



Economic Report

Rural Commodities Wrap – October 2014

Phin Ziebell, NAB Agribusiness Economist



Key points

- The overall price outlook for rural commodities stabilised somewhat in September and early October as a falling AUD blunted the impact of lower global prices across many agricultural commodities. The NAB Rural Commodities Index fell 0.2% (AUD) and 2.3% (USD) in September, with beef the only component tending substantially higher.
- 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, while economic upturns look secure in North America and the UK and Indian growth has picked up, China's gradual slowing continues.
- This month's Rural Commodities Wrap includes an in focus section on dairy. 2014-15 is shaping up as a mixed year for Australian dairy producers, with positive climatic conditions in autumn and winter balanced against sharply lower international prices and risks of reduced pasture growth on account of below average spring rainfall.

Contents

<u>Economic Update</u>	3
<u>Exchange Rates</u>	4
<u>Domestic Agricultural Outlook</u>	5
<u>Agricultural Sectors: Wheat</u>	7
<u>Agricultural Sectors: Beef</u>	8
<u>Agricultural Sectors: Lamb</u>	9
<u>Agricultural Sectors: Wool</u>	9
<u>Agricultural Sectors: Cotton</u>	10
<u>Agricultural Sectors: Sugar</u>	10
<u>In Focus: Dairy</u>	11



Economic Update

For a detailed analysis of Australian and global economic trends see our [Global and Australian forecasts](#) and [Australia and the world on two pages](#).

Global Economy

Global growth was around 3% in the first half of 2014, below trend and with marked variations in performance between major economies. North America continues to perform strongly with solid growth in both the US and Canada. Although the UK's pace of growth could have peaked, it continues to run at a solid rate while recovery in Japan and the Euro-zone has faltered. Conditions are also mixed across the emerging market economies with an upturn in India after some disappointing years, continuing trend slowdown in China, falling output in key Latin American nations like Brazil and Argentina and sluggish growth across most of emerging market East Asia.

Domestic Economy

Retreating confidence and conditions and likely sharp decline in terms of trade point to weak third quarter. In September, capacity utilisation continued falling, forward orders declined and employment slumped further into negative territory. In August, retail trade growth was soft, vehicle sales fell, personal credit growth remained weak and non-residential building approvals trended down. We still see few signs of a sustained increase in non-mining investment to fill the emerging mining investment cliff. However, the easing in the AUD should assist trade-exposed sectors of manufacturing and services.

Interest Rates

The RBA kept the cash rate at 2.50% in October, as expected, a rate at which it has remained for 14 months. We still expect no change in the cash rate until the end of 2015. Forward indicators are soft, national income will remain under pressure from the terms of trade and spare capacity is likely to persist. In the absence of any major surprises, the cash rate is unlikely to risen until late next year as monetary policy commences its return journey to normality.

Table 1: NAB Global Economic Forecasts

% change year on year	2014	2015	2016
China	7.3	7.0	6.8
US	2.2	3.0	2.8
Euro zone	0.7	0.9	1.1
Emerging Asia	3.9	4.2	4.4
Japan	1.0	1.0	0.8
Middle East	2.7	3.9	4.7
Advanced economies	1.8	2.2	2.1
Emerging economies	4.7	5.1	5.4
World GDP	3.0	3.4	3.6

Source: NAB Group Economics

Table 2: NAB Australian Economic Forecast

% change year on year	2013-14	2014-15	2015-16
GDP growth	2.8	2.8	3.2
Private consumption	2.5	2.1	2.6
Unemployment rate	5.9	6.5	5.9
Consumer Price Index	2.8	2.0	2.5

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

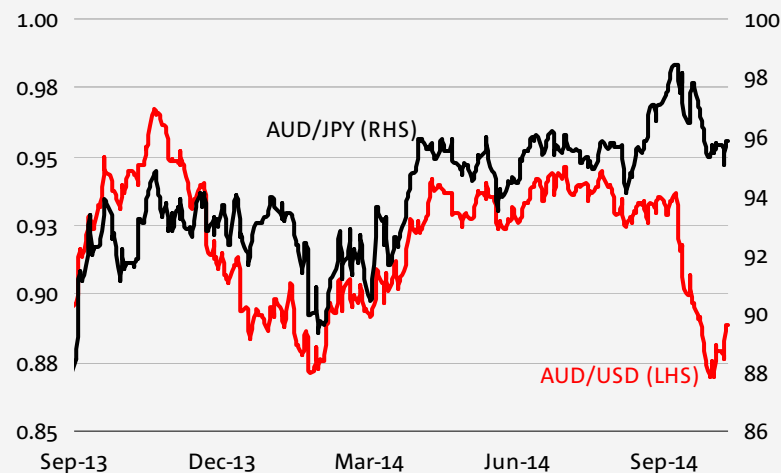
Source: NAB

Exchange Rates

The AUD fell steadily against the USD for most of September and into early October, sinking below 86.5 US cents by 3 October. The AUD now looks to be consolidating this position rather than extending losses, and there has been quite limited movement in the AUD against a range of currencies in the past fortnight.

A confluence of factors, including 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, points to a falling AUD over the medium term. We expect the AUD to fall to 88 US cents in the fourth quarter and 85 US cents by mid 2015.

Figure 1: Daily currency movements



Source: Bloomberg

Table 4: 4 NAB FX Strategy Targets

		2014 Q4	2015 Q1	2015 Q2	2015 Q3
Australian Dollar	AUD/USD	0.88	0.86	0.85	0.84
New Zealand Dollar	NZD/USD	0.78	0.76	0.75	0.74
Japanese yen	USD/JPY	108	110	112	115
Euro	EUR/USD	1.26	1.25	1.24	1.22
British Pound	GBP/USD	1.62	1.58	1.53	1.50
Swiss Franc	USD/CHF	0.99	1.01	1.02	1.07
Chinese New Yuan	USD/CNY	6.15	6.12	6.10	6.08
Canadian Dollar	USD/CAD	1.11	1.12	1.12	1.12

Source: NAB

Domestic Agricultural Outlook

Climatic Conditions

September rainfall was above average in much of central and coastal Queensland, parts of western New South Wales and across the edge of the Western Australian wheatbelt. Much of Victoria, Tasmania, the Northern Territory, coastal South Australia as well as parts of New South Wales and western Queensland saw below average rainfall for the month.

The Bureau of Meteorology's (BoM) rainfall outlook for October to December forecasts below average rainfall for most of Australia with the exception of Tasmania, south west Western Australia, southern South Australia and western Victoria. Forecast rainfall in northern Australia is of particular concern with BoM projecting a less than 40% chance of exceeding median rainfall for much of drought affected Queensland and northern New South Wales.

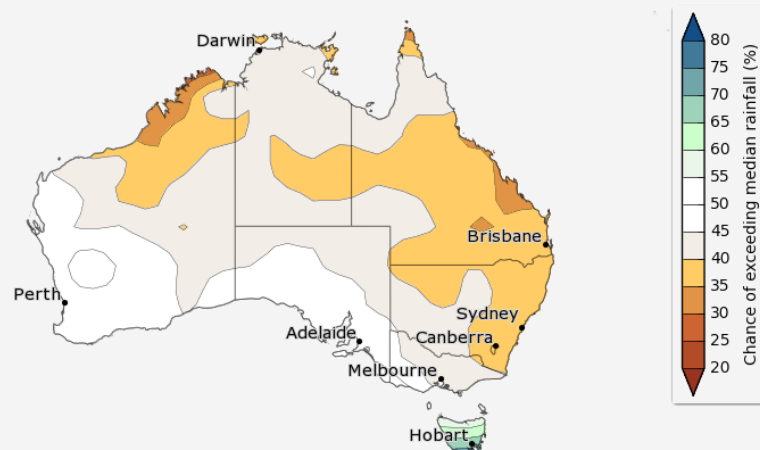
Production Outlook

Overall, we have kept our 2014-15 production outlook in line with our forecasts from last month while we have made minor adjustments to our price outlook in line with updated data.

The outlook for winter grains remains mixed as disappointing winter and early spring rainfall across most grain regions combined with reports of frost damage weighs on expected yields.

The outlook for protein is likewise mixed. While Queensland cattle producers enjoyed reasonable rain in August and September, the rainfall outlook coming into the wet season is looking increasingly challenging. Dairy producers, particularly in Victoria, have experienced below average spring rains and now face the prospect of higher hay and feed grain dependence in spring.

Figure 2: Australian Rainfall Outlook: chance of exceeding median rainfall - October to December 2014



Source: Bureau of Meteorology

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

	Production	Price (AUD)
Wheat	-10.3	-8.7
Beef	-3.4	7.7
Dairy	1.9	-12.7
Lamb	-3.6	-2.4
Wool	-5.0	-4.6
Sugar	5.0	-10.7
Cotton	-34.8	-12.4

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

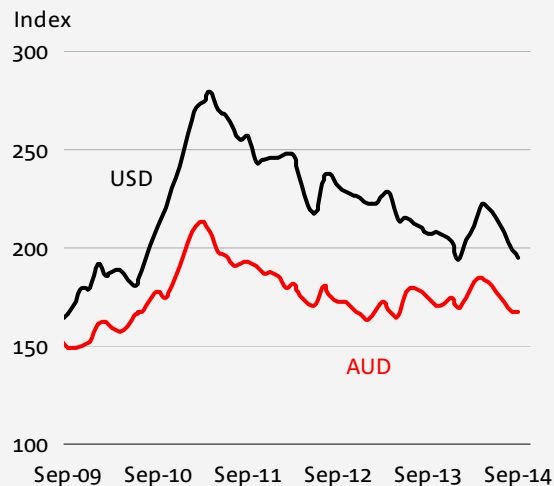
Domestic Agricultural Outlook

NAB Rural Commodities Index

The NAB Rural Commodities Index fell for the fifth straight month in September, albeit by only 0.2% in AUD terms as the currency tended lower. In USD terms, the index was down 2.3%.

The index is now 4.1% lower in AUD terms than the same time in 2013.

Figure 3: NAB Rural Commodities Index



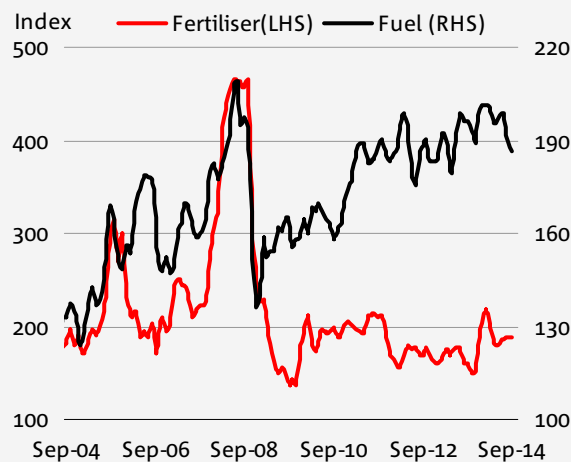
Source: NAB Group Economics, ABARES, Meat and Livestock Australia, The World Bank, Bloomberg and Thomson Datastream

NAB Farm Input Prices

The NAB Fertiliser Index was steady in September, as lower USD diammonium phosphate, natural gas and urea prices were offset by a falling AUD.

Petrol prices continued to fall in September in response to lower international crude oil prices. Weighted capital city unleaded prices averaged 142.4 AUc/l in September, down 1.9%.

Figure 4: NAB Farm Input Price Index



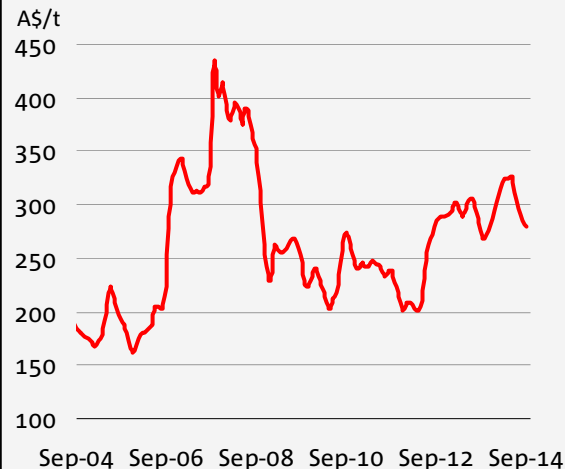
Source: ABARES, BNZ and NAB Group Economics

NAB Weighted Feed Grain Prices

Feed grain prices were moderately lower in September, with the NAB Feed Grain Price Index down 1.8% for the month.

While international grain prices remain low on account of plentiful global supply, domestic price premiums may grow if lower spring rainfall sees reduced pasture growth and lower hay yields and a lower AUD sees local grain prices edge relatively higher.

Figure 5: NAB Weighted Feed Prices



Source: ABARES and NAB Group Economics

Agricultural Sectors

Wheat

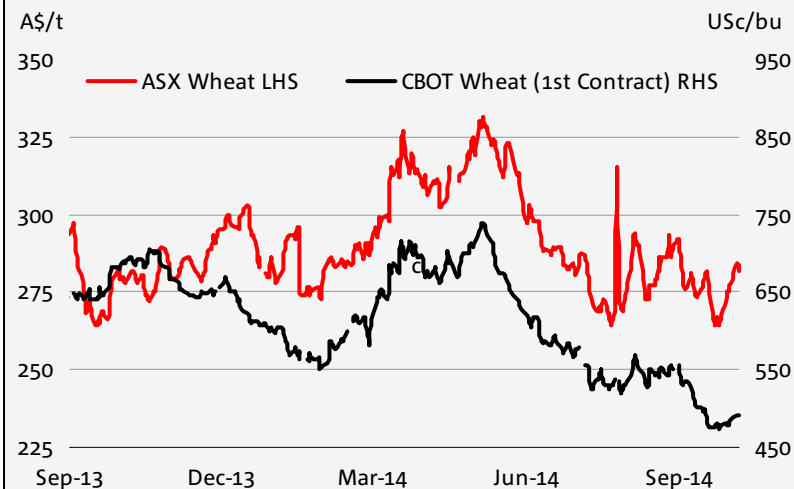
Global wheat prices fell in 7.5% in September on plentiful global supplies. US Hard Red Winter averaged US\$5.77/bushel for the month, but has since recovered somewhat. Factors supporting upward pressure on prices include Russia's departure from wheat export markets due to strong Russian domestic demand as well as USDA forecasts of lower US domestic ending stocks due to higher feed use and increased exports. Overall, the USDA has revised up global production to a record 721 million tonnes for 2014-15.

The forecast for 2014-15 Australian wheat production is far more mixed. Below average winter rainfall in parts of the Western Australian wheatbelt as well as much of South Australia, northern Victoria and Southern New South Wales combined with mixed spring conditions, especially in parts of the Mallee and Wimmera, has seen a reduction in forecast yields.

Lower forecast domestic production, combined with a falling AUD and reports of a mixed hay cutting season has lent some support to Australian wheat prices since late September. If spring pasture growth continues to disappoint in many areas and hay yields drop, it is likely that there will be higher local feed grain demand coming into summer.

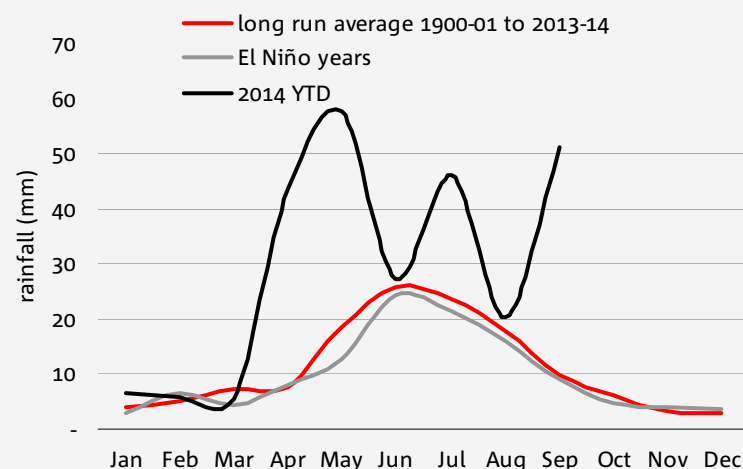


Figure 6: Australian and international wheat futures



Source: Bloomberg

Figure 7: Rainfall in the Western Australian wheat belt



Source: Bureau of Meteorology and NAB Group Economics

Agricultural Sectors

Beef

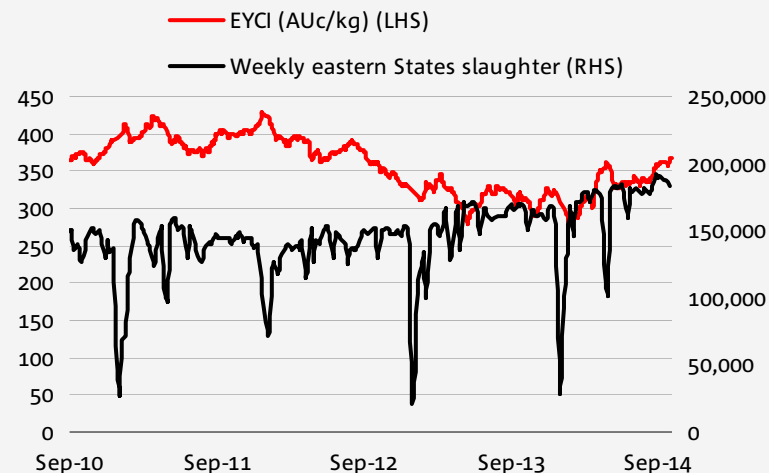
Beef prices continued to rise in September, with the Eastern Young Cattle Indicator (EYCI) gaining 4.5% to average 361 AUc/kg in the third straight month of higher prices.

While discounting persisted in northern sales owing to the ongoing drought, there were some signs of increased optimism on account of above average rainfall in Queensland beef regions in August and September. However, the BoM's latest rainfall outlook forecasts below average rainfall for much of Queensland from October to December. Producers are looking to a decent wet season to rebuild herds and poor rainfall would likely significantly weigh on sentiment.

Australian beef exports to the US continued to grow in September, standing at 47,238 tonnes, a 142% increase on the same time in 2013. Australian beef exports to the US have been driven largely by the 90cl hamburger beef market, which has increasingly looked to imports on account of drought conditions depleting the US cattle herd.

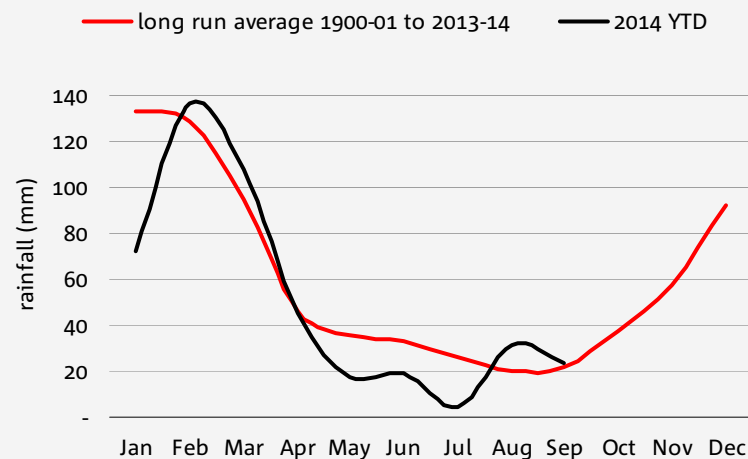
While this has allowed Australian imports to gain a strong foothold in the US market, improving weather conditions in the US, combined with strong corn, soy and wheat supply and low feed grain prices points to a stronger US cattle outlook over the coming years. This may see Australian beef exports to the US come under pressure.

Figure 8: Eastern Young Cattle Indicator and slaughter



Source: Meat and Livestock Australia

Figure 9: Rainfall in Queensland beef regions



Source: Bureau of Meteorology and NAB Group Economics

Agricultural Sectors

Lamb

Heavy lamb prices fell slightly in September, down 1.0% to average 472 AUc/kg carcase weight for the month as lacklustre early spring rain in many areas saw elevated turnoff continue. Lamb exports jumped 17% in September to 21,084 tonnes shipped weight and are 23.2% higher than the same time in 2013.

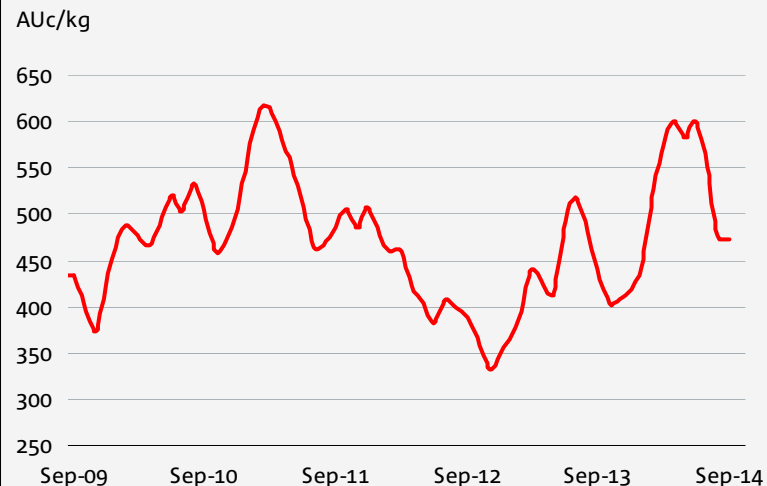
Despite these prevailing mixed conditions, we expect that that there should be renewed upward pressure on prices into next year. While spring rainfall has been patchy thus far, should rainfall conditions improve we expect to see renewed restocker interest and flock rebuilding after a long period of elevated slaughter.

Wool

Wool prices were steady in September, with the benchmark Eastern Market Indicator averaging 0.5% higher at 1,020.8 AUc/kg. Price movements have been small of late – September marked the fifth straight month in which prices moved less than 2% month on month.

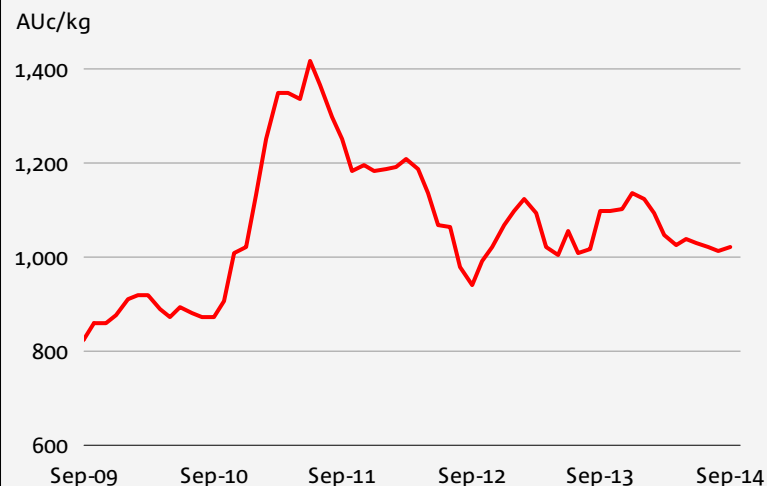
China is far and away the largest customer of Australian wool. In 2012-13, over three quarters of Australian wool exports were sent to China. Continued economic slowing in China brings the risk of falling wool demand and lower prices.

Figure 10: Heavy lamb prices



Source: Meat and Livestock Australia

Figure 11: Eastern Market Indicator



Source: DXdata

Agricultural Sectors

Cotton

The downward trend in cotton prices was briefly arrested in September, although prices have since fallen in October. ICE cotton first futures fell 0.9% (USD) in September to average 73.4 USc/lb for the month, and are now trading around 70 USc/lb.

Prices have been driven lower by strong global supply (in particular by a large expected US harvest) and weak demand from China. Our outlook for domestic cotton is for substantially lower planting in 2014-15 due to lower irrigation water availability.

Sugar

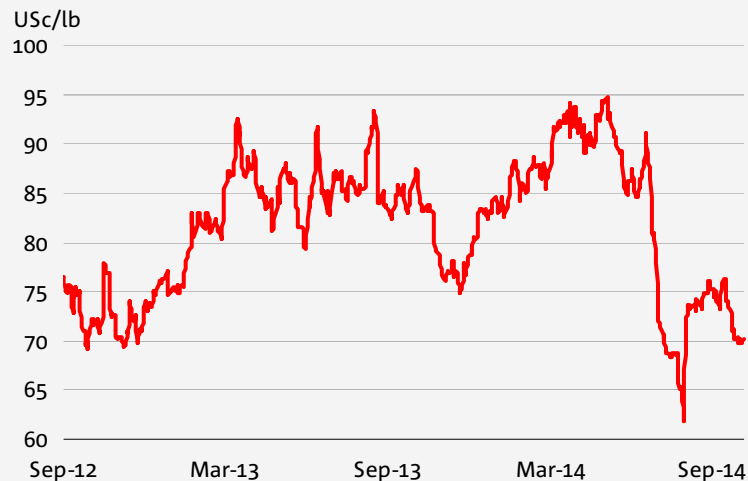
Sugar has rebounded after seeing falling prices from July to September as previous expectations of abundant supply have been replaced by pessimism as drought conditions in Brazil continue to hamper local production. While sugar prices averaged 7.9% lower (USD) in September, they have since recovered to levels not seen in several months.

Proportion of land area devoted to sugar cultivation 2011

- none / no data
- <5%
- 5-10%
- 10-15%
- 15-20%
- >20%

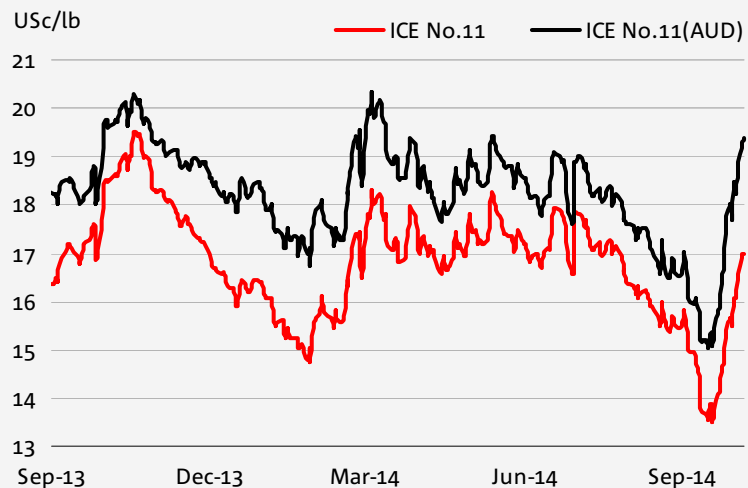
Source: Australian Bureau of Statistics
2011 Agricultural Census

Figure 12: Global cotton prices



Source: Bloomberg

Figure 13: Global sugar prices



Source: Bloomberg

In Focus: Dairy

2014-15 is shaping up as a mixed year for Australian dairy producers. While the year began with considerable optimism on account of record international dairy prices and a good autumn break, prices on world markets have since fallen considerably in response to large Chinese inventories, plentiful global supply and, since August, the effects of the Russian dairy embargo.

Climatic conditions remain relatively favourable for many Australian dairy producers, although recent conditions have been more mixed. Mild winter weather and adequate winter rainfall has enabled generally good pasture growth coming into spring, however producers, particularly in Victoria, have seen below average spring rain and may come under pressure coming into summer. Overall, we forecast production to increase 1.9% in 2014-15 but weighted dairy prices to fall 12.7% (AUD) over the same period.

Longer term trends for Australian dairy have been characterised by industry consolidation driven by deregulation over the past two decades. High levels of government intervention ended with the removal of price and production quantity regulation in 2000.

As detailed in Productivity Commission's October 2014 [research report](#) into dairy manufacturing in Australia, between 1989-90 and 2012-13, the number of Australian dairy farms fell by 58%, but the average number of cows per property increased 143% and milk production per cow increased 46%.

It is likely that the removal of European Union milk production quotas in 2015 will see further international competition for Australian dairy exporters.

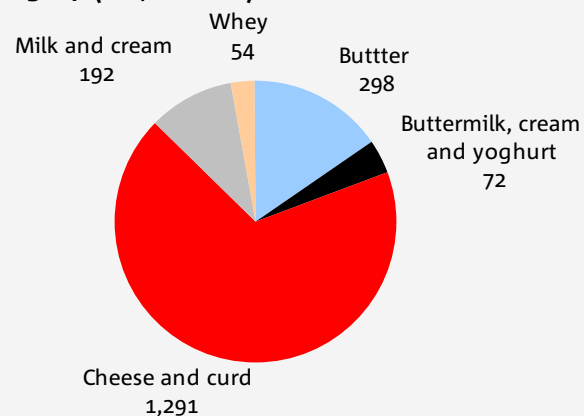


International Conditions

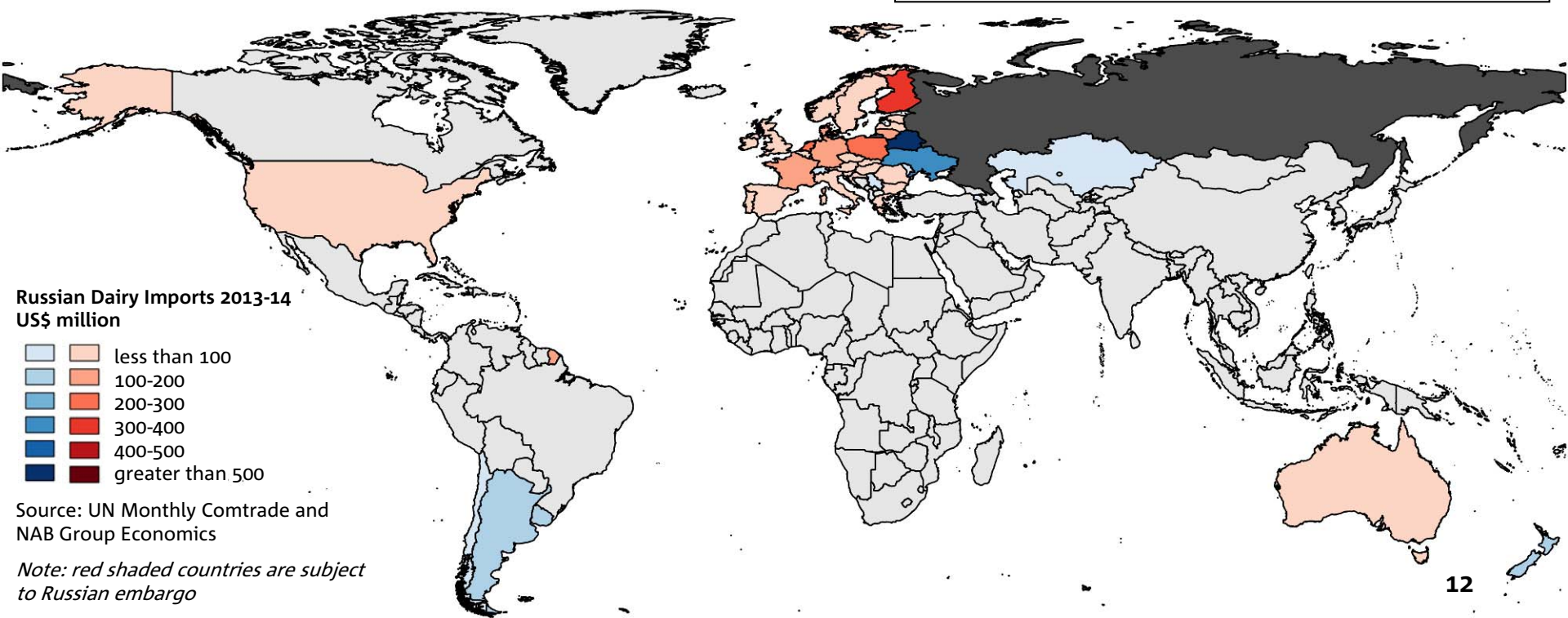
International conditions remain sluggish, driven in large part by high Chinese inventories, plentiful global supply and the effects of the Russian dairy embargo. In response to these trends, Fonterra in September lowered its 2014-15 forecast farmgate milk price for New Zealand farmers from NZ\$6.00 to NZ\$5.30/kg milk solids.

Australian dairy exports to Russia had been growing strongly in recent years, reaching US\$99 million in 2013-14, of which US\$88 million was butter. While this represents a small portion of Australia's AU\$2.6 billion dairy export industry, banned EU exports to Russia (totalling US\$1.8 billion in 2013-14, of which 71% was cheese and curd) have moved to alternative markets, placing further downward pressure on prices.

Figure 14: Russian dairy imports from now embargoed countries 2013-14 (US\$ million)



Source: UN Monthly Comtrade and NAB Group Economics

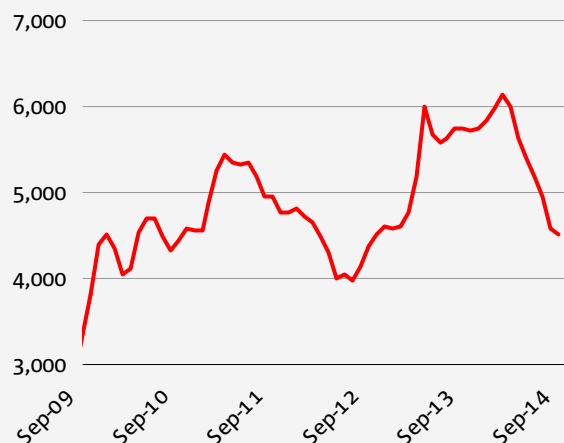


World Prices

Having reached all time highs in February 2014, international dairy prices spent the next six months in virtual freefall before showing some limited signs of stabilisation in September. BNZ monthly global weighted dairy prices have fallen 26.4% (USD) since their February high to US\$4,513.54/tonne for September.

Although prices were only 1.4% lower in September, weekly price movements for the first two weeks of October have seen further falls below US\$4,000/tonne.

Figure 15: BNZ global dairy prices (US\$/tonne)



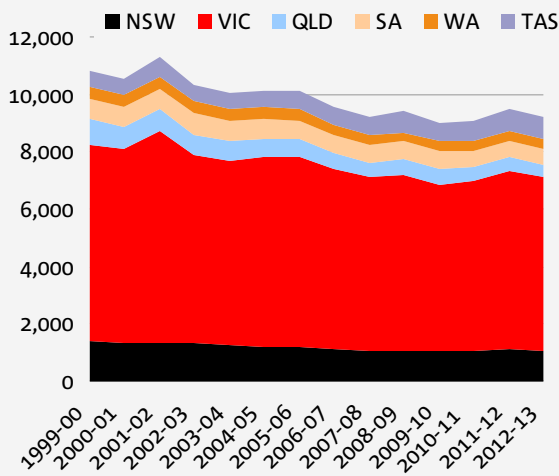
Source: BNZ

Australian Production and Trade

Most Australian milk production is concentrated in Victoria, which accounts for more than 65% of national output. The smaller dairy areas of New South Wales, Queensland, South Australia, Western Australia and Tasmania are focussed mostly on fresh milk for the domestic market, whereas Victorian and Tasmanian farmers send much of their milk to processors making manufactured dairy products for export.

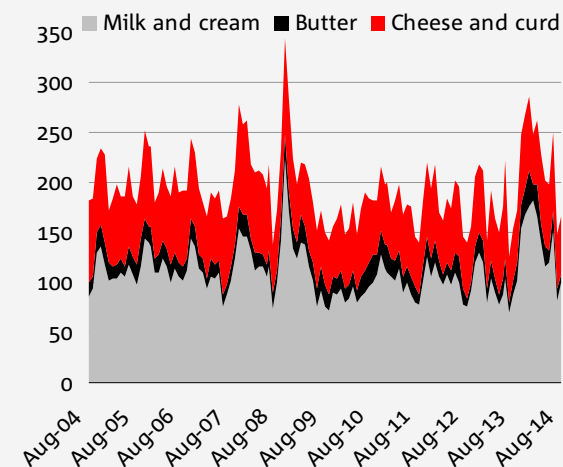
Total milk production has been trending downward since the early 2000s, falling 15.2% between 1999-00 and 2012-13. Exports – which consist mostly of milk, cream, cheese and curd – increased in late 2013 and early 2014, but have since fallen on seasonal conditions and the impacts of the Russian dairy embargo. The long term trend has not seen substantial growth in Australian dairy exports.

Figure 16: Australian milk production (million litres per year)



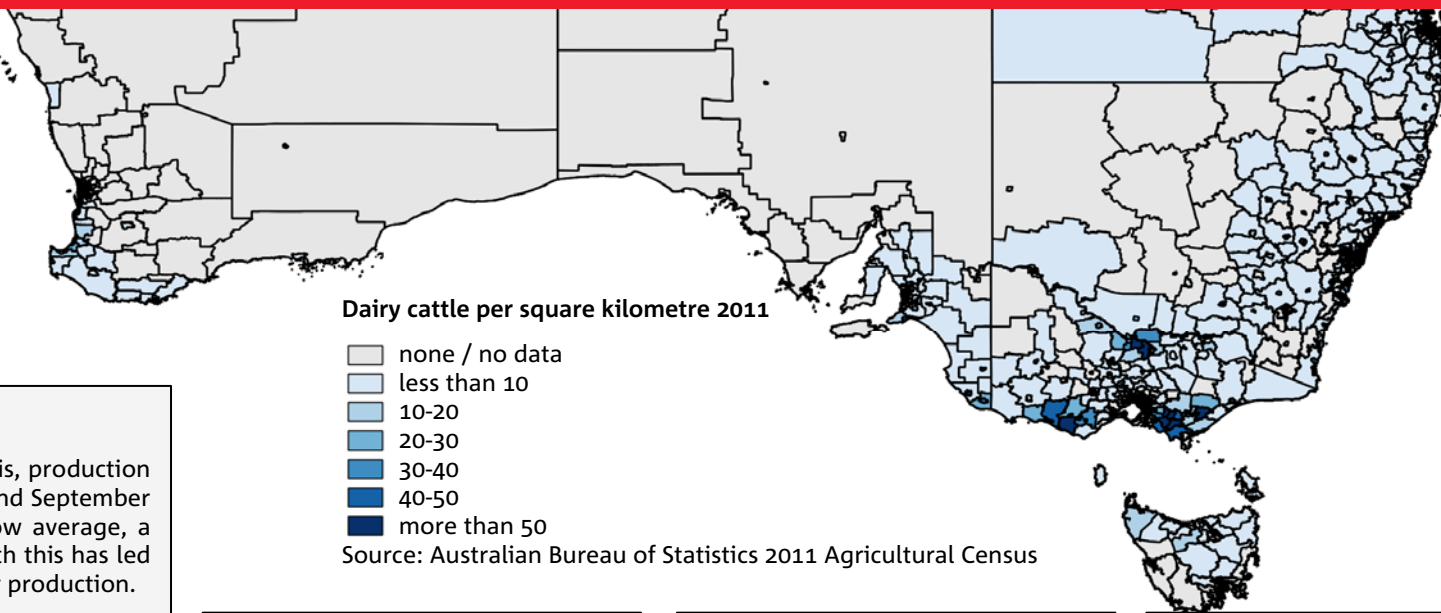
Source: Dairy Australia

Figure 17: Australian dairy exports (AU\$ million per month)



Source: Australian Bureau of Statistics

Dairy Outlook



South West Victoria

On a year on year basis, production is up. Whilst August and September rainfall has been below average, a wet July combined with this has led to good conditions for production.

Good rain is required within the next week or it will be a poor harvest from silage and hay. Also the spring will be shortened and supplementary feeding may begin earlier.

In respect of commodity prices, the factories have maintained prices in spite a significant downturn in major commodities. They are of the view that prices will rally on the premise that China re-enters the market in the back half of the year. In addition they have rolled out various incentive schemes to grow production.

John Brown
Senior Agribusiness Manager
Warrnambool, Victoria

Goulburn and Murray catchments

Although a lot of the hype around dairy has dissipated as price forecast has dropped off, the region is still doing pretty well overall.

We have seen a dry spring so far although there is still plenty of feed around for the time being. Producers will be looking to get good rains very soon and are already looking at buying water and additional feed.

Megan Hodge
Agribusiness Manager
Shepparton, Victoria

Gippsland

Things are going generally well in Gippsland after a mild winter with average rainfall through to early spring. Due to the milder winter farmers have been able to grow surplus feed, much of which is now being cut for silage. Rainfall from now through to Christmas will be the key to a successful season.

Farmgate prices are holding steady, although with little prospect of upside in the current market.

Kingsley Bauer
Agribusiness Manager
Sale, Victoria

Tasmania

The majority of farmers we have spoken with so far this season are seeing good production gains on the back of the very favourable season to this point. Some as much as 20% lift to the same period last year which is very pleasing.

The Autumn/Winter period was very kind, with conditions not getting super cold and rain at the right times. This has led to very favourable spring conditions and we would expect the silage/hay season to be busy.

David Martin
Regional Agribusiness Manager
Launceston, Tasmania

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

Risk Management Services

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

Corporate Communications

Chris Owens
Senior Manager
Corporate Communications
+61 (0) 409 945 476



Disclaimer

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances. NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it. Products are issued by NAB unless otherwise specified.

So far as laws and regulatory requirements permit, NAB, its related companies, associated entities and any officer, employee, agent, adviser or contractor thereof (the "NAB Group") does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("Information") is accurate, reliable, complete or current. The Information is indicative and prepared for information purposes only and does not purport to contain all matters relevant to any particular investment or financial instrument. The Information is not intended to be relied upon and in all cases anyone proposing to use the Information should independently verify and check its accuracy, completeness, reliability and suitability obtain appropriate professional advice. The Information is not intended to create any legal or fiduciary relationship and nothing contained in this document will be considered an invitation to engage in business, a recommendation, guidance, invitation, inducement, proposal, advice or solicitation to provide investment, financial or banking services or an invitation to engage in business or invest, buy, sell or deal in any securities or other financial instruments.

The Information is subject to change without notice, but the NAB Group shall not be under any duty to update or correct it. All statements as to future matters are not guaranteed to be accurate and any statements as to past performance do not represent future performance.

The NAB Group takes various positions and/or roles in relation to financial products and services, and (subject to NAB policies) may hold a position or act as a price-maker in the financial instruments of any company or issuer discussed within this document, or act and receive fees as an underwriter, placement agent, adviser, broker or lender to such company or issuer. The NAB Group may transact, for its own account or for the account of any client(s), the securities of or other financial instruments relating to any company or issuer described in the Information, including in a manner that is inconsistent with or contrary to the Information.

Subject to any terms implied by law and which cannot be excluded, the NAB Group shall not be liable for any errors, omissions, defects or misrepresentations in the Information (including by reasons of negligence, negligent misstatement or otherwise) or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the Information. If any law prohibits the exclusion of such liability, the NAB Group limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable.

This document is intended for clients of the NAB Group only and may not be reproduced or distributed without the consent of NAB. The Information is governed by, and is to be construed in accordance with, the laws in force in the State of Victoria, Australia.

Analyst Disclaimer: The Information accurately reflects the personal views of the author(s) about the securities, issuers and other subject matters discussed, and is based upon sources reasonably believed to be reliable and accurate. The views of the author(s) do not necessarily reflect the views of the NAB Group. No part of the compensation of the author(s) was, is, or will be, directly or indirectly, related to any specific recommendations or views expressed. Research analysts responsible for this report receive compensation based upon, among other factors, the overall profitability of the Global Markets Division of NAB.

United Kingdom: If this document is distributed in the United Kingdom, such distribution is by National Australia Bank Limited, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 800 Bourke Street, Docklands, Victoria, 3008. Incorporated with limited liability in the State of Victoria, Australia. Authorised and regulated by the Australian Prudential Regulation Authority. Authorised in the UK by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

US Disclaimer: If this document is distributed in the United States, such distribution is by nabSecurities, LLC. This document is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of nabSecurities to create legal relations on the basis of information provided herein.

Hong Kong: In Hong Kong this document is for distribution only to "professional investors" within the meaning of Schedule 1 to the Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong) ("SFO") and any rules made thereunder and may not be redistributed in whole or in part in Hong Kong to any person. Issued by National Australia Bank Limited, a licensed bank under the Banking Ordinance (Cap. 155, Laws of Hong Kong) and a registered institution under the SFO (central entity number: AAO169).

New Zealand: This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication. National Australia Bank Limited is not a registered bank in New Zealand.

Japan: National Australia Bank Ltd. has no license of securities-related business in Japan. Therefore, this document is only for your information purpose and is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action.