more give, less take

agribusiness

Economic Report

Rural Commodities Wrap

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- **Globally, commodity markets experienced heightened volatility in March, with the concerns of a slowdown in China and its first domestic bond default triggering some investor risk aversion, while the US Fed's assurance that monetary policy will remain suitably accommodative provided some support.**
- **Australian business conditions remained soft in March amid signs the weaker environment is taking a toll on business confidence, which continues to slide.**
- **Global business surveys are pointing to a weather-related slowdown in the recovery of advanced economies, but the upturn remains solid.**

Economic data was mixed over the past month, but the impact from extreme winter conditions on advanced economies appears to be abating. Partial indicators suggests more slowing in China, amid concerns they could miss their 7.5% 2014 economic growth target. China also experienced its first domestic bond default, fuelling financial stability concerns. In the US, the Federal Reserve performed another stimulus cutback. The latest minutes from the Fed's policy meeting showed a more positive stance than investors previously expected, providing some support to major equity markets and precious metals prices. Industrial metals and energy commodities moved more in line with news emerging from China, which have mostly been weaker than expected. Interest rates look set to remain very low in the big advanced economies for some time yet, despite central banks facing divergent economic conditions. We expect the Fed to begin lifting its funds rate in the latter half of 2015.

Global March business surveys suggest the levelling out in business growth we saw in the opening months of 2014 reflected more than just bad weather. While the UK and US surveys showed decent growth overall still, recent trends have been downwards. Headline Purchasing Manager Index measures dipped slightly across the UK, Japan and the Euro-zone while the US numbers turned down even earlier (partly reflecting weather related disruption to supply chains). The Euro-zone picked up from weak levels but fell slightly in March. Japan's services sector will likely show lower levels of activity in April as the rise in indirect taxes takes effect. The long running Tankan survey also shows growth slowing post the tax hike.

Apart from China, there is not much sign of brighter conditions across the other emerging economies of East Asia. Industrial growth remains less than 2% yoy and export growth is around the same low level. Similarly, overall Indian monthly output and foreign trade data show little sign of the upturn that was signalled in some of the business surveys.

2013-14 Estimates, Rural Prices & Production

Commodity	Production	Price
Wheat	17.0%	-16.6%
Beef	3.1%	-8.4%
Dairy	-2.7%	37.7%
Lamb	-1.1%	23.6%
Wool	-2.0%	5.8%
Sugar	-1.2%	2.0%
Cotton	-2.7%	19.4%
Oil (Tapis)	-	-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 2013-14financial years

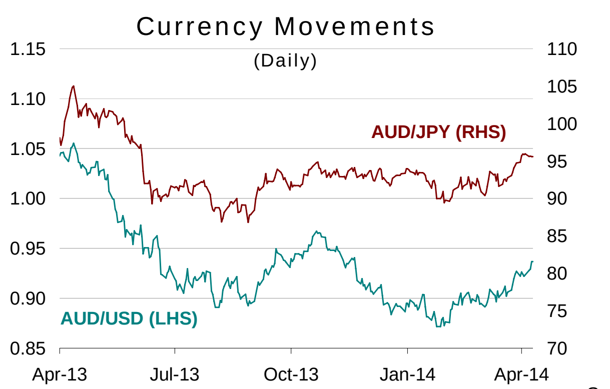
Locally, Australian business conditions remained soft in March amid signs the weaker environment is taking a toll on business confidence, which continues to slide. Labour market indicators are weak and, though better than mid-2013, still look too soft to prevent a further deterioration. Growth is likely to be supported by dwelling investment, growing minerals and energy exports and declining capital goods imports. Business investment, government demand and welfare support should provide significant headwinds. The RBA appears unlikely to move on the cash rate in the near term, expecting better news in the second half of 2014. In NAB's view, the combination of mining sector adjustment and fiscal restraint is still likely to see the unemployment rate continuing to edge up, forcing the RBA to cut rates once more towards the end of 2014.

In March, major Australian rural commodity prices were mixed. More widespread rainfalls across most parts of Australia saw a continued upward trend in livestock prices despite high throughput volumes. Domestic grain markets continued to trend upwards in line with a global rally on dryness concerns in the US and continued geopolitical volatility in the Black Sea. Global dairy prices recorded a mild decline this month, potentially heralding the start of a period of price correction from historically elevated levels on the back of a strong finish to the New Zealand production season while Northern Hemisphere supplies ramp up. For softs, cotton has held up as the US recorded its smallest crop in four years. Sugar rose further on concerns of drought conditions in Brazil threatening crop yields from the largest global producer and exporter. Meanwhile, wool prices tracked lower in the month on thin export activity and less valuable transactions as price-sensitive customers were deterred by renewed vigour in the AUD.

Currency Movements

The AUD maintained its momentum against the USD in March, and showed renewed strength against other currencies. This comes as the RBA moved to neutral, noting that "the prudent course is likely to be a period of stability in interest rates". March saw a 3.9% rise in AUD/USD and a similar rise on a trade-weighted basis. Our analysts have considered our forecasts, and left them unchanged at AUD/USD 0.87 by mid-year and 0.84 by year-end. The domestic outlook is a little improved with regards to the housing sector. Housing construction is rising, and sales and certainly prices are higher. However, broader investment remains lacklustre, the NAB business confidence survey has deteriorated and we still see more deterioration in the labour market than the RBA are presently forecasting. Currency speculators have reduced AUD shorts to their lowest level since May last year, while real money investors continue to be buyers of Australian assets. Our outlook for a modestly weaker AUD remains one driven from a lower terms of trade over time, rather than in the short term. We believe the delay in the AUD depreciation is being held up by the failure of US yields to respond in any meaningful manner to the US Fed's suggestion that it is likely to raise interest rates in mid-2015 and better economic data. The dovish tone of recent US Fed policy meeting minutes which implied a no less accommodative setting for months to come has also weighed on the greenback. Our analysts still predict a recovery in the USD but the risk is for a further delay.

AUD enjoy renewed upswing in the past month



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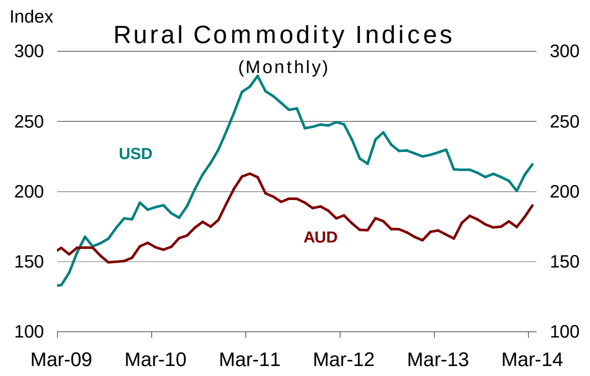
ource: Datastream

NAB Rural Commodity Index

In March, sharp rallies in the prices of domestic livestock and wheat, which account for more than half of the commodities basket, combined with a marginal fall in the AUD saw a 4.6% rise in the NAB Rural Commodity Index in AUD terms. In USD terms, this represents a more modest rise of 3.6%. Leading the rise of the AUD index were marked lifts in wheat (+15%) lamb (+9%), beef (+5%), sugar (+9%) and barley (+7%). As mentioned, livestock prices benefited from welcome rain across large swathes of drought-affected areas in Queensland and northern New South Wales which boosted livestock restockers' confidence and reduced livestock offerings at saleyards. Meanwhile, weather concerns in the US and Brazil have supported wheat, barley and sugar prices. After four consecutive monthly rises, dairy prices eased 1% in March, potentially flagged a downward trend period as spring flush in the Northern Hemisphere commences. Wool prices were also lower (-3%) on weak export demand conditions while sugar reversed some gains in February (-1%). Looking ahead, livestock prices which are expected to rise further will provide some support to the rural commodity index but this is likely to be restrained by further falls in dairy and grain prices.

Stronger livestock and grain prices drove the indices higher



Source: Bloomberg, NAB Economics

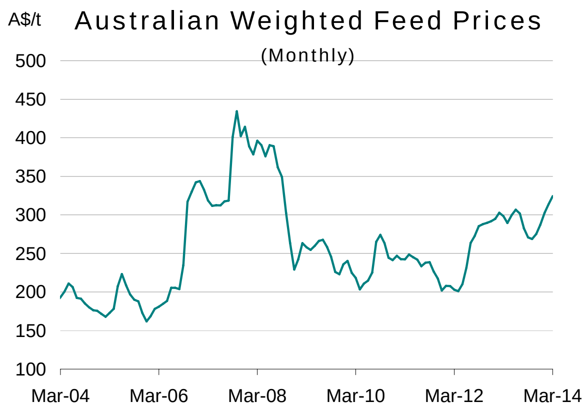
NAB Farm Input Indices

Over the past month, global Diammonium Phosphate prices were largely unchanged at USD 497.5/tonne while urea prices have dipped further to USD 302/tonne. Meanwhile natural gas prices also retreated from their historical high in February to be at around USD 4.6/million Btu. Robust demand for phosphates exports and higher raw material costs have lent support to their prices lately. In the coming months, Indian imports will be the key determinant of global prices. Meanwhile, supply side remains loose for urea, with a high level of inventory weighing on prices. Petrol prices remained largely unchanged in the month at historically high levels despite moderation in global crude oil prices.

NAB Weighted Feed Grains Price

Domestic coarse grain prices have benefited from strong feed demand in the drought-impacted livestock-intensive regions of Queensland and northern NSW, as well as the wave of global price rallies due to drought concerns in the US and Brazil, the leading grain producers in the world. As a result, NAB Feed Price Index has risen to the highest level since September 2008.

Feed grain prices remain elevated from tight inventories



Source: ABARES, NAB Economics

In Focus – Wine

- **Australian wine production rose moderately in 2013, largely driven by more favourable seasonal conditions for grapes leading to the 2013 vintage, relative to the previous two years across the country.**
- **While the domestic wine industry continues to be challenged by stiff import competition, oversupply and strong retail market dominance, there are a number bright spots: a domestic market that increasingly trades up to higher-value products and growing Chinese imports of premium Australian wines.**
- **While the structural reduction of the number of vineyards globally has continued since peaking in the mid-2000s, global wine production rebound in 2013 to levels not seen since 2006, largely driven by Old World production.**
- **Global consumption has recovered somewhat after reaching a trough in 2010 when European consumers cut back on discretionary spending in the aftermath of the GFC, but not to pre-crisis levels. A partial recovery in French consumption, and the continuing catch-up phase in the US and China from relatively lower bases, have contributed to this trend.**

Global production gradually recovering from glut

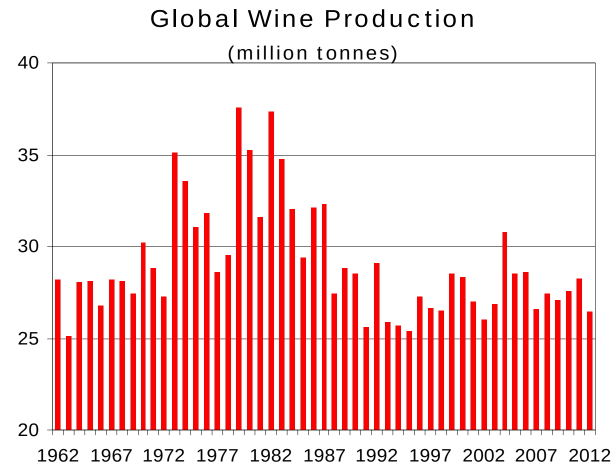
Since the recent peak in 2004, an ongoing structural reduction in global wine production capacity, modest harvests in the EU from 2007 to 2011 and an exceptionally poor harvest in 2012 have seen the world wine market slowly correcting the global glut situation built since the early 2000s. Global production is estimated to have jumped by a significant amount in 2013 (data not yet available for UN Food and Agriculture Organisation for the chart on the right) on the to return to levels not seen since 2006 at around 281 million hectolitres (Mhl) (1 hectolitres =100 litres), despite the continued downward trend in vineyard numbers around the world, according to the latest forecasts by the International Organisation of Vine and Wine (OIV). This has been predominantly led by a recovery in European production, with the three major Old Wine countries of France, Spain and Italy expected to show improvements relative to 2012, while production in New World regions of the US, South America and Oceania also rose.

The surge in Spain's production is expected to be especially prominent, to rise by 23% to around 40 Mhl to account for approximately 14% of total global production in 2013. Italian production finally recorded a rise in 2012 and is expected to build on momentum in 2013 to grow by 2% to 45 Mhl, 2% more than in 2012. An increase of 7% is forecast for France (44 Mhl), Portugal (6.7 Mhl) and 79% in Romania (6 Mhl).

Outside Europe, 2013 should see a departure from the relatively stable trend seen between 2008 and 2012, with a production increase of nearly 7 Mhl (+9.5%). This will come from clear rises in Argentina (+27% to 15 Mhl), the US (+7% to 22 Mhl), Australia (+7% 13.5Mhl) and record production in Chile (12.8Mhl) and New Zealand (2.5Mhl). At the height of the global glut in 2004, there was a supply surplus of 57 Mhl, just under a quarter of global consumption, but this fell to just around 9 Mhl in 2012 after years of production consolidation across major producers, reflected in the long-term downward trend in the global number of vineyards. The structural decline in the number of Old World vineyards was only partly offset by the rise in China and New World countries and this process was further hastened by 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, where subsidies were paid to producers to turn excess wine they couldn't sell into alcohol for industrial purposes or biofuel. Crisis distillation was eventually phased out in 2012. New World countries such as Australia and the US have also seen declines in production amid actions to reduce vineyard acreage to address oversupply.

The reversal of this trend in 2013 could have been partly prompted by a firmer footing in the global economic recovery, a continued benign monetary environment supporting business confidence, and more favourable weather conditions in a number of key regions in the US and parts of Europe.

Despite the long-term decline in its global share, the Old World has always dominated the overall global production landscape, accounting for just under 60% of total wine production. In 2012, its share was 57% but this is likely to have risen to 58% in 2013. Meanwhile, the share of New World production remains largely unchanged at around 28%.



Source: UN FAO, NAB Economics

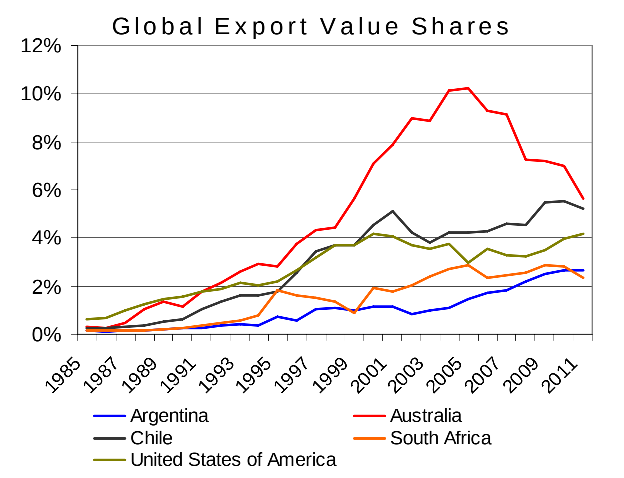
Global wine consumption stabilising

In the years after the global financial crisis, global wine consumption levels fell sharply, led by the major consumer European countries of Italy, Spain and the UK. This is perhaps not surprising, given the discretionary spending power of consumers in a number of key European countries was severely curtailed by the economic downturn, especially in Italy and Spain. Overall global consumption levels have recovered somewhat since bottoming out in 2010, although not to pre-crisis levels. The latest projections by OIV suggests total global consumption should be around 245 Mhl in 2013, only marginally higher than the 243 Mhl in 2012 but significantly below the peak of 255 Mhl in 2007. France, the US and China are the driving forces behind the improvements while other Old World countries continue to show declines.

Global *per capita* consumption also reached a trough around 2010, but has not shown much sign of a revival since then. Growth from New World markets and China is more than offsetting declines in some Old World countries. Meanwhile, French consumption per capita experienced a turnaround in 2011 after an extended period of decline. Major New World countries' per capita consumption nevertheless still lags behind Old World countries by a long stretch. The US and Russian per capita wine consumption was around 9.2 litres and 7.3 litres per person in 2012 respectively, compared to around 47.7 litres in France on average. Despite the robust growth in overall consumption levels, China's per capita consumption is still low by international standards at less than 2 litres per annum, which suggests plenty of opportunities for further growth.

Over the medium term, we expect continued increases in per capita consumption levels in New World countries to be the key driver of growth in global wine consumption. In 2012, the US is only trailing behind France as the second largest consumer of wine by gross volume and consumption and this is only going to increase as consumer acceptance of wine grows. China, currently ranked 5th in the world in total wine consumption, is on track to catch up to Germany and Italy to become one of the top three wine-consuming countries within the next few years.

Australian share of global wine exports has been falling since peaking in 2005



Source: UN FAO, NAB Economics

That said, wine as a consumer good is facing increasing competitive pressures from other types of alcoholic beverages such as beers and spirits, which have become highly differentiated and of better-quality over time. Furthermore, the commercial success of any particular alcoholic beverage is increasingly contingent on its brand marketing relative to its intrinsic characteristics. This implies that rising incomes may not necessarily guarantee an in-tandem rise in wine consumption. For instance, Chinese per capita consumption is at the high end of the range in Asia, behind Japan but still in front of the more developed South Korea.

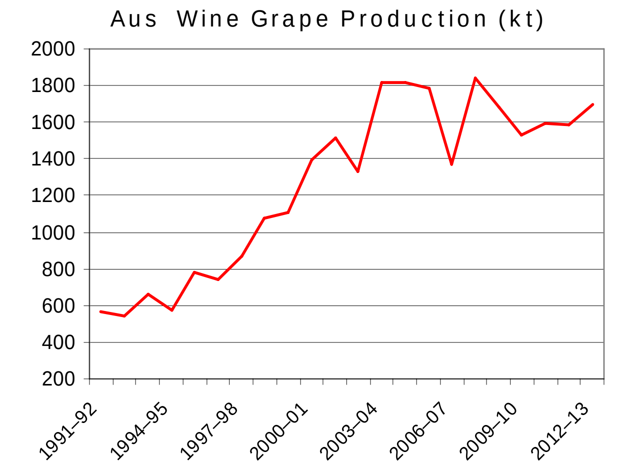
Contrary to trends in production, global wine trade has risen notably over the past two decades, with global export volumes accounting for only 20% of total production in early 90s to around 35% in 2013. Old World countries continue to be dominant forces in exports, as Italy, Spain and France occupy the top three spots by volume, followed closely by Australia in fourth place. In the last few years, the growth in unit value of wine exports has generally outpaced that of volume, with world trade volume actually falling in both in 2012 and 2013, but growth in value terms continuing. The average unit price of global wine exports has risen steadily since 2010 to reach EUR 2.6 per litre in 2013, significantly above the average of EUR 2.2 recorded for the decade before. This partly reflects the relatively short harvest in the Northern Hemisphere in 2012 which constrained the amount of wines available for export as well as consumers' increasing willingness to pay more. Data from OIV suggest that global export volumes decreased by nearly 100 litres in 2013, largely attributable to significant falls of those stemming from Spain and Italy, but the total value of exports actually rose by 5% to EUR 25.6 billion (approximately AUD31.6 billion). French wine exports, which command significantly higher unit values than most other European wines, account for around one-third of total export value but only represent half of that in volume terms.

On the flip side of the export equation, import demand growth in recent years has largely been driven by countries outside continental Europe. The US overtook the UK in 2013 as the top importer by value to account for around 16% of total global imports.

Australian wine industry outlook

Australian wine production rose moderately in 2013, largely driven by more favourable seasonal conditions for grapes leading into the 2013 vintage, relative to the past two years. The generally hot and dry conditions early last year helped to curb the development of diseases, while a heatwave in South Australia and the eastern states in January last year did not significantly affect yields because of the good soil moisture profile from sufficient winter rains in 2012. According to data from the Australian Bureau of Statistics (ABS), production of beverage wines in Australia picked up substantially in 2011-12 and maintained similar levels of output in 2012-13 of around 12.3 Mhl after years of consolidation since the most recent peak in 2008-09. Although not directly comparable to OIV's forecast of Australian production for 2013 of 13.5 MHl, this figure implies a more pessimistic outcome for 2013 than OIV's prediction might indicate.

Australian wine grape production recovered recently

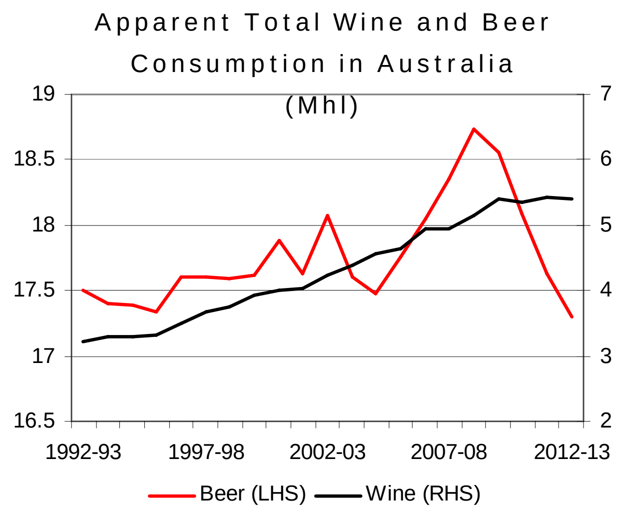


Source: ABARES, NAB Economics

The trend in domestic wine consumption appears to have stabilised since 2009-10 after steady growth for nearly two decades. Similarly, a sharp drop in beer consumption in recent years suggests Australians have cut down their consumption of all alcoholic beverages, as consumers become increasingly health conscious and domestic consumption reaches saturation point.

Stronger wine production in the last two years against a backdrop of sluggish consumption and export growth has resulted in the accumulation of wine inventories of approximately 1.8 billion litres. 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.

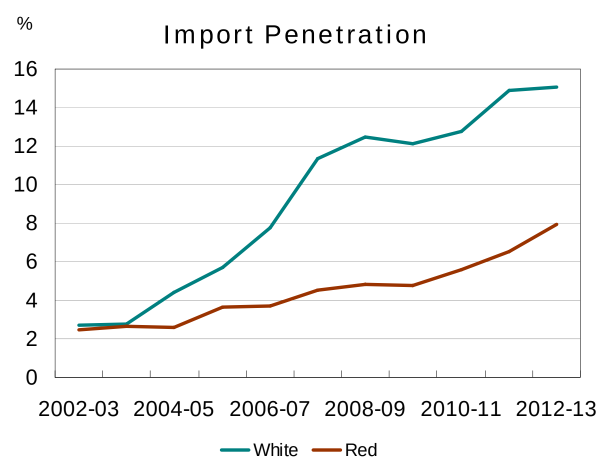
Australian wine consumption has flat-lined



Source: ABS, NAB Economics

Domestic sales of Australian wines have shown similar trends of stagnation, which has been further exacerbated by heightened import competition. In 2012, total Australian wine sales fell 2% according to the ABS. In 2012-13, the share of domestic red wine consumption by imports continued to rise to around 8%, while white wine appeared to stabilise at around 15% of the market. Woolworths and Coles are expected to continue to push for their generally more price-competitive private-label liquor products, thereby reducing shelf space of branded products and exerting downward pressure on margins of branded products. However, it appears domestic consumers are increasingly trading up towards higher-quality Australian wines. According to the Winemakers' Federation of Australia (WFA), domestic consumption of Australian wine sold above $15/bottle increased by $268 million (64%) in value terms and 11.6 million litres (42%) by volume between 2007 and 2012, but this category represents only a relatively small share of 16% all domestically produced wine by value and 3% by volume.

Imports continue to gain market share



Source: ABS, NAB Economics

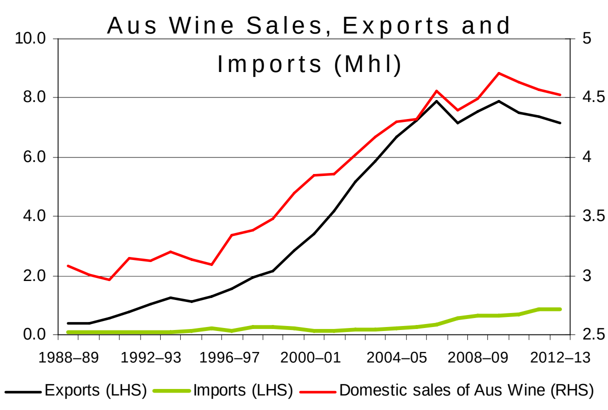
The Wine Equalisation Tax (WET) which has encouraged the production of cheaper, higher alcoholic content wine, and production based on volume and not value, has indirectly contributed to the oversupply issue in the domestic market. The WET system, which offers full rebate to wineries and anyone who converts grapes into wine by a contract winemaker for the first AUD $1 million sales, is providing smaller growers the perverse incentives to produce low-quality wines in order to be eligible for the rebates.

Australian wine exports still under pressure, but key export markets set to grow

On the export front, the competitiveness of Australian wine has weakened considerably in recent years, despite being the fourth largest wine exporter by volume in the world. The rise of New World exports has impinged considerably on the market share of Australian exports, especially at the lower price points of less than $2.50 and $2.50 to $4.99 a litre. According to WFA, around 33% and 52% of the volume of exported wine fell into the first and second category respectively in 2012, with the remaining small percentage made up of higher-valued products. Relative to 2007, the lowest-priced category of less than $2.50 recorded the strongest volume growth by 2012, driven largely by the exports of bulk wine. This perpetuates the trend of "de-premiumisation", a phenomenon where the unit value of Australian exports has been deteriorating in US dollar terms, although this also partly reflects the strength of the AUD. Interestingly, there has been marginal growth on the opposite end of the price spectrum above $10 a litre, largely driven by the demand of Chinese buyers for premium products. According to WFA, exports to China rose 144% (26 million litres) by volume and 333% ($186 million) by value from 2007 to 2012. More recent export data by Wine Australia, however, point to lacklustre export sales to China in the twelve months to March this year, with volume down by 12% but value was up modestly by 2%, partly driven by the crackdowns by the Chinese central government lavish banquets involving government officials.

Despite the recent slowdown, China's current low base of per capita wine consumption, rapidly rising incomes and penchant for premium Australian wines represent favourable conditions for the growth of Australian exports in the medium term. In 2013, China accounted for only 5% in total Australian export volumes but 13% by value, a relative small share which leaves ample room for future expansion.

Australian domestic wine sales and exports on a moderate downward trend

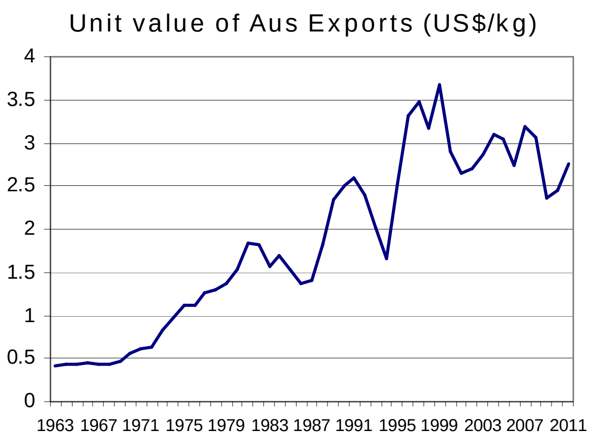


Source: ABS, NAB Economics

The "de-premiumisation" trend, high AUD, and fiercer competition from other New World producers has served to constrain the export profitability of Australian wine exporters. The sector is also confronted with the challenge of changing consumer preferences, with overseas drinkers increasingly preferring lighter wines to full-bodied Australian shiraz and chardonnay. Australian exporters have reacted accordingly by increasing exports of lower alcoholic content wines for all wine types — from sparkling to rosé, reds to whites. In this highly competitive global environment, the exporters likely to emerge triumphant are those who understand and cater to the idiosyncratic needs of overseas drinkers, as well as those who dare to innovate. For example, Victoria-founded Lupé Wines has tasted success in their overseas markets, especially those in Asia, with its offerings of wine packaged in single-serve plastic glasses with tamper proof seals.

By value shares, the US (25%) was the top destination for Australian exports in 2013, followed by the UK (21%), China (13%) and Canada (10%), although the UK still remains the largest market by volume (35%) due its large intake of Australian bulk exports for repackaging onshore. Future growth in Australian export revenue will be contingent on the further opening up of emerging New World export markets such as Ireland, Canada, Germany, China, India, South Korea, and Japan. Nonetheless, these markets will be highly competitive.

Australian prices under pressure



Source: UN FAO, NAB Economics

The Australian wine industry is likely to continue to undergo structural changes for some time to come. In the last five to six years, the industry was essentially caught up in a "perfect storm" of a glut in grape production, stiffer import and export competition which partly reflected the sustained height of the AUD, and the stronger market power of retailers. While a certain degree of rationalisation of production capacity is currently underway, any tightening in grape supply is likely to benefit grape growers disproportionately more than wine makers in the form of higher prices. Wine makers will have to bear higher input costs with limited pass-through options to retailers who are well-positioned to flex their muscle to limit any wholesale price increase. Despite the consolidation process, there continues to be an overproduction of low-quality and value wines which weighs heavily on the profitability outlook of wine makers. While the domestic market is gearing towards higher value, it has reached a saturation point for consumption volume. That said, there are some green shoots emerging: a lower AUD since mid last year should have had some supportive cash flow effects on exporters to date, although exporters would most likely have traded volume for margins. The increasingly valuable Chinese market also constitutes long-term opportunities for Australian exporters to adjust the value propositions of their products. As Australia inches closer towards a free trade agreement with China, exporters may stand to benefit from lower tariffs which currently stand at around 14%. ABARES estimated in 2012 that the removal of China's import tariff on Australian wine could lead to a fall in the Chinese retail price for Australian wine by about 12% for bottled wine and 17% for bulk wine, implying significant upside for the competitiveness of Australian products.

Comments from the field

The current vintage in the Hunter produced good yields and quality is looking promising. Parts of the Orange district were hit by black frost, which reduced yields by 30% for some of the vineyards. The outlook for the vineyards that have scale and a well-known brand is positive. This will be helped if the AUD can continue to drop as increased opportunities will arise on the export markets. It is proving much harder for producers that provide wine into the bulk market. Therefore I think there may be continued consolidation within the industry. - **George Hardy, Agribusiness Manager, Sydney, NSW**

Vintage for 2014 is well underway in the Margaret River wine region. Picking of white varieties has been completed, with red varieties currently underway and expecting completion over the next 2 – 3 weeks. The wettest winter on record last year gave the year an ideal start, however wet and windy conditions around flowering have impacted yields. White varieties picked have mixed yield results, chardonnay is generally down 40% in isolated areas however semillon is up 20% in some areas. Red varieties are only just being picked with expectations of yields at average levels at this stage. Across the region both red and white varieties are expected to yield around longer term average levels, due to impacts of weather conditions early in the year.

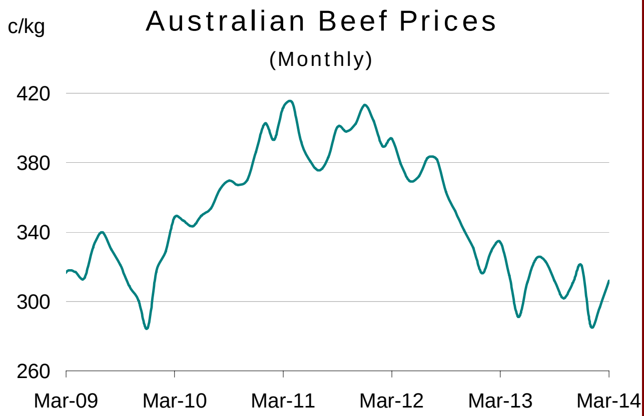
Ideal weather conditions over summer have wine makers reporting very high quality wines at this early stage. Demand for quality fruit has been high, fruit prices have increased compared with 2013 and wineries are looking to secure supply for quality fruit. Growers are securing contracts for 3 year terms at prices that have not been seen for some years. Bulk wine prices increased during the later part of 2013 and with the current vintage resulting in average yields prices after vintage are expected to remain high.

Whilst economic conditions and the sales environment remain tough, prices for bulk wine and fruit have increased quickly over the last 12 months. The increase in prices and discussions about securing 3-year contracts suggest that there is a level of cautious optimism amongst the industry that has not been seen for some years. - **Chris Omodei, Agribusiness Manager, Bunbury, WA**

We are well into 2014 vintage after a challenging growing season with growers having to contend with frosts, very high temperatures through January and then large rain event in February. This region produces approx 20% of Australia's annual crush and reports to date is that yields are average to above average, however with some reports of damage due to frosts, sunburn and rain. Growers have been informed that winery prices have been reduced by approx 20% on 2013 vintage prices which we are already starting to see the resulting strain on customer' cash flows when projecting the next 12 months. The drop in price has been associated with the supply and demand issue which is still affecting the industry especially if 2014 Australian vintage is up around the 1.8m tonnes. **- Scott Wittwer, Agribusiness Manager, Renmark, SA**

Key Commodity Prices

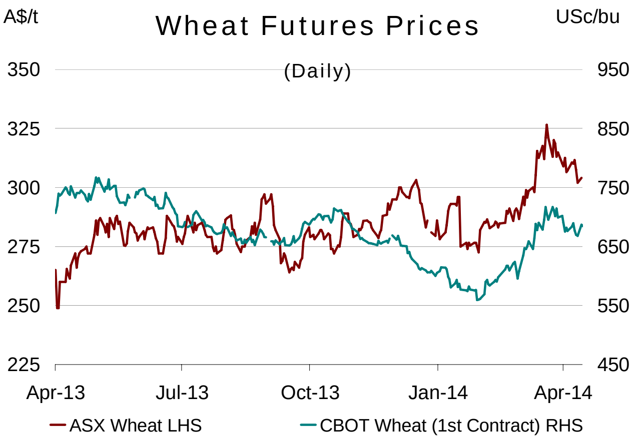
Cattle prices rose for the second consecutive month on widespread rainfall in drought-affected areas



Source: MLA

Average cattle prices rose for the second consecutive month in March to AUc 312/ kg cwt (+5%) as above average rainfalls in a number of key producing regions, including large large swathes of drought-affected Queensland and northern NSW areas, showed immediate impacts on the cattle market in terms of lower offerings. However, throughput in March remained high, given the steady lines of cattle already booked into processors' schedules in advance. According to the Meat and Livestock Association, there is typically a lag of a few weeks before lower offerings at the market flow into reduced production. Record slaughter rates in February and early March resulted in beef and veal exports reaching another record level in the month. In the near-term, the prospects of the domestic beef sector are looking up, with forecast rain across parts of Australia in the coming weeks likely to fuel restockers' interests further. The free-trade agreement that Australian struck with Japan will benefit the beef industry by front-loading tariff cuts for chilled and frozen beef.

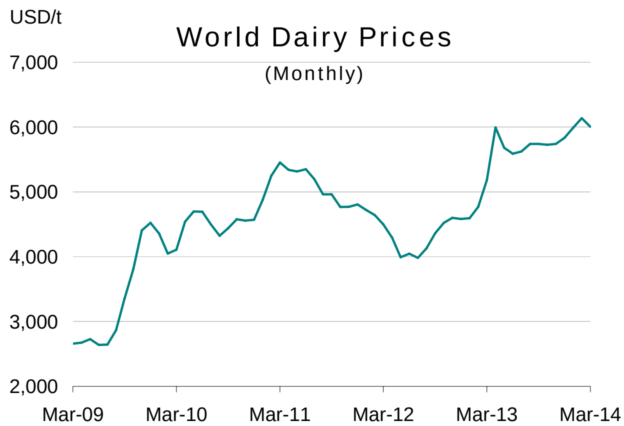
Domestic wheat prices capped off an impressive rally on heightened geopolitical situation in the Black Sea region



Source: NAB, Bloomberg

Domestic wheat prices, which demonstrated robust trends since the second quarter of 2013 on the back of strong domestic fundamentals, recently rode the wave of a rally in global CBOT prices to reach the highest level in over three years on 20 March. The recent peaking in global prices was largely fuelled by the heightened geopolitical uncertainty in Crimea and its implications on grain exports by Russia and Ukraine, the fifth and sixth largest grain exporters in the world. Prices also gained some support on concerns of the impact of continued dryness of the Southern Plains in the US, the largest wheat producer, on its production prospects. The Russia-Ukraine situation remains highly volatile, with the recent intensification reigniting worries of potential grain supply disruption in the Black Sea region. This has pushed prices higher in the last few days. This, combined with sustained strength in domestic stockfeed demand, is likely to see domestic prices trading range-bound at elevated levels until some certainty is established for this year's winter crop outcome.

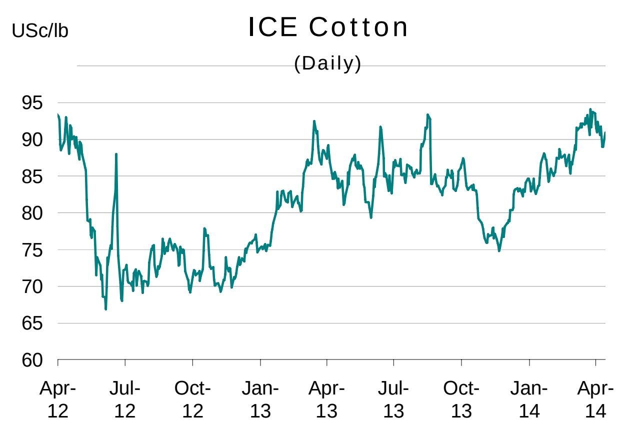
Global dairy prices showed first signs of correction from historically high but underlying fundamentals remain firm



Source: BNZ

Global dairy commodity prices showed some signs of correction in March, with the BNZ dairy weighted product price falling by 2% in the month to around USD 6004/ tonne but not a soft reading by any means. There are divided views amongst analysts and industry commentators as to whether this represents the start of a sustained correction period or simply a temporary phenomenon. Proponents of the former view will have the support of the four consecutive falls in the fortnightly auction price as at 1 April on GlobalDairyTrade, the largest online auction platform for dairy commodities in the world. However, others believe this correction is likely to be short-lived, driven largely by a temporary slowdown in Chinese purchases which are likely to recover in the coming months. NAB is of the view that prices are likely to fall further in April and May, as a strong finish to New Zealand production and the spring flush in the Northern Hemisphere from positive supply responses to elevated prices will serve as a drag on prices. The new normal trading range for dairy prices is likely to be maintained between the USD5000 and 6000 mark for the foreseeable future.

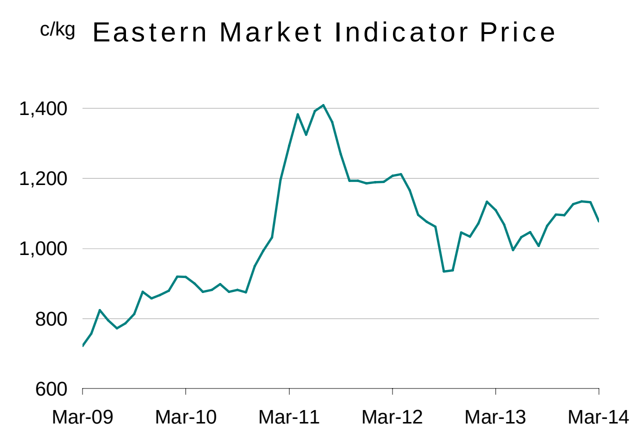
Cotton prices firmed further in March on dryness concerns in the US and resilience in Chinese imports



Source: Bloomberg

Cotton prices maintained their upward momentum in March and rose to the highest level in almost two years late in the month on continued production concerns in the US, as the largest cotton cropping state of Texas enters its fourth year of drought. The latest March World Agricultural Supply and Demand Estimates (WASDE) report by the US Department of Agriculture projects that the current season's cotton stockpiles in the US, the world's top exporter, will be 11% lower than projected last month to reach 2.5 million bales, the lowest in 23 years. Meanwhile, consumption by major textile producing countries of India and Pakistan, as well as imports by China in 2013-14 were also revised up. The projection of Chinese imports was made on the assumption that its government will announce additional import quota this year, despite having announced a series of amendments to its industry support policies recently, notably more towards providing direct income support to growers. Nonetheless, the uncertainty surrounding the Chinese government's likely actions on the management of its mammoth domestic inventory stocks remain the biggest risk to the global price trajectory in the medium term.

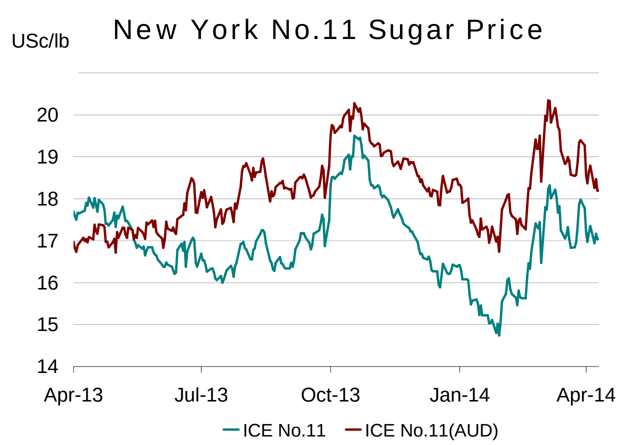
Wool eased on continued weak trading conditions



Source: Datastream

The Eastern Market Indicator (EMI) eased again in monthly terms in March, after a modest fall in February. This is despite some level of stock withholding by growers in anticipation of higher prices as poor buyer interest in general drove market trends. Merino fleece of all types and descriptions lost significant ground in the last month, while cross-bred types fared better, which suggests the dominance of activity by price-sensitive buyers. Exporters continue to face subdued forward order conditions. While there were a number of major purchases by Indian manufacturers, they were agreed at price levels considered well below the market. The lack of export demand is likely to be partly attributable to the rejuvenated buoyancy in the AUD in the last two months, as the RBA switched from an easing bias in their interest rate decision to a neutral stance in February. The just-in-time nature of most export orders renders them particularly sensitive to any movements in the exchange rate.

Sugar prices demonstrated resilience on vulnerable Brazilian and Australian production prospects this season



Source: Bloomberg

Sugar prices were range-bound in March to average around USc 17.6/pound on lingering concerns that the worst drought in Brazil in over 40 years will reduce the 2014-15 output from the world's largest producer. Increasingly, there are also worries of a likely El Nino event developing later this year which could result in a deluge in Brazil that would curb cane production. Locally, an El Nino event is expected to cause warmer and drier-than-normal conditions for Australia's winter months, which may affect cane crops adversely here as well. Sustained low levels of sugar prices for more than a year also had discouraging effects on cane and beet plantings which will likely constrain global sugar production in the 2014-15 season. This, against a steady consumption trend, could culminate in the first global deficit in five years and fuel some upward price momentum. The extent to which sugar prices may rise this year will be limited by the large inventory overhang from four preceding years of global production surpluses. Furthermore, subsidies paid to Indian sugar exporters for up to four million tonnes of raw sugar for this season and next and the sufficient levels of inventories will ensure steady shipments from the country.

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