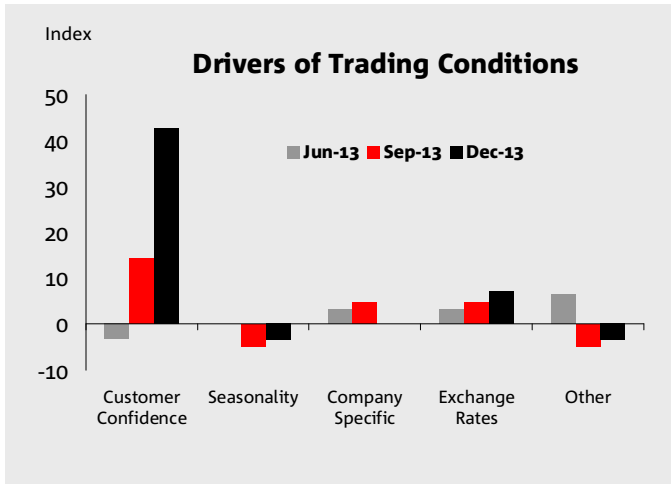
Consistent with average seasonal patterns in the past, capacity utilisation of post-farmgate businesses tracked higher in the December quarter to 78.4%, broadly in line with the 5 year December quarter average. Nonetheless, the seasonal average for capacity utilisation has been low: the 5 year December quarter average for years 2004 to 2008 was closer to 81%. The higher reading in the December quarter corresponded with notably stronger forward orders and flat export sales in the quarter. Strong demand for Australian exports of proteins, wool and dairy continued to support operating activity in the quarter.

The more resilient trend in the capacity utilisation of post-farmgate businesses relative to the total industry average, which until recently has experienced a long-term declining trend, suggests that it is benefiting from rising demand for Australian produced agricultural products, especially from overseas. This has also provided some certainty to businesses when considering undertaking capital expenditure expansion.

When asked about their expectations on trading conditions in the next 12 months, post-farmgate business survey respondents continued to demonstrate robust optimism, which foreshadows further improvements in trading activity.



Source: NAB Group Economics

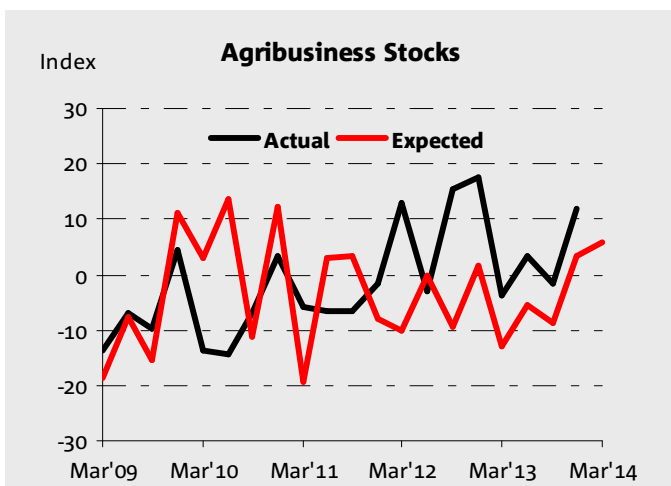


Source: NAB Group Economics

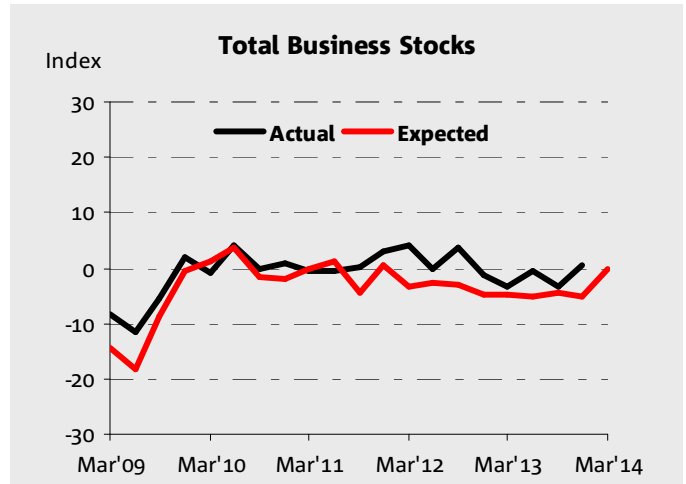
### Stocks expected to climb in the December quarter on a rise in production of major crops and dairy

The post-farmgate stock levels index lifted strongly in the December quarter to 12, partly reflecting the inventory building phase by businesses, as indicated by a higher capacity utilisation reading, to meet increased demand and forward orders by customers, as well as the higher availability of raw material supplies from the peak in the production cycles of grains, dairy and some fruit and vegetables.

For the coming quarter, majority post-farmgate business respondents expected stocks to remain unchanged (54%), while 16% expected more/much more stocks and 14% less/much less. Overall, the positive expected stocks reading suggests that production activity is likely to stay resilient in the coming March quarter.



Source: NAB Group Economics



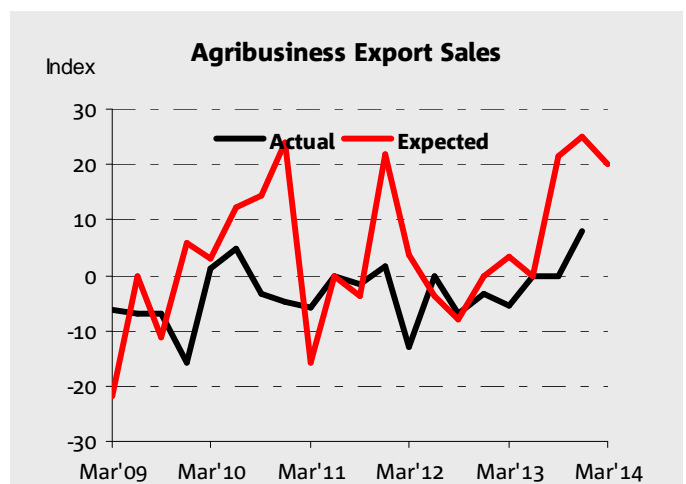
Source: NAB Group Economics

### Export sales rose but remained below expectations in December

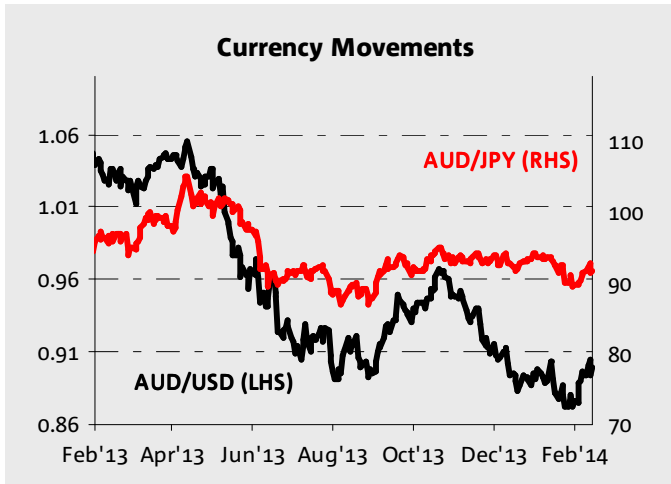
As predicted in our last survey, the export sales index breached modestly into positive territory in the December quarter in a clear rising trend, but not to the same extent as respondents' expectations established in the previous quarter.

According to the survey results, 14% of survey respondents reported an increase in export sales, compared to 6% reporting a fall in the quarter. Contributing to the rise in index is the robust pace of wheat, protein and dairy exports in the quarter. Wheat export revenues spiked in December as the harvest drew to a close, while beef and lamb exports scaled new heights in 2013 (actual export volumes exceeded previous records set in 2012 by 14% and 13% respectively).

A softer AUD in the quarter also helped to support export outcomes for a range of rural commodities.



Source: NAB Group Economics



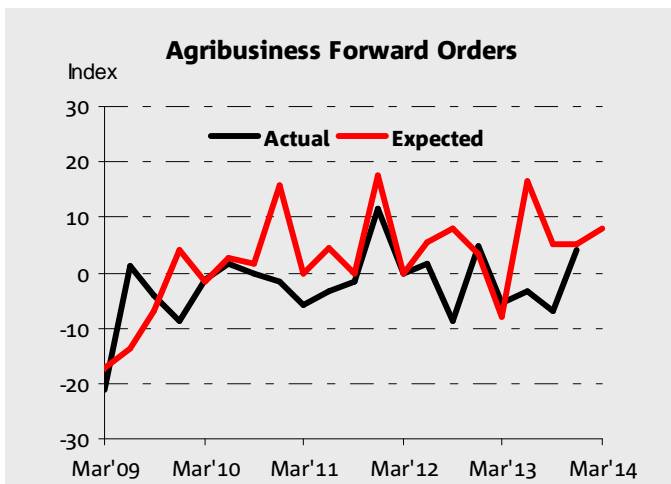
Source: NAB Group Economics

### Forward orders benefited in the December quarter from stronger demand, a weaker AUD and turnaround in business conditions

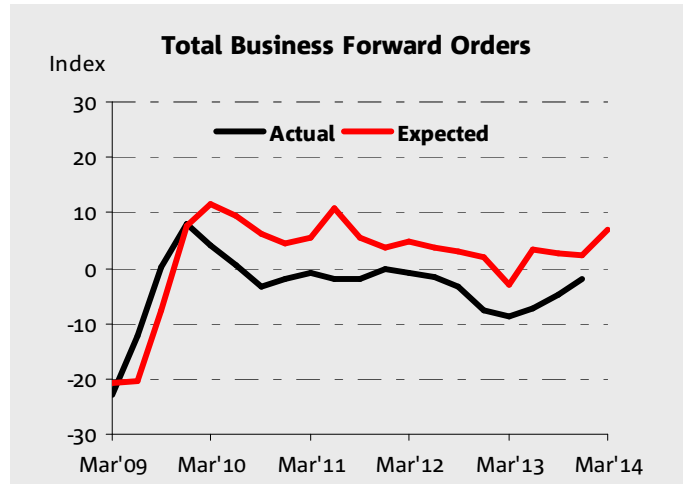
Forward orders from the customers of post-farmgate agribusinesses improved in the quarter, consistent with higher capacity utilisation and stronger export sales. According to the survey, 14% of respondents reported increased forward orders over the period, compared to 10% for reduction and 26% unchanged.

Unlike the trading conditions and export sales indices which show clearer upward trajectories, the factory orders index has not demonstrated any discernible trend in the past year.

Large fluctuations in the exchange rate have created additional sources of uncertainty in the post-farmgate agribusiness market, which is more highly exposed to global trade. In contrast, the equivalent for total businesses suggests that it is on an upturn, possibly reflecting improvements in demand conditions.



Source: NAB Group Economics



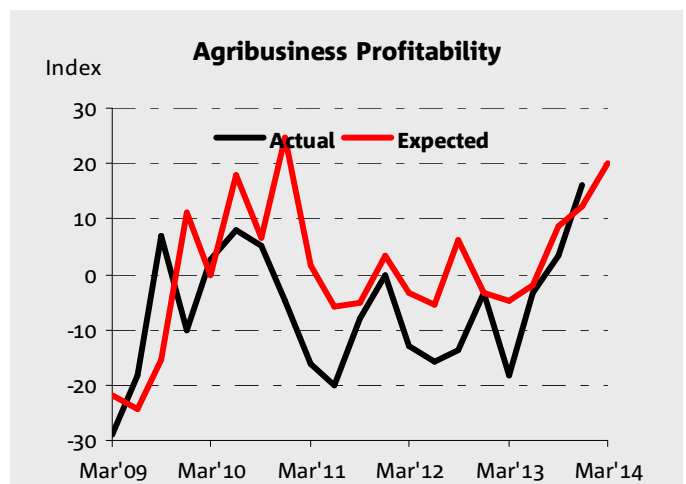
Source: NAB Group Economics

### Profitability scaled new height on favourable supply-side conditions

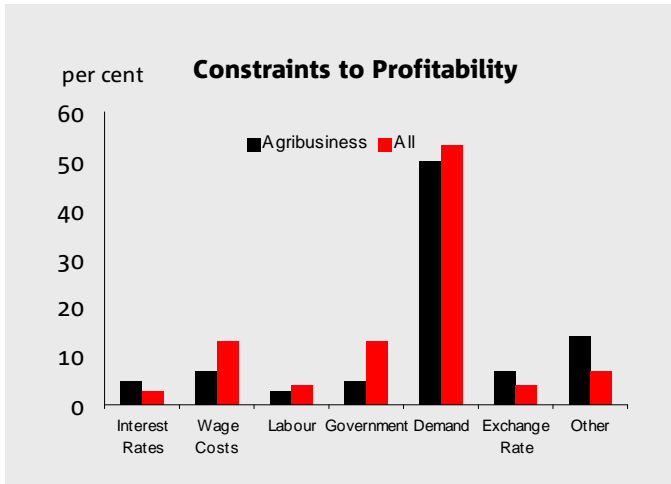
After staging an impressive jump in the September quarter, the profitability index gained momentum to reach a record level in the December quarter. This was consistent with better sales margins and cash flows reported by survey respondents.

Favourable supply side factors continued to play a significant role in supporting profitability in the quarter, as low interest rates, soft wage cost growth and a still-high exchange rate helped to keep costs in check. However, the lack of demand continued to be perceived as the dominating constraint on post-farmgate agribusiness profitability, although it is less so when compared to overall businesses.

In the December quarter, significantly more respondents had cited good or very good profitability. For the quarter ahead, survey respondents continued to maintain their optimistic outlook, with their profitability expectations hitting +20 points, the highest in more than three years.



Source: NAB Group Economics

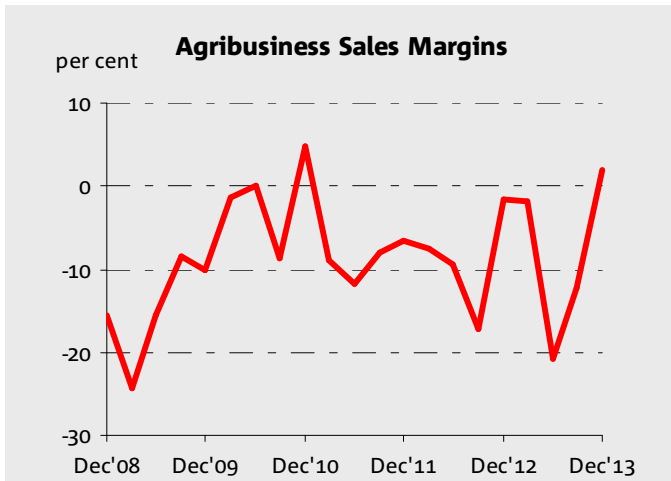


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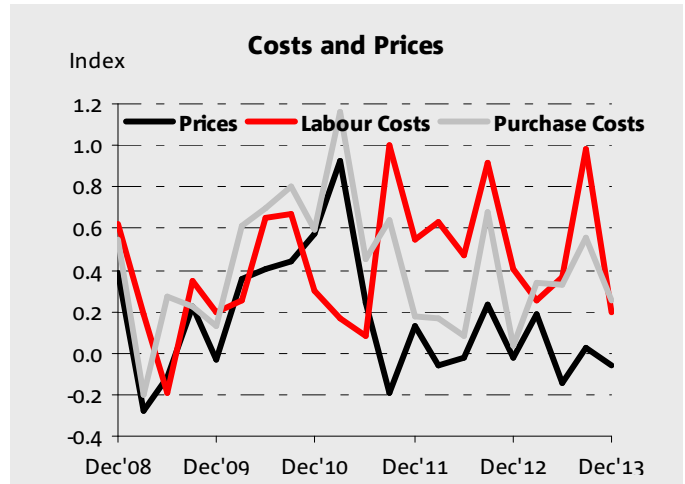
### Sales margins gained further traction in the December quarter

Underpinning the improvement in profitability in the quarter has been a surge in the sales margins conditions index to break into positive territory for the first time in more than 3 years, which was in turn driven by lower input costs in the quarter overall.

Significantly lower labour costs were the main contributor to the index over the period, as wage growth pressures remained subdued. Also providing a positive impetus to sales margins has been lower purchases costs, presumably a manifestation of plentiful seasonal supplies coming onto the market. These more than offset the negative effect on sales margins from lower prices in the quarter.



Source: NAB Group Economics

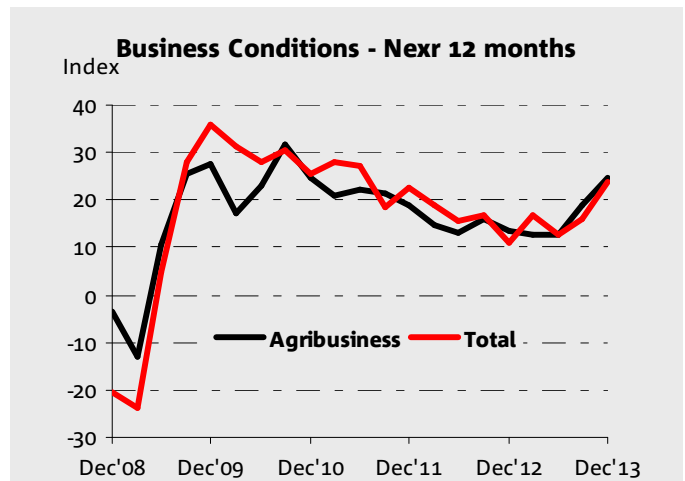


Source: NAB Group Economics

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

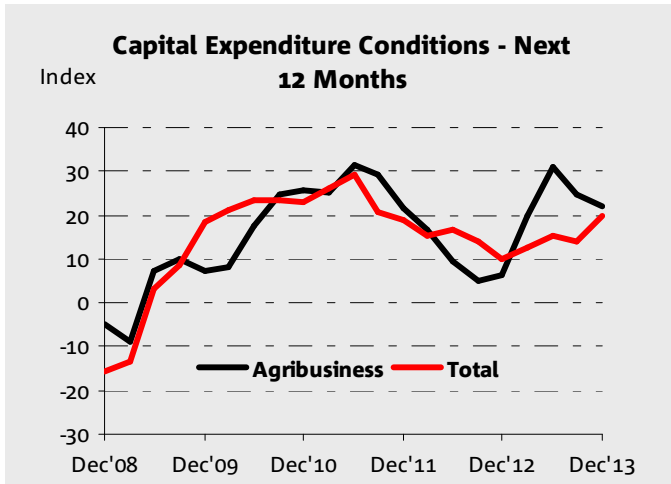
Riding the wave of a surge in actual reported business conditions in the quarter, respondents had a robust medium-term outlook for post-farmgate agribusiness conditions, with the business conditions expectations index for the next 12 months rising to +25 points. As such, the 12-month outlook for capital expenditure was also reasonably optimistic, although lower than that of September quarter following the financial markets' predictions that the RBA's easing cycle has ended.

More recently, the RBA stated in their February meeting that rate cuts to date have appeared effective in providing stimulus to the economy. However, NAB still forecasts for a 25bps cut to take place in November this year on the basis of a soft outlook for the Australian economy and potential further deterioration in the labour market.



Source: NAB Group Economics





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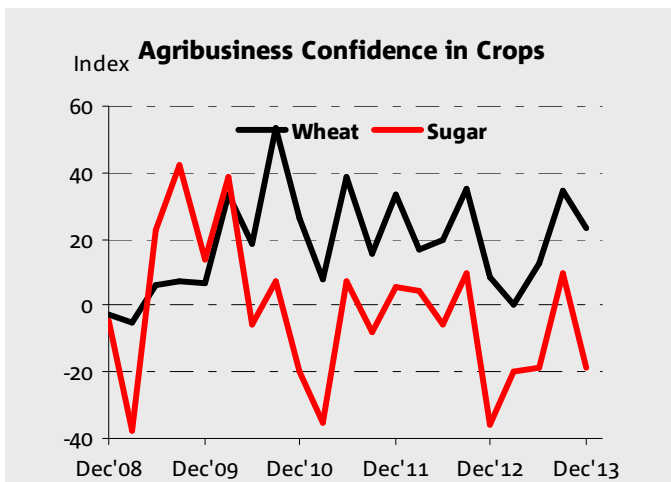
### Agribusiness confidence in commodities and other supplies

Post-farmgate agribusiness confidence in crops was mixed overall in the quarter. Confidence in wheat fell in the quarter, but was maintained at an elevated level as domestic prices continue to defy the sluggish trend in global prices with resilient domestic demand.

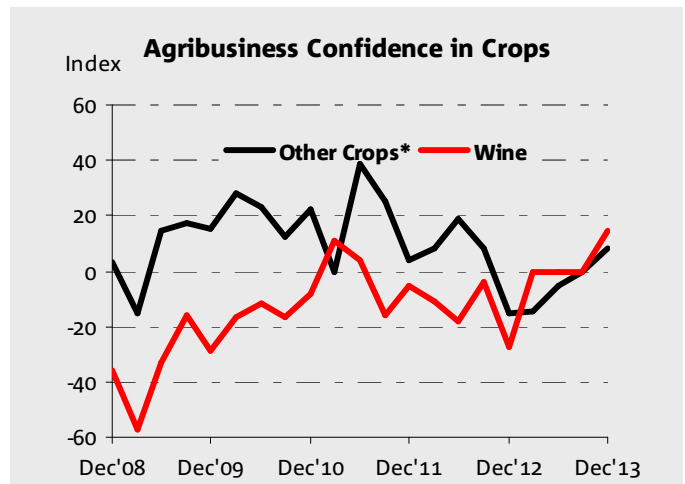
In contrast to the bumper grain crop outcomes in the southern states and Western Australia as 2013-14 harvests concluded, the cattle regions of Queensland and northern New South Wales have been impacted by feed grain shortages as a result of higher feedlot cattle numbers, driving demand and prices for grains in the region.

Meanwhile, confidence in sugar reversed its gains in the September quarter to be overwhelmingly pessimistic, as global sugar prices continued to be weighed down by excessive supplies.

The confidence index for wine gained further momentum in the quarter, possibly reflecting the favourable impact of a lower AUD on the exporting outlook for the industry.



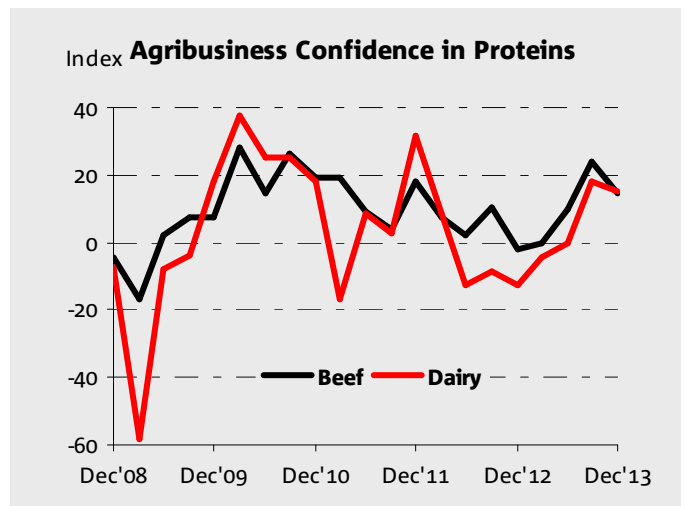
Source: NAB Group Economics



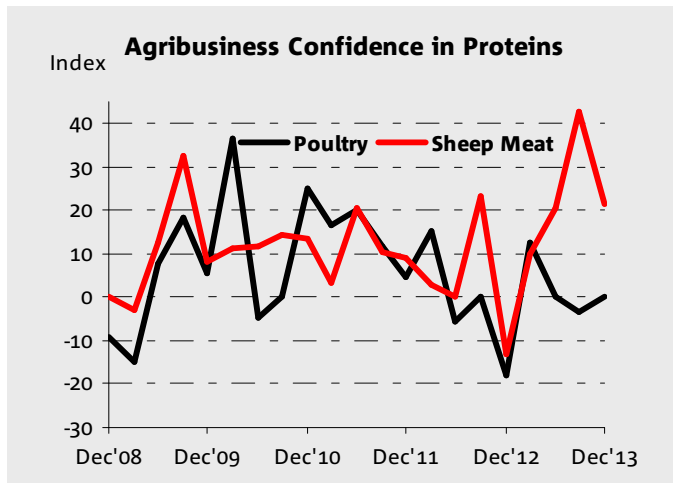
Source: NAB Group Economics

After posting a remarkable improvement in the September quarter, post-farmgate agribusiness confidence levels in livestock, apart from poultry, witnessed a partial reversal in the December quarter. Strong beef and sheepmeat confidence levels were maintained as slaughter rates reached record-highs as a result of farmers reducing herd numbers due to poor seasonal conditions. This benefited processors (within post-farmgate businesses) with plenty of supplies at competitive prices.

Meanwhile, the poultry index has risen marginally to be at the neutral point.



Source: NAB Group Economics

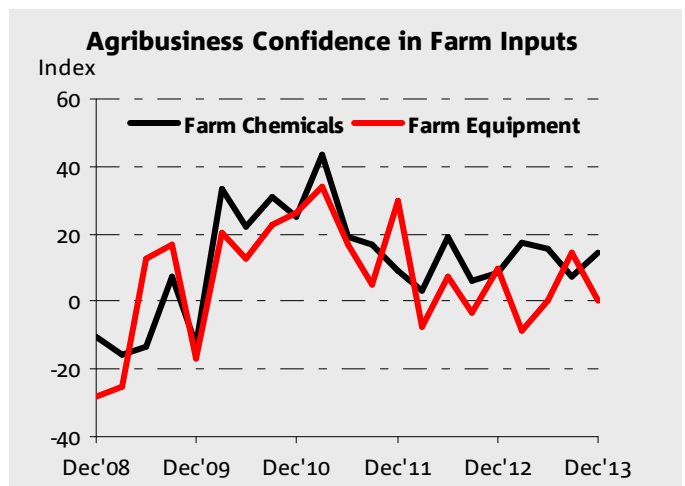


Source: NAB Group Economics

Confidence in wool and cotton deteriorated further in the December quarter, with both at neutral points. The index for cotton has fallen for the second consecutive quarter, as export prospects faltered on the back of the Chinese government’s proposed change from its current cotton stockpiling policy to keep domestic prices (hence farmers’ income) elevated, to offering direct subsidies to farmers as a means of income support.

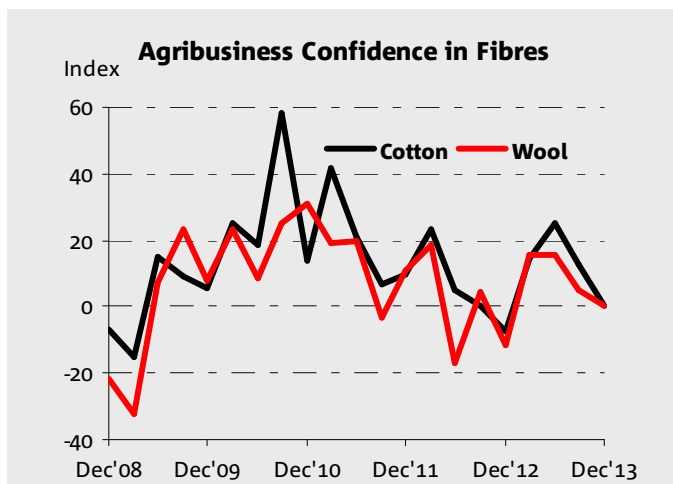
The recorded fall in the wool index is somewhat surprising considering the solid price trends at wool auctions in the quarter.

Agribusiness confidence in farm input was mixed in the quarter, with the fall in confidence for farm equipment partly offset by a rise 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 +14 in the December quarter). In contrast, the dip in farm equipment confidence was probably a reflection of respondents’ expectations that RBA’s easing cycle has come to an end.



Source: NAB Group Economics

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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. Gundabluey 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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