

Rural Commodities Wrap – August 2014

Phin Ziebell, NAB Agribusiness Economist

Summary

- The overall outlook across most agricultural commodities remains strong. The wheat season is progressing well over most areas and lamb and beef slaughter continues at elevated levels, heightened by dry conditions in northern New South Wales and Queensland.
- Prices declined across most agricultural commodities in July, led by falls in wheat (down 8.5% in USD terms), lamb (down 8.1% in AUD terms), cotton (down 7.8% in USD terms) and dairy (down 4.5% in USD terms). Beef was up by 0.9% and wool down 0.5%. The NAB Rural Commodities Index fell 2.9% (USD and AUD) for the month.
- Global data remain mixed, with solid growth in the US and UK balanced against risks in the Eurozone, Japan and Latin America. Chinese growth remains robust while Indian growth continues to disappoint. Locally, weak retail trade and net exports point to soft GDP growth in the second quarter and employment continues to drift. Business conditions, business confidence, orders and capacity utilisation are improving however.
- This month's Rural Commodities Wrap includes an in focus section on beef. We see the outlook for beef as positive overall, based on strong export growth and increasing prices. While the ongoing drought continues to loom over northern producers, a decent wet season should increase restocker confidence and see producers rebuild their herds. This would likely see production fall and prices increase.

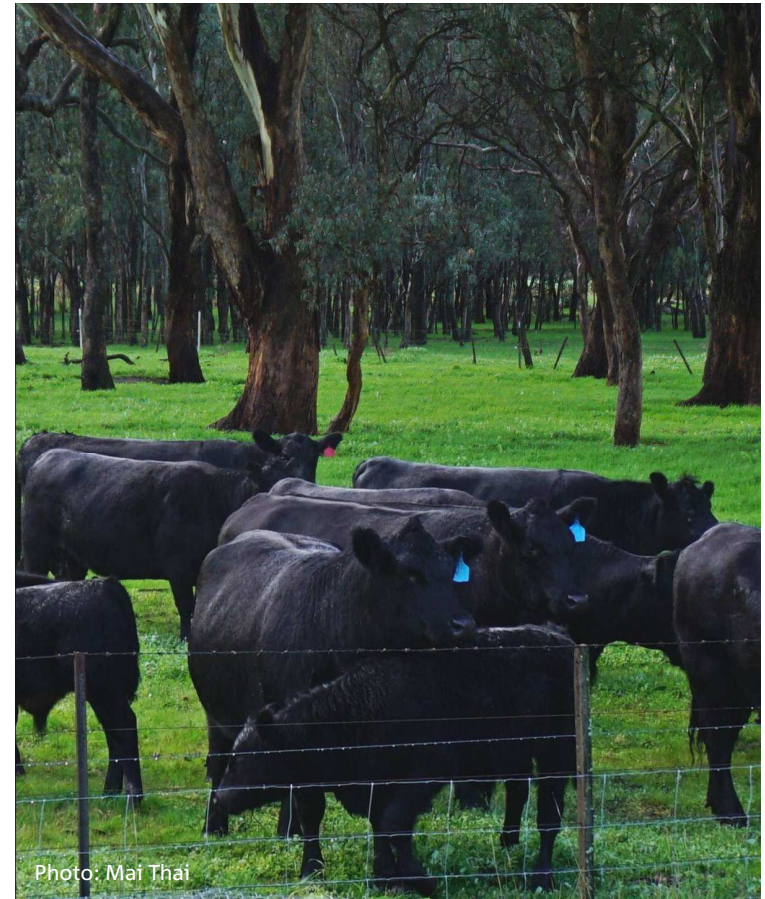


Photo: Mai Thai

Economic Update

Global economy:

- We have trimmed our global forecasts to take account of the impact of default in Argentina on Latin American growth and unexpectedly soft Japanese exports and post-tax consumption which led us to significantly lower our Japanese forecast. Elsewhere, solid growth numbers are coming from the UK and US but the Euro-zone presents downside risks (with soft recent business surveys and second quarter GDP in Italy and Belgium) to growth and a clear threat of deflation. The emerging economies now drive around 70% of global output growth but present a mixed picture. China's growth remains robust, India's has disappointed but could be about to pick up and East Asian economies are likely to remain subdued pending faster world trade. Overall, world growth in 2015 to rise to 3.6% (nearer trend) from a mixed and disappointing 3.1% in 2014.

Domestic Economy:

- Weak retail trade and net exports point to soft GDP growth in the second quarter. Employment continues to drift and the jump in unemployment rate appears to be a quirk from ABS measurement changes (which probably added 0.2 points to unemployment). Partial indicators are generally better: business conditions jumped to four year high in July, while, business confidence, orders and capacity utilisation are all looking better. But headwinds remain, especially a high AUD, declining mining investment and fiscal restraint. Australian forecasts are revised down in 2014-15 (3.1% from 3.3%) and up in 2015-16 (3.2% from 3.0%). We forecast the official unemployment rate to peak at 6½% by end 2014 (was 6¼%) and only slowly improve (6.2% by end 2015). The cash rate is likely to remain on hold until late 2015 but there is a risk of a cut(s) if unemployment rises above the current forecasts.

Interest Rates:

- We still expect no change in the cash rate until the end of 2015. Labour demand remains tepid but there are encouraging signs from forward indicators, including our own survey. However, the potential near term weakness in GDP represents a clear risk that the cash rate may need to be cut if conditions worsen again. A pain point for the RBA would be unemployment at 6¾%.
- For more information on recent global and domestic economic trends, see our [August Global & Australian Forecasts](#) and [World on Two Pages](#) reports.

Table 1: NAB Global Economic Forecasts

% change year on year	2014	2015	2016
China	7.3	7.0	6.8
US	2.1	3.0	2.8
Euro zone	0.9	1.3	1.6
Emerging Asia	4.0	4.3	4.5
Japan	1.3	1.5	0.8
Middle East	3.1	4.8	4.7
Advanced economies	1.9	2.3	2.3
Emerging economies	4.9	5.3	5.5
World GDP	3.1	3.6	3.7

Source: NAB Group Economics

Table 2: NAB Australia Economic Forecast

% change year on year	2013-14	2014-15	2015-16
GDP growth	2.9	3.1	3.2
Private consumption	2.5	1.2	0.9
Unemployment rate	6.0	6.1	5.6
Consumer Price Index	2.8	2.1	2.7

Source: NAB Group Economics

Table 3: 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

Exchange Rates

- The AUD has remained in a relatively narrow range between 93 and 95 US cents for much of 2014, reflecting a relatively low volatility environment. However, the USD has made an attempted break higher across the board of late. If volatility slips lower again, the AUD is likely to move into the lower 94 to 92 US cents range; a rise in volatility would see a more sustained move toward NAB's 90 US cents end third quarter target.
- The ratcheting up of geopolitical tensions has seen JPY, CHF and to a lesser extent USD display some traditional safe-haven characteristics. How volatility behaves will be key; ultimately higher volatility and a return to focus on (good) US data are required for stronger and sustained USD advances.

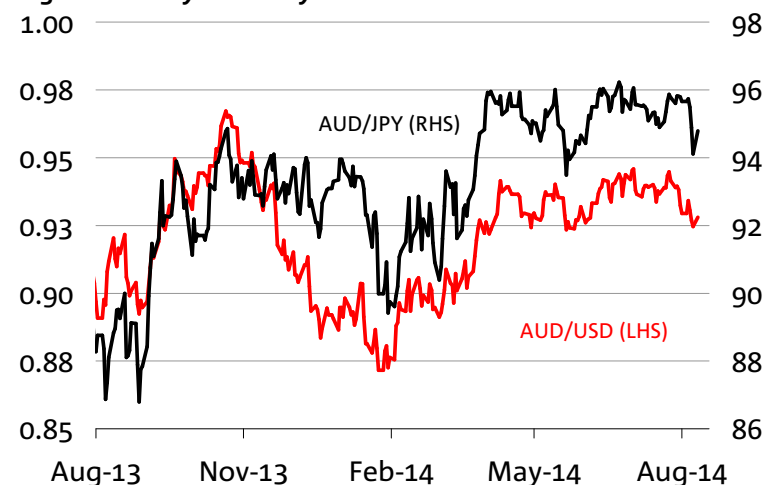


Table 4: NAB FX Strategy Targets

		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

Climate Conditions Update

- July rainfall was below average over much of southern and western Queensland, northern and Western New South Wales as well as the Gascoyne and parts of the wheatbelt in Western Australia. Above average falls were recorded in the Kimberley, around Darwin, Cape York, coastal South Australia and parts of Victoria. Parts of eastern Australia have endured unusually frequent and severe frosts over the winter. It is likely that these frosts will have some impact on winter crop yields.
- The Bureau of Meteorology (BoM) forecasts that rain from September to November is likely to be below average in central and parts of northern Victoria, western Queensland and much of southern and central New South Wales.. Above average rainfall is forecast for parts of central Australia and Tasmania.
- BoM has downgraded the likelihood of El Niño developing in 2014 to 50%. While this is still double the normal likelihood of an El Niño event occurring, BoM expects it is unlikely to be a long lasting event.

Production Outlook

- The production outlook for winter grains remains strong. Wheat yields are likely to benefit from the recent El Niño risk downgrade, although Victorian and southern New South Wales producers could be chasing rain in the event of a dry spring.
- The outlook for protein will be influenced by spring rainfall. If conditions return to normal in northern New South Wales and Queensland, it is likely that cattle slaughter will contract and producers will look to rebuild herds. Dairy had a strong autumn and winter break, but below average spring rainfall in Victoria and eastern South Australia remains a risk.
- Fibre production may come under pressure over the coming months, with cotton production at risk from lower water availability and both wool and cotton producers concerned about lacklustre prices and uncertain Chinese demand.

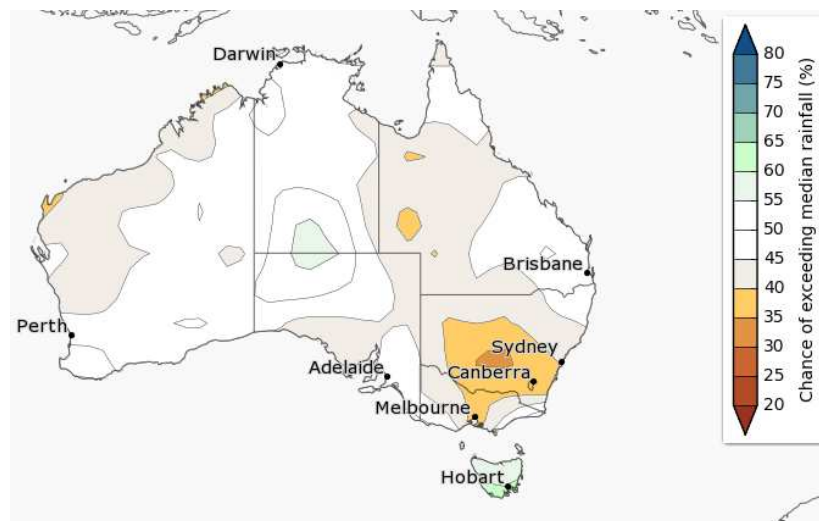
Table 5: NAB Commodity Price and Production Growth Forecasts (%) for 2014-15

	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, Meat and Livestock Australia, 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

Figure 2: Australian Rainfall Outlook: chance of exceeding median rainfall - September to November 2014



Source: Bureau of Meteorology

Domestic Agricultural Outlook

NAB Rural Commodities Index

- The NAB Rural Commodities Index fell for the third straight month in July, led by lower wheat, lamb, cotton and dairy prices. An improved supply outlook in the United States, driven by improved weather, has put downward pressure on international grain prices.
- Overall, the index gave up 2.9% in both AUD and USD terms.

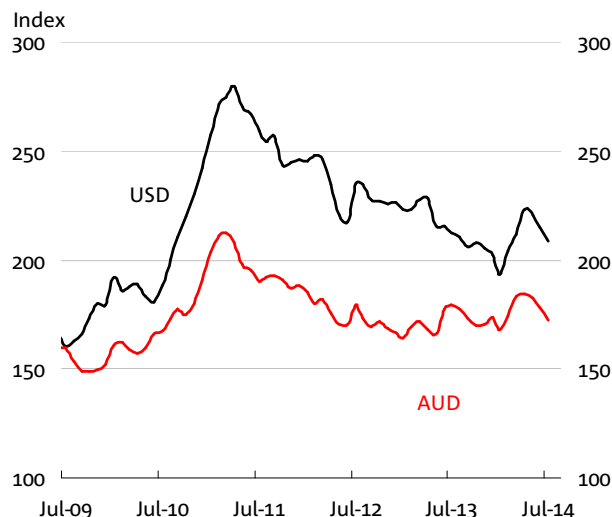
NAB Farm Input Prices

- Global Diammonium Phosphate prices increased to USD 511/tonne in July while urea was steady at USD 308/tonne. Meanwhile natural gas prices fell to US\$4/MMBtu, down from US\$4.6/MMBtu in June. Overall, the AUD fertiliser index was down just 0.1% in June.
- Petrol prices were essentially steady in July, falling 0.1AUC/litre for the month.

NAB Weighted Feed Grain Prices

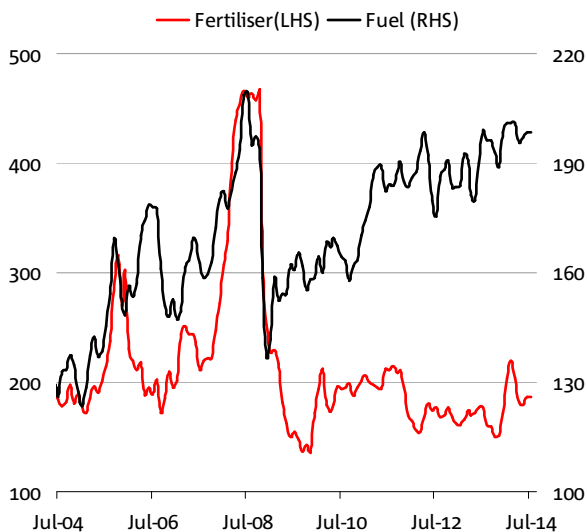
- Weighted feed grain prices fell 4.7% in July, brought down by lower wheat, barley, oats and triticale prices. Sorghum prices increased while maize was steady.
- If south eastern Australia receives a drier than average spring, poor pasture growth may put upward pressure on feed grain prices.

Figure 3: NAB Rural Commodity Prices



Sources: NAB Group Economics, ABARES, Meat and Livestock Australia, Bloomberg and Thomson Datastream

Figure 4: NAB Farm Input Price Index



Source: ABARES, BNZ, NAB Group Economics

Figure 5: NAB Weighted Feed Prices



Source: ABARES, NAB Group Economics

Agricultural Sectors

Wheat

- Global wheat prices continued to fall in July before staging something of a recovery in early August as rains delayed harvest in France and Germany (demoting much of the crop to stock feed quality) and tensions increased in the Ukraine. Prices have since eased somewhat on account of welcome August rains in New South Wales and Western Australian wheat regions as well as a downgrade in the likelihood of El Niño occurring, although some south eastern areas have experienced unusually frequent frosts.
- The United States Department of Agriculture's (USDA) *World Agricultural Supply and Demand Estimates* report for August sees the 2014-15 world wheat supply forecast raised 10.9 million tons to a record 716.1 million tons based on increased forecast production in the United States, China and the Black Sea region.

Lamb

- Heavy lamb prices fell 8.1% in AUD terms in July to 551AUc/kg carcase weight. Prices are nonetheless 6.4% higher than the same time in 2013.
- Lamb slaughter was down 4.3% in the eastern States, led by a sharp fall in South Australia. Slaughter was 7.8% higher in Queensland, 7.9% higher in New South Wales and 12.7% higher in Victoria. Slaughter rates have been elevated over the past year by drought conditions in New South Wales and Queensland, which have seen high turnoff and limited restocker interest. However, Meat and Livestock Australia projects that producers will increasingly look to rebuild their flocks over the coming year. This is likely to lead to lower production and higher prices.

Figure 6: Global and Australian wheat futures prices

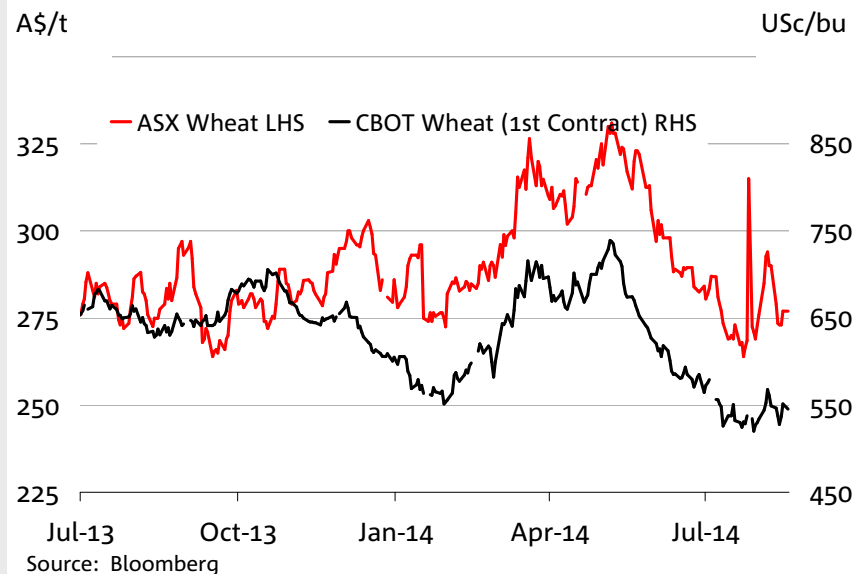
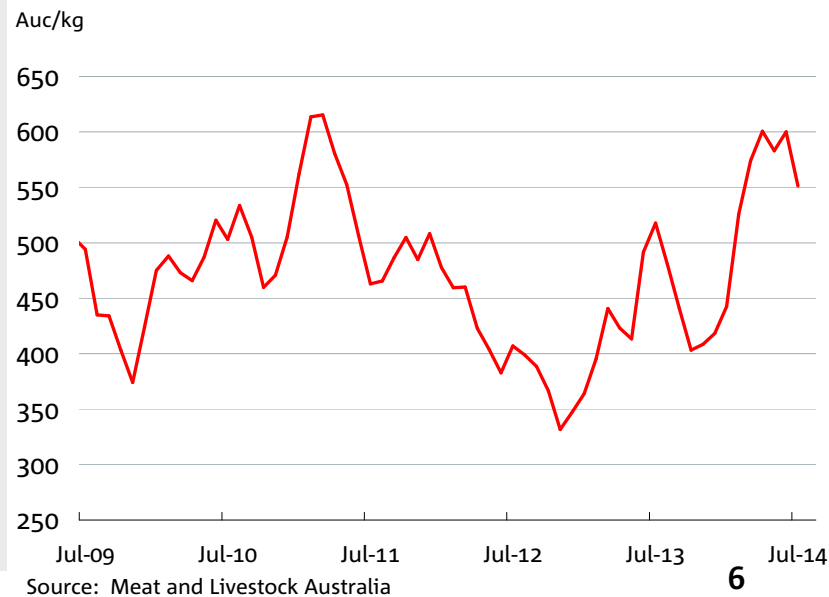


Figure 7: Heavy lamb prices (Monthly)



Agricultural Sectors

Wool

- Wool prices fell slightly in July, with the benchmark Eastern Market Indicator falling 0.5% to average 1024 AUc/kg for the month, although the annual three week recess saw lower trading volumes.
- China is far and away the largest customer of Australian wool. In 2012-13, over three quarters of Australian wool exports were sent to China. Partial indicators in China point to a stabilisation in the economy, after the slowing trend across late 2013 and early 2014. However, similar growth in the third quarter could be difficult to achieve, pointing to continued mixed performance in the wool industry.

Dairy

- Global dairy prices continued to fall in July and were down 4.5% for the month. Prices have been falling for much of 2014 and are now 19.3% lower than their February peak. Prices have since shown some signs of stabilisation in August, although risks continue to be weighted on the downside.
- Russia's announcement in August 2014 that it would ban most food imports from the United States, European Union, Canada, Australia and Norway has caused some concern in the Australian dairy industry. Australian dairy exports to Russia have been growing strongly in recent years. While Australian dairy exports to Russia were worth around AU\$29 million in 2012-13, recent reports from Murray Goulburn suggest that the exports could be approaching \$100 million in 2014. While this represents a small portion of Australia's AU\$2.2 billion dairy export industry, there is a risk that international prices will fall further as European Union producers look to find alternative buyers.
- For more information on the Russian sanctions, see our *Special Report: Impact of the Russian Food Embargo on Australian Agriculture*.

Figure 8: Eastern Market Indicator



Source: Meat and Livestock Australia

Figure 9: BNZ Global Dairy Prices



Source: BNZ

Agricultural Sectors

Sugar

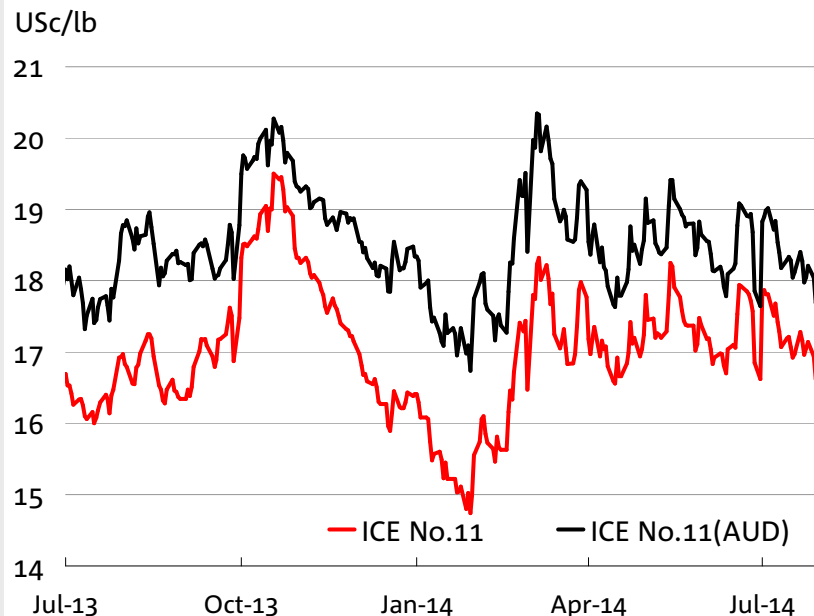
- Global sugar prices held steady in July, averaging 17 USc/lb for the month. Sugar futures have since fallen below 16 USc/lb in August reflecting ample global supply and large stockpiles. There are concerns however that Brazil's harvest, although starting well, may ultimately fall short due to drought damage.

Cotton

- Global cotton prices tumbled in July. Cotlook 'A' index prices were 7.8% lower in July at 84 USc/lb. Cotton futures have tumbled further, ending the month at 62 USc/lb and remaining stable to mid August. The considerable drop in prices is a result of changes to Chinese stockpile arrangements and good rains in Texas cotton regions.
- Australian cotton production is forecast to fall. Cotton Australia projects that Australian production could fall up to 50% in 2014-15 due to drought conditions causing constrained water availability. Poor international prices may see further trepidation on the part of local producers and lead to changed production plans.

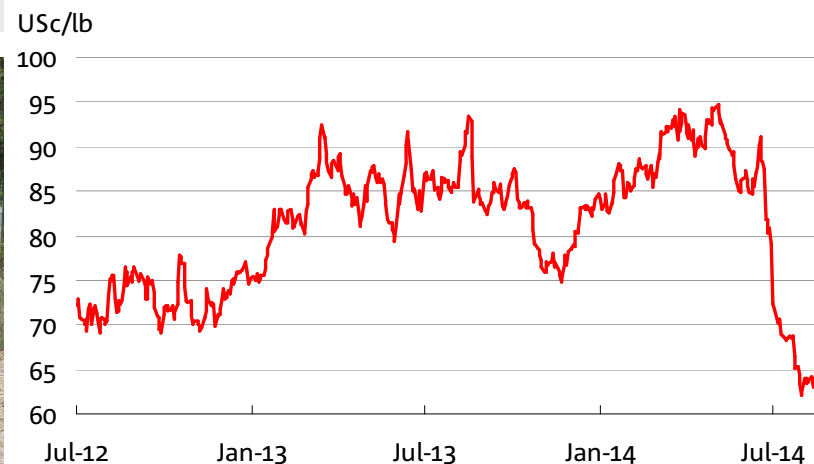


Figure 10: Global Sugar Prices



Source: Bloomberg

Figure 11: Global Cotton Prices



Source: Bloomberg

In Focus: Beef

- Australian beef exports have performed strongly in 2014, driven by higher turnoff and strong export prices.
- Average slaughter rates for 2014 (YTD) in the eastern States are 8.8% higher than 2013. Ongoing drought conditions in northern New South Wales and southern and western Queensland have seen higher turnoff and limited restocker interest. Despite these trends, the benchmark Eastern Young Cattle Indicator (EYCI) has grown moderately in 2014 and is now 3.7% higher than the same time last year.
- International trends have been favourable overall in 2014. Australian beef exports to the United States have performed particularly well, with Australian exports of hamburger beef filling the void left by the smallest US cattle herd in more than half a century.
- The Japan-Australia Economic Partnership Agreement, announced in April, will see lower Japanese tariffs on Australian beef, while stalled trade with Russia is unlikely to cause significant disruption to Australian producers.
- The outlook for Australian beef for the remainder of 2014 hinges largely on climatic conditions in Queensland. If the State enjoys a good wet season, producers will look to rebuild their herds and prices will likely rise on lower turnoff and increased restocker interest.
- On balance, we expect Australian beef production to fall moderately (4%) in 2014-15 and prices to increase 3.5% as producers rebuild their herds.



Global trends

August 2014 – Russia embargos Australian food imports

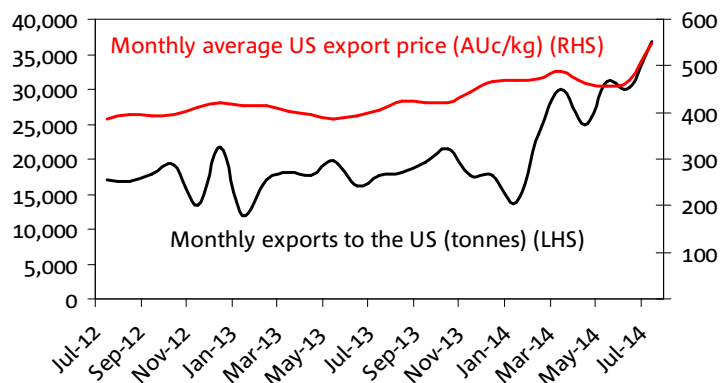
The Russian Government announced in early August that it would introduce a full embargo on most food imports from the European Union, the United States, Canada, Australia and Norway. The ban covers beef, dairy, fruit and vegetables and will apply for one year.

FAOSTAT data indicate that 82% of Australia's food exports to Russia are beef products, although no Australian beef has been exported to Russia since April over protocol and quality concerns. Total Russian beef imports now subject to embargo are less than US\$900 million, which suggests that any secondary price impacts for Australian producers are likely to be moderate. It remains possible that exports of live breeder cattle to Russia will continue despite the ban.

2014 – Australian beef exports to the US increase

Australian beef exports to the US have grown strongly in 2014. Export quantity grew 38% year on year to July 2014 and prices increased 15.2% in AUD terms over the period.

Figure 12: exports to the US and prices received



Source: Meat and Livestock Australia

April 2014 – Japan-Australia Economic Partnership Agreement

The Japan-Australia Economic Partnership Agreement, announced in April, will see Japanese tariffs on beef fall substantially from 38.5% to 19.5% for frozen beef over 18 years and to 23.5% for fresh beef over 15 years. The cuts will be front loaded, with an 8% cut for frozen beef and a 6% cut for fresh beef in the first year.

These upfront cuts to beef tariffs will give Australia a competitive advantage in beef relative competitors such as the US and Canada. However, the Trans Pacific Partnership, currently under negotiation, could see Japanese beefs tariffs cut for US and Canadian producers as well, blunting Australia's advantage.

Regional trends: Northern Australia

2014 – renewed interest in northern Australian properties

We see increased activity from mostly Indonesian and Chinese interests purchasing cattle stations to shore up beef supply as rising incomes have supported a strong demand for protein in Asia. Live exports have also diversified, for example Vietnam where domestic slaughter rates have outpaced breeding.

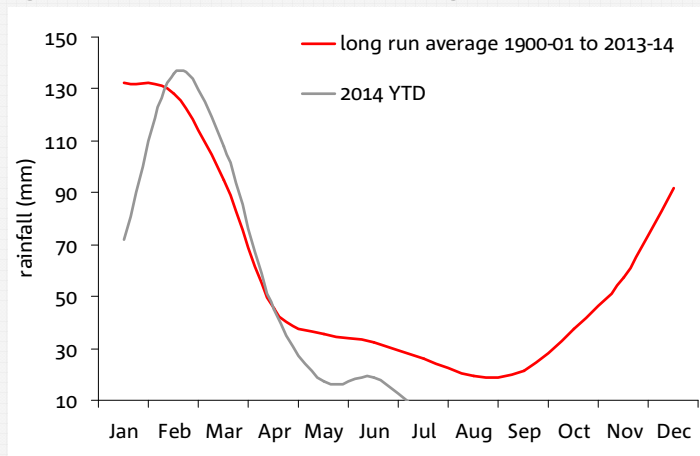
The forthcoming opening of the AAco abattoir in Darwin will give producers an alternative, especially for stock not the correct size or weight for trade. The facility will also process buffalo.

Gary King
Regional Agribusiness Manager
Brisbane QLD

Winter 2014 – drought persists in northern NSW and Queensland

After encouraging early autumn rains, dry conditions have returned to much of southern and western Queensland.

Figure 13: rainfall – Queensland beef regions



Source: Bureau of Meteorology, NAB Group Economics

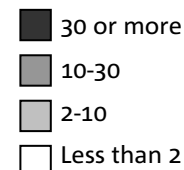
August 2014 – conditions in central Queensland

Cattle Prices throughout 2013/2014 have continued to be depressed following an oversupply of cattle to the market as producers destock in line with drought conditions.

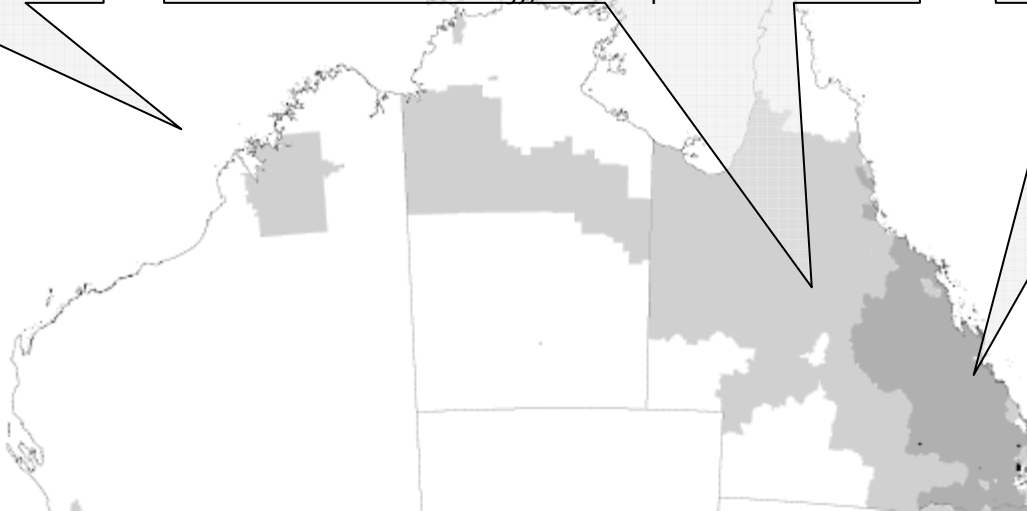
Receipt of decent widespread rain however is likely to see a distinct shift in market conditions. Volumes of cattle simply won't be available over the next couple of years as the industry rebuilds its herd and on a pure supply / demand basis we are likely to see prices significantly strengthen above any long term averages.

Tim Pincombe
Senior Agribusiness Manager
Rockhampton QLD

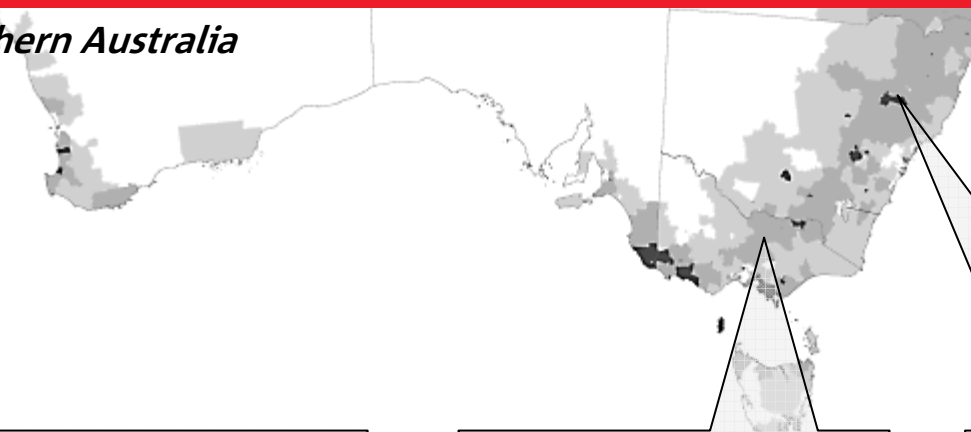
Cattle density per sq km



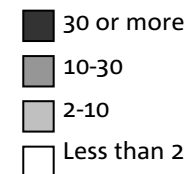
Map source: ABS



Regional trends: Southern Australia



Cattle density per sq km

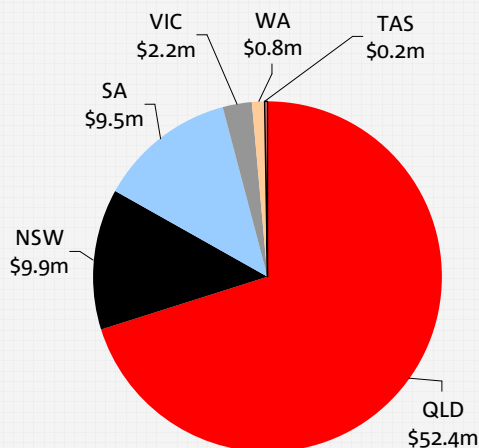


Map source: ABS

The organic beef industry in Australia

With a quarter of the organic market, beef is the single biggest organic sector in Australia. The Australian Organic Market Report valued farmgate sales valued at over \$70 million in 2012, up 111% from 2010.

Figure 14: total organic beef cattle on holdings value – 2012



Source: Australian Organic Market Report 2012

August 2014 – conditions in North East Victoria

Conditions in North East Victoria are improving, we've had a strong autumn break and have had a good start to spring. Producers are looking to northern markets hoping for rain to set a floor on prices. If we don't see much spring rain there is a potential for destocking around November-December, putting downward pressure on prices.

Greg Packer
Agribusiness Manager
Wangaratta VIC

August 2014 – conditions in northern NSW

A lack of rainfall before winter did not allow any major pasture growth, that has made it tough during winter. Graziers are keen to get through the last of winter and would love to see some rain before and during spring. If we see a decent break coming into spring, people will be keen to purchase stock, with high expectations that prices will rise.

Vincent Woodgate
Senior Agribusiness Manager
Tamworth NSW

Key beef indicators

Figure 15: Eastern Young Cattle Indicator



Figure 16: monthly average export prices

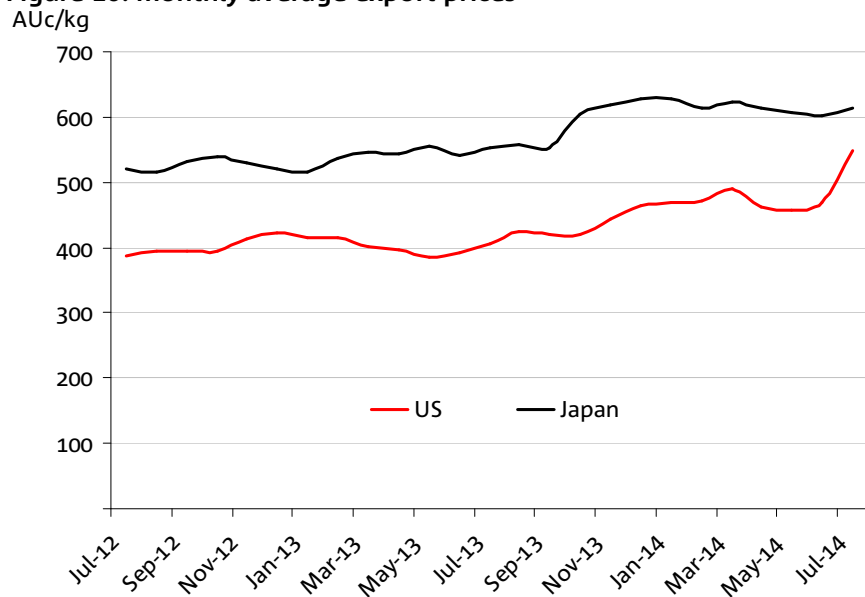


Figure 17: Eastern States cattle and calf slaughter (weekly)

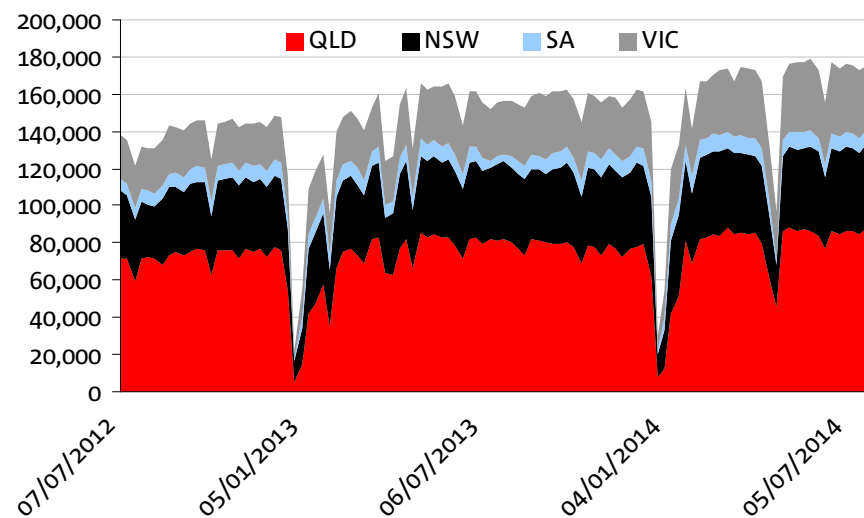
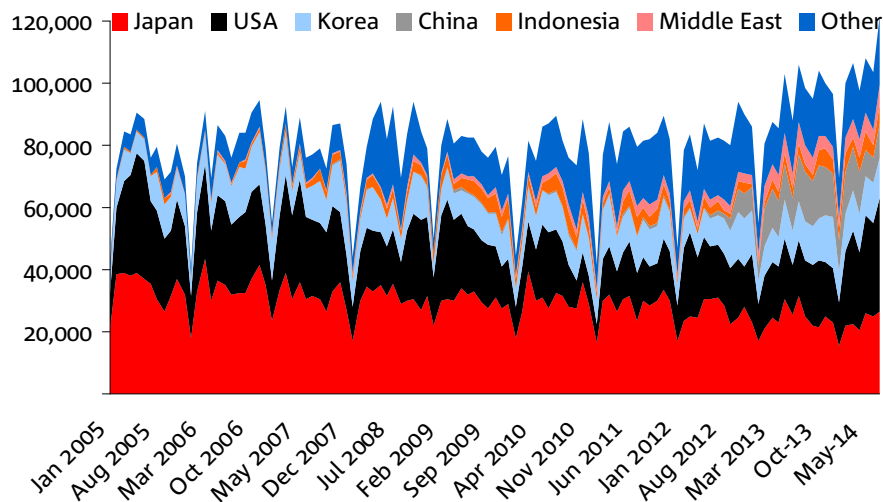


Figure 18: monthly Australian beef and veal exports (tonnes)



Source: Meat and Livestock Australia

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