



nab

Economic Report

Rural Commodities Wrap – August 2015

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agribusiness

Key points

- The NAB Rural Commodities Index continues to rise in AUD terms (up 4.1% in July), supported by a lower dollar and higher beef, fruit, domestic wheat and sugar prices. Prices have seen greater tumult on international markets as stormy US weather affects major grains and continued sluggish international demand continues to punish dairy auction results. Overall the index was down 0.4% in USD terms in July.
- We have revised down our AUD/USD forecasts, looking to 70 US cents by the end of year (previously 72) before bottoming out in Q1 2016 at 68 US cents (previously 71). This remains good news for Australian agricultural producers.
- Weather remains a concern, with rainfall still patchy overall in July and parts of the country still very dry. The Bureau of Meteorology's latest three-month rainfall outlook to October predicts below average rainfall in the top end, much of Victoria, Tasmania and northern New South Wales but above average falls in Western Australia and neutral conditions in the Riverina. Drier conditions in northern and eastern Australia through late winter and early spring are consistent with a 'classical' El Niño event.

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NAB Rural Commodities Index

The NAB Rural Commodities Index rose in AUD terms in July (up 4.1%), supported by a lower dollar and higher beef, fruit, domestic wheat and sugar prices. Prices have seen greater tumult on international markets as stormy US weather affects major grains and continued sluggish international demand continues to punish dairy auction results. Overall the index was down 0.4% in USD terms in July.

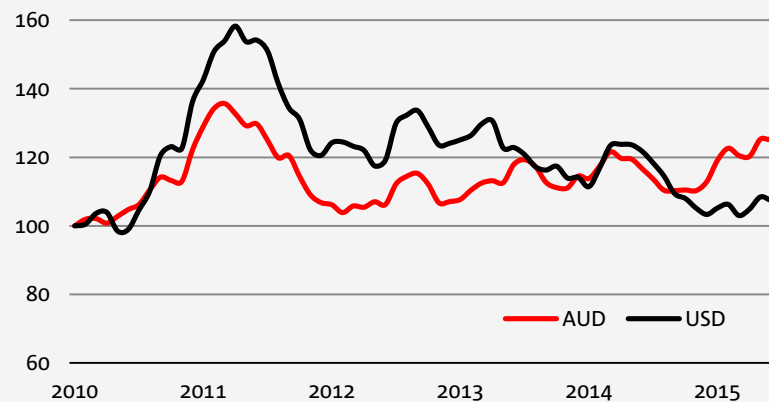
NAB's Rural Commodities Index includes 28 commodities (wheat, barley, sorghum, rice, oats, canola, chick peas, field peas, lupins, wool, cotton, sugar, wine grapes, beef, lamb, pork, poultry, dairy, apples, bananas, oranges, mangoes, strawberries, broccoli, carrots, lettuce, potatoes and tomatoes). The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

Production and Price Outlook

The Bureau of Meteorology's declaration of El Niño earlier this year clouds the production outlook, particularly for winter grains. Last month we highlighted the risk of El Niño to Australia's wheat crop. While this risk remains very much live, we have upgraded our wheat production forecast to 21.6 million tonnes in 2015-16 in the event of a classic El Niño spring although a national harvest of around 23 million tonnes is achievable in the event of average spring rain.

We have also adjusted our price forecasts in line with our revised AUD forecast and to reflect market conditions for beef, dairy and wool. With signs that declining beef slaughter is likely to continue owing to a shortage of stock, we note that the upside for prices is now higher and have increased our forecast accordingly. Conversely, ongoing weakness in Global Dairy Trade auction results, with little prospect of meaningful upturn for the foreseeable future, sees our dairy price forecast revised downwards, although this is partly offset by a lower forecast AUD. Price and production forecasts for major commodities are shown in *Table 1*.

Figure 1: NAB Rural Commodities Index



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

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

| | Month on month price change (AUD) | 2015-16 annual production change | 2015-16 annual price change (AUD) |
|--------|-----------------------------------|----------------------------------|-----------------------------------|
| Wheat | ▲ 6.3% | ▼ 8.6% | ▲ 8.6% |
| Beef | ▲ 9.5% | ▼ 8.8% | ▲ 39.9% |
| Dairy | ▼ 8.6% | ▲ 1.6% | ▼ 10.0% |
| Lamb | ▲ 0.2% | ▼ 1.0% | ▲ 1.2% |
| Wool | ▼ 7.9% | ▼ 4.4% | ▲ 9.6% |
| Sugar | ▲ 5.4% | ▲ 4.3% | ▲ 1.1% |
| Cotton | ▲ 4.1% | ▲ 2.0% | ▲ 14.9% |

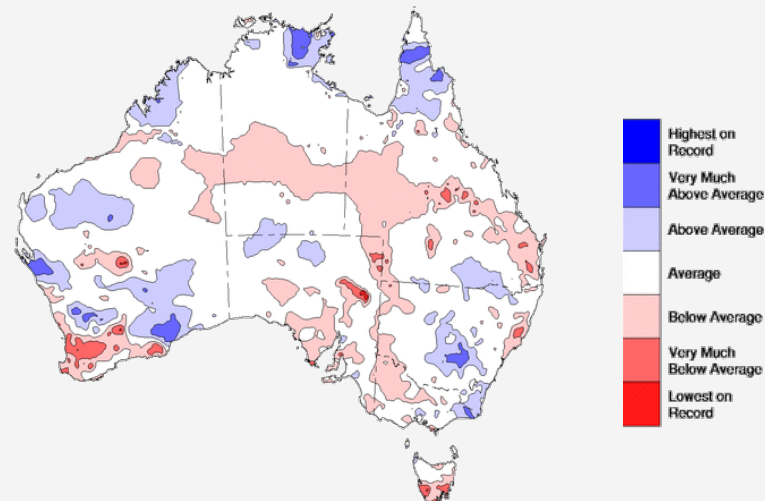
Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Bloomberg, BNZ and Profarmer. Forecasts represent year-on-year average changes.

Climatic Conditions

Rainfall continued to be patchy in July, with above average falls in Cape York, southern Queensland, the Riverina, Gippsland and parts of the Western Australian wheatbelt contrasted with well below average rainfall in some areas. Challenges remain approaching spring, compounded by the presence of El Niño since May this year. El Niño causes generally lower winter and spring rainfall in northern and eastern Australia.

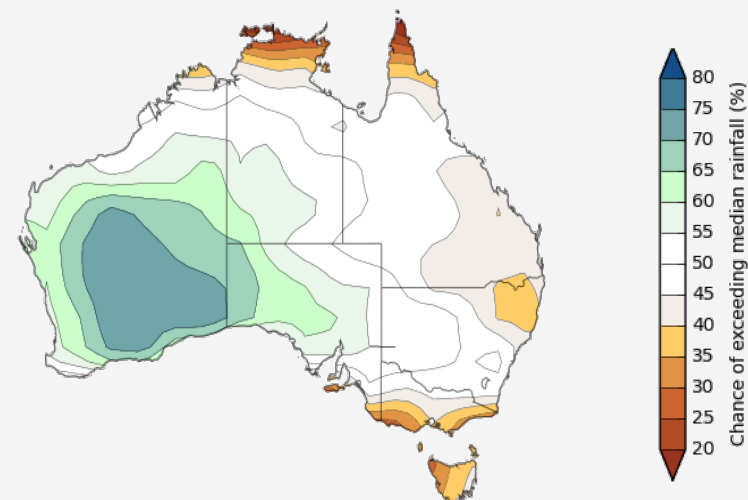
Figure 3 shows the three-month rainfall outlook to October, which forecasts below average rainfall in the top end, much of Victoria, Tasmania and northern New South Wales but above average falls in Western Australia and neutral conditions in the Riverina. Drier conditions in northern and eastern Australia through late winter and early spring are consistent with a 'classical' El Niño event.

Figure 2: Australian rainfall deciles – July 2015



Source: Bureau of Meteorology

Figure 3: Rainfall outlook – August to October 2015



Source: Bureau of Meteorology

Economic Update

For detailed analysis of Australian and global economic trends see our Global and Australian Forecasts. Below is a précis of this report.

Global Economy

Global growth is running below trend and looks set to remain lacklustre, limiting the pace of expansion in commodity demand. Output has been growing faster recently in some of the big advanced economies (notably the US and UK) and the Greek crisis has had little impact on activity across the rest of the Euro-zone. Stagnation in growth across the emerging market economies, the principal drivers of recent global output expansion, is the main area of disappointment and reflects the sluggish growth in world trade volumes and falling commodity prices. The bursting of the share market bubble will probably only worsen China's trend slowdown, recent Indian data is again disappointing and there is weakness across large parts of East Asia and Latin America – not a good environment for commodity prices.

Domestic Economy

The Australian economic outlook remains mixed and patchy. Mining investment is declining sharply, public spending is limited and national income growth is weak amidst declining commodity prices. Meanwhile, resource exports are ramping up, monetary policy is highly stimulatory and the AUD is acting as a shock absorber, with tentative evidence of further recovery in non-mining activity. House prices are growing strongly, particularly in the eastern states, and consumer spending has picked up recently. Non-mining investment remains the missing ingredient – with firms demanding very high rates of return before investing – 13% according to our survey.

Interest Rates

With rates already low, this outlook is not sufficiently weak to prompt further monetary policy easing. Equally, expectations for elevated unemployment imply that rate hikes are unlikely until the recovery in non-mining activity is more entrenched (late 2016 on our view). Risks emanating from offshore are overwhelmingly to the downside, while stronger local data if sustained suggest some modest upside risk.

Table 2: NAB Global Economic Forecasts

| % change year on year | 2015 | 2016 | 2017 |
|-----------------------|------|------|------|
| China | 7.1 | 6.9 | 6.5 |
| United States | 2.3 | 2.6 | 2.5 |
| Euro zone | 1.4 | 1.8 | 2.1 |
| Emerging East Asia | 3.8 | 4.0 | 4.2 |
| Japan | 0.9 | 1.2 | 1.1 |
| Advanced economies | 2.0 | 2.2 | 2.2 |
| Emerging economies | 4.9 | 5.0 | 5.0 |
| World GDP | 3.2 | 3.3 | 3.4 |

Source: NAB Group Economics

Table 3: NAB Australian Economic Forecasts

| % change year on year | 2015 | 2016 | 2017 |
|------------------------------|------|------|------|
| GDP growth | 2.6 | 3.0 | 3.3 |
| Private consumption | 2.8 | 2.9 | 2.8 |
| Unemployment rate (year end) | 6.2 | 5.9 | 5.8 |
| Consumer Price Index (core) | 2.5 | 2.6 | 2.5 |

Source: NAB Group Economics

Table 4: NAB Interest Rate Forecast (end of quarter)

| | 2015 Q1 | 2015 Q2 | 2015 Q3 | 2015 Q4 |
|---------------|---------|---------|---------|---------|
| RBA Cash Rate | 2.25 | 2.0 | 2.0 | 2.0 |

Source: NAB Group Economics

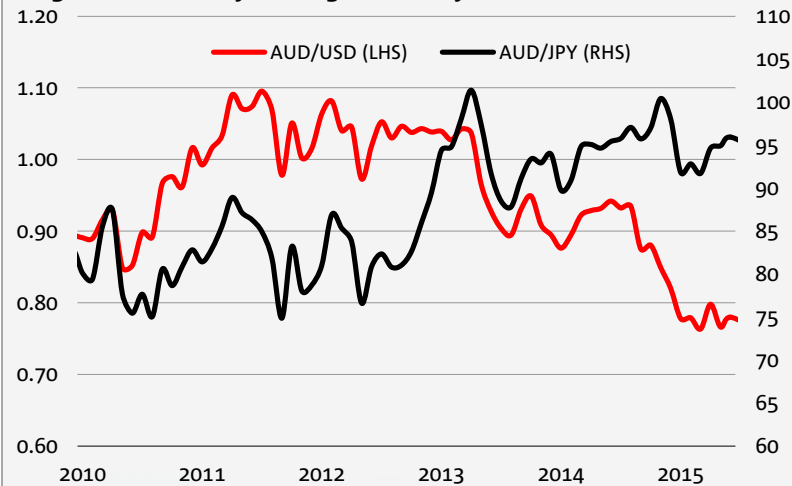
Exchange Rates

The AUD continued its downward trajectory in July, the trend accelerating in August with the People's Bank of China's move devaluation of the Yuan. We have updated our AUD/USD forecast in light of the following:

- Our view that the market has not adequately priced the risk of the US Federal Reserve's expected September rate hike;
- The likelihood of continued terms of trade weakness; and
- Ongoing risks to the growth outlook in China and the recent depreciation of the Yuan.

We now forecast the AUD to fall to 70 US cents by the end of year (previously 72 US cents) before bottoming out in Q1 2016 at 68 US cents (previously 71 US cents). This represents an upside for local prices and is good news for Australian agricultural producers.

Figure 4: Monthly average currency movements



Source: DXdata, NAB

Table 5: NAB FX Strategy Targets

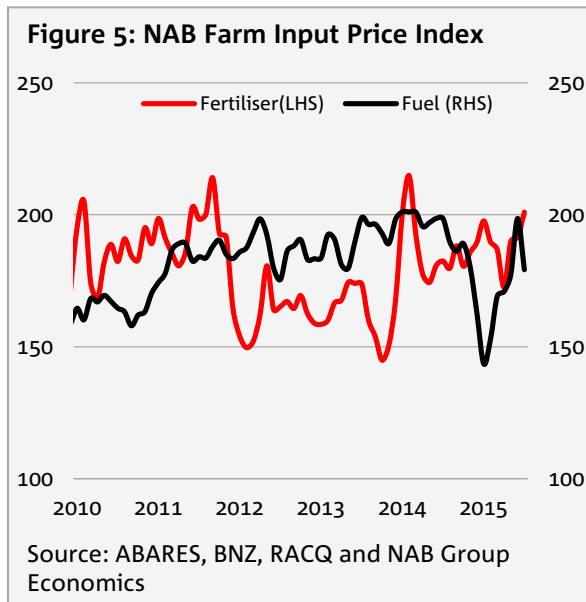
| | | 2015 Q3 | 2015 Q4 | 2016 Q1 | 2016 Q2 |
|--------------------|---------|---------|---------|---------|---------|
| Australian Dollar | AUD/USD | 0.72 | 0.70 | 0.68 | 0.69 |
| New Zealand Dollar | NZD/USD | 0.64 | 0.62 | 0.60 | 0.60 |
| Japanese yen | USD/JPY | 124 | 125 | 126 | 126 |
| Euro | EUR/USD | 1.07 | 1.05 | 1.03 | 1.03 |
| British Pound | GBP/USD | 1.53 | 1.52 | 1.51 | 1.51 |
| Swiss Franc | USD/CHF | 0.98 | 1.01 | 1.04 | 1.04 |
| Chinese New Yuan | USD/CNY | 6.50 | 6.55 | 6.60 | 6.62 |
| Canadian Dollar | USD/CAD | 1.33 | 1.35 | 1.37 | 1.36 |

Source: NAB

NAB Farm Input Prices

Petrol prices fell 9.8% in July to average 136.9 AUC/litre for the month. This price came as global oil prices resumed their downward slide. The AUD is forecast to fall further in the coming months, presenting a moderate upside risk for petrol prices.

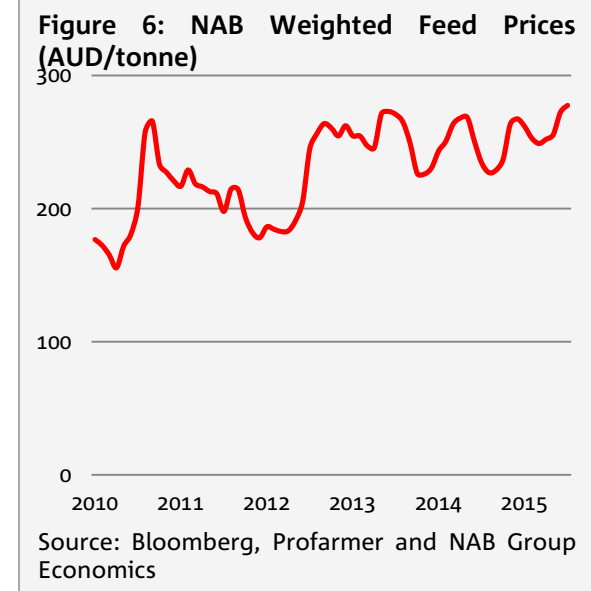
The NAB Fertiliser Index was up 5.0% in AUD terms in July as the lower AUD offset stable international natural gas and diammonium phosphate and lower urea prices.



Weighted Feed Grain Prices

NAB's weighted feed grain price indicator includes feed wheat, barley, oats and sorghum. Three quarters of the indicator is made up of feed wheat and barley.

This month we present a reconstituted index based on a new data source. Weighted feed grain prices rose slightly in July (up 1.9%), after a jump in June (6.5% based on revised data). This trend reflects generally higher prices among major feed grains in domestic markets as the dollar trends lower. If spring rain is below average, domestic feed grain demand is likely to increase as graziers look for additional supplementary feed.



Crops

Wheat

Generic 1st Australian milling wheat prices gained in July – up 6.3% to average AUD325.87/tonne for the month. Global wheat supply remains broadly favourable, although stormy and wet weather conditions in parts of the US has led to heightened volatility on global markets.

Coarse grains

Coarse grains also gained in July. Eastern Australia feed barley was flat while sorghum fell 2.8% (AUD). Meanwhile oats (feed, Albany) appeared untraded and rice (US rough) gained 16.1% (AUD).

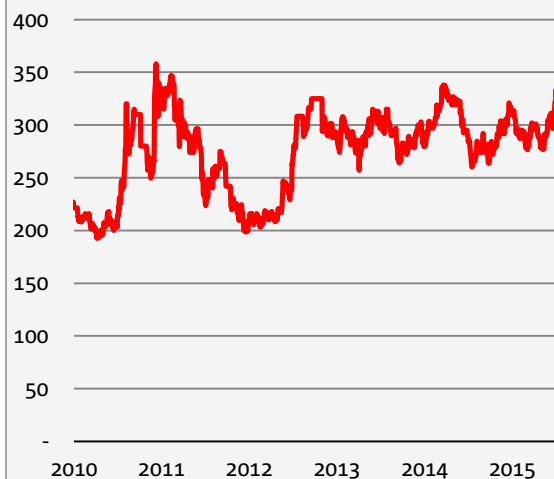
Oilseeds

Domestic canola (Newcastle NSW) followed wheat upwards in July, rallying 4.0% to average AUD546.46/tonne. The USDA forecasts that Canadian canola production will decline, with increased planting area being offset by lower yields.

Pulses

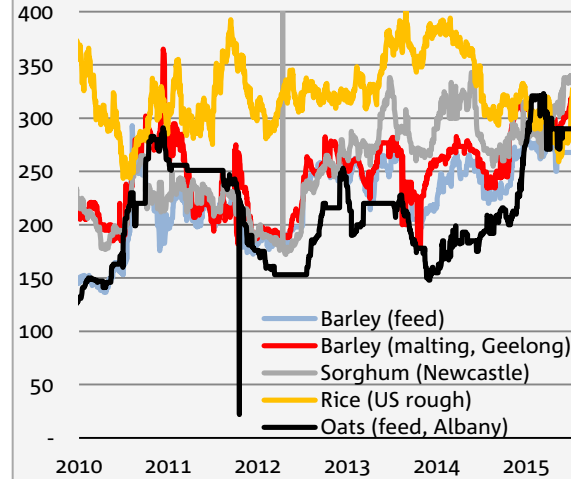
Pulses were mixed in July. Chick peas (Brisbane) continued their stellar run this year, 5.0% (AUD) to AUD878.26/tonne. Chick peas were trading at just AUD433.91/tonne at the same time in 2014. Field peas (Port Adelaide) were off 9.0% and lupins (Port Adelaide) recorded no change, appearing untraded.

Figure 7: Generic 1st Australian milling wheat (AUD/tonne)



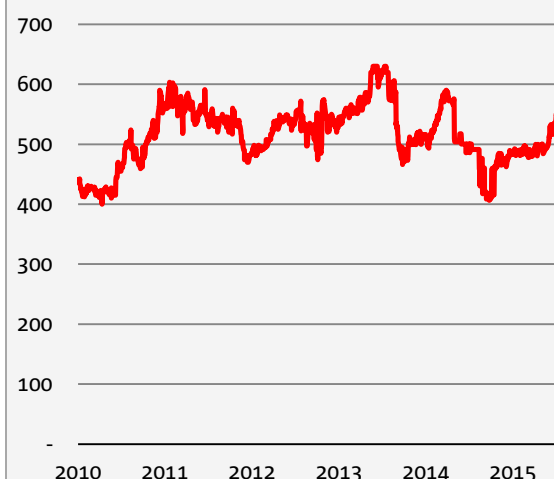
Source: Bloomberg

Figure 8: Selected coarse grains (AUD/tonne)



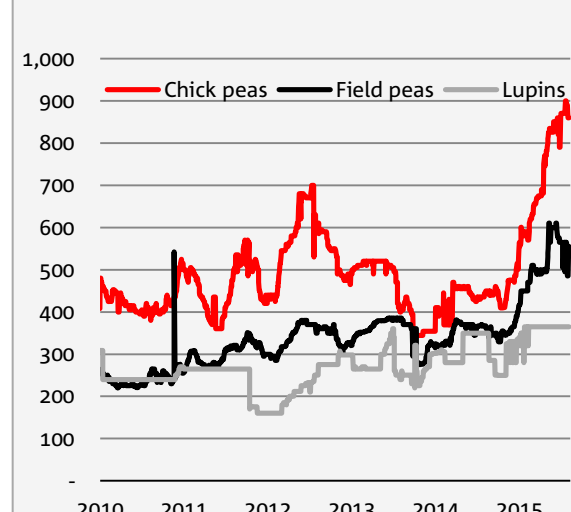
Source: Bloomberg, Profarmer

Figure 9: Canola, Newcastle NSW (AUD/tonne)



Source: Bloomberg, Profarmer

Figure 10: Selected pulses (AUD/tonne)



Source: Bloomberg, Profarmer

Protein

Beef

The Eastern Young Cattle Indicator continues its run well into record territory and broke through 550AUc/kg in late July. The indicator now stands at 564AUc/kg. Overall, the indicator was up 9.5% in July.

Exports to the US remain strong, standing 44,290 tonnes in July, some 36.4% of total exports by volume for the month. However, domestic slaughter has now started to decline, reflecting a scarcity of stock after a prolonged period of higher slaughter. This will likely keep prices high, but export volumes will come under pressure.

Figure 11: Eastern Young Cattle Indicator (AUc/kg)

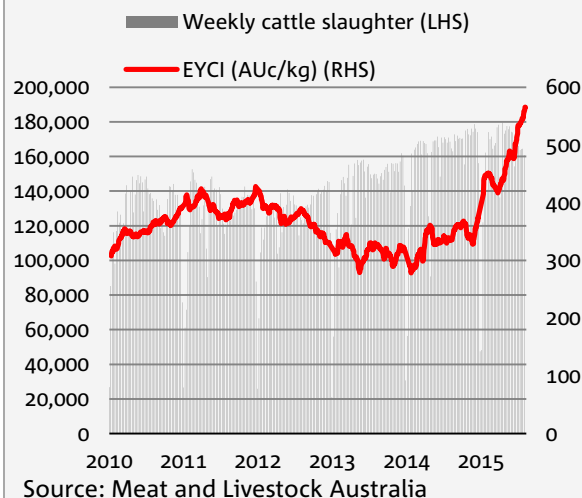
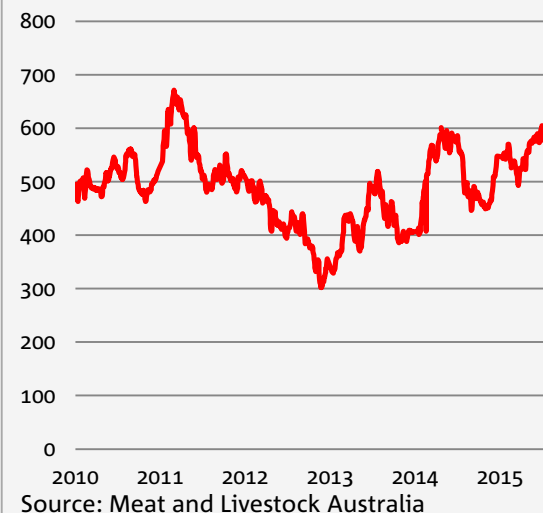


Figure 12: Eastern States Trade Lamb Indicator (AUc/kg)



Lamb

Lamb prices rose were steady (0.2% AUD in July), with the Eastern States Trade Lamb Indicator averaging 586 AUc/kg. Prices traditionally fall in spring, reflecting the seasonal nature of the industry.

Pork

Australian wholesale pork prices (measured as an average of buyer and seller prices for eastern seaboard 60.1-75kg animals) were up 1.5% (AUD) in July, reflecting continued stability in prices in the industry.

Figure 13: Pork – 60.1-75kg (AUc/kg)

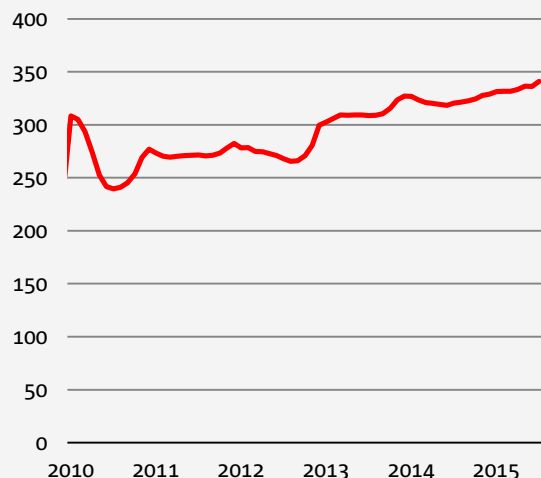
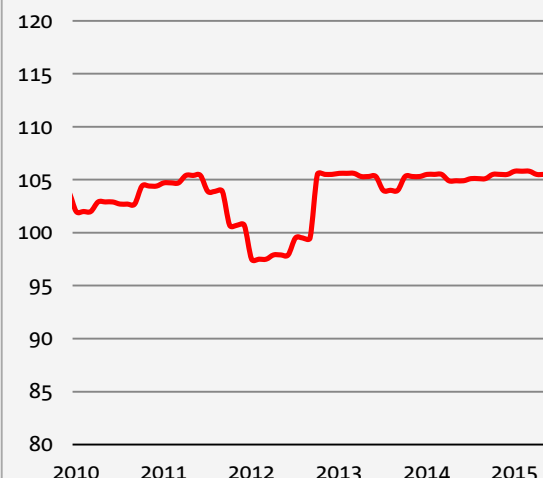


Figure 14: Poultry – Australia (ABS index)



Poultry

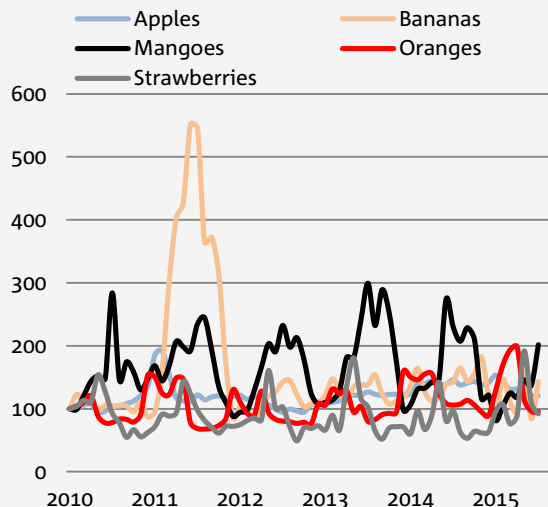
While we do not collect wholesale poultry price data, retail prices have remained stable since late 2012, gaining falling 0.3% in the June quarter (the most recent data available).

Fruit

The NAB Fruit Price Index, based on data from the Melbourne and Sydney wholesale markets, rebounded in July and was up 23.8% for the month, all but erasing the 24.8% in June. The rise was led by higher tropical fruit prices.

The index stands at 134.6 for July 2015 (note January 2010 = 100), 9.3% lower than the same time in 2014.

Figure 15: Wholesale market price index, selected fruit – Sydney and Melbourne



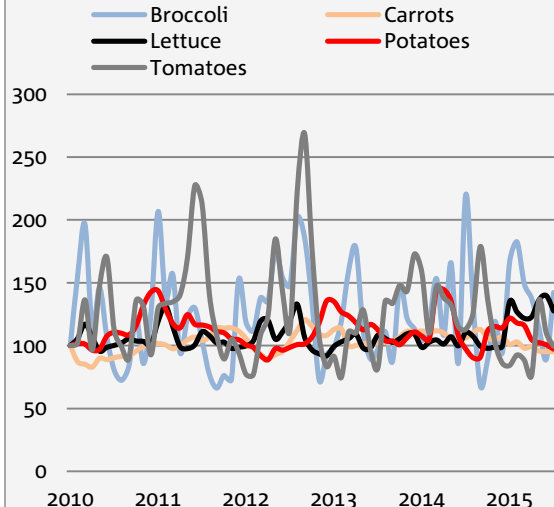
Source: Ausmarket Consultants and NAB Group Economics

Vegetables

The NAB Vegetable Price Index, based on data from the Melbourne and Sydney wholesale markets, was slightly lower in July, down 0.6% (AUD). Broccoli was sharply higher while lettuce, tomatoes and potatoes declined.

The index stands at 110.0 for July 2015 (note January 2010 = 100), 7.7% lower than the same time in 2014.

Figure 16: Wholesale price index, selected vegetables – Sydney and Melbourne



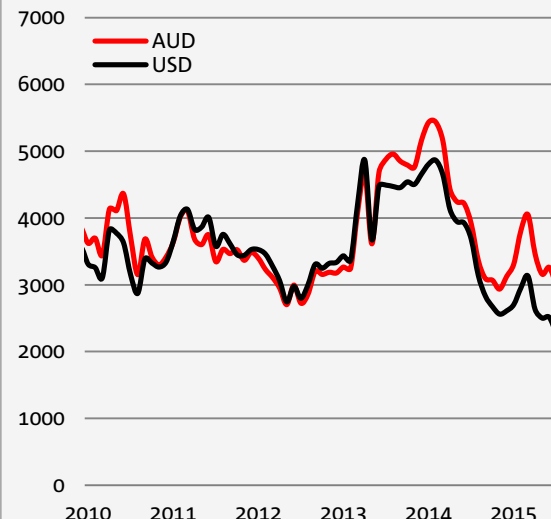
Source: Ausmarket Consultants and NAB Group Economics

Dairy

NAB's measure of dairy export prices, based on Global Dairy Trade auction results, is weighted by the quantity of Australian exports for whole milk powder, skim milk powder, butter and cheese.

The NAB monthly weighted dairy price indicator fell 8.6% AUD terms in July, with a lower dollar providing little comfort while USD prices fell 10.0%. The last ten International Dairy Trade auctions have trended lower in USD terms, and we forecast little upside for the rest of 2015.

Figure 17: NAB monthly weighted dairy price indicator (\$/tonne)



Source: Global Dairy Trade and NAB Group Economics

Fibres

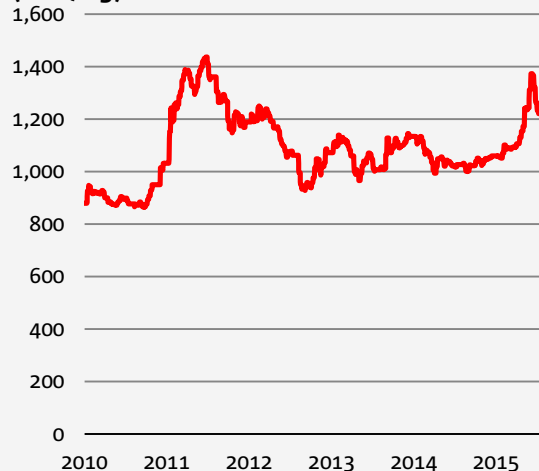
Wool

Wool's rally peaked in mid-June with the Eastern Market Indicator approaching 1400 AUc/kg. Since then, a downturn in demand and more supply coming to market has put renewed pressure on prices. The index was down 7.9% (AUD) in June.

Cotton

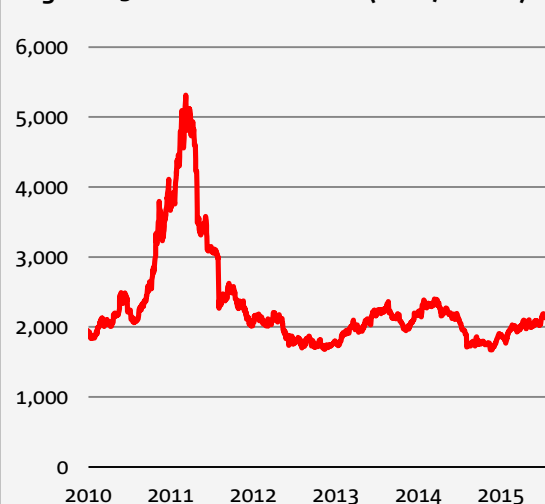
Global cotton prices were steady in June, but enjoyed a jump in AUD terms, with Cotlook A up 4.1% (AUD). Although cotton is trading below the same time last year, AUD prices have recovered from lows late in 2014.

Figure 18: Wool - Eastern Market Indicator (AUc/kg)



Source: Bloomberg

Figure 19: Cotlook A cotton (AUD/tonne)



Source: Bloomberg

Industrial crops

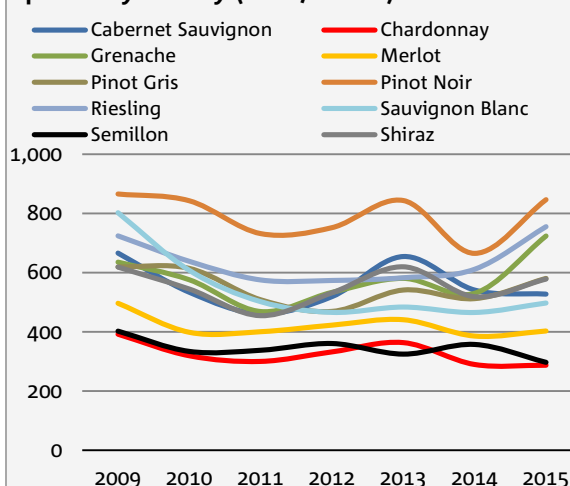
Wine grapes

Wine Australia's 2015 Price Dispersion Report, released in July, shows a rebound in prices for several more expensive varieties. Grenache, Pinot Noir and Riesling all gained (36%, 13% and 24% respectively). However, lower priced varieties such as Chardonnay, Semillon and Merlot fared generally worse.

Sugar

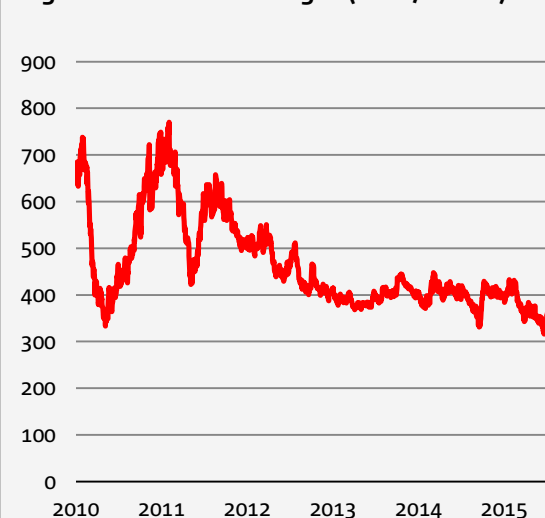
Global sugar prices rebounded in AUD terms in July, with ICE no.11 sugar up 5.4% (AUD). This reflects the lower AUD, with the depreciation of the Brazilian Real (Brazil being a major sugar producer) still affecting global prices.

Figure 20: Volume weighted wine grape prices by variety (AUD/tonne)



Source: Wine Australia, NAB Group Economics

Figure 21: ICE no.11 sugar (AUD/tonne)



Source: Bloomberg

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