

Rural Commodities Wrap – September 2014

Phin Ziebell and Karla Bulauan, NAB Group Economics

Summary

- The overall outlook for rural commodities deteriorated in August and September on account of a weak finish to winter rains in many areas combined with forecasts of abundant global grain supplies and lower prices for major agricultural commodities.
- Price falls in August were led by lamb (down 13.5% in AUD and 14.8% in USD), cotton (down 10.4% in AUD and 11.7% in USD), sugar (down 6.3% in AUD and 7.7% in USD), dairy (down 6.2% in AUD and 7.5% in USD) and wheat (down 2.8% AUD and 4.2% in USD).
- Global economic data continues to be mixed. Weakness in Japan, stagnation in the Euro-zone and a hard landing in Latin America have resulted in a slowdown in the pace of global growth through the first half of 2014. Elsewhere, economic upturns look secure in North America and the UK and Indian growth has picked up, although China's gradual slowing continues.
- This month's Rural Commodities Wrap includes an in focus section on oilseeds. Conditions so far point to a reasonable 2014-15 Australian canola crop, albeit with substantial regional variation, but a much smaller forecast cottonseed crop on account of lower expected irrigation water availability. With the USDA forecasting record world oilseed production in 2014-15, it is likely that global oilseed prices will come under further pressure.

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Economic Update

Global economy:

- Weakness in Japan, stagnation in the Euro-zone and a hard landing in Latin America have resulted in a slowdown in the pace of global growth through the first half of 2014. World GDP growth reached 3.4% yoy in late 2013, it slowed to 3.1% yoy in March quarter 2014 and 2.9% yoy in June quarter. We have trimmed our 2014 global forecasts to take account of weaker than expected June quarter data in the Euro-zone and Latin America (Brazil, Argentina).
- Economic upturns look secure in North America and the UK, Indian growth has finally picked up and we may revise our numbers higher, China's gradual slowing continues and we are counting on monetary stimulus to eventually get faster growth in the Euro-zone and Japan as the latter's tax rise effects wear off.

Domestic Economy:

- There are signs that growth may be strengthening in Q3. NAB business conditions have been well into positive territory since June. In August, business conditions retraced much of their recent sharp gain, although the environment remains better than earlier in the year and business confidence is still solid. However, employment still looks like a soft spot. Domestic forecasts revised marginally: 2014-15 2.9% (was 3.1%); 2015-16 3.4% (was 3.2%). The unemployment rate is still forecast to peak at 6½% by end-2014. Inflation is forecast to remain at the bottom of the RBA target band, with the cash rate still on hold until late 2015.

Interest Rates:

- The RBA kept the cash rate at 2.5% in September, as expected, a rate at which it has remained for 13 months. We still expect no change in the cash rate until the end of 2015. The Governor's most recent remarks suggest that the next rate move will be up, even if it is a long way off. But while that may be the current mood, it might be a different matter if the labour market began to struggle with the mining adjustment task over coming months.
- For more information on recent global and domestic economic trends, see our September [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	0.7	1.1	1.6
Emerging Asia	3.9	4.2	4.4
Japan	1.3	1.5	0.8
Middle East	3.1	4.8	4.7
Advanced economies	1.8	2.3	2.3
Emerging economies	4.7	5.1	5.4
World GDP	3.0	3.5	3.7

Source: NAB Group Economics

Table 2: NAB Australia Economic Forecast

% change year on year	2013-14	2014-15	2015-16
GDP growth	2.8	2.9	3.4
Private consumption	2.5	2.5	2.8
Unemployment rate	5.9	6.4	6.2
Consumer Price Index	3.0	2.1	2.8

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 now fallen below 90 US cents. The catalysts for the fall have been a rise in volatility, an unwinding of long positions and declining metals prices. In order to hold the drop, we need to see the rise in volatility sustained.
- With relatively little local news, the AUD is vulnerable to global conditions, and, for now, the sentiment is largely negative. With a declining terms of trade, a narrowing interest rate differential to trading partners as the RBA remains on hold for an extended period and a normalisation in market volatility, we expect the AUD to fall to 88 US cents in the fourth quarter and 85 US cents by mid 2015.

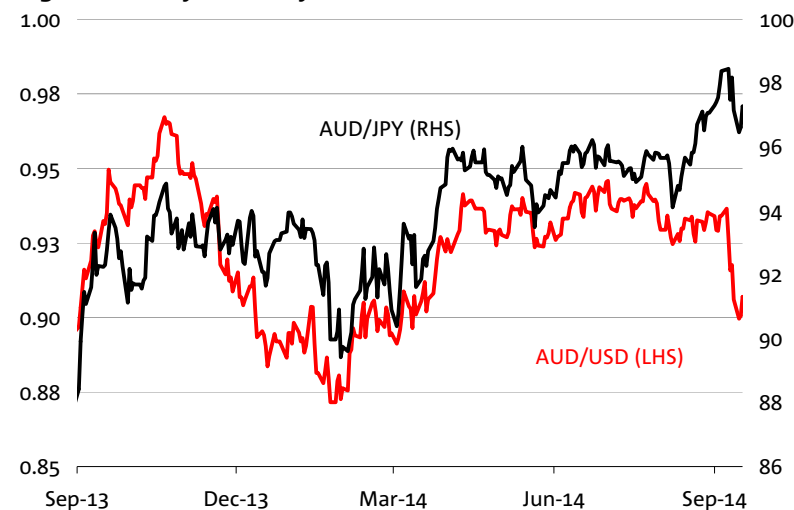


Table 4: NAB FX Strategy Targets

		2014 Q3	2014 Q4	2015 Q1	2015 Q2
Australian Dollar	AUD/USD	0.90	0.88	0.86	0.85
New Zealand Dollar	NZD/USD	0.82	0.80	0.78	0.75
Japanese yen	USD/JPY	106	108	110	112
Euro	EUR/USD	1.29	1.30	1.28	1.27
British Pound	GBP/USD	1.66	1.64	1.58	1.53
Swiss Franc	USD/CHF	0.94	0.98	0.99	1.01
Chinese New Yuan	USD/CNY	6.16	6.15	6.12	6.10
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

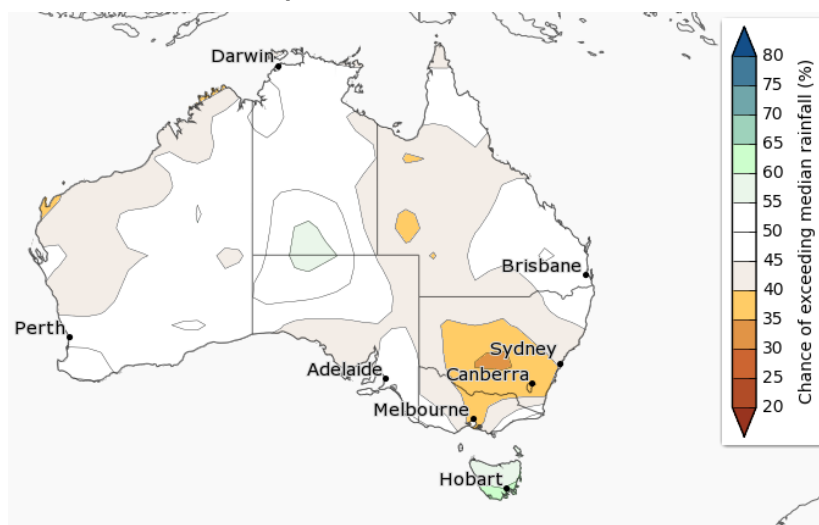
Climate Conditions Update

- Poor rainfall continued in August across much of southern Australia, falling below long term averages in most of Victoria and southern New South Wales, southern South Australia and much of Western Australia. However, conditions are showing signs of improvement in drought affected northern New South Wales and southern and western Queensland.
- The outlook remains subdued with below average rain fall forecasts by the Bureau of Meteorology (BoM) and a drier September to November period for southeast Australia. For the southern parts and northern Cape York Peninsula, warmer nights are more likely. These forecasts are influenced by warmer temperatures in the Pacific Ocean and a weakening Indian Ocean Dipole.

Production Outlook

- The outlook for winter grains has weakened in the past month as disappointing winter rainfall across most grain regions combined with reports of frost damage weighed on expected yields. We have revised down our production outlook for winter grains accordingly, with 2014-15 wheat production now forecast to decline 10.3% year on year to 24.234 million tonnes, in line with ABARES' estimate.
- The outlook for protein continues to depend on spring rainfall enabling reasonable pasture growth. If conditions return to normal in northern New South Wales and Queensland, it is likely that cattle and lamb slaughter will ease as producers look to rebuild their herds and flocks. Below average upper level soil moisture in much of Victoria is a potential concern for spring pasture growth and may weigh on dairy production, although this may be offset by lower feed grain prices.
- Fibre production is likely to come under further pressure over coming months as lower prices, uncertain Chinese demand and lower water availability putting cotton production at risk. Continued lacklustre wool prices may see wool growers substitute to lamb or beef.

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



Source: Bureau of Meteorology

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

	Production	Price (AUD)
Wheat	-10.3	-6.9
Beef	-3.4	7.1
Dairy	1.9	-12.3
Lamb	-3.6	-2.4
Wool	-5.0	-4.6
Sugar	5.0	-10.6
Cotton	-34.8	-12.1

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 **4**

Domestic Agricultural Outlook

NAB Rural Commodities Index

- The NAB Rural Commodities Index fell for the fourth straight month in August, down 3.0% for the month (AUD) and 4.4% (USD). The falls were led by lower lamb, dairy, cotton wheat and sugar prices.
- The index is now 5.6% lower than August 2013 (AUD).

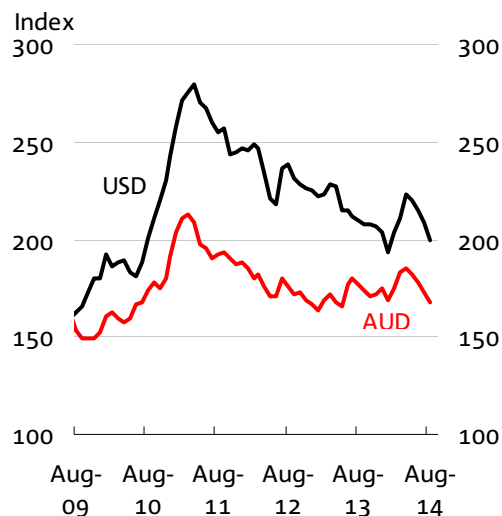
NAB Farm Input Prices

- The NAB Farm Input Price Index was steady in August, up 0.2% for the month (AUD) as higher urea prices were offset by lower natural gas and diammonium phosphate prices.
- Petrol prices fell in August in response to lower international crude oil prices. Weighted capital city unleaded prices averaged 144.9 AUC/l in August, down 4.5%.

NAB Weighted Feed Grain Prices

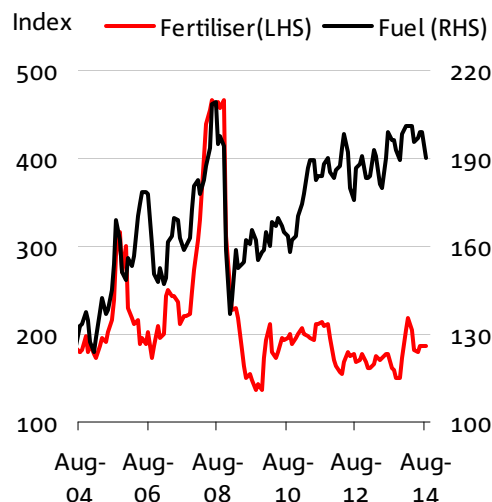
- Feed grain prices fell overall in August, with the NAB Feed Grain Price Index down 3.9% (AUD) for the month. Barley, oats, sorghum, maize, feed wheat and triticale were all lower for the month.
- While international grain prices are generally trading lower on account of plentiful global supply, domestic price premiums may persist as lower winter rainfall may see reduced pasture growth.

Figure 3: NAB Rural Commodity Prices



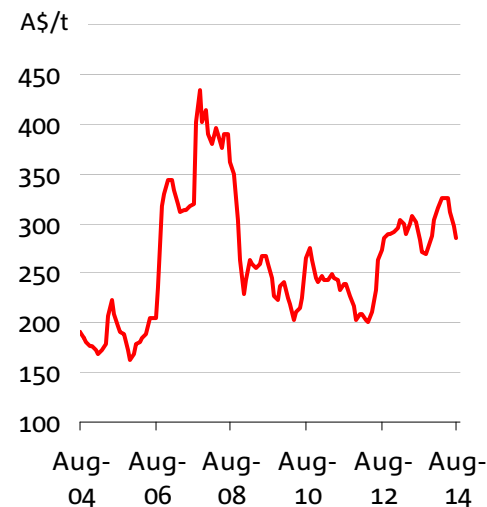
Sources: NAB Group Economics, ABARES, Meat and Livestock Australia, The World Bank, Bloomberg and Thomson Datastream

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

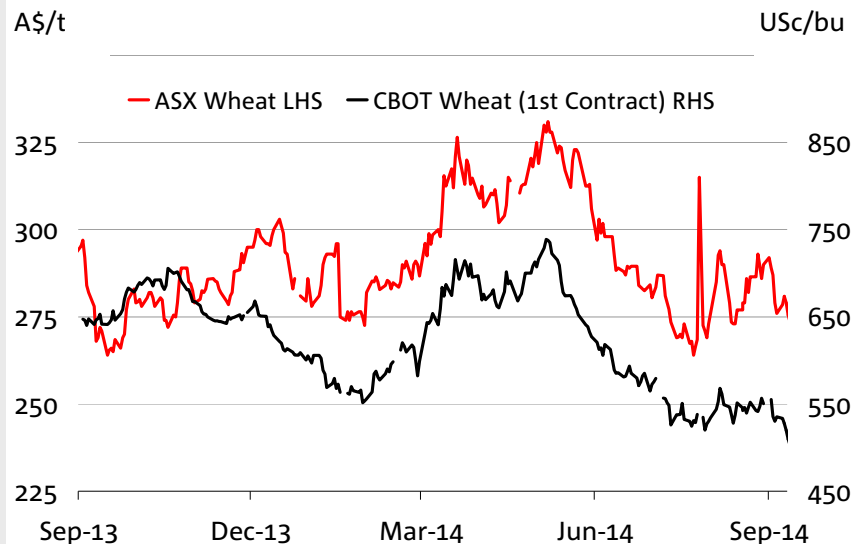
Wheat

- After a strong start, the 2014-15 Australian wheat season has come under pressure from below average winter rainfall across the Western Australian wheatbelt as well as much of South Australia, northern Victoria and Southern New South Wales. ABARES reports that upper level soil moisture is below average across much of southern Australia. These conditions will likely affect yields and we have revised down our forecasts accordingly.
- Meanwhile, the USDA has again revised up its forecasts for 2014-15 world wheat production to a record 720 million tonnes. In response, world prices have once again fallen after a period of relative stability in August.
- For Australian growers, the combination of poor winter rain and low international prices is likely to dampen sentiment as harvest approaches.

Lamb

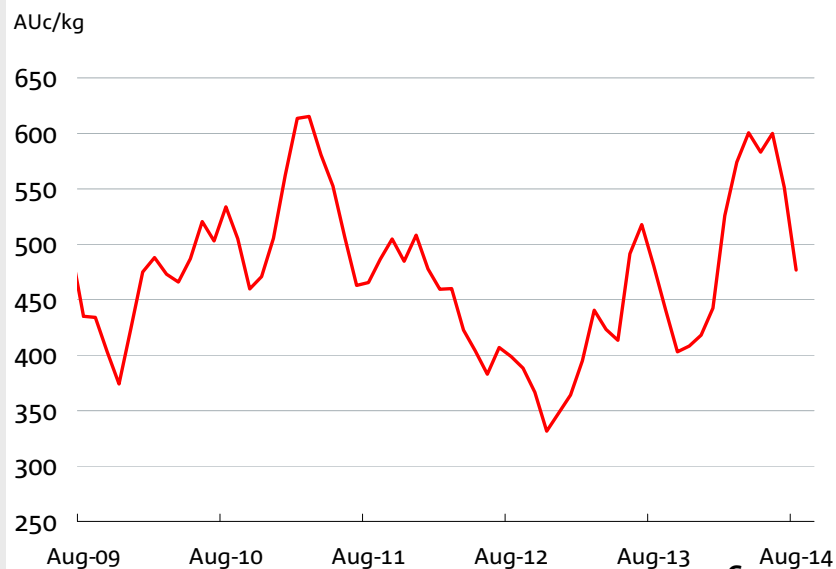
- Heavy lamb prices fell 13.5% in August as below average winter rainfall saw elevated turnoff continue. Meat and Livestock Australia data shows that heavy lamb averaged 476.8 AUc/kg carcass weight for the month amid elevated concerns over prospects for spring rain. Australian lamb exports fell in August on seasonal factors but are nonetheless 10.2% higher than August 2013.
- Despite this, we expect that there should be renewed upward pressure on prices later this year and into next. Decent spring rainfall and reasonable pasture growth is likely to pique restocker interest.

Figure 6: Global and Australian wheat futures prices



Source: Bloomberg

Figure 7: Heavy lamb prices (Monthly)



Source: Meat and Livestock Australia

Agricultural Sectors

Beef

- The Eastern Young Cattle Indicator edged up a notch to average 345.40 AUc/kg in August, posting a growth rate of 2.5% month on month. Poorer rainfall in southern areas weighed on sentiment, although there are signs of improvement in northern New South Wales and Queensland.
- While slaughter rates contracted overall in August, weekly eastern States slaughter in late August was at the highest level this decade as poor conditions continued to see elevated destocking.
- We expect prices to remain on the upside over the coming year as producers look to rebuild herds, especially in the event of a decent northern wet season. Strong international demand looks set to continue (particularly in the United States where drought has cut herds) and the Chinese government owned Beijing Agricultural Investment Fund recently committed to spending \$3 billion on Australian agriculture, including beef.

Dairy

- Dairy prices continued to fall in August, giving up 7.5% (USD) – or 6.2% (AUD) – in the sixth straight month of falling prices amid strong global supply and muted demand in East Asia. While there are signs that the falls in prices have abated somewhat in September dairy auctions, it is possible that farmgate milk prices will come under further pressure.
- The Russian embargo on dairy products from the United States, Canada, the European Union, Norway and Australia continues to put downward pressure on prices as European dairy producers look to alternative markets for products previously sold in Russia.

Figure 8: Eastern Young Cattle Indicator



Source: Meat and Livestock Australia

Figure 9: BNZ Global Dairy Prices



Source: BNZ

Agricultural Sectors

Wool

- Wool prices continued their overall downward trend in August (despite a spike early in the month) – the EMI index lost 0.8% to 1015 AUc/kg month on month. EMI has experienced negative growth for 7/8 months to date in 2014, as China's economy was less accommodative.
- Nevertheless we foresee the impact on the wool market moderating with stronger outlook for demand.

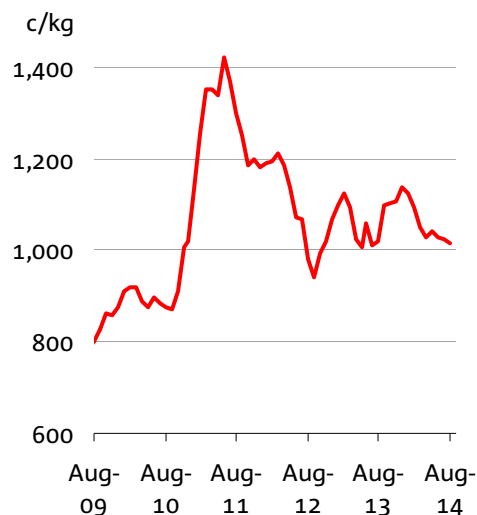
Cotton

- Cotlook 'A' index prices edged marginally lower to 74 USc/lb, down 11.7% for the month in August. ICE cotton futures averaged higher from 68 USc/lb in July to 74 USc/lb in August.
- Our outlook for domestic cotton has been revised down based on expectations of substantially lower planting in 2014-15 due to lower irrigation water availability.

Sugar

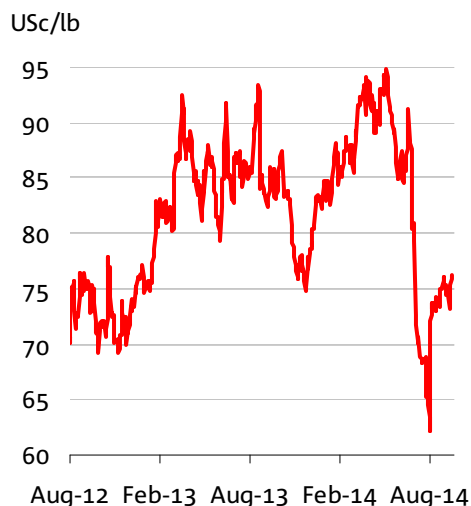
- Sugar prices averaged 15.9 USc/lb, edging down 7.7% for the month. Global supplies remained robust. The International Sugar Organisation has forecast a global glut of approximately 4 million tonnes for the season.
- We expect Australian production to increase 5.0% in 2014-15 but prices to fall 10.6% in AUD terms.

Figure 10: Eastern Market Indicator



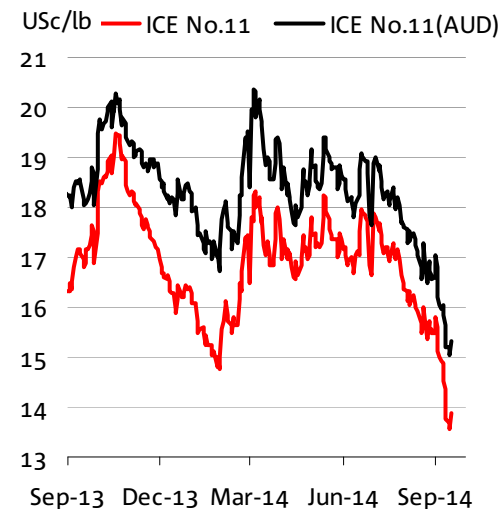
Source: Meat and Livestock Australia, DXdata

Figure 11: Global cotton prices



Source: Bloomberg

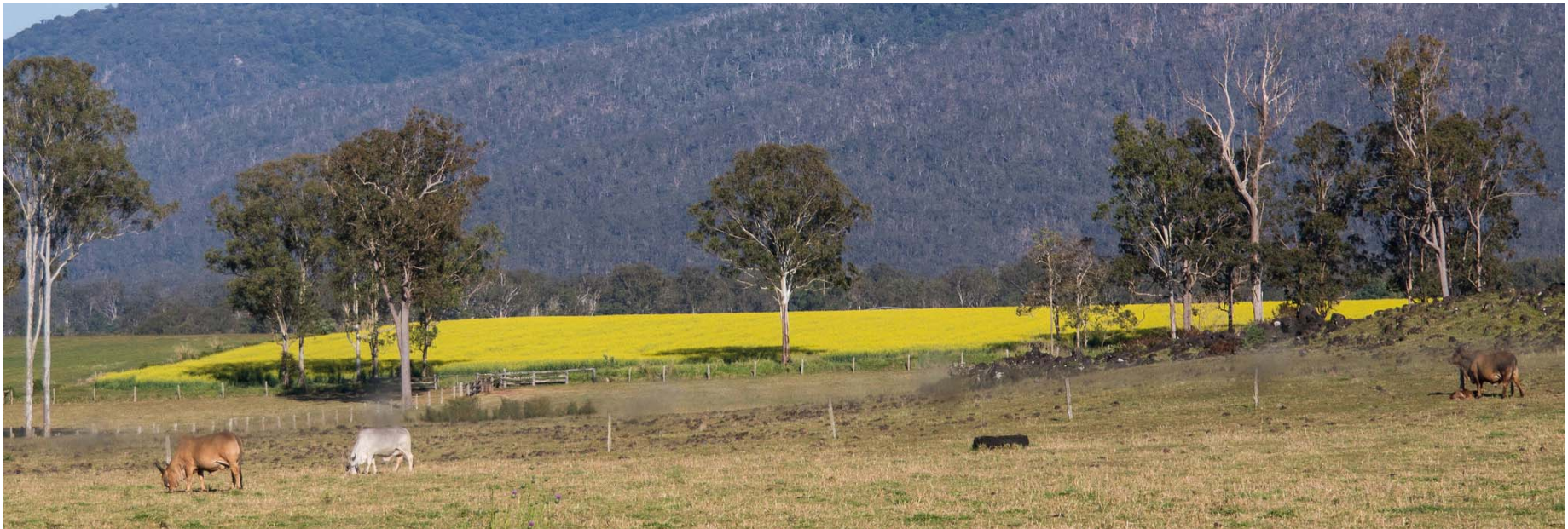
Figure 12: Global sugar prices



Source: Bloomberg

In Focus: Oilseeds

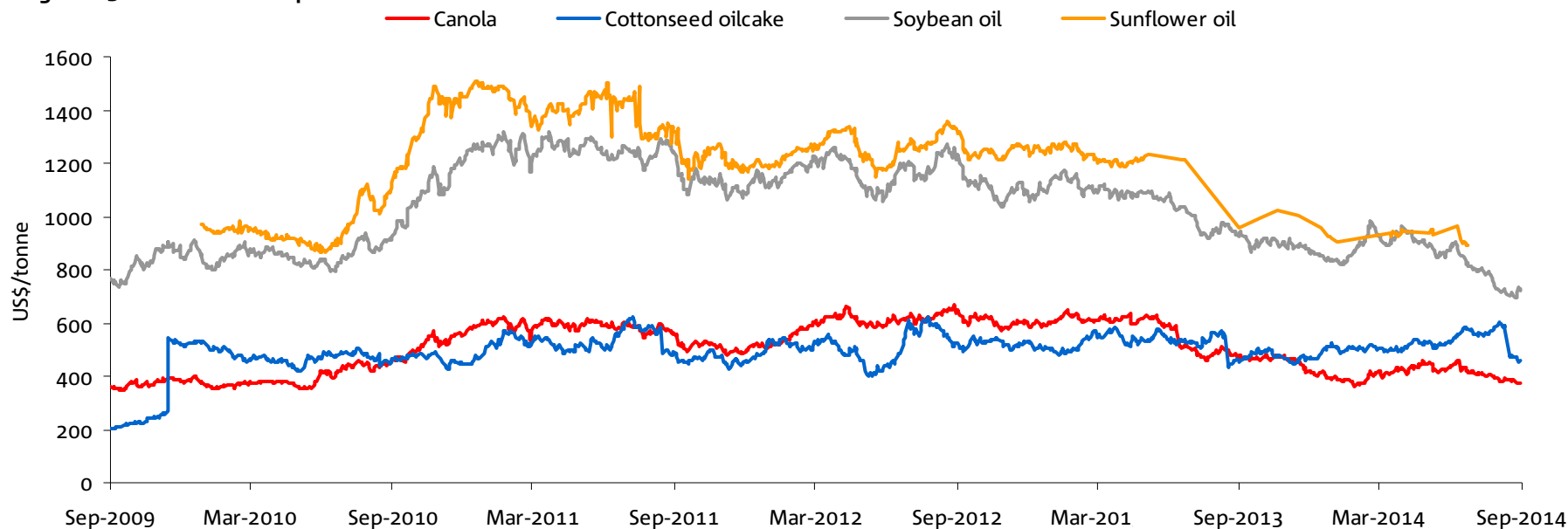
- Oilseed production in Australia is geared predominantly towards canola in Western Australia, New South Wales, Victoria and South Australia, and to a lesser extent cottonseed in New South Wales and Queensland. While there is some soybean and sunflower cultivation in New South Wales and Queensland, production from these crops is relatively small.
- Canola is grown as a winter crop and is often used as a break crop for wheat while cottonseed is grown in the summer alongside cotton destined for fibre.
- Conditions so far point to a reasonable 2014-15 Australian canola crop, but with substantial regional variation. NAB Agribusiness Bankers report that conditions are satisfactory overall, although conditions in Western Australia and parts of Victoria are more challenging than other areas.
- ABARES forecasts that 2014-15 canola production will fall moderately in Western Australia, Victoria and South Australia but will hold steady in New South Wales. Total production is predicted to reach 3,388 kt.
- The outlook for Australian cottonseed for the coming year is significantly weaker than canola. ABARES projects that cottonseed production will fall 34.8% in 2014-15 to 820 kt.
- Expectations of sharply lower Australian cottonseed production are driven largely by lower irrigation water availability following much higher water availability in the previous three years. Uncertainty surrounding Chinese cotton demand and abundant global oilseed supply are also likely to weigh on producers.



International trends

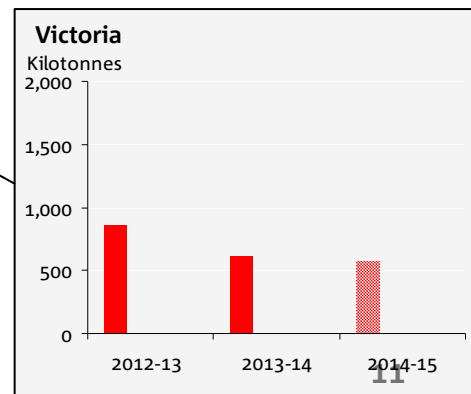
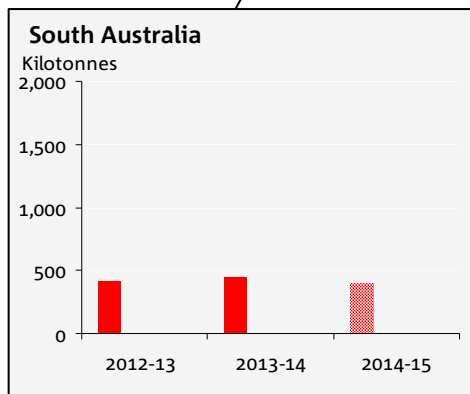
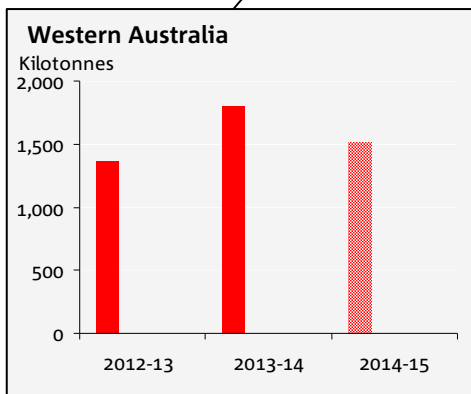
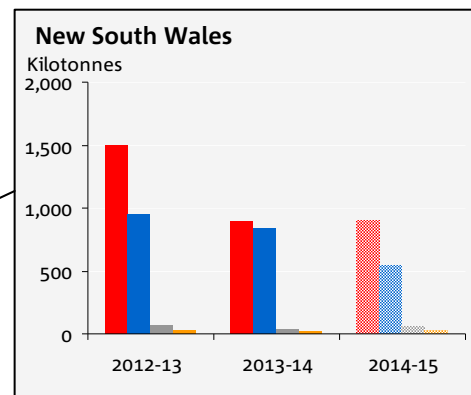
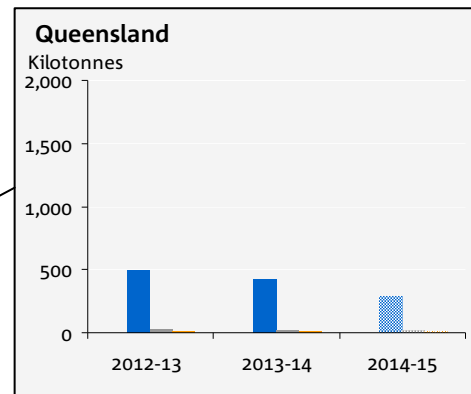
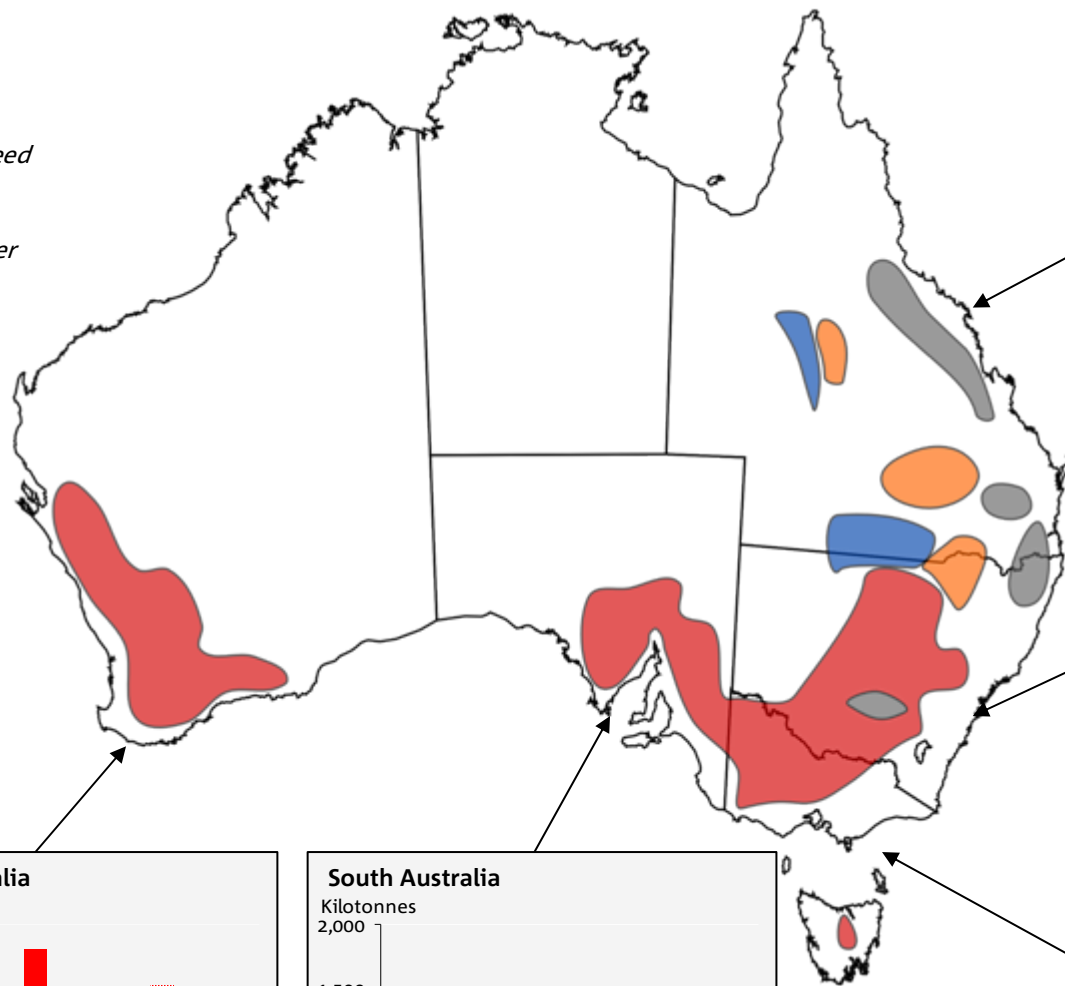
- Global oilseed supply is buoyant overall, with the USDA forecasting that global supply will total a record 528 million tonnes in 2014-15.
- Increased supply is supported by higher expected soybean yields in the United States, Brazil and Argentina and higher canola production in Europe reflecting favourable weather conditions. Elsewhere, the USDA projects higher sunflower seed production in Europe but lower production in Argentina and Bolivia. Indian cottonseed and Malaysian palm oil production are both expected to increase.
- Oilseed prices have come under pressure in response to increased supply (Figure 13). Soybean and sunflower oil prices have been falling since 2011, while canola has trended downwards since 2013.
- Previous stability in cottonseed oilcake prices has been broken by changes to Chinese cotton stockpile arrangements and good rains in Texas cotton regions.
- Overall, we expect oilseed prices to continue to fall over the coming year, reflecting above average forecast production in most growing regions.
- If prices continue to edge lower, Australian cottonseed producers may revise their planting accordingly. Australian cotton planting is already forecast to contract considerably on lower water availability and it is likely that lower world prices will create an additional disincentive to plant.

Figure 13: Global oilseed prices



Australian oilseeds distribution and ABARES forecast production

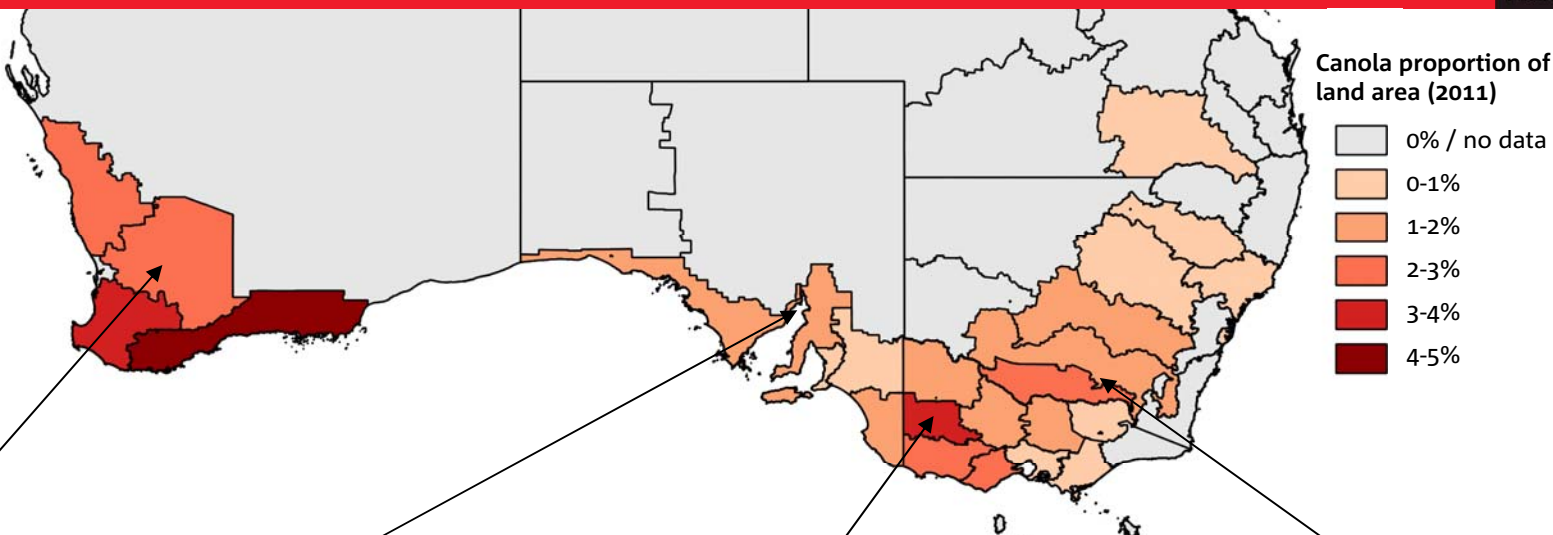
- Canola
- Cottonseed
- Soybean
- Sunflower



Source: ABARES, American Oil Chemists' Society, Australian Oilseeds Federation, Australian Bureau of Statistics and NAB Group Economics. 2014-15 values represents ABARES' forecast as of September 2014.

Canola 2014-15 outlook

Map denotes canola planting as a proportion of land area per Natural Resource Management Region. Data derived from ABS 2011 Agricultural Census.



The Wheatbelt

The story for canola this year has been mixed in Western Australia. In the Avon Valley and central wheatbelt down to Narrogin we are looking at potentially above average yields, although yields are looking less positive in the north and east of the wheatbelt.

Subsoil moisture in the north and east in particular has been below average and many farmers are now living rain to rain.

Matthew Leverington
Agribusiness Manager
Albany WA

The Mid North

Canola performance for the Mid North this year is a bit early to call at this stage, we saw a mixed bag early on with viruses and with warmer weather returning there could be aphids and other pests. Time will tell how well the plants have recovered what level of oil quality is likely.

Sub soil moisture has been generally very good, assisted by mild weather through September.

Michael Laidlaw
Agribusiness Manager
Clare SA

The Wimmera-Mallee

With well below average rainfall received during the past 2 months, particularly August, as it is traditionally our wettest month of the year, yields for Canola in the Wimmera and Southern Mallee have largely been downgraded.

Crops are currently hugely varied with soil type and previous season's rotation being a large determiner on how well the crops have withstood the past two months of dry conditions. An average yield scenario would now be considered a great outcome, however, timely rains would still be required in the very near future.

Brad Sudholz
Senior Agribusiness Manager
Horsham VIC

The Riverina

Canola is going broadly well in the Riverina this season, although we have received reports of some frost damage in certain areas of the region with early sown crops being the most affected.

The region had a fantastic start to the season rainfall wise in autumn, however spring rainfall has been somewhat uneven across the area. Growers are still hopeful of a good finish to the season provided decent spring rain is received.

Narelle McBurney
Agribusiness Manager
Wagga Wagga NSW

Contact details

Agribusiness

Khan Horne
General Manager –
Agribusiness

Zaklina Kukeski
Senior Consultant
+61 (0) 439 255 981

Economic Research

Alan Oster
Chief Economist
+61 3 8634 2927

Rob Brooker
Head of Australian
Economics &
Commodities
+61 3 8634 1663

Phin Ziebell
Economist -
Agribusiness
+61 3 8634 0198

Karla Bulauan
Economist -
Economics &
Commodities
+61 3 8641 4028

Risk Management Services

Greg Noonan
Head of Agribusiness
& Health – Business
Markets
Specialised Sales
+61 477 717 607

Corporate Communications

Samantha Dawson
Manager, Corporate
Communications
Business Banking &
NAB Wealth
+61 (0) 477 716 296

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