

RURAL COMMODITIES WRAP

OCTOBER 2016



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CONTACTS

Phin Ziebell
Agribusiness Economist
+61 (0) 475 940 662

Alan Oster
Chief Economist
+61 3 8634 2927

Riki Polygenis
H-O Australian Economics
+61 3 8697 9534

Khan Horne
General Manager
NAB Agribusiness

Kristin Kenny
Senior Consultant
+61 (0) 439 255 981

Important Notice

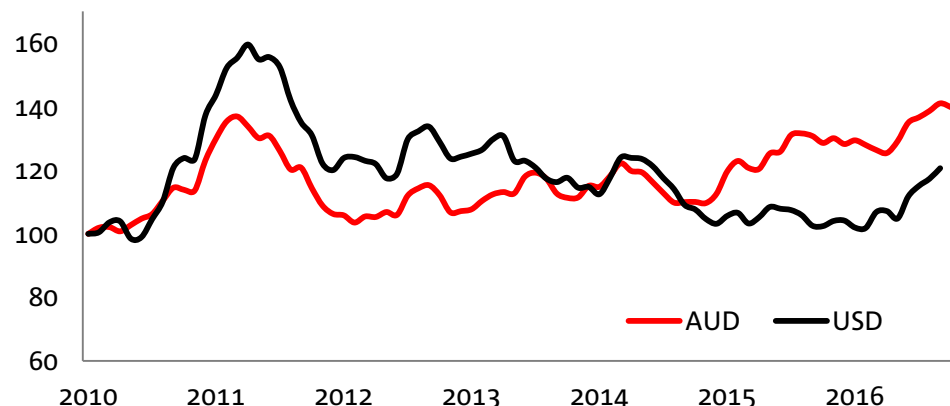
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RECENT RURAL COMMODITY PRICE MOVEMENTS

NAB RURAL COMMODITIES INDEX

Index value, January 2010 = 100



MONTHLY AUD PRICE CHANGES – SELECTED COMMODITIES

	August 2016	September 2016	October 2016 (to date)
Wheat	▼ 5.4%	▼ 3.5%	▲ 1.2%
Beef	▲ 7.1%	▲ 0.7%	▼ 1.1%
Dairy	▲ 6.8%	▲ 21.5%	▼ 3.2%
Lamb	▼ 2.0%	▼ 0.7%	▼ 6.0%
Wool	▼ 0.4%	▼ 0.2%	▲ 0.6%
Sugar	▲ 0.1%	▲ 7.0%	▲ 7.9%
Cotton	▼ 2.4%	▼ 2.3%	▲ 0.4%
Index	▲ 1.5%	▲ 1.7%	▼ 0.8%

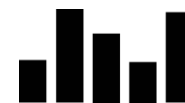
Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Australian Pork, Ausmarket Consultants, Australian Bureau of Statistics, Bloomberg and Profarmer.

The progress of the season, which has been generally much wetter than average in eastern Australia but dryer in the west, continues to be the major consideration for Australian agriculture. Well above average rainfall in September and into October across eastern Australia, combined with storm damage in some areas is creating potentially serious problems for grain growers, who had been hitherto on track for a bumper season. In Western Australia, a dry and very cold start to spring has caused frost damage. While we still see the headline Australian wheat production figure to be well above average, quality and yield downgrades, especially in New South Wales are a distinct possibility.

Rainfall is also slowing milk production in parts of Victoria (northern Victoria especially), while dairy prices have been more muted of late after significant gains in August and September. The rain has also limited the usual seasonal flush of sheep and cattle, with flock and herd rebuilding taking more precedence this year after dry years in many regions. While cattle prices have come off their recent records, we note that there are considerable downside risks in 2017 and beyond.

Overall, in AUD terms the NAB Rural Commodities Index gained 1.7% in September and partial data point to a decline of 0.9% in October (excluding horticulture). In USD terms, the index was up 2.8% in September. 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 according to the gross value of production of each industry.

PRICE, PRODUCTION AND EXPORT FORECASTS



We have kept our forecasts for production and price unchanged this month. Cattle prices are likely to come under pressure in 2017 in response to higher US supply and improved South American access, although this pressure isn't likely to intensify until it dries out and restocker interest is diminished.

Dairy prices have moved relatively little over the past month, following strong gains in August and September. Our forecasts do not factor in major upside in USD terms for the foreseeable future, although further signs of lower EU and NZ production could change the outlook.

Our outlook for agricultural production is highly reliant on the climate outlook. There is substantial uncertainty around winter crop production, especially given how late it is in the season. While the east is too wet, Western Australia has seen potentially substantial frost damage to winter crops. While we have kept our production estimate for wheat unchanged this month at 27.6 million tonnes, uncertainty in New South Wales could see this number swing either way, although more likely on the upside.

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.

PRODUCTION, PRICE AND EXPORT FORECASTS (AUD)

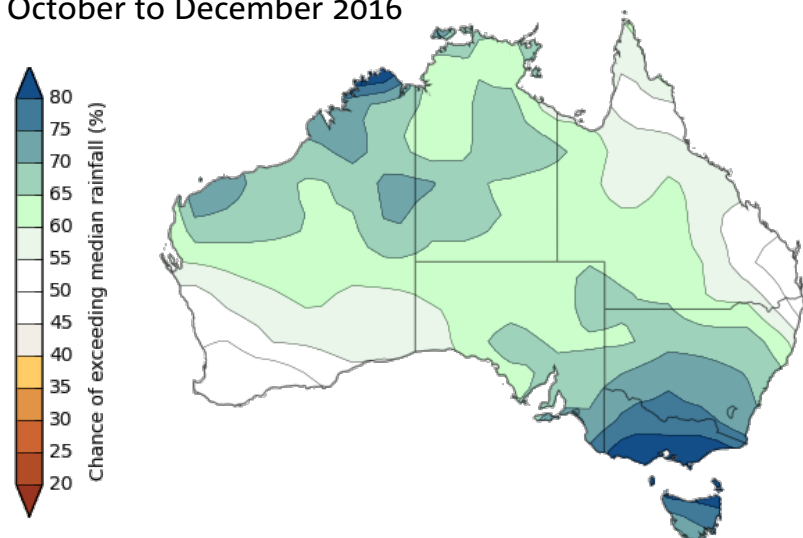
	Production change		Price change		Export value change	
	2015-16	2016-17	2015-16	2016-17	2015-16	2016-17
Wheat	▲ 1.9%	▲ 13.9%	▼ 2.7%	▼ 14.5%	▼ 7.8%	▼ 1.6%
Beef	▼ 12.0%	▼ 9.5%	▲ 43.7%*	▲ 14.3%*	▼ 6.5%	▼ 9.5%
Dairy	▼ 2.0%	▼ 2.3%	▼ 5.0%	▲ 12.0%	▲ 4.5%	▲ 9.4%
Lamb and mutton	▼ 1.2%	▼ 6.4%	▲ 4.7%*	▲ 2.1%*	▼ 6.9%	▼ 5.8%
Wool	▼ 5.4%	▼ 1.0%	▲ 14.4%	▲ 7.0%	▲ 4.1%	▲ 6.0%
Sugar	▲ 7.6%	▲ 3.7%	▲ 13.1%	▲ 25.1%	▲ 15.2%	▲ 28.4%
Cotton	▲ 12.1%	▲ 51.2%	▲ 11.2%	▲ 10.3%	▼ 18.7%	▲ 43.6%

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



THREE MONTH RAINFALL OUTLOOK

October to December 2016



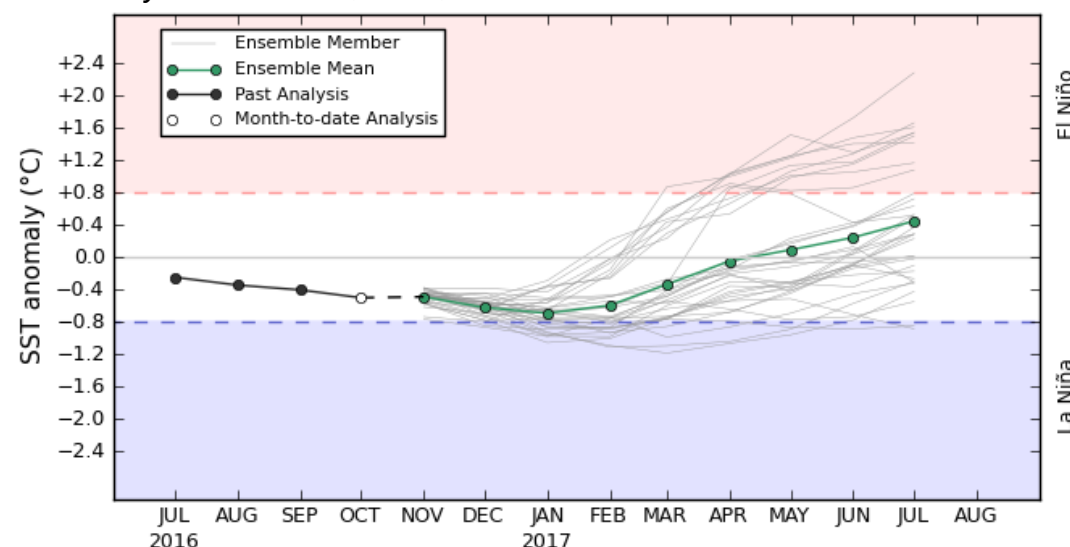
The Bureau of Meteorology (BoM) three month rainfall outlook to December points to generally average to well above average rainfall across most of Australia. Victoria, which accounts for around two-thirds of Australian milk production, is forecast to see very strong rainfall over the period. Reports suggest that very wet spring conditions are hampering production.

Recent heavy rain, combined with the outlook for more to come, presents a risk to wheat quality in eastern Australia, even if the headline production number is strong. Should this eventuate, it is likely that there will be an above average volume of feed-grade wheat in eastern Australia in the first half of 2017, easing feed prices for dairy farmers.

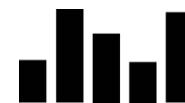
Source: Bureau of Meteorology

BOM POAMA MODEL LONG-RANGE EL NINO OUTLOOK

Monthly mean NINO 34 – 23 October 2016



The Bureau of Meteorology's long range outlook for El Niño points to a return to neutral conditions, moving close to El Niño by winter 2017. The BoM ENSO tracker remains on La Niña watch (placing the chance of a La Niña event at around 50%). This outlook suggests wetter than average conditions for the rest of the year but points to risks in winter-spring 2017.



NAB AUSTRALIAN ECONOMIC FORECASTS

Per cent change calendar year on year

	2016	2017	2018
Real GDP	3.0	2.8	2.6
Terms of trade	-2.9	-5.0	-5.7
Unemployment rate (year end)	5.7	5.6	5.6
Consumer Price Index (core)	1.5	2.3	2.4
RBA cash rate (year end)	1.5	1.0	1.0

NAB GLOBAL ECONOMIC FORECASTS

Per cent change calendar year on year

	2016	2017	2018
United States	1.5	2.1	1.9
Euro-zone	1.6	1.5	1.6
Japan	0.5	0.6	0.6
China	6.6	6.5	6.3
Emerging East Asia	3.5	3.6	3.5
World GDP	2.9	3.2	3.2

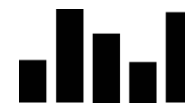
Source: NAB Group Economics

For more detail, see our [Global](#) and [Australian](#) Forecasts

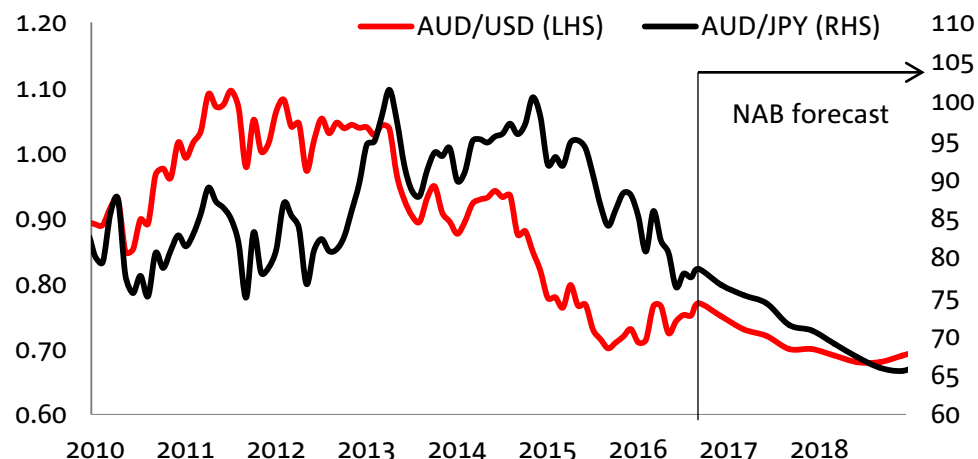
Global growth remains sluggish and sub-trend. Despite signs of stabilisation in areas of the world where economic activity has been weak, there is little evidence of new growth engines that could pull economic growth out of the doldrums. Consequently, we do not expect much improvement in global growth, which should remain below trend. Weak growth and below target inflation allows central banks to keep rates historically low and the focus in fiscal policy is shifting away from austerity to wind back big public debts and towards how public sector investment can be increased. While global growth has been disappointingly sluggish it has at least proved resilient, continuing through numerous shocks – Brexit, 2015's Chinese currency and share market volatility, and the early 2016 growth scare to name just three.

Real GDP forecasts for Australia are largely unchanged at 3.0% in 2016 and easing to 2.8% in 2017 and 2.6% in 2018. The unexpectedly high settlement for Q4 coking coal prices will provide a boost to Australia's terms of trade, nominal GDP and government revenues, but is unlikely to be sustained. Business survey data is showing weakness in retail conditions, which implies some risks to our already moderate forecasts for real household consumption growth of 2¼-2½% in 2017 and 2018. The labour market outlook is key, but while we expect the unemployment rate to remain in its current range between 5½% and 5¾%, the recent softening in trend employment growth bears close watching. House prices in Sydney and Melbourne have re-accelerated, which should prevent any further RBA cuts this year barring an exceptionally low Q3 CPI outcome in late October. Further cuts in 2017 remain likely.

EXCHANGE RATES AND INTEREST RATES



MONTHLY EXCHANGE RATES AND QUARTERLY FORECASTS



The AUD remains contained within the broad 0.7450 - 0.7750 trading range established over two months ago. We expect any change will likely come from the USD side of the equation. Ultimately, we still see the (inevitable) break coming to the downside. Looking into 2017, our forecasts show the AUD falling to 0.72 by mid-year and 0.70 by end-2017. We see the AUD falling into the high 60s in 2018.

We expect two 25bp cuts to the cash rate in May and August 2017 (to a new low of 1%). Monetary policy deliberations may then turn to the possible use of nonconventional policy measures if the outlook deteriorates further, although that is not in our forecast. Additionally, persistent weakness in CPI inflation could potentially trigger a rate cut even sooner than expected.

NAB FX STRATEGY TARGETS

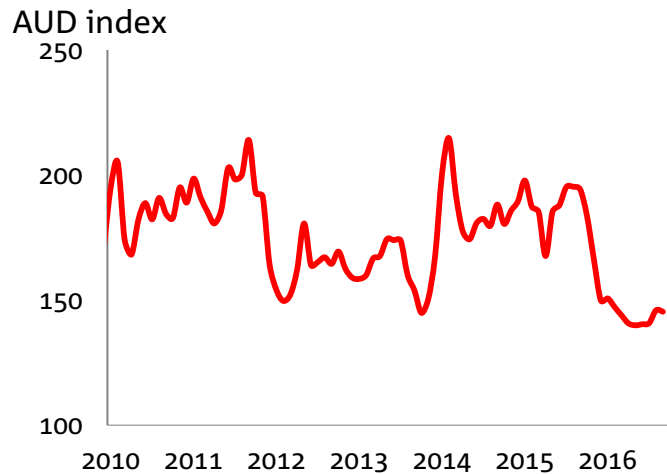
	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2	2018Q3
AUD/USD	0.75	0.73	0.72	0.70	0.70	0.69	0.68	0.68
NZD/USD	0.72	0.70	0.68	0.67	0.67	0.68	0.68	0.69
USD/JPY	102	103	103	102	101	100	99	97
EUR/USD	1.12	1.10	1.09	1.07	1.06	1.06	1.07	1.08
USD/CNY	6.70	6.70	6.68	6.65	6.65	6.65	6.63	6.60
AUD TWI	63.6	62.7	62.0	60.4	60.2	59.9	58.0	57.5

Source: NAB

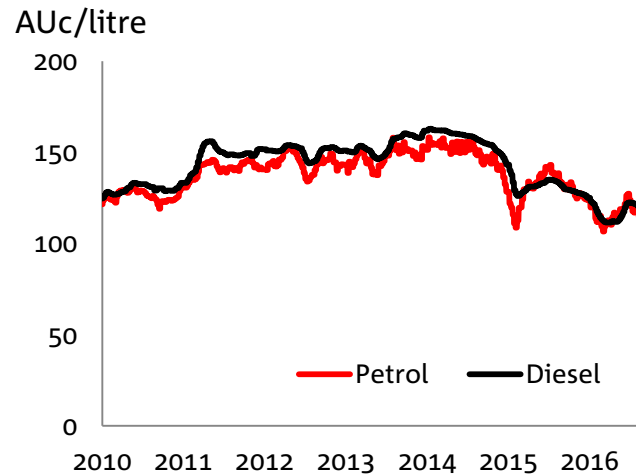
FARM INPUT PRICES



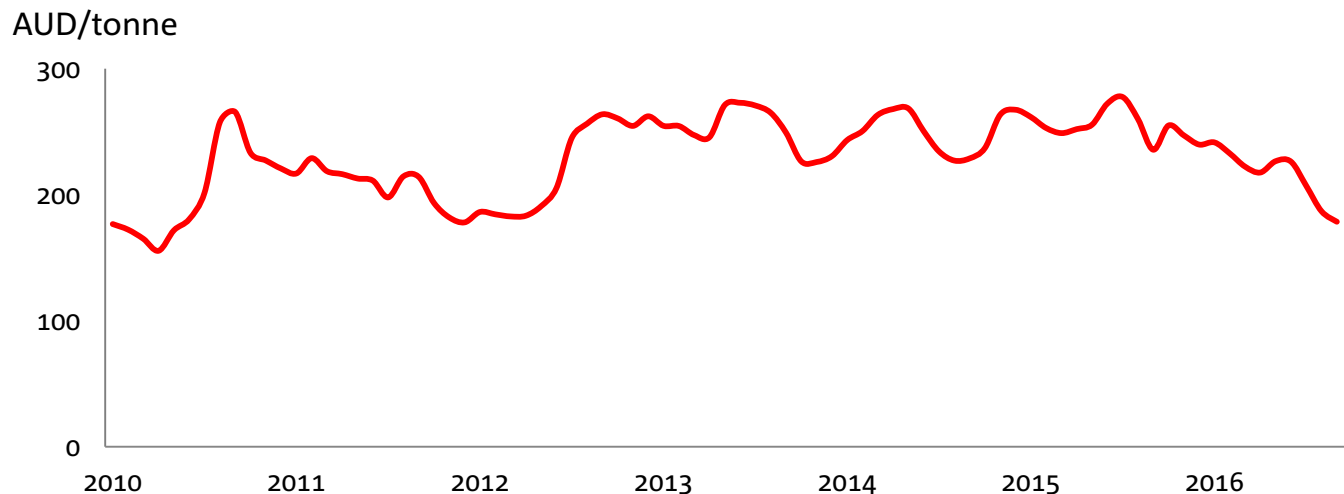
NAB FERTILISER INDEX



NATIONAL AVERAGE FUEL PRICES



NAB WEIGHTED FEED GRAIN PRICE INDEX



The drop in global fertiliser prices of late 2015 looks to have ended, with relative stability in fertiliser prices since early this year. September saw the NAB fertiliser index off 0.4% as higher DAP and natural gas offset lower urea prices. The recent strength in global oil prices points to some upside for fertiliser in the coming months, although we note that prices remain at very low levels.

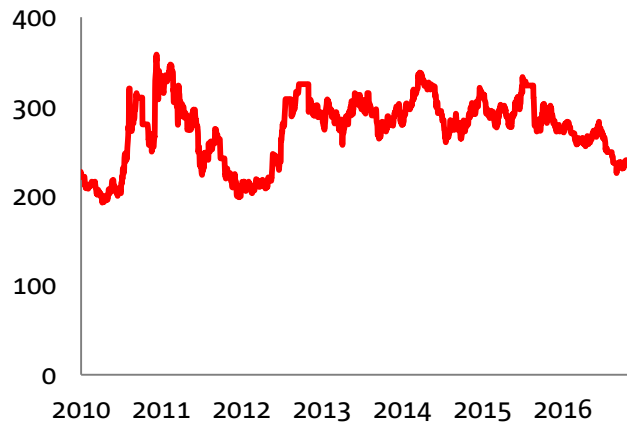
Weighted feed grain prices continue to fall, in line with continued weakness on global grain markets. The NAB feed grain price index fell 4.4% in September after falling almost 10% in August. We see strong signs that Australia is on track for a large winter crop, with the potential for greater than normal downgrades to feed quality if eastern Australia sees late season rain. Combined with good pasture availability and global weakness, we expect further downside pressure in domestic feed grain markets into 2017. NAB's index includes feed wheat, barley, oats and sorghum. Three quarters of the indicator is made up of feed wheat and barley.

Source: Bloomberg, Profarmer and NAB Group Economics



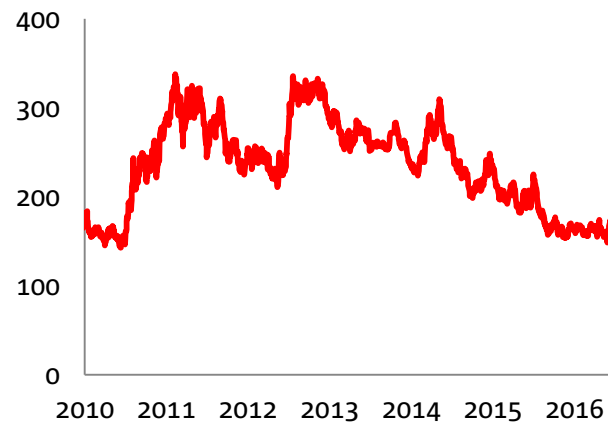
GENERIC 1ST MILLING WHEAT

Eastern Australia, AUD/tonne



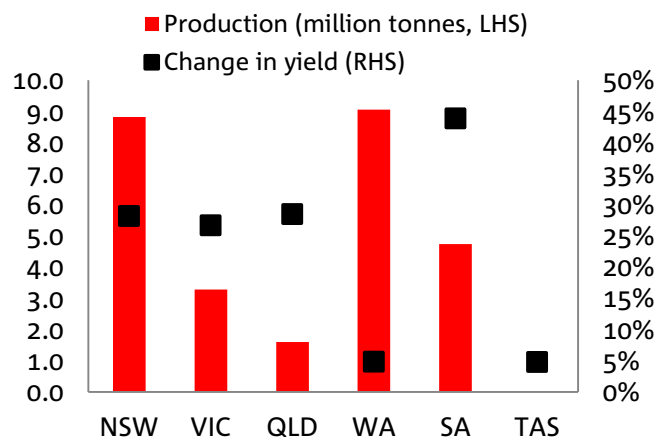
CBOT SOFT RED WINTER WHEAT

USD/tonne



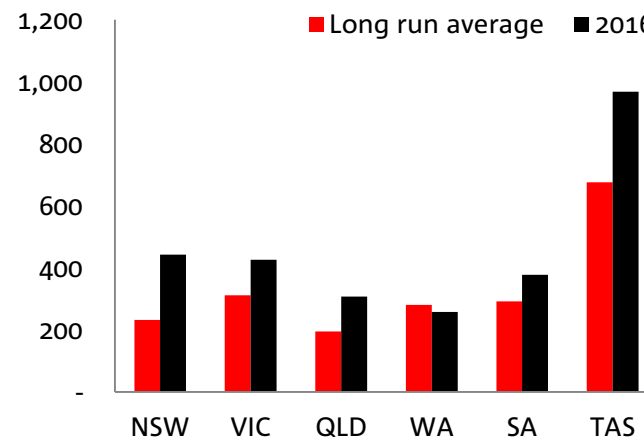
WHEAT PRODUCTION OUTLOOK

Production and change in yield



SEASONAL RAINFALL IN WHEAT REGIONS

Total average rainfall April-September, mm



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

Prices

The steady downward trend in USD denominated global wheat prices over the last four years has abated over the last two weeks, with prices moving higher on supply concerns combined with expectations of higher demand. However, global wheat supply remains plentiful. Combined with favourable shipping costs and low production costs in the Black Sea region, Australia remains under substantial pressure. Generic 1st Eastern Australian milling wheat was off 3.5% so far in September but is up 1.2% in October (to date).

Production

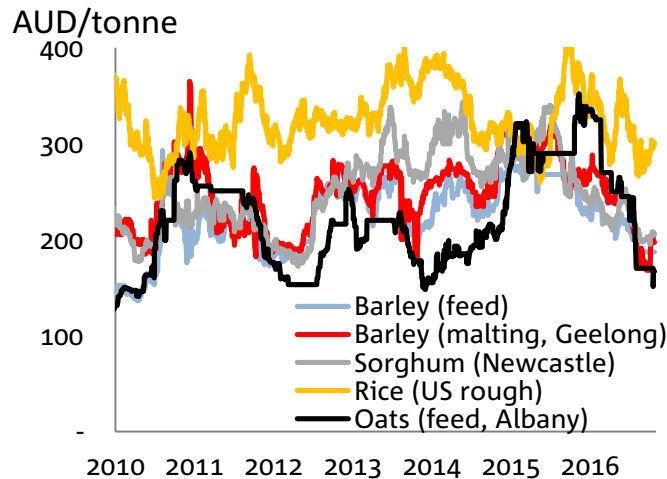
Spring has been generally average to dryer than average in Western Australia but much wetter than average in the east. This widespread late season rain, combined with the outlook for more to come, has placed considerable uncertainty on the quality and yield of the crop in eastern Australia. Meanwhile, there are reports of widespread frost damage in Western Australia.

Had the rainfall been more evenly distributed and storm damage and waterlogging less widespread, we would be looking to national production over 29 million tonnes (29.4 according to our framework), but given the uncertainty we have held our forecast at 27.6 million tonnes this month.

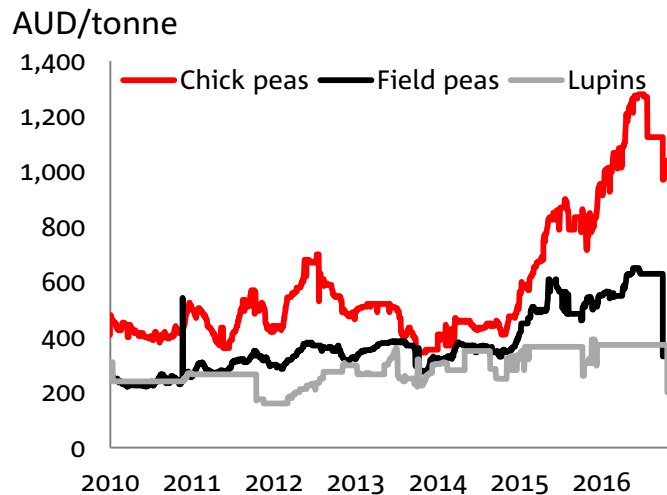
OTHER BROADACRE CROPS



SELECTED COARSE GRAINS

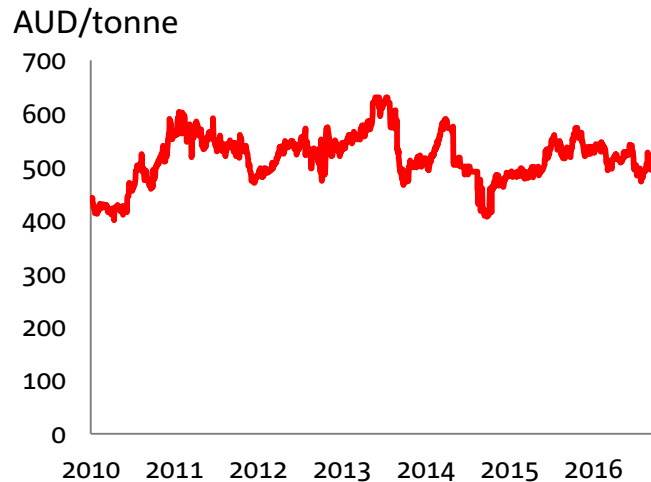


SELECTED PULSES

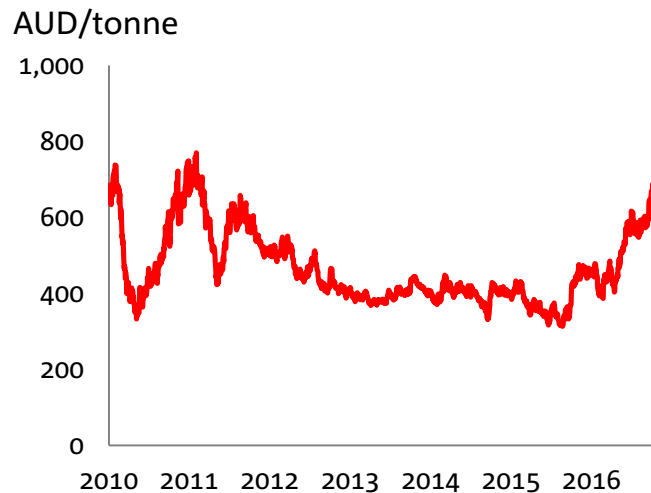


Source: Bloomberg, Profarmer and NAB Group Economics

CANOLA, NEWCASTLE NSW



ICE NO.11 SUGAR



Australian coarse grain prices have mostly followed broad trends set by wheat this year, reflecting a dependence on movements in the AUD. Recent data point to light trading of old season crop. Sorghum (Newcastle) was off 1.7% in September while barley (feed, generic) did not report. Rice was 0.4% lower and oats saw very light trading.

Domestic canola continues to perform, essentially steady in September but up 6.3% so far in October. With canola remaining in the high AUD400s to low 500s over the last several months, those who planted canola should see a strong premium compared to wheat this season. However, we note reports of storm damage and excessive moisture affecting yield.

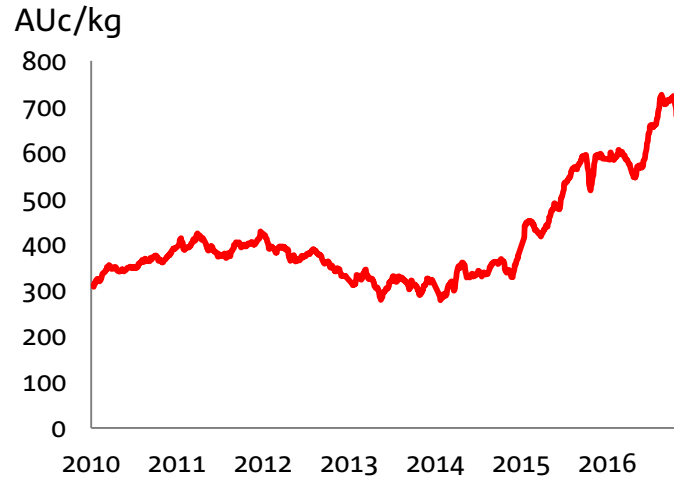
We have tempered our expectations for Australian pulses production this season, based on reports of widespread damage to chick pea crops. This comes as a disappointment given substantially elevated planting. We remain circumspect when it comes to the outlook for prices. This is particularly the case for pulses predominantly destined for India, such as chick peas and lentils.

Global sugar prices have continued to surge amid supply shortfall concerns and we continue to expect higher prices, noting improving global demand.

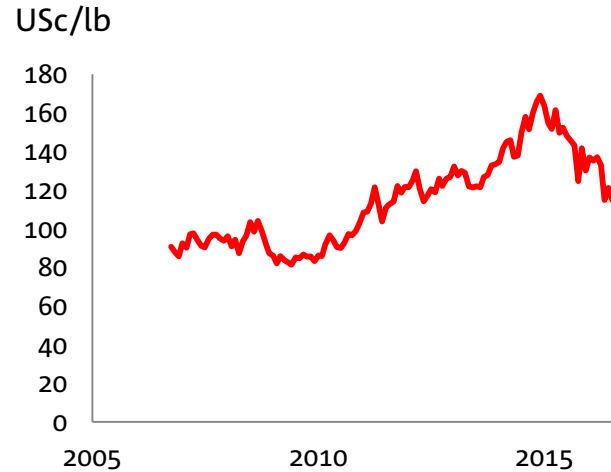




EASTERN YOUNG CATTLE INDICATOR



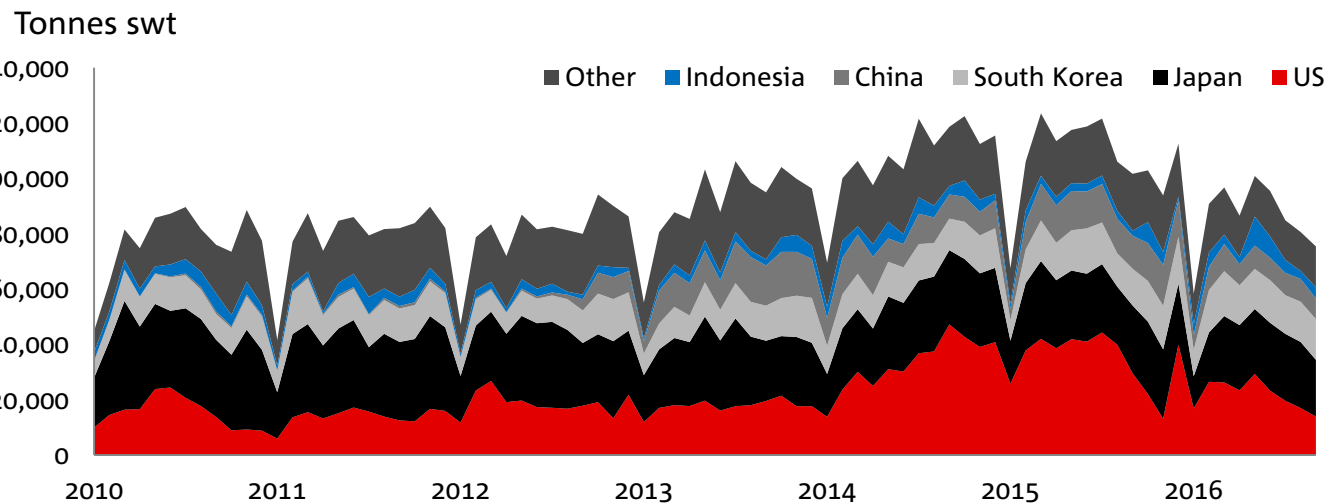
CME LIVE CATTLE FUTURE



Cattle prices have headed south this month, with the EYCI falling well below 700AUc/kg. This movement is in line with a seasonal increase in supply. However, as [MLA notes](#), herd rebuilding and abundant pasture availability will keep this surge limited compared to previous years.

The bigger question is to what extent this decline presages much greater contraction. It has been our view for some time that the international beef outlook is now much weaker than in 2014 and 2015.

MONTHLY AUSTRALIAN BEEF EXPORTS



Source: Meat and Livestock Australia and NAB Group Economics

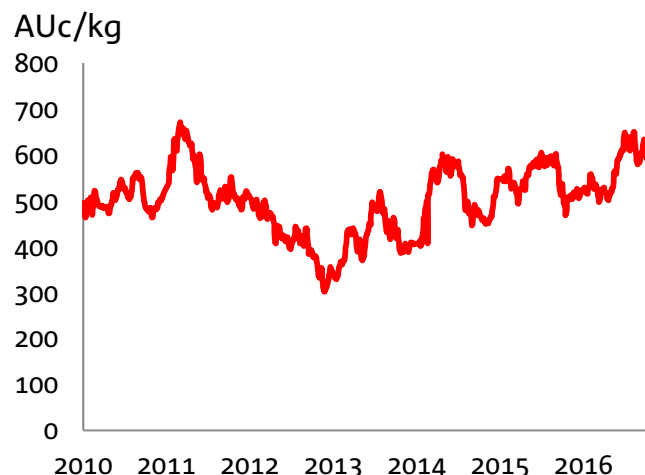
The US market in particular presents a sobering picture for the industry. Australian 90cl cow meat into the US averaged 542.66AUc/kg last week, compared to a peak in September last year of 739.54AUc/kg. Meanwhile, US cattle futures on the Chicago Mercantile Exchange have fallen to five year lows. Low feed grain prices, especially for corn, have substantially improved input costs for US cattle producers.

While cattle prices are likely to stay high for the remainder of the year (especially if it keeps raining), the risks to the outlook into 2017 and beyond are increasing and we expect prices to retreat in the new year.

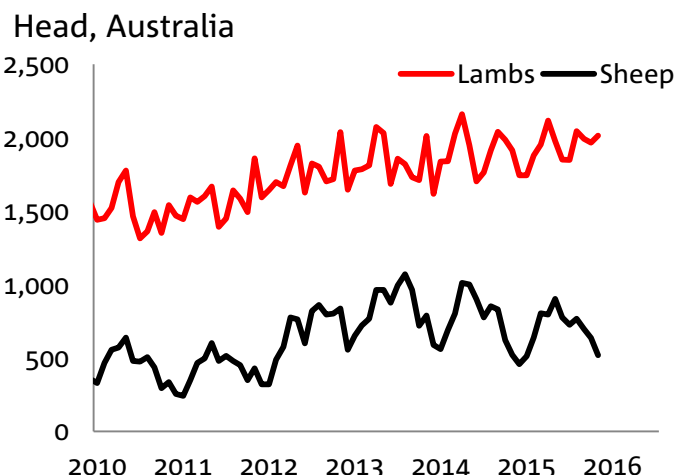
LAMB, PORK AND POULTRY



NATIONAL TRADE LAMB INDICATOR

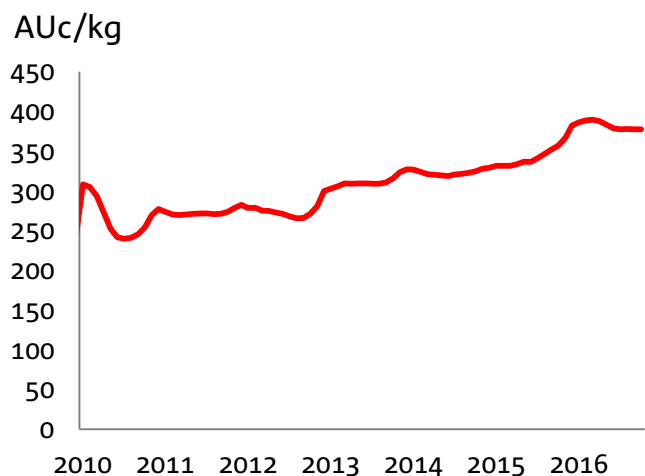


MONTHLY SHEEP AND LAMB SLAUGHTER

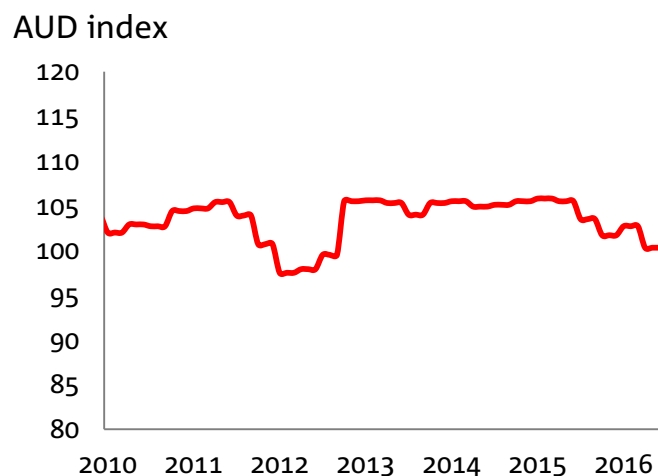


The Australian lamb industry continues to enjoy broadly favourable conditions, and we remain upbeat in our assessment of the industry. While the spring flush has brought prices down somewhat, prices are performing better than the same time last year. We expect stable to moderately higher prices into next year, continuing the good run since 2013. We place lamb prices at 2.1% higher in 2016-17. Overall, we expect the value of lamb and mutton exports to fall 5.8% in 2016-17, reflecting lower volume.

AUSTRALIAN PORK PRICE INDICATOR



ABS POULTRY PRICE INDEX



Export markets for lamb are reasonably diversified, with the US and China accounting for a substantial volume. However, the Middle East remains a very important market, particularly for mutton and live sheep.

Australian wholesale pork prices (measured as an average of buyer and seller prices for eastern seaboard 60.1-75kg animals) has seen virtually no change in the last month following some movement earlier in the year (albeit in an industry that generally sees relatively little volatility). Prices were down 0.1% in September but are up 0.1% for October to date.

Retail poultry prices have remained reasonably stable since late 2012. National retail prices fell 0.3% in the September quarter 2016.

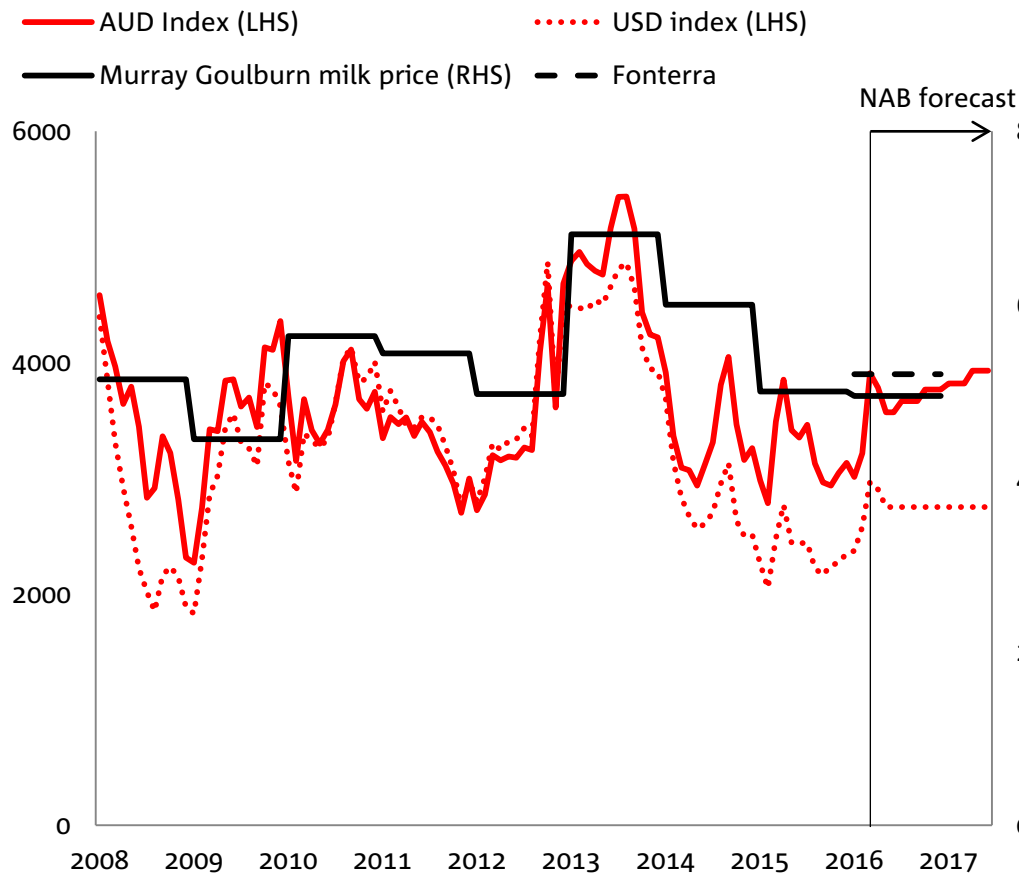
Source: Meat and Livestock Australia, Australian Pork, Australian Bureau of Statistics and NAB Group Economics



NAB WEIGHTED DAIRY EXPORT PRICE INDICATOR

\$/tonne (export price, LHS)

AUD/kg milk solids (farm gate price RHS)



Source: Australian Bureau of Statistics, Global Dairy Trade, Dairy Australia, Fonterra, Murray Goulburn, ABC 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

For more information, see our in focus note on dairy, released concurrently with this report.

Global dairy markets have faced very difficult conditions since plummeting in the first half of 2014, reflecting a combination of increased supply and sluggish global demand. However, the full force of the downturn was not fully felt by Australian dairy farmers until earlier this year when major processors Murray Goulburn and Fonterra substantially downgraded farmgate milk prices.

Recent Global Dairy Trade auction results, combined with a step-up last month from Australia's largest dairy processor Murray Goulburn and generally favourable seasonal conditions suggests that the situation is stabilising.

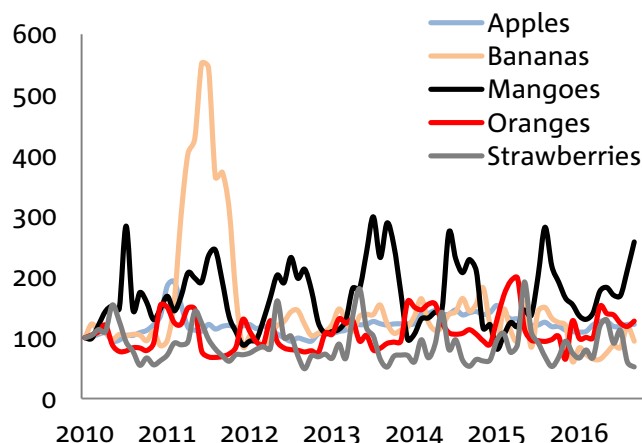
We upgraded our forecasts for dairy last month to reflect lower international supply conditions, with recent data from the European Union and New Zealand showing raw milk deliveries falling in August compared to the same time last year. While New Zealand is the world's largest dairy exporter, EU production levels are particularly important given the uncertain impact of the removal of milk production quotas last year on more efficient EU production regions.

Although our forecasts do not point to major upside in global markets in the coming year, we expect a small depreciation in the AUD which should provide some upside. It remains to be seen whether this will flow through to farmgate prices. Dairy Australia's latest forecasts point to Victorian farmgate milk prices remaining below \$5/kg milk solids in 2016-17, although South Australia is expected to fare better. Input costs should provide some respite, with feed and fertiliser unit costs below last season.



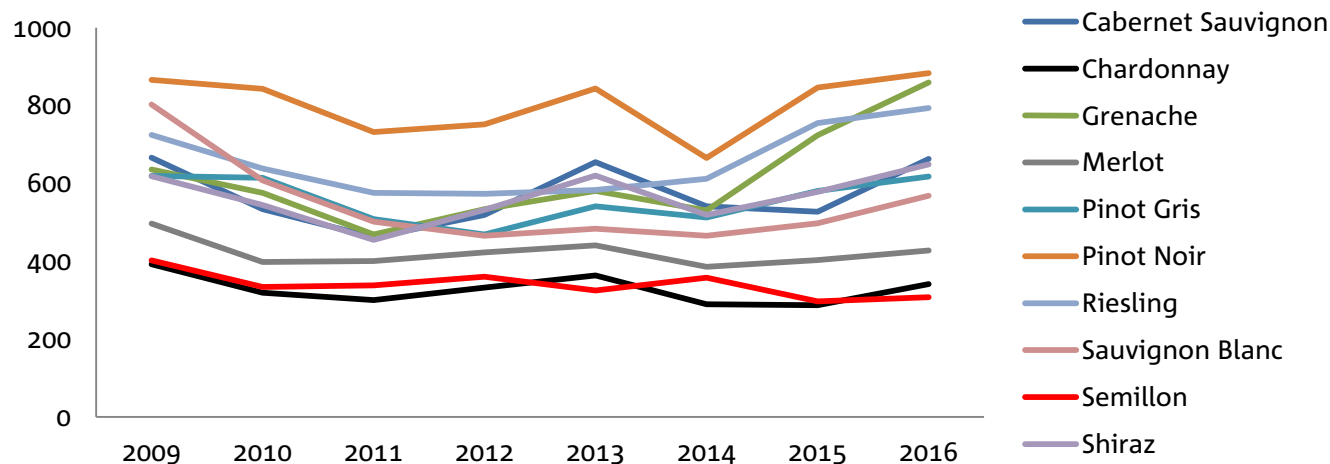
WHOLESALE FRUIT PRICES

AUD index, Sydney and Melbourne



NAB WEIGHTED WINE GRAPE PRICES

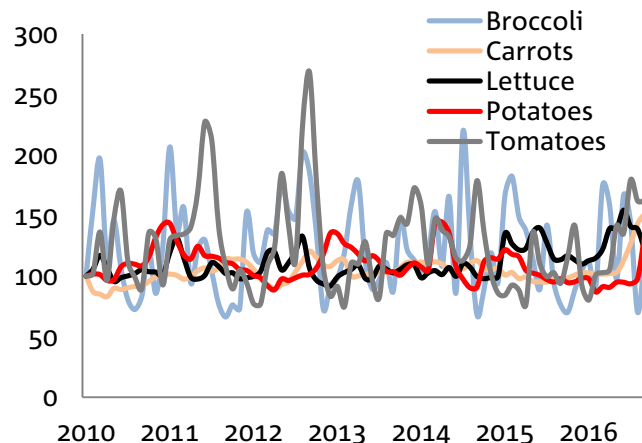
AUD/tonne



Source: Ausmarket Consultants, Wine Australia and NAB Group Economics

WHOLESALE VEGETABLE PRICES

AUD index, Sydney and Melbourne



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

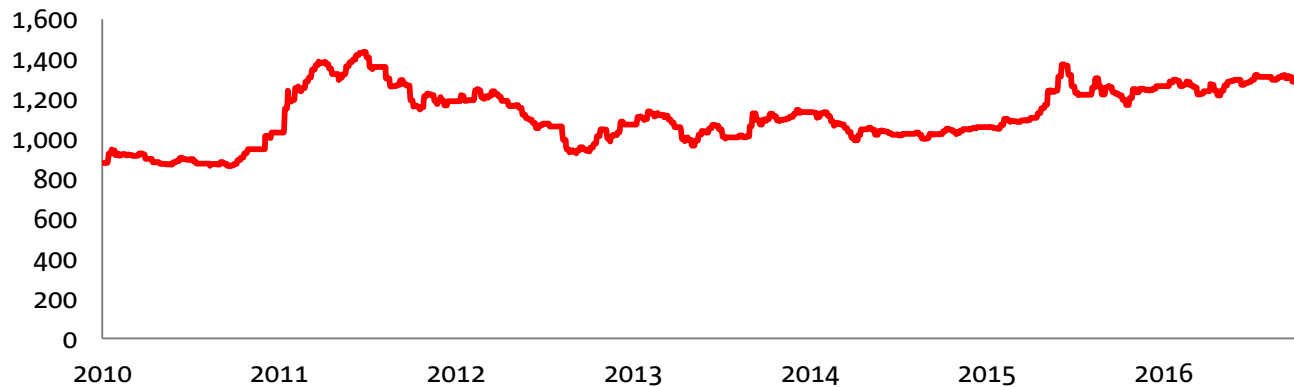
Wholesale fruit and vegetable prices rose in September. Fruit prices rose 1.8% in August to an index value of 131.3 (January 2010 =100). Vegetables surged 7.7% in September to an index value of 138.9 (January 2010 =100). ABS data indicates that retail fruit prices rose almost 20% in the September quarter 2016.

Wine Australia's 2016 Price Dispersion Report, shows further strengthening in wine grape prices in the 2016 vintage, reflecting the rewards of a lower AUD. Overall, wine grape prices for major varieties were higher to much higher. Cabernet Sauvignon was a standout performer, up 26% from last season. Chardonnay and Grenache also grew strongly, both up 19% in volume weighted terms.



WOOL – EASTERN MARKET INDICATOR

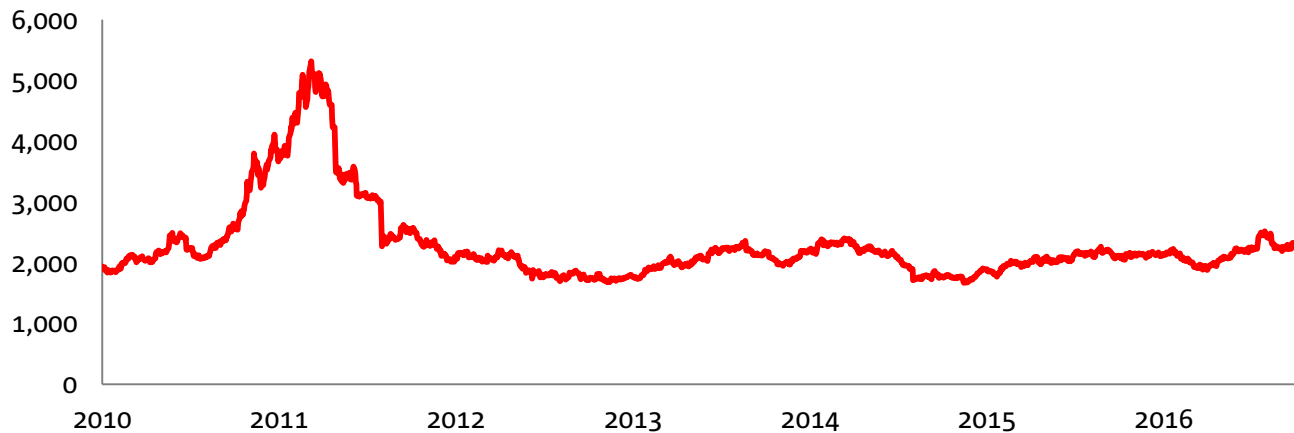
AUc/kg



After several years of unfavourable prices, wool producers have enjoyed a moderate upturn since last year, although more recent data show prices stabilising. The Eastern Market Indicator gave up 0.2% in September but has gained 0.6% so far in October. Continued AUD strength has put a brake on the price rally (wool is quite sensitive to movements in the dollar) any move downward in the AUD provides an upside to price. We forecast that prices will increase 7.0% in 2016-17.

COTLOOK A INDEX

AUD/tonne



The higher prices are forecast to offset lower production in 2015-16 and provide some production incentive to wool growers in 2016-17. We forecast the value of Australian wool exports to increase 6.0% in 2016-17.

Global cotton prices have given up some of their earlier gains. Cotlook A was off 2.3% (AUD) in September but is up moderately in October (to date) – gaining 0.6%.

Source: Bloomberg and NAB Group Economics