ANZ AGRI

INFOCUS

JUNE
2022

COMMODITY INSIGHTS

ANZ

FOREWORD

As the winter months officially start, much of southern Australia has been feeling the early cold snap for a few weeks now. The good news is, that's where the early frosty environment seems to begin and end. With strong commodity prices, outlook for another very strong cropping season and land values continuing to grow, the Australian agricultural industry now seems to be approaching every hurdle with a sense of optimism and confidence. Which isn't to say that there aren't issues facing the industry. Labour force issues, rising interest rates and input costs all present very real challenges. The difference is, the industry is now approaching these issues with the mindset that strong prices, production and profitability are the new norm.

In many ways, the Australian agriculture industry seems to be in a completely different place than it was just three or four years ago. With the breaking of the drought in 2019, we seem to have entered a new, more buoyant era. While this is obviously dependent on season, and one dry season especially could change the picture markedly, for now the industry has a new set of expectations for what is considered normal.

There are real issues playing on producers' minds however. Most particularly the cost of fertiliser, fuel and chemicals, and labour force shortages. Rising interest rates are also a key cost point for those producers with debt and many of these factors hold true further through the Agri supply chain.

The geopolitical uncertainty which is dominating the headlines around the Russian war in Ukraine, food security around the world and an increase in protectionism stemming from shortages in vegetable oil and grains remains an issue of considerable concern – although, to date, those global food shortages have played as a positive for an exporting nation such as Australia.

A new Federal Government will also add a certain sense of uncertainty into the mix in the short term, anyway, as the industry looks to the new Minister to outline their agenda for their government. To date, there are no indications, however, that there will be a marked departure from the policies under which the industry is flourishing.

As autumn/winter sowing is well underway or near completion in much of the country, producers are well and truly looking forward to the next harvest given the strong opening seasonal conditions. ANZ's view is that the 2022-23 winter plantings will see national plantings slightly higher than last year's as some marginal or livestock country is expected to be cropped to take advantage of soil moisture and strong prices. While this bodes well for the possibility of another record harvest, many producers are likely to minimise their use of fertiliser and chemicals this year which may impact the ultimate yield, but time will tell.

The cattle and dairy industries have also moved to trading at a new level, with ANZ expecting the Eastern Young Cattle Indicator to continue to trade above 1,000c/kg for the foreseeable future, while dairy farmers have recently been receiving unprecedented opening offers of almost $9/kg MS. Cotton prices continue to soar, despite rain in Texas, while the Australian sheep and wool industry are steady and strong.

As producers ponder the current year, for most, it's through rose-coloured glasses, and understandably so.

Mark Bennett
Head of Agribusiness & Specialised Commercial, Business & Private Bank

@bennett2_mark

EXPORT BANS

OVERVIEW

- The world is currently seeing more countries banning agri exports than at any time since the 2008 food price crisis
- These bans impact not just grains and oilseeds, already in tight supply due to the Ukraine crisis, but agri products including sugar, chicken and processed foods
- While the bans are aimed at individual countries ensuring domestic food supplies and reducing food price inflation, they can also have far wider impacts for populations in importing countries, as well as entire food supply chains.

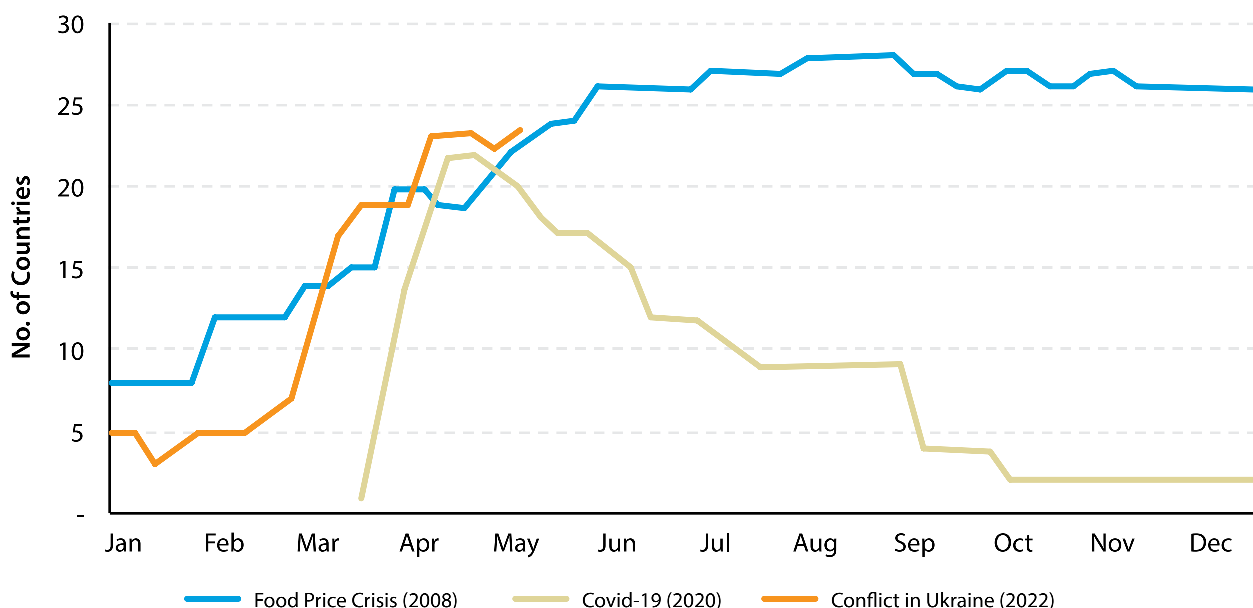
The current period of geopolitical volatility, particularly driven by the conflict in the Ukraine, has seen a sharp rise in the number of countries implementing bans or restrictions on the exports of their agricultural products. While some of these restrictions have been widely publicised, many more have received little attention outside of their own geographic region, despite having an impact on millions of consumers, particularly in developing countries. In looking across the scope of the current export bans, it is important to analyse just how widely this practice has been used by countries in the past, why governments make this decision, and just what the longer-term impacts have been. From this, it is possible to look at what the impacts of the current set of trade bans may be, and how they may impact stakeholders across the agri supply chain going forward.

The period of 2022 following the start of the conflict in Ukraine has seen an escalation in the number of agricultural export bans globally, as many countries grow increasingly concerned about the cost and availability of foodstuffs. A number of these bans have been well publicised, such as India's bans on wheat and sugar, while many others are little known outside of their own regions.The recent export restrictions have covered a range of commodities and regions. Among the most prominent, Indonesia's temporary ban on palm oil exports, combined with the loss of Ukrainian sunflower exports, contributed to a surge in most oilseed prices. Egypt, which had been hit hard by the loss of wheat exports from Ukraine, banned its own exports of wheat, flour, lentils, pasta and fava beans, in a bid to maintain food supplies.

Outside of the direct impacts of the Ukraine conflict, China's ban on fertiliser exports, which began in 2021, not only drove up fertiliser prices globally, but had the dual impacts of potentially reducing global crop yields and production levels, while also driving up the costs of agri products reliant on fertiliser.

Additionally, Argentina's ban on exporting its own beef in 2021 contributed to a rise in global beef prices, as major importers reacted to reliability concerns from one of their major suppliers, with further concerns this could be repeated by other South American exporters.

NO. OF COUNTRIES WITH EXPORT RESTRICTIONS ON FOOD & FERTILISERS



Source: IFPRI Food & Fertilizer Export Restrictions Tracker, ANZ

With many of these restrictions having taken place recently, and with the outlook of a number of them uncertain, it becomes important to examine why these restrictions are imposed, what consequences have been seen in the past, and how they have been ended.

Agri export restrictions can take several forms. A country can completely ban the exports of a particular product, or it can selectively choose which countries receive its agri exports, as India has stated it will do, being open to exports to countries in dire need. An exporting country may also look to limit agri exports by imposing an export tax, as Russia did with its wheat in early 2021, which effectively makes the price of the exports almost prohibitive, or an export quota.

The aim of the restrictions is to maintain both an adequate supply of the particular agri product in the exporting country, as well as to seek to ensure that domestic food prices do not rise too high. For example, if wheat is worth a high price on world markets at a particular point, then producers and exporters will sell it at the global price, which may lift domestic prices dramatically – not just for the grains themselves, but for all the food products which are made from them, particularly bread and noodles, which form the basic and essential food staples in many developing countries.

The largest concern from essential foods being in short supply or too high priced is that populations will not be able to access them, with the consequences ranging from reduced diets and calorie intakes to the potential in extreme cases of famine and starvation. In addition, as was seen in the 2008 global food crisis, populations who are concerned about being able to access adequate food have the potential to rise up against their governments, in the form of civil unrest.

While the move by some governments to restrict agri exports seeks to limit the potential for these developments, governments will sometimes also seek to make other changes to prevent domestic food shortages and price rises. These include laws to prevent people or companies from stockpiling food, as well as regulating industries so that only government entities can trade or sell agri goods.

The question around whether export restrictions are justified is one which will always be difficult and contentious. On one hand, the move usually does succeed in its aims of avoiding food shortages in the producing country, as well as keeping a lid on prices. In this way, it will help in easing the potential for civil unrest, and the implications that could have for a country's citizens.

On the other hand, it can also have longer term structural impacts on the producing country's agricultural sector. For example, if a country's wheat farmers are forced to accept a lower domestic price, rather than a higher export price which they could have received, then they are less likely to work hard to produce a major crop in the coming year, an impact which could see overall production fall. Alternatively, they may also pursue a different agri crop of some kind which is more attractively priced, again reducing supplies of the major crop.

Additionally, in terms of their own farms, if a nation's farmers are restricted in the revenue they can generate, then this means less money for them to put into a range of inputs and equipment such as fertiliser, seed, farm machinery and irrigation, which could result in a lower level of crop production over the longer term, and potentially less sustainable farming practices.

IN ADDITION, THE MARKETS WITH WHICH THESE COUNTRIES HAVE TRADITIONALLY TRADED WILL NEED TO LOOK ELSEWHERE FOR THEIR AGRICULTURAL EXPORTS. THIS MAY WELL MEAN THEY FORM NEW RELATIONSHIPS WITH OTHER EXPORTERS, INCLUDING SEEING THEM AS MORE RELIABLE, AND COULD POTENTIALLY NOT RETURN TO THE ORIGINAL EXPORTER TO THE SAME EXTENT.

Agri export restrictions also inevitably impact the consumers in their main export markets. For example, when Malaysia banned exports of chicken in May, it particularly impacted Singapore, which had imported a third of its chicken from its neighbour, and where chicken rice is one of the country's most popular dishes.

A further impact of export restrictions is the likelihood that there will be more by other exporters. Following India's decision to ban sugar exports, the move was followed rapidly by both Kazakhstan and Kyrgyzstan. Both countries cited the fact that the Indian export ban had seen such a sharp rise in prices that they worried that a surge in exports from their own countries could lead to domestic shortages.

Overall, while export bans are usually put in place due to rising commodity prices, they also serve to push them up even further, as countries scramble to pay whatever is needed to procure dwindling supplies.

A further consequence, over the longer term, is that importing countries which have the capacity will seek to increase their storage levels of agri commodities, particularly grains. This has especially been the case for China, who have lifted their storage of major grains since the 2008 crisis to a point where they now account for around half the global total.

Clearly, where there have been agri export restrictions in the past, they have almost always been temporary, though of varying lengths. The major cause of them ending is when supply concerns are eased, whether through supplies in storage being released, supply chain blockages removed, or major agri producers having strong production years. In the 2008 global food price rises, which were largely about the high price of rice, a decision by Japan to export its stockpiled rice played a major role in contributing to the easing of global supply and price concerns.

Looking ahead in 2022, the outlook for many of the current export restrictions, and their consequences, remains uncertain and concerning. Aside from any developments which would see a relaxation of agri exports impediments from Ukraine and Russia, it may well be that good seasons for most of the world's major agri producing and exporting countries will be vital to easing the current situation.

BEEF INSIGHTS

OVERVIEW

- On current indicators, Australian cattle prices may well stay around current record levels for at least the next two years
- While feedlot economics have benefitted from strong demand, they are likely to be impacted by high feed prices
- With changing economic conditions likely to impact the choices of meat of domestic shoppers, this may start to ripple back through the beef supply chain

While cattle prices in Australia may have levelled out to a relative degree, the industry may also be entering a new era, the likes of which it has never seen before, which will increase the need for all industry participants to map out their forward planning strategically. In particular, while cattle prices may have eased off their record highs of January 2022, the medium to long term outlook could well see them remaining around the 1,000 cent/kilogram (c/kg) level for the benchmark Eastern Young Cattle Indicator (EYCI) for at least the next two to three years.

Arguably, the Australian cattle industry has been experiencing some level of price volatility for around the past seven years. Prior to that, from around 1998 to 2015, the EYCI remained almost entirely within a band of 200 c/kg to 400 c/kg, only going very slightly above that level two or three times. In relative terms, at the time, there was certainly some price volatility on a percentage basis. For example, the fall from 380 c/kg in August 2006 to 267 c/kg in December 2006, as much of the country went through a drought, represented a fall of around 30 percent, which hit many cattle growers hard at the time.

However, in dollar terms, the relative stability of cattle prices over that period has not been seen again until this year. Looking back, from 2015 to 2017 cattle prices rose dramatically, to over 720 c/kg driven by the initial surge in exports to China, and the market expectation that this would continue. Following that, from 2017 to late 2020, prices dived again, falling back below 400 c/kg in March 2019. This was driven by the strong growth of export competition for the rapidly growing Chinese market, followed by the onset of the drought, and the subsequent sell-off of cattle from farm herds across Australia as feed availability and prices became increasingly tougher.

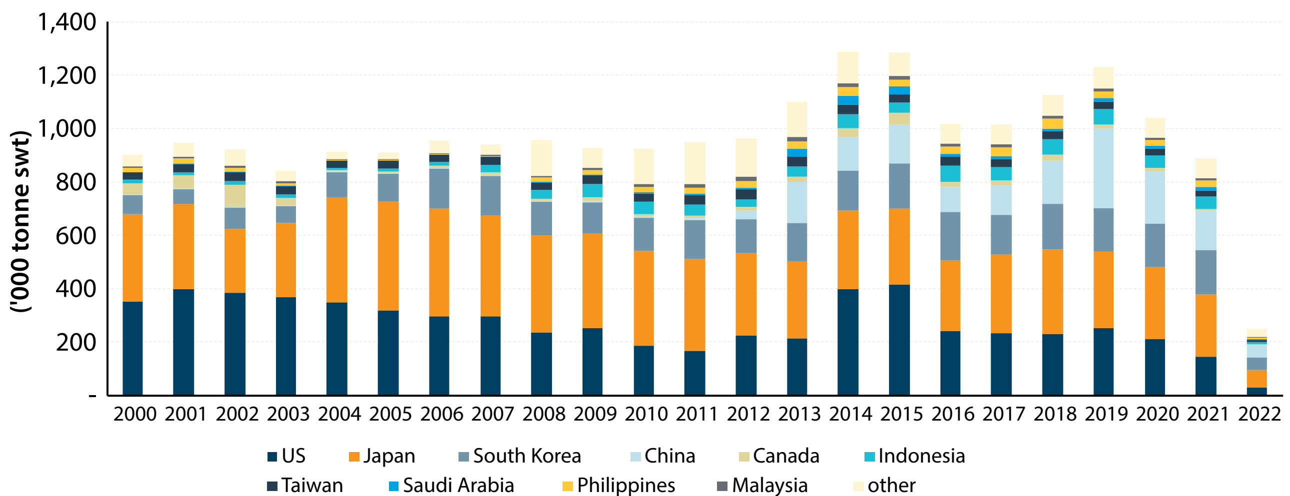
Following this, as all industry stakeholders are well aware, prices then saw a period of completely unprecedented growth from the start of 2020 until early 2022, as the arrival of the drought-breaking rain across much of Australia encouraged growers to enter a period of sustained restocking activity, a phase which arguably fed itself as rising prices fuelled greater restocking enthusiasm.

While 2022 is only just approaching the halfway point, the signs are reasonable that cattle prices may now be entering a relatively flat period. Over the course of this year, they have stayed in a roughly narrow band, mostly within 1100 – 1150 c/kg.

A number of factors have contributed to this flattening of volatility. While most cattle producers are largely restocked, they are continuing to turnover enough cattle to keep markets active. Domestic and export consumption outlooks remain strong, despite some question marks over the impact of global rate rises, as many economies continue their post-covid recovery. Importantly, the longer-term weather outlook continues to forecast a combination of good rain and reasonable growing temperatures, which should see adequate feed continue at least until well into 2023, if not beyond.

In terms of exports, volumes in 2022 have remained somewhat sluggish in comparison to previous years, particularly driven by supply chain issues. Given that export requirements such as container access and shipping availability, as well as the smooth operation of ports have all been hampered by challenges in many countries, including labour shortages and post-covid recovery, meat exports have suffered as a result.

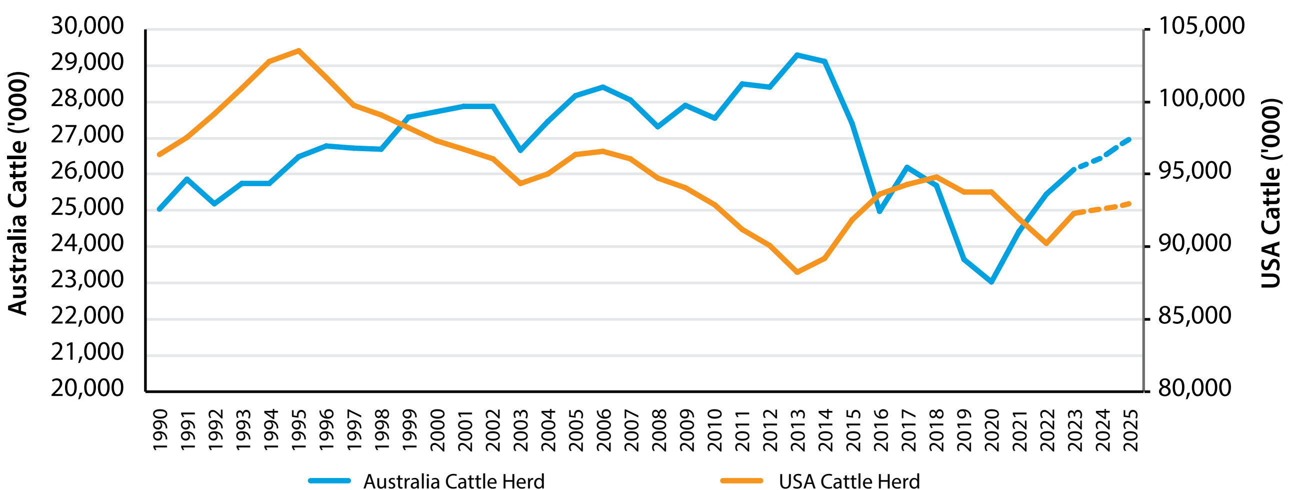
AUSTRALIA BEEF EXPORTS BY DESTINATION ('000 TONNE SHIPPED WEIGHT (SWT))



Source: MLA, ANZ

Examining the major export markets individually also shows distinct trends emerging. For the US market, which has taken an average of 23 percent of Australia's beef exports for the past decade, the market share YTD is a much lower 12 percent. This could partly be a result of the drought in some US cattle areas, which has seen an abundance of cattle sold to feedlots, which are now being processed and reducing demand for imports.

CATTLE HERDS ACROSS USA AND AUSTRALIA MOVE IN CONTRAST TO EACH OTHER



Source: MLA, USDA PSD, USDA ERS, ANZ

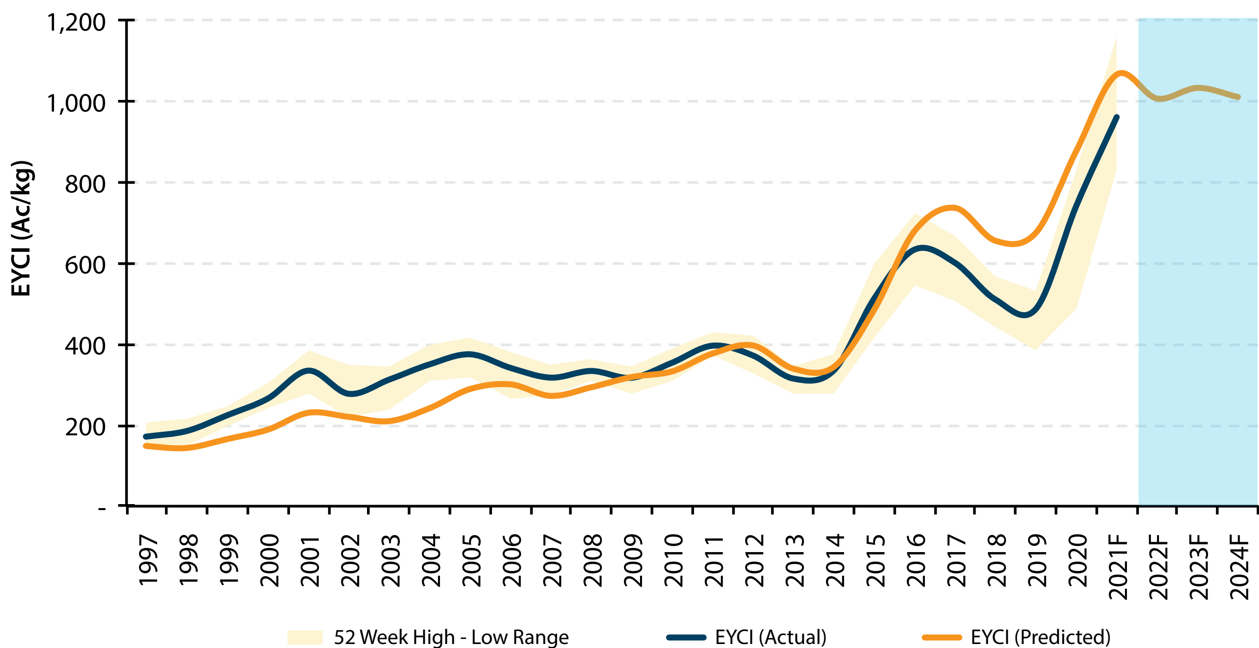
In contrast, while China has averaged 13 percent of Australia's beef imports over the past decade, albeit with a reasonable degree of variance, YTD it has accounted for 18 percent of imports, putting it close to South Korea as the second largest market for Australian beef, behind Japan.

Looking ahead, the impact of the US drought may take some time to work through, which could impact cattle sold primarily for that market. As a result, the need to enhance exports to the major Asian markets has increased, although the impact of high grain prices on feedlots, particularly to supply japan and South Korea, could start to have an impact on margins, and may require feed lotters to re-examine their strategies.

ANZ PRICE FORECAST MODELLING

In looking forward over the rest of 2022 and the subsequent years, ANZ has utilised updated modelling, aimed at predicting cattle prices going forward. The model incorporates a range of variables impacting the beef sector, including herd growth rates, female slaughter levels, exchange rates and US herd growth. Under the model – and noting that it has been quite accurate historically – Australian cattle prices are forecast to stay high for the next two to three years, potentially hovering around the 1,000 c/kg level.

EYCI COULD POTENTIALLY STAY HIGH THROUGH 2022 & BEYOND



Source: MLA, USDA PSD, USDA ERS, Bloomberg, ANZ

Arguably, in the absence of a black swan event such as a drought, there would appear no major reason why cattle prices should fall markedly for at least the next years. Domestic and global demand looks set to remain strong, while producers are also still in the process of rebuilding their herds in the years following the drought.

Some slowing in cattle sales to both processors and feedlots could occur if labour shortages continue to restrict operational capacity at abattoirs. The meat processing sector has signalled that the system of work visas to seek to bring more offshore employees into abattoirs would be one of the first items it raised with the new Federal government.

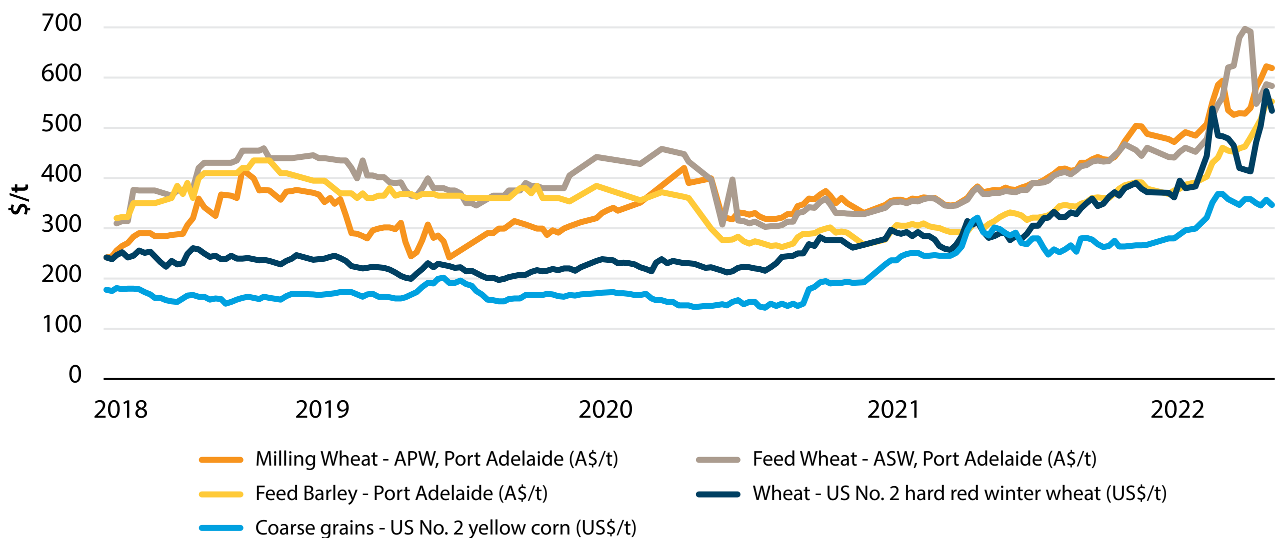
WHEAT AND GRAINS INSIGHTS

OVERVIEW

- Global grain prices have skyrocketed stemming from the Russian war on Ukraine, although intervention by the United Nations may help ease wheat supply concerns
- The global stocks-to-use ratio for wheat is still forecast to fall further in 2022-23 meaning that high prices and concerns over supply are likely to persist
- We are expecting winter crop plantings to be slightly up on last year's crop, particularly for wheat and canola, as farmers appear to be moving to take advantage of high commodity prices despite skyrocketing input costs.

As winter crop planting continues across the country, global events and concerns over food security have set up Australian producers for another highly lucrative year. Despite concerns that the spike in global prices has not been fully realised in the prices paid to Australian producers, solid price increases in late May have quelled many of those fears. The biggest question for the local industry – outside of the larger geopolitical issues – is how next year's crop is shaping up. Despite concerns that booming fertiliser, fuel and chemical prices will lead to some producers pulling back on plantings, we are hearing that producers are more focussed on taking advantage of high prices with plantings tracking at least on par, but likely slightly higher, than 2021/22. Yield may be compromised somewhat however, as producers manage fertiliser and other input costs throughout the season.

DOMESTIC AND INTERNATIONAL GRAINS PRICES



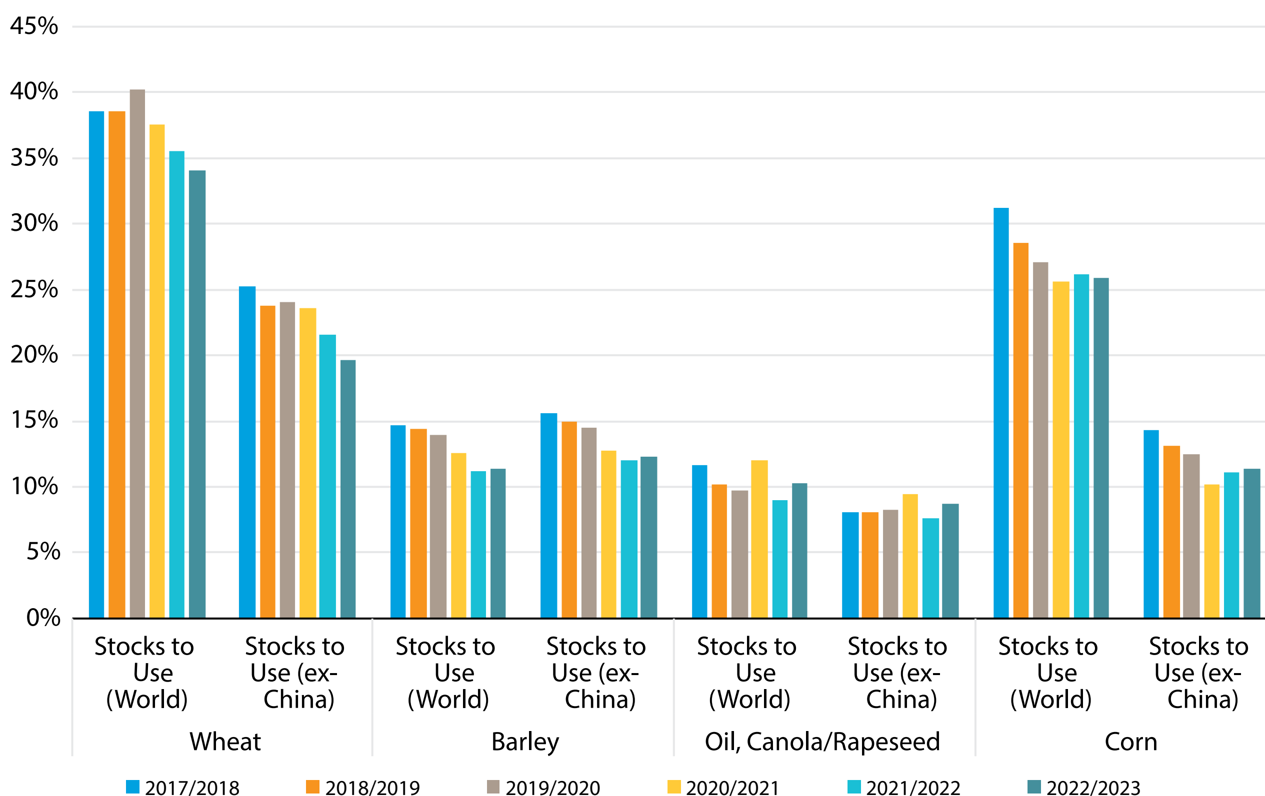
Source: ABARES, ANZ

Global wheat prices peaked in May to levels not seen since 2007 following the most recent United States Department of Agriculture (USDA) forecast for global production. Those prices have come off slightly in the past few weeks – but still sit at over decade long highs. This is being driven not only by the Russian war in Ukraine limiting wheat supplies, but also the prospect of lower production in 2022/23 and the flow-on effects, such as the Indian export ban, further limiting supplies. As a result of the unpredictability of both global production and trade restrictions, the global wheat price remains jumpy, and the futures market continues to rise. Early June saw some falls in the Chicago Board of Trade Wheat Futures which were based on reports of United Nations efforts to restore Ukraine grain shipments as well as forecasts from Russian consultancy IKAR of a Russian wheat crop of 85 million MT – 10 million MT more than last year's crop.

Local prices have jumped strongly for wheat and barley have risen strongly in recent weeks. In the past month alone, milling wheat and feed barley prices have risen 15 per cent as the northern hemisphere looks to the southern hemisphere to fill growing gaps in supply. As those gaps in supply become clearer and Australia's stores from previous record crops are run down, Australian producers are expecting to see prices to continue to climb in coming months.

The latest USDA figures show a 0.6 per cent drop in global wheat production, as well as 0.4 per cent fall in consumption, primarily from a drop in feed grain consumption in China – leading to a 4.5 per cent drop in global stocks. Production is expected to fall in Australia, Ukraine and Morocco, which is expected to be partially offset by increases in Canada and Russia. However, many in the market consider the increased crops in Canada and Russia to be overly optimistic, and indications emerging of another poor crop in the United States – resulting in a significant amount of jumpiness in the market, and buyers' pricing in the expectation of even lower crops than currently forecast.

GLOBAL GRAINS STOCKS-TO-USE RATIOS

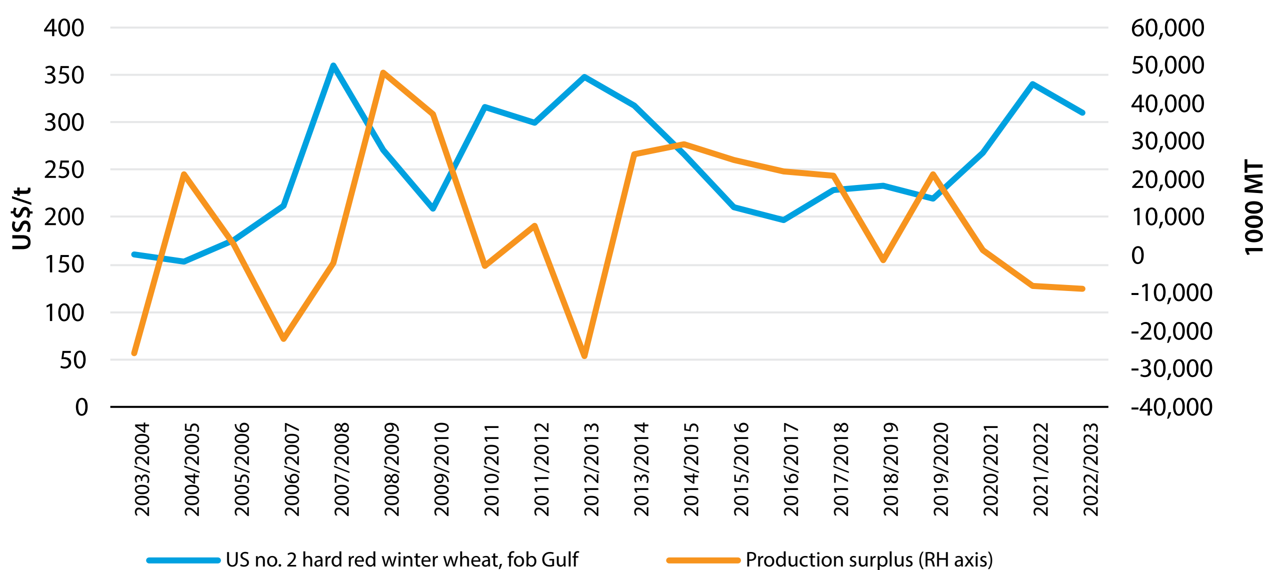


Source: USDA, ANZ

The key metric of global stocks makes the tightening global supply situation clearer, as the global wheat stocks-to-use ratio is forecast to decline from 36 per cent to 34 per cent in just one year. The most revealing figure however is the stocks-to-use ratio once China's vast stockpiles are removed – which will decline to just under 20 per cent – meaning that without China, the world has enough wheat to provide supply for just under 2 and half months. Other grains and oilseed stocks are improving slightly with barley, rapeseed (including canola) oil and corn stocks-to-use all forecast to improve slightly in 2022/23.

Other global events such as the Indian Government's ban on wheat exports are expected to have short-term impacts on global supplies. In mid-May, the Indian Government announced plans to export 10 million tonnes of wheat in 2022/23, only to be followed two days later by a Ministry of Trade announcement restricting wheat exports in order to protect domestic food security, blaming private traders for rent seeking. The Indian Government has stated that it will only raise export restrictions if prices cool and global supplies increase – indicating that India is likely to be little help to the global supply situation if it worsens further.

GLOBAL GRAIN PRODUCTION SURPLUS V PRICE



Source: USDA, ABARES, ANZ

The outlook for Australia's other cropping sectors also looks strong. Global vegetable oil prices continue to skyrocket on the back of the Russian war in Ukraine limiting the export of Ukrainian sunflower oil and while Canada's canola crops will bounce back from last year's drought, plantings are currently being constrained in some areas by excess rain. Global barley production is projected to increase to 149 million tonnes in 2022/23, up 4 million tonnes from a year earlier as a number of countries recover from last year's poor harvest. This increase in production in United States, Canada and Russia is forecast to offset the loss in production in Ukraine and Australia as producers switch to other crops.

Domestically, despite forecasts of a return to normal for Australian wheat and grain crops, farmers on the ground are tentatively foreshadowing a third bumper crop in a row, as a result of good seasonal conditions and increased plantings. While some in the industry are forecasting that skyrocketing fuel, fertiliser and chemical prices will result in significantly lower plantings across the country, ANZ is hearing that despite those very prevalent concerns – they are not being reflected in the area currently being planted. While producers are moving away from chickpeas and barley, total plantings to date appear to be at least on par or slightly higher with last year's acreage, although remain highly dependent on seasonal conditions. The dominant story being told is that producers are planting to take advantage or sky high prices and considerations of how to manage costs are secondary. As a result, yields may suffer somewhat as fertiliser and chemical use is pulled back to help manage ballooning costs.

SHEEP INSIGHTS

OVERVIEW

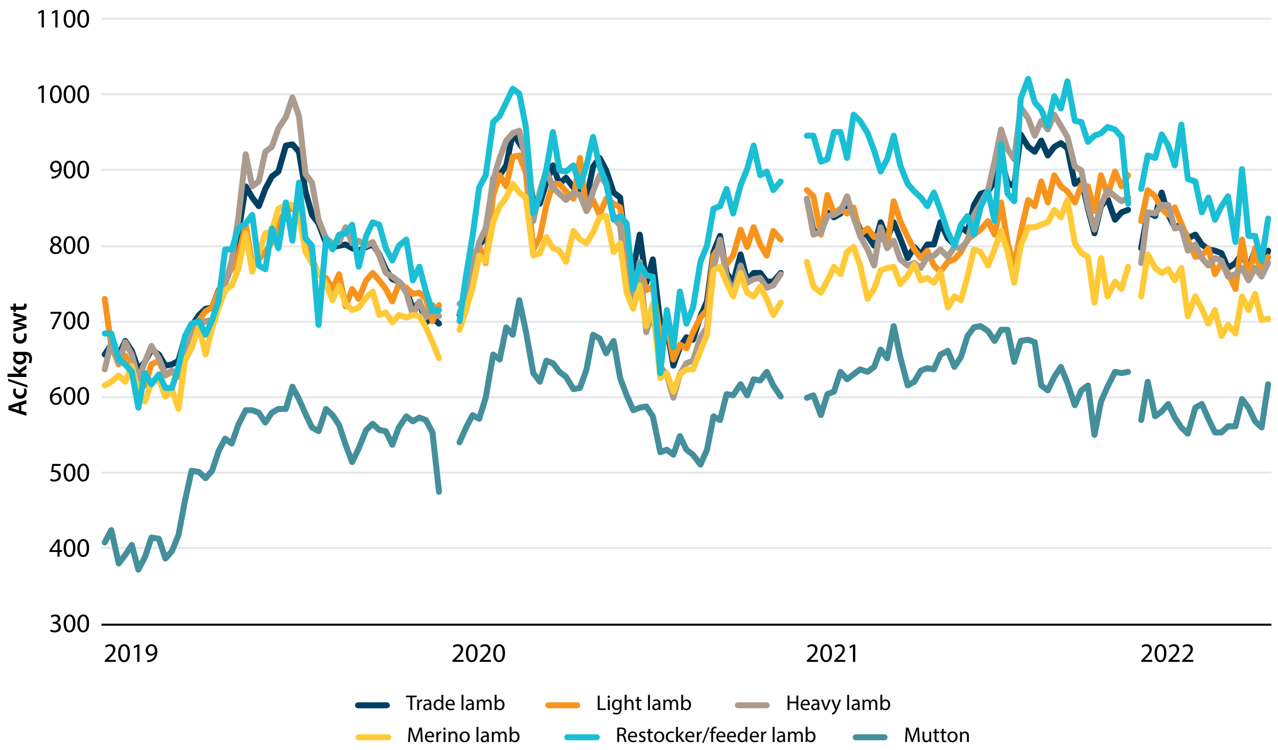
- The Australian sheep industry has been heavily impacted by lockdowns and lack of labour availability and processors are still trying to play catchup for a year of low slaughter rates
- Restocker demand has taken a drop, as often occurs in the south during winter, however heavy and trade lamb demand remains strong
- Sheep and lamb export markets are showing solid signs of growth and return to normal, which should support from solid price rises into spring.

The Australian sheep industry has had a solid first half of the year – not headline catching like the cattle industry – but a consolidation of the past five years' growth and a profitable operating level. While the sheep sector has been less impacted by the restocking zeal which has pushed cattle prices into the stratosphere, it has also felt a greater impact from some of the side effects of Covid and associated lockdowns.

PROCESSING SHUTDOWNS, LACK OF LABOUR AND LOWER THAN USUAL YARDINGS HAVE LEFT MORE HEAVY LAMBS IN THE PADDOCKS OVER WINTER. DESPITE THIS, AND PROCESSORS NOW FULL TO CAPACITY TRYING TO REBUILD THEIR STORES, SALEYARD PRICES REMAIN ON PAR WITH PREVIOUS YEARS - AND SOME OPTIMISTIC SIGNS ARE ON THE HORIZON FOR THE INDUSTRY EMERGING FROM WINTER.

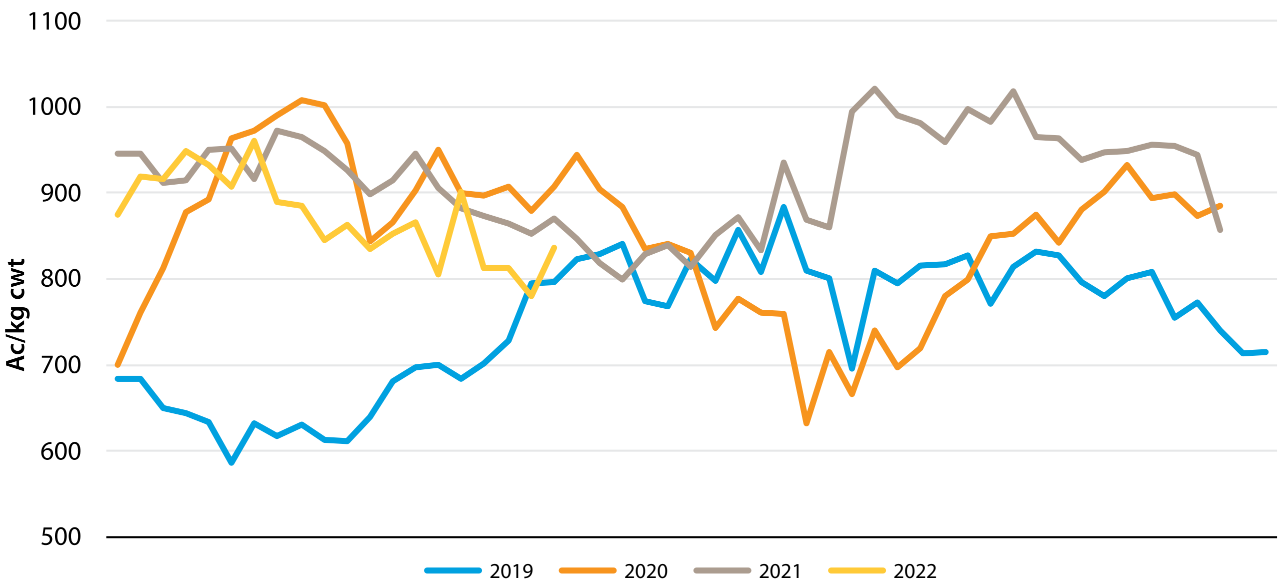
Saleyard restocker lamb prices have trended downward for much of the year – albeit with some significant volatility. In the last week of May alone, restocker and mutton saleyard prices jumped 7 and 10 per cent respectively after falling throughout the month. Volatility is being driven by low numbers in the yards due to seasonal factors – including wet weather and low prices – keeping lamb yardings for the year to the end of May lower than even last year's figures.

NATIONAL SALEYARD SHEEP PRICES



Source: MLA, ANZ

RESTOCKER LAMB PRICES



Source: MLA, ANZ

Prices for restocker and light lambs have come back through the year – with a number of factors influencing this. Firstly, the decline in slaughter and processing throughout the first half of the year has seen many producers retain stock on farm, leading to the expectation of many heavy lambs still to hit the market. Secondly, as the national flock is expected to hit highs not seen since 2013, and the competition for land from cropping and beef, the steam may have come out of the national flock rebuild.

Processors are working through a national backlog of lambs for processing due to low slaughter rates throughout the first half of the year, which have seen them booked out for months in advance. As a result, the usual dip in saleyard numbers which usually occurs at this time of year hasn't resulted in higher saleyard prices. Heavy lambs are receiving some interest in the saleyards, particularly in the southern states, as despite processors being at capacity, their need to rebuild stores run down during Covid means they are still active in the market for slaughter weight lambs.

Total yarding and slaughter numbers for the year are down significantly on previous years, and while they are rebounding well, there remains many sheep still in the paddocks yet to come to market. This is even despite the obvious intent of producers to rebuild their flocks by holding back ewe lambs which will see national flock numbers jump to almost 75 million head by the end of the year.

Year to the end of May, national lamb yardings are down 14 per cent – most markedly in Tasmania (-39 per cent), South Australia (-30 per cent) and Western Australia (-27 per cent).

The trade lamb indicator in Western Australia has taken a massive tumble since March – with the eastern States now trading at around a 400c/kg premium to Western Australia. This has been particularly a result of labour shortages as a result of Covid, as well as rain and strong grain prices meaning some producers are clearing their paddocks for sowing.

Export demand is improving with demand for sheep meat from the United States in particular increasing significantly in recent years. In March, lamb exports were up 18 per cent on the previous month and 8 per cent year on year. The stand out markets are the United States, PNG, Saudi Arabia, Malaysia and Japan while exports to Qatar and the European Union are down.

So what's coming down the turnpike for the Australian sheep industry in the coming months? There are a number of issues overhanging from Covid which are still impacting saleyard prices and supply. However the coming winter months should help regain a demand/supply balance. After that, all signs point towards a spring kick in the market with some in the industry even going so far as to speculate that the National Trade Lamb Indicator may breach the magic 1,000c mark.

WOOL INSIGHTS

OVERVIEW

- The Eastern Market Indicator (EMI) has had a relatively stable year in the first half of 2022, with most price gains and losses stemming from exchange rate movements
- Lockdowns in China and supply chain delays continue to pull downward on the market as smaller processors struggle to make new orders
- The gap between fine and coarse wool prices continues to grow, as 17 micron wool is now trading over 2,700c/kg while cross-bred wool is only returning 400c/kg.

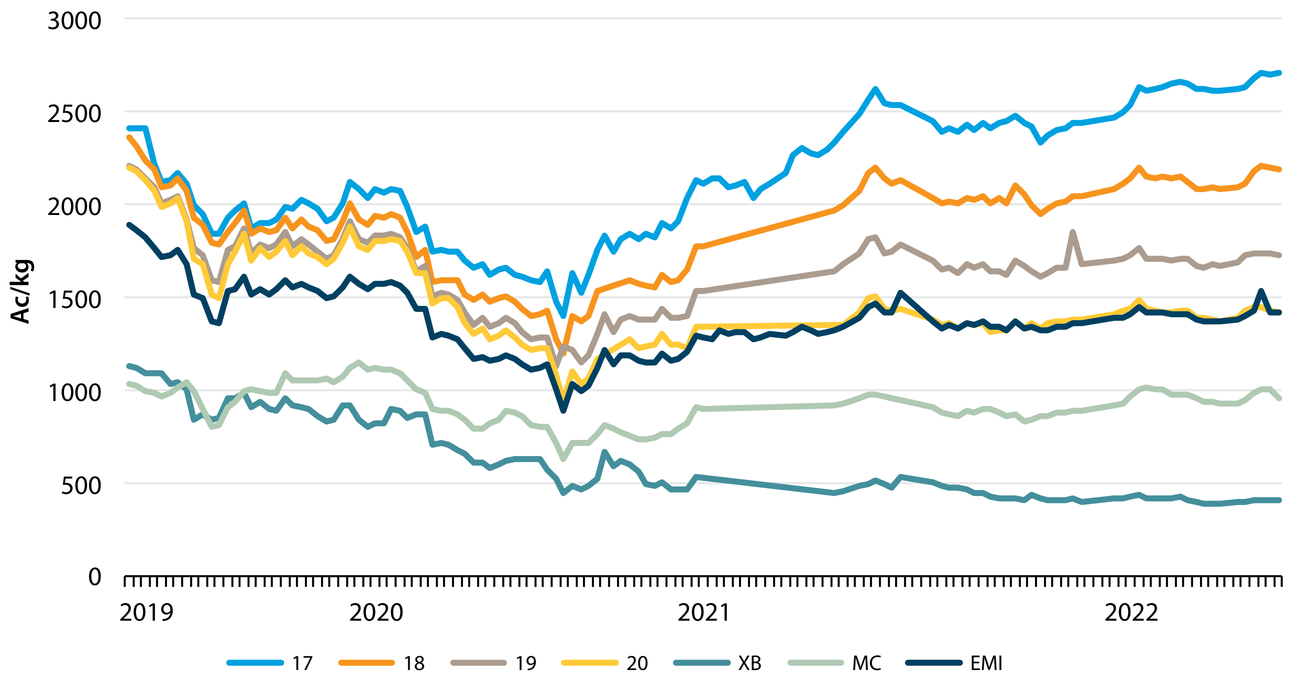
The Australian wool industry as a whole has shown a period of relative stability with the Eastern Market Indicator (EMI) remaining stable throughout much of the year. While certainly down from the highs of over 2,000c/kg, the indicator price seems to have found its level around 1,400-1,500c/kg. But that level is being constrained by a number of impediments, which once removed, should see prices move upwards into the new financial year. That's only really the story for fine wool however, with the industry now an industry of two halves. Fine wool demand and prices are strong – while coarse and cross-bred wool remains in doldrums with many producers now resigned to the fact that shearing is now a large cost for their business, rather than an income earning effort.

After weeks of solid price rises, the Australian wool market entered June with a series of price drops. The price movements through much of April and May have been driven primarily by changes in value of the Australian dollar. Indeed if looked at through a United States Dollar lens – the Eastern Market Indicator has remained relatively stable throughout much of the year. Buyers are reporting some difficulty in getting orders from Chinese buyers as lockdowns impact buying activity, as well as shipping delays impacting delivery of existing orders. On the flip side, sellers are showing they have their own price sensitivities and have responded to even slight price drops by significantly increasing the pass-in rate at auction.

Throughout the year to date, the number of bales that have gone to auction has increased strongly and provide a good indication that the wool stores that have been kept in sheds and auction houses around the country have been reduced and will soon cease to be a drag on prices.

Ongoing logistics and supply chain issues in China have taken the edge off demand slightly, as lockdowns in China and lack of available shipping have dulled Chinese demand. On the other hand, demand from the European Union and India has picked up to pre-pandemic levels and buying activity has been good. In general however, supply chain issues have left many in the industry believing that the EMI is currently sitting at a slightly depressed level to where it should otherwise. Indeed, there are likely to be a few months of difficulty moving ahead for the industry, as shipping and delivery issues mean that mills are unable to make new purchases due to delayed delivery times on previous orders.

AUSTRALIAN WOOL PRICES BY MICRON



Source: AWEX, ANZ

By micron, it is again and unsurprisingly, the fine end of the spectrum which is performing well and garnering most action. Coarse and crossbred wool continue to struggle, with the gap between the two ends of the spectrum continuing to broaden. The Australian wool industry has certainly become a tale of two ends of the spectrum, as fine wool has garnered solid demand through young, higher-income buyers looking for high-quality and sustainable clothing products. On the other hand, demand for woollen socks, carpets and other coarse wool products has failed to find similar consumer demand. While strongly increasing cotton and synthetics prices in the current market may help overcome some of the price sensitivity of consumers in purchasing staple products such as socks and carpets, the case still needs to be made on the longevity, quality and sustainability of coarse wool products to take advantage of the high-income, sustainability conscious sector of the market.

On a global stage, a view exists that Australian wool remains somewhat under-priced given the lack of global supply of fine wool following the concerns over Foot and Mouth Disease in South Africa limiting their supply. That view seems to be supported by the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) which is predicting an almost 200c rise in the average EMI in 2022-23 which lines up well with what the industry seems to consider the 'right' level. However as wool production picks up as a result of flock rebuilding and strong season, the strong domestic supply may keep some slight downward pressure on prices.

DAIRY INSIGHTS

OVERVIEW

- Australian farmgate milk prices are at around record levels, boosted by growing tight domestic and global supply
- Domestic milk production and dairy cow numbers continue to fall, driven by factors such as competition with beef for farmland, and ongoing farm labour shortages
- While most Australian dairy exports have fallen, cheese exports continue to show very strong growth

As it heads into the second half of 2022, the Australian dairy industry finds itself balancing a great outlook, combined with ongoing challenges, which could potentially keep milk production flat for some time to come.

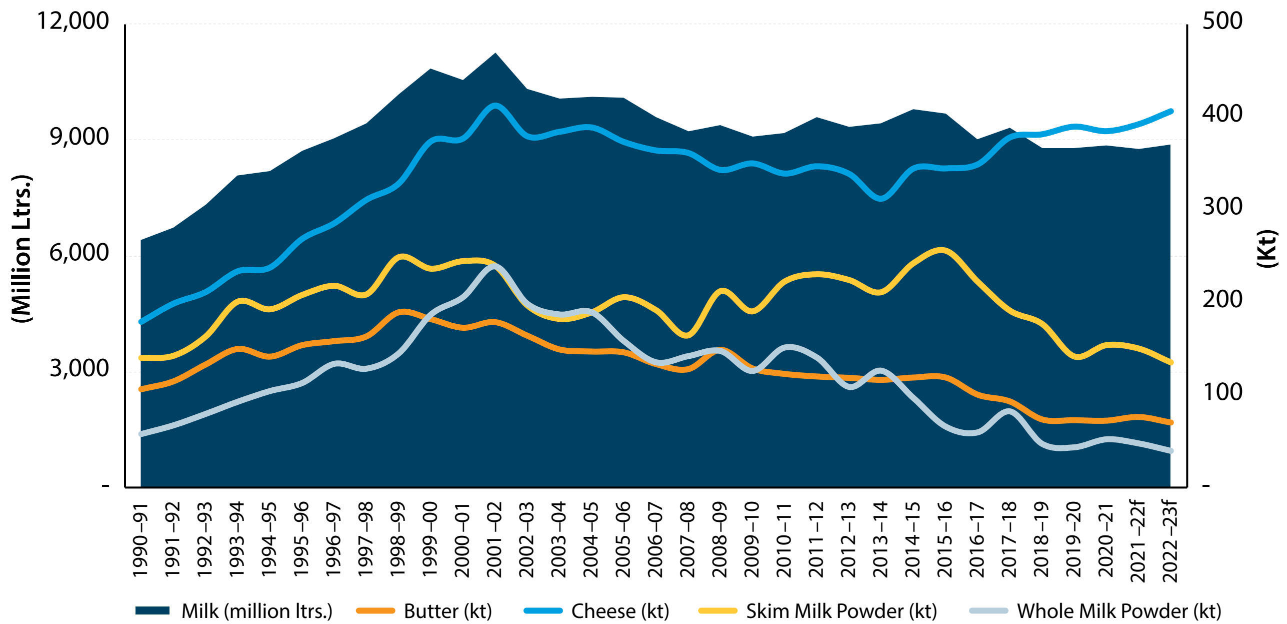
Promisingly, the latest round of farmgate prices, announced in June for the start of the milk season, have hit record levels. Across the board, all of the major processors announced that they would be offering over $8 per kilogram milk solids (kg/MS), with the top offer of $8.90 kg/MS. Within the industry, many expect that farmgate prices have further to rise, with a strong chance of exceeding $9 kg/MS this year.

The price rises have been largely driven by the imbalance between strong ongoing demand for milk and dairy products, combined with increasingly tight supply levels globally. Across the major global exporters, production continues to be flat to declining, driven by a combination of factors including poor weather, together with high feed, fertiliser and other input costs. For New Zealand in particular, new sustainability regulations have meant that dairy cow numbers continue to fall, resulting in a decline in overall production.

WITHIN AUSTRALIA, OVERALL DAIRY PRODUCTION VOLUMES HAVE CONTINUED TO DECLINE.

One exception to this is cheese, which is forecast to reach close to a record level of 406,000 tonnes. This is only around two percent below Australia's highest ever level of cheese production in 2001/02, despite the fact that overall milk production was over 25 percent higher at that time.

AUSTRALIA DAIRY PRODUCTION PROFILE

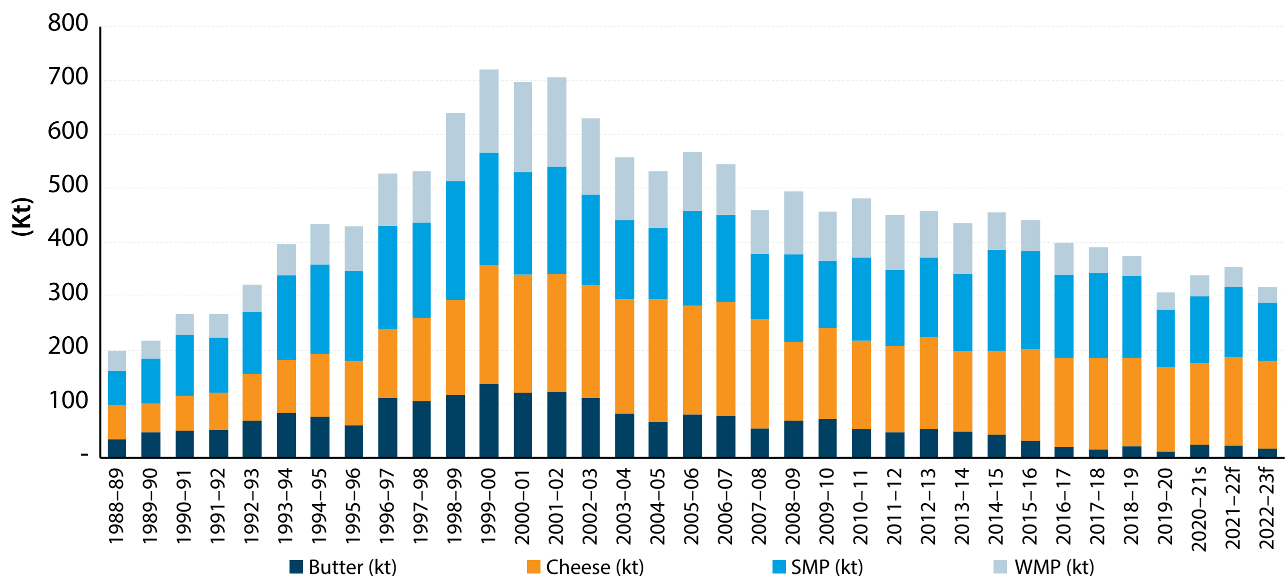


Source: ABARES, ANZ

The forecast total milk production in Australia for 2021/22, around 8.77 billion litres, would represent the lowest production level since 1995/96. This is especially reflective of the ongoing decline in the size of Australia's dairy milking herd, which has continued its long-term decline to 1.4 million head and is forecast to fall even further to 1.3 million head in 2022/23. This is despite the average milking yields also continuing to rise consistently to record levels each year, with a forecast average figure of around 6,500 litres per cow in 2021/22.

The decline in production has also meant a fall in exports, driven more by supply than demand. At the same time, the growth in cheese production has seen it take up an increasing share of dairy product exports, with it forecast to make up over 50 percent of exports in 2022/23, compared to 43 percent for skim and whole milk powders. These percentages represent a multi-decade high and low respectively for each category.

AUSTRALIAN DAIRY EXPORTS (KT)

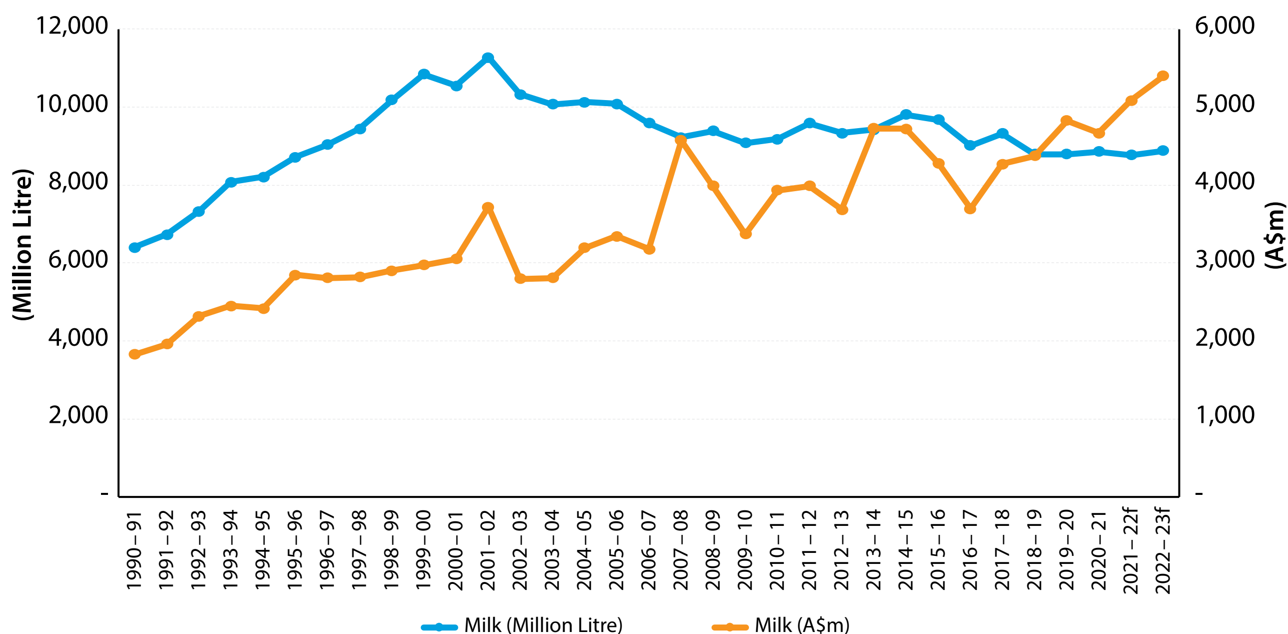


Source: ABARES, ANZ

While the volume of milk production declined, the high farmgate price has meant that the gross value of the industry is forecast to rise to a record $5 billion in 2021/22, with an outlook for an even strong climb the following year to $5.4 billion.

Similarly to the previous year, this forecast is likely to be driven by ongoing strong domestic and export demand, as well as continuing challenges to Australia's main export competitors, particularly New Zealand.

AUSTRALIA MILK PRODUCTION (VOLUME VS. VALUE)



Source: ABARES, ANZ

While the fall in milking cow numbers is reflective of the challenges to the industry, arguably not all of them are detrimental to the dairy farmer. A major push continues to be the ongoing rise in land prices, particularly in some of the major dairy regions of Victoria and Tasmania. Particularly driven by the forecast that beef prices could stay close to record highs for the next few years, some dairy farmers are clearly taking the opportunity to sell their properties to beef producers for a good return, and either retire or move on to other pursuits.

That said, other challenges to dairy remain strong. The restrictions on inbound international travel during the Covid period have exacerbated the shortage of farm labour in the industry, with many producers severely struggling to find the labour they need. At the same time, particularly with low unemployment across the country, and with rapidly growing regional centres seeing the growth of new job opportunities, many potential dairy workers are choosing other avenues of employment.

Looking ahead, the price outlook remains strong, particularly with the good seasonal outlook likely to reduce demand for fertiliser and supplementary feed, which would eat into margins at current high prices. The trend for some farmers to leave the industry is likely to remain, particularly with land and beef prices forecast to remain strong on the back of global food uncertainty and strong demand. For those farmers who remain in the sector, and who are able to structure their operations to best cope with the challenge of tight labour availability, the rest of the year looks very promising.

COTTON INSIGHTS

OVERVIEW

- Some very early signs that the global cotton price's stellar run may be moderating slightly, as rains hit West Texas
- Cotton consumption likely to come under pressure as high fuel and food prices eat into consumers' disposable income
- Global production is forecast to just fall short of global consumption meaning that strong cotton prices are likely to remain.

The global cotton industry has thrived throughout COVID lockdowns as prices have been on a steady increase since the beginning of 2020. While still early, some indications emerged in late May that the inexorable climb in prices may be turning. Rains in West Texas, growing global supply and the forecast lower consumption on the back of decreasing disposable incomes is likely to see cotton prices moderate slightly in coming months.

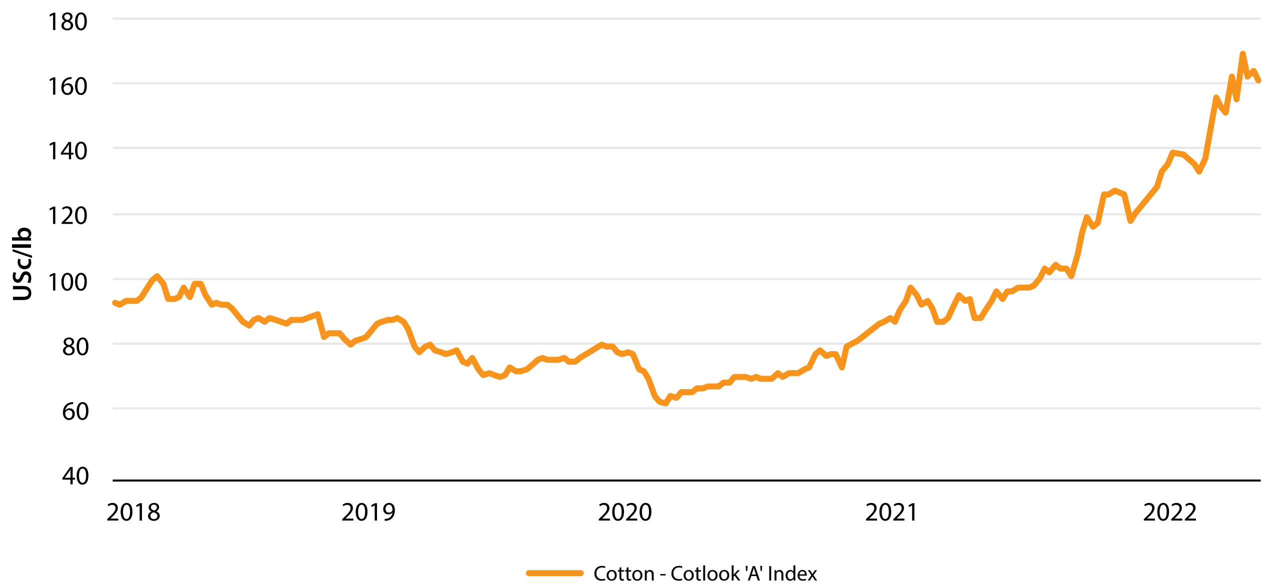
Have the outstanding prices we've been seeing in the cotton industry for the past two years – which only recently culminated in 11-year highs - possibly reached their peak? While there's no clear trend yet, there are some indications that global cotton prices may be in for a more moderate run.

One of the major factors supporting recent higher prices had been the drought in West Texas which, up until recently, had meant that plantings in the heart of US cotton producing area were poor. Just a few weeks ago however, rains hit which were larger than anticipated and have come in time for farmers who were holding back to complete some plantings. While it is unlikely to return a bumper season for that area, cotton production in Texas is looking less dire than a few weeks ago.

Underlying a boost in expected production are concerns over global consumption as a result of global inflation, fuel and food costs and declining disposable income. Forecast global consumption is expected to fall just under 1 per cent as a result. Despite this, global production is forecast to just fall short of global consumption meaning that stocks are also anticipated to fall a further 1 per cent by the end of 2022/23. While the production shortage, which hit just over 10,000 bales in 2020/21 is forecast to fall to just over 800 bales in 2022/23, the continued decline in stocks is a clear signal that while prices are not anticipated to continue their solid growth, nor are they expected to fall considerably.

Of greater concern perhaps is the expected change in consumption habits as countries leave Covid lockdowns behind them, but are faced with growing cost of living pressures and lower disposable income. During Covid lockdowns, cotton consumption in the form of homewares, decorations and casual clothing boomed. However, as households are facing less discretionary expenditure, as well as relatively expensive cotton goods, indications are that households could lower their expenditure on 'extras' or move to cheaper synthetic goods.

GLOBAL COTTON PRICES



Source: ABARES, ANZ

SUGAR INSIGHTS

OVERVIEW

- Sugar prices remain at a multi-year high, driven by concerns over tight global supply
- With oil prices forecast to remain high, increasing volumes of Brazilian sugar are likely to be diverted from global food supplies into ethanol production
- India's ban on sugar exports has triggered nervousness in global markets, including other countries banning sugar exports

While the impacts of the conflict in Ukraine have been most prominent around the grain sector, the flow on effects have increasingly had a major impact on the global sugar industry. As a result, in the same way that Australian crop producers have benefitted from the steep rises on global grain and oilseeds prices, domestic sugar producers are also likely to see similar strong prices.

In terms of the global sugar landscape, the two most prominent developments at the moment are in Brazil and India, where enhanced ethanol production and export restrictions have respectively contributed to global sugar prices remaining high.

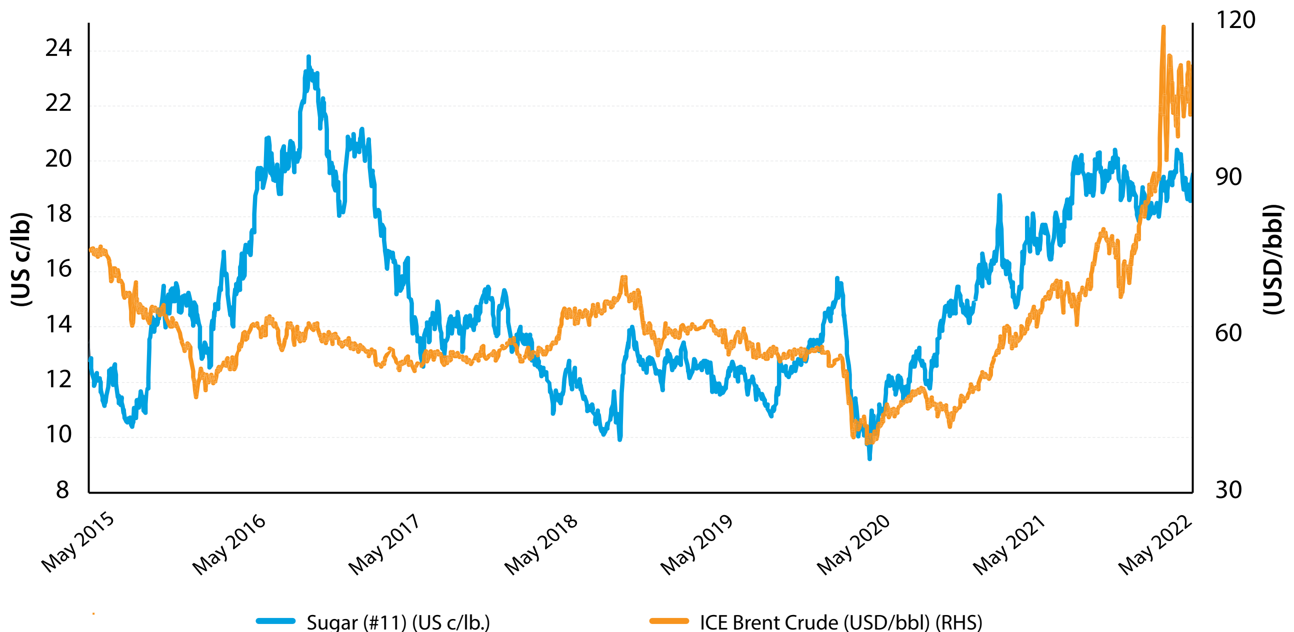
Globally, Brazil has long been one of the world's largest producers of sugar, as well as by far the largest exporter. Over the past ten years, Brazil has averaged 44 percent of annual global sugar exports, compared to thirteen percent for Thailand, seven percent for India, and six percent for Australia. As a result, any major change in Brazil's rate of sugar exports will inevitably have an impact on global prices.

While much of Brazil's sugar is produced for food, a large amount is also utilised for ethanol production, both for Brazil's domestic usage, as well as for export. As ethanol can be utilised as a substitute for or blend into petroleum, depending on the market, its demand rises when oil prices outstrip the price of ethanol. As a result, in those periods, more of Brazil's sugar will be utilised for ethanol and less produced for food. As a result, global sugar prices are pushed up, as sugar buyers globally pay higher to ensure their demand is met.

Globally, sugar cane or sugar beet accounts for around 33 percent of global ethanol production, compared to grains such as corn (and to a lesser degree wheat), which account for around 65 percent.

The rise in global oil prices, partly driven by the Ukraine conflict, has seen oil prices continue to rise strongly, from around US$40 per barrel in May 2020 to around US$111 per barrel in May 2022. At the same time, sugar prices have climbed from around US9c/lb to around US20c/lb.

GLOBAL SUGAR VS. OIL PRICES



Source: Bloomberg, ANZ

Going forward, the sugar market will be watching whether Brazilian sugar mills continue to increase their diversion of sugar from food to ethanol. If this continues, then major importers may start to fear a global sugar shortage, and push prices up further.

A further development likely to keep sugar prices high has been the decision by India to restrict its sugar exports, the first time the country has done this in six years. As well as being the world's second largest sugar exporter, India vies with Brazil for being the world's largest sugar producer, with each country forecast to account for around 20 percent of global production in 2021/22.

The Indian export ban followed the country's decision to apply similar restrictions to wheat exports. The move is aimed to ensure that India's domestic consumers do not run short on sugar, or that domestic prices are not pushed too high if traders seek to take advantage of high export prices.

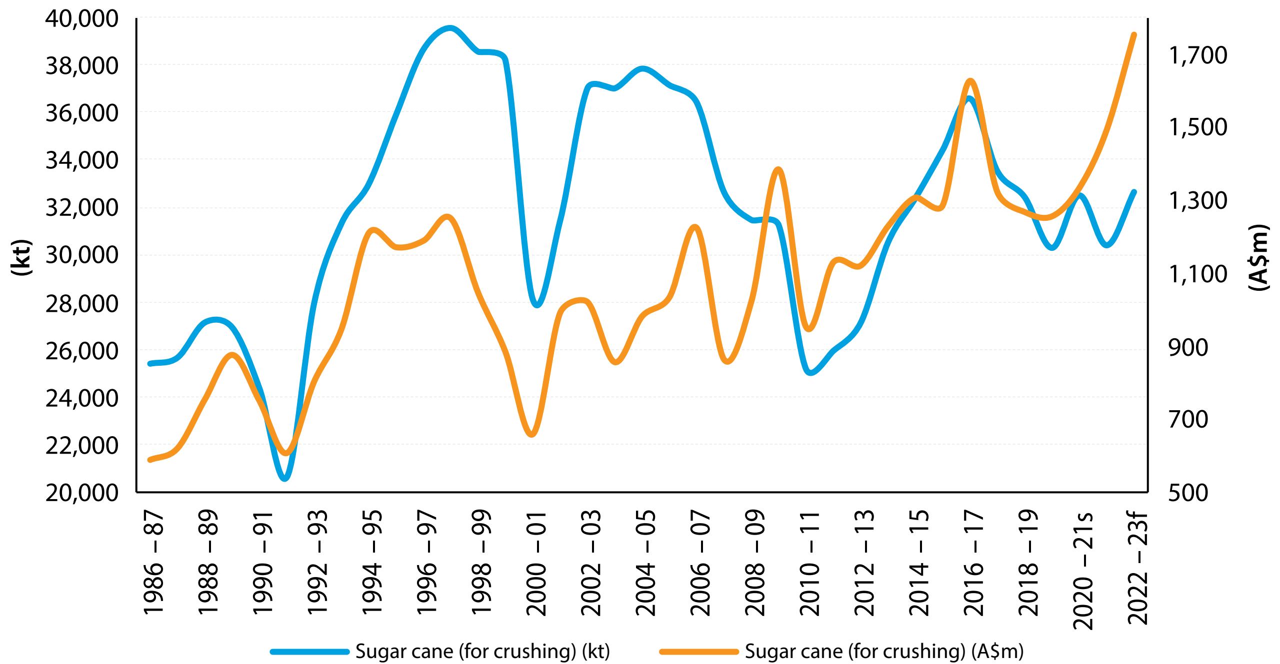
India's sugar export restrictions will impact a number of major markets, particularly China and Indonesia, who may well seek to procure supplies from other exporters, such as Australia, to make up the shortfall.

While the Indian sugar export restrictions have received the most attention, several other countries have also followed suit. These include Pakistan, the world's tenth largest sugar exporter, as well as Kazakhstan and Kyrgyzstan, all citing "food security" concerns.

For Australian sugar producers, the global machinations have provided the industry with one of the strongest outlooks in years. As they seek to take advantage of the high prices, some sugar farmers are looking to lock in prices up to two and even three years in advance, providing many of them with new margins of profitability which have been far thinner in the past few years.

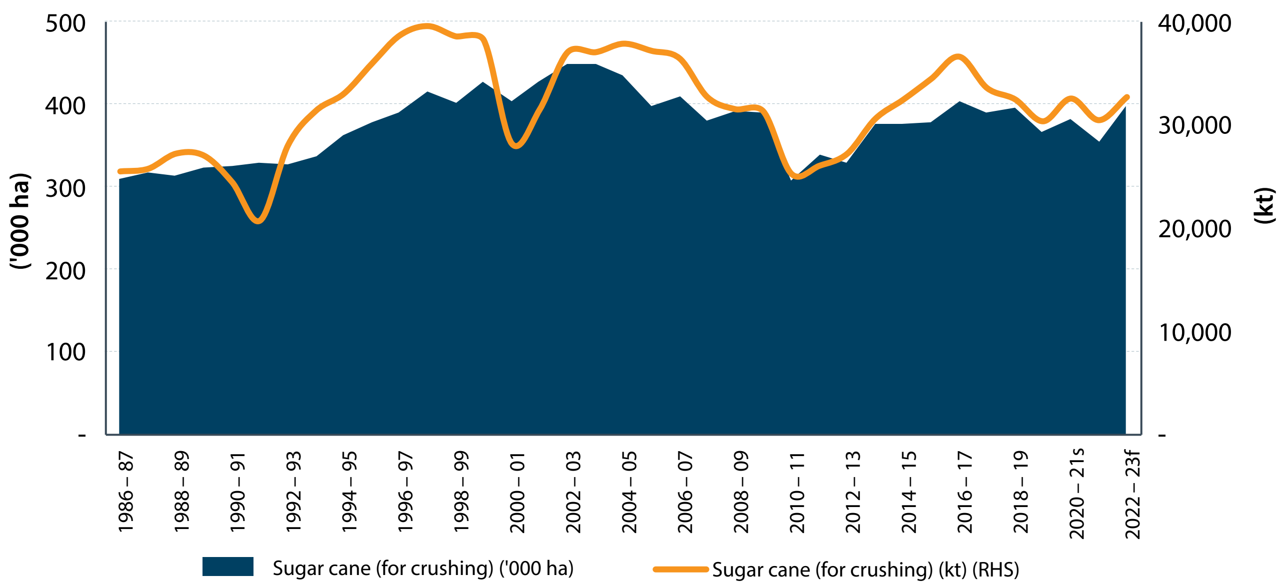
As a result of the high global prices, the value of Australia's sugar cane production is forecast to reach a record A$1.7 billion in 2022/23. While a positive outlook, clearly this forecast will also be impacted by ongoing developments around not just ethanol production and export bans, but the outlook for sugar production in competing countries. In addition, growers will continue to be impacted by higher input costs, particularly fertiliser. At the same time, they will also need to increasingly factor in the impact of enhanced sustainability requirements, particularly around issues to do with the Great Barrier Reef. In the shorter term too, the wet weather in northern Australia may also delay the current season's harvest by some weeks, though the industry remains optimistic that all the cane will still be cut.

AUSTRALIAN SUGAR CANE PRODUCTION (VOLUME VS. VALUE)



Source: ABARES, ANZ

AUSTRALIAN SUGAR CANE AREA HARVESTED VS. PRODUCTION



Source: ABARES, ANZ

Looking ahead, a further indicator will be whether Australia's cane volume looks to climb back to the high levels last seen around 2016/17, or whether changes in cane land usage, particularly to horticulture, mean that current planted acreage and volume production have reached a peak.

Finally, an inevitable question is whether the ongoing high sugar prices will have an impact on the price of goods bought by domestic consumers.

To a degree, while this is almost inevitable, the rise in sugar price as an ingredient will be a small component in other consumer good price pressures, such as transportation and labour. As such, domestic sugar producers are likely to continue to benefit positively from ongoing strong demand, both from domestic customers, as well as from the export markets which account for around 70 percent of demand.

Health
House

AUSTRALIAN ECONOMICS INSIGHTS

Cost of living the central issue in the Australian economy

Inflation has escalated. Trimmed mean inflation surged to 1.4 per cent q/q in Q1 (3.7 per cent y/y), while headline inflation reached 5.1per cent y/y, the strongest result since the mid-90s (excluding the introduction of GST in 2000). Petrol prices (+35 per cent y/y) and food prices (+6.7 per cent y/y) were key drivers of the strong inflation result. The increase in non-tradables inflation signals that this is strong demand within the Australian economy and not just due to disruptions in the global economy. We expect inflation to reach a peak of 7per cent in the second half of 2022.

Interest rates have started to rise. To help contain local drivers of inflation, the RBA increased the cash rate in May for the first time since 2010. Before the increases in the cash rate, fixed rates in Australia had already started moving up in response to the end of the RBA's quantitative easing, yield curve control and term funding facility. We expect the cash rate to move to 2.6 per cent by May 2023, before pausing for some time. We expect the eventual peak of the cash rate to be above 3 per cent but likely not until 2024 or 2025.

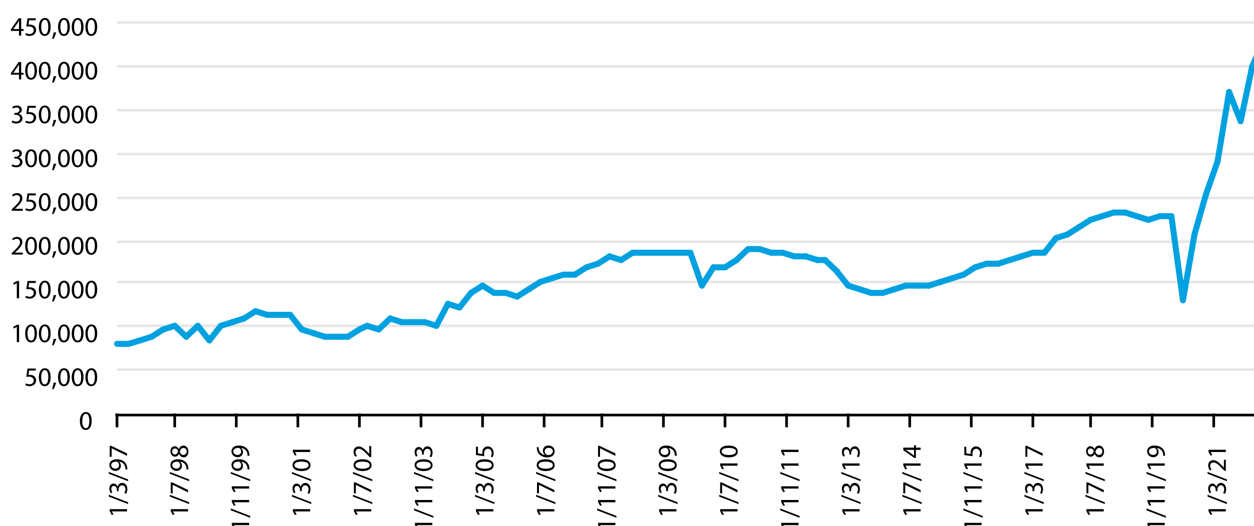
The rising cost of living has hit confidence, but not spending. Consumer confidence has fallen materially in recent months, reflecting concerns about cost of living, as wage growth fails to keep up with the movement in prices. Though ABS data show that in Q1, retail volumes lifted by 1.2 per cent q/q. This suggests people are not only spending more due to price increases, but are also increasing the amount of goods/services they buy.

Strong household savings are protecting both consumption and financial stability. The eventual negative impact on spending of increased interest rates amidst continuing inflation is likely to be delayed by very large savings buffers. Households with variable rate mortgages have a median of 20 months' worth of repayments in offset/redraw accounts, up from a median of 8 months in January 2020. And the persistently high household savings rate, which was 11 per cent in Q1 2022 (vs 5-7 per cent in the years before COVID) will protect households from increases in minimum mortgage payments and the cost of living, until wages catch up.

The unemployment rate is at a 48-year low. The unemployment rate dropped to 3.9 per cent in April and maintained this low rate in May. The total underutilisation rate (unemployment + underemployment) dropped further in May to its lowest level since 1982. The reopening of borders will add to business demand for workers and the record-high job vacancy rate indicates employment should continue to grow well. We expect unemployment to fall to the low-3s later this year and underemployment to also decline further. While it will take some time for population growth to get close to the pre-COVID norm, it's important to note that population growth adds to available workers, but also adds to the spending in the economy, which creates more jobs.

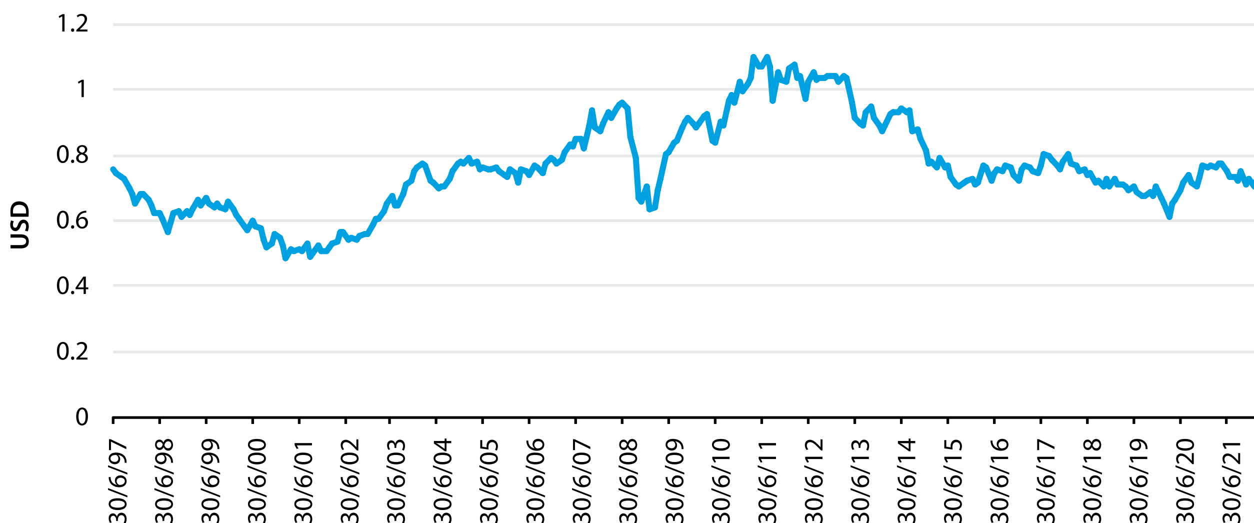
AUD value faces opposing forces. There are currently two opposing forces determining the direction of the AUD. The first is USD exceptionalism, which looks to be fading. Data releases this month show a deceleration in US activity, while Fed hawkishness appears to have peaked for now. Acting in the other direction is a clear deterioration in the outlook for global growth. This is weighing heavily on risk appetite. Key forward indicators, such as the PMIs and regional Fed surveys, have reiterated the supply side pressures constraining manufacturing. In China, COVID lockdowns have curbed consumer and producer activity, weighing on key industrial commodities, like copper and iron ore. Domestically, however, economic momentum remains strong. We think the AUD will appreciate, but by less than previously expected. As such, we have downgraded our year-end forecasts from USD0.78 to USD0.76.

JOB VACANCIES ARE AT A RECORD HIGH



Source: ABS, Macrobond, ANZ Research

AUD LIKELY TO APPRECIATE IN THE COMING YEAR



Source: Bloomberg, ANZ Research

CONTACTS

MARK BENNETT
Head of Agribusiness & Specialised Commercial, Commercial Banking
T: +61 3 8655 4097
E: mark.bennett@anz.com

NATASHA KEMP
Acting Head of Food, Beverage & Agribusiness, Australia – Institutional Banking
T: +61 466 855 962
E: natasha.kemp@anz.com

AUTHORS

MICHAEL WHITEHEAD
Head of Agribusiness Insights, Institutional
T: +61 3 8655 6687
E: michael.whitehead@anz.com

MADELEINE SWAN
Associate Director Agribusiness Research, Commercial Banking
T: +61 419 897 483
E: madeleine.swan@anz.com

SWATI THAKUR
Senior Analyst Institutional Client Insights & Solutions
T: +91 8067 953 039
E: swati.thakur@anz.com

ADELAIDE TIMBRELL
Economist, ANZ Research
T: +61 466 850 588
E: adelaide.timbrell@anz.com

PREETI RANI
Associate Institutional Client Insights & Solutions
E: preeti.rani@anz.com

DISCLAIMER

The distribution of this document or streaming of this video broadcast (as applicable, "publication") may be restricted by law in certain jurisdictions. Persons who receive this publication must inform themselves about and observe all relevant restrictions.

1. Disclaimer for all jurisdictions, where content is authored by ANZ Research:

Except if otherwise specified in section 2 below, this publication is issued and distributed in your country/region by Australia and New Zealand Banking Group Limited (ABN 11 005 357 522) ("ANZ"), on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (collectively, "recipient"). This publication may not be reproduced, distributed or published by any recipient for any purpose. It is general information and has been prepared without taking into account the objectives, financial situation or needs of any person. Nothing in this publication is intended to be an offer to sell, or a solicitation of an offer to buy, any product, instrument or investment, to effect any transaction or to conclude any legal act of any kind. If despite the foregoing, any services or products referred to in this publication are deemed to be offered in the jurisdiction in which this publication is received or accessed, no such service or product is intended for nor available to persons resident in that jurisdiction if it would be contradictory to local law or regulation. Such local laws, regulations and other limitations always apply with the non-exclusive jurisdiction of local courts. Before making an investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

The views and recommendations expressed in this publication are the authors. They are based on information known by the author and on sources that the author believes to be reliable but may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this publication and are subject to change without notice; and, all price information is indicative only. Any of the views and recommendations which comprise estimates, forecasts or other projections, are subject to significant uncertainties and contingencies that cannot reasonably be anticipated. On this basis, such views and recommendations may not always be achieved or proven to be correct. Indications of past performance in this publication will not necessarily be repeated in the future. No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided.

Additionally, this publication may contain 'forward-looking statements'. Actual events or results or actual performance may differ materially from those reflected or contemplated in such forward-looking statements. All investments entail a risk and may result in both profits and losses. Foreign currency rates of exchange may adversely affect the value, price or income of any products or services described in this publication. The products and services described in this publication are not suitable for all investors, and transacting in these products or services may be considered risky. ANZ and its related bodies corporate and affiliates, and the officers, employees, contractors and agents of each of them (including the author) ("Affiliates"), do not make any representation as to the accuracy, completeness or currency of the views or recommendations expressed in this publication. Neither ANZ nor its Affiliates accept any responsibility to inform you of any matter that subsequently comes to their notice, which may affect the accuracy, completeness or currency of the information in this publication.

Except as required by law, and only to the extent so required: neither ANZ nor its Affiliates warrant or guarantee the performance of any of the products or services described in this publication or any return on any associated investment; and, ANZ and its Affiliates expressly disclaim any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this publication.

If this publication has been distributed by electronic transmissions such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. ANZ and its Affiliates do not accept any liability as a result of electronic transmission of this publication.

ANZ and its Affiliates may have an interest in the subject matter of this publication as follows:

- They may receive fees from customers for dealing in the products or services described in this publication, and their staff and introducers of business may share in such fees or receive a bonus that may be influenced by total sales.
- They or their customers may have or have had interests or long or short positions in the products or services described in this publication, and may at any time make purchases and/or sales in them as principal or agent.
- They may act or have acted as market-maker in products described in this publication.

ANZ and its Affiliates may rely on information barriers and other arrangements to control the flow of information contained in one or more business areas within ANZ or within its Affiliates into other business areas of ANZ or of its Affiliates.

Please contact your ANZ point of contact with any questions about this publication including for further information on these disclosures of interest.

2. Country/region specific information:

Australia. This publication is distributed in Australia by ANZ. ANZ holds an Australian Financial Services Licence no. 234527. A copy of ANZ's Financial Services Guide is available at http://www.anz.com/documents/AU/aboutANZ/FinancialServicesGuide.pdf and is available upon request from your ANZ point of contact. If trading strategies or recommendations are included in this publication, they are solely for the information of 'wholesale clients' (as defined in section 761G of the Corporations Act 2001 Cth). Persons who receive this publication must inform themselves about and observe all relevant restrictions.

Australia and New Zealand Banking Group Limited (ANZ) ABN 11 005 357 522. Item No. 98174 06.2022 WZ121186

anz.com