ANZ AGRI
INFOCUS
DECEMBER
2020

COMMODITY INSIGHTS

FOREWORD

In reflecting on the 2020 year, the agriculture industry will be best remembered for being one of the most resilient industries in the face of global shutdowns.

The pandemic and its impact on supply chains, retail spending, travel and working has been the defining feature of one of the most tumultuous years in recent memory. For Australian agriculture, 2020 has strangely been a year of positives for many despite the global upheaval. While the year started under the heavy shadow of drought and bushfires, considerable rain across eastern Australia would set the course for a strong season and booming livestock prices.

In reflecting on the 2020 year, the agriculture industry will be best remembered for being one of the most resilient industries in the face of global shutdowns. While isolated impacts were felt throughout some sectors of the industry, including meat processing in Victoria, fruit picking and air-travel-reliant exports, the overwhelming story has been one of flexibility and adaptation to new constraints. The move to online livestock auctions, accommodating staff on-farm and managing shift rotations, and ensuring contact-free goods transfer are all examples of a robust and resilient supply chain.

The strong season for farmers was reflected in a recent ANZ Roy Morgan Financial Wellbeing Indicator which found that in the five months to August 2020 and in the midst of the COVID-19 pandemic lockdowns, the financial wellbeing of farmers and farm managers improved 4.3 per cent, from 60.2 to 62.8 (as a score out of 100), compared to the national average which declined 6.4 per cent, from 60.7 to 56.8. The report also found that regional Australians experienced a much smaller decline (0.7 per cent) in their ability to meet financial commitments, compared to a decline of 8.6 per cent experienced by those living in capital cities.

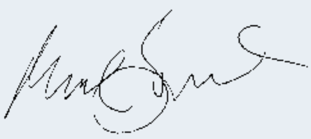
On the downside, the ongoing escalation of the China–Australia trade tensions continues to make many in the industry nervous. The unpredictable approach of the Chinese to halting or impeding Australian agricultural exports appears to be aimed at displaying the Chinese Government's displeasure at the Australian Government. The message that is being heard at the farm-gate is far more straightforward however, with some in the industry now questioning the long-term value and certainly the concentration risk that has emerged. Given our location, Australian agricultural exports will always be closely tied to export markets across Asia, with China remaining one of the most important of those markets.

But it makes sense to pursue opportunities for expansion and to diversify into new markets through additional trade relationships. The China demand story will continue to be an enormous influence on global demand, and represents a net positive opportunity for Australian agriculture, but we do need stability in order to maintain confidence and investment at the production level.

On a commodity basis, the Australian wheat harvest is shaping up very well, with prices holding firm despite strong domestic and global supply. Livestock prices are also strong with cattle prices continuing their rise, despite queries of 'how high can they go', and sheep prices recovering to sit above levels at the same time last year, despite falls earlier in the year. Global dairy prices are up on last year across most commodity sectors, except butter, and even the struggling wool sector is showing solid signs after finding its floor level and now appears to be steadily improving.

As we look forward to the 2021 year, there are clearly a number of hurdles for both the agriculture industry and the global economy as a whole to overcome. First among them are the continuing waves of COVID-19 outbreaks and the impact of global economic growth and confidence. Second is the impact of the new Biden administration on global trading systems and stability. As Australia continues to navigate through the stoush with China, the overarching influence of a more moderate United States administration is likely to set the scene for ongoing negotiations.

Having said all that, Australian farmers can go into 2021 with a strong sense of optimism and with a generally strong 2020 under their belt. And this makes a monumental shift from how we saw the world at the start of the year.



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WHEAT & GRAIN INSIGHTS

OVERVIEW

- \+ As the Australian wheat harvest continues, we are expecting to see the domestic production volumes beat expectations and push towards 30 million tonnes
- \+ The global outlook for the coming year will be impacted by China, as they chart their way out of African Swine Fever and increase domestic pork production
- \+ Global grains prices continue to grow strongly on the back of latest USDA estimates of slightly lower global production, increased consumption and a drop in ending stocks
- – Domestic prices have dropped off slightly as a result of the strong harvest and concerns over mooted export bans to China
- – Concerns linger over the disconnect between record global crop levels and the continuing rally in prices in the face of increasing COVID-19 infections and recent rains in the northern hemisphere
- – With the world awash with grains, and prices being supported in large part by China's import demand, there is a downside risk if China's forecast demand does not come to fruition

As the harvesters move south, the Australian wheat harvest is looking strong. Off the back of a bumper crop in New South Wales, this year's wheat crop is expected to better Australian Bureau of Agricultural and Resource Economics and Sciences' (ABARES) forecasts and push towards the 30 million tonnes mark. Strong forecast global consumption and export demand, particularly for feed wheat in China, is extending the global price rally such that the global indicator price is sitting 25 per cent higher than this time last year. However, concern over the potential for Chinese import sanctions on Australian wheat, as well as the strong harvest, have kept a lid on domestic prices. Globally, there is some concern that China's booming export demand may not be able to maintain its pace.

With grain handler GrainCorp expecting a harvest from the eastern states to rival the 2016–17 record year, the fluctuating fortunes of the New South Wales crop are very much on the upswing this year. Across Queensland, New South Wales and Victoria it has been reported that both quality and quantity are strong across cropping regions and that the New South Wales crop alone could be over four times last year's harvest – coming in at between 10 and 12 million tonnes. On that basis, and given a continuing strong harvest into Victoria, the national wheat harvest could reach above official forecasts and towards the 30 million tonne mark.

Globally, the International Grains Council (IGC) grains and oilseeds index (GOI) reached its highest point in six years as a result of strong export demand and rising consumption. The GOI rose 8 per cent in October alone and caps off three months of stellar price growth. Much of the growth has come courtesy of the forecasts from the United States Department of Agriculture (USDA) of slightly lower production, higher consumption, higher exports and lower ending stocks. USDA forecasts from early November indicate lower global production in Argentina and Turkey which more than offsets a forecast higher Russia harvest due to some timely rains as the crop went into the ground. Global consumption was boosted by 1.7 million tonnes to 752.7 million tonnes, based primarily on the back of higher feed and residual use in China, the European Union (EU) and Vietnam. Global trade was also forecast up as a result of exports from Russia, EU, and Kazakhstan.

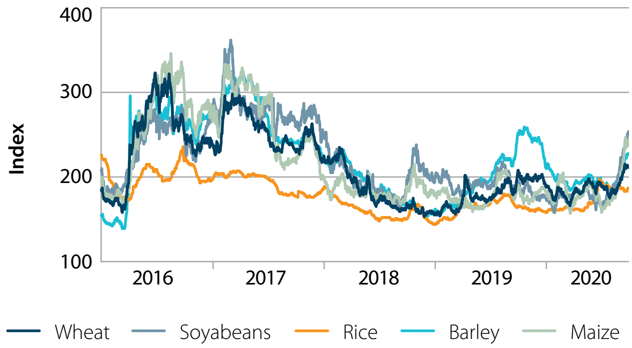
Domestic prices have, understandably, trended lower on the back of the strong harvest rolling in, but also due to the unofficial warnings of trade bans on Australian wheat imports in China. While Australian wheat producers are very aware of the risks posed by China's warnings, it is also clear that an import ban on wheat would not pose such an immediate threat as it did to Australia's barley producers, as China is not a major destination for Australian wheat exports.

Prices remain historically strong, however, sitting just below the prices received the same time last year when supplies were dramatically lower. For example Australian Premium White Wheat (APW1), Port Adelaide is receiving just over $300 a tonne, down from $328 at the end of October. Export prices for APW1 are sitting on par with most other exporting nations at an average across ports of $US255/MT (FOB).

Underlying the strong global and domestic prices, however, there is some concern over the seeming disconnect between the continuing increase in prices and very strong production levels. Currently, prices seem to show no reaction to reports of a record global harvest, leaving prices somewhat exposed to any large changes in export demand or consumption profiles.

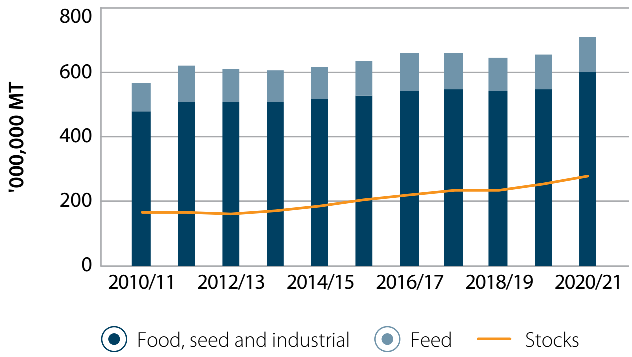
Looking forward, the global price of wheat has been heavily reliant on food and industrial consumption through 2020. For the coming year, it is likely to be the returning pork industry in China and the demand for feed to rebuild the industry following African Swine Fever that will provide the greatest impetus for consumption growth. Given continual and enduring strong production across the world as a whole, as well as the large stockpiles currently being held in China and India, the consumption profile will be the one which determines wheat prices into the future.

IGC GRAINS AND OILSEEDS INDICES



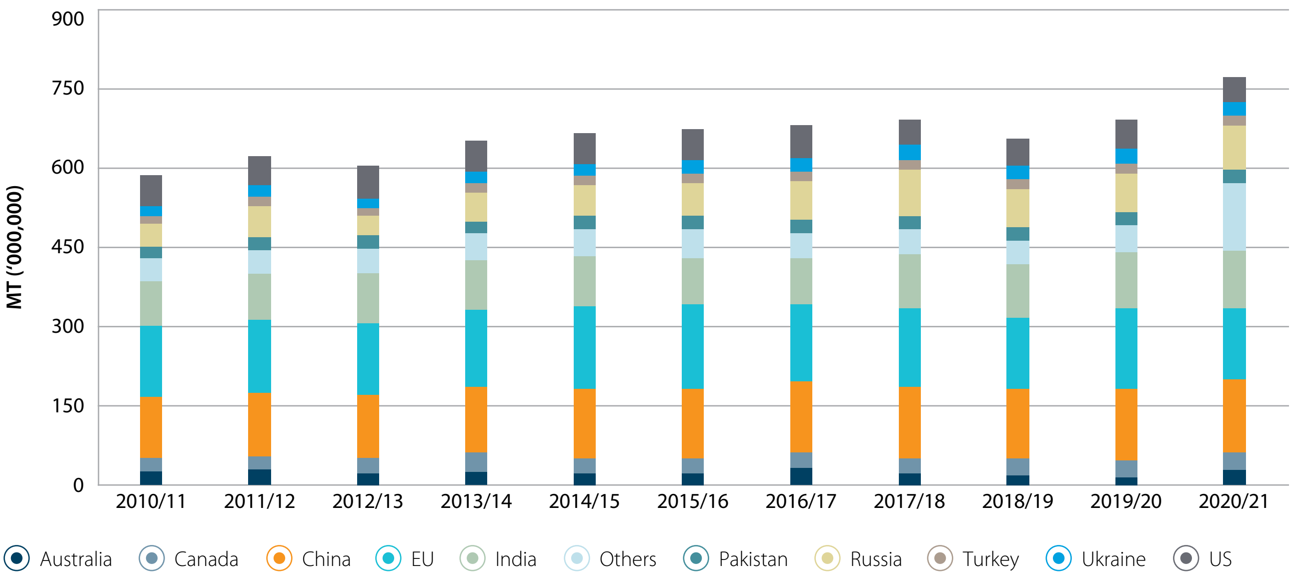
Source: International Grains Council

GLOBAL CONSUMPTION AND STOCKS



Source: USDA PSD, ANZ

GLOBAL WHEAT PRODUCTION



Source: USDA PSD, ANZ

BEEF INSIGHTS

OVERVIEW

+ The forecast for a reasonably wet few months heading into 2021 means feed availability and cost is unlikely to be an issue
+ The tight herd supply and ongoing demand by restockers should see cattle prices remain relatively strong
+ While current bans on beef imports by China are concerning, they have so far been limited to five processing plants

– The record high cattle prices will squeeze margins for processors and could impact production values
– The recovery of China's pig herd numbers from African Swine Fever
– The relatively high Australian dollar continues to impact Australia's beef export competitiveness

The Australian beef and cattle industry has experienced a year like no other. For an industry which was arguably hit harder by the drought than any other agri sector, the arrival of the rain had an impact on prices that very few would have predicted. The disruptions from COVID-19 to the beef supply chain hit the headlines, particularly in the US, but also in Australia – for processing, particularly in Victoria. Meanwhile, throughout the year, the issue of the potential impact of Chinese bans on Australian beef imports continued to loom over the sector, leading to uncertainty and caution, though with no major impact on price.

Of all the many discussion points around the beef and cattle supply chain this year, perhaps the biggest one has been the rise and rise of cattle prices. This time in 2019, cattle prices had fallen to some of the lowest levels in five years. For the first half of the past decade (2010–2014) the benchmark Eastern Young Cattle Indicator (EYCI) had sat steadily between 300 and 400 c/kg. When the Chinese market opened up to more Australian imports, prices quickly rose to between 500 and 700 c/kg for the next three years, until the drought-induced sell-off of cattle by producers saw prices fall over 2018 and 2019, back below 500 c/kg.

The price rise in 2020 has been unparalleled, even by 2015–16 standards, and despite ongoing predictions by many in the industry that a market correction is imminent, there has still been no sign of one. And as 2021 approaches, the question is how long this will continue?

Certainly, the fundamentals for prices staying reasonably high are strong, as cattle producers across Australia continue to drive prices through restocking, to build up their depleted herds, or 'up-stocking', in looking to run as many head as possible, on the expectation of prices remaining strong.

With forecasts of a wet summer, while the plentiful grass in many cattle regions will thin, there is little sign of a lack of feed in most regions. Similarly, the conditions which have led to forecasts of a major domestic grain crop, together with abundant hay, mean that low feed costs will maintain the incentive to increase individual herds.

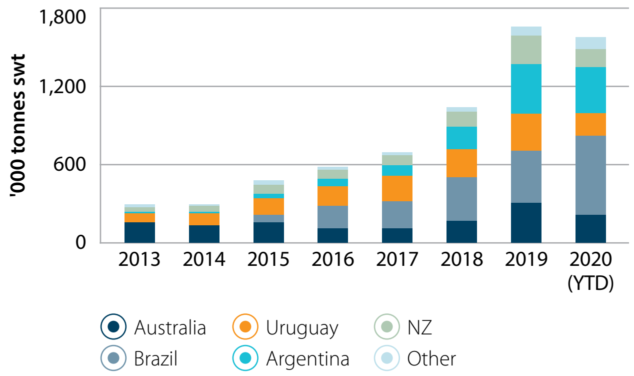
In addition, many producers will be mindful of the fact that the slow national herd recovery process means that while cattle supply will gradually increase, it will unavoidably take time. Under ANZ modelling, given a return to optimal female slaughter rates, it could take the national herd until 2028 just to reach the 2015 levels of over 28 million head.

Another factor which could potentially come into play is whether a reasonable number of producers may look to change their operations to increase their cattle numbers, whether through running fewer sheep, planting lower crop acreage or reducing dairy herd numbers. Ultimately, producers are making their business decisions on the belief that the low national herd numbers will mean that processors will have no choice but to pay well, that feedlots will keep buying to meet demand and take advantage of low feed prices, and that prices will still be high for next season's calves.

Given these drivers, there is a reasonable chance that cattle prices could continue climbing, particularly given the weaner sales which will be held in many regions in coming months, or that any price fall will be minimal.

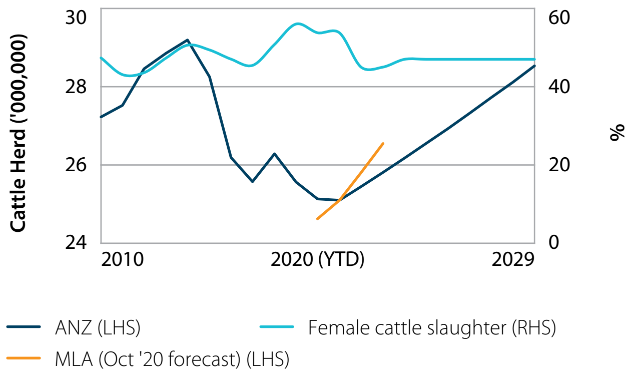
For processors, the ongoing strength of prices presents a challenge which will need to be absorbed somewhere.

CHINA'S BEEF IMPORTS



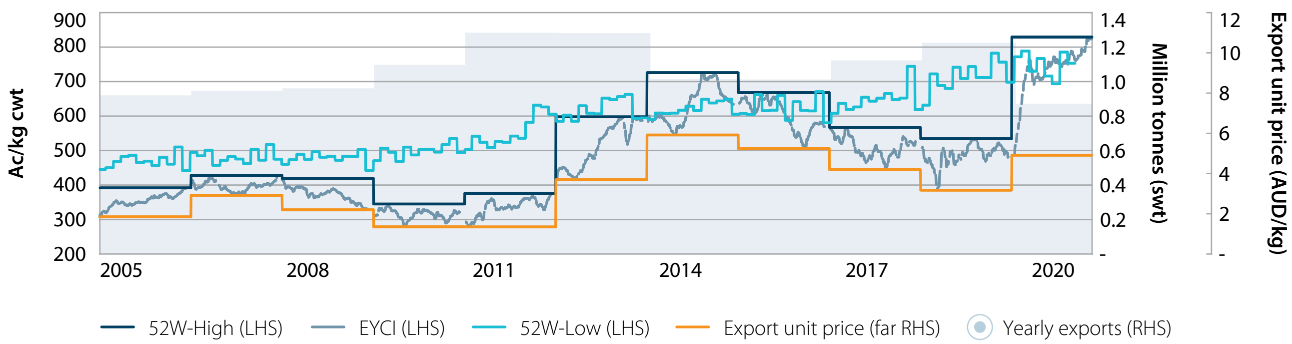
Source: MLA, ABARES, ANZ

AUSTRALIAN CATTLE HERD REBUILD FORECAST



Source: MLA, ABARES, ANZ

AUSTRALIAN CATTLE PRICES VS EXPORTS



Source: MLA, ABARES, ANZ

As some processors have already tried, the option does exist to reduce capacity or shifts, while waiting for the market to cool, although as domestic and export orders will eventually need to be filled, this can only be a short-term option. More likely is that some of this cost will be passed on to the retailer, and ultimately the consumer. While theories vary, it seems reasonable that a moderate increase in beef prices would have minimal impact on domestic consumption, particularly at a time when many Australian consumers are coming into the Christmas and summer BBQ season, as well as going through a relaxed post-COVID-19 period, when household spending may be less tightly scrutinised than earlier in the year.

The outlook for beef exports heading into 2021 continues to be dominated by question marks over the outlook for trade with China. While China initially banned imports from five Australian processing operations, the lack of any further action since August has led to some cautious speculation that this may be the extent of the bans.

Trade with China is clearly down – beef exports to October this year were 27 per cent down on the previous year – but this has also been impacted by triggered safeguard tariffs on Australian beef, as well as strong competition from much cheaper South American competitors, at a time when the Australian dollar remains surprisingly strong.

The outlook for exports to China will be undoubtedly be influenced by the policies of the new US administration, and how hard they push American beef to compete with the Australian product in China – or other markets. In addition, as China's pig herd continues to rebuild after the worst of the African Swine Fever (ASF) reduction, it will be important to watch how much this eats into China's meat import requirements.

ASF could also impact other markets, if a build-up of beef in global supply chains, originally planned for China, needs to be utilised in markets like Korea and Japan, or reduces the US demand for Australian beef. For Japan and Korea, as with China, the actions of the new US administration, particularly around trade agreements and promotion, will impact the level of competition Australia faces in these markets.

For all the different challenges it has faced over the past three years, the Australian beef industry, and beef producers, find themselves in a relatively strong position heading into 2021. That said, given the circumstances required over the coming year for current prices to prove rewarding, there will be no room for complacency.

SHEEP INSIGHTS

OVERVIEW

+ After a year of ups and downs, saleyard prices are performing well on the back of continuing restocker demand and returning export demand
+ Providing good seasonal conditions and restocker demand continue, 2021 may see the National Trade Lamb Indicator (NTLI) reach a peak, challenging the 1,000c/kg mark
+ Restocker demand and the low national flock will continue to support prices into the foreseeable future

– The sheep market has been impacted more than most by the events of 2020 through processing plant closures and export demand reductions

– The spring flush from Victoria has yet to really hit the market, meaning some softening of prices is expected

– Export levels have not yet fully recovered and important markets such as China still continue to lag export levels from last year

The Australian sheep industry has suffered from more volatility than most other commodities through 2020, after feeling the impacts of meat processing closures in Victoria, a reduction in export demand due to COVID-19 and falls in the wool price. Having said that, indicator prices are currently sitting higher than this time last year and demand is strong for both sheep and lambs as producers continue to rebuild following the drought. Looking forward to 2021, the outlook is strong and with the national flock rebuild continuing at pace, the peak of NTLI may threaten the 1,000c mark. A number of factors may pull the market up short of that mark however, and producers should continue to keep a 'weather eye' on export demand from the US, Middle East and China and the global economic recovery following COVID.

Lamb slaughter rates in the east are steadily increasing as is usual at this time of year, and slaughter numbers are sitting at similar levels on previous years. However New South Wales is currently undertaking the bulk of the eastern states' slaughtering as Victoria lags slaughtering at this time last year. Slaughter rates in the west for lambs are down substantially from this time in 2019, primarily as a result of a large number of lambs being shipped across the Nullarbor to eastern states. The story for mutton slaughter is markedly different with sheep slaughterings down almost 50 per cent on 2019 in the east, although on par with last year in the west. There is a supply lining up in the saleyards, however, as yardings start to increase strongly across the country.

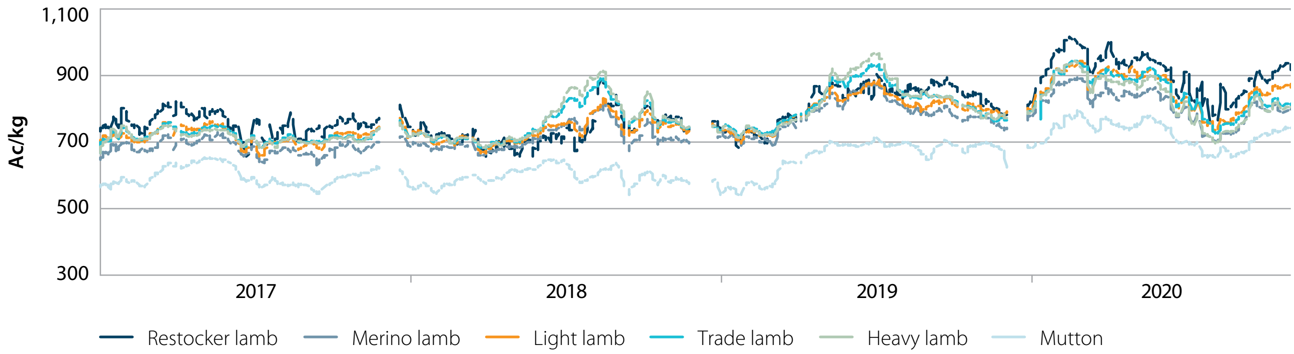
To date, yardings in South Australia are up significantly, although yardings in Victoria are yet to record to the numbers seen in the spring flush – however coming weeks should see those numbers increase strongly.

Looking forward at expectations for 2021, the continuing demand from restockers for lambs and ewes, as well as the global economic recovery driving export demand, particularly for lamb, should see strong upward pressure on prices. Provided good seasonal conditions also continue the NTLI could peak at close to the 1000c/kg mark.

Saleyard prices are holding firm in the face of the spring flush, however, with ongoing restocker demand smoothing over the impact of increased yardings. The NTLI is now sitting over 760c/kg, almost 50c/kg higher than this time last year, although there was some slight softness in the South Australian market due to yarding numbers while Victorian prices firmed. Prices in Western Australia are also holding firm, however much of this stems from destocking and transporting ewes and lambs across to eastern states. Relatively poor seasonal conditions, and low soil moisture in the west and high ewe prices in the east are seeing Western Australian producers take advantage.

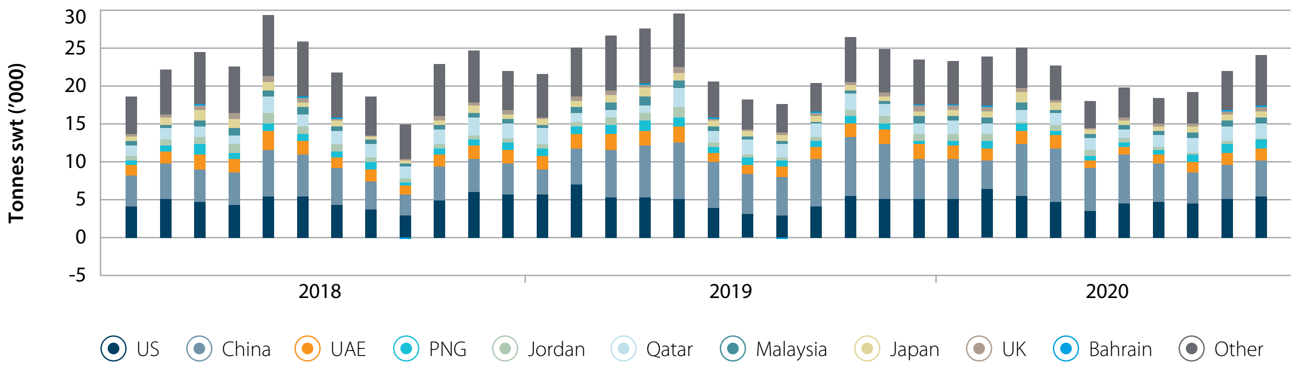
The real story is mutton prices which, at the time of writing, saw the National Mutton Indicator sitting at over 630c and while not yet back to the record levels seen early in 2020, the price spread between trade lambs and mutton is the smallest on record.

EASTERN STATES SALEYARD INDICATORS



Source: MLA

LAMB EXPORTS

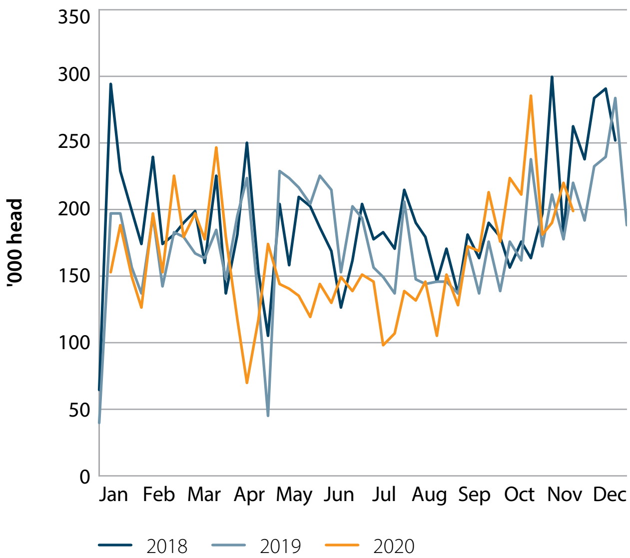


Source: MLA

This is obviously stemming from lack of supply as sheep slaughterings are over 40 per cent below the same time last year. This comes as producers retain ewes for an additional year or two to help boost their flock replacement. At the same time, export demand for mutton continues to be strong from China as a result of ASF reducing pork supplies, as well as lower global economic growth pushing consumers towards cheaper cuts of meat.

Lamb exports continue to grow out of the COVID-19 period and while not yet back to the same levels seen last year, we are seeing solid growth. While calendar-year-to-date lamb exports are down 7 per cent on 2019 and mutton exports are down 21 per cent, this deficit is being eroded as markets such as US, China and the Middle East start to return to normal. Also on the positive side, lamb meat exports have not yet been flagged as a potential target of China's trade bans, primarily because the Australian industry's key role in international trade, meaning that China would find it difficult to source enough sheep meat from alternative markets. And while this is no safeguard against future trade sanctions, Australia's sheep meat exports are sufficiently diversified across a range of destinations to make finding alternative markets for Australian exports easier to find than for some other commodities.

WEEKLY LAMB YARDINGS



Source: MLA

WOOL INSIGHTS

OVERVIEW

+ September's historic lows seem to have subsided with Eastern Market Indicator (EMI) consistently remaining above the 1000 c/kg mark.
+ Prices are still profitable and premiums are available to those with differentiated products such as super fine non-mulesed wool

– Erratic prices are likely to continue as we see COVID-19 pandemic continue impact global demand
– Buyers looking for clarity from National Wool Identification on non-mulesed wool classification

With shearing well and truly underway across Australia, the industry has seen consistently higher volumes hitting the market in recent weeks and some significant intra-week volatility in prices.

The second wave of COVID-19, sweeping through Europe as it enters winter, has slowed production as a result of reduced global demand for retail and consumer spending. On the other hand, the industry continues to see strong buying from China, with high demand from the domestic market.

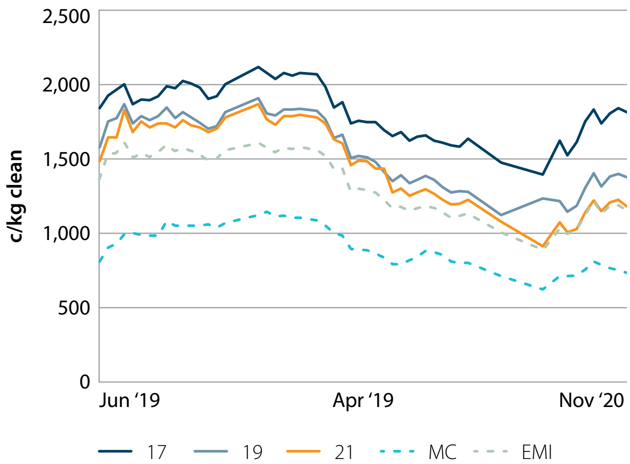
This increase in Chinese buying raises concerns about wool exports being impacted in the ongoing trade tensions, should China pull out of local wool markets. Australia is by far the largest supplier of wool to China, making the trade relationship mutually beneficial and although they may have some stocks, Chinese processors would still need to purchase wool to meet their ongoing requirements.

Producers with premium quality product in the ultra-fine merino range will continue to look towards markets such as Japan and Italy. While formal wear and suits may not currently be 'en vogue' the finer micron wool is highly suitable for wearing against the skin due to its low itch factor and is therefore ideal for the growing athleisure market.

There is also a growing trend in buyers paying a premium for products where specifications under the National Wool Declaration (NWD) have been met. Both International and local apparel brands, such as Hugo Boss and Country Road, are seeking out 'ethical' sources of wool from non-mulesed animals for their garments. There is also a trend toward traceability of the product back to the grower, with NZ implementing this practice as standard in 2018.

AWEX data shows non-mulesed Merinos consistently receiving a premium in the finer micron ranges even while prices have dropped across the board for wool. Analysis by SustainWool from July 2019 has shown a higher clearance rate of 81 per cent for Non-mulesed/Ceased mulesed wool versus just 74 per cent for mulesed without pain relief or undeclared.

WOOL PRICES BY MICRON



Source: AWN, ANZ

Recently there has been some debate in the industry as to whether 'Sheep Freeze Branding' should be independently identified; while it technically meets the current description provided by AWEX of non-mulesed, the question is whether it aligns to expectations of customers. Further studies will need to be completed to provide buyers with the assurance that the new method meets their expectations for welfare standards.

To date, the industry has not seen significant issues with lack of shearing mobility as a result of border closures, as was earlier feared. Additionally, with processors keen to ensure they have wool stocks to cover the three-week Christmas break in auctions, volumes are likely to continue to see strong prices maintained.

COTTON INSIGHTS

OVERVIEW

+ Australian cotton harvested area for 2020–21 tipped to more than triple from last season, as rainfall replenishes soil moisture profiles and on-farm storages
+ La Niña predicted to significantly improve water flow through the Murray Darling Basin, increasing water allocations
+ Australian cotton industry continuously improving production efficiencies

– Global supplies of cotton are ample, with record stocks to use ratios of over 90 per cent for the last two years
– Ongoing lockdowns in Europe and potentially the United States likely to impact on consumer spending
– Uncertainty and volatility likely to continue in the market where the influence of stockpile movements and the US–China trade relationship remain leading factors

Australian cotton producers are looking forward to a better year ahead after significant rainfall was received across much of the country's cotton producing landscape. While many areas are seeing a full profile and water filling dams, others will be limited to small allocations as some areas have, so far, missed rains.

ABARES forecasts production of up to 2 million bales compared to a 12-year low of 590,000 in 2019/20. However, with lower global demand and high stock to use ratios, ABARES forecasts cotton prices to reach their lowest levels (in real terms) since 2001–02 a forecast decline of 6 per cent from 2019–20.

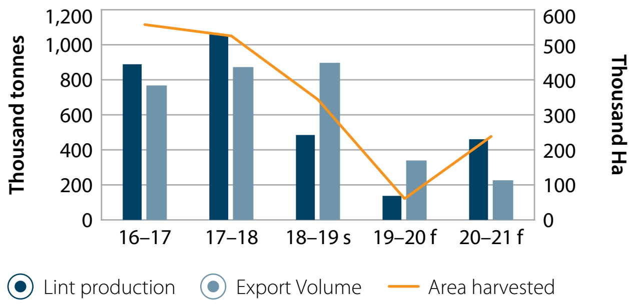
Across much of the eastern seaboard we are seeing increased flows through river systems, leading to increased planting. In a drought year with limited water, a grower may choose not to plant and instead sell their diminished water allocation to another farmer growing perennial crops like vineyards or orchards.

Some growers in NSW are receiving their first water allocations in three years. This has allowed planting areas to increase up to 220 per cent in NSW, however this remains well below the 10-year average. Meanwhile parts of Queensland are yet to see above average rainfall expected from the forecast La Niña.

Europe, the United States and Japan are responsible for importing over 60 per cent of global apparel imports and with additional COVID-19 control measures in Europe and potentially in the US as President Elect Joe Biden takes office, global economic recovery is likely to be slow. Restrictions have reduced consumer demand for apparel and disrupted all parts of the textile supply chain, with demand for apparel and soft furnishings highly income-elastic. While spending on services was reallocated to goods early in lockdown, a slower recovery over the next 12 months is likely to put downward pressure on spending as confidence and demand wanes.

While there has been no official change to the cotton trade agreement between China and Australia, Chinese spinners and mills have been discouraged from buying Australian cotton, with the warnings that they may have their future quotas slashed or be forced to pay up to a 40 per cent tariff.

AUSTRALIAN COTTON AREA, PRODUCTION AND EXPORTS



Source: AWN, ANZ

At the start of this season, China had stocks which equated to 98 per cent of a year's domestic demand. When adding domestic production to the equation, it points to reduced import requirements.

While China is by far the leading spinning centre, markets such as India, Bangladesh and Vietnam are growing. Mill-use is currently at a 10-year low following the global slow down however, with many of these processing countries seeing a recovery, this is expected to improve. Australian exporters will need to focus on marketing the quality and consistency of product to find market share for the increased production.

Lower cotton prices will result in some competition for land from rice, sorghum and potentially pulses looking increasingly more attractive.

While longer term price forecasts remain closer to $500/bale, the focus on improved efficiencies in production by the local industry means it remains at a profitable level.

The question is, given the volatility of climate in Australia and cheaper producers overseas, can cotton remain a profitable long-term option?

DAIRY INSIGHTS

OVERVIEW

+ After decades of gradual decline, Australian dairy herd numbers have now remained steady for the past few years
+ Average milk yields in the Australian dairy herd have continued to rise steadily and strongly
+ Regulatory changes to the New Zealand dairy sector may reduce the NZ level of competition in key markets
+ Yields continue to rise with technology and efficiency gains

– Ongoing strong prices in other agri sectors, especially beef and sheep, may see increasing competition for dairy land usage
– Gains from consolidation in dairy production operations may be less than competing agri sectors, impacting competition for outside investment
– While global dairy prices are currently strong, they remain volatile, with particular exposure to geopolitical trade dynamics

While it passed unnoticed outside the industry, this year marked the 20th anniversary of one of the most momentous events in the history of the Australian dairy sector. In July 2000, the Australian dairy industry was deregulated, an event which still creates discussion and debate. Undeniably, the 20 years since that time have been a rollercoaster ride for the industry. But as the Australian dairy sector looks toward 2021 and the decade ahead, there are many signals that the coming period may see the rewards for the years of hard work.

To grasp the impact of dairy deregulation, and the impact that the events of 2000 may be having on the outlook for Australian dairy in the 2020s, it's important to look at what the events of the time entailed.

Like a number of other Australian agri sectors – notably wool and wheat – the Australian dairy industry operated for decades under a regulated structure. The prices farmers received were kept high by subsidies through the state dairy boards, while the negotiations and sale of dairy products for export was centrally controlled by the Australian Dairy Produce Board, which became the Australian Dairy Corporation. As the system evolved through the 1980s and 1990s, analysis by subsequent governments found that the industry in 1986 was receiving around 57 per cent assistance, compared to 11 per cent at the time for other agricultural industries, all while consumers were paying hundreds of millions of dollars more than necessary for milk and dairy products.

After a series of gradual reforms over several years, in July 2000, the Federal Government abolished the last two major price support mechanisms. Effectively, the result set the industry onto the path where it sits today, where prices are directly impacted by the world market and the actions of the major Australian retail players, while the major processors largely play the role of providing farmgate price options to most producers.

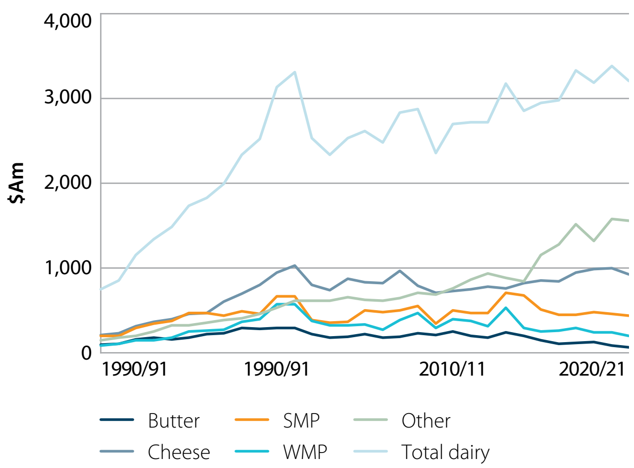
While the impact of the events at the time were major, an analysis of the industry's current prediction clearly provides a cause for optimism.

Looking ahead, Australian milk production looks set for one of the strongest volume rises in 20 years. With ABARES forecasting domestic milk production to rise 3 per cent to 9 billion litres in 2020/21, this would also mean that it is roughly equivalent to 2010 levels, continuing a decade-long trend of having roughly plateaued, albeit with some volatility.

At the same time, forecasts would also indicate that the national milking herd has also roughly plateaued. From 2.2 million milkers in 2000/01, out of a total dairy herd of 3.2 million, milker numbers are forecast to remain at around the 1.4 million mark in 2020/21 for the third year in a row, again roughly similar to the 2010/11 herd size.

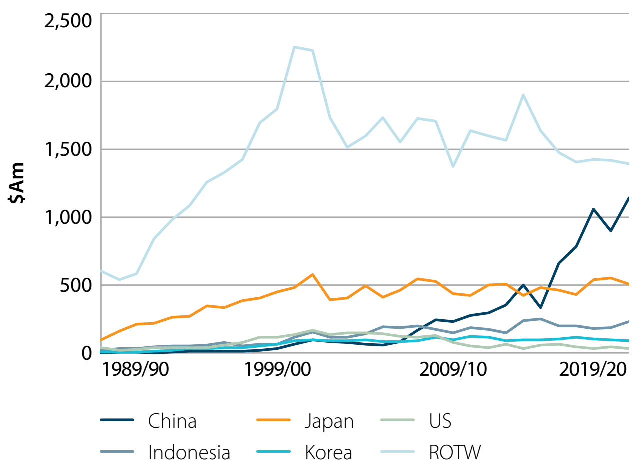
A stabilisation of these overall herd numbers is arguably a stronger sign of market sentiment in the dairy industry than for a sector such as beef cattle. For the latter, the high female slaughter rate in the herd, caused by several years of drought, has meant that herd numbers were forced down, and that a slow recovery in the herd size, to allow producers to restock, is unavoidable.

AUSTRALIAN DAIRY EXPORTS (BY VALUE)



Source: Dairy Australia

AUSTRALIAN DAIRY EXPORTS – MAJOR MARKETS (BY VALUE)



Source: Dairy Australia

For the dairy industry, however, where the ability to ramp up (or down) the herd numbers is far more at the discretion of the producers, this stabilisation indicates that producers are not changing land use for sectors such as beef or sheep. Rather, they are showing confidence in the sector by choosing to stay in it, over the alternatives.

A further reason for confidence in the future of the sector is the steady average yield growth of Australian cattle, at a rate and consistency unmatched by any other major agri sector. For 2020–21, ABARES is forecasting the annual litre/cow production at 6,432 litres. This is up 11 per cent over the previous 10 years, 32 per cent over the previous 20 years, 68 per cent since 1990 and a staggering 123 per cent since 1980. Given that yields are continuing to rise while many technological and efficiency gains are seeing costs fall, this bodes well as a positive sign for producers, particularly those looking to benefit from growth in scale.

On the domestic demand side, dairy is likely to be one of the food categories which emerge stronger from the 2020 COVID-19 disruption. As Australian households have cooked far more at home, they have utilised far more ingredients such as cheese and natural yoghurt for their recipes. Interestingly, one category which has suffered has been flavoured milk, presumably due to the disruptions to people travelling to work, and to the trades who are traditionally the biggest consumers, although this is likely to return.

While Australian per capita consumption of milk has been falling marginally over the past decade, it remains among the world's largest consumers per head. Interestingly, Australians have continued to drink more regular milk and less reduced fat milk over the past decade, with the market shares moving from 50 per cent regular/31 per cent low fat in 2010 to 57 per cent regular/24 per cent low fat in 2020. The remainder of liquid milk consumption is largely made up of flavoured and UHT milk.

In terms of exports, the outlook remains similarly promising, albeit with the same caution being felt by all other agri commodities. This is emphasised by the fact that China now makes up one-third of the value of Australia's total dairy exports. The outlook for these exports remains unclear. While China has initiated trade bans or disruptions on a number of agri sectors, it is also possible that the importance placed by Chinese consumers on the perceived safety and quality of Australian Infant Milk Formulas and Skim/Whole Milk Powders, particularly for their children, could make this a sensitive trade channel to disrupt.

To a lesser extent, Australian dairy exports may also benefit from some of the regulatory changes which may impact the New Zealand dairy industry, which are forecast to see milk production decline, potentially reducing export competition with Australia in key markets.

One industry factor which will have a major bearing on the direction of the industry will be the rate of outside investment into the supply chain, particularly into the production sector. Looking back over the past decade, the growth of new entrants and investors into the sector was at its strongest around five years ago, driven by the promise of growing exports to China, as well as the reasonable availability of smaller or distressed production assets. In the years since then, the investment flow has focused more on sectors such as grain and beef, potentially due to their lower labour intensiveness and less volatile global markets, as well as to permanent crops such as nuts and citrus.

Looking ahead, given that the consolidation of the sector has led to the growth of greater average farm efficiencies, and that infrastructure costs are falling for new and more advanced dairy operations, and that the outlook for domestic and export consumption remains reasonably strong, it is quite foreseeable that investors keen to enter the Food, Beverage and Agriculture (FBA) space will be having a whole new look at the dairy industry.

PIG INSIGHTS

OVERVIEW

+ After a dramatic decline in numbers due to African Swine Fever (ASF), China's domestic pig herd is recovering reasonably quickly, almost back to pre-ASF levels
+ The Chinese pork supply chain is evolving rapidly from one of largely small farmers to more modern, efficient and safer process
+ The Australian pork industry continues to see steady growth, including rising export premiums to key markets

– The quick recovery of China's pork supply chain may see some disruption in the global pork and meat trade, which had anticipated a greater import need by China in the longer term

– While the threat of ASF to the Australian pork industry has greatly reduced, it remains an area requiring diligence by the sector

– Australian pork products continue to face competition in the local market, particularly from the US

For the past two years, the main discussions around pigs and pork in agricultural circles have been around their indirect impact. The spread of ASF, through China and globally, has had major ramifications not just for the global pork market, but for the entire global meat sector, especially beef and sheep meat.

At the same time, Australia's domestic industry, while considerably smaller than the other meat industries, continues to grow at a steady rate of production.

In China, while the impact of ASF continues to be felt, the country is also going through an impressive recovery period to build its pig herd and pork production numbers. Prior to the start of ASF, China had around 420 million pigs, or over half of all pigs on Earth. By late last year, this number had fallen over a third, to 264 million pigs, though is now estimated to have recovered to around 375 million pigs.

A major factor in this recovery has been the transformation of China's pork production sector, from one dominated by small farmers, to one increasingly dominated by large scale industrial pork production operations. By doing this, China is not only working towards restoring the domestic supply of pork to consumers, but seeking to avoid a repeat of the conditions which led to the previous ASF outbreak.

During the period of ASF, China markedly altered its animal protein consumption patterns, replacing the unavailable pork supplies with substantial imports of beef and, to a degree, sheep meat. In addition, China also sought to substantially increase its imports of pork, particularly from the US.

The challenge for exporters from Australia and globally will be how to plan and position for China's meat consumption and import needs as the pig herd recovers. As part of this, stakeholders will need to decide whether the Chinese per capita consumption of pork will or will not return to previous levels, and if so, what proportion will be taken up by imported beef, sheep meat and other meats.

At the same time, global pork exporters will be looking to gear their production levels or redirect certain levels of their exports, if the previously forecast long term Chinese pork import needs are reduced faster than originally forecast.

While the Australian pork industry is not on a major scale in comparison to the largest global pork producers, it has continued to see an ongoing upward trend in production as well as yields. In terms of consumption, Australian pork has continued to trend upwards for decades, from 100,000 tonnes 60 years ago to a forecast of over 600,000 tonnes in 2021. Of this, around two-thirds is produced domestically, while around a third is imported.

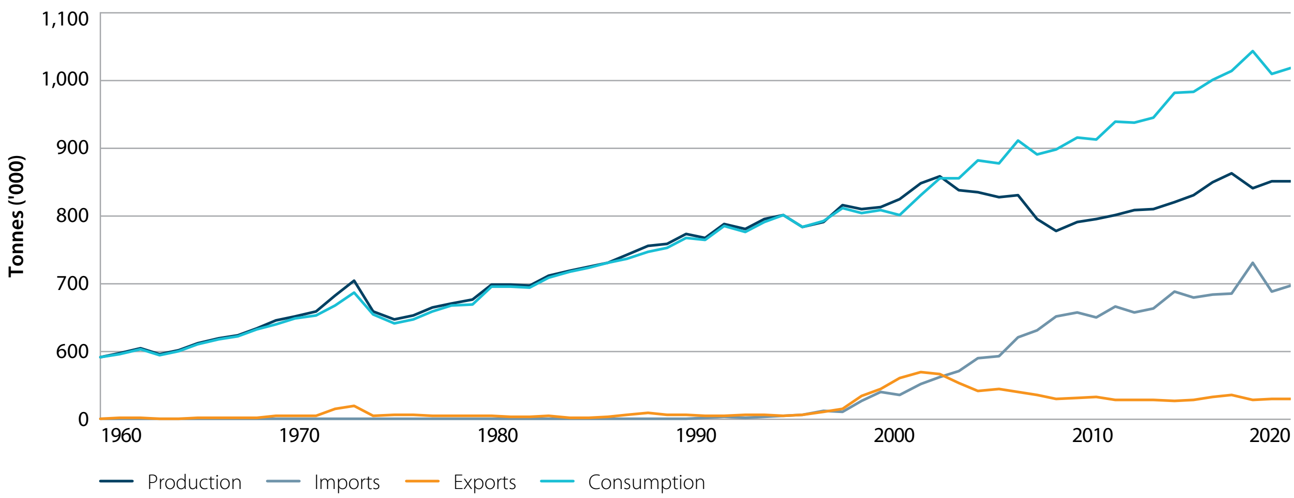
The Australian pork industry is also seeing reasonable export value growth, with annual pork exports to September 2020 up almost 30 per cent to $165 million. In a sign of rising pork prices, this is despite annual export volumes only being up 2 per cent, to 40,000 tonnes. Singapore is the largest market for exports for almost half the export revenue, followed by Vietnam, Papua New Guinea, New Zealand and Hong Kong.

At the same time, imports of pork to Australia continue to climb strongly. To mid-2020, Imports had reached almost $900 million or 183,000 tonnes, up 20 per cent on the previous year. Of this, the US accounted for around half, followed by Denmark, the Netherlands, Canada and Ireland. This is a considerable change from a decade ago, when Canada and Denmark accounted for two-thirds of Australian imports.

Given the attention paid by consumers to the origin of many of their food products, interestingly, less attention is paid to the origin of pork products. Essentially, all fresh pork products are produced in Australia, while the pork ingredients such as ham, bacon, salami and other smallgoods are mostly from imported products.

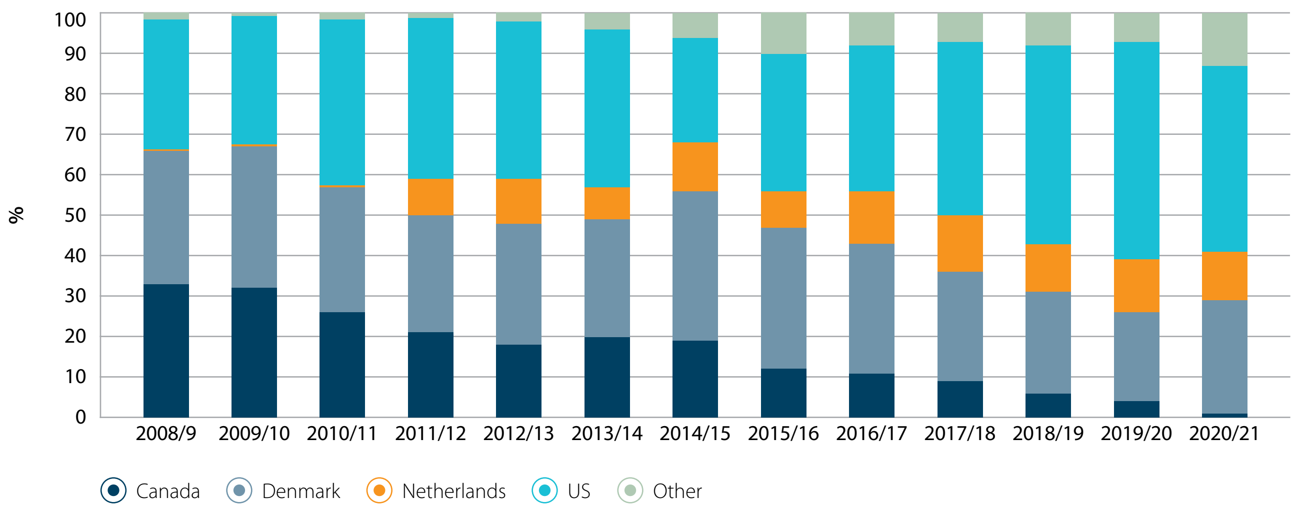
Looking ahead, the Australian pig industry is likely to continue to see steady growth, while being happy to stay out of the headlines. As consumers return to some of their pre-COVID-19 food-buying behaviours, including becoming discerning about the origins of their food purchases, one potential area of growth would be for local producers to seek a greater share of the processed market. Given the economies of scale by the major processors in the US and other markets, it would seem likely that Australian producers would need to market as a premium product, seeking profitability through a price premium.

AUSTRALIAN PORK INDUSTRY TIMELINE



Source: ABARES, Bloomberg, ANZ

AUSTRALIAN PORK IMPORT VOLUME (PERCENTAGE)



Source: ABARES, Bloomberg, ANZ

SURVIVING COVID-19

COVID-19's impact on the Australian economy was quicker and deeper than the triggers for other recessions.

The 7 per cent GDP decline in Q2 was unprecedented, as were the 870,000+ job losses that occurred between March and May. While things have improved greatly since the pandemic's initial impacts, with more than 648,000 jobs regained, the flow-on effects are far from over. We expect to see more unemployment and record low wage growth during the gradual return to pre-pandemic levels of economic activity in the future.

COVID-19 was fundamentally different from other downturns because much of the economic loss came from the restriction of people's movement. Restrictions in access for households to earn and spend as they usually do was a major, if not the biggest, factor in the economy's record decline in Q2. At its worst, optional travel in major cities was 40–50 per cent lower than pre-pandemic. Household consumption fell by 12.1 per cent quarter on quarter in Q2, the biggest quarterly decline by more than 10 ppts since quarterly records began in 1959.

But restrictions in household movement did not hurt all types of spending. After a shaky June quarter, retail sales grew stronger on an annual basis in the September quarter (+4.2 per cent year-on-year) than all but one quarter in the 12 years prior. Government income support had a big part in this, not only by reducing the peak of unemployment by keeping businesses afloat, but also by directly assisting households through JobKeeper payments and the JobSeeker supplement.

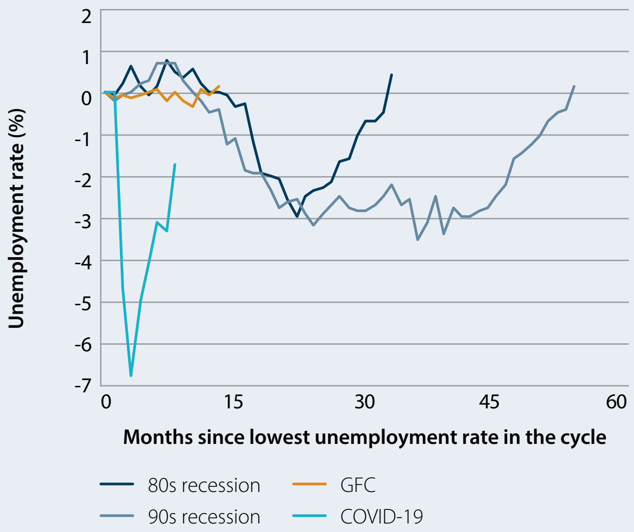
Government support and the shift of consumption from services, entertainment and travel to physical goods were a boon for many retailers, particularly those that traded in household goods, food and groceries. Household goods sales grew 22.3 per cent year-on-year to the September quarter, while supermarket sales grew 11.8 per cent year-on-year. ANZ-observed spending has indicated that shopping and grocery spending has been consistently above pre-pandemic growth rates since May.

Price-adjusted sales growth for food retailers (i.e. grocers and the like, not restaurateurs) grew 9.1 per cent quarter on quarter in the March quarter, more than double the previous record-high for price-adjusted food retail sales growth. Annual growth for this sector in the September quarter (7.5 per cent year-on-year) was higher than any other quarter since retail sales records began in 1983. But when we take dining/takeaway spending into account, annual growth in price-adjusted food spending falls to just +1.4 per cent year-on-year to the September quarter. Far from unusual, 1.4 per cent year-on-year was the average annual growth for quarters between March 2014 and December 2019.

When we look to the recovery of Australia's economy from the COVID-19 downturn, there are a number of international risks. Border closures slow our population growth (from 1.5 per cent in 2018–19 to 0.2 per cent in 2019-20) and reduce our exports from tourism and international education. Reports of possible issues for Australian exports to China of coal, barley, sugar, timber, wine and lobster may also slow the recovery of goods exports. The value of these in 2019 was about AUD20 billion, representing around 5 per cent of total goods exports. The coordinated global slowdown in economic activity from COVID-19 also limits the speed of recovery for our exports.

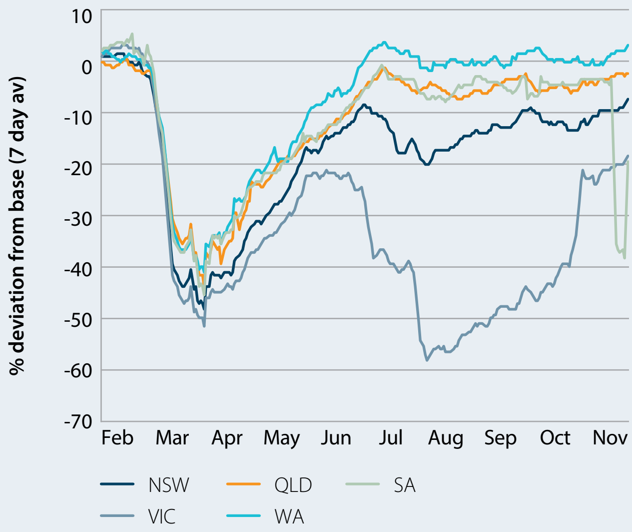
Looking closer to home, the reduction in direct fiscal support as the emergency policies put in place reach their end-by date will slow local consumption growth, as elevated unemployment continues in 2021. While this will decrease consumption for discretionary products more than food, it may also make the average consumer more budget-conscious, which affects all consumption categories. Overall, we expect a 'Nike Swoosh' shaped recovery, where Australia's economic activity will increase more slowly than it fell, until we get back to pre-pandemic levels of activity sometime in the future.

EMPLOYMENT



Source: ABS, ANZ Research

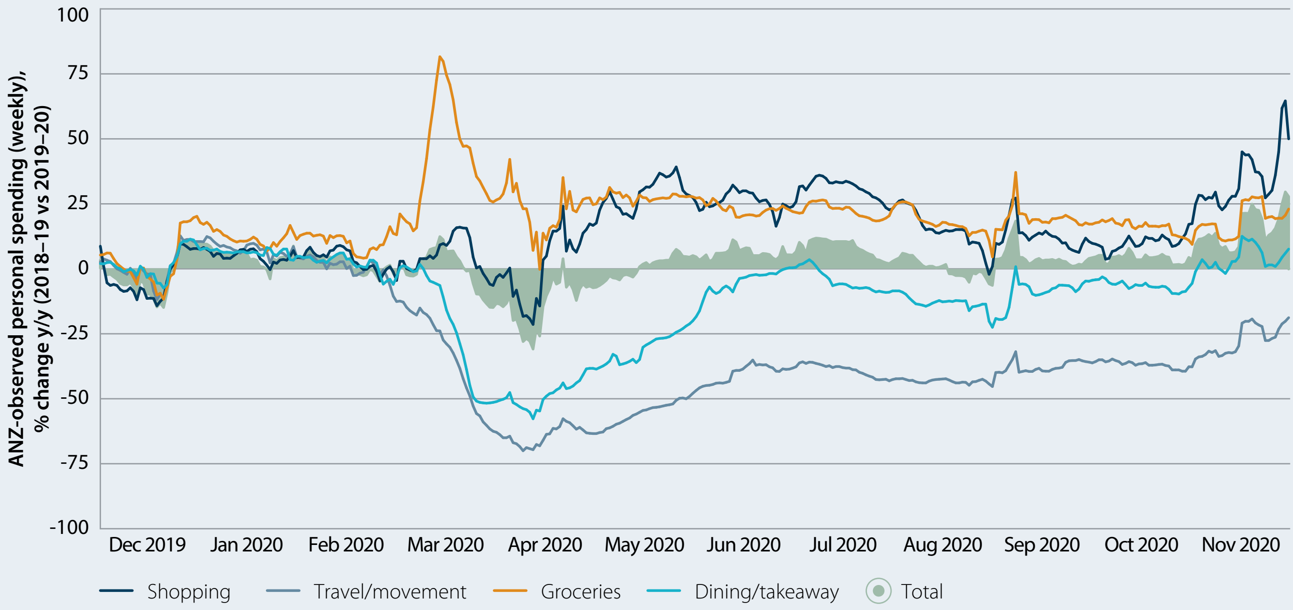
TRAVEL



Source: ABS, ANZ Research

OVERALL, WE EXPECT A 'NIKE SWOOSH' SHAPED RECOVERY, WHERE AUSTRALIA'S ECONOMIC ACTIVITY WILL INCREASE MORE SLOWLY THAN IT FELL, UNTIL WE GET BACK TO PRE-PANDEMIC LEVELS OF ACTIVITY SOMETIME IN THE FUTURE.

PERSONAL SPENDING



Source: ANZ Research

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