

Rural Commodities Wrap – July 2014

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Summary:

- Rural commodity prices were lower overall in June. Beef prices were stable, while lamb prices increased and wool saw a subdued end to 2014-15. Led by declines in wheat and dairy prices, the NAB Rural Commodities Index continued to fall after its April peak.
- The global economy shows mixed signs and moderate growth continues after falling in early 2014. US growth is likely to pick up after a harsh winter but the recovery in Europe appears to be stalling. Trend slowing in China continues while growth in other East Asian economies remains sluggish.
- Domestic conditions are subdued overall as consumers continue to react to the 2014-15 federal budget. Domestic indicators continue to point to unemployment growth and a lack of certainty that declining mining investment will be replaced quickly.
- We expect that the AUD will fall to 85 US cents by the December quarter 2014, while official interest rates will remain on hold until late next year.
- The prospect of El Niño continues to weigh on the minds of producers, especially wheat growers in eastern states. This month's *Rural Commodities Wrap* focuses on the progress of the 2014-15 Australian wheat crop, which has started well in most areas except northern New South Wales and southern and western Queensland. These growers will be counting on strong rains in winter and early spring to counter low subsoil moisture levels.

Table 1: NAB Commodity Price and Production Growth Forecasts (%) for 2014 -15

	Production	Price
Wheat	-3.8	-1.8
Beef	-4.0	3.5
Dairy	1.9	-7.1
Lamb	-6.6	1.5
Wool	-5.0	5.1
Sugar	5.0	1.8
Cotton	-9.9	-0.1

Source: NAB Group Economics, ABARES, MLA, Bloomberg and Thomson Datastream

These forecasts represent year-on-year average changes in Australian production and corresponding AUD prices between 2013-14 and 2014-15 financial years

Global economy:

- Moderate global growth continues after slowing in early 2014. This has resulted in slightly lower growth forecasts in 2014 which are projected to return nearer to trend in the out years. Advanced economies paint a mixed picture. While US GDP growth went backwards in the first quarter after a harsh winter, unemployment is falling steadily. Euro-zone growth has been dented by poor performance in France and Italy but the UK appears largely on track. Japan has coped with April's tax increases better than some feared. This mixed picture is likewise reflected in emerging economies. Trend slowing in China continues, while other East Asian economies, and India and Latin America remain sluggish.

Domestic Economy:

- Overall, a mixed picture of the Australian economy has emerged. While business confidence is still largely unaffected by the budget, NAB's quarterly Australian Consumer Anxiety Index has spiked and is now at the highest level since the survey began in early 2013. Domestic indicators continue to point to unemployment growth and there is no certainty that declining mining investment will be replaced quickly. Retail looks softer and the property market seems near a plateau with June house price increases potentially partly seasonal. The extent of fiscal consolidation remains uncertain and could be a slow burn on activity with concerned consumers.

Interest Rate:

- The RBA kept the cash rate at 2.5% in July, largely in line with expectations. With the RBA expecting growth for the coming year to be slightly below trend and the impact of restructuring associated with the end of the mining investment boom still uncertain, the cash rate is unlikely to increase for the rest of the year. A higher cash rate would also place upward pressure on the AUD which the RBA appears keen to avoid. Conversely, the RBA may be reluctant to lower the cash rate for fear of a renewed boom in house prices. These cross-currents are likely to see the cash rate on hold well into next year.

Table 2: NAB Global Economic Forecasts

% change year on year	2014	2015	2016
China	7.3	7.0	6.8
US	1.6	3.0	2.8
Euro zone	0.9	1.3	1.6
Emerging Asia	4.0	4.3	4.5
Japan	1.6	1.4	0.9
Middle East	3.2	4.4	4.7
Advanced economies	1.7	2.3	2.3
Emerging economies	5.1	5.4	5.5
World GDP	3.2	3.7	3.7

Source: NAB Group Economics

Table 3: NAB Australia Economic Forecast

% change year on year	2013-14	2014-15	2015-16
GDP growth	3.0	3.3	3.0
Private consumption	2.5	2.8	3.1
Unemployment rate	5.8	6.1	5.6
Consumer Price Index	2.7	2.1	2.8

Source: NAB Group Economics

Table 4: NAB Interest Rate Forecast

	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
RBA Cash Rate	2.5	2.5	2.5	2.5	2.5	3.0

Source: NAB

The Australian Dollar

- The AUD remains range bound, failing to hold breaks. While the AUD has tried to break its range, more so to the upside than the downside in the last few weeks, it has failed to do so and remains stubbornly in the 93.5-0.94.5 US cents range.
- RBA Governor Glenn Stevens recently commented that “most measurements would say (the AUD) is overvalued, and not by just a few cents” and that “investors are underestimating the likelihood of a significant fall in the Australian dollar at some point”. This shows that while AUD does remain supported by the general “carry,” low volatility environment, it is not gaining any further impetus on low levels of volatility.
- Our June quarter 2014 Post-farmgate Agribusiness Survey shows that post-farmgate agribusinesses expect the AUD to average 90.5 US cents over the next six months, slightly lower than the average business estimate of 91.5 US cents. These expectations are well above NAB’s forecasts of AUD performance, which project the AUD to fall to 85 US cents by the December quarter of 2014.

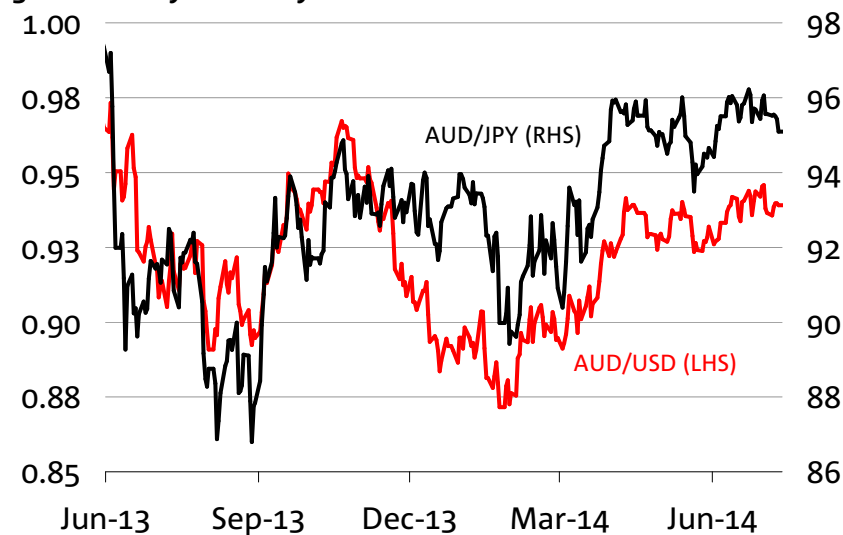


Table 5: NAB FX Strategy Targets

		2014 Q3	2014 Q4	2015 Q1	2015 Q2
Australian Dollar	AUD/USD	0.90	0.85	0.84	0.83
New Zealand Dollar	NZD/USD	0.84	0.80	0.78	0.77
Japanese yen	USD/JPY	106	108	110	112
Euro	EUR/USD	1.32	1.30	1.28	1.26
British Pound	GBP/USD	1.67	1.64	1.58	1.53
Swiss Franc	USD/CHF	0.95	0.96	0.98	1.01
Chinese New Yuan	USD/CNY	6.19	6.15	6.11	6.09
Canadian Dollar	USD/CAD	1.10	1.11	1.12	1.12

Source: NAB

Figure 1: Daily Currency Movements



Source: Thomson Datastream

Domestic Agricultural Outlook

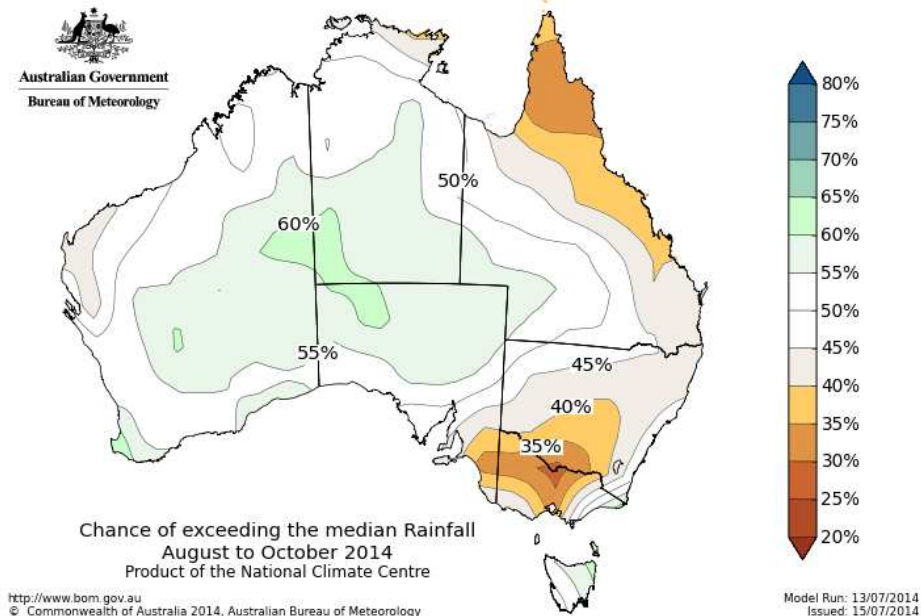
Production Outlook:

- In 2013-14, winter crops were unaffected by drought conditions and delivered a strong result, with the exception of parts of New South Wales and Queensland. The 2014-15 season has progressed well in most States, although growers in northern New South Wales and Queensland continue to be challenged by unreliable rainfall and a lack of subsoil moisture. ABARES expects that winter crop production will fall 12% in 2014-15, but it is possible that this estimate is conservative for Western Australia, South Australia and Victoria, where wheat has enjoyed a strong start to the season. The possibility of an El Niño event is a downside risk should it emerge before November.
- Red meat production and exports continue to proceed at a rapid pace in June following a strong performance in previous months on high slaughter rates. It is likely that supplies will tighten in the second half of this year.

Climate Conditions Update:

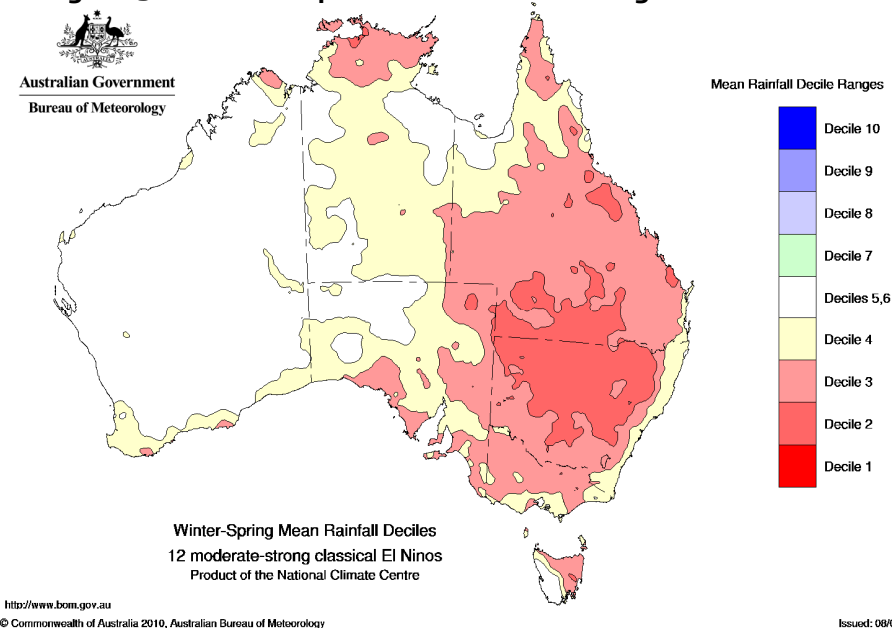
- The Bureau of Meteorology (BoM) now forecasts a drier than normal winter for northern Queensland, most of Victoria, south eastern South Australia and southern New South Wales, but Tasmania and central Australia are forecast to see above average rainfall.
- A transition towards an El Niño event may currently be underway. The BoM forecasts that El Niño remains likely to materialise in spring, it is increasingly unlikely to be a strong event. Nonetheless, El Niño could place producers in the eastern states in a more difficult position coming into summer.
- Northern New South Wales and southern and western Queensland remain under pressure from significant rainfall deficiencies. While autumn brought some welcome rains, growers will be heartened to see more optimistic BoM forecasts for rainfall from August to October, which now predict closer to average rainfall from August to October.

Figure 2: Australian Rainfall Outlook



Source: Bureau of Meteorology

Figure 3: Rainfall impact of moderate-strong El Niño events



Source: Bureau of Meteorology

Domestic Agricultural Outlook (Con't)

Rural Commodities Index:

- The NAB Rural Commodities Index continued to fall in June after its April peak as dairy and wheat prices edged lower. Overall, the Index declined 2.5% (AUD) and 2.6% (USD). Beef prices were stable, falling 0.7% (AUD) while lamb rebounded 2.9% (AUD), erasing falls in May. Dairy continued to fall for a fourth straight month, with global prices falling 3.9% (USD) in June. Wheat prices fell 8.9% (USD) on the back of plentiful global supply, while barley posted similar falls. Wool fell 1.6% (AUD) in a lacklustre finish for the financial year while cotton was slightly up. Sugar was down 1.6% (USD).

NAB Farm Input Prices:

- Global Diammonium Phosphate prices rose to USD 478/tonne in June and urea prices have rebounded to USD 308/tonne. Meanwhile natural gas prices were stable having retreated from their historic high in February to around USD 4.6/mmBtu, unchanged since April. Overall, the AUD fertiliser index was up 5% in May, rebounding from falls in March, April and May. Underlying fuel prices also edged higher, influenced in part by recent sectarian strife in Iraq. However, crude prices have since fallen on account of minimal Iraqi supply disruptions thus far.

NAB Weighted Feed Grain Prices:

- Domestic feed grain prices dipped due to falling barley, oats, sorghum, maize feed wheat and triticale prices. This has coincided with a strong autumn break in the south east from good autumn rainfall and above average autumn temperatures, which has seen pastures rebound. While the fattening and slaughtering of cattle and sheep in recent months has continued into June, falling global wheat, corn and soybean prices due to plentiful global supply are likely to mitigate many domestic pressures. Poor spring rainfall prospects if an El Niño weather pattern settles in will likely weigh on the mind of farmers and may lead to higher domestic feed grain demand approaching spring and summer, especially in areas which have received sporadic rainfall in the late autumn and early winter.

Figure 4: NAB Rural Commodity Prices

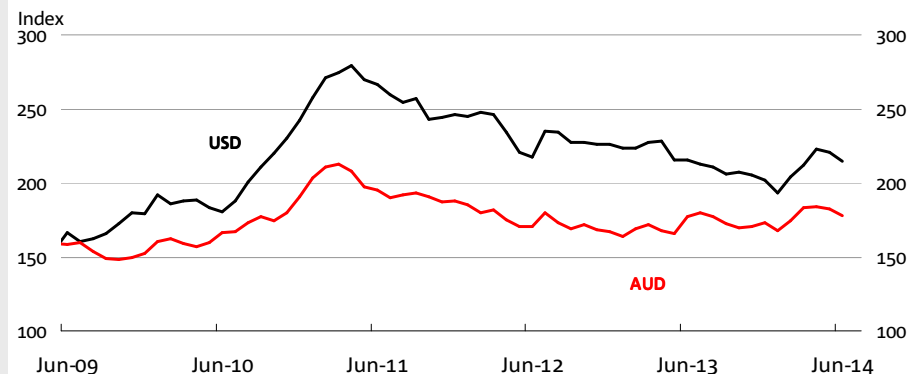


Figure 5: NAB Farm Input Price Index

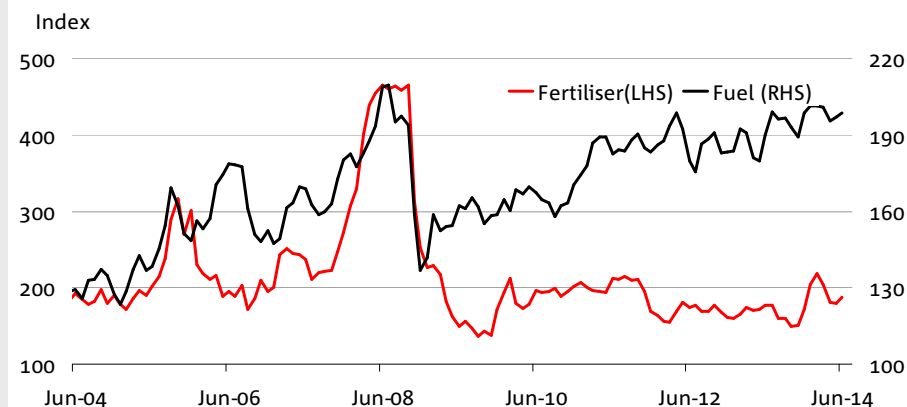


Figure 6: NAB Weighted Feed Prices



Sources: ABARES, BNZ, NAB

Agricultural Sectors

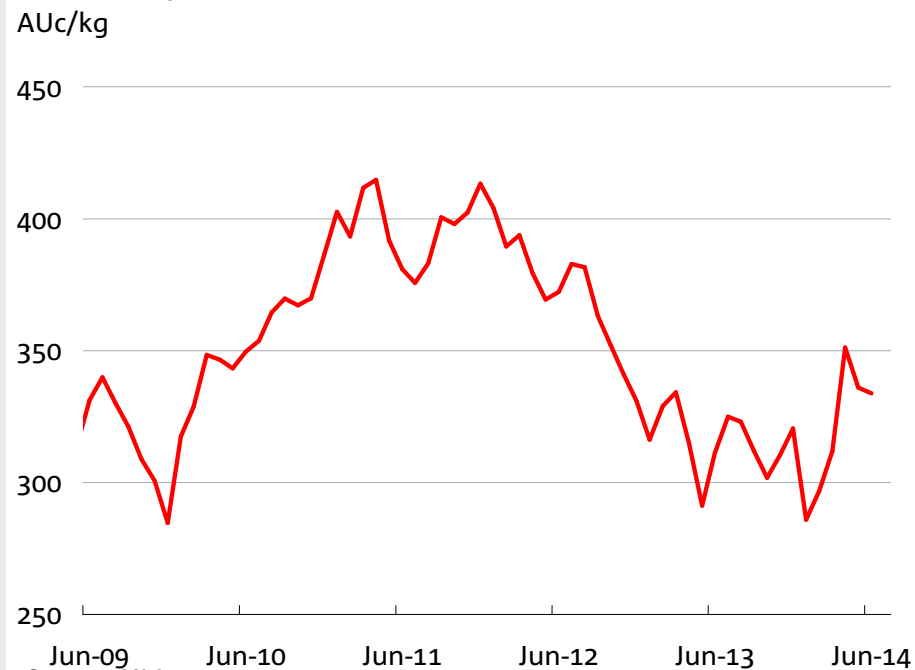
Cattle:

- Average cattle prices eased very slightly (-0.7%) to AUc 334/kg carcass weight, but are still 7% above the same period last year as decent rainfall in autumn and early winter across central and southern parts of Australia helped to boost restockers' confidence, although the prospect of El Niño in the spring remains a risk for the sector.
- In the meantime, cattle slaughter rates were lower in June overall, but up on May in New South Wales and Victoria, offset by lower slaughter rates in Queensland in particular.
- Australian exports of beef and veal were down somewhat in June from their May record, with 103,257 tonnes exported. Nonetheless, exports are almost 18% higher than this time last year. Meat and Livestock Australia forecasts that the US will be Australia's largest beef export market in 2014, surpassing Japan for the first time since 2003.

Lamb:

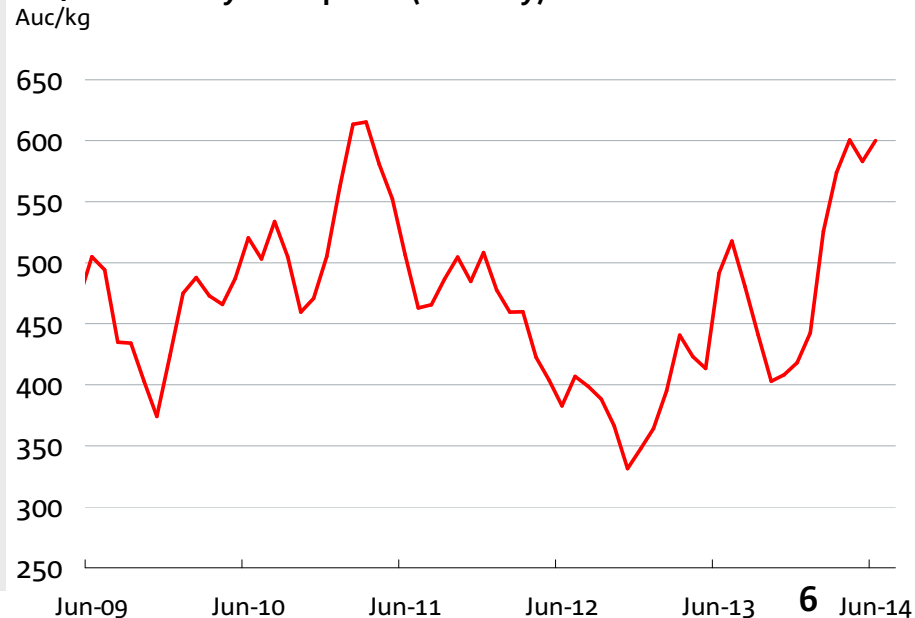
- Lamb prices rebounded in June to erase their May falls in what continues to be a strong year for the sector. Heavy lamb prices are up 2.9% in AUD terms to 600 AUc/kg carcass weight. Exports fell 4% in June but are still 15% higher than last year
- Slaughter rates fell in June from elevated levels earlier in 2014. The sustained long period of high slaughter in 2013 and 2014 combined with poor weather conditions during the joining season have resulted in fewer breeding ewes and lower conception rates in 2014, which foreshadows a significantly tighter supply of stocks available for slaughter in 2015.

Figure 7: Australian Cattle Prices – Eastern Young Indicator (Monthly)



Source: MLA

Figure 8: Heavy lamb prices (Monthly)



Source: MLA

Agricultural Sectors

Wool:

- Wool prices gave up their May gains in June, with the Eastern Market Indicator falling 1.3% to 1031 AUc/kg. June 2014 prices are virtually unchanged from the same time last year.
- Overall, the mood among farmers was subdued at the end of 2013-14, with superfine wool in particular performing disappointingly. If prices continue to disappoint, it is possible that Australian wool supply will further decline as substitution to lamb or beef becomes more enticing.
- The Australian wool market has been gripped by soft demand conditions since February, partly reflecting the lack of available credit for Chinese manufacturers as Chinese authorities clamped down on lending and raised required capital to loan ratios for a number of banks. However, recent reports suggest that the Chinese central bank is now boosting supply and pushing banks to extend loans. With around three quarters of Australian wool destined for China, farmers will be hoping for improved Chinese economic conditions in 2014-15.

Dairy:

- Global dairy prices continued to fall for their fourth straight month in June, with BNZ's global weighted index down 3.9% to US\$5187/tonne. Despite international headwinds, domestic opening prices for this season are similar to last year. Lion is opening with \$6.35/kg milk solids, followed by Murray Goulburn with \$6, Warrnambool Cheese and Butter with \$5.86 and Fonterra with \$5.80.
- In Australia, above-average rainfall in the southern parts of the country during the autumn months, combined with above average temperatures in May, has given dairy farmers a good break going into winter. However, if El Niño materialises in the spring, producers will likely need to increase supplementary feeding, increasing costs and hurting margins.

Figure 9: Eastern Market Indicator



Source: MLA

Figure 10: BNZ Global Dairy Prices



Source: BNZ

Agricultural Sectors

Sugar:

- Global sugar prices fell 1.7% in June, continuing the subdued pace that began with falling prices in late 2012 and early 2013. The US Department of Agriculture recently cut Mexican and US production estimates, which, combined with drought conditions in Brazil and persistently low prices for producers, could see the supply overhang dissipate and cause shortages.
- In Australia, uncertainty continues over the future of Queensland Sugar Limited's (QSL) single desk for sugar exports precipitated by the decision of Wilmar, Tully and MSF to leave the scheme for 2017. The ABC reports that Isis Sugar Mill, Bundaberg Sugar and Mackay Sugar have renewed their contracts with QSL for the the 2017 season. QSL now controls around 600,000 tons of sugar for 2017, a considerable reduction.

Cotton:

- Cotton prices inched up 0.9% to 91 USc/pound in June, before falling steadily at the end of the month and into July. Prices are lower than the same time last year on account of higher global production and lower consumption from China as textile production shifts towards polyester.
- The US Department of Agriculture has sharply revised up its forecast of US cotton production for 2014-15 its July 2014 *World Agricultural Supply and Demand Estimates*. The report projects that world cotton stocks for 2014-15 will amount to 105.7 million bales, with 2014-15 production increasing by 500,000 bales.

Figure 11: Global Sugar Prices

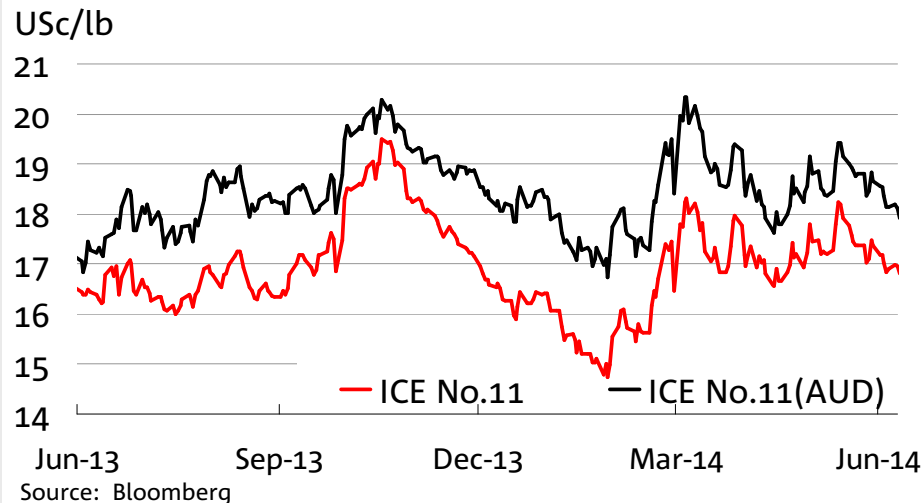
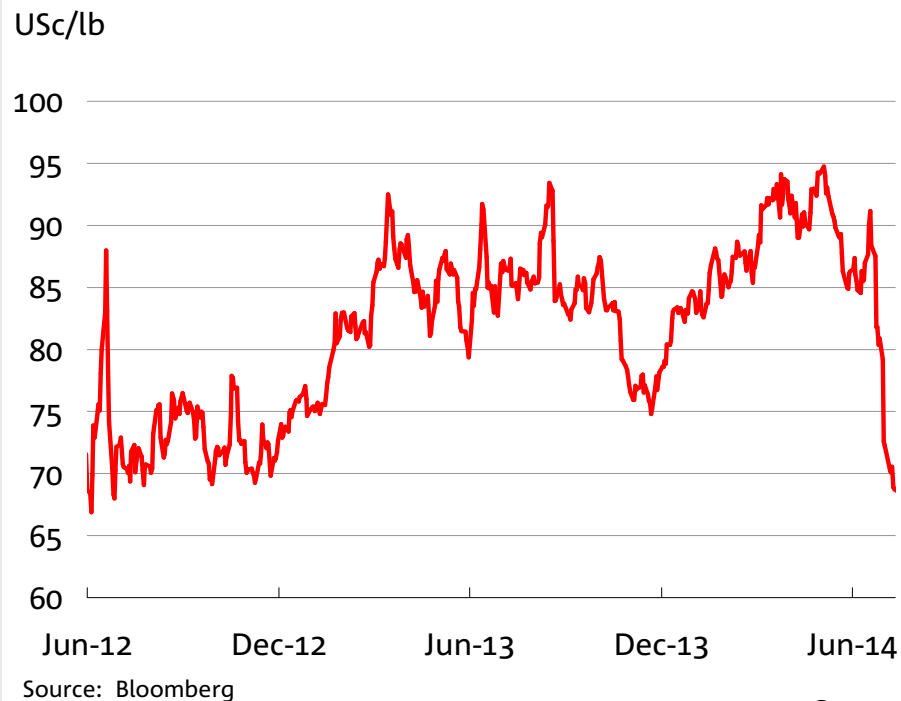


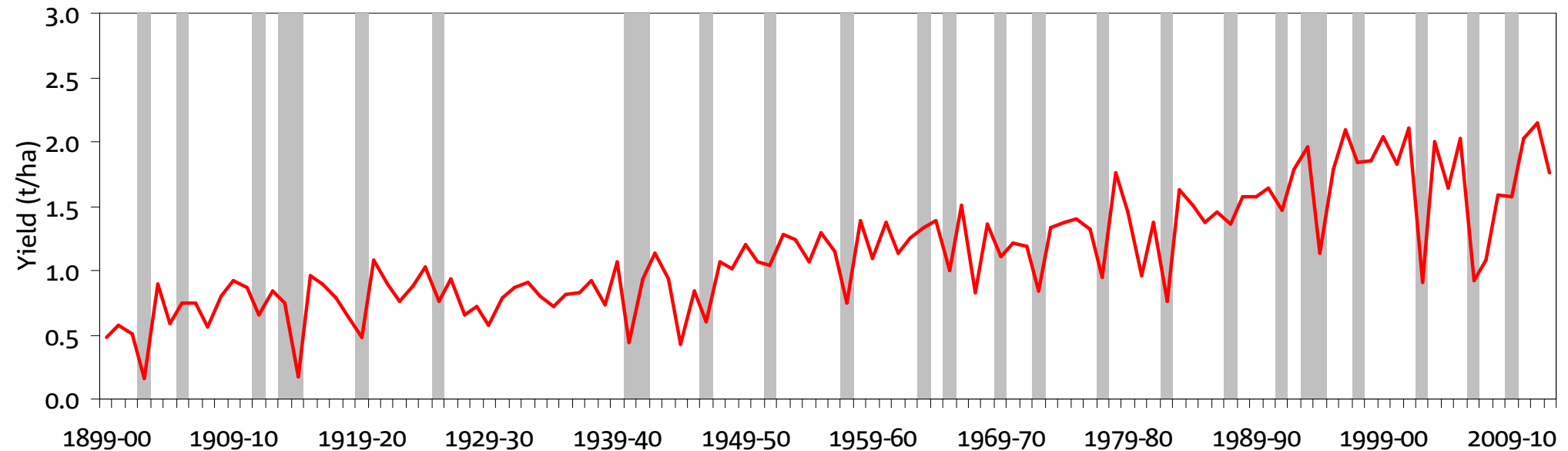
Figure 12: Global Cotton Prices



In Focus: Wheat

- Global wheat prices have been falling since May as a result of plentiful supply in most world wheat growing regions. US wheat production rebounded in the spring after a difficult winter and the EU and Ukraine look set for a good season based on favourable weather conditions. Although wheat futures were 538 USc/bushel on 25 July – almost 20% below their July 2013 average – it will be some time before the strength of the 2014-15 wheat season is fully revealed.
- The 2014-15 Australian wheat season has started well in Western Australia, South Australia, southern New South Wales and Victoria, but northern New South Wales and Queensland producers are facing greater challenges caused by sporadic rainfall and low subsoil moisture levels.
- El Niño remains the biggest concern for the industry over the coming months, although BoM now forecasts that it is increasingly unlikely to be a strong event. While the impact of El Niño on wheat yields is difficult to predict, an emergence of the phenomenon in early spring would generally see lower spring rainfall in wheat growing regions and poorer wheat yields.
- More detail on the impact of El Niño on State wheat yields can be found in our *Special Report: Impact of El Niño on State Wheat Yields*.

Figure 13: Wheat yield – Australia (shaded areas show El Niño events)

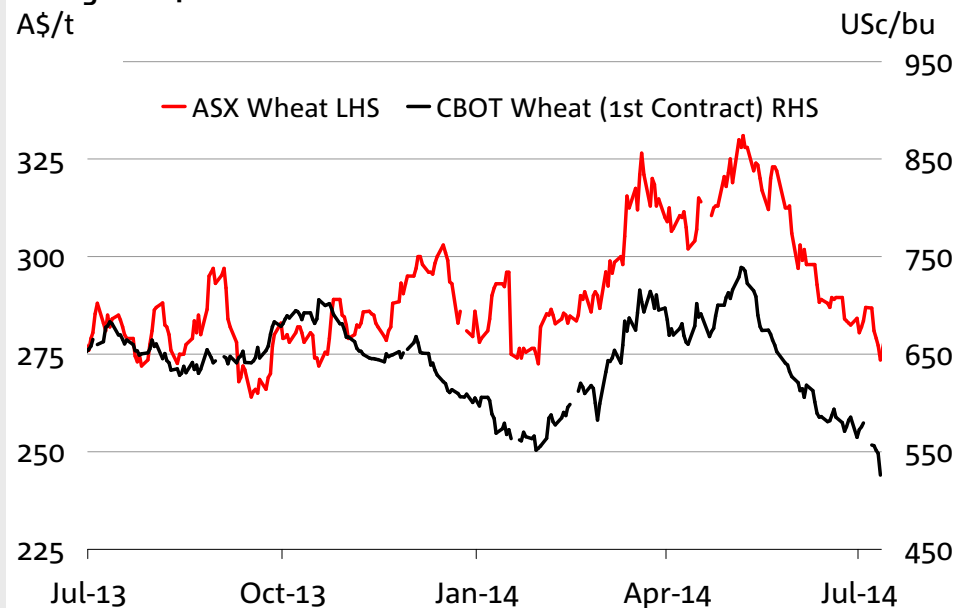


Source: Bureau of Meteorology, Australian Bureau of Statistics

Wheat: global trends

- Global wheat prices have been falling steadily since early May as producers look to bumper wheat, corn and soy crops in most growing regions. Wheat futures on the Chicago Board of Trade (CBOT) fell below 600 USc/bushel in early June and are now below 540 USc/bushel.
- The US Department of Agriculture has sharply increased its forecast for US hard red spring wheat for its July 2014 *World Agricultural Supply and Demand Estimates* on account of high soil moisture levels and cooler than average early summer temperatures across the Northern Plains. This is projected to more than offset the lower hard red winter wheat crop.
- Production in the EU and Ukraine is forecast to increase due to favourable weather conditions, while production in Kazakhstan and Canada is forecast to decline. Overall, the US Department of Agriculture forecasts world wheat production to be down on last year but still the second highest on record at 705.2 million tons.
- Geopolitical events do not appear to be affecting prices at present. Concerns earlier this year that unrest in Ukraine could hamper wheat production have not been borne out so far. While recent moves by the government in Egypt - the world's largest wheat importer - to reduce bread subsidies have caused domestic controversy, they are unlikely to reverberate globally in the short term.
- Domestic wheat prices, while generally tracking downward global trends, continue to maintain a premium to international prices on the back of lingering nervousness about the emergence of El Niño this spring, as well as strong feed grain demand caused by elevated rates of fattening and slaughter of cattle and sheep.

Figure 14: Global Wheat Futures Prices



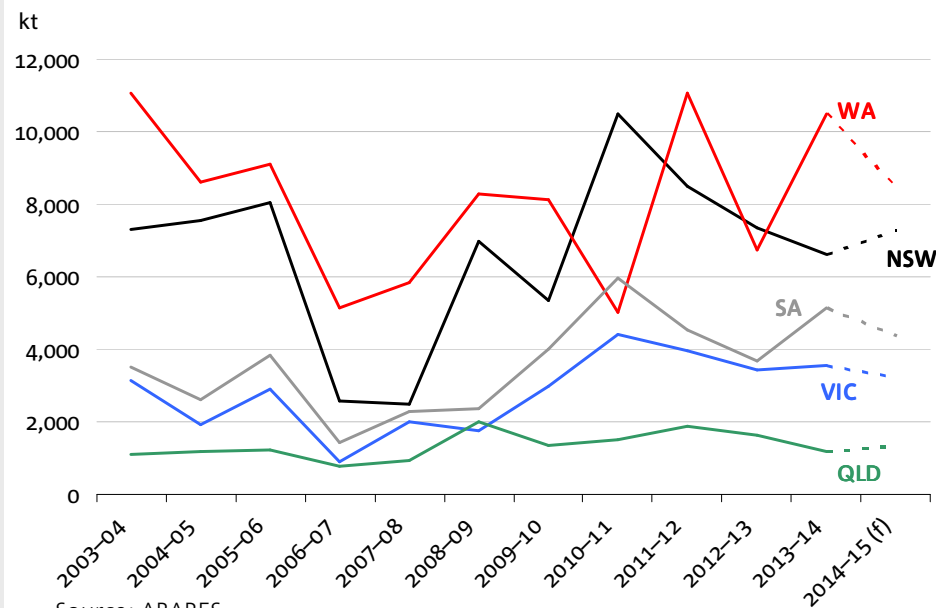
Source: Bloomberg



Wheat: domestic production outlook

- The 2014-15 Australian wheat season has generally been off to a good start in Western Australia, South Australia, Victoria and southern New South Wales. After a long and hot summer which saw summer crop production fall 33%, decent autumn rainfall across many wheat growing regions have improved growers' spirits. NAB agribusiness bankers report that the season has started very well in Western Australia, South Australia and the Riverina in New South Wales, while in Victoria growers are hopeful of average yields if decent spring rains offset lower subsoil moisture levels.
- The situation in northern New South Wales and Queensland is less optimistic. In the Darling Downs, good pre-planting rainfall arrived in March but low subsoil moisture combined with a number of heavy frosts is placing pressure on crops. NAB agribusiness bankers report that without decent rains over July and August yields will likely decline.
- ABARES forecasts that Australian wheat production will decline 9% in 2014-15, led by falls in Western Australia and South Australia. We consider that developments since the release of the ABARES estimate on 11 June suggest that wheat yields in Western Australia, South Australia and Victoria will be better than the ABARES estimate, while ABARES' projection of higher wheat production in Queensland may be optimistic.
- El Niño remains the biggest concern for the industry over the coming months, although the outlook has become somewhat less concerning over July. While the lack of El Niño onset into winter has given south-eastern and western growers a good start to the season, an emergence of the phenomenon in the spring could put pressure on wheat yields across eastern Australia. Although the impact of El Niño on conditions is difficult to predict, few wheat producers would welcome its emergence before November.

Figure 15: Wheat Production and ABARES 2014-15 Forecast



Source: ABARES



Comments from the Field: 2014-15 wheat season

The season has started off remarkably well with good opening rainfall in April/May and good follow up rain in June/July in the Upper Great Southern area.

Farmers are fairly optimistic of above average wheat yields, the main risk potentially is frost damage in September. The only drawback at the moment is lower prices, but farmers are hoping for increased yields to offset price.

**– Michelle Halstead
Agribusiness Manager, Narrogin**

Generally growers in most areas of the Darling Downs have been able to plant some, if not all of their planned winter cropping area. Good pre-planting rain in March, combined with recent smaller but patchy falls, has seen crops remain in a relatively healthy condition. The last month saw winter well and truly arrive with a number of heavy frosts occurring and these, combined with a lack of subsoil moisture, has growers hoping for further rain to ensure crops continue on a positive path.

With a long way to go and a 'not so great' forecast the Darling Downs winter crop could go either way with rain over the next month (or a lack of it) to determine how our season ends. I would forecast that across the Darling Downs, unless we get 1-2 inches of rain by the end of July/August, we will see a significant drop off in yield expectations.

**– Sarah Short
Agribusiness Manager, Goondiwindi**

It's been a very good start to the year and we're hearing farmers 60, 70, 80 years old saying this year is the best start they've ever seen. It has been a very casual type of year, with everything more or less as intended and spraying and spreading urea haven't seen many problems. If there are decent rains in July and August we should get a good crop.

**– Randall Holmes
Senior Agribusiness Manager, Wagga Wagga**

We see an excellent start to season in all local areas. There have been good early rains to commence programs and warm days and continued rainfall in May/June has meant crops are away to vigorous growth.

Crop development stage overall is in advance of the same time last year and we have a full sub soil moisture profile to hold in good stead for the remainder of the year. There are small cases of areas suffering from water logging.

**– Michael Laidlaw
Agribusiness Manager SA North, Claire**

In the Wimmera Mallee we are tracking to average or slightly above average in some patches, particularly the Northern Mallee, which received above average summer rainfall. With that being said, yields will be largely determined by the strength of the spring rains, as subsoil moisture levels are low, following a long, dry summer.

Whilst the threat of an early onset of El Niño remains, should this hold off until early November, we expect yields to remain largely unaffected.

**– Brad Sudholz
Senior Agribusiness Manager, Horsham**

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