

RURAL COMMODITIES WRAP

SEPTEMBER 2017

KEY POINTS

This month, the NAB Rural Commodities Index fell to a 15 month low, slipping 7.6% (the biggest monthly fall since the expanded index began in 2010) amid a stubbornly high Australian dollar, retreating grain prices and weakness in cattle. Only four of the 28 commodities that make up the index rose in the month. Seasonal conditions are mixed to poor. While most of southern Australia (below a line stretching roughly from Western Australia's Shark Bay to Canberra) saw above average rainfall last month, north of the line it remains very dry indeed. Frosts in New South Wales and Queensland have caused potentially considerable damage to winter crops.

Over the coming months, we will be closely watching two areas, the performance of which will be key for the agricultural sector:

- Seasonal conditions remain a major consideration. While spring rain is probably too late for much of the crop in northern New South Wales and Queensland, improved conditions could allow some opportunities for summer crops. Likewise, better seasonal conditions would likely stem some of the recent falls in cattle prices.
- The Australian dollar remains in the high 70s, approaching an uncomfortable level for agriculture. In August NAB changed its forecast for the AUD from 70 cents by year end to 75 cents. We will be watching for signs of strength in the USD that are necessary for a depreciation in the AUD to occur.

PRICE UPDATE



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The NAB Rural Commodities Index plummeted 7.6% in August, the biggest monthly drop for the expanded index (with data going back to 2010) and a 15 month low. The fall reflected the strength of the Australian dollar combined with lower global grain and domestic cattle prices. Dairy also fell following lacklustre auctions and a higher AUD. Meanwhile cotton and sugar were also lower.

On a state basis, previous outperformer Queensland (with its large cattle industry) took the biggest hit to fall 8.3%, while New South Wales was off 6.7%. Dairy heavy Victoria and Tasmania fell 6.4% and 6.8% respectively, while grain dependent Western Australia fell 8.0% and South Australia fell 7.0%.

The index tracks 28 commodities weighted by the relative size of each commodity in the Australian agricultural sector.

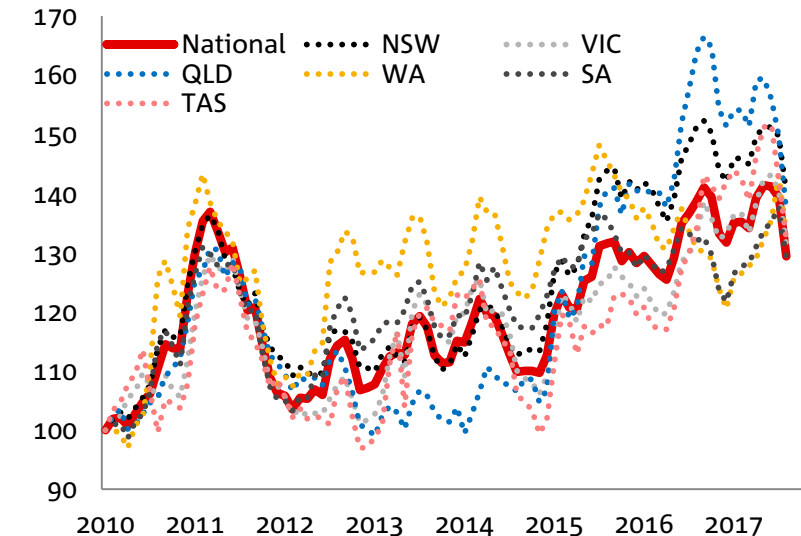
MONTHLY AUD PRICE CHANGES

Monthly average price change

	June	July	August
Wheat	▲ 8.2%	▲ 10.8%	▼ 13.0%
Beef	▼ 1.1%	▼ 6.3%	▼ 7.3%
Dairy	▲ 5.5%	▼ 4.2%	▼ 3.8%
Lamb	▲ 2.5%	▼ 9.1%	▲ 1.6%
Wool	▼ 1.5%	▲ 1.5%	▲ 2.5%
Sugar	▼ 15.0%	▲ 1.1%	▼ 3.7%
Cotton	▼ 5.8%	▼ 3.8%	▼ 7.1%

NAB RURAL COMMODITIES INDEX

January 2010 = 100



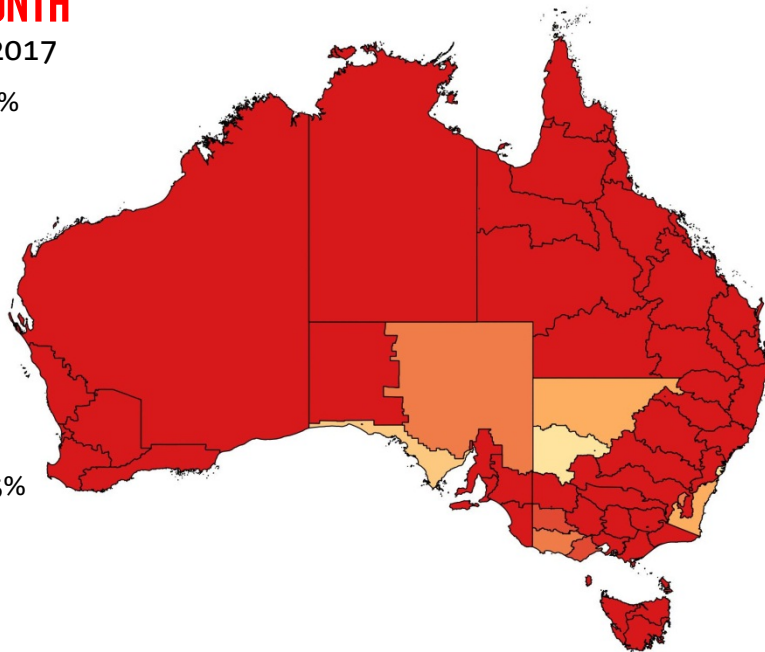
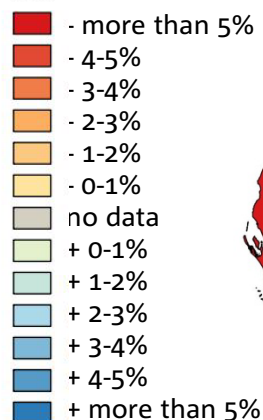
Source: NAB Group Economics, ABARES, Meat and Livestock Australia, Australian Pork, Ausmarket Consultants, Australian Bureau of Statistics, Bloomberg and Profarmer.

REGIONAL PRICE INDICATORS



MONTH ON MONTH

July to August 2017

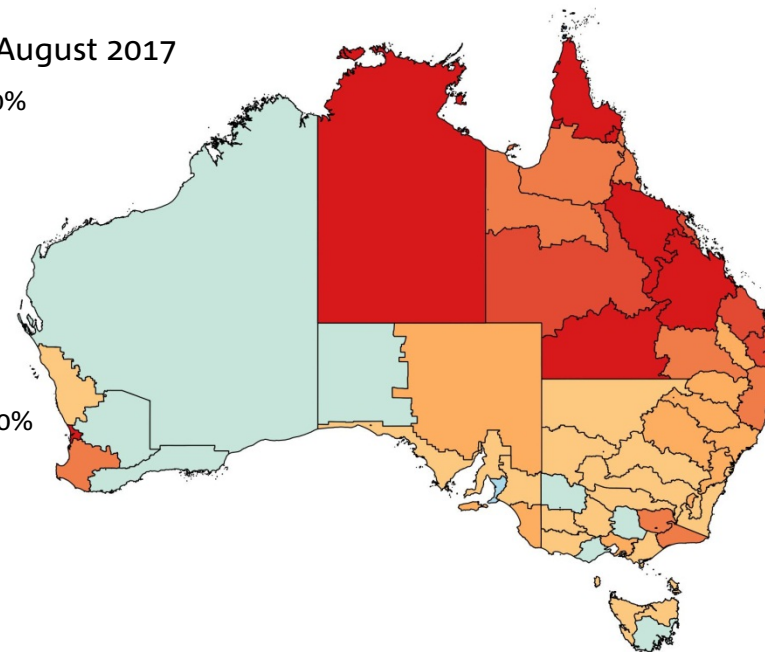
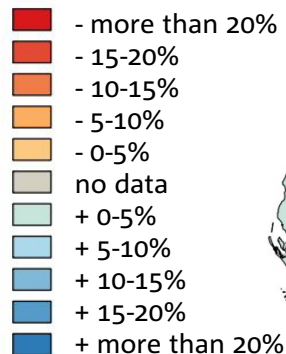


Monthly regional price indicator data shows a negative picture across the country for August. All regions were lower and only 10 fell by less than 5%. The combination of lower cattle and grain prices was reflected in steep falls across most of the country.

Dairy export prices fell, although this should be read with some caution as farmgate prices have been quite steady recently. Farmgate opening prices have been released and both Murray Goulburn and Fonterra have issued upward revisions. For more information on dairy see page 13.

YEAR ON YEAR

August 2016 to August 2017



On a year on year basis, some regions are still ahead (mostly those with a broadacre cropping focus) but cattle country across Queensland and the Northern Territory has seen steep falls with prices well below their level at the same time in 2016.

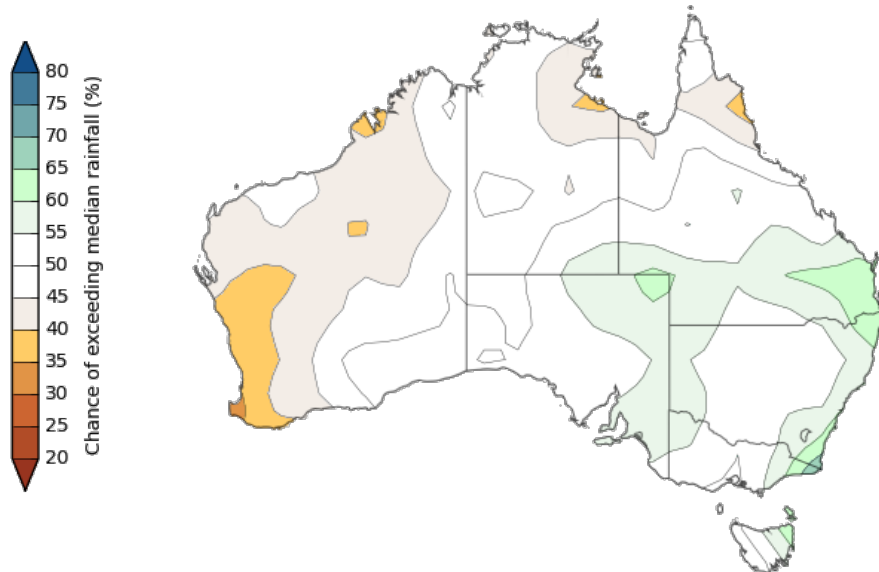
This is the fifth month of NAB's new regional price indicators – in effect a separate NAB Rural Commodities Index for every region in Australia. The data is based on state natural resource management regions (rather than ABS SA4 regions) to match agricultural regions as well as possible. Our maps are based on 2011 region boundaries. When the ABS releases production data based on updated boundaries, these boundaries will change.

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

SEASONAL CONDITIONS

THREE MONTH RAINFALL OUTLOOK

September to November 2017



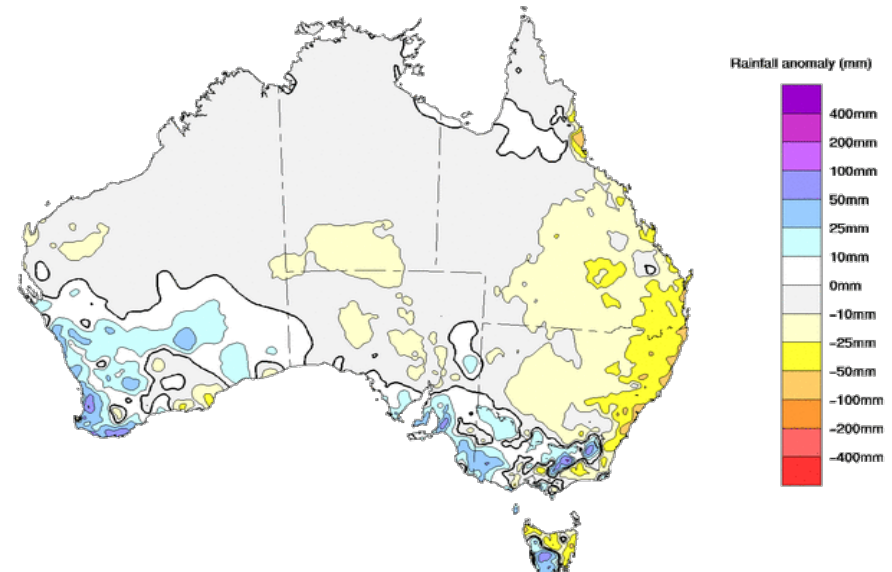
The Bureau of Meteorology's latest three month climate outlook for spring points to average to above average rainfall across New South Wales, Victoria, South Australia and Tasmania, mostly average to above average rainfall for Queensland (although Cape York is expected to see below average falls), while most of Western Australia and parts of the Northern Territory are expected to see drier conditions.

While improved rainfall is certainly welcome in the eastern states, grain growers faced a string of late frosts and a wet finish may be a hindrance.

Source: Bureau of Meteorology

RAINFALL ANOMALY – AUGUST

mm



Rainfall saw a very strong north-south pattern in August, with a line from roughly Shark Bay to Canberra dividing generally above average rainfall to the south and average to below average rainfall to the north. Tasmania was patchy, with the south west seeing much more rain compared to average.

While this rain was certainly very welcome, data for the last three months shows very serious deficiencies across most of Australia's agricultural regions. The northern wheatbelt of Western Australia, the Eyre Peninsula, Gippsland and parts of New South Wales saw especially bad conditions in early winter and we expect these areas to see among the worst yield deficiencies come harvest.

OUTLOOK FOR PRICES AND PRODUCTION



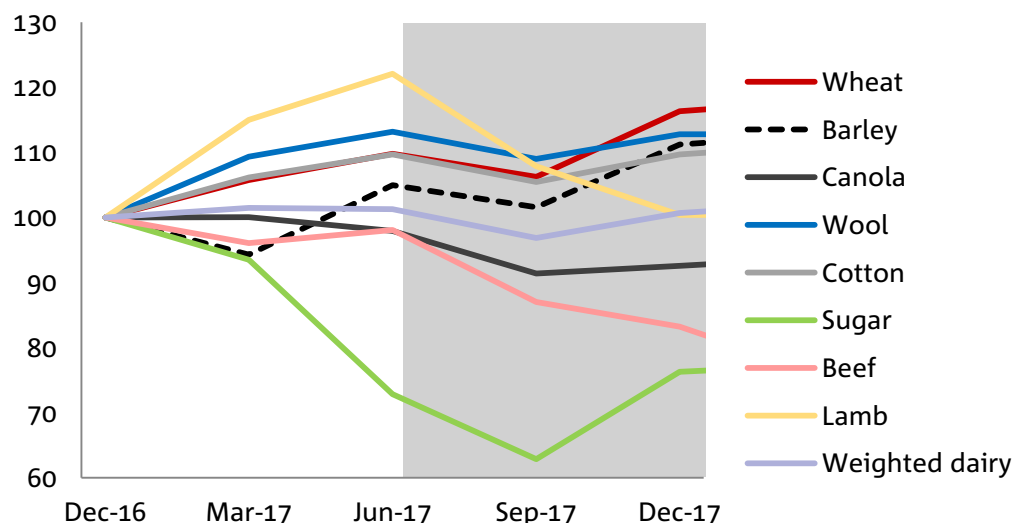
Prices

The outlook for the coming year is highly dependent on the course of the Australian dollar which remains stubbornly in the high 70s range having briefly touched above 80 US cents. We now see the AUD at 75 cents at the end of 2017 and 73 cents for much of next year. This has seen us revise down our forecasts for most agricultural commodities.

Weather will continue to be a major driver of livestock prices. Drier weather has already had a major impact on cattle and sheep prices. If these conditions continue we expect to see further downside for livestock, although the Bureau of Meteorology now expects average to wetter than average spring conditions across eastern Australia.

INDEX OF PRICE FORECASTS FOR RURAL COMMODITIES

AUD index value, December quarter 2016 = 100



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

Production

Rainfall (or more accurately the distinct lack of it), is the major issue for production this year and while August saw southern producers receive a boost, frost activity has been above average and some parts of New South Wales and Queensland saw abnormally hot weather. Our latest estimate for national wheat production is 20.1 million tonnes, although a poor finish could see production drop into the high teens, especially given very challenging conditions in New South Wales.

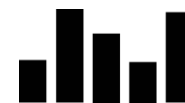
Conversely, dry conditions have already seen an uptick in cattle slaughter. If it remains dry, production is likely to be higher for some months before declining again.

PRODUCTION OUTLOOK (ABARES JUNE 2017 EXCEPT WHEAT)

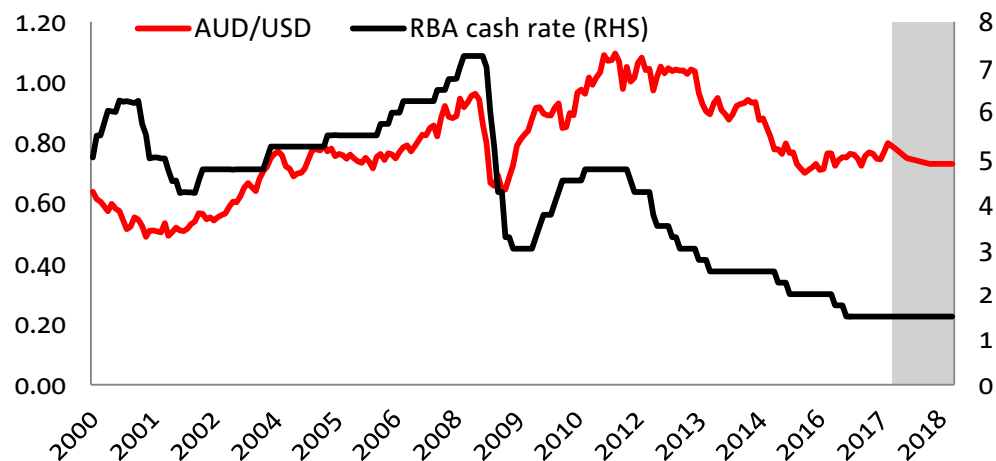
Financial year production estimates, Australia

	2016-17	2017-18	% change
Wheat (million tonnes)	35.1	20.1	▼ 42.8%
Beef (kt)	2,035	2,114	▲ 3.9%
Dairy (milk, ML)	8,910	9,250	▲ 3.8%
Lamb and mutton (kt)	669	668	▼ 0.1%
Wool	431	442	▲ 2.6%
Sugar (kt)	4,804	4,821	▲ 0.4%
Cotton (lint, kt)	960	1,083	▲ 12.8%

EXCHANGE RATES AND INTEREST RATES



EXCHANGE AND INTEREST RATES INC. QUARTERLY FORECASTS



NAB FX STRATEGY TARGETS

	2017Q3	2017Q4	2018Q1	2018Q2
AUD/USD	0.78	0.75	0.74	0.73
NZD/USD	0.72	0.70	0.69	0.69
USD/JPY	112	116	118	118
EUR/USD	1.19	1.17	1.18	1.20
USD/CNY	6.65	6.67	6.64	6.64
AUD TWI	65.9	64.2	63.4	62.3

Source: NAB

For the USD an almost non-stop run of negative news has seen the big USD fall 8% in broad trade-weighted index terms this year. While this partly represents a reversal of the 5% November-December 2016 rise following Trump's election victory as the White House proves unable to pass any meaningful legislation, the addition of prospective policy reversals at the ECB and other developed economy central banks alongside a burgeoning Trump discount factor, now sees the USD plumbing key long-term supports.

At 0.7965, the AUD/USD is little changed in the past fortnight. A move above 80c remains elusive, however our fair value model estimate has continued to edge higher. At the start of August, our model was suggesting fair value for the AUD/USD was around 0.7710. Now five weeks later, fair value sits at 0.7920 and the fair value range is 0.7650 - 0.8180. On this basis, today the AUD/USD can comfortably move above the 80c mark without necessarily being seen as overvalued.

AUD/USD is likely to remain contained in a 0.78 to 0.8050 range near term. Short term valuation is not stretched, suggesting scope to grind higher on 'no news' but AUD is still very sensitive to bad news (either domestic data or global risk sentiment). Ultimately we forecast the AUD to fall to 0.75 by the end of 2017 and spend most of 2018 around the 0.73 mark.

We do not envisage any cash rate hikes until 2019, although there is some risk of an earlier hike if current strength in the labour market is sustained beyond 2017. That said, there is now little possibility of a cut, despite the higher AUD complicating the outlook. Some reacceleration of detached house prices, despite measures to cool investor and foreign demand, will not sit comfortably at the RBA.

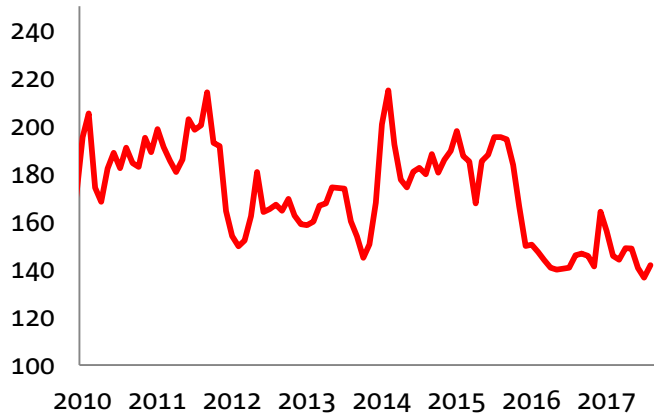


FARM INPUT PRICES



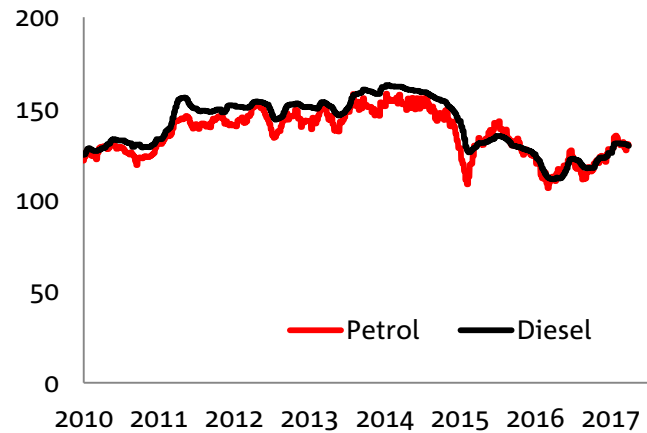
NAB FERTILISER INDEX

AUD index



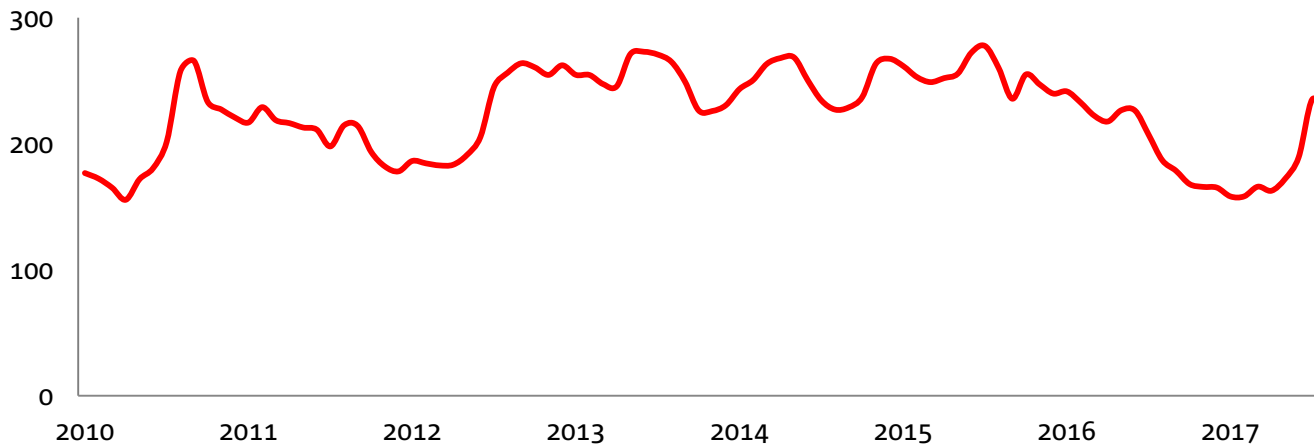
NATIONAL AVERAGE FUEL PRICES

AUc/litre



NAB WEIGHTED FEED GRAIN PRICE INDEX

AUD/tonne



Source: Bloomberg, Profarmer and NAB Group Economics

Feed prices fell 9.8% to \$212/tonne in August, as the sharp global grains rally of June-July fell away. Nonetheless, prices remained somewhat higher than global benchmarks on account of dry seasonal conditions in New South Wales and Queensland. There have been numerous reports of livestock producers scrambling to secure old season crop for stock feed as dry weather bites.

While we expect little upturn in global prices over the coming months the combination of i) the risk of below average grain yields this season and ii) a possible shortage of old season crop remaining on farm, could see domestic feed prices continuing to attract a premium.

Fertiliser prices were up in August, reflecting higher DAP and urea prices, although the elevated AUD lessened this impact somewhat. Overall, the index was up 3.8% for the month.

With oil still mired in the low 50s and the AUD back up to the high 70s range, it comes as something of a surprise to see fuel prices increasing. Latest national data shows petrol prices at 128.5 cents/litre and diesel at 126.8 cents/litre. Petrol is up around 8 cents/litre for the month although diesel has been more stable.

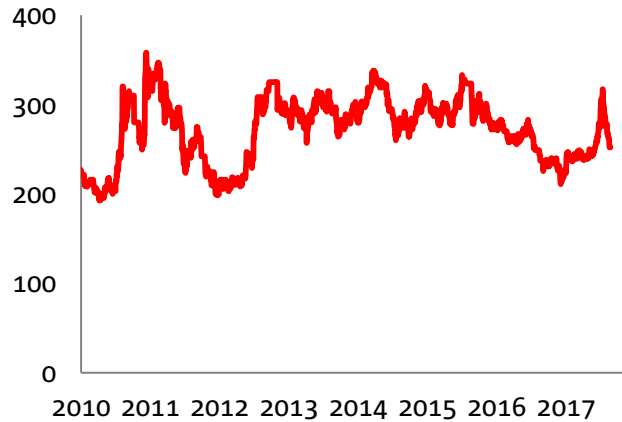


WHEAT



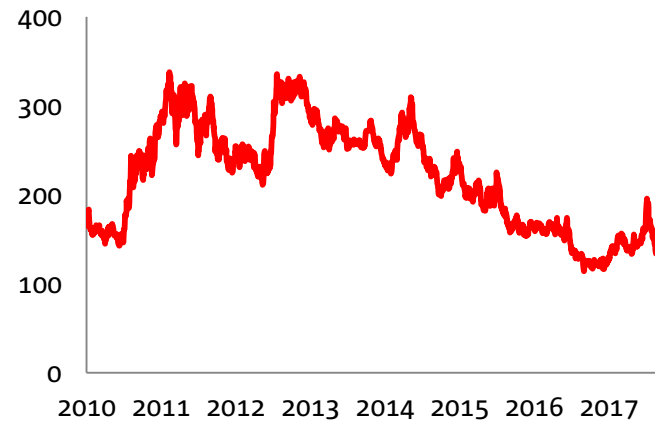
ASX MILLING WHEAT FUTURE

Eastern Australia, AUD/tonne



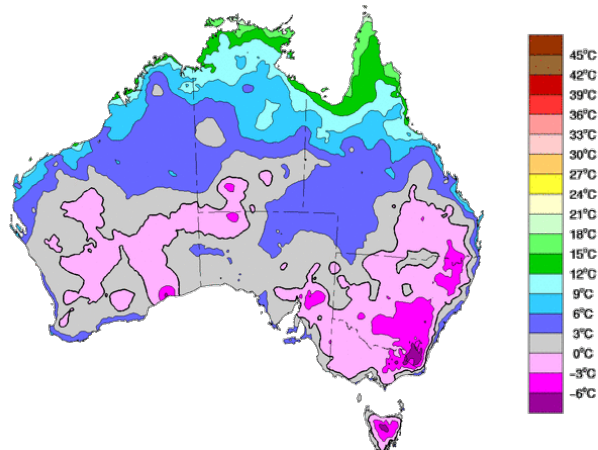
CBOT SOFT RED WINTER WHEAT

USD/tonne



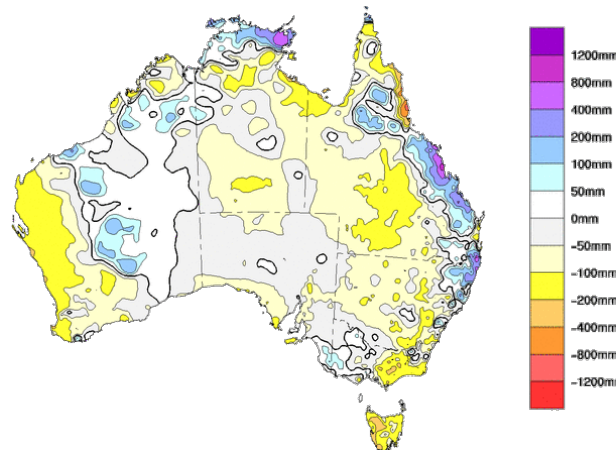
LOWEST MINIMUM TEMPERATURE

August 2017



RAINFALL – LAST SIX MONTHS

Anomaly mm



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

Prices

The last few months have seen substantial volatility in wheat prices, with eastern Australian futures briefly surging above \$300/tonne (topping out at \$317/tonne), an extraordinary result given prices had been mired in the mid-240s range for months. This price spike, caused by US crop concerns, is now well and truly over and wheat is back in the mid-200s range in AUD terms. Meanwhile, global indicators have fallen even further, underling something of a premium for domestic wheat in the coming months as livestock producers scramble for feed. Nonetheless we expect wheat prices to remain subdued on global markets.

Production

August brought mixed to bad news for our wheat production model, with above average rainfall Victoria, South Australia and Western Australia but continuing dry weather in New South Wales and Queensland. Elevated frost activity and heat waves add further uncertainty to the outlook.

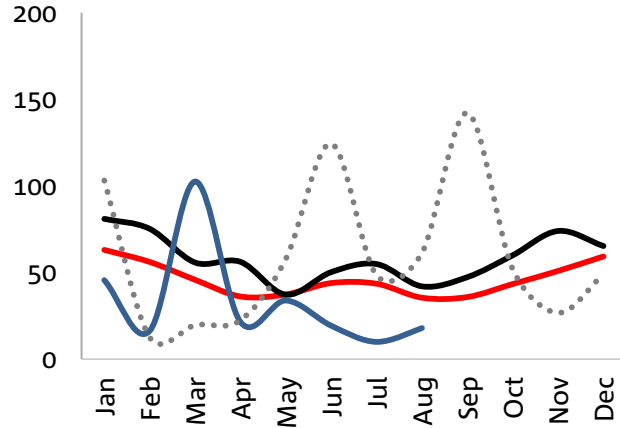
Our central case estimate for the 2017-18 Australian wheat crop is now 20.1 million tonnes (down from 22.7 million tonnes last estimate), based on rainfall to date and adjusted for frost activity. It is possible that this estimate will fall further next month.



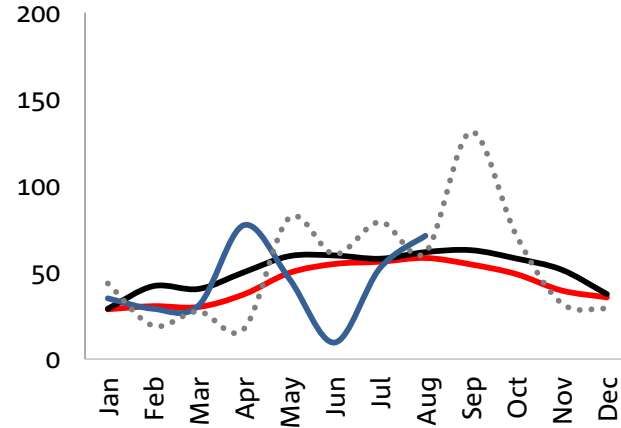
WHEAT CONTINUED: AVERAGE RAINFALL IN WHEAT REGIONS

— Long run average 1900-01 to 2013-14 — La Nina years — 2017 YTD 2016

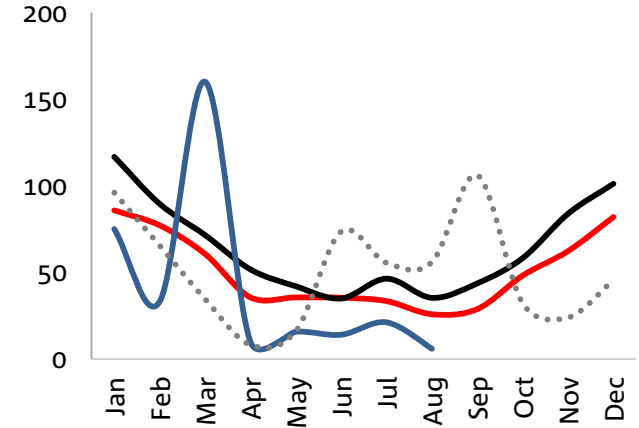
NEW SOUTH WALES



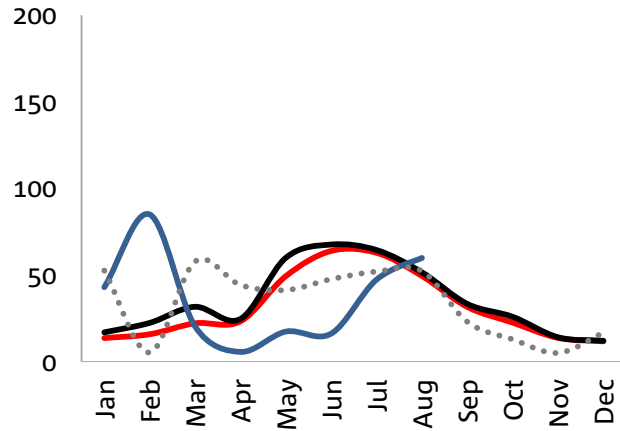
VICTORIA



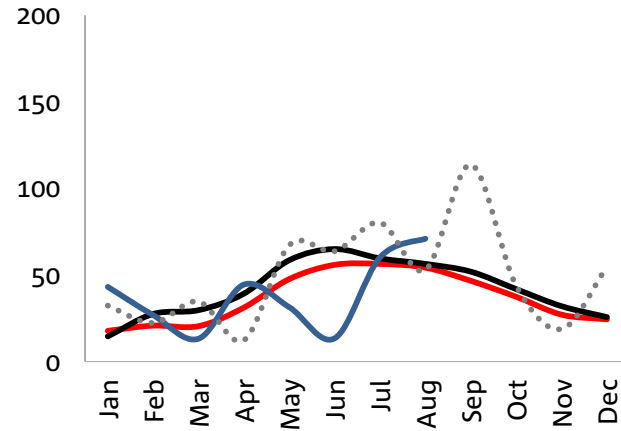
QUEENSLAND



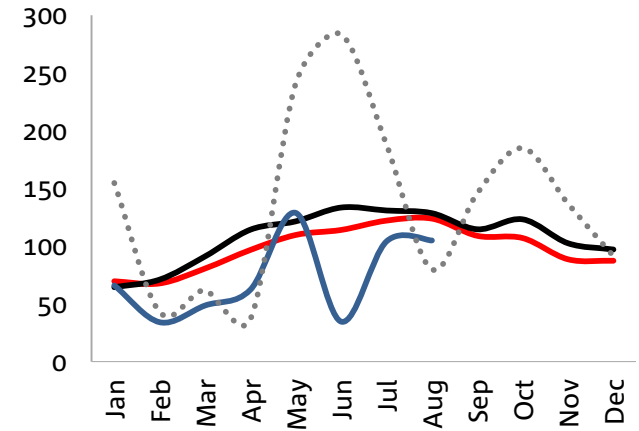
WESTERN AUSTRALIA



SOUTH AUSTRALIA



TASMANIA

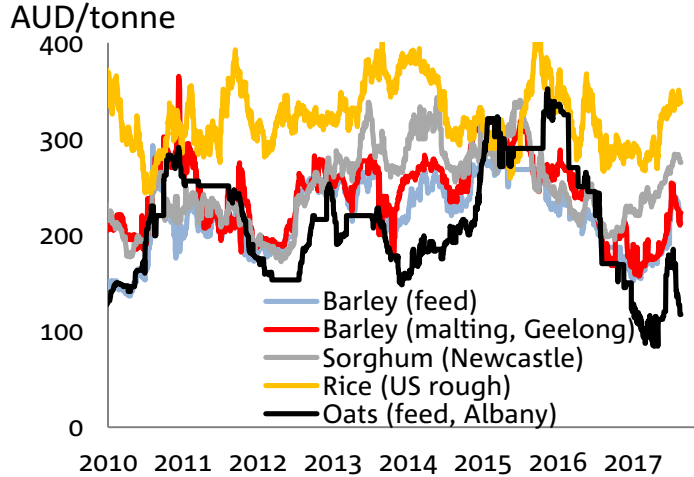


Source: Bureau of Meteorology and NAB Group Economics

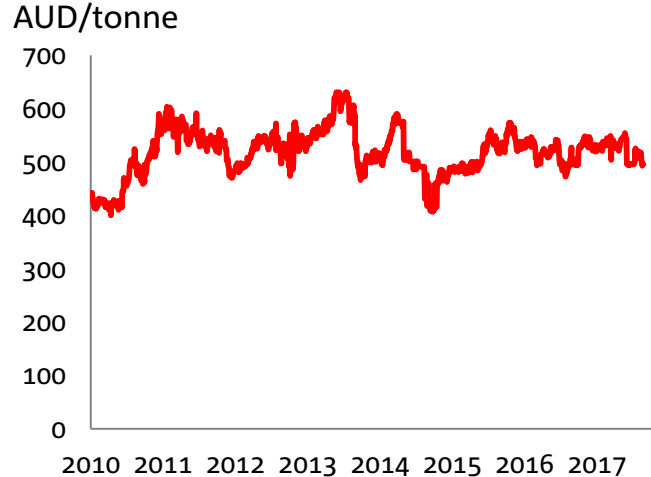
OTHER BROADACRE CROPS



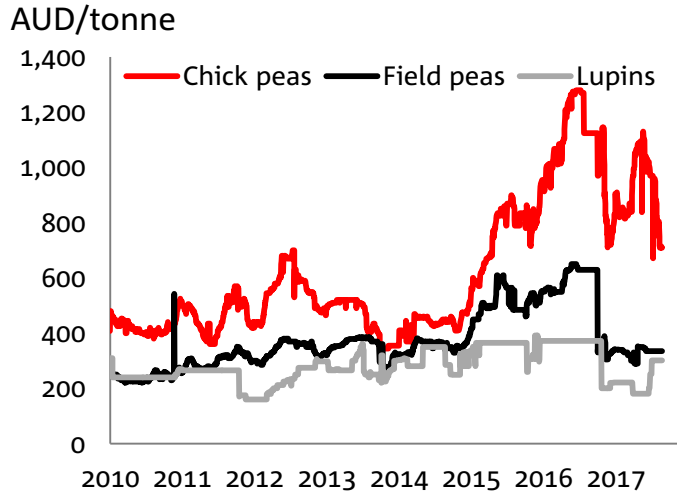
SELECTED COARSE GRAINS



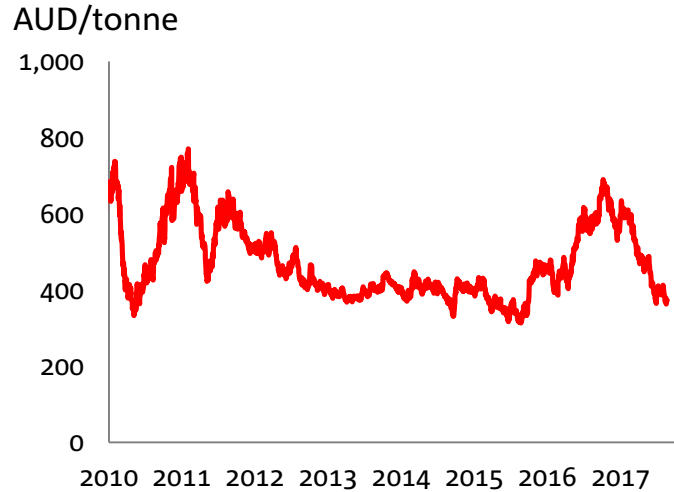
CANOLA, NEWCASTLE NSW



SELECTED PULSES



ICE NO.11 SUGAR



Prices for most coarse grains mostly saw a big jump (reflecting wheat) followed by a steady retreat. Rice and sorghum (with their different production systems – rice being irrigated and sorghum a summer crop) have both remained higher however. Canola remains a stand-out, with prices holding up much better, although obtaining seed was a major challenge for planting and anecdotal evidence points to late flowering, frost damage and patchy yields across many areas.

Chick pea prices are back in the mid-700s range in AUD terms, a drop from the \$1,200/tonne peaks of last year but still a substantial premium compared to alternative crops. Most of Australia's chick peas are grown in northern New South Wales and Queensland and have suffered from generally poor seasonal conditions, including low rainfall and late frosts. We expect yields to be well down on last year.

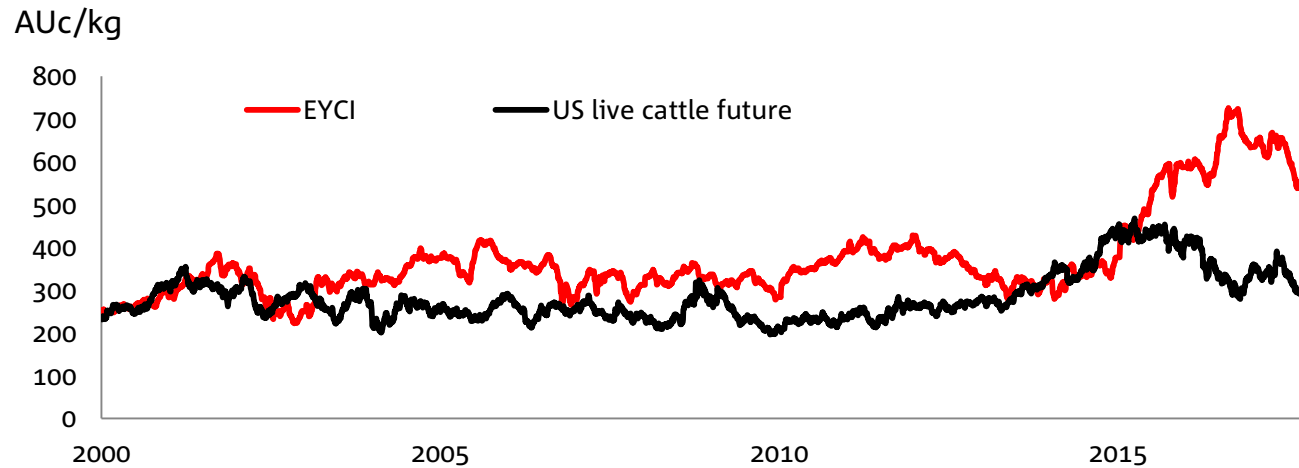
Sugar prices had shown some tentative signs of stabilisation after a big tumble this year which wiped off all of the previous rally and fell close to 2015 lows in AUD terms. However prices fell 3.7% in AUD terms in August, not helped by the unexpected strength of the AUD.

Source: Bloomberg, Profarmer and NAB Group Economics

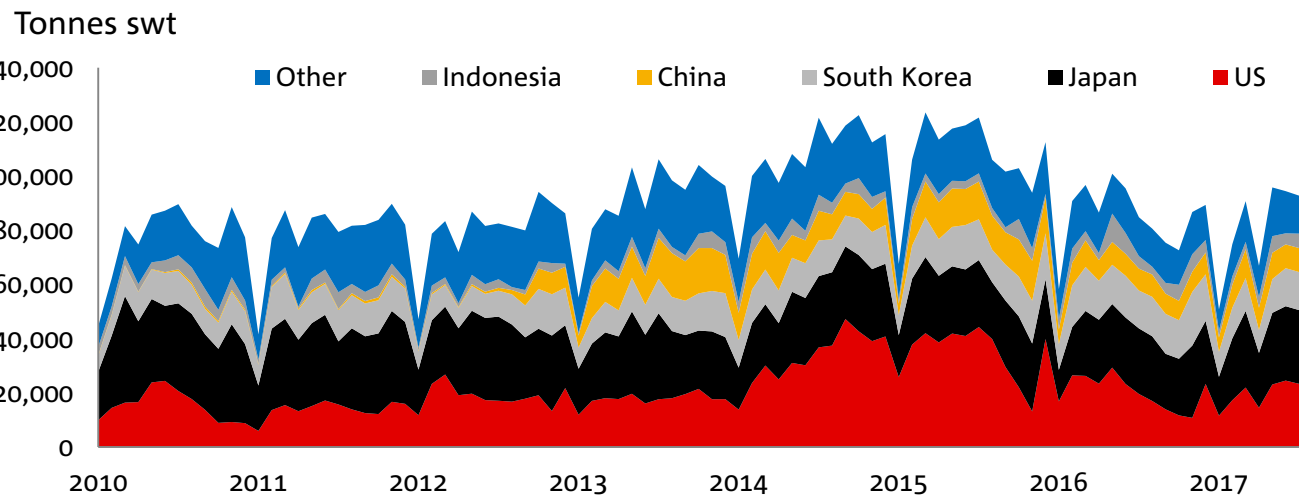




EASTERN YOUNG CATTLE INDICATOR AND US CATTLE FUTURES



MONTHLY AUSTRALIAN BEEF EXPORTS



Source: Meat and Livestock Australia and NAB Group Economics

The concerted downward run in young cattle prices, which began in early May when the EYCI was in the mid-600s, looks to have stalled for now in the mid-500s range. Dry weather continues to bite in Australia's biggest cattle state Queensland as well as New South Wales. Furthermore, beef export prices to the key US market have drifted lower over the past three months (although with restocker interest the key driver of domestic prices over the last year, Australian prices had not followed US cattle futures for some time). The EYCI is now below its level at the same time in 2015.

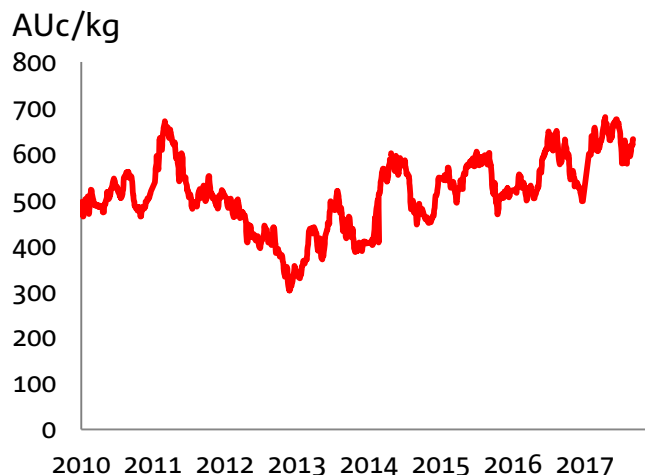
Beef export data reflects the uptick in slaughter in Queensland in particular, with Australian beef export volumes up 22% year on year in August. With winter dryness potentially persisting into spring, it is likely that there will be further turnoff and increased pressure on saleyard prices. Elevated feed prices had been a concern for some producers, although the retreat of the global grain market has eased much of this pressure.

We see the EYCI falling to 500c/kg either late this year or early next. While this represents a sharp fall, prices should remain well above pre-boom levels.

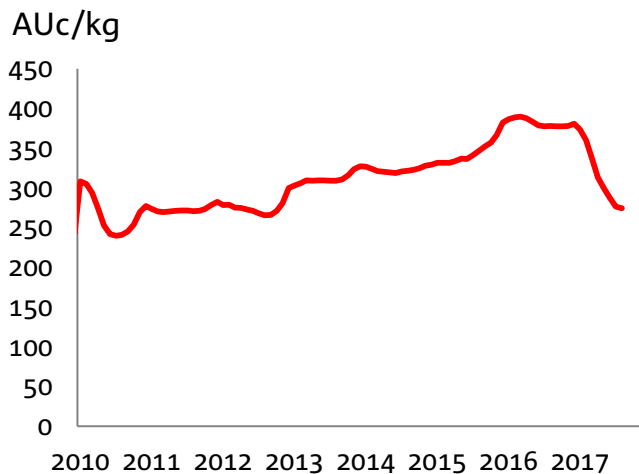
LAMB, PORK AND POULTRY



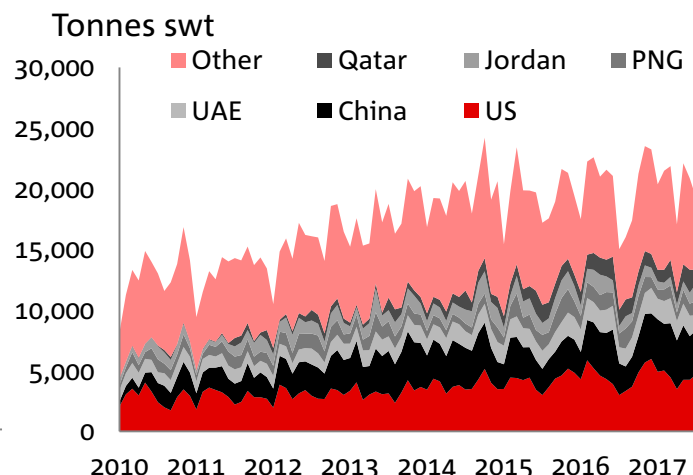
NATIONAL TRADE LAMB INDICATOR



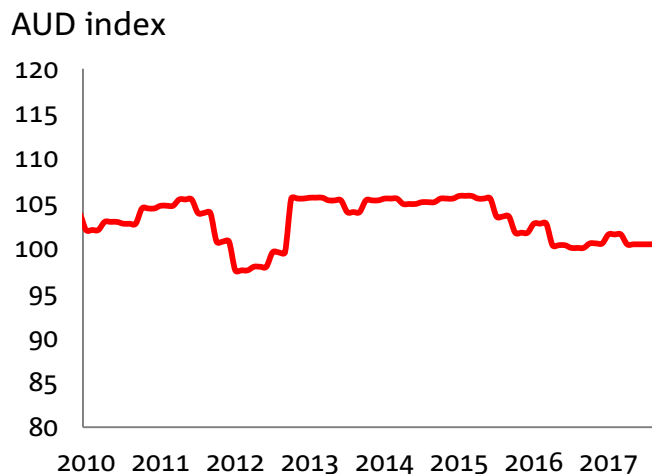
AUSTRALIAN PORK PRICE INDICATOR



MONTHLY LAMB EXPORTS BY DESTINATION



ABS POULTRY PRICE INDEX



Lamb prices felt the pressure of a dry start to winter but have bounced back in the last month, likely reflecting the improved seasonal conditions in key southern lamb regions. The National Trade Lamb Indicator gained 1.6% in August, one of the few commodities in our index to appreciate. While price falls are likely in line with the usual spring flush, the trajectory for the industry remains positive.

Export markets for lamb are reasonably diversified, with the US and China accounting for a substantial volume (around 41% by weight 2017 YTD). This compares to almost 54% for the top two markets for Australian beef. The Middle East also remains a very important market, particularly for mutton and live sheep.

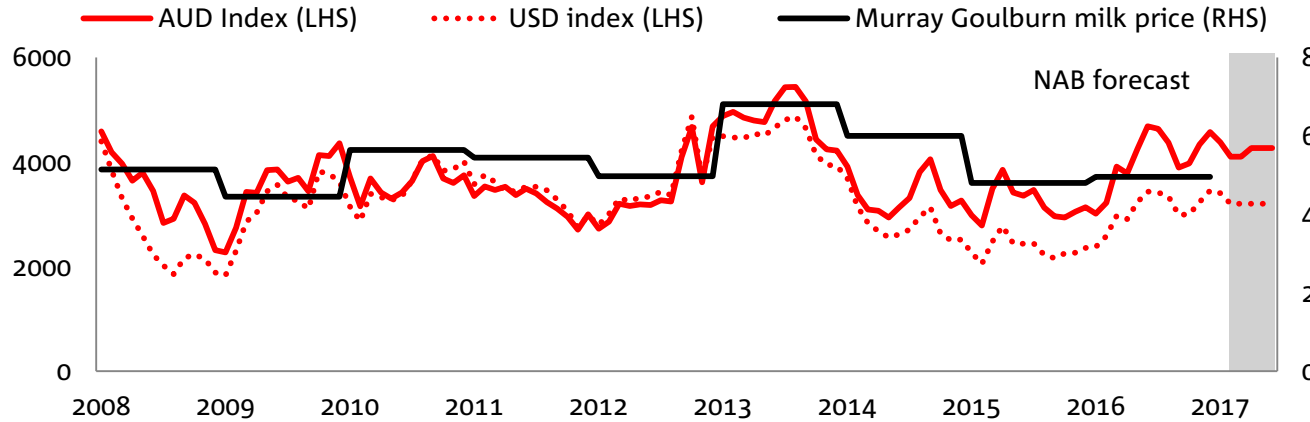
The severe drop in Australian pork prices looks to have stalled, with prices (measured as an average of buyer and seller prices for eastern seaboard 60.1-75kg animals) down only 0.7% in August. Nonetheless, pork is off more than 27% year on year. Competition from cheap imports (particularly with the AUD having risen) will remain a key challenge for the industry over the coming year.

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)

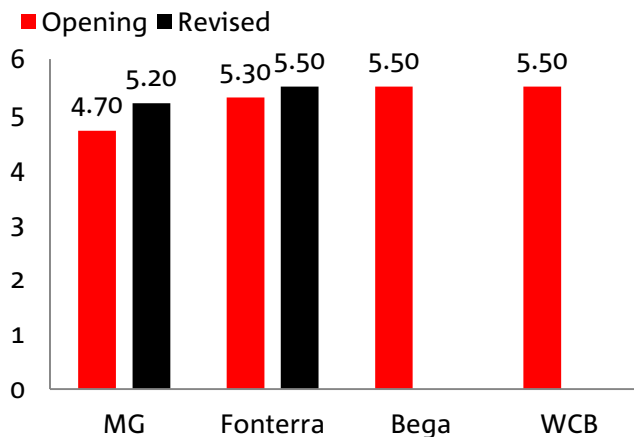


Global Dairy Trade auction results in August were again lower (despite expectations of flat to increasing prices) and the NAB weighted dairy export price indicator fell 3.8% for the month in AUD terms.

While recent auctions have perhaps underperformed, the move in farmgate prices for the 2017-18 season has been much more closely watched domestically. Murray Goulburn opened at \$4.70/kgms, well below Bega and Warrnambool Cheese and Butter (both on \$5.50/kgms) and Fonterra (\$5.30/kgms). Seeking to maintain milk flow, Murray Goulburn revised its opening price substantially higher to \$5.20/kgms. Fonterra has now announced a step-up to \$5.50/kgms, leaving Murray Goulburn again somewhat off the pace.

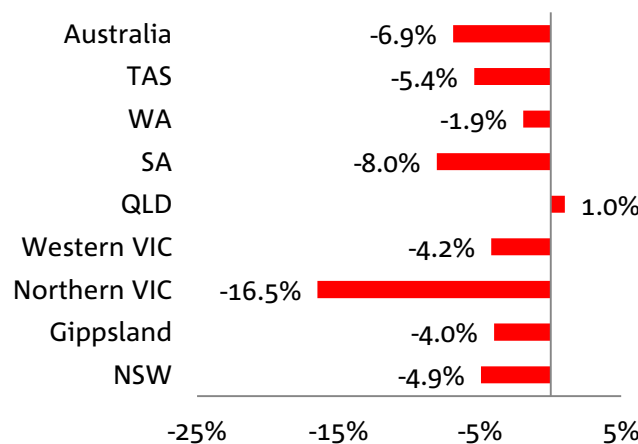
FARMGATE PRICES

2017-18 season



SEASONAL MILK PRODUCTION CHANGE

2015-16 to 2016-17



Milk flow last season was well down – off 6.9% nationally. The worst falls were in the major export states of Victoria, South Australia and Tasmania. Northern Victoria saw particularly steep declines, reflecting poor prices combined with a very wet 2016 spring. This season, seasonal conditions are looking much better across northern and western Victoria and South Australia, although very dry conditions in Gippsland are a concern.

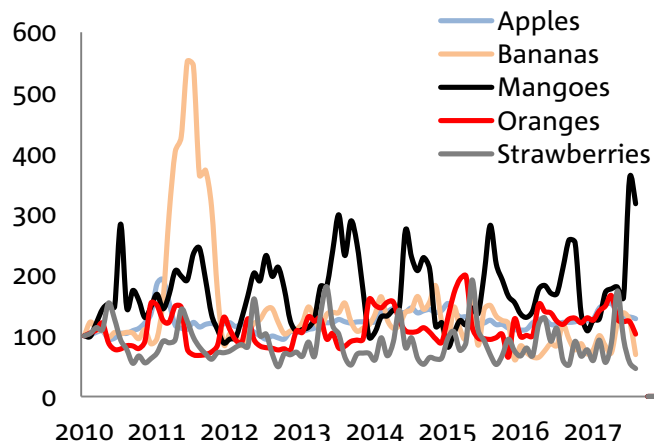
Source: Australian Bureau of Statistics, Global Dairy Trade, Dairy Australia, processors, ABC and NAB Group Economics
 Note: chart shows Murray Goulburn farmgate prices except 2008-09 which shows Dairy Australia's reported Victorian average value





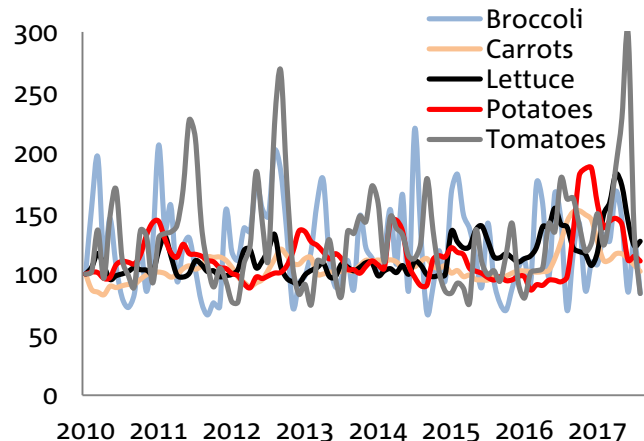
WHOLESALE FRUIT PRICES

AUD index, Sydney and Melbourne



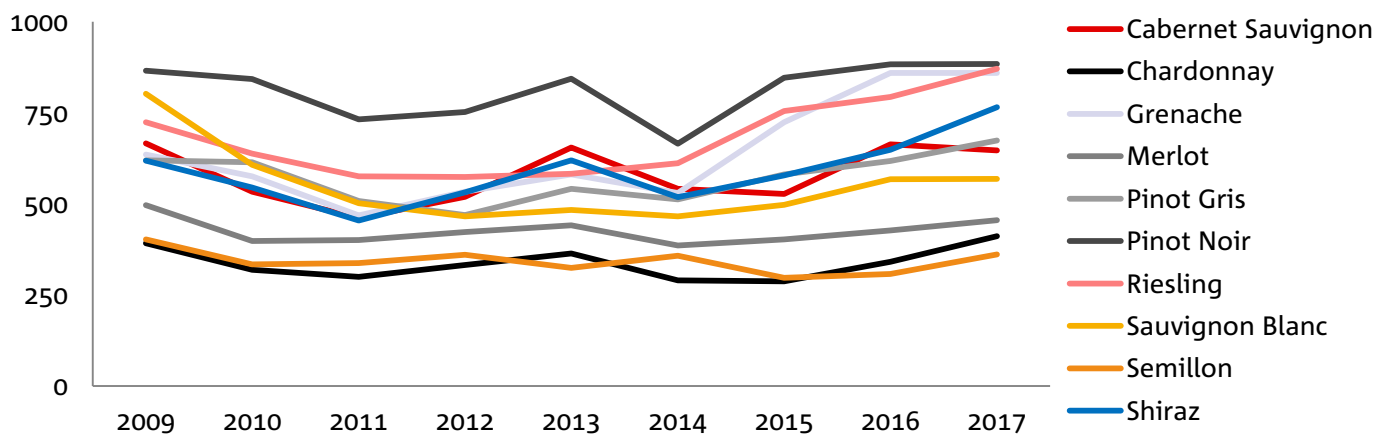
WHOLESALE VEGETABLE PRICES

AUD index, Sydney and Melbourne



WINE AUSTRALIA 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 again displayed characteristic volatility in August, although both were lower. Fruit was down 17.6%, largely reflecting seasonal factors, including lower orange and strawberry prices. In August the index stood at 132.4 index points (January 2010 = 100). Vegetables again fell sharply, down 14.7% to 104.3 index points. This drop reflects the end of an extraordinary rally in tomato prices brought on partly by the effects of Cyclone Debbie this year.

Wine Australia's 2017 National Vintage Report shows prices rose once again this year, with the average of all wine grapes up 7% on a volume weighted basis. An AUD at more sustainable levels in 2016 likely explains some of the increase, although the higher currency more recently is some concern. Overall the industry looks to be on a more sustainable footing following years of glut and poor export conditions. Among the best performers were Riesling (up 13%), Shiraz (up 12%), and Pinot Gris (up 9%).





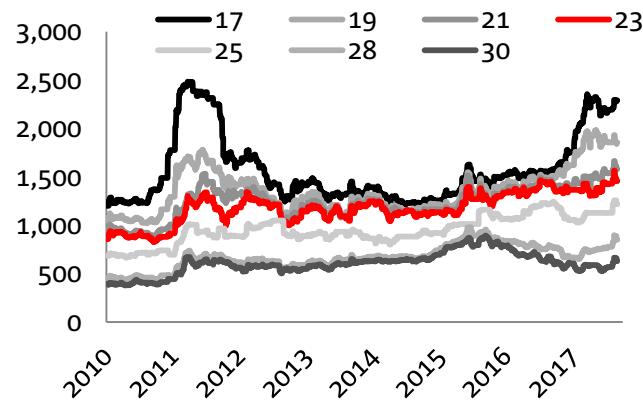
WOOL – EASTERN MARKET INDICATOR

AUc/kg



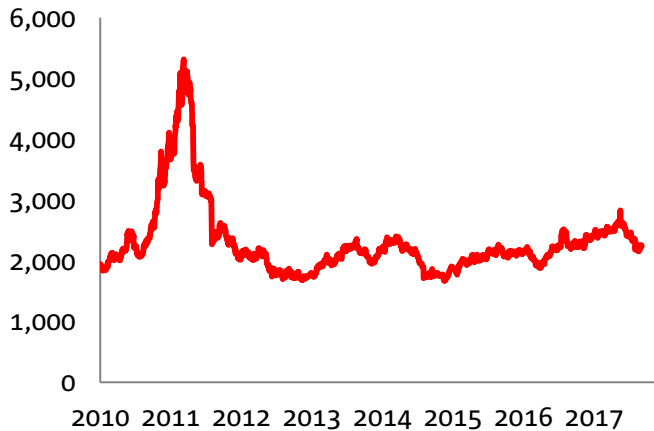
WOOL PRICES BY MICRON

Southern Region



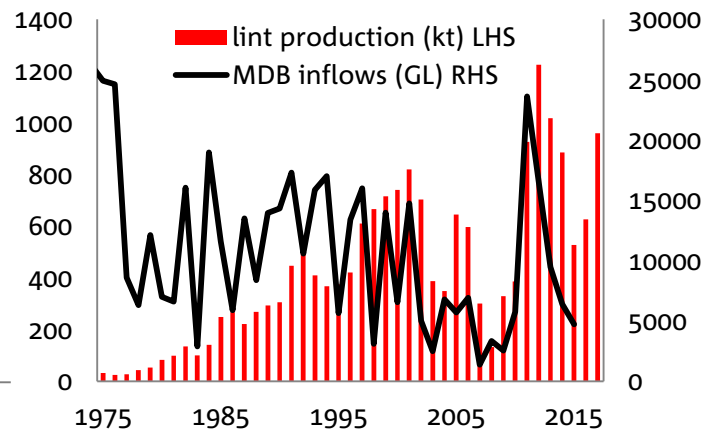
COTLOOK A INDEX

AUD/tonne



AUSTRALIAN COTTON AND BASIN INFLOW

Production and MDB system inflows



The wool market roared back from the winter recess with gains across the micron range and the EMI topping 1600c/kg. This comes despite the sharp rally in the Australian dollar, to which the wool industry is usually very sensitive. With yet another rally in the market, the question is whether prices are sustainable at their current levels. While we see good signs in the form of very strong Chinese demand, the rally across the board (rather than at the premium end) gives us some pause. It is likely that prices will come back from their peak over coming months.

The Eastern Market Indicator rose 2.5% in August. With prices at these levels, ABARES projects that wool production will increase in the coming year, arresting (at least temporarily) a long decline in production.

Cotton prices fell 7.1% in AUD terms in August. While the Australian cotton industry has expanded rapidly over the past three decades, it remains dependent on irrigation water, with around three-quarters of Australian cotton acreage irrigated. With low northern basin inflows amid dry conditions, there is an emerging risk to production for the coming season.

Source: Bloomberg, ABARES, Murray Darling Basin Authority and NAB Group Economics

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