



In Focus

Year Ahead Price and Production Forecasts – June 2015

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Key points

- This report provides production and price forecasts for 2015-16 for seven major commodities within NAB Rural Commodities Index; namely wheat, beef, dairy, lamb, wool, sugar and cotton. Overall, we expect prices to generally rise in AUD terms for most of these commodities, with the exception of dairy and sugar, reflecting strong demand for beef in particular as well as the impact of a falling AUD.
- The production outlook is more clouded, underscored by the Bureau of Meteorology's declaration of El Niño in May 2015. Our forecast for wheat in particular reflects the risk of a major El Niño event occurring this year. Further, we forecast a contraction in beef and lamb supply after a prolonged period of elevated slaughter rates.

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Summary of forecasts

Overall, we expect prices to generally rise in AUD terms, with the exception of dairy and sugar. This reflects strong demand for beef in particular as well as the impact of a falling AUD, which we expect to fall to 74 US cents by the end of 2015 before bottoming out at 73 US cents early in 2016. Our overall NAB Rural Commodities Index AUD forecast track is forecast to flat-line in the September quarter 2015 before increasing until the September quarter 2016. After this point, we forecast a rising AUD to dent the index somewhat. In USD terms, we expect the index to remain relatively stable over the forecast period.

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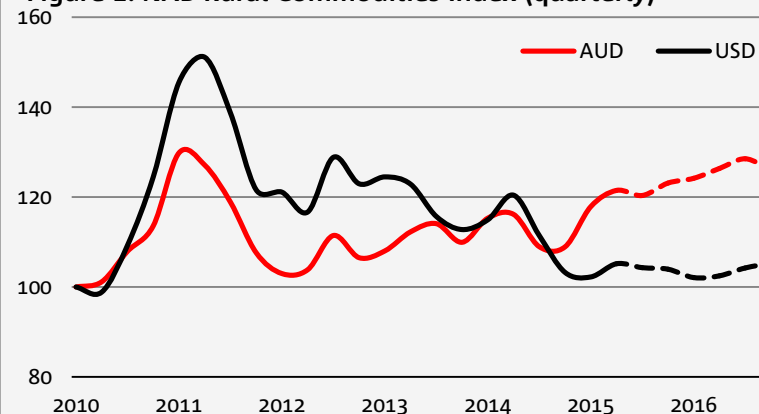
Our forecasts for AUD price and Australian production changes, as well as 2014-15 average levels, in 2015-16 are shown for selected commodities in *Table 1*. All levels reflect price indicators detailed in the following pages of this report.

Background

This report provides production and price forecasts for 2015-16 for seven major commodities within NAB Rural Commodities Index; namely wheat, beef, dairy, lamb, wool, sugar and cotton. Also provided is a forecast track for the NAB Rural Commodities Index to Q4 2016 (*Figure 1*).

NAB's Rural Commodities Index includes 28 commodities (wheat, barley, sorghum, rice, oats, canola, chick peas, field peas, lupins, wool, cotton, sugar, wine grapes, beef, lamb, pork, poultry, dairy, apples, bananas, oranges, mangoes, strawberries, broccoli, carrots, lettuce, potatoes and tomatoes). The index is weighted annually according to the gross value of production of each industry in Australia.

Figure 1: NAB Rural Commodities Index (quarterly)



Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Australian Pork, Ausmarket Consultants, BNZ, Australian Bureau of Statistics, Bloomberg and Profarmer. Q1 2010 = 100

Table 1: April 2015 price movements, production and price forecasts for major agricultural sectors

	2015-16 annual production change	2015-16 annual price change (AUD)	2015-16 annual price level (AUD)
Wheat	▼ 15.5%	▲ 3.4%	\$299.30/tonne
Beef	▼ 8.8%	▲ 26.2%	506.25c/kg
Dairy	▲ 1.6%	▼ 5.3%	\$3,194.52/tonne
Lamb	▼ 1.0%	▲ 1.2%	523.75c/kg
Wool	▼ 4.4%	▲ 11.7%	1,225c/kg
Sugar	▲ 4.3%	▼ 3.8%	\$369.09/tonne
Cotton	▲ 2.0%	▲ 9.3%	\$2,073.95/tonne

Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Bloomberg and Profarmer. Forecasts represent change in annual average price between 2014-15 and 2015-16..

Wheat

Global wheat markets have been somewhat volatile of late, partly in response to storm conditions in the US. However, the USDA forecasts that total global wheat supply will increase in 2015-16, suggesting that prices will remain subdued overall over the year ahead. Locally, we expect that the falling AUD will provide some support to local prices. Overall, our forecast is for prices to increase 3.4% in 2015-16.

However, the outlook for domestic production is clouded by the Bureau of Meteorology's declaration of El Niño in May 2015. El Niño affects temperature and rainfall in North and South America, Africa, East and Southeast Asia, the Indian subcontinent, Australia and the Pacific. Locally, the phenomenon causes generally lower winter and spring rainfall in northern and eastern Australia.

Although the impacts of El Niño events are disparate and difficult to forecast, severe events have been associated with drastically lower wheat yields in eastern Australia. For example, the 2002-03 and 2006-07 El Niño events saw the Australian wheat harvest more than halved compared to the preceding seasons.

Noting these downside risks, we are somewhat more pessimistic than ABARES' forecast for a harvest of 23.6 million tonnes this season. A classic El Niño could readily push the harvest down to 20 million tonnes or potentially lower.

Figure 2: Generic 1st Australian milling wheat (AUD/tonne)

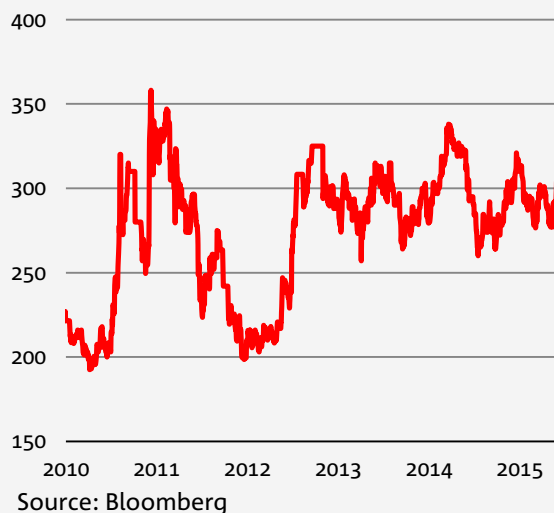


Figure 3: USDA global wheat output and supply forecasts (million tonnes)

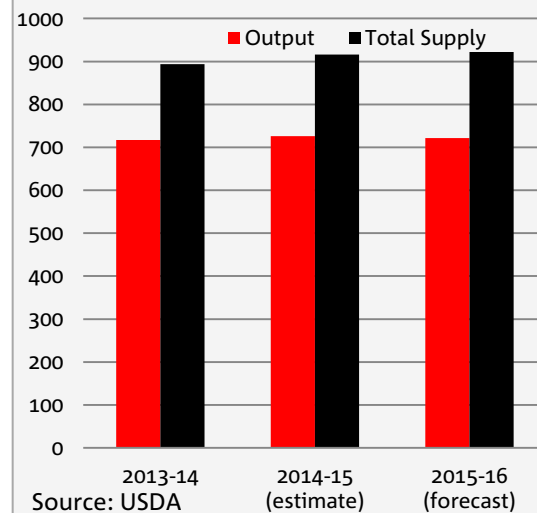
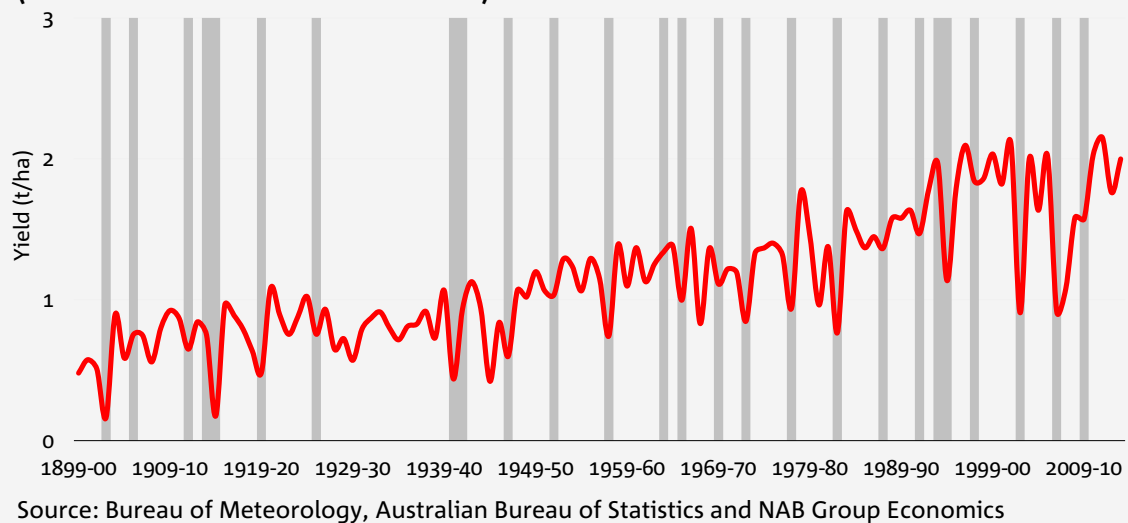


Figure 4: Impact of El Niño on Australian wheat yields (shaded areas indicate El Niño events)



Beef

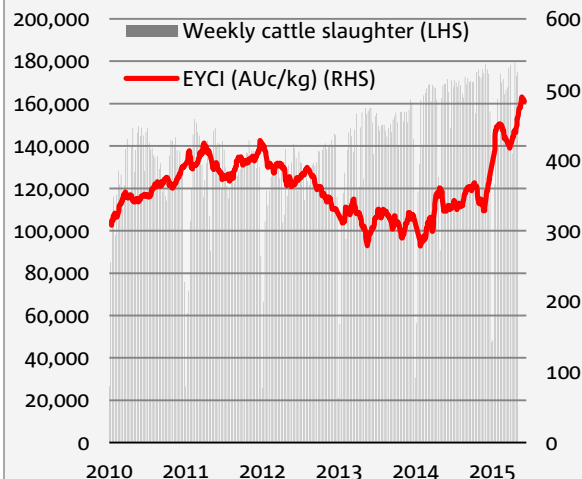
Upward momentum in Australian cattle markets continues virtually unabated. The Eastern Young Cattle Indicator is well into record territory and now stands at almost AUc/kg boosted by strong feedlot demand as the US continues to sate its appetite for beef through higher imports from Australia.

Meanwhile, slaughter rates remain elevated as drought induced destocking in northern Australia meets US demand.

However, while fundamentals appear strong, weather continues to present a significant risk to the industry outlook. Despite some encouraging early rains, the most recent northern wet season mostly fizzled out and failed in many areas. Parts of Queensland – Australia's largest cattle producing state – have not seen meaningful rain in three to four years, which has led to substantial destocking. If the next wet season fails, it will be difficult to maintain herds and keeping breeding stock alive.

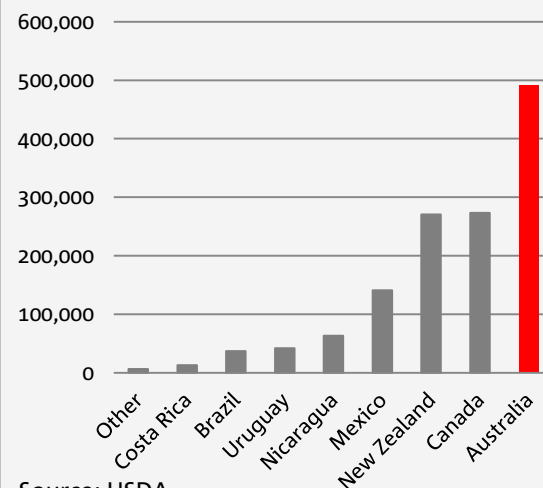
On balance, we expect prices to level out at higher levels, leading to an annual price increase of 26.2% in 2015-16. However, production is likely contract as current slaughter rates do not appear sustainable. We expect production to contract 8.8% in 2015-16, in line with ABARES' forecast.

Figure 5: Eastern Young Cattle Indicator (AUc/kg)



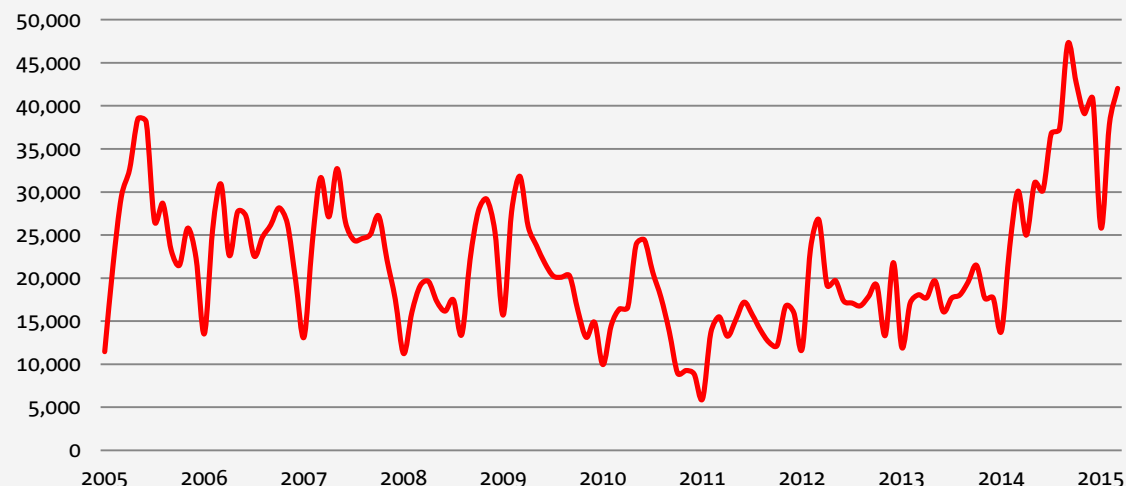
Source: Meat and Livestock Australia

Figure 6: US beef imports by source country (tonnes) 2014



Source: USDA

Figure 7: Monthly Australian beef exports to the US (tonnes)



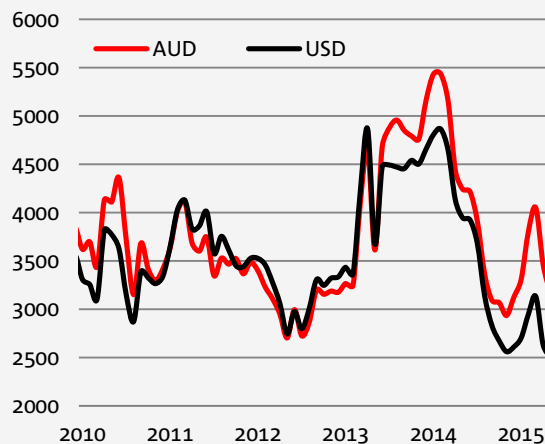
Source: Meat and Livestock Australia

Dairy

Apart from a brief recovery earlier this year, international dairy prices have generally declined over the last 18 months. NAB's monthly weighted dairy price indicator started 2014 at USD4,806/tonne but declined to USD2,502/tonne by May 2015. China's milk powder replenishment of 2013 and early 2014 does not look set to be repeated, with inventories continuing to increase. Meanwhile, global supply remains generally strong. Consequently, we see little upside for dairy prices in the year ahead.

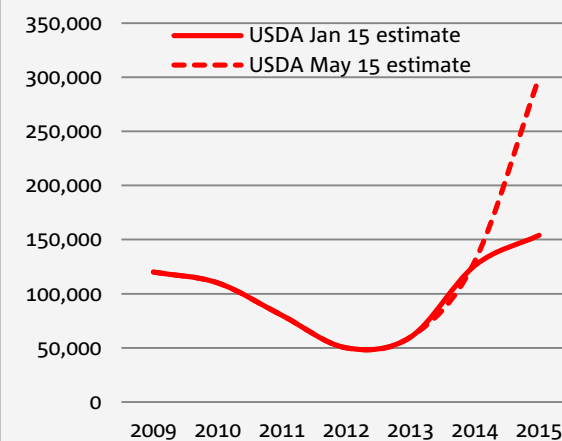
On the domestic production side, the main risk is likely to be poor spring pasture growth if winter rainfall disappoints.

Figure 8: NAB monthly weighted dairy price indicator (\$/tonne)



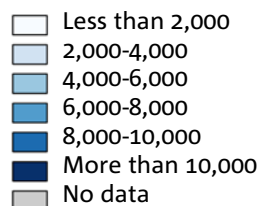
Source: Global Dairy Trade and NAB Group Economics

Figure 9: Chinese milk powder beginning stocks (tonnes)



Source: USDA and Indexmundi

Value of dairy* exports (million USD) – 2013



Source: UN Comtrade, Natural Earth Data and NAB Group Economics. * Includes eggs and honey.

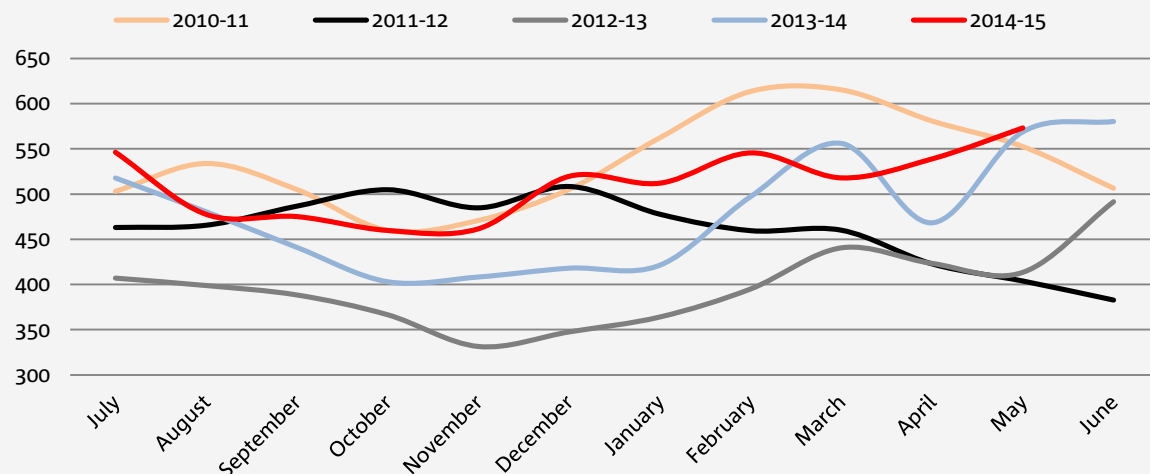
Lamb

Lamb prices follow a generally seasonal pattern, rising early in the year before declining in spring as spring lamb supply becomes available. Nonetheless, monthly average trade lamb prices have generally performed towards the upper end of the five year range in 2014-15.

These moderately higher prices have been sustained as supply has increased over the past five years, especially from Victoria. Much of this additional supply has been exported, with growth in exports to China, the Middle East, and to a lesser degree the US, over the last five years. Conversely, domestic per capita consumption of lamb has declined considerably over recent years.

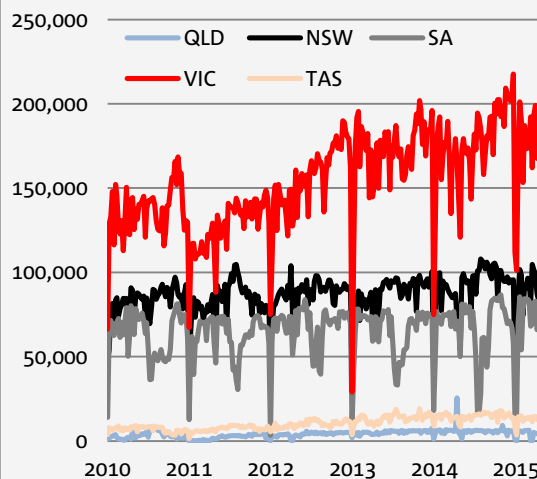
Slaughter rates have been elevated for much of 2014 and 2015, especially in Victoria. We do not believe that slaughter can continue to be sustained at these levels, and expect a contraction in supply in the coming year. Our forecast for a 1.0% decline in lamb production in 2015-16 is in line with ABARES' estimate.

Figure 10: Eastern States Trade Lamb Indicator – monthly average (AUc/kg)



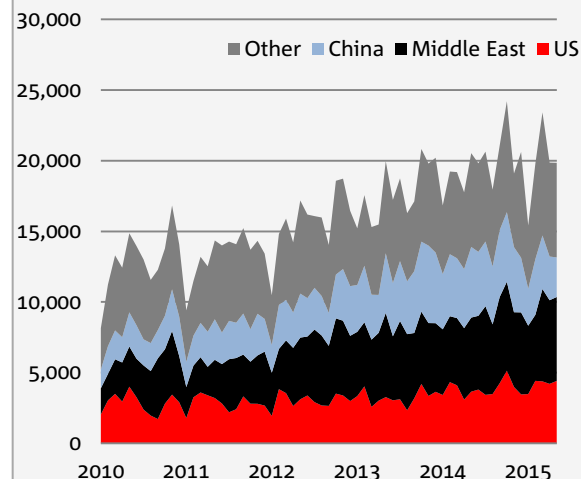
Source: Meat and Livestock Australia

Figure 11: Weekly sheep and lamb slaughter



Source: Meat and Livestock Australia

Figure 12: Monthly Australian lamb exports by destination (tonnes)



Source: Meat and Livestock Australia

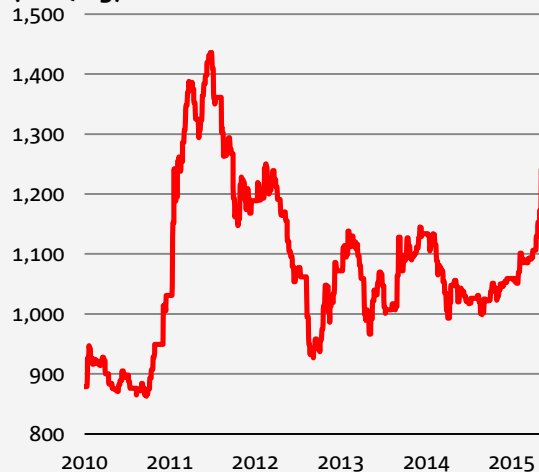
Wool

Wool has rallied since April, with the Eastern Market Indicator at its highest level since mid-2011. Demand has jumped, with good competition among buyers and reports of stockpiles being cleared. With the wool industry now heavily reliant on exports to China, an uptick in demand from Chinese wool mills on account of easing credit conditions and signs of higher global demand has seen prices increase significantly.

Production in the wool industry has been in decline since the collapse of the reserve price scheme in the early 1990s, compounded by a long term shift from wool to synthetic and cotton substitutes in clothing. These trends have led to many producers switching from wool to more profitable lamb operations. However, if the recent higher prices can be sustained, wool grower profitability should improve somewhat.

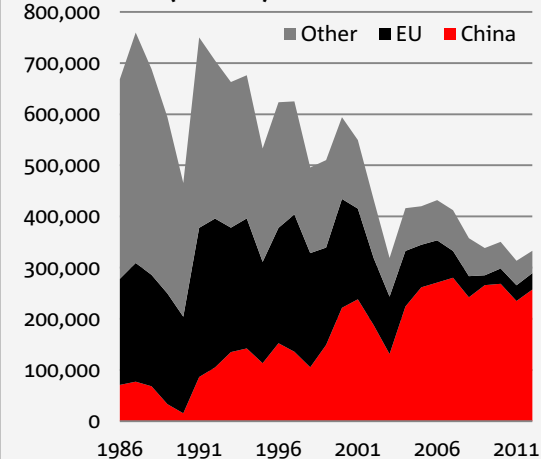
Overall, we forecast the Eastern Market Indicator to rise 11.7% in 2015-16 but for production to decline 4.4% over the year.

Figure 13: Wool - Eastern Market Indicator (AUc/kg)



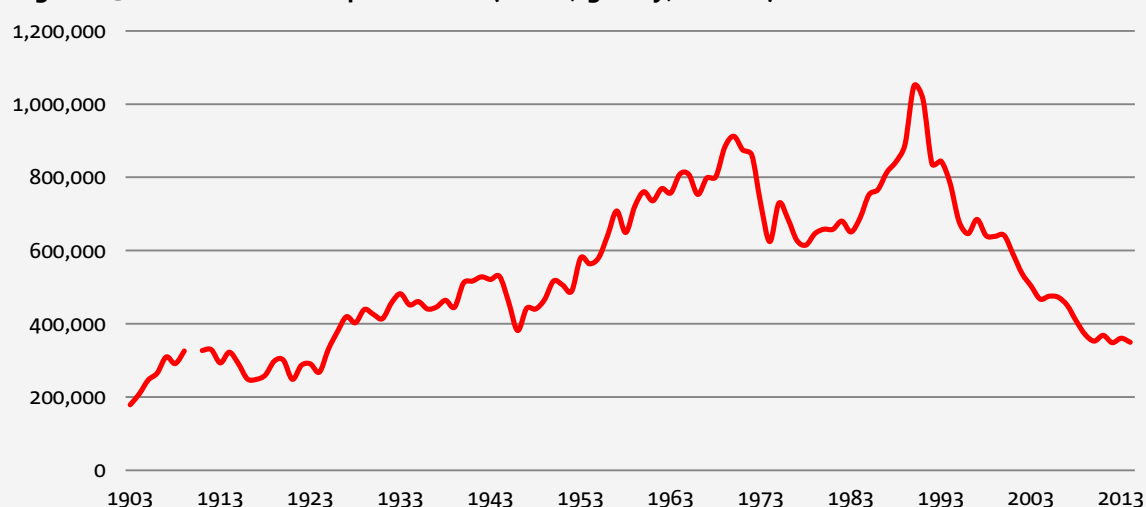
Source: Bloomberg

Figure 14: Australian wool exports by destination (tonnes)



Source: UN FAOSTAT. Includes greasy and degreased wool.

Figure 15: Australian wool production (shorn, greasy, tonnes)



Source: Australian Bureau of Statistics and ABARES

Sugar

Sugar markets have trended mostly lower in 2015, owing to a relatively strong supply outlook combined with tumult in Brazil, a major sugar producer, causing a depreciating Real.

Overall, our forecast for domestic production to increase 4.3% in 2015-16 is in line with ABARES' estimate. We forecast prices to decline 3.8% in AUD terms.

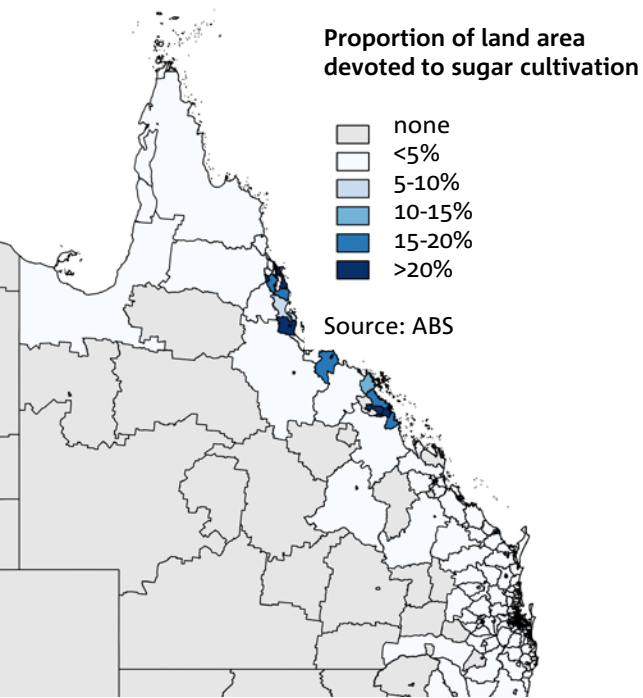
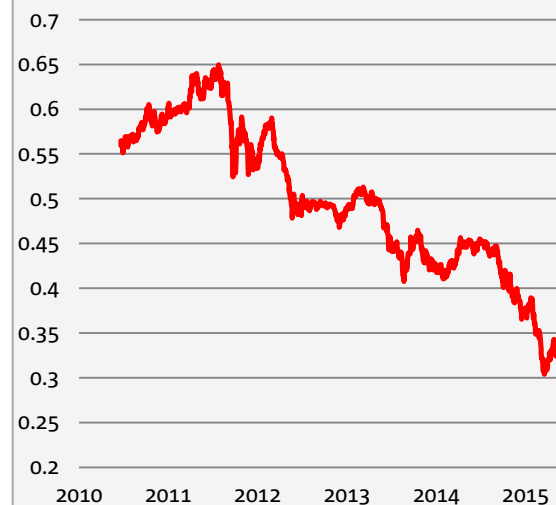
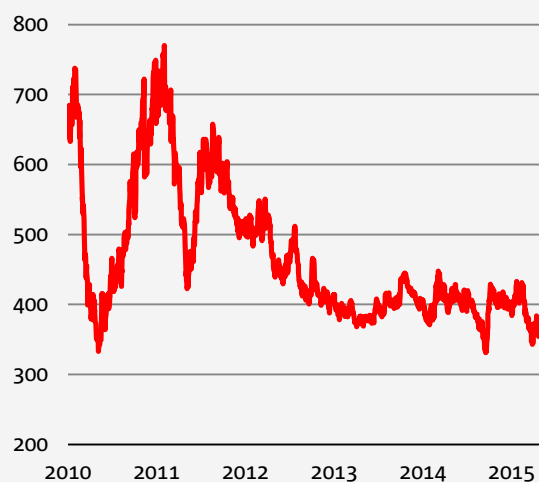


Figure : 16: Brazilian Real/USD cross



Source: Bloomberg

Figure 17: ICE no.11 sugar (AUD/tonne)



Source: Bloomberg



Cotton

After falling in mid-2014, cotton prices have stabilised and even moderately increased in AUD terms this year. However, decent supply and signs of sluggish Chinese demand have weighed on sentiment.

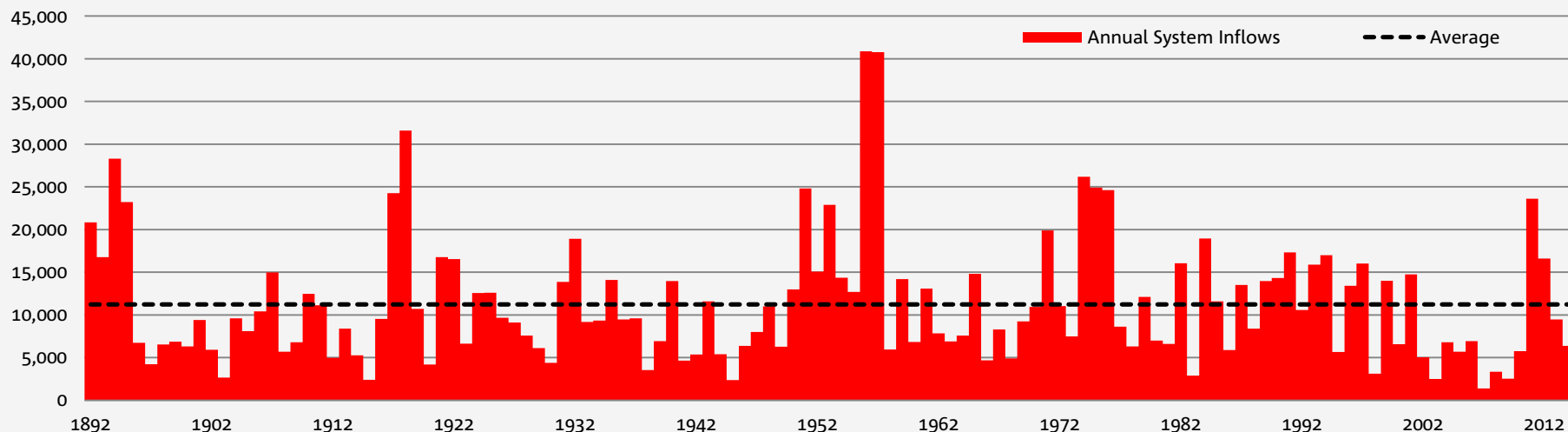
In 2014-15, Australian cotton production was estimated to have declined 43.5% on markedly lower plantings due to reduced irrigation water availability. Last season's yields were quite strong however. ABARES forecasts Australian cotton lint production to increase 4.0% on the back of a 7.1% increase in area planted. We see a downside risk as a result of continued below average inflows into dams in the Murray Darling basin, and consequently look to a 2.0% increase in production. We forecast prices to rise 9.3% in 2015-16.

Figure 18: Cotlook A cotton (AUD/tonne)



Source: Bloomberg

Figure 19: Annual Murray Darling Basin System Inflows (GL per annum)



Source: Murray Darling Basin Authority (includes Menindee Inflows, excludes Snowy Releases)

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