

RURAL COMMODITIES WRAP

MARCH 2017



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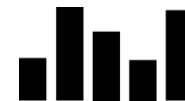
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PRICE UPDATE: NAB'S RURAL COMMODITIES INDEX

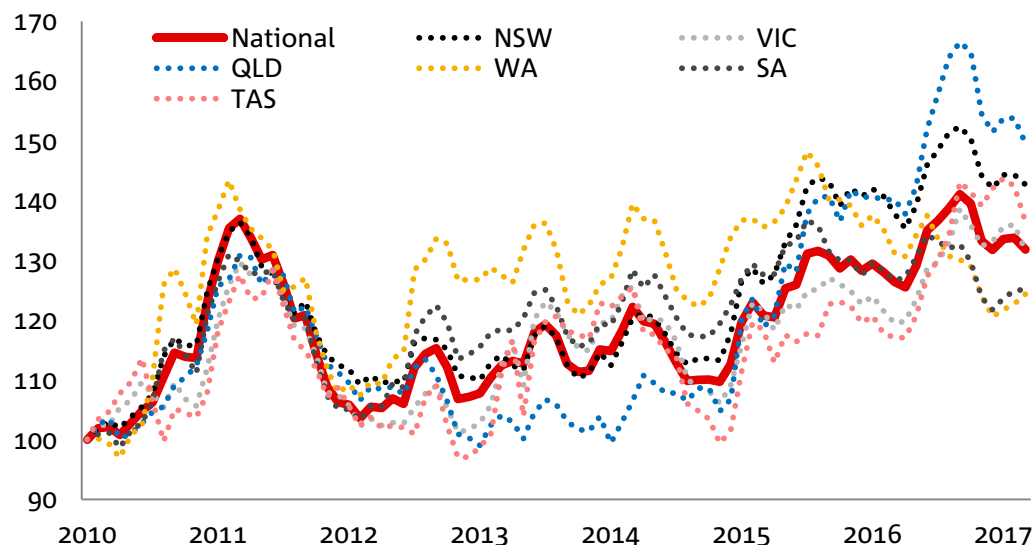


The NAB Rural Commodities Index is an index of 28 agricultural commodities weighted by the relative size of each commodity in the Australian agricultural sector. In addition to the national indicator, we publish state-level indicators, reflecting the particular composition for each state.

Q4 last year saw a sustained drop in the price of many commodities, but Q1 2017 has seen somewhat more stability. Wheat prices have increased moderately this month, while wool continues its excellent run. Cattle prices continue to decline (in line with our expectations) and lamb has retreated somewhat albeit from high levels. Dairy prices have notably given up their earlier gains, down 11% in March.

NAB AG-INDICATOR

Agricultural price index, 2010 = 100



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

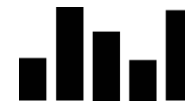
Overall, the index rose 0.1% in February but is on track to fall 1.5% in March (excluding horticulture). At a state level, New South Wales was steady in February but off 1.1% in March. Dairy-heavy Victoria was up 0.2% in February but fell 3.2% in March, reflecting the sharp fall in dairy prices. Queensland saw no change in February but a 2.7% decline in March, in large part reflecting lower cattle prices. Grain-dependent Western Australia and South Australia up 0.8% and 1.0% respectively in February and 1.3% and 0.2% in March following an increase in wheat prices. Tasmania saw a decline of 0.9% in February and a further 4.1% fall in March.

MONTHLY AUD PRICE CHANGES – SELECTED COMMODITIES

Monthly average price change

	January 2017	February 2017	March 2017 (to date)
Wheat	▼ 0.5%	▲ 0.1%	▲ 3.5%
Beef	▲ 1.4%	▼ 1.5%	▼ 3.8%
Dairy	▼ 1.1%	▼ 5.6%	▼ 11.0%
Lamb	▲ 17.4%	▲ 5.9%	▼ 3.2%
Wool	▲ 3.3%	▲ 2.5%	▲ 6.0%
Sugar	▲ 7.5%	▼ 3.3%	▼ 9.3%
Cotton	▲ 2.0%	▲ 0.7%	▲ 2.6%

OUTLOOK FOR THE COMING YEAR



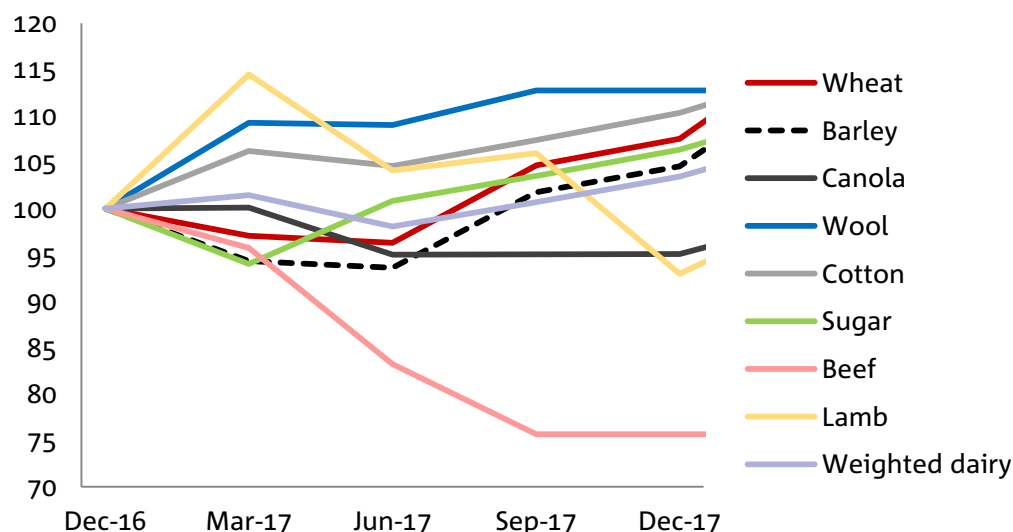
Prices

The outlook for the coming year is highly dependent on the course of the Australian dollar, although we still expect the AUD to fall to 70 US cents at the end of 2017, providing some upside towards the end of the year. We see the 70 cent mark as a low point for the AUD, with the currency to remain around that level well into 2018.

We continue to expect cattle prices to fall further in 2017. While we have already seen some contraction in saleyard prices, restocker interest could slow rapidly if conditions are dry over winter-spring as major export markets show a generally subdued pricing outlook. Our forecasts point to the EYCI falling to 500 AUc/kg in the September quarter 2017. This is an approximately 30% contraction from peak.

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 outlook for production is somewhat mixed. While winter crops had a generally spectacular season, with a record 35 million tonnes of wheat harvested, the much drier outlook for the coming year is likely to see downward pressure in the 2017-18 season. Latest modelling from the Bureau of Meteorology points to El Niño by winter.

ABARES forecasts point to lower production for major proteins in 2016-17. While lower beef and sheepmeat production reflects the need to rebuild herds and flocks, low prices are the primary driver for lower milk production. Without further upside in farmgate prices, it is likely that dairy production will continue to lag.

ABARES PRODUCTION OUTLOOK

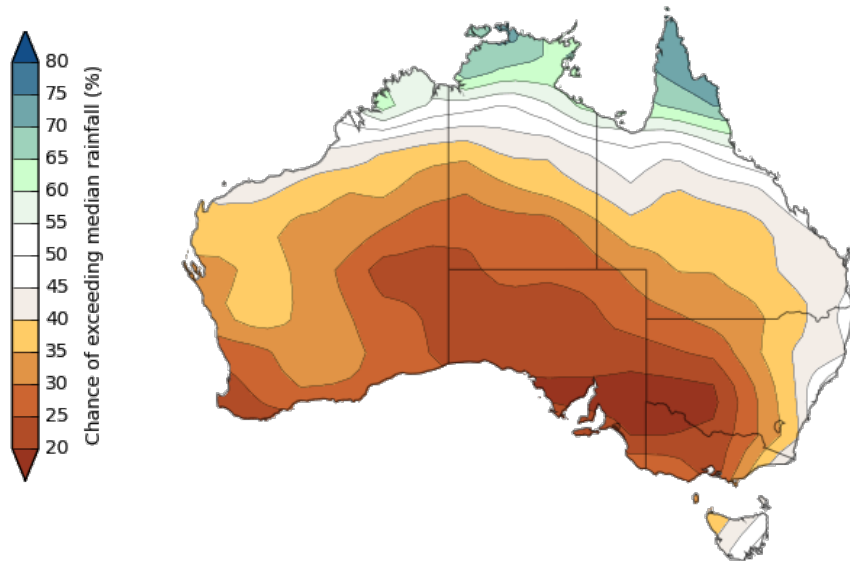
Financial year production estimates, Australia

	2016-17	2017-18	% change
Wheat (million tonnes)	35.1	24.0	▼ 31.7%
Beef (kt)	2,140	2,091	▲ 2.9%
Dairy (milk, billion litres)	8.8	9.0	▲ 1.7%
Lamb and mutton (kt)	661	663	▲ 0.4%
Wool	415	427	▲ 3.1%
Sugar (kt)	5,087	5,161	▲ 1.5%
Cotton (lint, kt)	1,029	1,117	▲ 8.5%



THREE MONTH RAINFALL OUTLOOK

April to June 2016

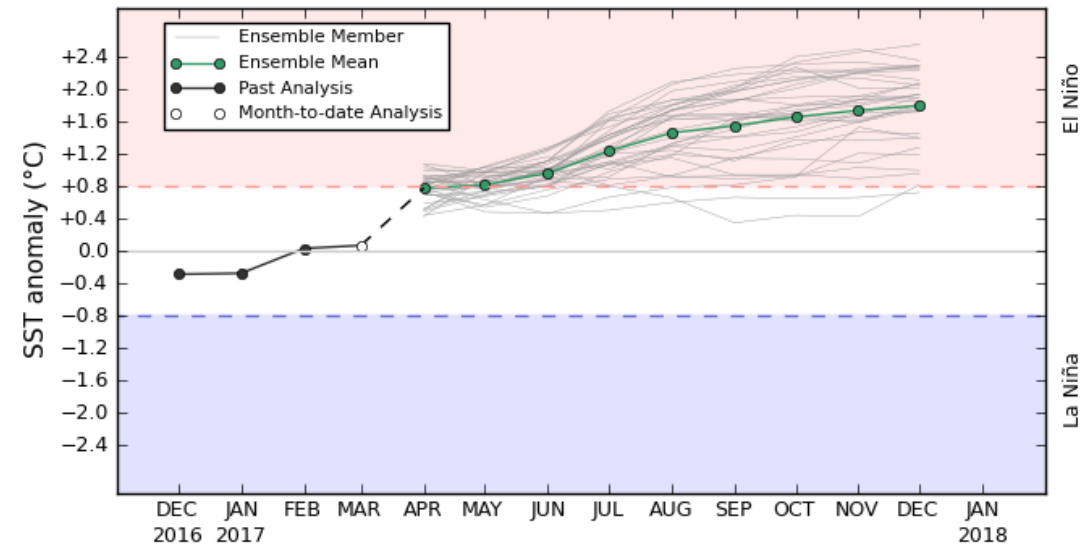


The climate outlook for the rest of autumn and into winter is very troubling. The Bureau of Meteorology's three month outlook points to a very high chance of drier than average conditions across Australia (except for Cape York and Arnhem Land).

Even more concerning is the Bureau's long range El Niño outlook for this year. While last year saw a late autumn break in the east, near La Niña conditions recorded across much of the year were reflected in a very wet winter and spring.

BOM POAMA MODEL LONG-RANGE EL NINO OUTLOOK

Monthly mean NINO 34 – 12 March 2017

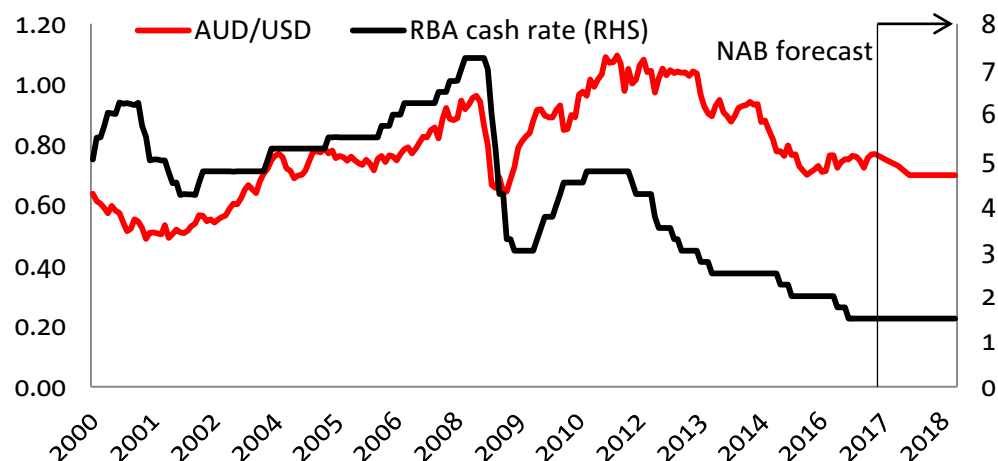


This year, the outlook is deep into El Niño territory from winter. While these projections naturally carry a degree of uncertainty, particularly at this time of year, El Niño events tend to bring hotter and drier conditions on average to eastern and northern Australia. The impact of any given event is difficult to predict, but the 2006-07 El Niño saw Australian wheat production fall below 11 million tonnes. On the other hand Australia managed over 24 million tonnes in 2015-16 despite El Niño.

EXCHANGE RATES AND INTEREST RATES



EXCHANGE AND INTEREST RATES INC. QUARTERLY FORECASTS



The AUD slippage we have seen in recent weeks has been driven mostly by commodity prices – oil (and so LNG) in particular. Commodities will remain key for the AUD and later in Q2 also the Fed, US tax reform plans and emerging market Asia.

The AUD’s month-to-date weakness in trade-weighted terms has been most pronounced against the pre-eminent so-called ‘funding currencies’ (EUR and JPY). Earlier strength versus the NZD that had taken the cross briefly above 1.10 (March 16th) has gone quite smartly into reverse in the last week or so. We expect the AUD to continue to move lower in coming weeks and months, more so on crosses other than vs. USD. Our forecast is for the AUD to fall to 70 US cents by the end of this year.

NAB FX STRATEGY TARGETS

	2017Q2	2017Q3	2017Q4	2018Q1
AUD/USD	0.75	0.73	0.70	0.70
NZD/USD	0.71	0.70	0.67	0.68
USD/JPY	114	116	118	120
EUR/USD	1.05	1.04	1.04	1.05
USD/CNY	6.92	7.05	7.04	7.03
AUD TWI	66.0	63.5	63.0	63.0

Source: NAB

The RBA’s emphasis has shifted even more clearly to financial stability considerations in the past month, with particular emphasis on household balance sheets in the context of further acceleration in house prices in Sydney and Melbourne amidst already high levels of household debt and weak household income growth. This includes RBA Assistant Governor (Financial System) Bullock highlighting the possibility of a further step up in macro-prudential measures.

Despite our ongoing concerns about economic growth and the labour market in 2018, an interest rate cut in 2017 would be contrary to the RBA’s desire to slow household debt accumulation. As such, we have removed our forecast interest rate cut in late 2017. Rates are likely to remain on hold for an extended period.

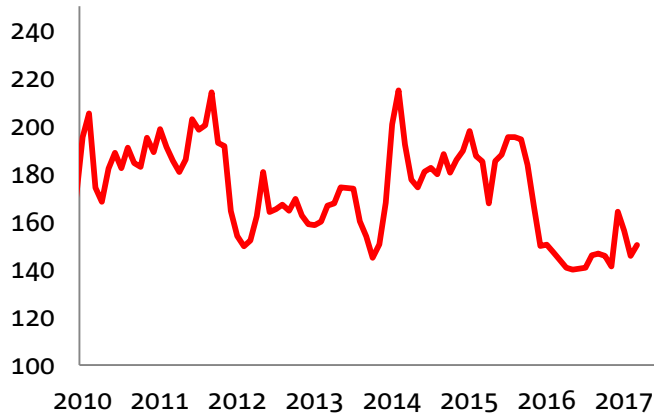


FARM INPUT PRICES



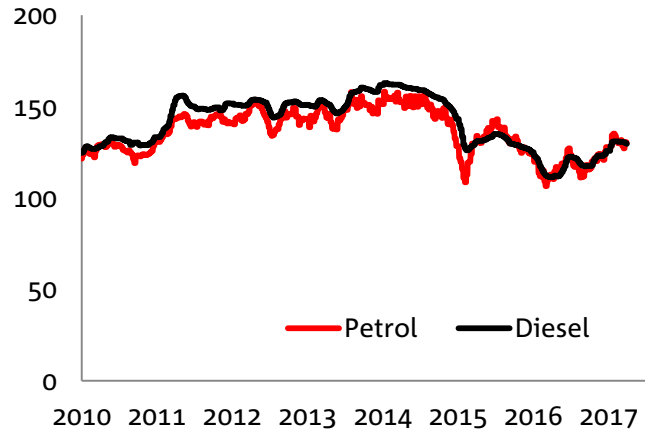
NAB FERTILISER INDEX

AUD index



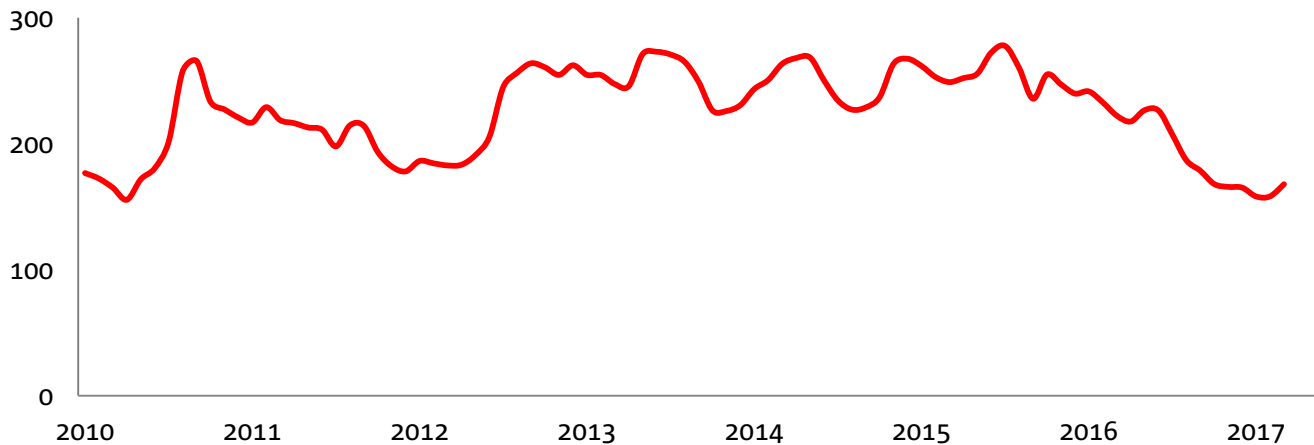
NATIONAL AVERAGE FUEL PRICES

AUc/litre



NAB WEIGHTED FEED GRAIN PRICE INDEX

AUD/tonne



Source: Bloomberg, Profarmer and NAB Group Economics

Feed prices remain very low in the wake of a bumper grain and hay season across eastern Australia, although international market developments have seen some upside this month. NAB's weighted feed grain price index rose 6.1% in March to AUD 167.8/tonne, although we see little upside in global grain markets this year amid exceedingly strong supply. Domestically, the combination of a record grain harvest and quality downgrades in some areas ensures that there will be ample feed grain for some time to come, although a dry winter could see stocks depleted with some speed. NAB's index includes feed wheat, barley, oats and sorghum. Three quarters of the indicator is made up of feed wheat and barley.

Fuel and fertiliser prices show some signs of breaking their upward trend. Fuel prices have moderated slightly, reflecting lower oil prices and a higher than expected AUD. Most recent data show national petrol prices averaging 130.1c/litre and diesel averaging 129.6c/litre. The NAB fertiliser index has retreated further amid lower US natural gas prices. The index was off 6.7% in February but up 3.1% in March.

The trajectory of oil prices will be a key factor in fertiliser prices this year. If prices rise slower than expected there may be a downside for fertiliser.

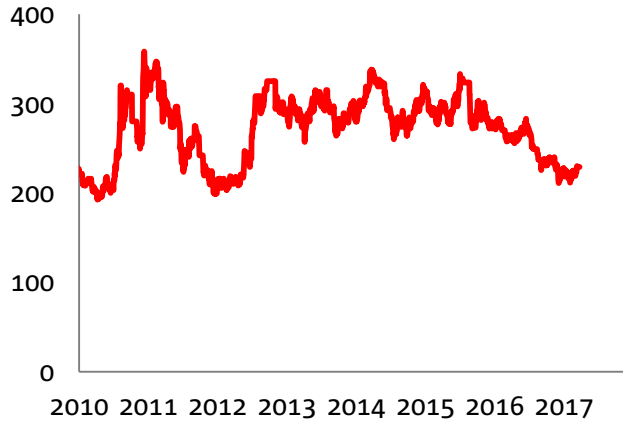


WHEAT



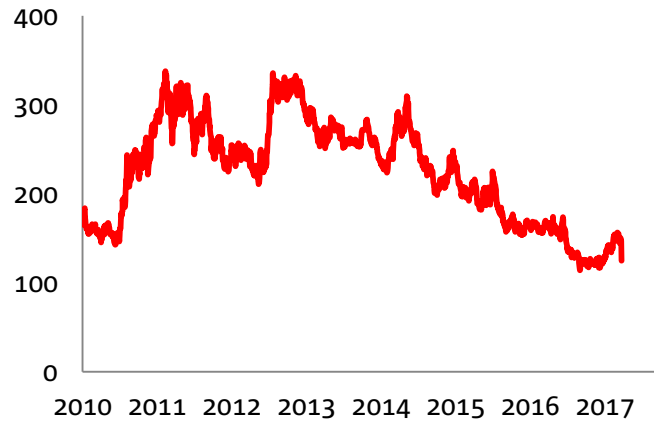
GENERIC 1ST MILLING WHEAT

Eastern Australia, AUD/tonne



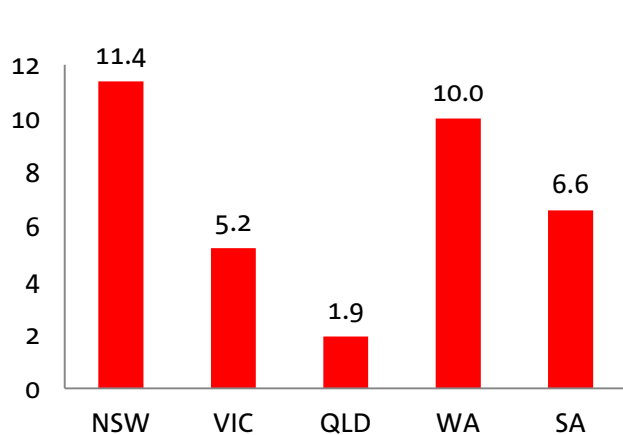
CBOT SOFT RED WINTER WHEAT

USD/tonne



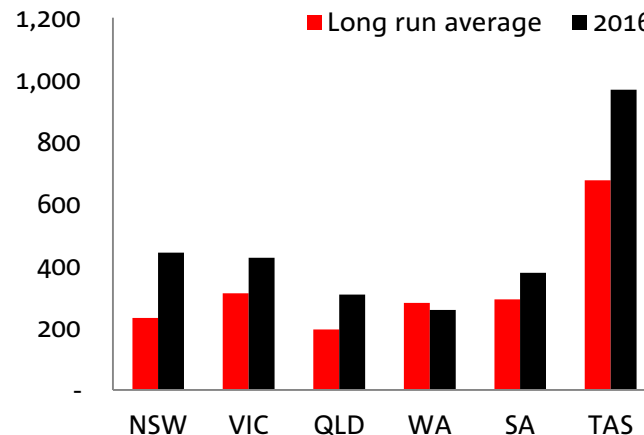
WHEAT PRODUCTION BY STATE

ABARES February 2017 estimates



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

Global wheat markets showed some signs of life in February and March but now look to have given up most of their gains. Prices remain generally moribund. The world is awash with wheat and inventories remain extensive, with the USDA upgrading its assessment of global production this month. It remains unlikely that USD prices will rise significantly this year. Our forecast is for Australian wheat prices to increase around 12% in AUD terms by the end of calendar year 2017, although AUD strength in the first half of the year will probably see prices fall in Q2. If the AUD does not fall, there is unlikely to be much upside for local prices.

Production

The 2016-17 harvest has gone down in the record books as Australia's biggest ever, with a massive 35 million tonnes harvested, more than 5 million tonnes higher than the previous record set in 2011-12.

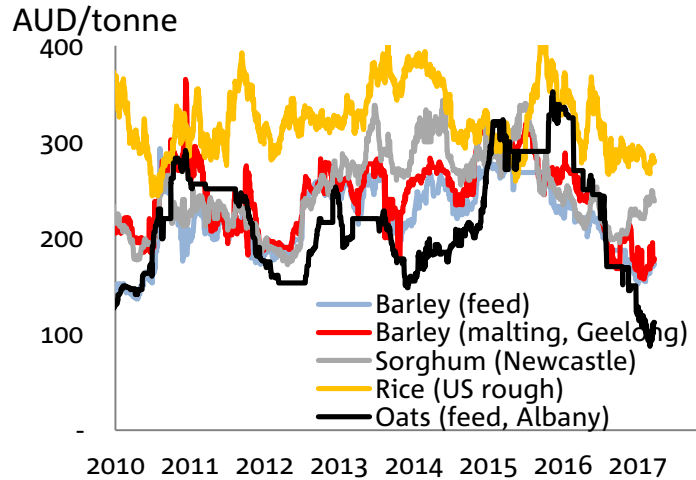
But as we look ahead to the 2017-18 season, the outlook is considerably more circumspect. If El Niño occurs this season, there is an elevated risk of lower yields. While this is by no means certain, El Niño events seldom deliver above average crops in Australia.



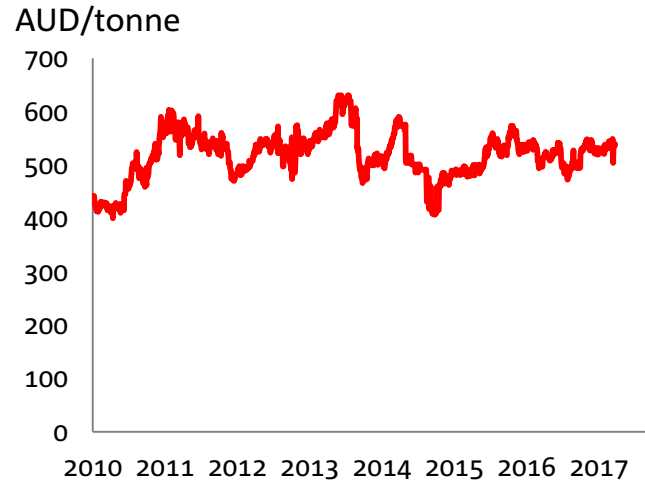
OTHER BROADACRE CROPS



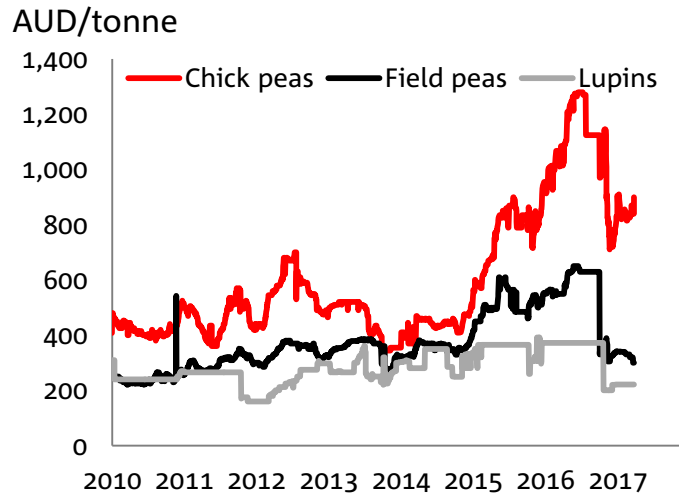
SELECTED COARSE GRAINS



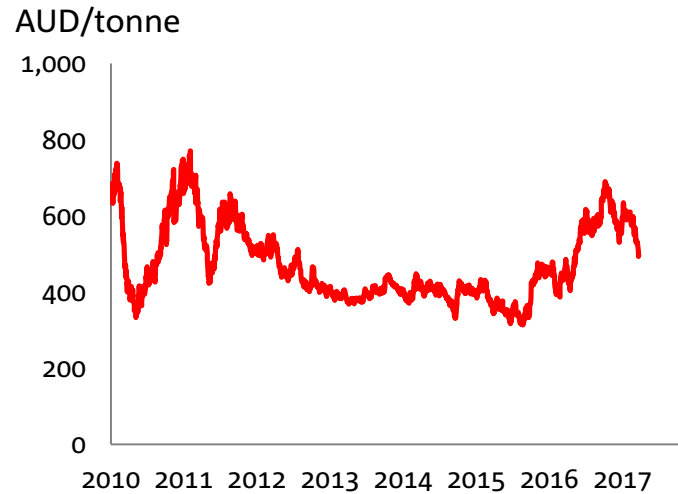
CANOLA, NEWCASTLE NSW



SELECTED PULSES



ICE NO.11 SUGAR



Prices for most coarse grains remain mired in much the same situation as wheat. Strong global supply has seen prices tumble and the outlook is broadly similar to wheat for the coming year. Canola remains a stand-out, with prices holding up much better. The price premium for canola is likely to see higher Australian plantings this year.

Last year we noted our concerns around the then extraordinary chick pea prices, which had exceeded AUD1,200/tonne following two poor Indian monsoon seasons. But with the return of more favourable conditions to India prices have receded to the AUD800 range. While we continue to expect lower prices, an El Niño event could dent Indian production (where the vast majority of Australian chick peas and lentils are exported), potentially mitigating the worst price falls. Chick peas are likely to remain more expensive than alternative crops this season.

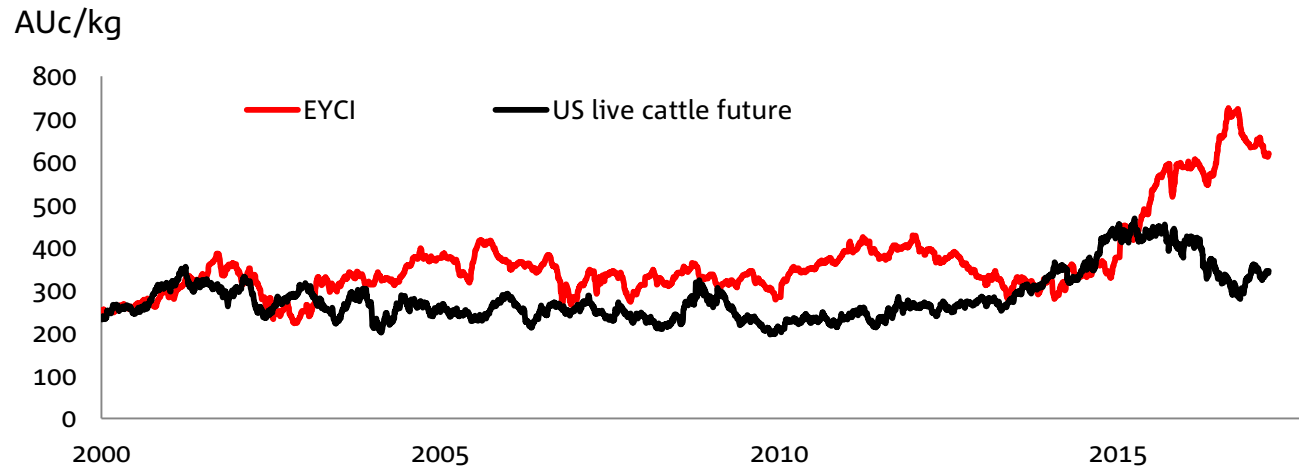
Sugar prices have taken something of a tumble of late, approaching a 20% fall from their September 2016 peak in AUD terms. However, prices remain above their 2015 lows. Locally, grower concerns around QSL-Wilmar issue remain present. Australian production is expected to be moderately higher this year.

Source: Bloomberg, Profarmer and NAB Group Economics

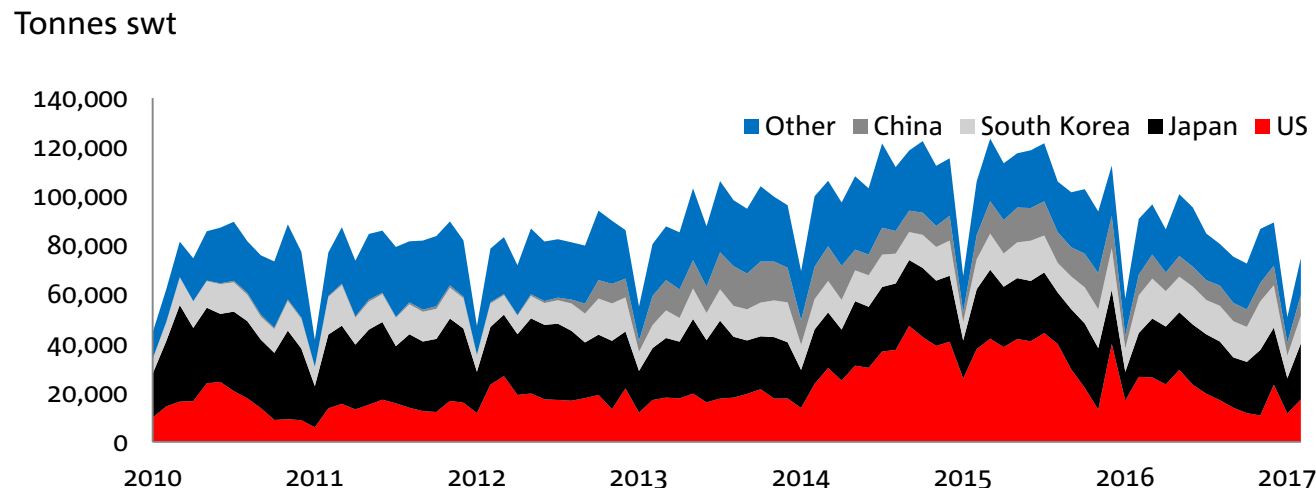




EASTERN YOUNG CATTLE INDICATOR AND US CATTLE FUTURES



MONTHLY AUSTRALIAN BEEF EXPORTS



Source: Meat and Livestock Australia and NAB Group Economics

The Australian cattle industry enjoyed a stellar two year run of rising prices, with the Eastern Young Cattle Indicator smashing records to reach 725 AUc/kg in August last year, all the more exceptional given that the indicator had not exceeded 428 AUc/kg before 2015.

While the initial phase of the boom reflected US demand for imported beef in response to domestic US supply constraints following high corn prices and drought in 2011, these factors have long since dissipated and US beef prices have fallen substantially. While US live cattle futures have seen some upside recently, the gap between US and Australian cattle prices remains well above historic norms. With corn remaining cheap and plentiful, it is difficult to see major upside in US cattle prices.

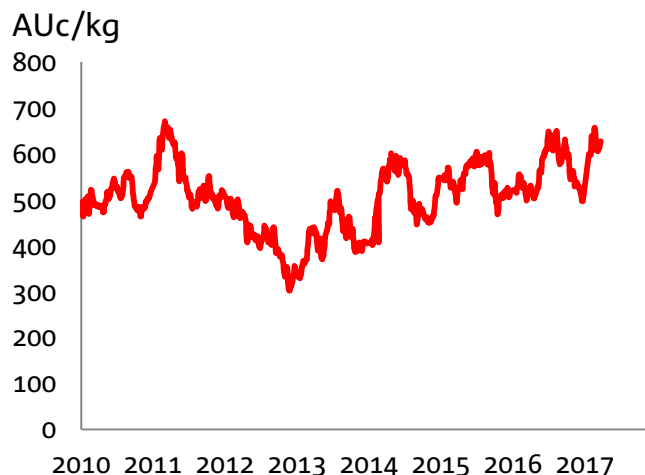
The Chinese frozen beef market has seen limited growth for Australian producers in the last year, with intense competition from South America. However, Australian market access in the chilled market is being significantly expanded and China has recently suspended the import of Brazilian beef. These factors present a new opportunity for Australian producers in an often difficult market.

On balance, we have retained our price forecast for the EYCI to fall to 500 AUc/kg later this year, noting mounting weather risks.

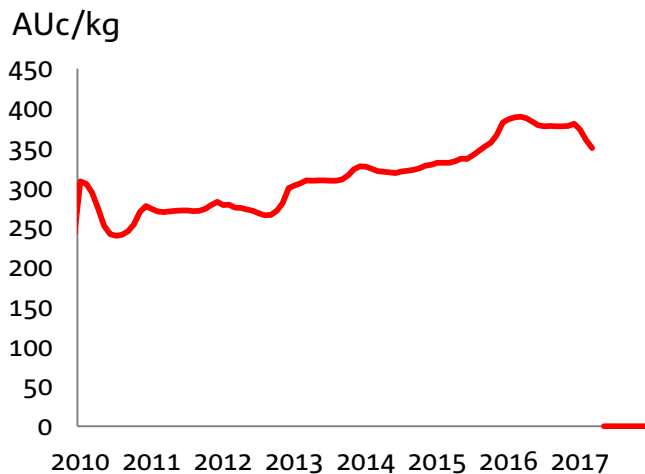
LAMB, PORK AND POULTRY



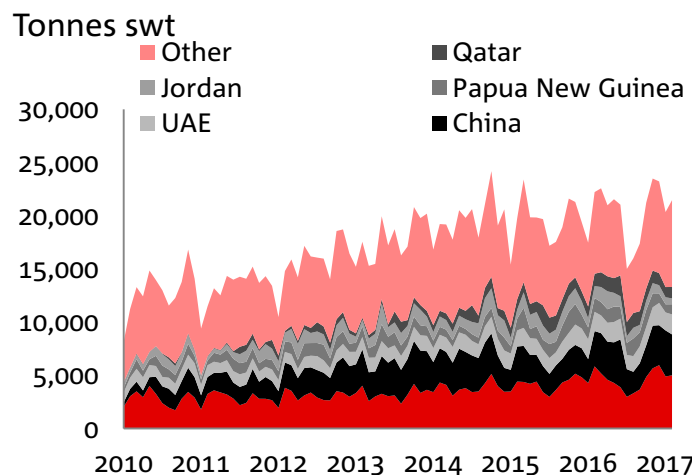
NATIONAL TRADE LAMB INDICATOR



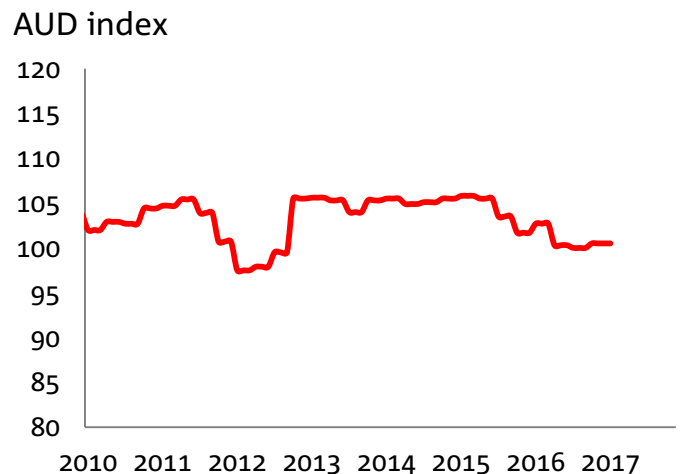
AUSTRALIAN PORK PRICE INDICATOR



MONTHLY LAMB EXPORTS BY DESTINATION



ABS POULTRY PRICE INDEX



Lamb prices surged in the new year and after a pause have resumed their upward trend. This price increase has come several months before the usual autumn-winter increase. Constrained supply has been a major driver of improved prices, although the climate outlook may make flock rebuilding less enticing. Nonetheless, lamb and mutton producers have done generally very well. We expect stable to moderately higher prices this year. 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. Jitters in the oil market may see some issues in the middle east, but these are likely to be minor.

In contrast, wholesale pork prices (measured as an average of buyer and seller prices for eastern seaboard 60.1-75kg animals) have fallen relatively rapidly. Prices were off 3.5% in February and a further 2.8% in March. The second half of 2016 saw monthly price changes of less than 1%.

Retail poultry prices have remained reasonably stable since late 2012, with a small downward trend since mid-2015. National retail prices rose 0.5% in the December quarter 2016.

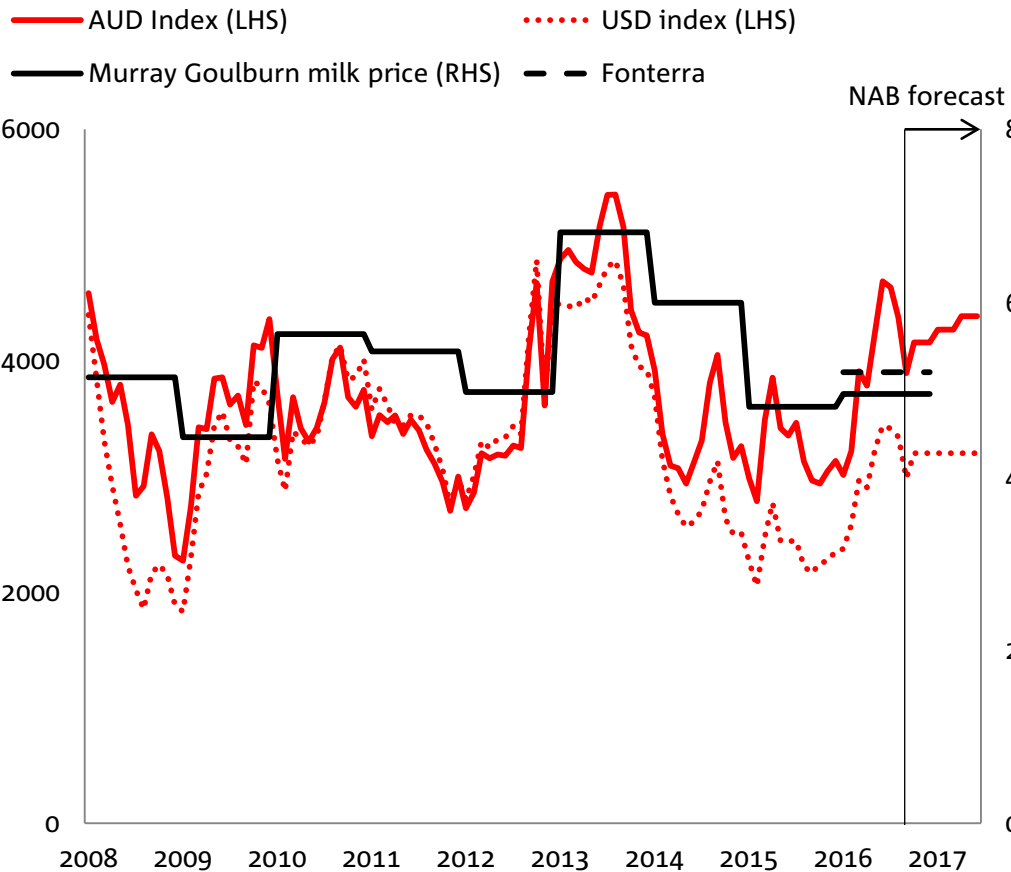
Source: Meat and Livestock Australia, Australian Pork, Australian Bureau of Statistics and NAB Group Economics



NAB WEIGHTED DAIRY EXPORT PRICE INDICATOR

\$/tonne (export price, LHS)

AUD/kg milk solids (farm gate price RHS)



While 2016 was a very tough year for many Australian dairy producers, steady improvements in both global prices and local seasonal conditions in the second half of the year saw some optimism return, although Australian farmgate prices remained subdued.

2017 has seen more mixed to lower Global Dairy Trade auction results. NAB's weighted dairy export price indicator now shows AUD denominated dairy prices having given up more than a third of their gains over the second half of last year. Data showing falling milk deliveries in New Zealand and the European Union was a key driver of the recovery last year, but recent data from New Zealand show milk production beating expectations, putting pressure on prices.

New Zealand is the world's largest dairy exporter and exports around 95% of the milk it produces. Fonterra New Zealand currently forecasts a farmgate price of NZD6/kg milk solids, a significant recovery from last year.

In Australia, the recovery in farmgate prices has been much slower so far, which has been reflected in lower milk production. Australian milk production plunged last year, and the latest data for 2017 shows February deliveries down 10% and production for the season to date 8.4% lower.

Absent further increases at farmgate, it is unlikely that production will recover this season. However, the industry finds itself in something of a catch-22, as falling milk deliveries are denting processor revenue, impeding their ability to offer the higher prices needed to boost raw milk production.

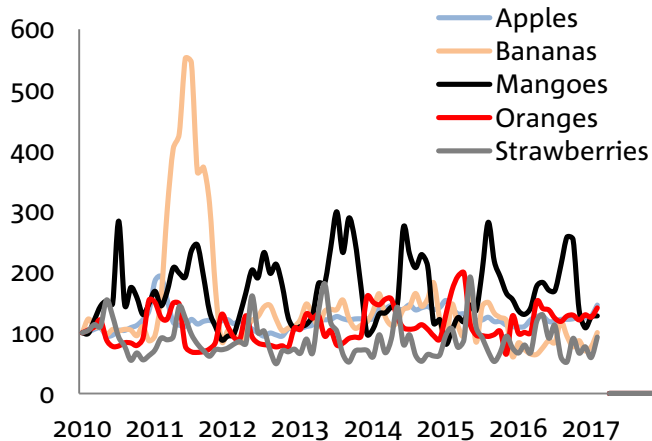
Source: Australian Bureau of Statistics, Global Dairy Trade, Dairy Australia, Fonterra, Murray Goulburn, ABC and NAB Group Economics

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



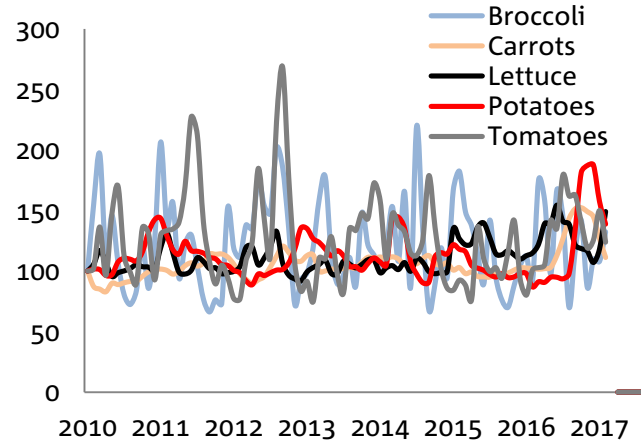
WHOLESALE FRUIT PRICES

AUD index, Sydney and Melbourne



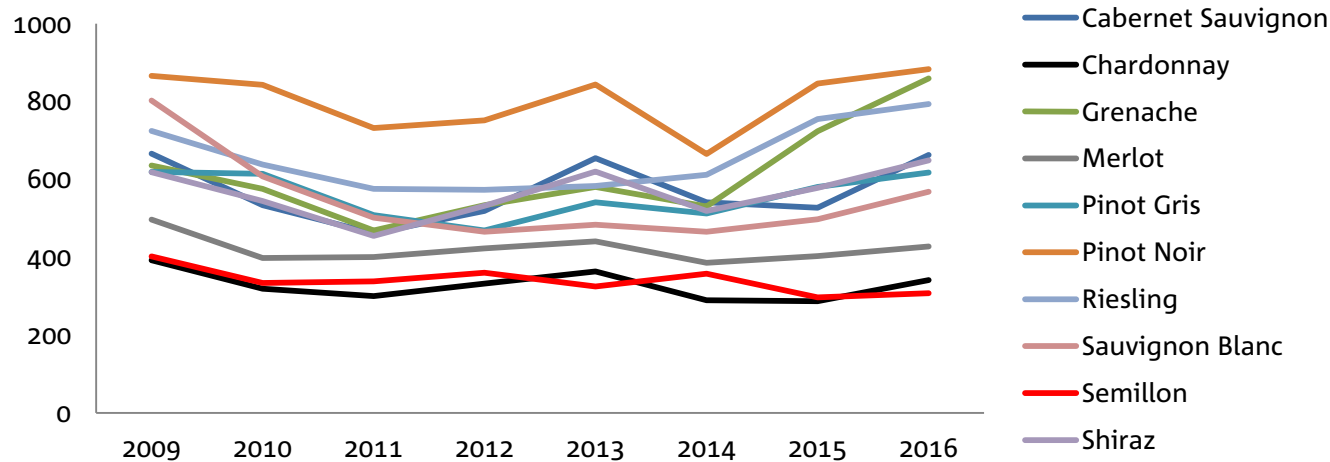
WHOLESALE VEGETABLE PRICES

AUD index, Sydney and Melbourne



NAB WEIGHTED WINE GRAPE PRICES

AUD/tonne



Source: Ausmarket Consultants, Wine Australia and NAB Group Economics

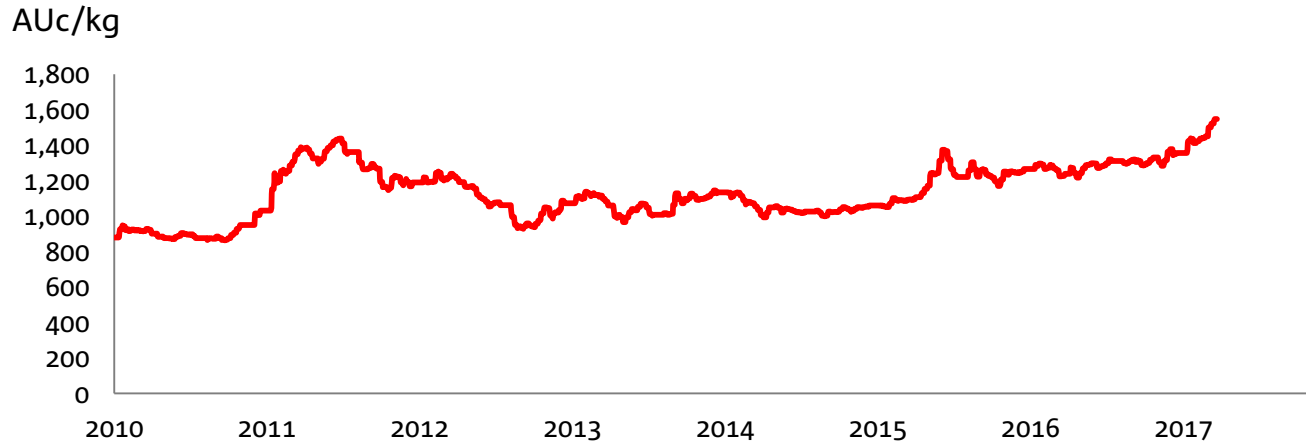
We produce wholesale price indices for fruit and vegetables, based on data from the Melbourne and Sydney wholesale markets.

Wholesale fruit and vegetable prices were again mixed in February. Fruit prices surged 17.4% to an index value of 122.4 (January 2010 = 100). Vegetables fell 1.7% to an index value of 132.1 (January 2010 = 100). While fruit and vegetable prices show strong seasonal volatility, the trend since the beginning of the index in 2010 shows very limited growth in wholesale prices, a concerning trend for producers.

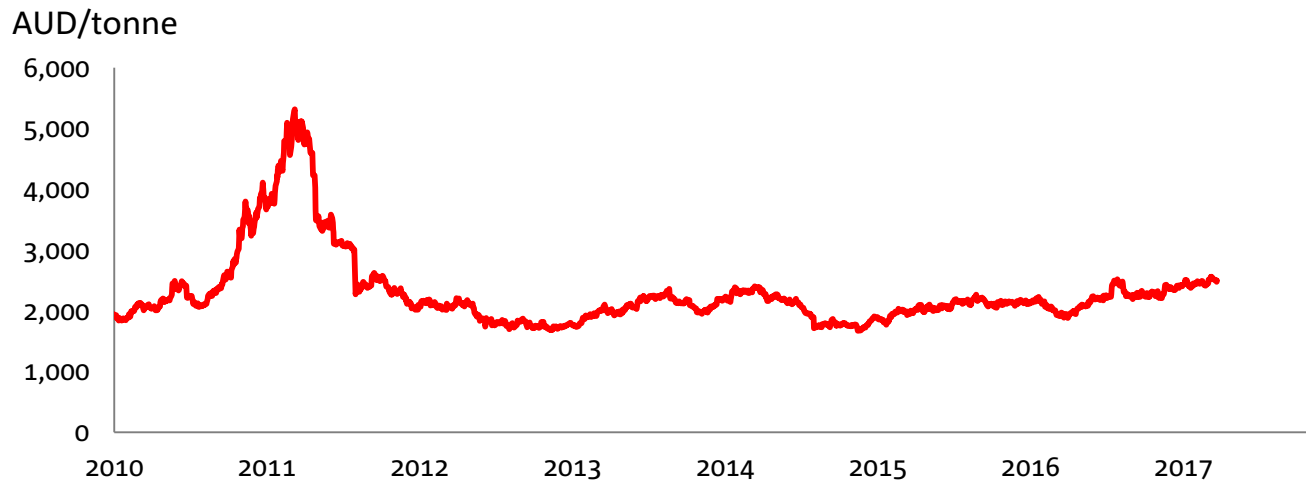
Wine Australia's 2016 Price Dispersion Report, shows further strengthening in wine grape prices in the 2016 vintage, reflecting the rewards of a lower AUD. Overall, wine grape prices for major varieties were higher to much higher. Cabernet Sauvignon was a standout performer, up 26% from last season.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



WOOL – EASTERN MARKET INDICATOR



COTLOOK A INDEX



Source: Bloomberg and NAB Group Economics

The wool market continues with some of the best conditions in decades. This follows a return of confidence to the industry last year after several years of unfavourable prices. The price upturn enjoyed by wool producers has continued despite recent USD weakness (wool is quite sensitive to movements in the dollar), and our expectations of a lower AUD this year point to further upside. The Eastern Market Indicator rose 2.5% in February and a further 6.5% in March so far. With prices rising, ABARES projects that wool production will increase in the coming year, arresting (at least temporarily) a long decline in production.

Cotton prices continue to rise, up 2.6% in March. However, the major story for Australian cotton is the rapid expansion in cotton production this season, as plantings stretch as far south as the Victorian border on plentiful irrigation water availability. ABARES forecasts cotton lint production to increase a further 8.5% in 2017-18.