ANZ AGRI

INFOCUS

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COMMODITY INSIGHTS

FOREWORD

While everyone involved in agriculture is well accustomed to the cycles of the industry, it has been a long time since the year began with so many positives. Despite all the complexities from many aspects of farming, nothing is as important as the season itself, and in almost every farming region of Australia, the level of rainfall, combined with the summer temperatures over the past few months have been excellent. This particularly includes livestock or dairy producers making the most of some of the best late summer pasture in years to keep stock in top condition and save on supplementary feeding costs, as well as grain producers, fresh from a record harvest, preparing to sow into areas of excellent soil moisture.

At the same time, while prices for agri commodities may start to level after some of the extraordinary peaks of 2021, they remain historically very high across the board. Whether it is cattle, sheep, dairy products or grains and oilseeds, most agri commodity prices are continuing to be boosted. There are challenges faced by Australia's main global competitors, increasing global demand as economies continue their Covid recoveries, and a heightened push to procure exports based on the global geopolitical uncertainties – all topped off by the high production volumes, Australian producers have largely continued to enjoy in the last two years since the drought.

As agricultural producers and supply chain operators look ahead to see what the year may hold, it will be important to view the glass (of good local milk or perhaps Chardonnay) as being both half empty and half full.

The half empty glass reminds all those in agribusiness that while a great season may be a time to enjoy the fruits of your hard work, and to take a break at some point, it is not a period for complacency. At some point, the season will inevitably turn, commodity prices will come down from their highs, and interest rates will eventually rise again. For these and other possible eventualities, agribusinesses across Australia need to continue to plan their strategies accordingly.

Crucially, it is just as important to remember that the glass is also half full. While every challenge is a day closer so is every great opportunity. Taking the time to research and implement a change to any operation can bring a wide range of benefits – not just economic and agronomic, but also increasing the enjoyment and mental stimulation of running the business. This could take a vast array of forms – whether increasing farm plantations for stock benefits and income diversity, exploring new crop varieties, or implementing new developments in agtech, genetics or sustainability management.

This potential to grasp new opportunities at the right time extends right down the agri supply chain, as companies right from the farm-gate to the consumer's table look for new efficiencies, new markets, and new technologies. The importance of developing a number of these changes will have been as a reaction to the ongoing Covid-related supply chain interruptions, but there is every reason why these developments could have long terms benefits for many businesses.

For agribusinesses who are doing well at the start of 2022, the benefits are only partially due to the impact of good weather and favourable global factors, and more to do with all the hard work the industry has experienced in tougher years leading up to this point – and for that, farmers and agribusinesses should justly be proud. The need to make the most of these good times will be the next iteration of that hard work.

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GLOBAL CROPPING INSIGHTS

OVERVIEW

- Global stock-to-use ratios remain highest in the geopolitically sensitive staple grains of wheat and rice
- China's high end-stock policy will continue to impact the global grain trade
- Soybeans aside, China's share of the global imports for other crops is less concentrated than may be widely thought
- The percentage of Australian wheat, canola and barley exported has seen recent strong growth based on robust global demand

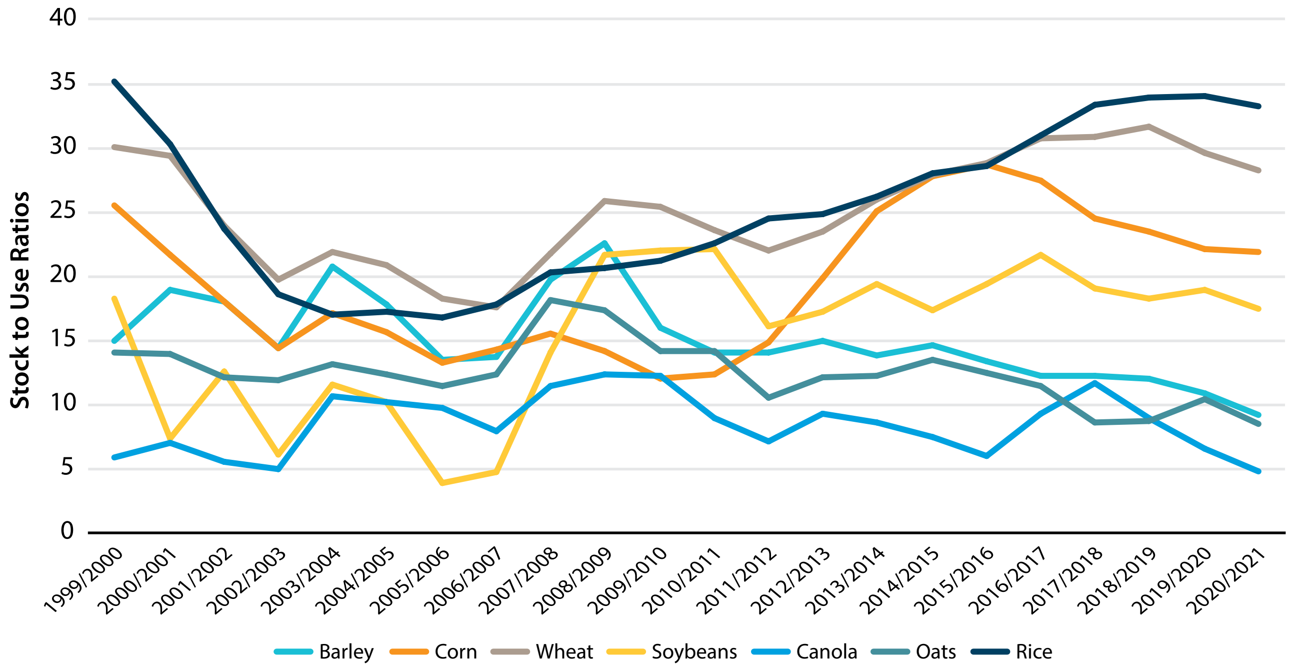
While the grains and oilseeds sector may have two fundamental events each year, globally it is in a constant cycle. Granted, the central tasks for every grain grower in the world are sowing and harvesting, while crop monitoring, input application and machinery maintenance also remain vital.

Yet while these factors are central to each farm, it is global factors and cycles which will normally be the major determinants of the price of each commodity. In addition, analysis of these cycles, particularly over the longer term, will play an indirect but important role in the cropping strategies both of farmers and individual countries, as they clarify potential issues such as crop concentration risk, market concentration, opportunities for alternative crops, and areas where greater research may be required.

This longer-term analysis is particularly pertinent at the current time, with most grain and oilseed prices sitting at multi-year highs. This has largely been the result of geopolitical volatility, but also due to poorer crop forecasts in some regions, as well as ongoing strong demand as many economies gradually recover from Covid-related disruptions.

Using data from the USDA from 1999 to 2021, it is possible to examine several aspects of the world's grains and oilseeds landscape over the past two decades and to discuss both the causes and possible opportunities, particularly for the Australian sector.

GLOBAL STOCK TO USE RATIOS OF MAJOR GRAINS AND OILSEEDS



Source: USDA PSD, ANZ

One of the most-watched aspects of the global grain sector is the stock-to-use (SU) ratios or the level of grain in storage compared to the demand at the time. SU ratios have a major impact on the price, as low levels can trigger concerns of possible shortages, leading to enhanced buying levels, as countries seek to increase their stocks. These levels are also likely to increase at times of geopolitical volatility, as countries weigh the risk of possible export bans from their main suppliers.

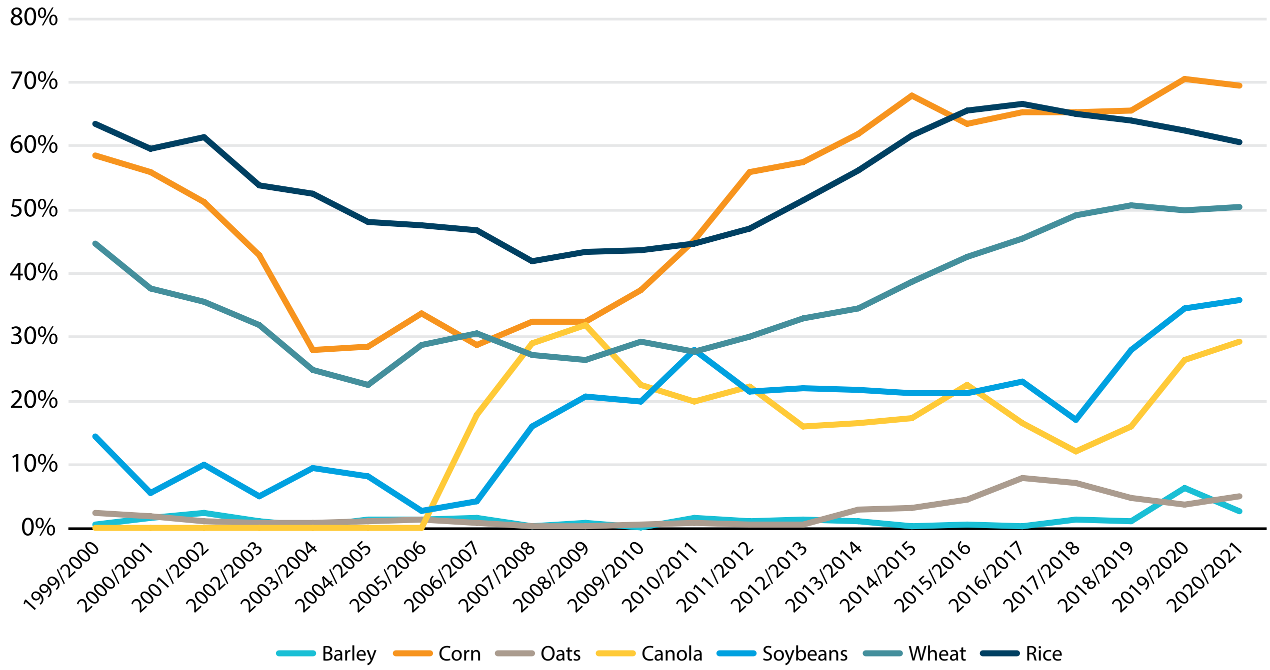
Looking at the data, it is unsurprising that both rice and wheat are by far from the two main crops with the highest SU levels. Each of these is a staple food for many countries, including noodles and bread. The upward trend in SU ratios has largely continued since 2006/07, which was around the time that several countries and governments experienced food riots due to concerns over shortages, as many global exporters instituted temporary bans. In this period, many countries have strategically built up their food reserves, including the infrastructure to achieve this over the long term in a bid to protect themselves should the same level of uncertainty arise again.

While grain can be stored for a reasonable period, it remains a perishable product, thus requiring reserves to be regularly replenished. As a result, given that many countries are likely to seek to retain or increase food reserves, demand for these staples is unlikely to weaken markedly. This is even despite a gradual shift from rice to meat in the diets of consumers in the countries where incomes are increasing.

Any discussion around global grain and oilseed stocks needs to have a major focus on China. This is not just because China has around twenty per cent of the world's population and will therefore always be a major food consumer. Importantly, this is also due to the policies of the Chinese government in terms of maintaining a healthy level of grain and oilseed stocks, as well as the feed needs of China's complex animal supply chain.

For almost the past decade, China's end stocks of both corn and rice have accounted for between 60 and 70 per cent of the global total. In terms of corn, China relies on having adequate levels of it for feed for the pork supply chain, particularly as it rebuilds its hog herd after the impact of African Swine Fever over the past few years. In addition, China also needs to ensure that it will have adequate corn reserves for a reasonable term, given the fluctuations in its domestic corn industry. As the country has adjusted its program around stockpiling domestic corn, as well as paying minimum purchase prices, domestic production has shown a level of volatility.

CHINA % OF MAJOR GLOBAL GRAIN AND OILSEED END STOCKS



Source: USDA PSD, ANZ

While China's high rice stocks are also a protection against possible, at times they are also as a result of fiscal levers used to maintain high domestic prices through government purchases. For rice, as well as for corn and, to a degree, wheat, the high stocks can be interpreted as a positive sign that demand will stay strong for the long term. However, particularly for exporters to China, a very high level of stocks could also be a sign that China may reduce buying for a period, increasing the need for alternative markets.

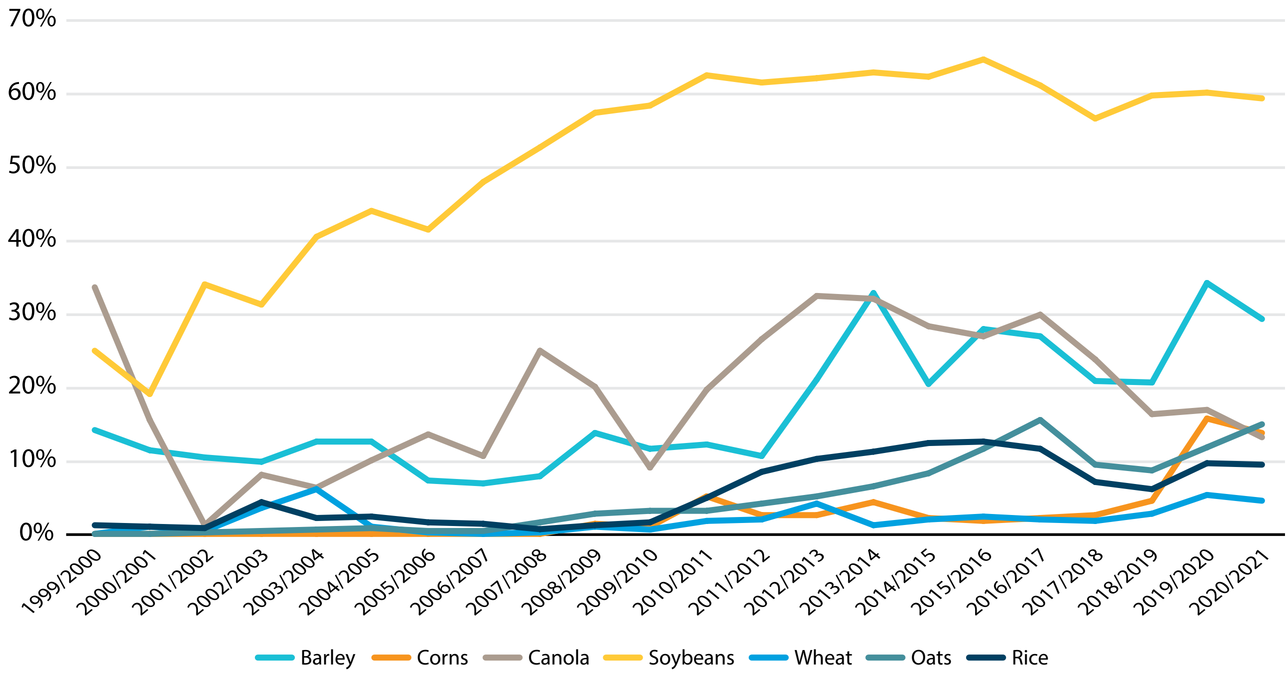
In terms of China's level of concentration as an importer for global grains and oilseeds, it is interesting to look at this from two angles. As far as China's percentage of total global imports of any grain or oilseed, it is the dominant buyer of soybeans, largely as animal feed, as well as for cooking oil. After this, however, it is a major gap to the next highest, barley and canola, both roughly between 20 and 30 per cent of global imports. This highlights the largely diverse global market opportunities for grain and oilseed exports, particularly for Australia.

From a different angle, China's reliance on some of the major crops remains extremely high. In particular, China relies on imports for almost all of its soybeans and barley consumption. Given the strength of the latter, it is little surprise that Australian barley exporters, shut out of China by high tariffs were quickly able to find new markets, as China quickly sought other major global barley exporters to fill this gap.

Interestingly, China is also reasonably reliant on imports of oats for its domestic consumption, a smaller but important opportunity for Australian growers.

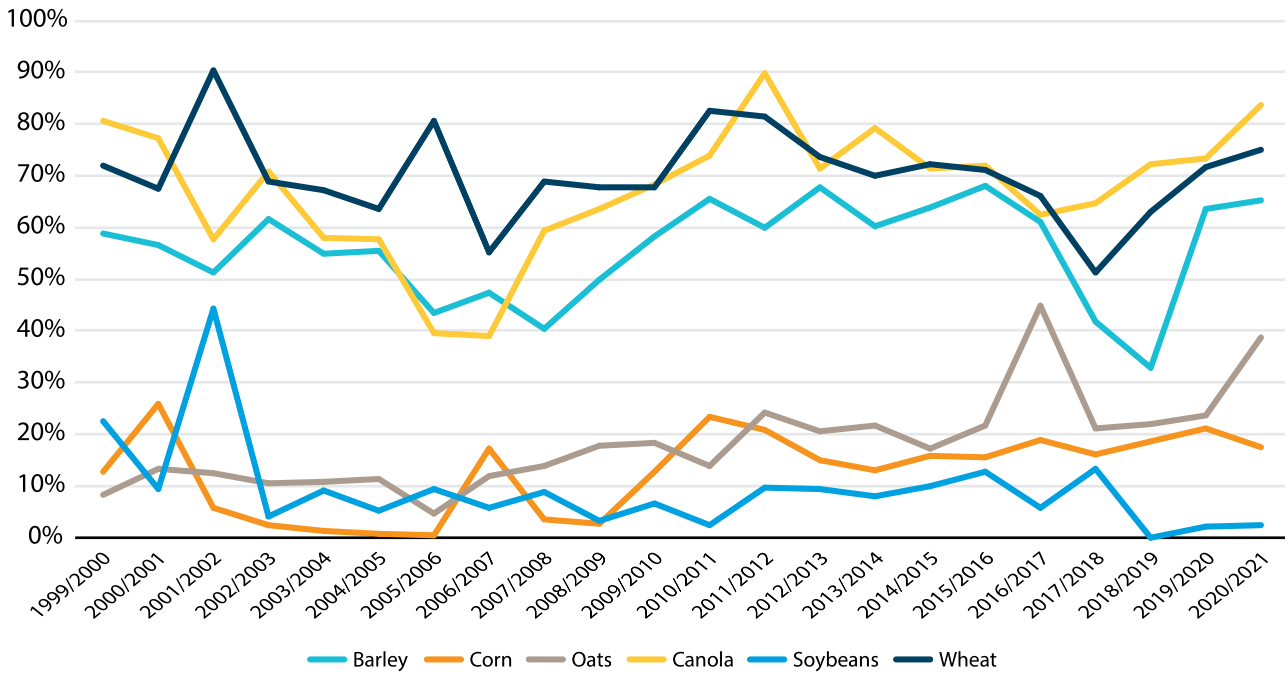
From an Australian production perspective, it is interesting to observe the difference in export dependency between different crops over the period. Certainly, the major crops of wheat, barley and canola remain overwhelmingly export focussed, with wheat and canola at times seeing exports exceed 80 per cent of production. One aspect which does stand out is the volatility of exports over that period. This could be driven by factors including enhanced domestic demand, particularly through feed, reduced production levels leading to the tight supply, and increased global competition. Nevertheless, it is a further reminder that the high export levels cannot be taken for granted.

CHINA % OF MAJOR GLOBAL GRAIN AND OILSEED IMPORTS



Source: USDA PSD, ANZ

PERCENTAGE OF MAJOR AUST CROPS EXPORTED



Source: USDA PSD, ANZ

BEEF INSIGHTS

OVERVIEW

- While restocking activity may slow over the warmer months, an upcoming good season and strong pasture growth should see it return
- The structural decline in the US cattle herd could see excellent potential for the growth in the imports of both Australian manufacturing and premium beef
- The past two years of good seasons should see very strong calving percentages in 2022
- Many Australia's competitors in the Chinese beef import market will continue to have a level of uncertainty around food safety as well as reliability

On most fronts, the Australian cattle and beef industry is heading into 2022 in an excellent position. Most importantly, the seasonal outlook remains good for the foreseeable future, providing a particular positive for restockers. Nationally, the country's cattle herd is forecast to continue to climb, which will ease the tight supply issues which have impacted the sector as it has continued to recover from the drought over the past two years.

Both domestically and globally, demand for beef will continue to grow. At the same time, in Australia's favour, many major international competitors are likely to experience a range of supply challenges, including herd declines, supply chain disruption, and food safety concerns.

Arguably the most discussed aspect of the Australian cattle sector over the past two years has been the rise in prices. As the industry moves through the first quarter of the 2022 year, while prices remain high, it appears that the new story may potentially be one of price volatility over the coming months.

At the start of February, the EYCI saw a two-day fall of almost 80 c/kg, its biggest drop in? While this meant that prices still stayed above 1,100 c/kg, it did highlight the potential for some kind of correction to finally hit the market, having been predicted by many observers over the past two years, yet never actually happening.

There are several factors behind this fall, both direct and indirect, but it will be the trend to watch through this year. At the saleyard level, the fact that the fall happened at the start of February may well reflect the fact that many farmers had actively participated in the annual weaner sales early in January, and had less need to restock than had been the case through 2021.

Looking further ahead, the industry will be buoyed by a number of the forecasts in 2022 Australian Cattle Industry Projections, recently released by Meat and Livestock Australia (MLA). Broadly, underpinned by a favourable weather outlook for at least the coming year. In the medium term, the Bureau of Meteorology is forecasting above-average rainfall for the major cattle regions of NSW and Queensland, with an average rainfall forecast for almost every other cattle region in Australia. This should mean that most of the country will see a continuation of the good pastures experienced over the past two years. In addition, a forecast of above-average temperatures for Queensland, combined with the rain should see enhanced pasture growth, lifting the potential for heightened restocking activity.

HEADING INTO 2022, WHILE THE AUSTRALIAN CATTLE HERD IS FORECAST TO CONTINUE ITS STEADY REBUILD, THE GROWTH RATES ARE LIKELY TO DIFFER ACROSS MAJOR REGIONS.

In southern Australia, given the likelihood of a third straight good season, the large herd of young breeding females and heifers, already in a good condition and on favourable pasture, are likely to see high calving percentages, further boosting herd growth.

In the northern cattle area, where rainfall over the past two years has been less favourable, the herd growth is likely to remain slower, at least until those regions have seen two successive seasons of good conditions.

Overall, the national cattle herd is forecast to grow by four per cent over the year, reaching 27.2 million head in 2022. On the current projects, this could see the herd continuing to grow to 28.2 million head by 2024, which would be the highest level since 2014. One feature of the growing herd will be an abundance of relatively young cattle, following the sell-off during the drought, as well as subsequent restocking and calving.

One important result of the strong herd growth will be an easing of the tight supply of slaughter numbers which have impacted the beef supply chain throughout the post-drought restocking period. In 2022, particularly with calves from late 2020 and early 2021 reaching processor weight, national slaughter numbers are forecast to rise by an impressive eleven per cent to 6.7 million head. Looking further ahead, given optimal conditions, slaughter numbers are forecast to continue to grow strongly, reaching 7.85 million head by 2024. This would be a rise of over 30 per cent in 2021, highlighting the tight conditions for processors over the past year. Notably, however the fact that even this figure would still be below the ten-year slaughter average emphasises the scale of the impact of the drought, and the time it takes to recover.

For processors, the forecast rise in slaughter numbers will be very welcome news, primarily because it is likely to see an easing of high prices, but also in that, it will allow them to not only see greater utilisation of plant capacity but to fill domestic and export demand. That said, processors will be very mindful of potential Covid-related disruptions, not only from possible labour shortages but also from disruptions to freight and logistics.

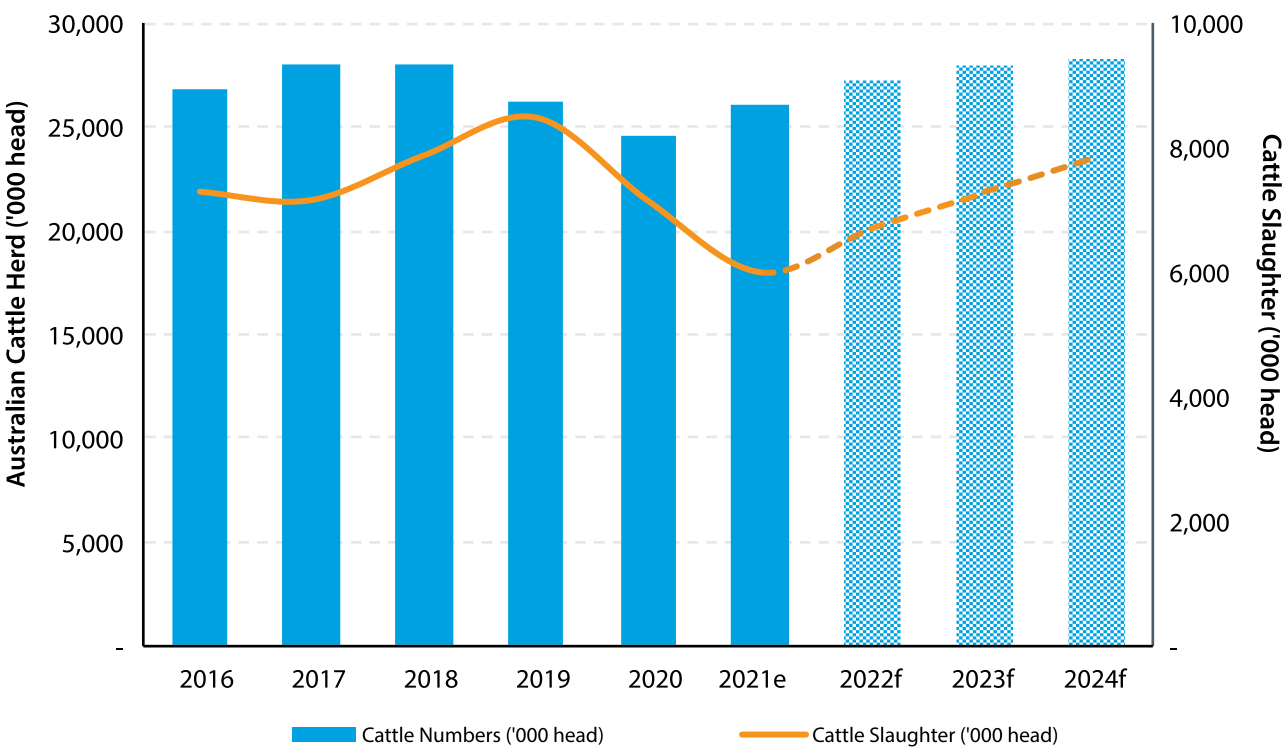
Given the rise in slaughter numbers, combined with improved animal weights, overall beef production is forecast to rise by twelve per cent in 2022, to around 2.1 million tonnes. Looking further ahead, the forecast beef production in 2024 of 2.44 million tonnes would be a new record, higher than the previous mark set in 2019 amid the drought-induced high sell-off.

GLOBALLY, THE OUTLOOK FOR MAJOR EXPORT MARKETS REMAINS STRONG, DRIVEN BY DIFFERENT FACTORS.

The US market is likely to strengthen for Australian exporters, as that country's cattle herd enters a structural decline, and will require greater exports to meet ongoing strong domestic demand. The South Korean market is also likely to present increased opportunities for Australia, due to reduced supplies of the US beef.

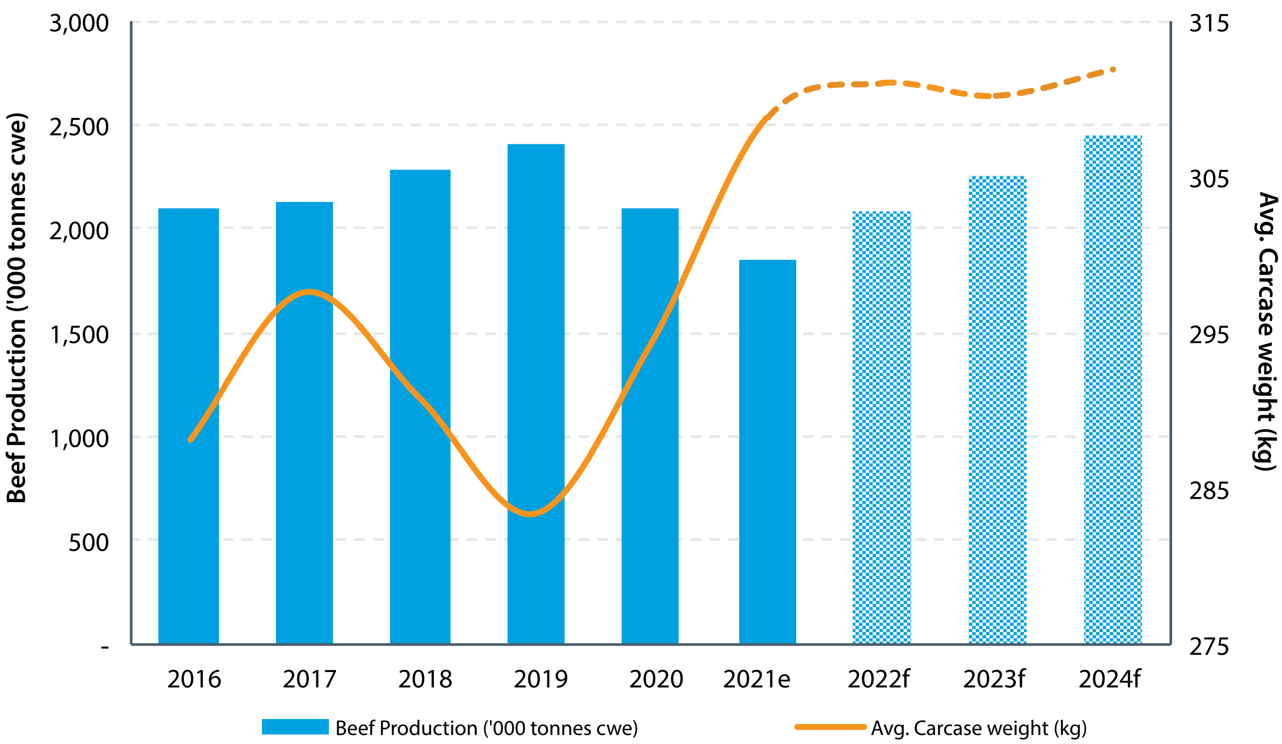
For China, overall beef imports are forecast to increase by ten per cent in 2022 to around 200,000 tonnes. Current predictions are that the bulk of this will be filled by exports from Brazil and Argentina, with Australia likely to see a minor increase in exports. Beef exports to China remain somewhat unpredictable, driven by factors at both ends of the supply chain. Australian processors remain aware of the potential of further bans on individual abattoirs, while South American exporters could also be impacted by any discoveries of BSE, or export bans, as seen in Argentina last year. At the import end, China's strong "Covid-Zero" policy could also potentially impact economic growth, and subsequently consumer beef demand. In addition, the level of Covid activity in a particular country's meat sector could also impact which exporters and markets China utilises more or less.

NATIONAL CATTLE SLAUGHTER FORECAST TO RISE WITH HERD REBUILD



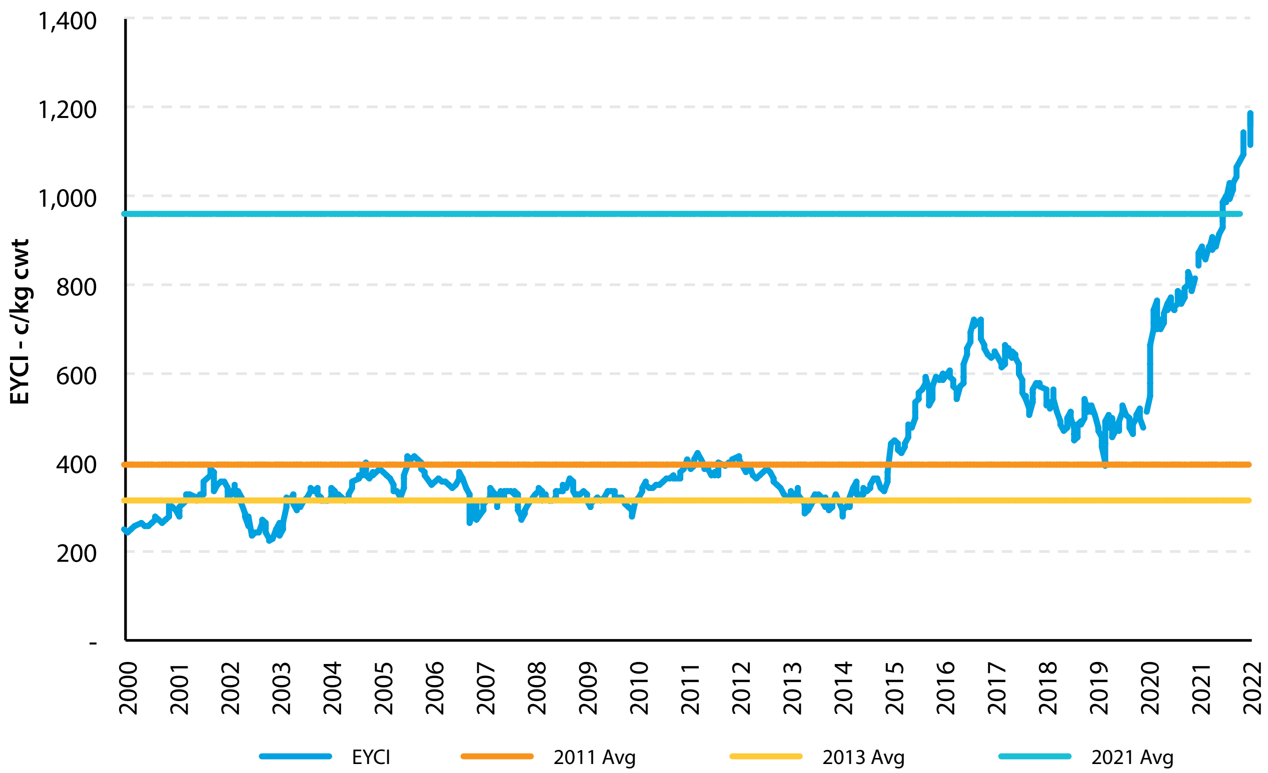
Source: MLA, ANZ

BEEF PRODUCTION FORECAST TO GROW, THOUGH CARCASE WEIGHT GROWTH WILL FLATTEN



Source: MLA, ANZ

EASTERN YOUNG CATTLE INDICATOR (EYCI) VOLATILE, BUT MAINTAIN STRONG LEVELS



Source: MLA, ANZ

GRAINS INSIGHTS

OVERVIEW

- While the pre-harvest rain failed to impact crop volumes, it did cause a notable downgrade in grain quality in some of the regions
- China has remained as a major destination for Australian wheat exports, largely driven by strong feed needs for its recovering hog herd
- Saudi Arabia is now Australia's largest barley export market, with overall barley exports rising, despite China's prohibitive barley import tariffs
- High input prices could see some reduction in crop yields for the 2022/23 harvest

Australian grain farmers know all too well that contrary to what some people may think, there's never really a "downtime" of year. Certainly, the sowing and particularly harvest periods are intensively busy, but the rest of the year involves either monitoring the crop in the ground and providing the inputs needed to maximise its potential, maintaining and upgrading all the plant and equipment needed to run an efficient operation, as well as all the other aspects of the modern farm.

That said, the period around February, when the harvest is effectively finished across the country, at least provides the industry with some kind of a breather to reflect on the harvest just passed and evaluate the factors likely to impact the year ahead. This could include both the choice of crops to be sown, as well as the variables which may impact grain prices.

Despite some concerns toward the end of the season, the 2021/22 Australian grain crop is estimated to have hit new record levels. In particular, the wheat crop reached another record, while Australia's barley reached its third-highest level, despite earlier concerns on the impact of Chinese tariff's on barley farmers' planting intentions.

For wheat, while the record harvest of 34 million tonnes was up around 0.7 million tonnes, or two per cent, on the previous year, it was a massive rise of around 135 per cent on the drought-impacted crop of 2019/20. The record volume was particularly boosted by an optimal growing conditions in Western Australia, which accounts for around 40 per cent of the national wheat crop.

While there had been concern late in 2021 around the possible impact of weather conditions on the crop in some regions, it ultimately had a minor bearing on the overall harvest volume. If anything, the main impact of the heavy rainfall in November 2021 on cropping regions in NSW and Northern Victoria was on the quality of the crop. The rain caused some of the grains to sprout, resulting in a reasonable volume of grain being downgraded to feed wheat in these regions.

The sharp increase in the proportion of feed wheat as part of the overall harvest had a notable impact on wheat prices. Ordinarily, the price gap between feed wheat and milling wheat is around \$20 to \$40 per tonne. However, given the major volume of feed wheat, this gap grew to around \$110 to \$150 per tonne. Notably, milling wheat prices rose sharply from their pre-harvest levels, while feed wheat prices declined from those levels, although remained relatively high based on strong global demand.

In line with the record wheat harvest, Australia is also likely to see record wheat export levels of around 25.5 million tonnes, up around seven per cent on the previous year. This will be driven not just by the record crop, but by ongoing strong global grain import demand.

While Indonesia would ordinarily be Australia's largest wheat export market, the 2021/22 export season has seen exports to China reach around 0.93 million tonnes, over double those to Indonesia in the same period. While the bulk of exports continues to be Asian markets, exports to African markets continue to grow strongly.

While not at the same heights as the wheat crop, the Australian barley harvest of thirteen million tonnes in 2021/22 is still estimated to have been the third-largest ever, not far behind the record crop of 13.5 million tonnes in 2016/17.

The imposition by China of prohibitive tariffs in 2020 have not had a major impact on barley plantings. If anything, the shift of some barley acreage towards canola was driven by high oilseed prices at the time.

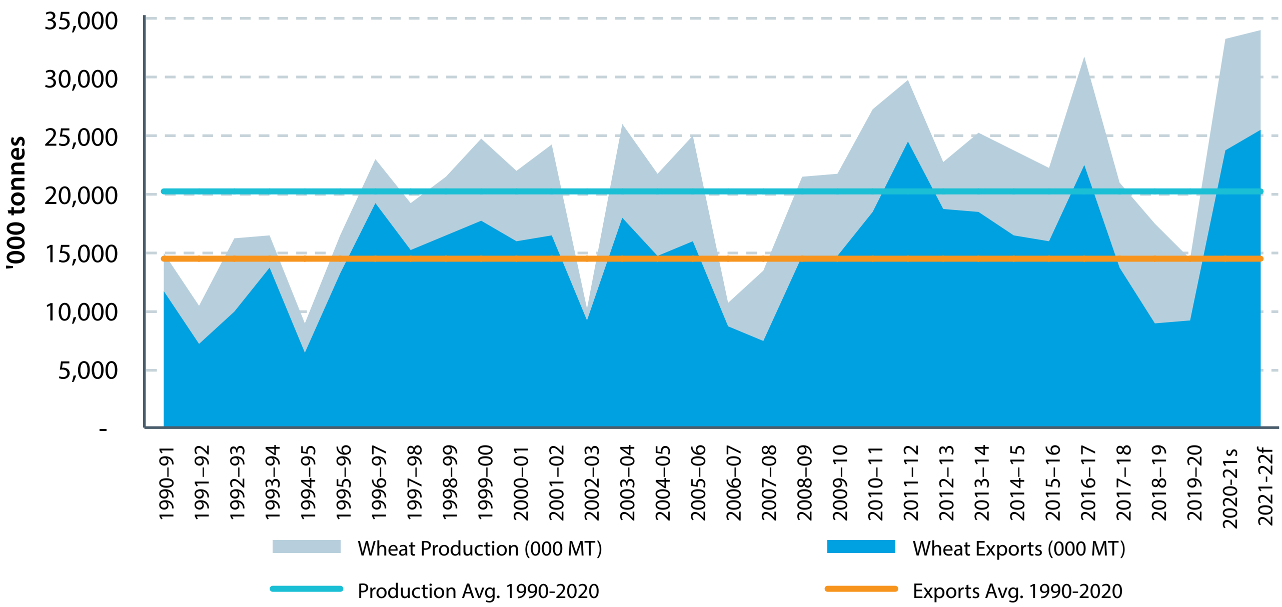
Just as the weather had impacted the wheat crop in different regions, the quality of barley in some regions of NSW, as well as northern Victoria, was also downgraded as a result of heavy rainfall. That said, given that most barley from these areas is feed quality, the impact on price and exports was minimal.

In terms of barley export, overall volumes rose by around two per cent to 8.5 million tonnes. With the Chinese tariffs meaning that barley exports to that country have fallen to zero, the largest market is now Saudi Arabia, which now accounts for around 36 per cent of all exports. Other major barley markets include Japan, Thailand and Vietnam.

Domestically, strong feedlot utilisation has continued to drive domestic barley demand, with this trend likely to continue, on the back of the continuing growth of the domestic cattle herd.

Looking ahead, Australian grain producers will be factoring in the outlook for fertiliser and chemical prices into their planting strategies, particularly given the ongoing uncertainty around global supply chain disruptions and Chinese export bans. One impact may be a slight shift by some producers to more legume crops, while other producers may accept that reduced fertiliser usage may lead to lower yields than over the past two years.

WHEAT PRODUCTION AND EXPORTS WELL ABOVE THIRTY YEAR AVERAGE



Source: Source USDA, ANZ

SHEEP INSIGHTS

OVERVIEW

- The recovery in processor demand has introduced some volatility into the market, with some producers holding stock back from the saleyard until prices stabilise;
- Yardings fell heavily throughout January before recovering slightly, although slaughter numbers at the end of January remained strong across most States except South Australia.
- Export demand has been a driving force for strong saleyard prices for many years – which is expected to continue as Australian producers take advantage of their strong competitive position;

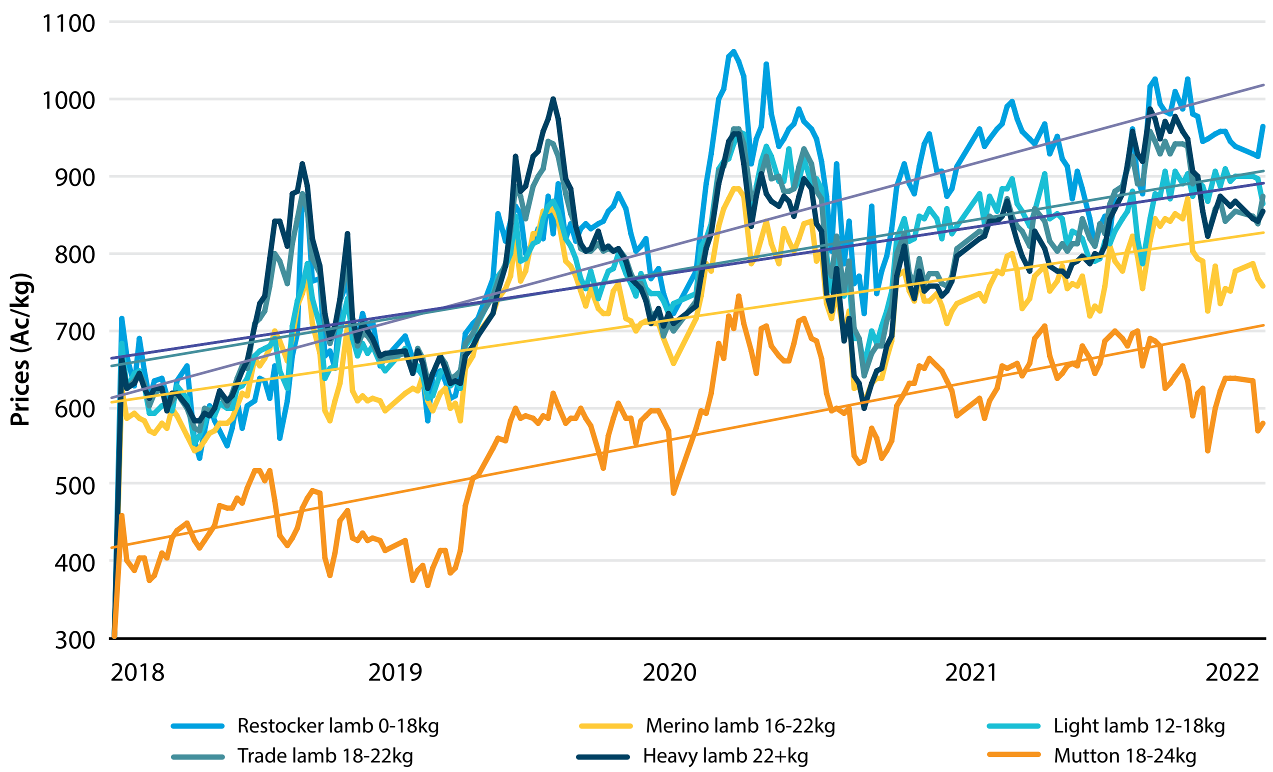
Disruptions to the processing sector stemming from increased covid infections have flowed on to saleyard prices with the market showing some volatility. Yardings have also fallen as producers hold back stock from the saleyard until prices stabilise. However, the strong season means that there is likely to be a significant backlog of heavier lambs ready to hit the market in the coming months, which may put some downward pressure on prices.

> **LOOKING FORWARD, EXPORTS HAVE PROVEN CRITICAL TO SUPPORTING DOMESTIC PRICES IN RECENT YEARS, AND THAT TREND LOOKS SET TO CONTINUE WITH AUSTRALIAN LAMB IN A VERY COMPETITIVE POSITION.**

Australian saleyard prices entered 2022 with a slight slump as demand for processors suffered a hiatus as a result of covid infections limiting available labour. While the National Trade Lamb Indicator has been in a steady decline from the heights of 950c in August last year, in line with seasonal expectations, lower prices have also seen yardings decline considerably. Since mid-2021, prices across categories have been mixed, with mutton prices now lower than winter 2021 as a result of the decline in demand from export markets, while lighter lamb categories have underperformed the heavier categories during the same time. Prices for restocker lambs remain a strong category – again, in line with seasonal expectations as producers expand their flocks prior to joining.

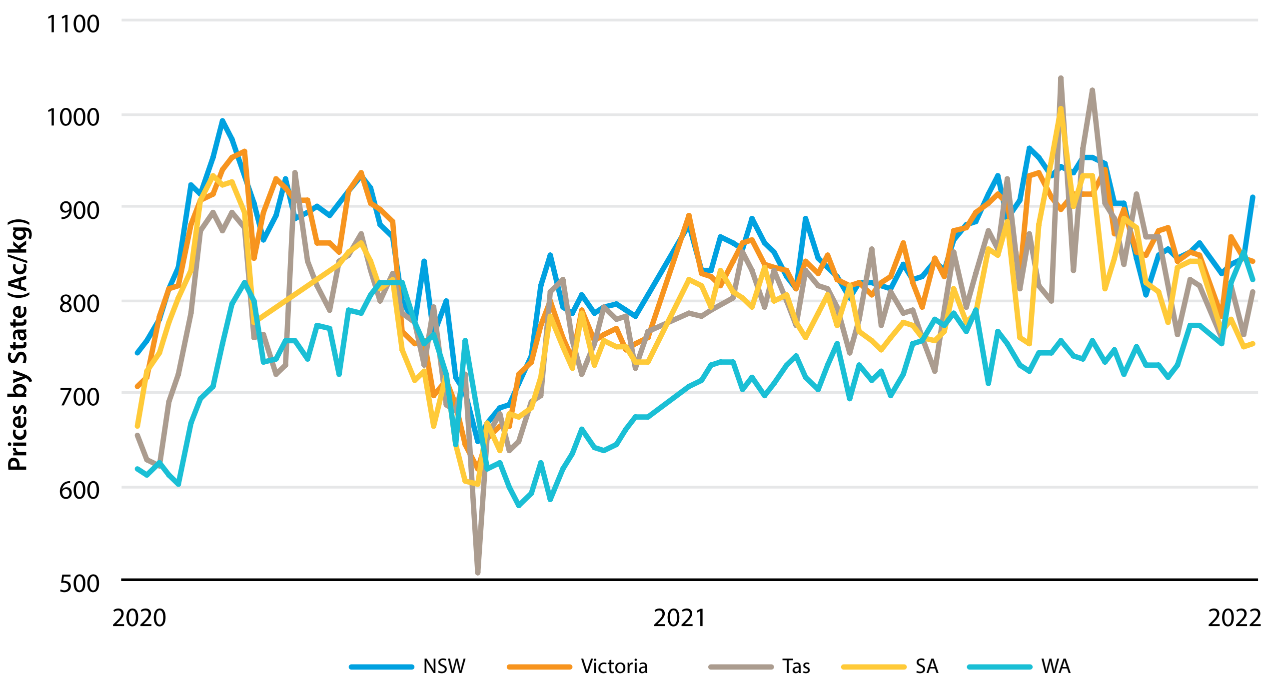
Contrary to the fall in prices across the eastern States, the saleyard prices in Western Australia have climbed sharply in recent weeks, as processor activity continue, while New South Wales prices rallied strongly in late January as yarding activity fell sharply. Producers continued to send lambs to market in the Southern States, although in lesser numbers, and as a result, Victoria, Tasmania and South Australian saleyards have seen the largest decline in prices.

NATIONAL SALEYARD SHEEP AND LAMB PRICES



Source: MLA, ANZ

TRADE LAMB SALEYARD PRICES BY STATE



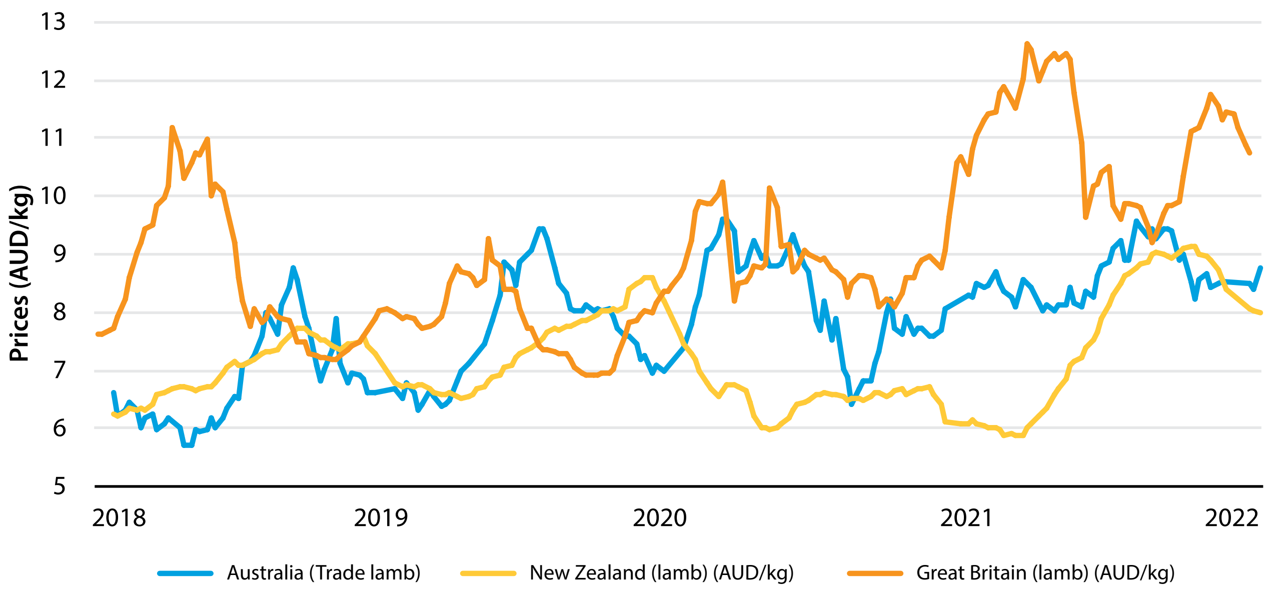
Source: MLA, ANZ

This downward trend is not expected to continue however, as abattoirs resume processing and buyers return to the saleyards, producers are expected to follow. However, a strong season means many producers have continued to fatten lambs on farm instead of sending them to market, as such there are likely to be a significant number of trade and heavy lambs hitting the market in the coming weeks and months. As a measure of how many lambs have been kept back from the saleyards, in the first four weeks of the year yardings were down almost one third on the same period last year – meaning an additional 200,000 lambs may be expected to hit the saleyards in the short-term.

While domestic demand and the national flock rebuild has been the primary driving force behind the strong performance of the Australian sheep industry in recent years, the growing international demand has also been a key factor. Sheep meat consumption remains far less per capita on the international scene than beef, poultry or chicken, and the United Nations Food and Agriculture Organisation forecasts a continued increase in per capita consumption in the medium-term. So as one of the world's largest sheep meat producers – where is the Australian industry placed to take advantage of this global demand?

Historically, Australian lamb has traded at a discount to European and United Kingdom lamb, but slightly more expensive than New Zealand lamb. A recent strong increase in New Zealand lamb prices stemming primarily from export demand from the United States, China and Europe has seen New Zealand lamb recently return to par with Australian lamb. At the same time, the relatively small flock size across Europe and the UK has meant that they have generally higher operational costs which, to a certain extent, is accepted by European consumers who see local lamb as the higher quality product.

GLOBAL LAMB PRICES (AUD/KG)



Source: MLA, AHDB, ANZ

2020 saw a sharp increase in the saleyard prices of Australian lamb which leapt away from our New Zealand competition, giving New Zealand a competitive edge going into the price-sensitive China market. The continued demand from China for lamb as a pork substitute also helped push New Zealand back up to par with the Australian product. With the opening of the British market to Australian lamb, and a decline in UK lamb production, it is expected that Australian produce will find a demand against the generally more expensive UK and European lamb. Added to New Zealand mutton now surpassing the price of Australian mutton, the outlook for the competitiveness of Australian sheep exports are very strong.

WOOL INSIGHTS

OVERVIEW

- The Australian wool industry has started 2022 strongly, with the Eastern Market Indicator now sitting higher than at the beginning of the pandemic;
- Global demand for woollen apparel is recovering strongly as workers start to return to the office;
- A strong flock rebuild and season is expected to see exceptional growth in the Australian wool clip in 2021/22;
- The cost of shearing as a percentage of wool receipts are sitting above the 10-year average, but lower than its 2005 peak.

Wool prices have seen a strong start to the year with the Eastern Market Indicator (EMI) entering January nearing an annual high of just under 1450Ac/kg. Price gains have been seen across all micron categories, although the coarser categories are still down on the higher levels reached early in 2021. This has meant that the first 5 weeks of 2022 has seen the market trading in the green. Australia wide, the sense of optimism in both sheep and wool is anticipated to see the domestic flock reach 70 million head this year, while wool production is also expected to jump an exceptional 8 per cent on the back of higher flock numbers and a strong season.

The Australian wool market entered February after 5 solid weeks of growth, and the EMI bettering the psychologically significant threshold of March 2020 – the start of the covid downturn for the wool industry. The EMI has also been substantially supported by global nervousness around Russia and Ukraine which has led to the appreciation of the US dollar against the Australian dollar as capital flows towards the major global currencies.

Demand from China, India and Europe all performed strongly and prices for all microns improved despite a greater number of bales on offer for the season. The finer end of the market performed particularly strongly in late January, with 17-micron wool reaching its highest level for both 2021 and 2022 – as did 21 – 23 micron wool. Looking forward, the number of bales on offer is expected to be down on last year in the latter part of February which may put further upward pressure on prices.

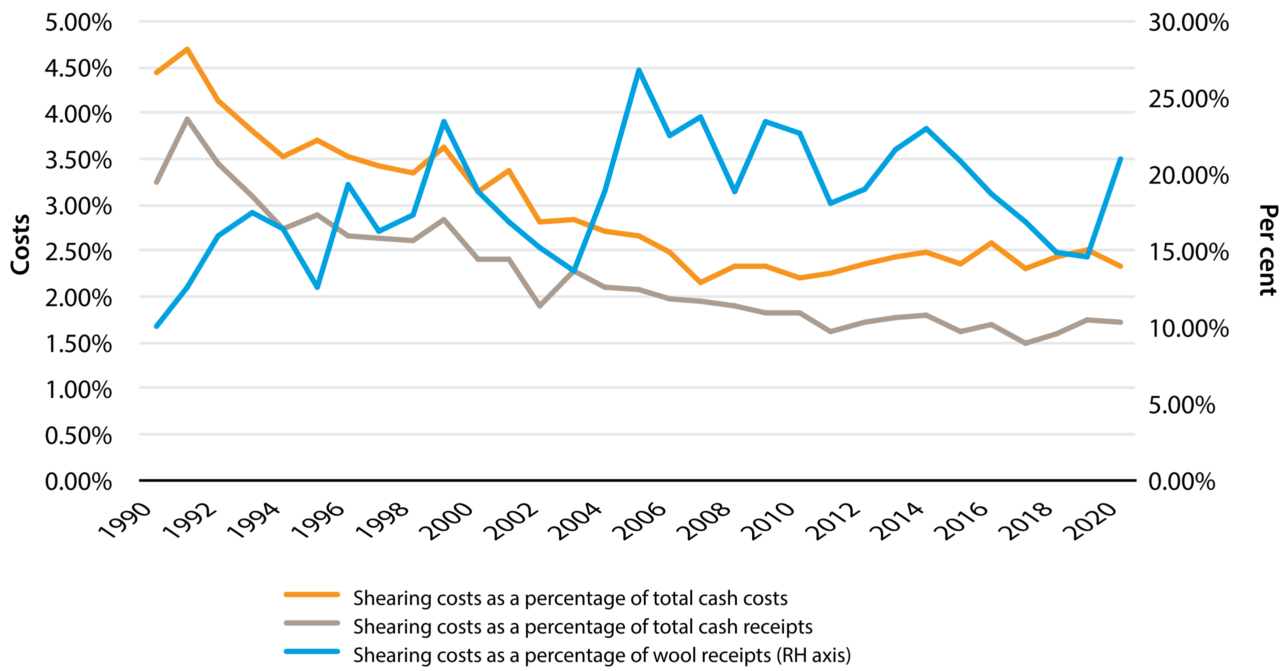
The recovery of the United States and European economies are seeing a return to 'normal' demand for apparel, including demand for woollen suits as workers start to return to the office. A harsh winter in India has also boosted demand for warm clothing and woollen material.

With a strong flock rebuild underway, the Australian Wool Production Forecasting Committee has forecast an 8.0 per cent increase in 2021/22 for shorn wool production. This predicated on an increase of at least 6.6 per cent in all States, with an increase of 21 per cent in Queensland and 14 per cent in Tasmania. This level of production assumes an increase in domestic flock numbers of over 3 million head, to 70 million head across the country.

One of the key issues facing the Australian wool industry currently is the availability of shearers and the resulting increase in the cost of shearing. With the rise in popularity of shedding breeds such as

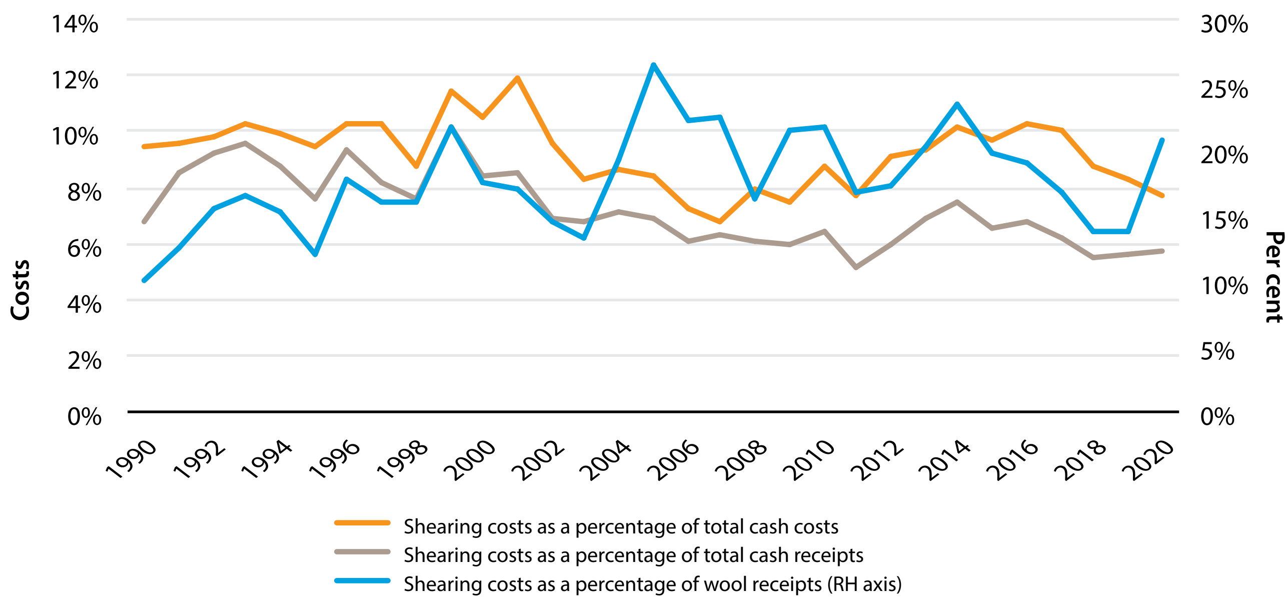
Australian Whites, attention has returned to the cost-return equation, particularly for meat breeds. Figures from the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) show that for sheep producers shearing costs now sit at just over 20 per cent of total wool receipts – down from a high of 26.6 per cent in 2005, but up on the 10-year average of 18.2 per cent. It is also of note that as a percentage of total costs and total receipts for sheep producers, the cost of shearing is at the lower end of its historic levels at 7.7 per cent of total costs compared with a peak of 11.9 per cent of total costs in 2001.

SHEARING AND CRUTCHING COSTS (ALL INDUSTRIES)



Source: AgSurf

SHEARING AND CRUTCHING COSTS (SHEEP INDUSTRY)



Source: Agsurf

DAIRY INSIGHTS

OVERVIEW

- While Australia's overall dairy production has continued to decline, this is largely due to changing land usage, with the growth in the beef cattle herd and sheep flock
- Tight supply levels across the major global dairy exporters have pushed farmgate and trade prices to strong highs
- Domestic and global demand for dairy products continue to grow, particularly driven by the post-Covid disruption recovery

While the Australian agricultural headlines have been dominated by the ongoing post-drought strength of the beef cattle and sheep markets, with high prices accompanying rebuilding numbers in the national herd and flock, the recovery in the national dairy sector is arguably slower. This has been reflected in both milk production levels, as well as the scale of the national dairy herd. That said, given that dairy products are a reasonably generic global commodity, the challenges impacting some of Australia's global competitors are translating into a period of strong prices for dairy products, a development that will be of relief to many producers across the sector.

In terms of Australia's milk production, in the most recent figures available, for November 2021, the monthly milk production fell by around five per cent to just under 900 million litres. On its own, this decline is not surprising – Australia's monthly milk production normally reaches an annual peak in October each year, before beginning a regular decline until it bottoms out in February.

What was notable, however, was that this was the fifth successive month that Australia's milk production had been below the same month in the previous year. If this trend continues, working on the average gap of these months over the previous year, then Australia's 2021/22 milk production could potentially be heading for an overall figure of 8.6 billion litres, which would be around 200 million litres down on the previous marketing year.

Interestingly, based on those figures, the trends in YOY milk production differed markedly by region. Gippsland, Western Victoria, and Tasmania all saw falls on the month for the previous year, while Northern Victoria, NSW, and SA all saw increases.

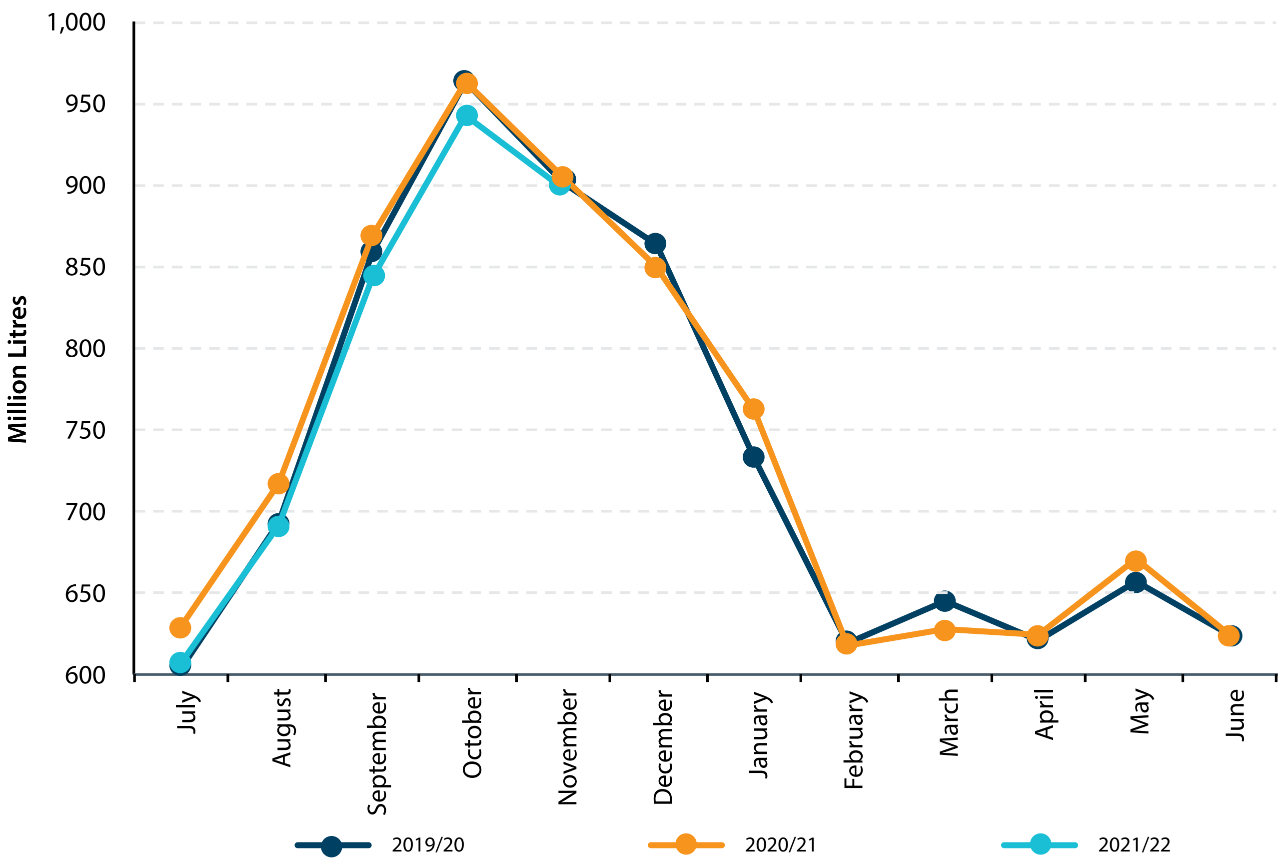
It is difficult to read too much into these variations, given that they could be driven by a variety of factors. Differences in rainfall by region may have impacted pasture growth, which could have a flow-on effect on milk production, given the regional herd sizes remained the same. However, particularly in areas that border each other, it could also be a result of the ongoing strength of the beef cattle market, and the impact of more dairy country being turned over to beef operations. For some dairy regions, a similar challenge could be coming from the ongoing strength in the sheep industry, backed by strong lamb and mutton prices.

One further indication of the challenge to a sharp revival for the dairy industry is reflected in the trends for the overall dairy herd. Under these figures, both Australia's dairy cattle herd, as well as the milking herd, show no sign at the moment of reversing the downward trend they have now been following for the past decade. Indeed, the current 2021/22 forecasts of a dairy cattle herd of 2.3 million head and a milking herd of 1.4 million head would both equal the lowest points in at least the last thirty years.

Importantly, while the overall volume of production, as well as the dairy herd, are each remaining low, this is not necessarily reflective of the current fortunes of Australia's dairy producers. For a start, at a farm management level, an average milk yields per cow have continued their ongoing steady rise. To the industry's credit, it is admirable that the forecast average yield for 2021/22 of around 6,600 litres is more than double the average figure in 1983/84.

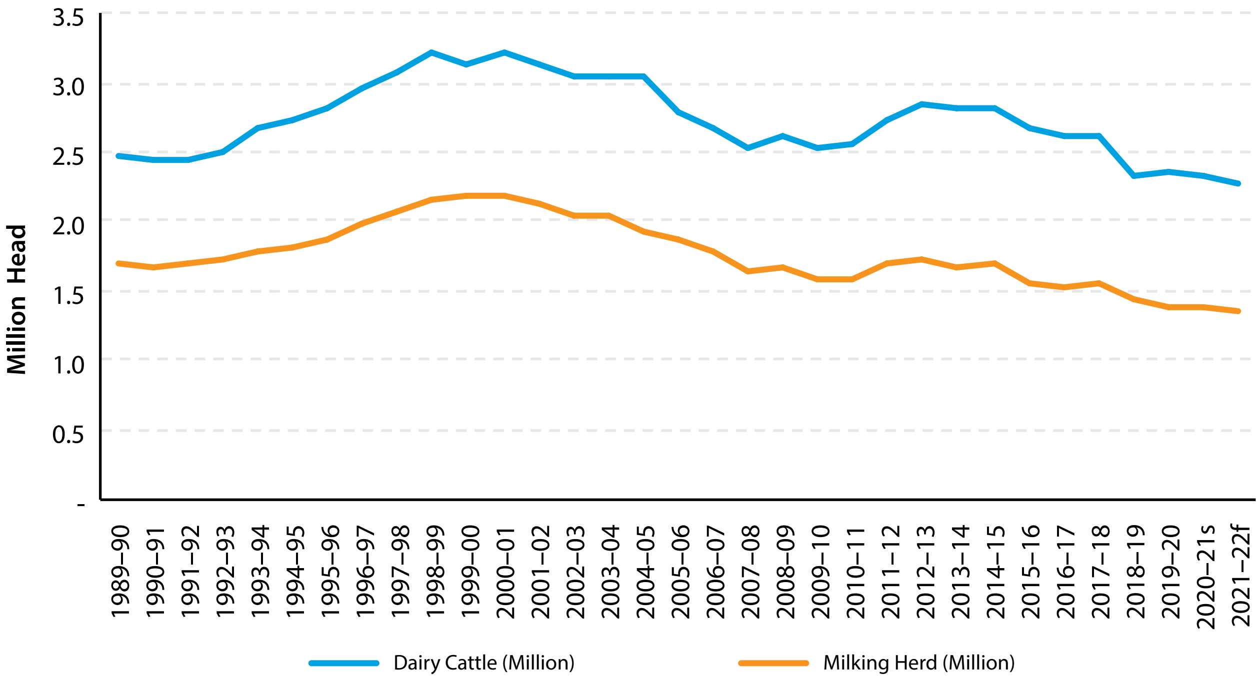
For Australia's estimated 4,600 dairy farmers, the current market is also a time for optimism, given the current high farmgate prices. In particular, the record farmgate prices currently being paid to the dairy farmers in New Zealand, the world's largest dairy exporter, is reflective of the current global conditions and bode well for Australian producers for the months ahead. As most global economies continue their recovery from the major Covid disruptions, consumer demand for the dairy products continue to strengthen. In many cases, this could even be enhanced, as the stronger focus on healthy diets sees even more of a shift to greater dairy consumption. However, in terms of supply, each of the major global producers is seeing little to no growth, putting upward pressure on the prices. Production from New Zealand has been essentially flat for the twelve months year-on-year, while the EU has seen a similar trend, based on declines in Germany, France, and the Netherlands. In the US, while milk production was up slightly over the last twelve months, this trend is likely to decline in the coming years, as the herd goes through a contraction in size.

AUSTRALIA MONTHLY MILK PRODUCTION (MILLION LITRES)



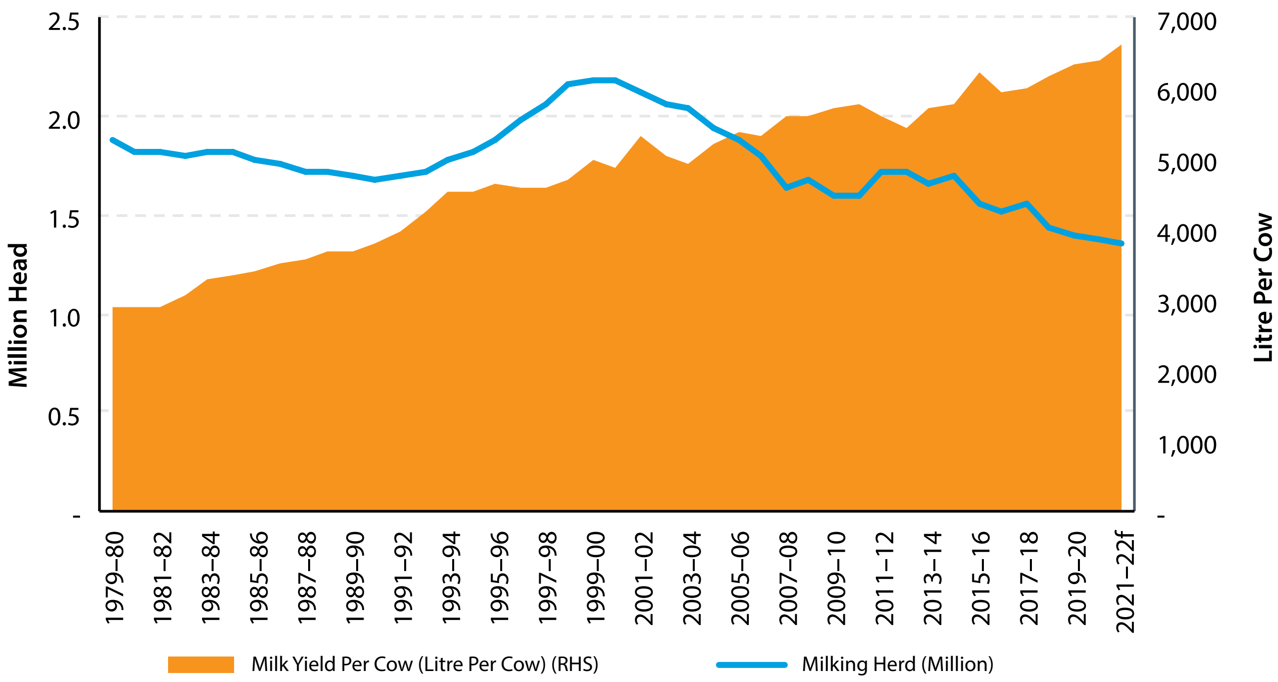
Source: Dairy Australia, ANZ

DAIRY CATTLE VS. MILKING HERD (MILLION)



Source: ABARES, ANZ

MILKING HERD (MILLION) VS. LITRE PER COW



Source: ABARES, ANZ

AUSTRALIAN ECONOMIC INSIGHTS

Interest rate increases loom in 2022

THE ECONOMY ENDED 2021 ON A STRONG NOTE

December data was strong across the board in Australia, providing a good foundation for both households and businesses in 2022. The unemployment rate fell to 4.2% and the underutilization rate (unemployment + underemployment) fell to a 13-year low. Total retail volumes were 3.4% higher in Q4 compared with before Delta lockdowns (Q2 2021), as spending more than bounced back after the Delta lockdown malaise.

Housing market activity also showed stronger momentum than expected in the last months of the year, with new owner-occupier lending surging in December to just 4% below the historic peak in May 2021. Quarterly underlying inflation accelerated to its highest rate since Q3 2008, and the annual figure pushed above the mid-point of the RBA's target band for the first time since mid-2014.

OMICRON DISRUPTIONS ARE UNLIKELY TO DERAIL THE ECONOMY IN 2022

ANZ-Roy Morgan consumer confidence is running a little lower than usual due to Omicron and the prospect of higher interest rates. ANZ data showed a downfall in consumer spending at the beginning of the year despite no formal lockdowns, as Omicron outbreaks led to less socialising and staff shortages across retail and hospitality. But the ANZ data also showed some recovery in spending in the second half of January.

Despite Omicron outbreaks in 2022 and lots of jobs being filled in late 2021, ANZ Job Ads only fell 0.3% in January. This is a very good sign that unemployment will fall further and push wages up through 2022.

RBA TO LIFT CASH RATE TO 0.75% END OF 2022 AND 2% END OF 2023

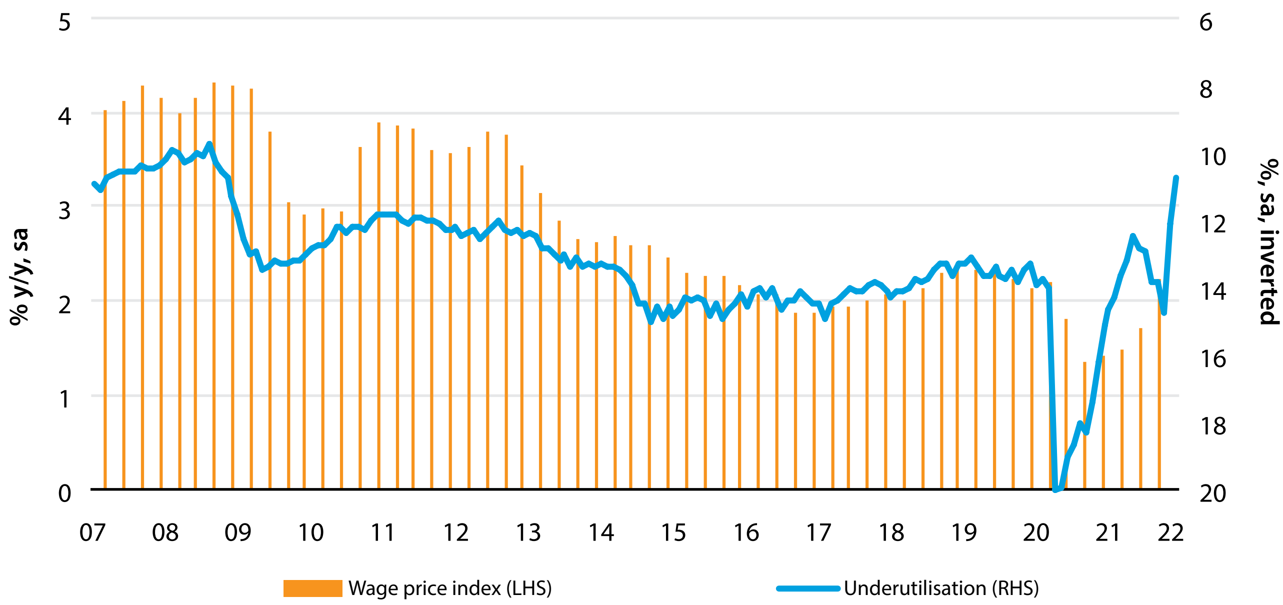
The RBA doesn't expect growth in the Wage Price Index (WPI) to reach 3% until mid-2023, which we think is too pessimistic. Lowe suggested that the RBA will be patient but a rate hike in 2022 is a "plausible scenario". We expect a stronger wages result to trigger a cash rate hike in September 2022. Once the RBA moves it will be all about the pace of rate hikes. We have the cash rate target at 0.75% by the end of 2022, lifting to 2% by the end of 2023. The end-point for tightening may be higher than the market expects, with a cash rate above 3% a possibility.

INTEREST RATES WILL INCREASE GLOBALLY AND WILL HELP KEEP AUD RISES AT BAY

In the latest European Central Bank (ECB) press conference, "transitory" was not mentioned. We have brought forward our expectations of a rate rise in the euro area to H2 2022. The Bank of England has already increased their cash rate to 0.25% and announced Quantitative Tightening (QT), which would drive up the cost of lending and borrowing money.

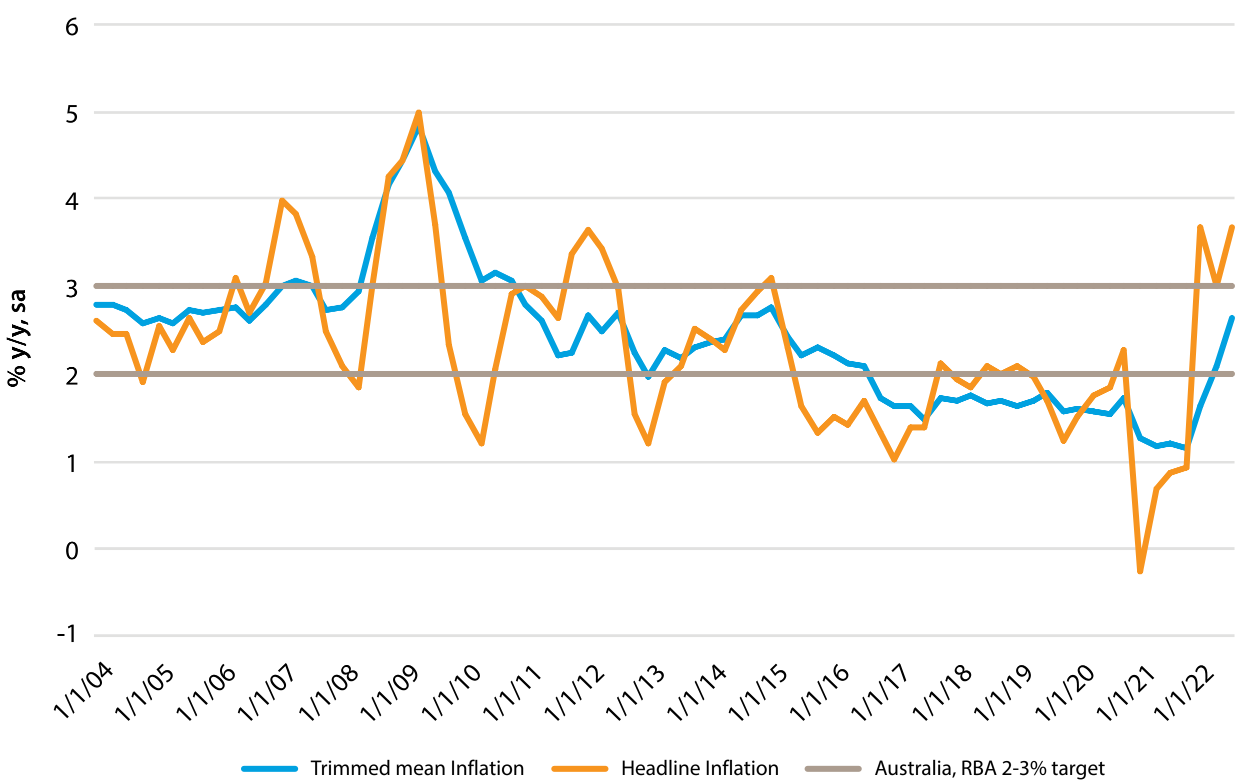
We are also expecting the US to tighten their rates, and are forecasting five rate hikes over the course of this year. The US labour market is running hot and there was unanimity among Federal Reserve speakers last week about the need for a rate hike in March and about starting quantitative tightening soon. We expect the AUD to drift up to 0.75 USD through 2022, tempered by interest rate increases globally including in the US.

THE FALLING RATE OF PEOPLE WITHOUT WORK OR ENOUGH HOURS IS A GOOD SIGN FOR WAGES GROWTH



Source: ABS, Macrobond, ANZ Research

INFLATION HAS ACCELERATED



Source: ABS, Macrobond, ANZ Research

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