



Rural Commodities Wrap

May 2016

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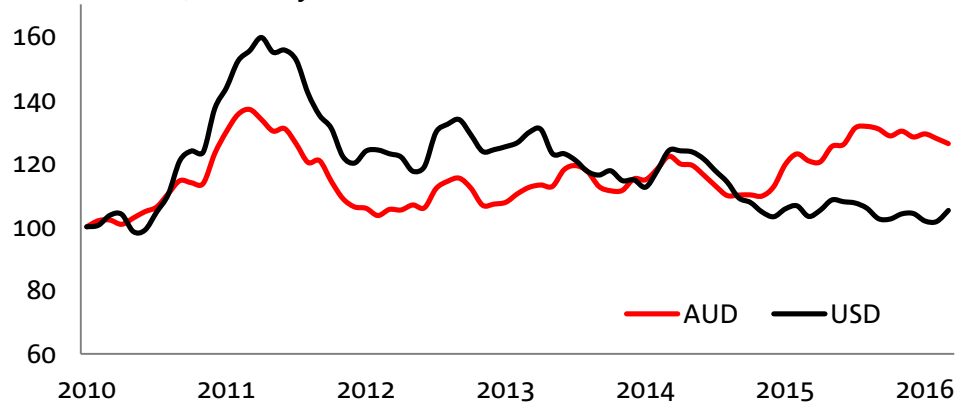
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Recent rural commodity price movements

NAB Rural Commodities Index

Index value, January 2010 = 100



Monthly AUD price changes for selected commodities

	February 2016	March 2016	April 2016
Wheat	▼ 3.1%	▼ 3.1%	▼ 0.4%
Beef	▲ 0.8%	▼ 1.2%	▼ 5.5%
Dairy	▼ 9.7%	▼ 5.3%	▼ 0.9%
Lamb	▲ 2.3%	▼ 4.4%	▼ 0.6%
Wool	▼ 0.5%	▼ 2.8%	▲ 0.3%
Sugar	▼ 8.9%	▲ 10.5%	▼ 5.1%
Cotton	▼ 4.9%	▼ 6.3%	▲ 3.3%
NAB RCI	▼ 1.1%	▼ 1.2%	▼ 0.7%

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

Australian agriculture has seen a number of significant developments since the release of the last NAB Rural Commodities Wrap. Winter crops were facing very dry planting conditions on the east coast but good rain has markedly improved sentiment. Improved weather conditions also saw an uptick in cattle restocker demand following a period of slipping prices since March. Meanwhile, dairy farmers have come under considerable pressure as a result of Murray Goulburn and Fonterra's surprise cuts to 2015-16 prices.

Australian agricultural commodity prices declined overall in April, with the NAB Rural Commodities Index off 0.7% in AUD terms (but up 0.4% in USD terms). The Australian Dollar continued to appreciate throughout April, putting pressure on local prices. However, the RBA cash rate cut in May has seen the AUD fall quite rapidly, which is likely to provide a support to Australian prices over the coming months.

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.

Headline agricultural commodity price, production and export forecasts

Our expectations for prices in the coming year are underpinned by our forecasts for a generally lower AUD, tracking in the high 60s range in late 2016 and 2017. This is likely to support local prices somewhat through challenging international conditions.

Cattle prices are likely to come under some pressure in 2017 in response to higher US supply and improved South American access, while dairy is likely to continue to feel the pressure on farmgate milk prices. We expect global wheat prices to remain subdued due to ample global supply.

Our outlook for agricultural production is, as always, dependent on prevailing weather conditions. The Bureau of Meteorology forecasts an around 50% chance of La Niña developing in the coming months, which is associated with higher rainfall in eastern Australia. Recent rainfall has come at an ideal time for wheat and barley and could see strong yields if followed up with good winter conditions.

The table below outlines our latest outlook for production, prices and the value of exports. These estimates are contingent on estimates for production and export volumes, prevailing global prices and NAB's foreign exchange outlook. We will provide updates to these forecasts periodically throughout the year.

Production, price and export forecasts (AUD)

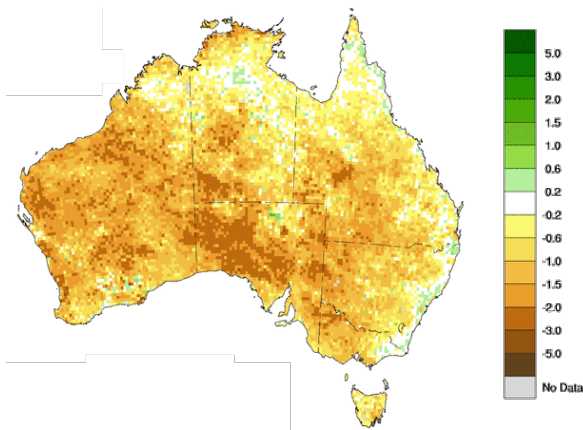
	Production change		Price change		Export value change	
	2015-16	2016-17	2015-16	2016-17	2015-16	2016-17
Wheat	▲ 5.0%	▲ 1.2%	▼ 3.2%	▲ 5.1%	▼ 1.1%	▲ 2.2%
Beef	▼ 9.1%	▼ 6.6%	▲ 43.3%	▼ 4.6%	▲ 3.7%	▼ 13.1%
Dairy	▼ 1.0%	▲ 2.0%	▼ 6.2%	▲ 3.1%	▼ 7.2%	▲ 5.1%
Lamb and mutton	▼ 7.5%	▼ 6.1%	▲ 4.2%	▲ 0.6%	▼ 7.4%	▼ 8.5%
Wool	▼ 7.0%	▲ 1.5%	▲ 14.0%	▲ 7.2%	▲ 9.0%	▲ 8.3%
Sugar	▲ 5.0%	▲ 5.9%	▲ 9.2%	▲ 18.6%	▲ 14.3%	▲ 23.5%
Cotton	▲ 5.7%	▲ 49.5%	▲ 8.9%	▲ 1.6%	▼ 18.6%	▲ 24.7%

Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Australian Bureau of Statistics, Bloomberg and Profarmer.

Climate outlook

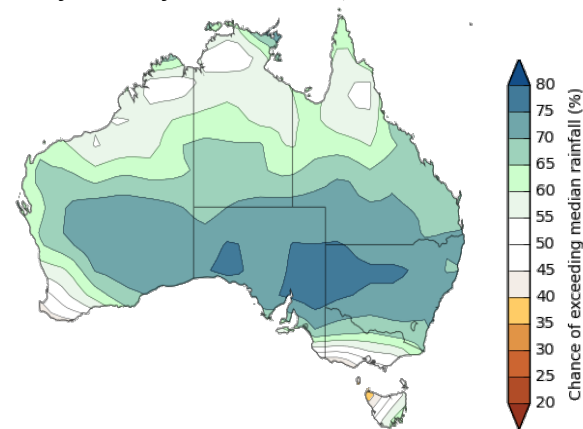
Vegetation greenness anomaly

Six months to 30 April 2016 (NDVI)



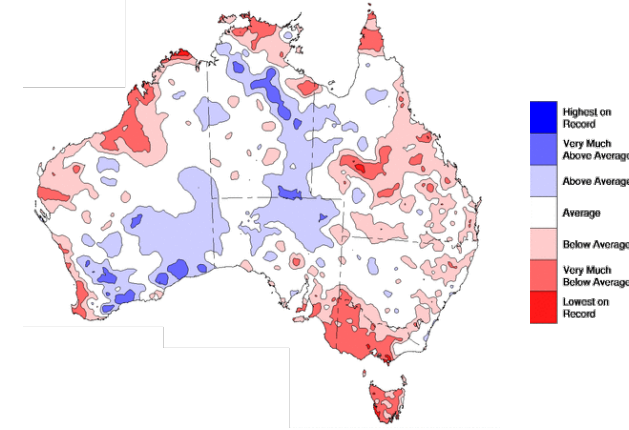
Three month rainfall outlook

May to July 2016



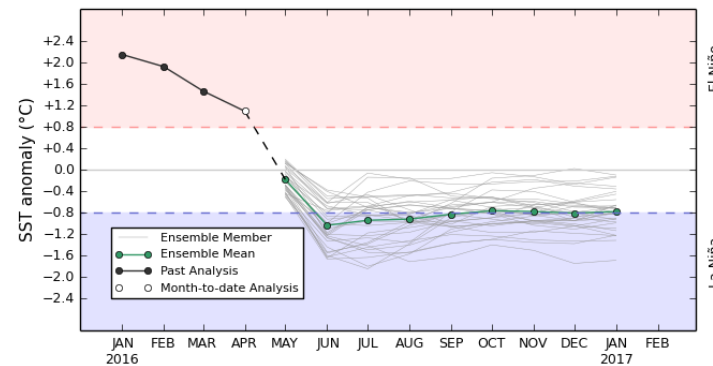
Australian rainfall deciles

12 months to 30 April 2016



BoM POAMA El Niño outlook model

Monthly mean NINO34



Eastern Australia saw a generally very dry February, March and April, while the Western Australian wheatbelt enjoyed arguably the best start to the wheat season in living memory. In May, many parts of Eastern Australia enjoyed good planting rain, lifting optimism around wheat yields this season.

The Bureau of Meteorology (BoM) three month rainfall outlook to July forecasts generally above average to well above average rainfall over the coming months, although parts of Tasmania could see below average falls.

The latest El Niño outlook modelling from the BoM shows sea surface temperatures dropping to La Niña levels in winter and remaining there until 2017. Currently, The BoM ENSO Wrap-Up is on La Niña watch, placing the odds of La Niña developing at around 50%.

La Niña is generally associated with above average rainfall in eastern and northern Australia, and conversely with drought on the other side of the Pacific Ocean. The 2010-12 La Niña event was associated with a significant increase in the NAB Rural Commodities Index in 2011 and a repeat of the event could see some supply pressures in the Americas.

Source: Bureau of Meteorology

Economic update

NAB Australian economic forecasts

Per cent change calendar year on year

	2015 -16	2016 -17	2017- 18
Real GDP	2.8	2.8	2.9
Private consumption	3.0	2.5	2.7
Unemployment rate (year end)	5.8	5.6	5.6
Consumer Price Index (core)	1.6	2.0	1.9
RBA cash rate (year end)	1.75	1.75	2.0

NAB global economic forecasts

Per cent change calendar year on year

	2016	2017	2018
United States	1.8	2.1	1.9
Euro-zone	1.5	1.5	1.6
Japan	0.4	0.7	0.5
China	6.7	6.5	6.3
India	7.6	7.4	7.7
Emerging East Asia	3.5	3.6	3.4
World GDP	2.8	3.2	3.2

Source: NAB Group Economics

For more detail, see our [2016-17 Budget Commentary](#)

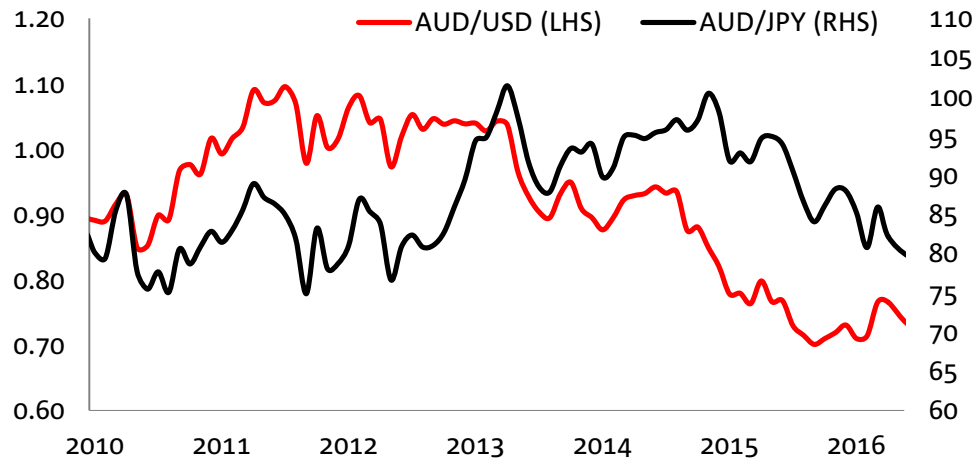
While the level of concern about the immediate global outlook has receded since the early months of the year, ongoing sluggish growth perpetuates the risks still hanging over the world economy. Business surveys for the advanced economies show at best modest growth in the industrial sector continuing through to April but services have fared better. Growth in the emerging economies has been easing with Chinese growth gradually slowing, Brazil in recession and sluggish growth across much of East Asia. In contrast, India has been the standout growth performer.

We envisage that the Australian economy will gradually transition towards non-mining sources of growth against a challenging economic backdrop. While low interest rates and a more competitive currency are assisting, and LNG exports will support real GDP, a weak global economy and low commodity prices will continue to weigh on national income, corporate profits and government revenue. A subdued outlook for domestic demand is expected, with moderate consumption growth (but reliant on lower savings rate), sharp falls in mining investment but weak non-mining investment outlook, and support (albeit dwindling) from dwelling investment.

We expect that employment growth will be strong enough to see further downward pressure on the unemployment rate in the near-term (to around 5½%), before stabilising. However, household income will remain weak, presenting a challenge to government revenue and consumer spending.

Exchange rates and interest rates

Monthly exchange rate movements



Australia's very low inflation in Q1 2016 was the primary reason the RBA cut rates to 1.75% this month. The response in the currency was swift – the AUD, which had been trading above 78 US cents, dropped rapidly and is now trading below 73 US cents.

This further increases our confidence in AUD returning to below 70 US cents later this year and remaining in the high 60s throughout 2017. We do not expect a sustained return above 70 US cents until mid-2018.

These forecasts depend on a stronger USD associated with the US Federal Reserve lifting rates twice this year. We do not expect the conditions for an RBA rate rise to be met before 2018.

NAB FX strategy targets

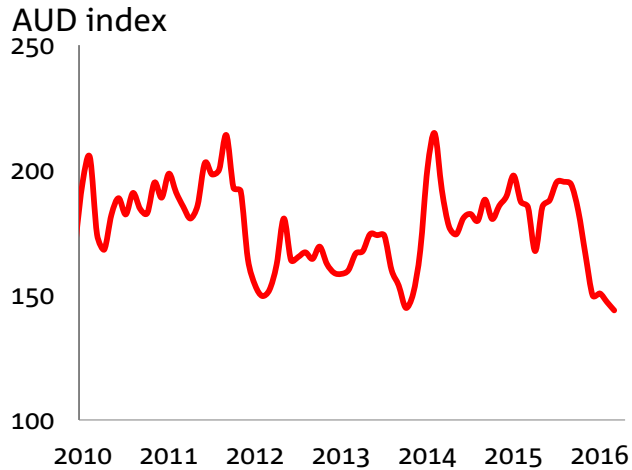
	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1
AUD/USD	0.73	0.71	0.69	0.69	0.68	0.67	0.68	0.69
NZD/USD	0.67	0.65	0.63	0.62	0.62	0.62	0.64	0.65
USD/JPY	109	110	111	111	112	113	112	112
EUR/USD	1.14	1.12	1.11	1.10	1.10	1.10	1.10	1.12
USD/CNY	6.55	6.60	6.65	6.60	6.55	6.55	6.50	6.50

Source: NAB

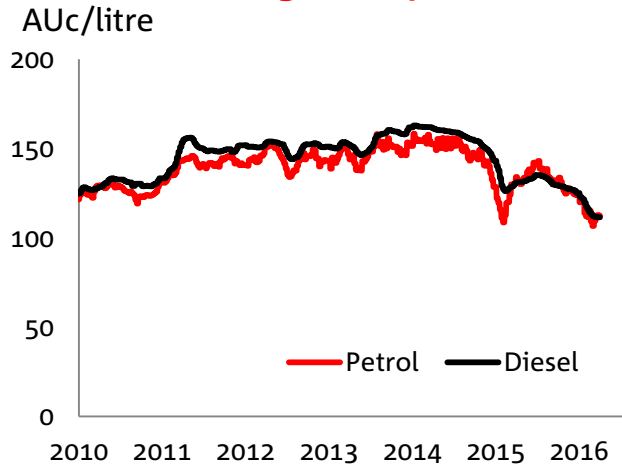
Farm input prices



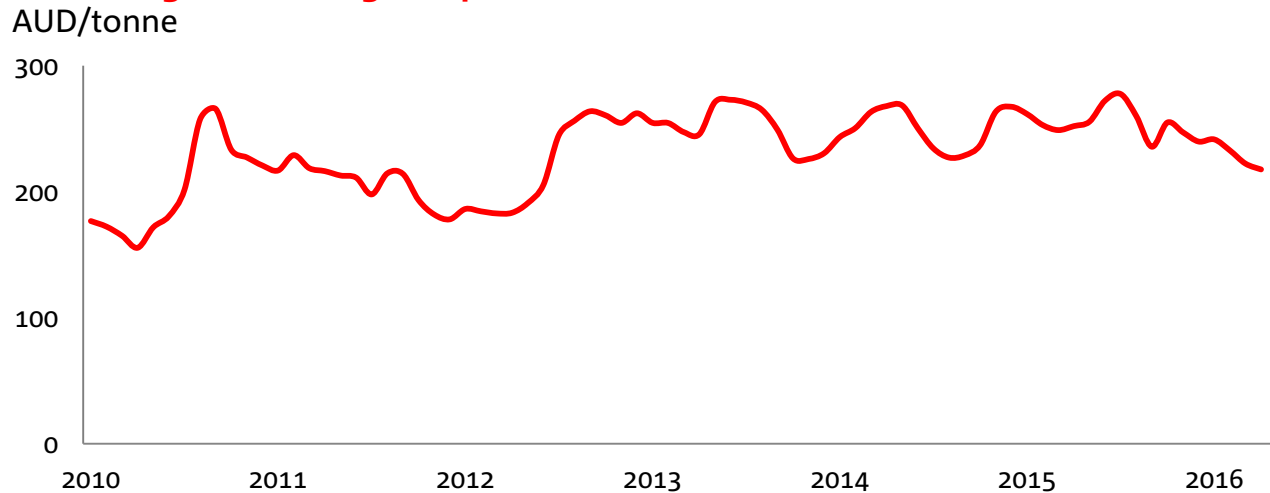
NAB Fertiliser Index



National average fuel prices



NAB weighted feed grain price Index



Global fertiliser prices have continued to trend lower this year. Overall, the NAB Fertiliser Index was 2.3% lower in (AUD) in April on lower urea and DAP prices. The index is comprised of natural gas, urea and DAP.

National average petrol prices were somewhat higher in April, with petrol up 2.8% and diesel almost steady at +0.2%.

Weighted feed grain prices were again lower in April, down 2.1%. While major feed grains have continue to trade at subdued prices on global markets, a renewed trend in the AUD may see some price upside later this year.

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.

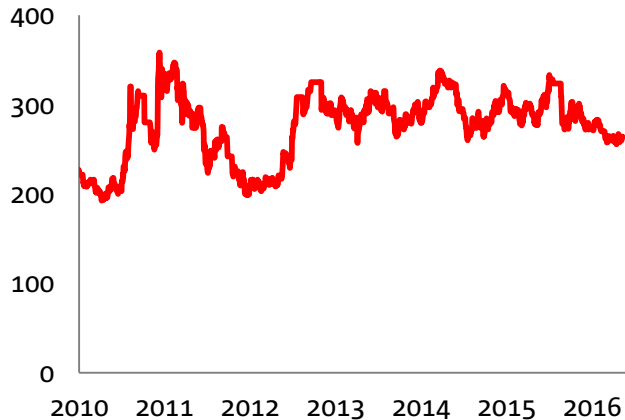
Source: Bloomberg, Australian Institute of Petroleum, Profarmer and NAB Group Economics

Wheat



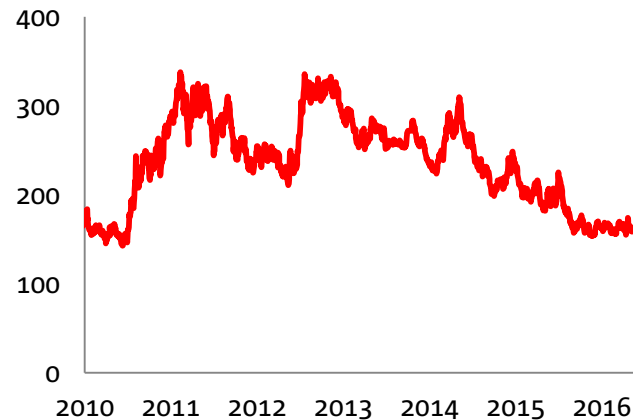
Generic 1st milling wheat

Eastern Australia, AUD/tonne



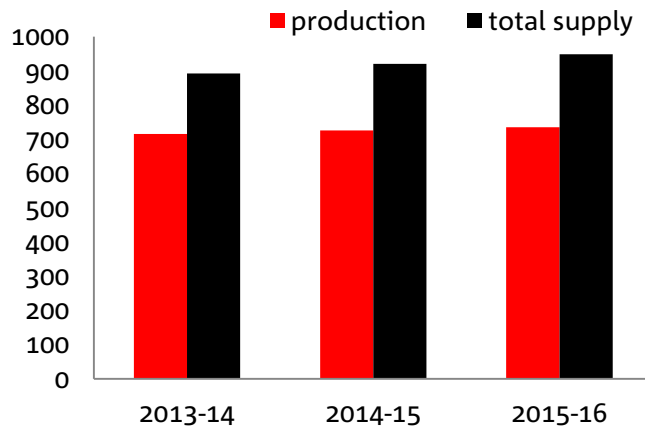
CBOT Hard Red Winter wheat

USD/tonne



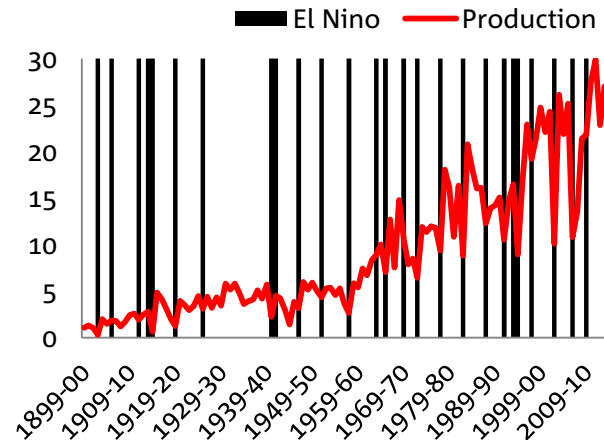
USDA forecast world wheat supply

Million tonnes



Australian wheat production

Million tonnes



Prices

Global wheat prices remain muted in response to very strong global wheat supply. For 2016, we do not see a significant upside for wheat prices in USD terms noting that the USDA continues to forecast record supply.

However, AUD priced wheat remained in a much narrower band since 2012 as the depreciation of the AUD supported prices. The appreciation of the AUD in early 2016 put some pressure on local prices, but renewed AUD depreciation since early May presents an upside domestically. Generic 1st Eastern Australian milling wheat was down 0.4% (AUD) in March.

Production

2016-17 began very nervously in Eastern Australia amid a generally very dry February, March and April. Recent rains across much of Eastern Australia have boosted sentiment greatly, with generally favourable planting conditions. Meanwhile, the Western Australian wheatbelt is enjoying arguably the best start to the wheat season in living memory. Pre-season rainfall created ideal soil moisture conditions for planting across much of the wheatbelt. If Australia sees good rain over winter, yields should be above average.

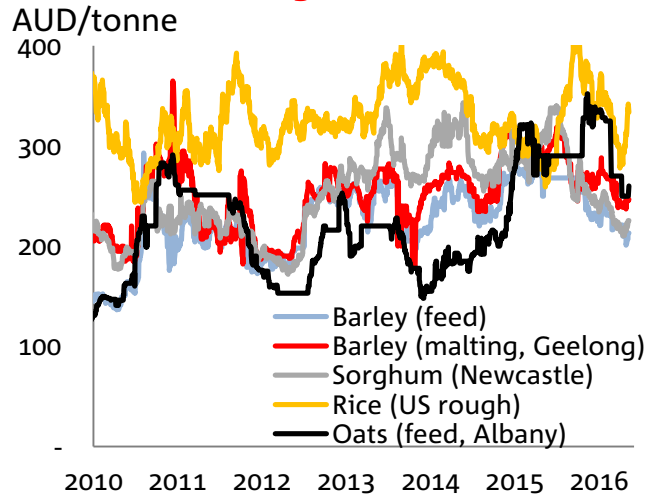
Source: Bloomberg, Profarmer, USDA, Australian Bureau of Statistics, ABARES and NAB Group Economics



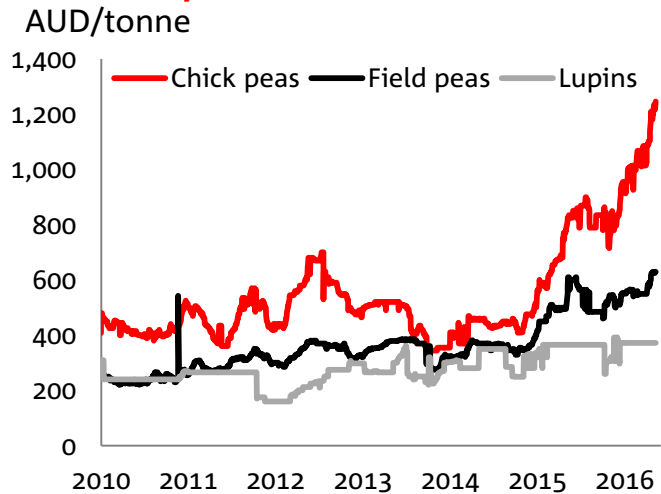
Other broadacre crops



Selected coarse grains

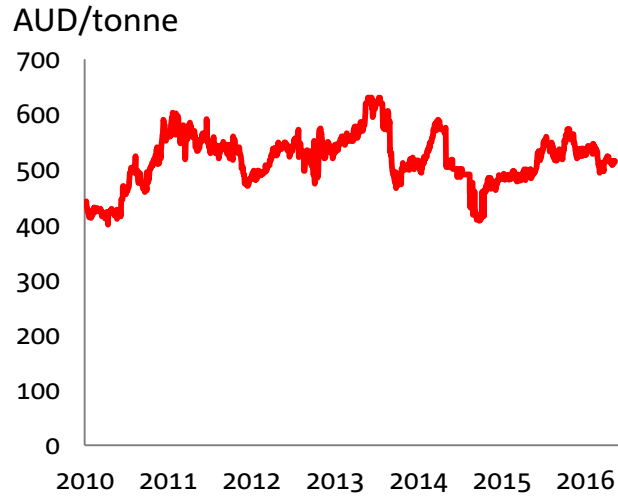


Selected pulses

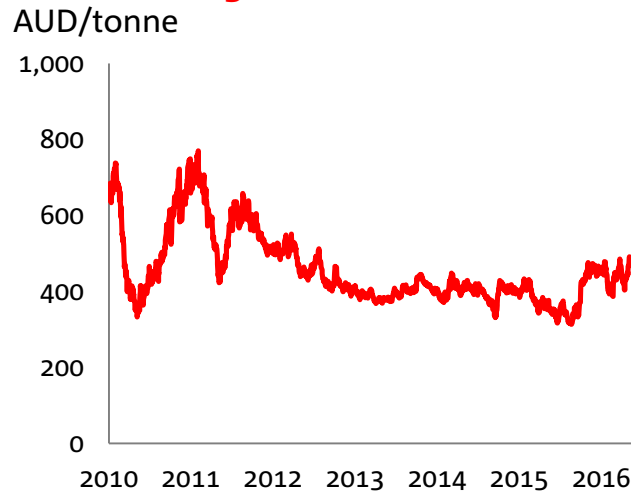


Source: Bloomberg, Profarmer and NAB Group Economics

Canola, Newcastle NSW



ICE no.11 sugar



AUD coarse grain prices have mostly followed wheat lower this year, reflecting favourable supply and a higher AUD since January. Sorghum (Newcastle) was down 3.6% in April while barley (feed, generic) was off 3.1%. Rice fell 3.2% in April but has rallied in May. Meanwhile oats were 5.6% lower.

Domestic canola was up 2.1% in AUD terms in April.

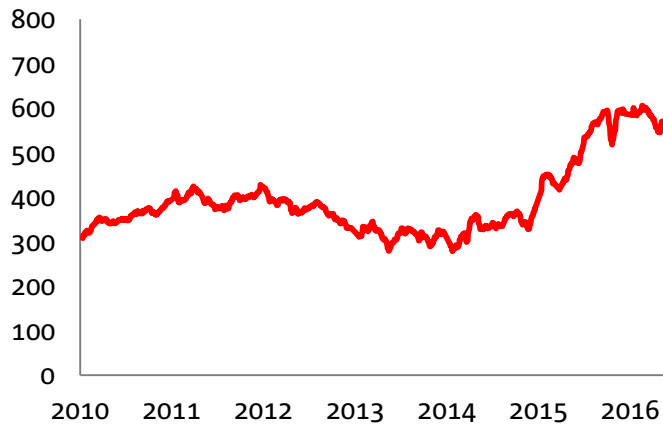
Chick peas' stellar run, which saw prices surge from less than AUD500/tonne at the end of 2014 to over AUD1,200/tonne this year, continues seemingly unabated amid continued difficult growing conditions in India. Chick pea prices rose 8.8% in April. As a result, chick pea plantings, especially in Queensland, have jumped substantially this season.

Global sugar prices fell in January and February before rebounding in March then falling in April (ICE no.11 sugar was off 5.1% (AUD) in April). While prices have been volatile, the general trend has been upward amid improving global demand, although strong supply from Brazil remains a risk.

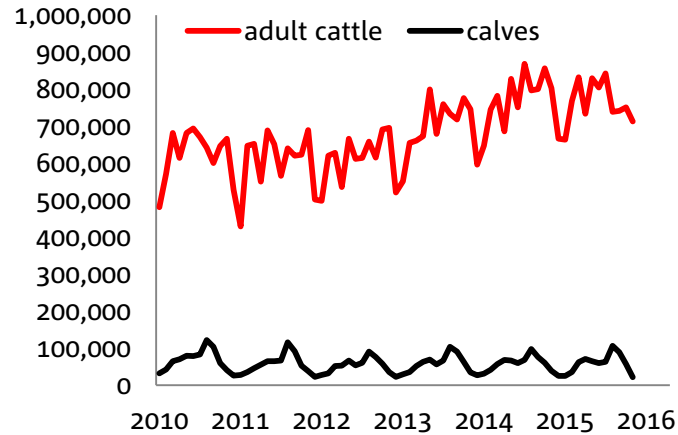




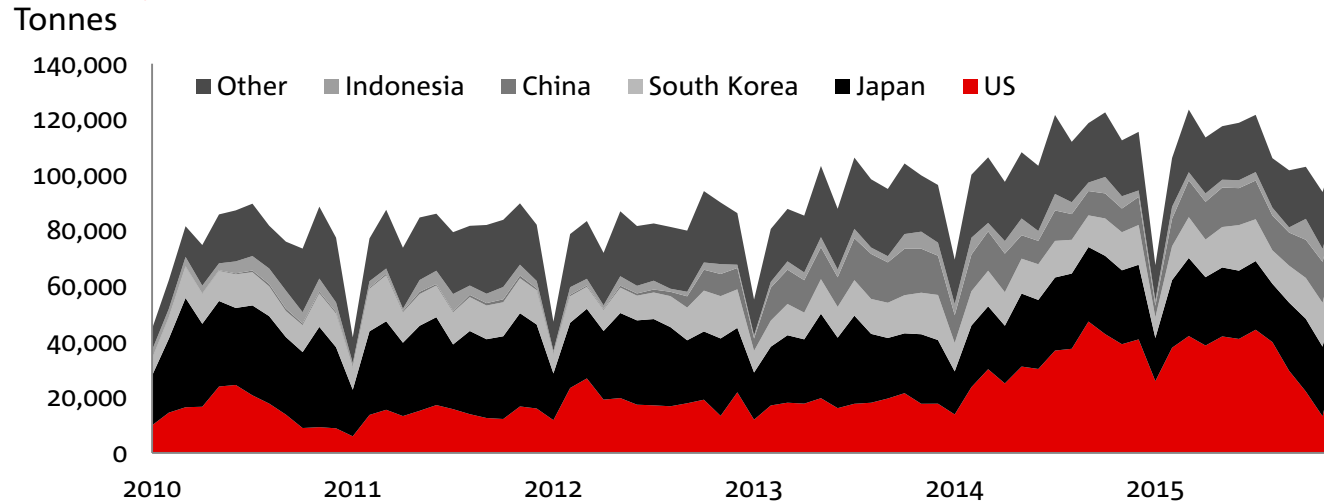
Eastern Young Cattle Indicator AUc/kg



Monthly cattle slaughter Head, Australia



Monthly Australian beef exports Tonnes



Source: Meat and Livestock Australia and NAB Group Economics

Australian cattle prices have enjoyed an exceedingly favourable set of circumstances since early 2015. Prices almost doubled amid a falling AUD and strong US demand.

However, we now see cattle prices as having peaked. The US market is now enjoying increased domestic supply with the drought well and truly over outside the west coast and feed grains generally inexpensive (except soy meal more recently). As a result, the key US 90cl beef export benchmark has retreated from its highs of September last year and while we forecast AUD to fall into the high 60s later this year, the majority of the currency adjustment has already occurred.

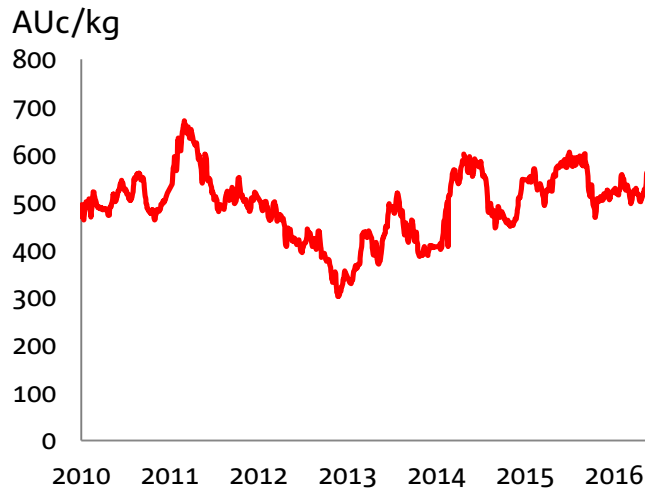
We expect saleyard prices to remain high this year reflecting domestic restocker interest as producers look to restock following destocking due to drought and to capitalise on high cattle prices. The impact of recent rains on the Eastern Young Cattle Indicator underscore the importance of a favourable season for restocking and prices.

Export prices are likely to remain under pressure given growing US beef supply and increasing competitiveness from South America. Overall, low export prices represent a downside risk to saleyard prices, which are supported primarily by restocker interest at present.

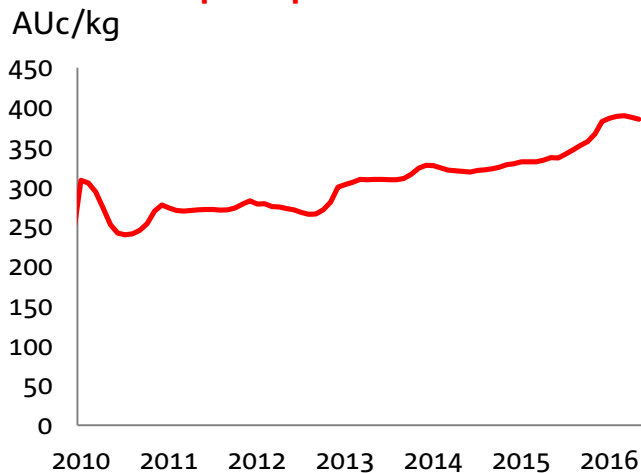
Lamb, pork and poultry



Eastern States Trade Lamb Indicator

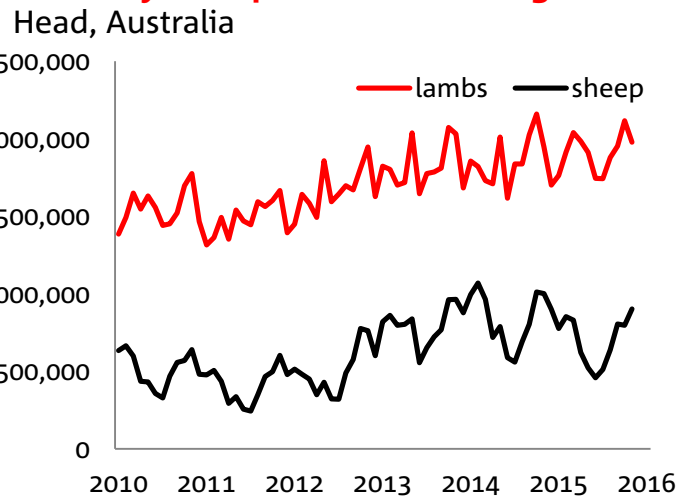


Australian pork price indicator

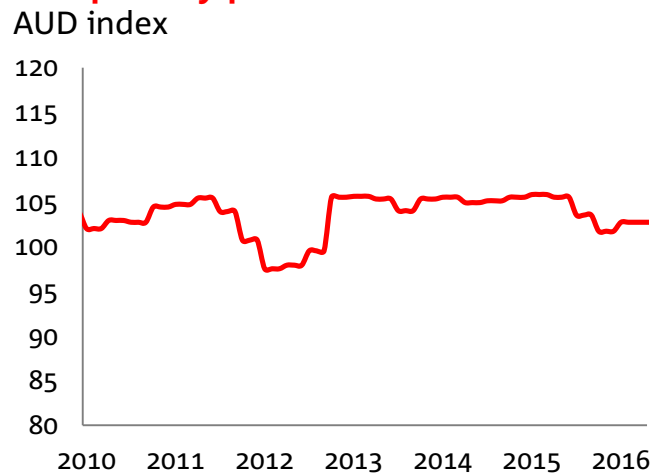


Source: Meat and Livestock Australia, Australian Pork, Australian Bureau of Statistics and NAB Group Economics

Monthly sheep and lamb slaughter



ABS poultry price index



Our forecasts for lamb reflect moderately higher prices this year. Indeed, the Eastern States Trade Lamb Indicator has been trending upwards since 2013, albeit with strong seasonal variation reflecting the usual spring lamb flush.

Production and exports have been elevated amid dry conditions over the past two years, but these levels were not sustainable and we see lamb and mutton production falling 7.5% in 2015-16 and 6.1% in 2016-17.

Overall we forecast the value of exports to fall 7.4% in 2015-16 and a further 8.5% in 2016-17 amid lower export volumes.

Australian wholesale pork prices (measured as an average of buyer and seller prices for eastern seaboard 60.1-75kg animals) fell slightly in April, down 0.5% to 387.3AUC/kg. While the industry generally sees relatively little volatility in prices, the sustained upward trend since mid-2015 has come under some pressure recently, confirmed by partial results for May.

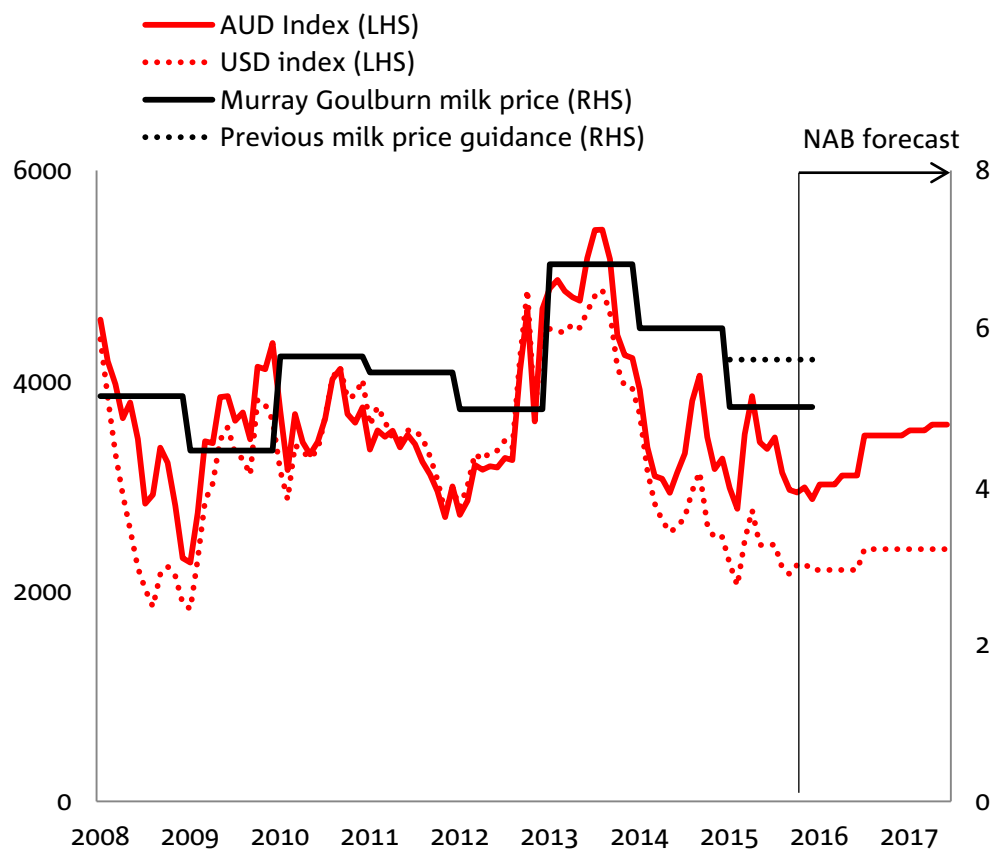
While we do not collect wholesale poultry price data, retail prices have remained reasonably stable since late 2012. However, national retail prices rose 1.0% in the March quarter 2016.





NAB weighted dairy export price indicator and farmgate price

\$/tonne (export price, LHS), AUD/kg milk solids (farm gate price RHS)



Australian dairy producers have faced two major shocks since April, as Murray Goulburn and Fonterra substantially downgraded their 2015-16 farmgate prices. Up until April, these processors had expected a final milk price around \$5.60/kg milk solids for 2015-16, but Murray Goulburn now expects to pay \$4.75-5.00 for the season and Fonterra \$5.00. These price changes will apply retrospectively for the 2015-16 season.

The underlying cause of these lower returns at farm gate is the decline in international dairy prices since 2014. The chart to the left shows NAB's weighted dairy export price indicator and Murray Goulburn's farm gate milk price since 2008. Export prices declined significantly from their February 2014 high of AUD5,436/tonne to around AUD2,937/tonne in April 2016. The depreciation of the AUD has provided a buffer against more precipitous declines, but AUD export returns remain well below their peak.

The price fall reflects a number of factors, notably lower Chinese milk powder demand, the removal of EU dairy quotas, the ongoing impact of the Russian dairy embargo and buoyant US domestic supply. We do not expect a substantial increase in Chinese demand in the coming year and as a result expect international prices to remain low for the foreseeable future. However, the low prices may see lower European supply, limiting further downside pressure. The lower AUD should boost Australian export prices in AUD terms, as shown to the left. At this stage, it is not clear at what level we will see opening farmgate prices for the 2016-17 season.

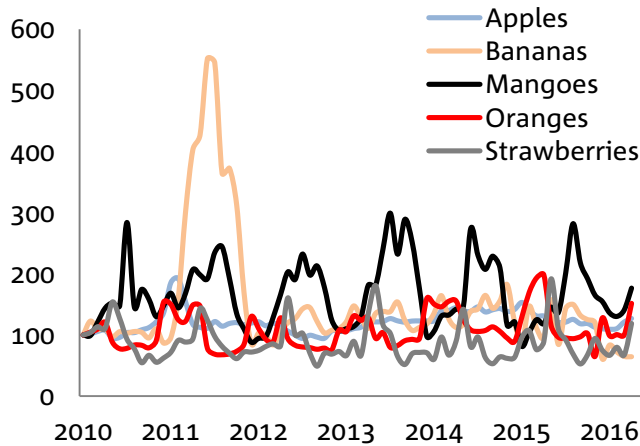
Source: Australian Bureau of Statistics, Global Dairy Trade, Dairy Australia, Fonterra, Murray Goulburn and NAB Group Economics

Note: chart shows Murray Goulburn farmgate prices (upper range for revised 2015-16 price) except 2008-09 which shows Dairy Australia's reported Victorian average value



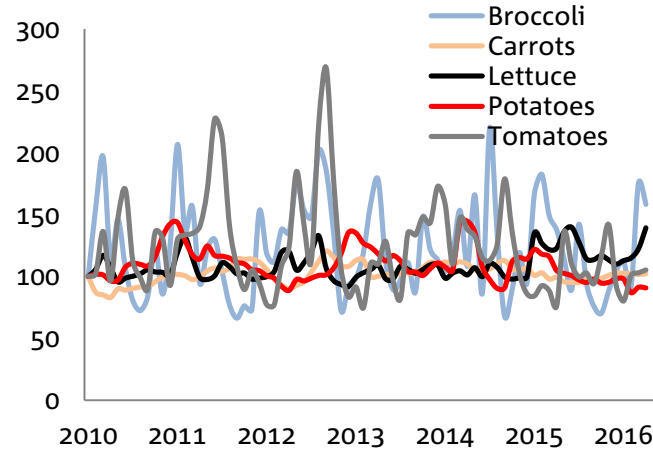
Wholesale fruit prices

AUD index, Sydney and Melbourne



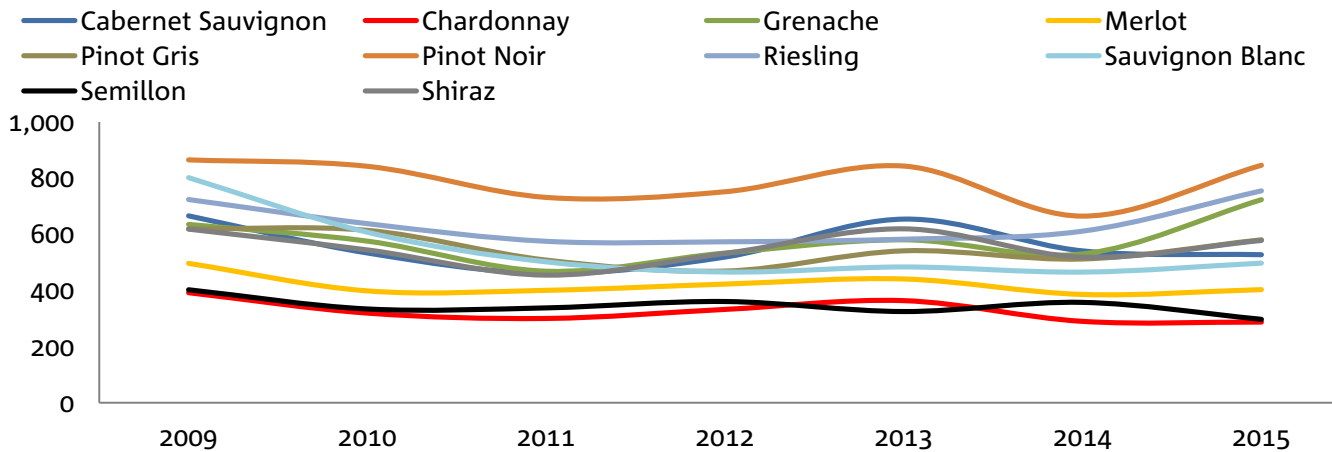
Wholesale vegetable prices

AUD index, Sydney and Melbourne



NAB weighted wine grape prices

AUD/tonne



Source: Ausmarket Consultants, Wine Australia and NAB Group Economics

We produce wholesale price indices for fruit and vegetables, based on data from the Melbourne and Sydney wholesale markets.

Wholesale fruit and vegetable prices have been characteristically volatile of late, reflecting their highly seasonal nature. Fruit prices rebounded 22.8% in April to an index value of 121.9 (January 2010 =100). Vegetables were up a more subdued 2.7% in February before surging 12.1% in March to an index value of 116.5 (January 2010 =100).

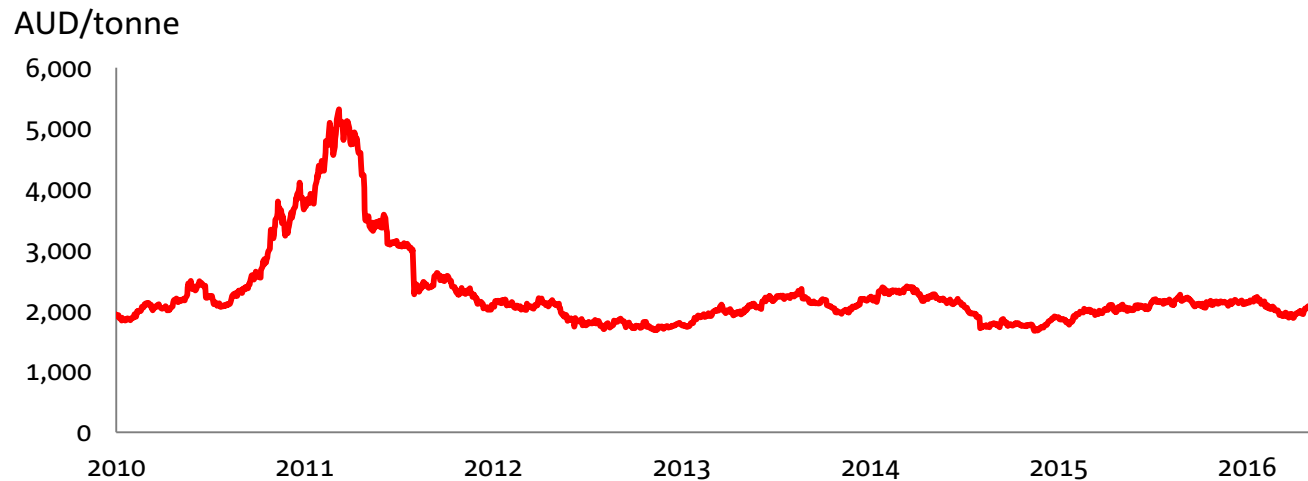
Wine Australia's 2015 Price Dispersion Report, released in July 2015, shows a rebound in prices for several more expensive varieties. Grenache, Pinot Noir and Riesling all gained (36%, 13% and 24% respectively). However, lower priced varieties such as Chardonnay, Semillon and Merlot fared generally worse.



Wool – Eastern Market Indicator



Cotlook A index



Source: Bloomberg and NAB Group Economics

After several years of unfavourable prices, wool producers have enjoyed a run-up in the Eastern Market Indicator since the second quarter of 2015. While the AUD strength earlier this year limited price upside (wool is quite sensitive to movements in the dollar) the recent fall in the exchange rate points to an upside for price. Overall, we forecast that prices will increase 14.0% in 2015-16 and 7.2% in 2016-17.

The higher prices are forecast to offset lower production in 2015-16 and spur an increase in production in 2016-17. We forecast the value of Australian wool exports to increase 9.0% in 2015-16 and 8.3% 2016-17.

Global cotton prices recovered somewhat in April after falls earlier this year in AUD terms. Cotlook A was up 3.3% (AUD) in April.

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