

RURAL COMMODITIES WRAP

NOVEMBER 2017



KEY POINTS

The NAB Rural Commodities Index rose 2.1% in October, its first monthly gain since May. This improvement largely reflects strengthening cattle prices in response to heavy rains across Queensland and New South Wales. On the other hand, domestic grain prices fell, reflecting global fundamentals and the expectation of a better sorghum crop reducing the demand for domestic stock feed. Domestic grain remains at a premium, although we expect this to dissipate somewhat in the new year. This month we have held our wheat production forecast at 18.7 million tonnes – the lowest in a decade.

The outlook for the new year is reasonably upbeat, although cattle prices remain in our view unsustainable. The latest outlook from the Bureau of Meteorology points to average rainfall for the continent for the rest of 2017, although much of central and northern Australia is forecast to be dry. Recent rains in Queensland and New South Wales are certainly very welcome. While the Australian dollar remains higher than most agricultural producers would like, recent pressure has been downward and we see the currency falling to 75 US cents at the end of this year and spending most of next year around the 73-74 US cent mark.

PRICE UPDATE



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The NAB Rural Commodities Index gained 2.1% in October, the first increase since May this year. The major driver of the rise was cattle, which saw prices roar back to life in line with good rains in Queensland and New South Wales. Lamb also performed well, as did fruit and vegetables.

The Australian dollar has receded somewhat from its recent highs, although remains at an uncomfortable level for many agricultural producers.

MONTHLY PRICE CHANGES

AUD prices

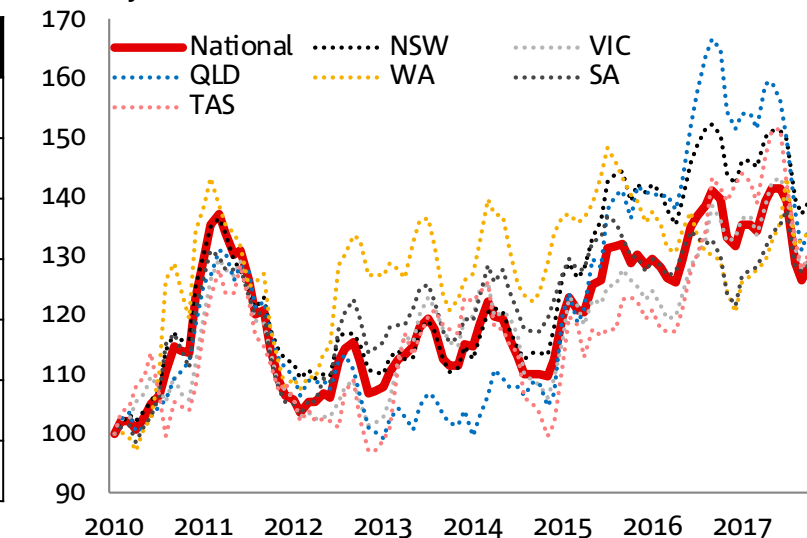
	Aug.	Sept.	Oct.
Wheat	▼ 13.0%	▲ 6.4%	▼ 1.8%
Beef	▼ 7.3%	▼ 5.3%	▲ 4.0%
Dairy	▼ 3.8%	▲ 0.2%	▲ 0.3%
Lamb	▲ 1.6%	▼ 0.8%	▲ 1.4%
Wool	▲ 2.5%	▼ 1.5%	▲ 1.5%
Sugar	▼ 3.7%	▲ 0.1%	▲ 4.7%
Cotton	▼ 7.1%	▲ 0.8%	▼ 0.2%

On a state basis, cattle-heavy Queensland was the best performer in Australia, rising 3.2%. New South Wales was up 1.9%. Victoria and Tasmania gained 2.1% and 2.6% respectively, while grain dependent Western Australia was the worst performer in line with lower grain prices, but still rose 0.9%. South Australia was moderately higher, posting a gain of 1.4%.

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

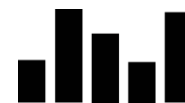
NAB RURAL COMMODITIES INDEX

January 2010 = 100



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

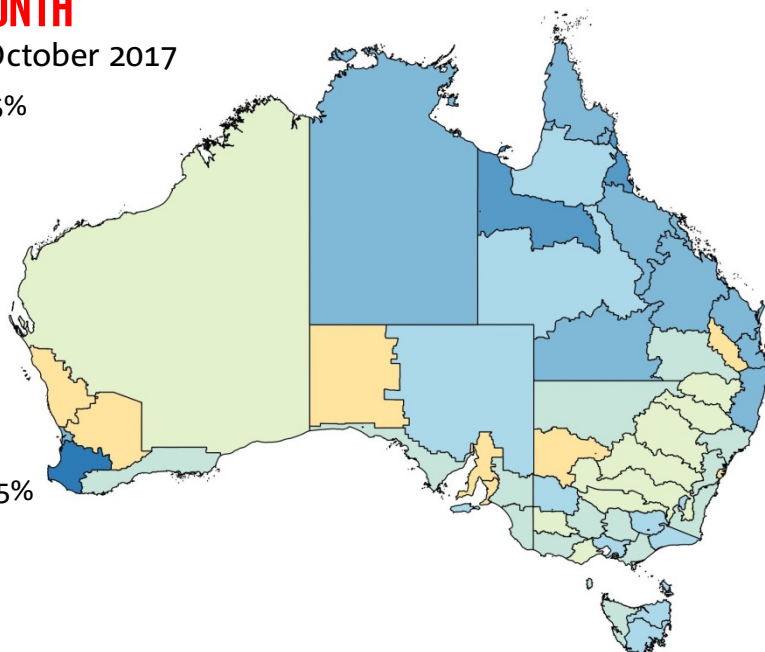
REGIONAL PRICE INDICATORS



MONTH ON MONTH

September to October 2017

- more than 5%
- 4-5%
- 3-4%
- 2-3%
- 1-2%
- 0-1%
- no data
- + 0-1%
- + 1-2%
- + 2-3%
- + 3-4%
- + 4-5%
- + more than 5%



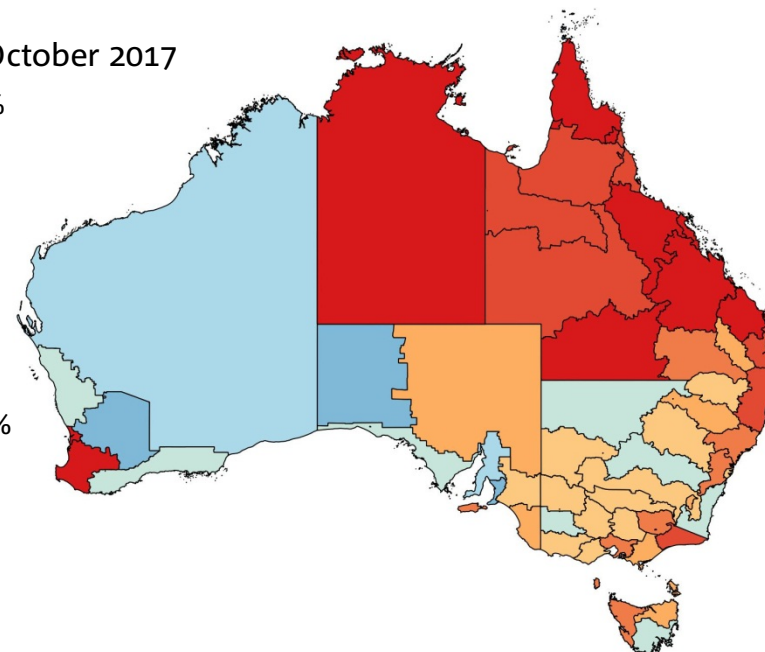
Monthly regional price indicator data shows a more positive picture for October, with most regions recording price gains. This largely reflects strength in cattle (and to a lesser degree sheep) prices over October. Some grain growing regions have seen moderately lower prices over the month.

On a year on year basis, the best performing regions are still those with a cropping focus, particularly in Western Australia and South Australia. On the other hand, cattle country across Queensland and the Northern Territory has struggled with falling cattle prices for most of the year, although this picture will change if cattle prices continue their resurgence.

YEAR ON YEAR

October 2016 to October 2017

- more than 20%
- 15-20%
- 10-15%
- 5-10%
- 0-5%
- no data
- + 0-5%
- + 5-10%
- + 10-15%
- + 15-20%
- + more than 20%



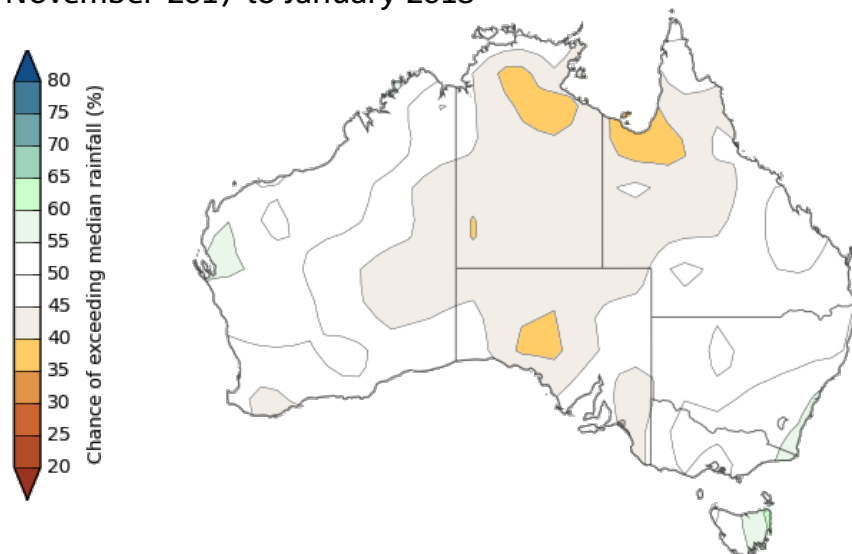
NAB's regional price indicators are in effect a set of separate NAB Rural Commodities Index for every region in Australia. The product is still in a trial stage and is calculated on a different basis to our national and regional data, without annual chain-weighting. We will continue to develop this series throughout 2018, making further improvements where possible.

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

November 2017 to January 2018

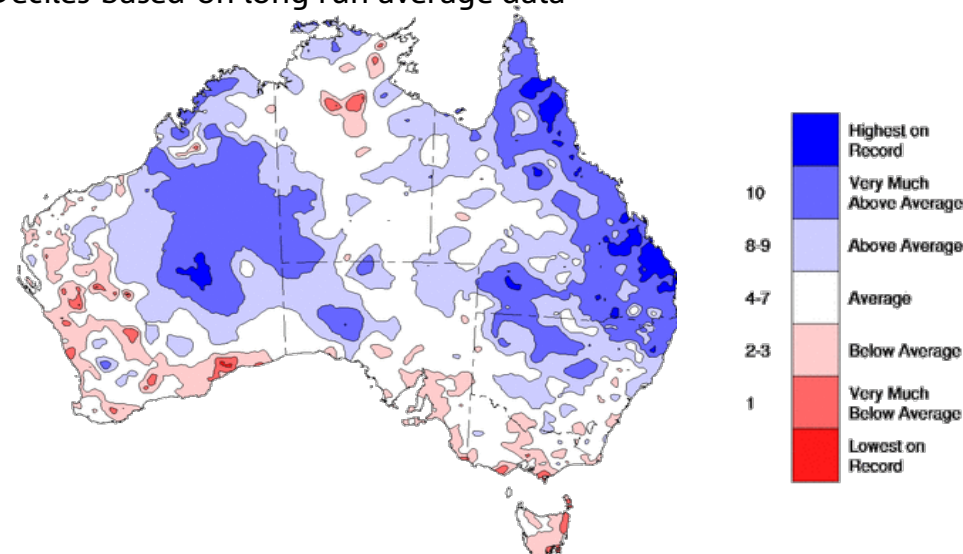


The Bureau of Meteorology's latest three month climate outlook to January 2018 points to neutral conditions for much of the continent, although large areas of Central Australia, Cape York and the top end are forecast to see below average rainfall in the crucial wet season.

A small area of southern New South Wales, far eastern Victoria and eastern Tasmania are expected to see above average rain. Nonetheless, this is less promising forecast than the previous iteration, which had been pointing to average to above average rain across Australia.

RAINFALL DECILES – OCTOBER

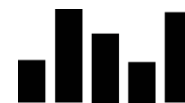
Deciles based on long run average data



October rainfall was generally average to below average in the south, but well above average in most of the north. Northern New South Wales and most of Queensland enjoyed well above rainfall – a welcome change from the extremely dry conditions they had seen throughout the year.

Seasonal conditions overall remain weakest in New South Wales. Much of the state has experienced severe rainfall deficiencies. While Western Australia started the year with very tough conditions, later season rains have been an improvement.

OUTLOOK FOR PRICES AND PRODUCTION



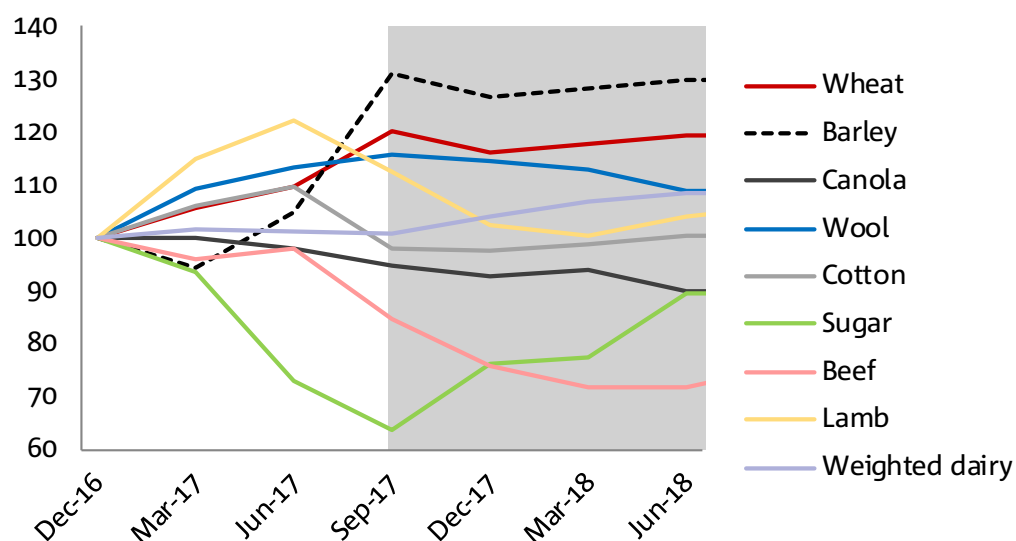
Prices

Weather has been a major driver of local prices and we expect this to continue. Drier weather saw cattle prices slide but rain in the last month has seen a dramatic turnaround. Still, we expect risks to cattle to continue to be on the downside after an extraordinarily good run. Domestic grain prices are at a premium as domestic suppliers scramble to source sufficient grain, although we expect this to retreat amid global realities and better sorghum prospects..

As always, the dollar will be a major driver. The AUD is off its recent highs but remains at an uncomfortable level for many producers. We see the AUD at 75 cents at the end of 2017 and 73 cents for much of next year.

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

The season has extremely challenging in some areas, but closer to average in others. New South Wales in particular has suffered very badly from below average rain, with wheat yields well down. We have kept our wheat forecast at 18.7 million tonnes, as October rainfall in New South Wales was arguably too late to boost yields.

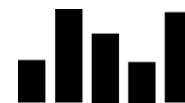
Conversely, dry conditions had kept slaughter at elevated levels, but the recent tightening in the market (bringing higher prices) likely presages some pullback.. ABARES forecasts point to beef production rising 8.5% in 2017-18.

PRODUCTION OUTLOOK (ABARES SEPT 2017 EXCEPT WHEAT)

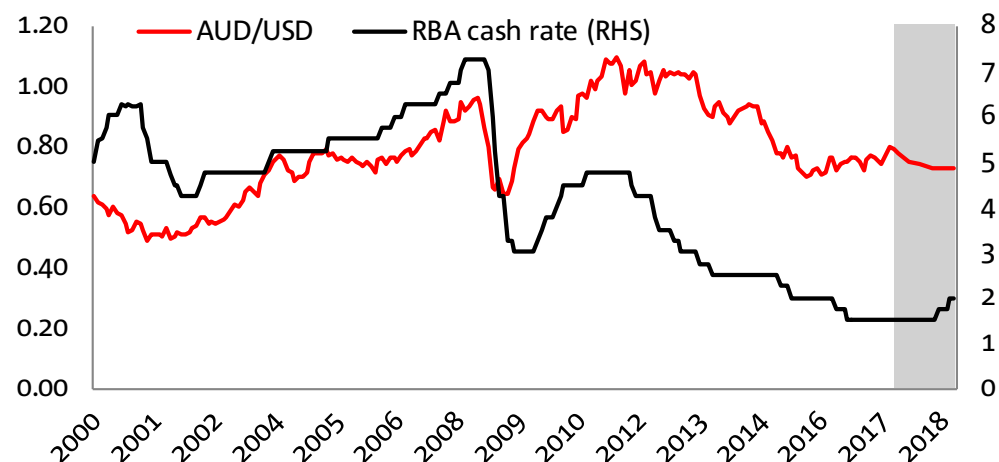
Financial year production estimates, Australia

	2016-17	2017-18	% change
Wheat (million tonnes)	35.0	18.7	▼ 46.6%
Beef (kt)	2,069	2,244	▲ 8.5%
Dairy (milk, ML)	9,015	9,250	▲ 2.6%
Lamb and mutton (kt)	670	673	▲ 0.5%
Wool	414	428	▲ 3.4%
Sugar (kt)	4,804	4,800	▼ 0.1%
Cotton (lint, kt)	935	956	▲ 2.2%

EXCHANGE RATES AND INTEREST RATES



EXCHANGE AND INTEREST RATES INC. QUARTERLY FORECASTS



NAB FX STRATEGY TARGETS

	2017Q4	2018Q1	2018Q2	2018Q3
AUD/USD	0.75	0.74	0.73	0.73
NZD/USD	0.70	0.69	0.69	0.70
USD/JPY	116	118	118	118
EUR/USD	1.17	1.18	1.20	1.22
USD/CNY	6.67	6.64	6.64	6.62
AUD TWI	64.1	63.4	62.3	62.1

Source: NAB

Rising US rates across the yield spectrum have been a key driver of the overall US dollar uptrend in recent weeks. Alongside, lower Australian rates at the shorter end of the yield curve, in particular following the soft Q3 CPI data which has left the local money market less sure about a first RBA tightening as early as Q3 2018, has compounded the negative impact on AUD/USD. At the same time, buoyant global risk appetite has been supportive as equity markets go from strength to strength, credit spreads continue to compress and Emerging Markets have held their poise. The VIX as a short-hand risk-appetite proxy languishes near 10 versus its long term average closer to 20.

The upshot is that the AUD has been falling further and faster than our short term valuation estimates suggest is justified. Yet the latest move hasn't been enough to leave the AUD looking particularly undervalued, or indeed beyond what a valuation methodology using real bond yield differentials would suggest. Now that we have breached key technical support levels near 0.77, coinciding with a drop below the 200-day moving average, re-establishment of positive USD momentum alone should be sufficient to see losses extend.

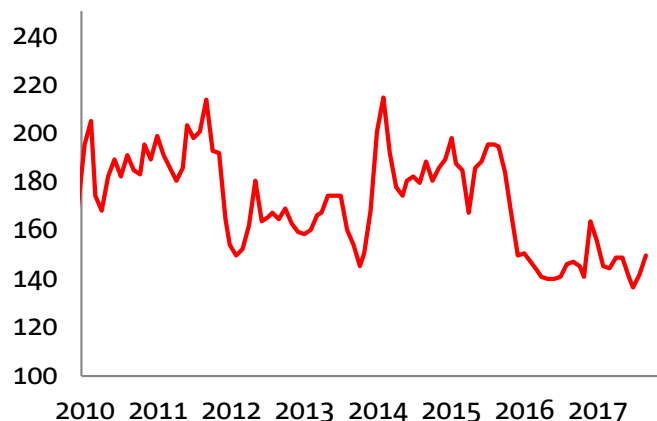
On balance, we remain comfortable with our view that the easing cycle for monetary policy has come to an end, but that tightening won't commence until mid-2018. Our forecasts published two months ago, for 2 sets of 25bp increases to the RBA's cash rate in August and November 2018, remain intact. Two further hikes also anticipated for 2019. This would take the cash rate back to 2.5%, a level well below the RBA's current estimate of "neutral" (3.5% nominal, 1% real), suggesting monetary policy will remain stimulatory at that point.

FARM INPUT PRICES



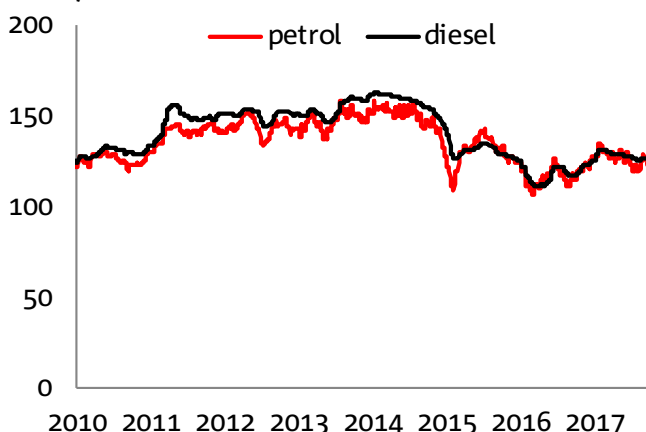
NAB FERTILISER INDEX

AUD index



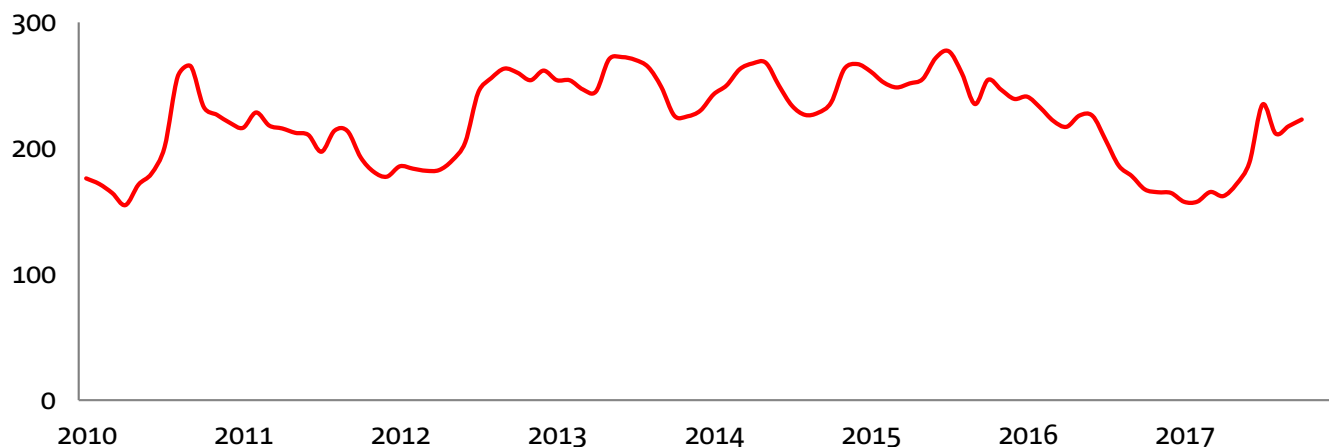
NATIONAL AVERAGE FUEL PRICES

AUc/litre



NAB WEIGHTED FEED GRAIN PRICE INDEX

AUD/tonne



Source: Bloomberg, Profarmer and NAB Group Economics

Feed prices rose 2.4% in October, amid limited supply of old season crop for stock feed. With most old season crop now gone, demand for stock feed has been elevated. While feed is available, much is in the south and transport costs will add a premium further north. Feed wheat remains at a premium in northern New South Wales and Queensland.

We expect little upturn in grain global prices over the coming months and while there may be shortage of feed grain in the domestic market, good planting conditions for sorghum and better than expected pasture prospects has alleviated some of this pressure. Nonetheless, domestic grain is likely to remain at a premium for the rest of 2017.

Fertiliser prices were up 1.9% in October, with higher urea prices and a lower AUD the major drivers.

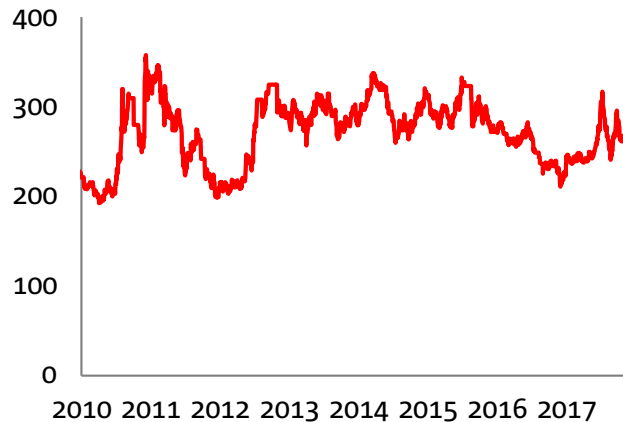
Higher fuel prices, combined with our expectations for a lower Australian dollar, are likely to lead to higher fuel prices for Australian motorists. The September quarter saw petrol average 123.3AUc/l, but we see petrol in the December quarter around 3.9% higher at 128.1AUc/l. Our forecasts point to petrol being above 130AUc/l for most of 2018.

WHEAT



ASX MILLING WHEAT FUTURE

Eastern Australia, AUD/tonne



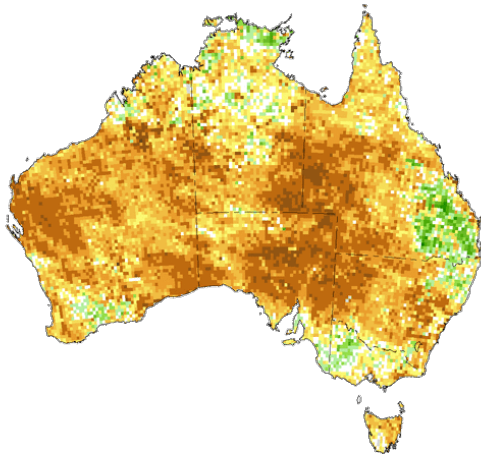
CBOT SOFT RED WINTER WHEAT

USD/tonne



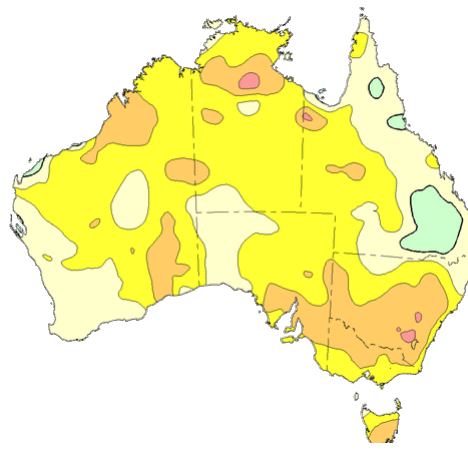
VEGETATION GREENNESS

NDVI anomaly October 2017



MAX TEMPERATURE ANOMALY

October, degrees c



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

Prices

Global grain prices remain moribund, with global growing conditions continuing to be very favourable indeed. Last month we noted concerns about inventory levels outside of China, but the reality is that it would still take a fair hit to global production to see a sustainable increase in global prices. We simply do not see these conditions currently. Domestic grain is trading at a premium amid a lack of supply, although this is likely to abate for export grain, which will need to meet the world market. Furthermore, rains across New South Wales and Queensland have boosted planting conditions for sorghum, potentially alleviating some of the stockfeed shortage.

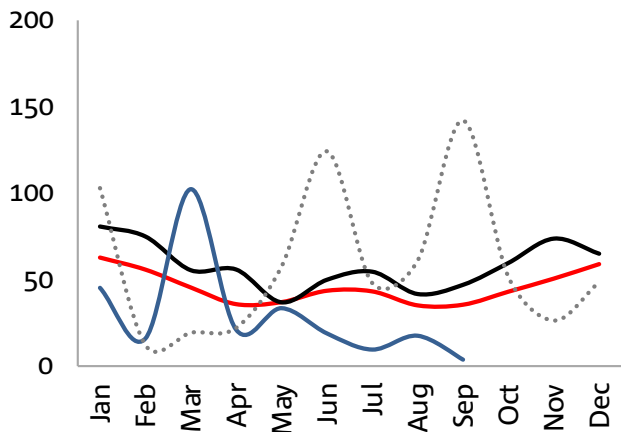
Production

While rains in Western Australia, and more recently Queensland, New South Wales and Victoria, have been a boost to prospects since September, overall the picture is very patchy and it is hard to see October rainfall making a big difference to yields in New South Wales. It is for this reason that we have kept our wheat production outlook at 18.7 million tonnes – the lowest wheat production in a decade. The biggest cuts have come from New South Wales, which has suffered from very low rainfall, frosts and heatwaves in just a few short months.

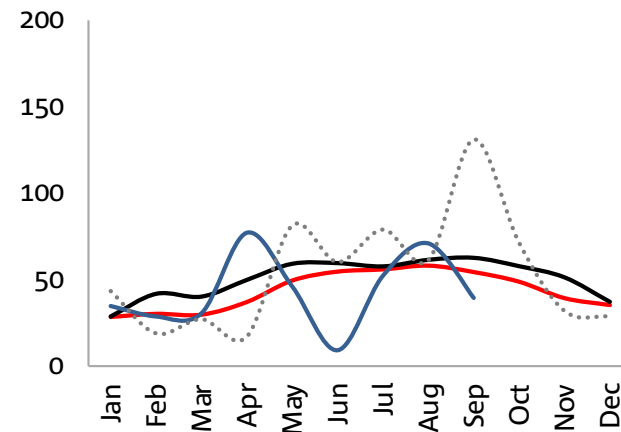
MONTHLY AVERAGE RAINFALL IN WHEAT REGIONS (MM)

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

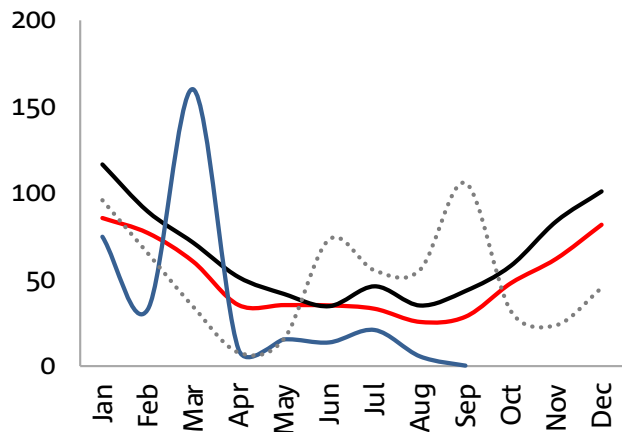
NEW SOUTH WALES



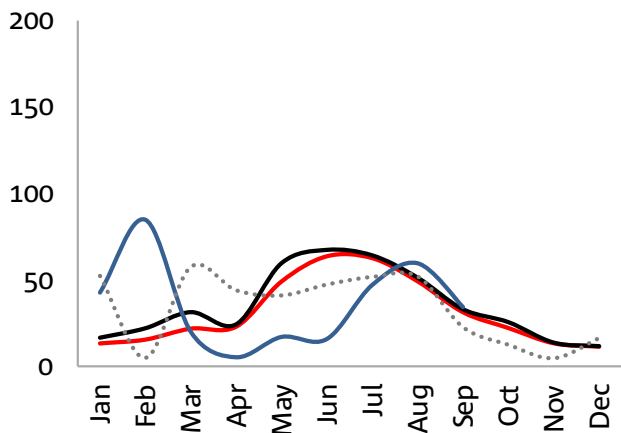
VICTORIA



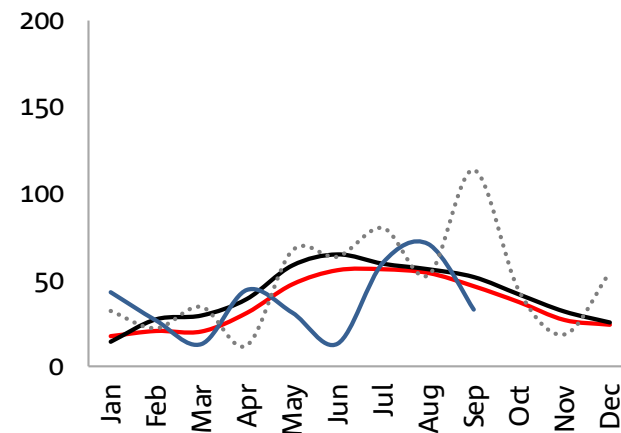
QUEENSLAND



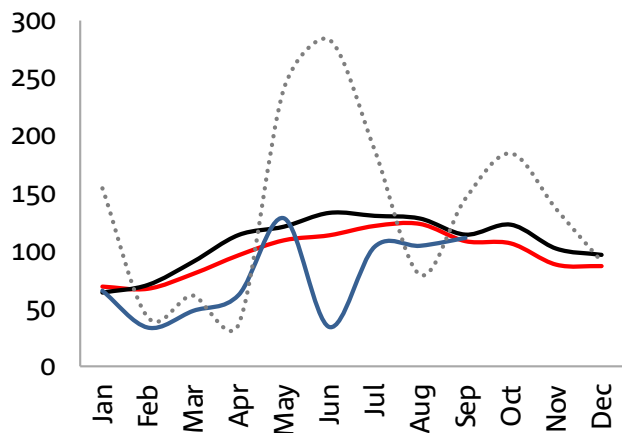
WESTERN AUSTRALIA



SOUTH AUSTRALIA



TASMANIA



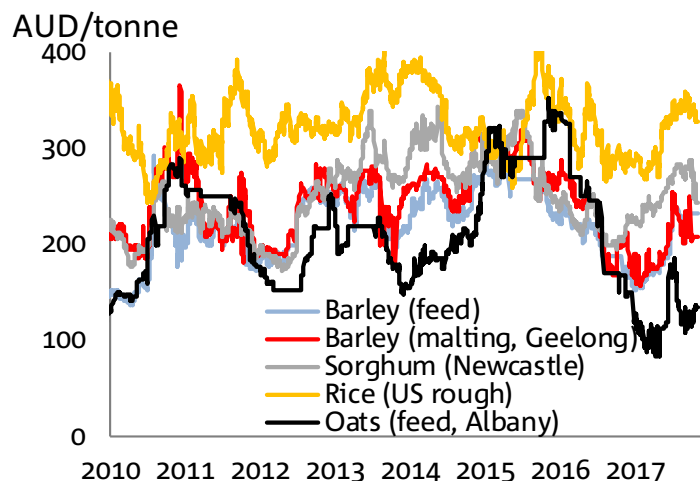
Source: Bureau of Meteorology and NAB Group Economics



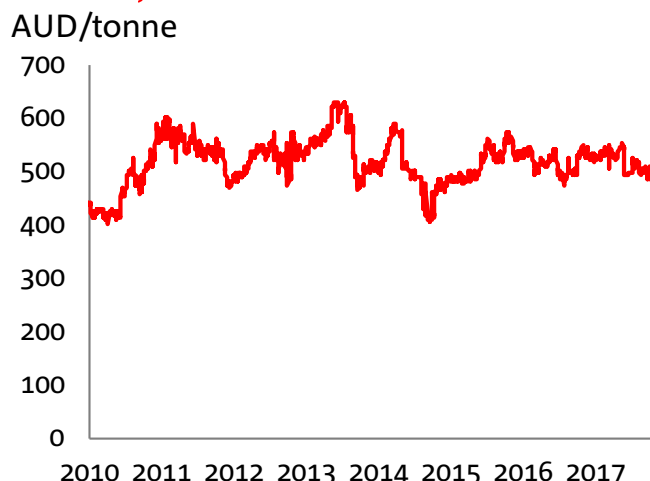
OTHER BROADACRE CROPS



SELECTED COARSE GRAINS

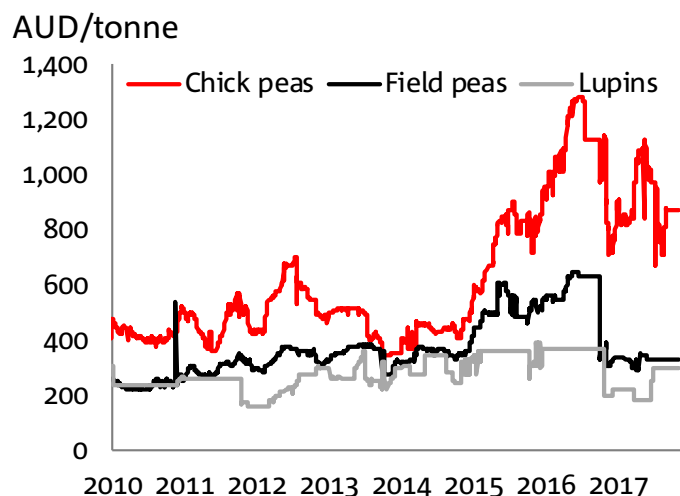


CANOLA, NEWCASTLE NSW

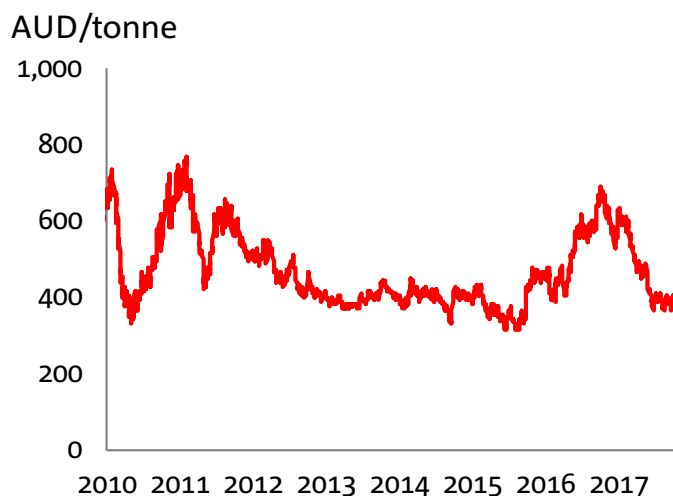


Prices for most coarse grains have fallen back recently. Sorghum has seen a big drop, likely because of rainfall raising expectations of a decent crop in New South Wales and Queensland this year. Rice looks to be relegated to second place in the New South Wales Riverina this season in favour of more profitable (and generally less water intensive) cotton. This trend is likely to continue with cotton so profitable and rice export markets generally so protected. Canola prices have trended downwards, although not drastically. Frost damage is likely to be above average in Australia this season.

SELECTED PULSES



ICE NO.11 SUGAR



The main pulse indicators we use for the Rural Commodities Index have not traded recently, although lentil prices are looking weak due to good supply from Canada and India. Indications are that the Australian lentil crop will be patchy this year.

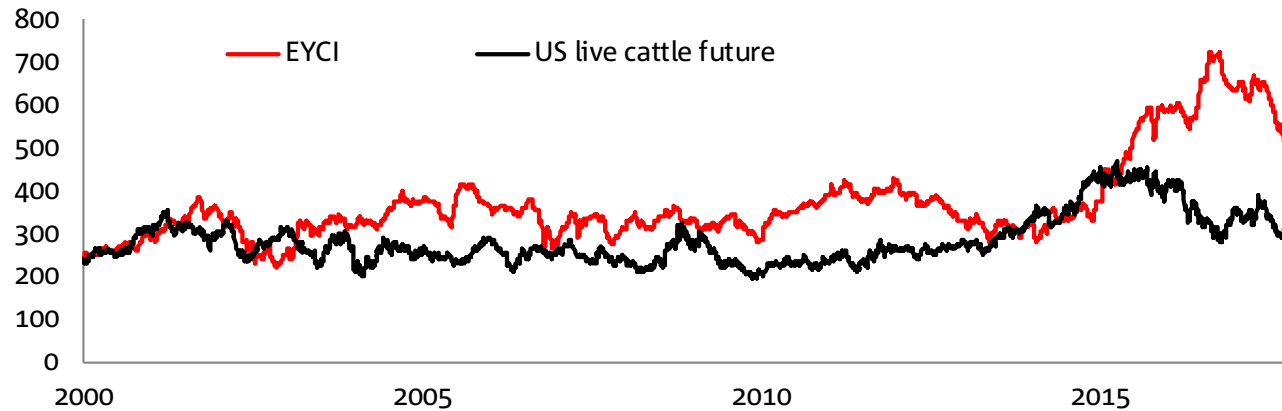
Sugar prices continue to show signs of stabilisation after a big tumble this year which wiped off all of the previous rally and fell close to 2015 lows in AUD terms. Prices were higher (up 4.7%) in AUD terms in October.

Source: Bloomberg, Profarmer and NAB Group Economics



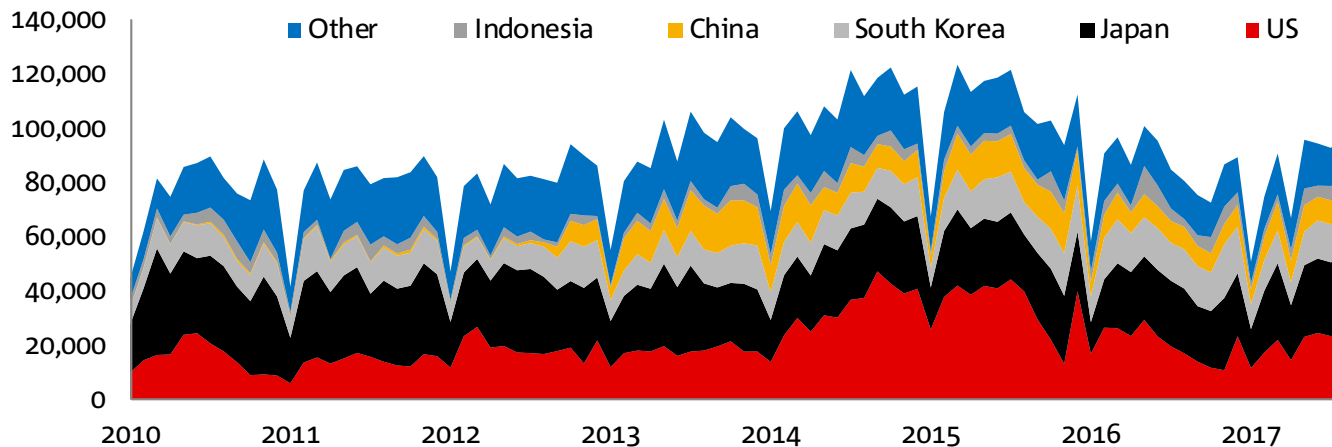
EASTERN YOUNG CATTLE INDICATOR AND US CATTLE FUTURES

AUc/kg



MONTHLY AUSTRALIAN BEEF EXPORTS

Tonnes swt



Source: Meat and Livestock Australia and NAB Group Economics

Cattle prices have roared back to life over the last month. After almost reaching the key 500c mark at the end of September, the EYCI is now over 575c/kg and still rising. This turnaround has been driven by very good rainfall causing grass fever in Queensland (Australia's biggest cattle producer) and New South Wales after months of abnormally dry conditions.

However, even if seasonal conditions remain strong – which is far from certain – key export markets remain a challenge. Export prices to the key US market have gained recently, although Australian prices still remain detached from US fundamentals in many ways. If Australia is to reflect the US market, the EYCI will likely need to fall further.

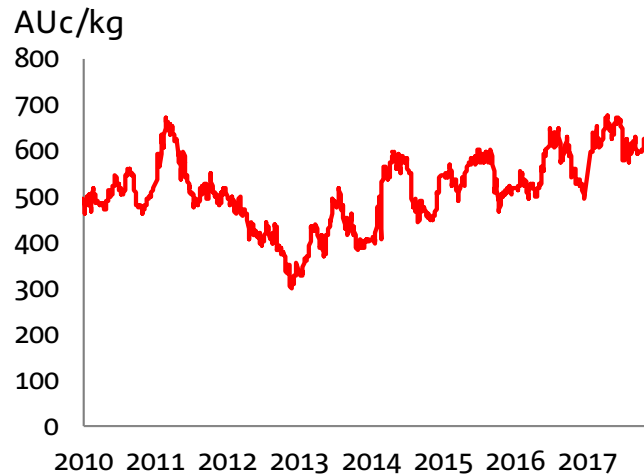
Beef export data reflects the uptick in slaughter in Queensland in particular this year. MLA and ABS data show adult cattle slaughter to be up 10% y/y in August. However, with conditions improving, we would expect to see some pullback over coming months.

We still see the EYCI at the 500 mark over the coming months, although a good season will challenge this. A price with a 4 in front of it remains a decent possibility in 2018.

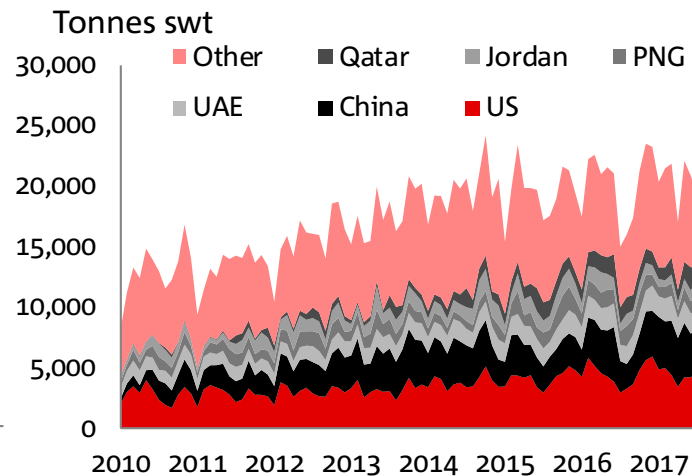
LAMB, PORK AND POULTRY



NATIONAL TRADE LAMB INDICATOR



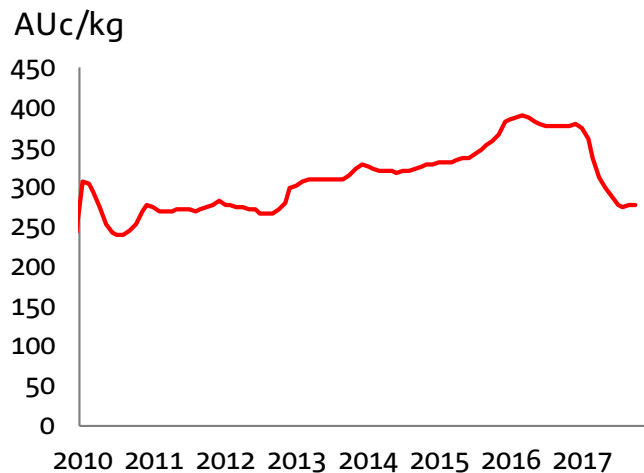
MONTHLY LAMB EXPORTS BY DESTINATION



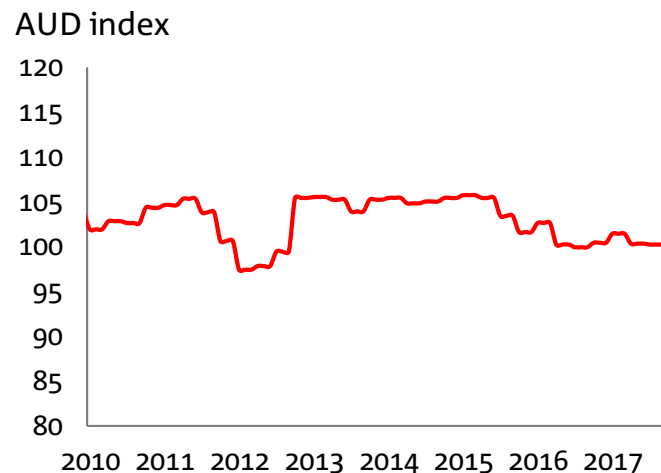
Lamb prices continue to display incredible resilience in the face of the usual spring flush. Normal seasonal factors would traditionally see lamb falling at this time of year, but instead, the MLA National Trade Lamb Indicator has been stable to higher. The NTLI remains well over 600 cents and is substantially higher than the same time last year. Ultimately we still expect to see a price drop for the spring flush, it may be smaller than we had previously expected.

Export markets for lamb are reasonably diversified, with the US and China accounting for a substantial volume (around 41% by weight 2017 YTD).

AUSTRALIAN PORK PRICE INDICATOR



ABS POULTRY PRICE INDEX



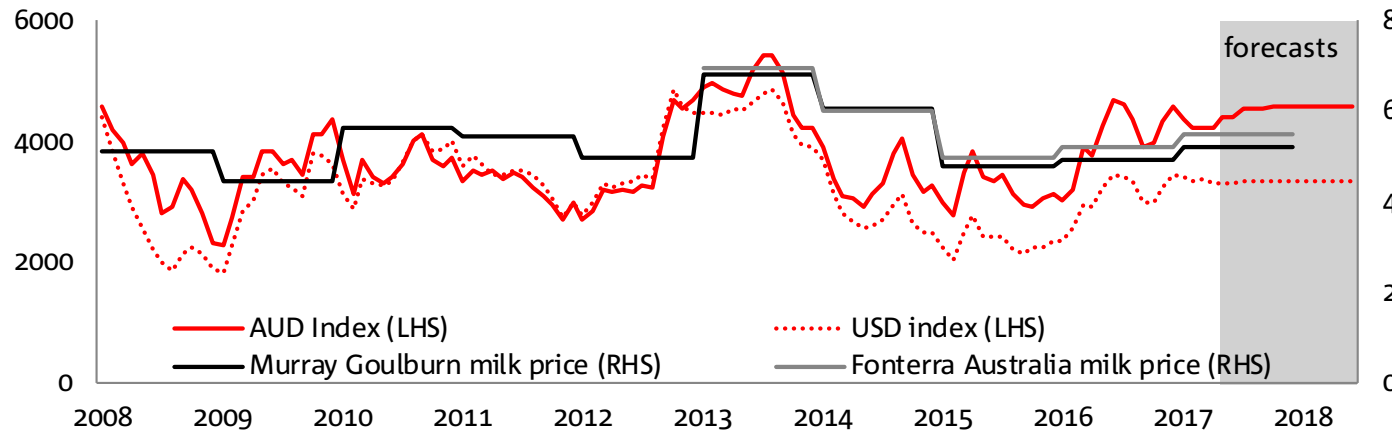
The severe drop in Australian pork prices looks to have stalled – our Australian pork price indicator (based on data provided by Australian Pork and based on an average of buyer and seller prices for eastern seaboard 60.1-75kg animals) was up 0.2% in October after gaining 1.0% in September (the first monthly rise since December 2016). Nonetheless, pork is still off more than 25% year on year. Competition from cheap imports will remain a major challenge for the industry.

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)

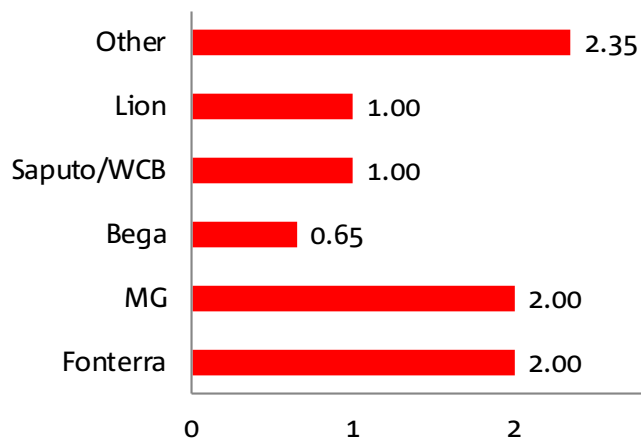


Global Dairy Trade auction results were lower in USD terms in October, with the 3 October auction recording a 2.4% drop and 17 October a 1.0% drop in USD terms. When weighted for Australia's exports and converted to AUD, the NAB weighted dairy export price indicator gained 0.3% in October. However, this was entirely down to currency movement – the NAB indicator was off 1.7% in USD terms.

The biggest news for the dairy sector remains the position of Murray Goulburn. It was recently announced that Murray Goulburn plans to sell its operating assets to Canadian-owned Saputo, subject to approval. Saputo already controls Warrnambool Cheese and Butter, which is expected to take in 1 billion litres of milk this season. Combined with Murray Goulburn's (much reduced) 2 billion litre intake, Saputo would become the largest dairy processor in Australia, ahead of Fonterra at 2 billion litres.

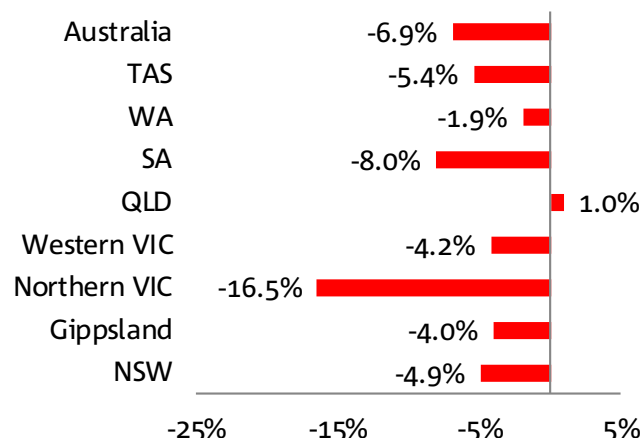
EXPECTED MILK INTAKE

Billion litres, 2017-18 season



SEASONAL MILK PRODUCTION CHANGE

2015-16 to 2016-17



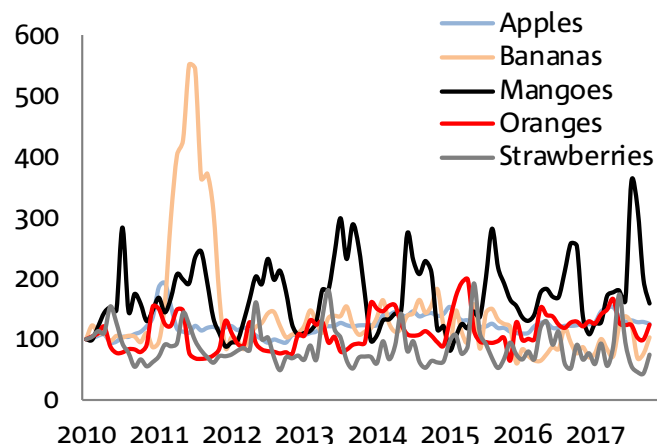
Milk flow was well down last season – off 6.9% nationally. The worst falls were in the major export states of Victoria, South Australia and Tasmania. Northern Victoria saw particularly steep declines, reflecting poor prices combined with a very wet 2016 spring. Expectations are stronger for this season, although challenging conditions in Gippsland warrant observation.

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



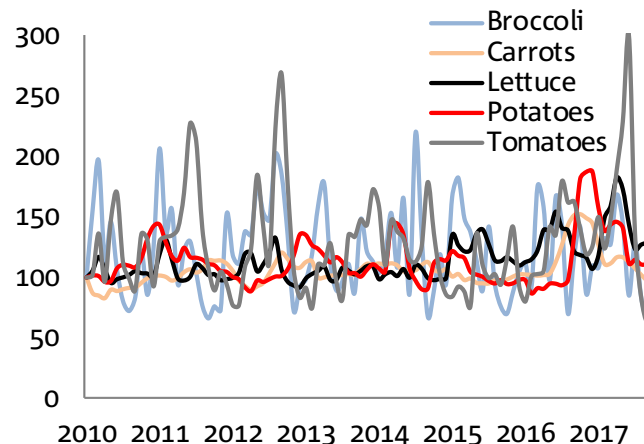
WHOLESALE FRUIT PRICES

AUD index, Syd+Melb, Jan 2010=100



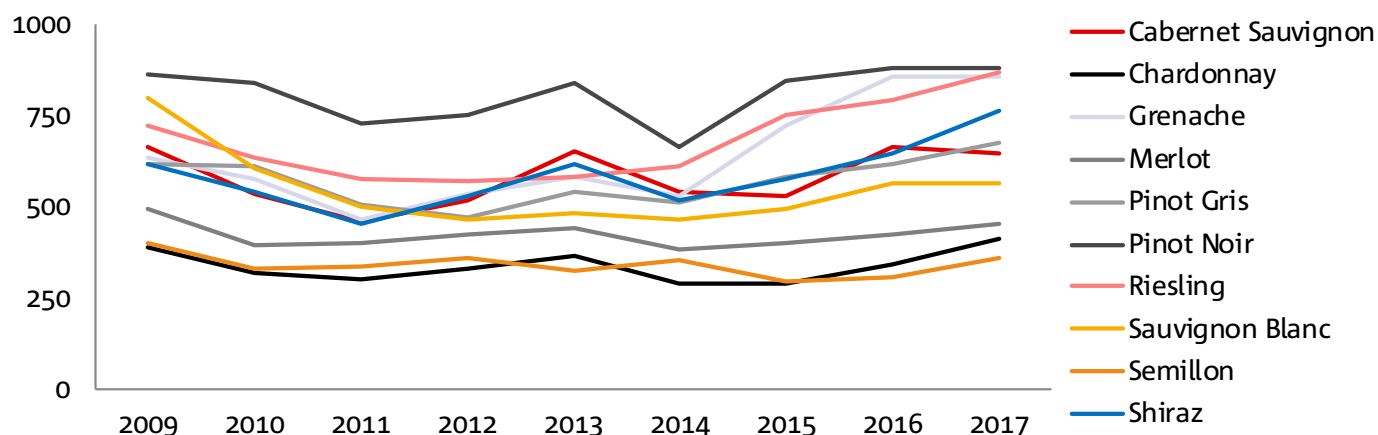
WHOLESALE VEGETABLE PRICES

AUD index, Syd+Melb, Jan 2010=100



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.

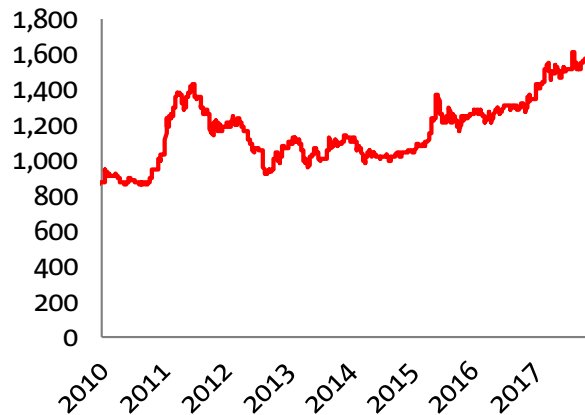
Wholesale fruit and vegetable prices were higher overall in October. Fruit was up 6.3%, largely reflecting seasonal factors. In October the index stood at 118.6 index points (January 2010 = 100). Vegetables were up 5.7% to 102.5 index points. This means that our basket of vegetables used in our index are now only slightly higher at a wholesale level than at the beginning of the decade.

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%).



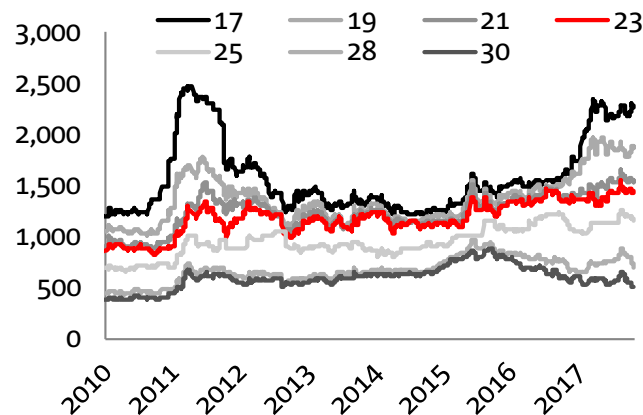
WOOL – EASTERN MARKET INDICATOR

AUc/kg



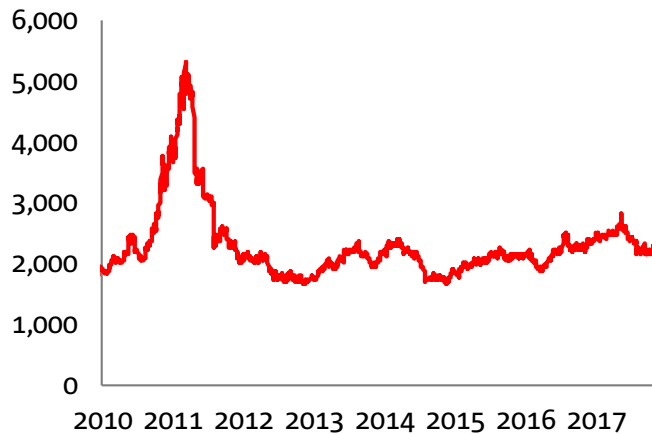
WOOL PRICES BY MICRON

AUc/kg, Southern Region



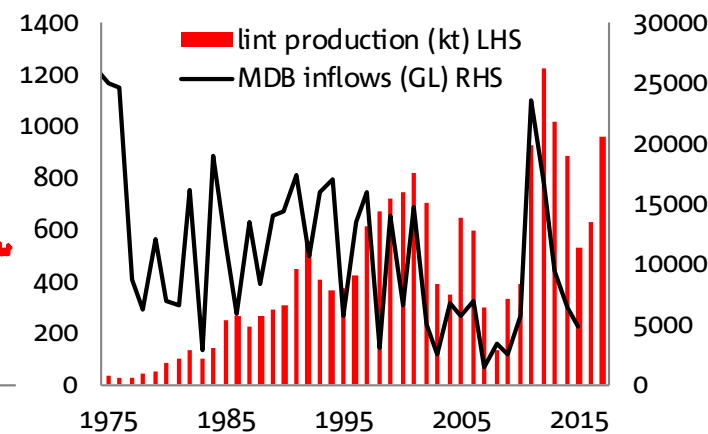
COTLOOK A INDEX

AUD/tonne



AUSTRALIAN COTTON AND BASIN INFLOW

Production and MDB system inflows



The wool market has almost back to record breaking highs. Wool prices declined 1.5% in September, but rose 1.5% in October. Importantly, the spike in coarser wools looks to have abated, with 25 micron and above seeing lower prices of late. Fine and super fine wool remains at a substantial premium. The somewhat lower Australian dollar, to which the wool industry is usually very sensitive, has probably helped in the last month. Still, it is unclear whether prices are sustainable at their current levels. While we see good signs in the form of very strong Chinese demand, this is not guaranteed to continue.

With prices at these levels, ABARES projects that wool production will increase 3.4% in 2017-18, arresting (at least temporarily) a long decline in production.

Cotton prices were down slightly in October. 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, ABARES has cut back production forecasts for the coming season. On the other hand, Southern New South Wales looks set up for a strong season as cotton continues to push south.

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

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