ANZ AGRI
INFOCUS
OCTOBER 2021

COMMODITY INSIGHTS

FOREWORD

After another year of disruption for many parts of Australia, it's hard to believe that the country is around halfway through Spring already and that the start of summer is only weeks away. With the Christmas period imminent, and consumers about to start the surge of their retail purchases, as well as their food purchases for the regular social events leading up to the end of December, activity is being enhanced right back through the supply chain, to ensure that as much as possible supplies are on shelves throughout this period. At the same time, businesses are well underway in planning their strategies for 2022, in what they hope will be a year with fewer of the challenges which disrupted 2020 and 2021.

For farmers and agribusinesses across Australia, the upcoming period is not only the busiest of the year for many, but also requires important short and long term preparation. As every stakeholder in agriculture knows well, with so many factors being beyond their control, nothing can ever be taken for granted, and while the outlook for both the season and most commodity prices is strong, there are still some challenges that will need to be factored into next year's planning.

While the warmer months are busy for every agribusiness, arguably things will be the most hectic for grain producers, as well as the whole grain supply chain. The harvest of the winter crop is well underway, having commenced in Queensland in September, and over the coming months will gradually work its way south, as well as kicking off in the west.

In terms of cropping area, this will be the biggest harvest ever, with over 23 million hectares planted, including a record five million hectares of canola. By and large, growers are rightfully optimistic – grain prices continue to be strong across the board, and the rainfall outlook is excellent in most regions.

To ensure that this year's crop comes off as seamlessly as possible, and makes its way to farm silos, receival sites and ports, the industry will continue to manage the challenges of cross-border movement disruptions, particularly of machinery and personnel, as many contractors seek to work their way south.

Similarly, as the sheep industry enters the busiest shearing period of the year, the challenges of ensuring that the already tight number of shearers can cross borders will also be something many wool producers will need to monitor closely.

For the cattle industry, much of which has its main weaner sales in January each year, while price expectations may be good already, it will be important to be planning for the logistical challenges which may arise around that time.

While some of these spring and summer challenges will impact farms directly, others will be well beyond the control of producers, but will still need to be managed. With several meat processors continuing to experience Covid-related disruptions to their workforces, livestock producers, and their agents, will need to be ready for any impacts on upcoming sales – this could particularly impact the usual busy lamb sale period.

In fresh produce, the Covid driven labour dilemmas remain a challenge which is ever-present right through transport and storage/distribution systems and retail settings across multiple geographies. This is a challenge which all producers will need to work on addressing.

Offshore, the current major global agri machinations also offer good news and challenges for Australian producers. Ongoing poor forecasts for much of the Northern Hemisphere grain crop, combined with disruptions to beef exports from South America, all point to stronger demand prices for Australian exports. That said, one big challenge looming for many farmers heading into 2022 will be the surge in fertiliser prices globally, which could last well into next year. With this playing such a central role in plans for next year's crops and pastures, producers finalising their upcoming farm plans and budgets will need to be very conscious of any impact this may have.

Mark Bennett
Head of Agribusiness & Specialised Commercial, Business & Private Bank
@bennett2_mark

FOOD PRICES INSIGHTS

ARE INCREASING FOOD PRICES THE NEW NORM?

- Both globally and domestically, the decades' long trend to lower food prices appears to be reversing - increasing retail food prices is seeing more of household budgets being spent on food
- Certain retail grocery prices have jumped strongly in recent months on the back of a shortage of livestock, labour and shipping for imports
- The jump in retail beef prices has outstripped any other food category in Australia, leading some to conclude that beef will soon be considered a luxury item
- The impact of COVID-19 and shutdown of food service outlets have seen the counterintuitive result of beef consumption rising strongly despite price increases, and chicken consumption falling despite smaller price rises
- On the other hand, the retail price of cereal and bread products remain incredibly stable despite strong rises in both global and domestic prices
- Fruit prices have surged on the back of labour shortages, while the price of dairy product have fallen slightly in the past year on the back of a slightly cooling global market

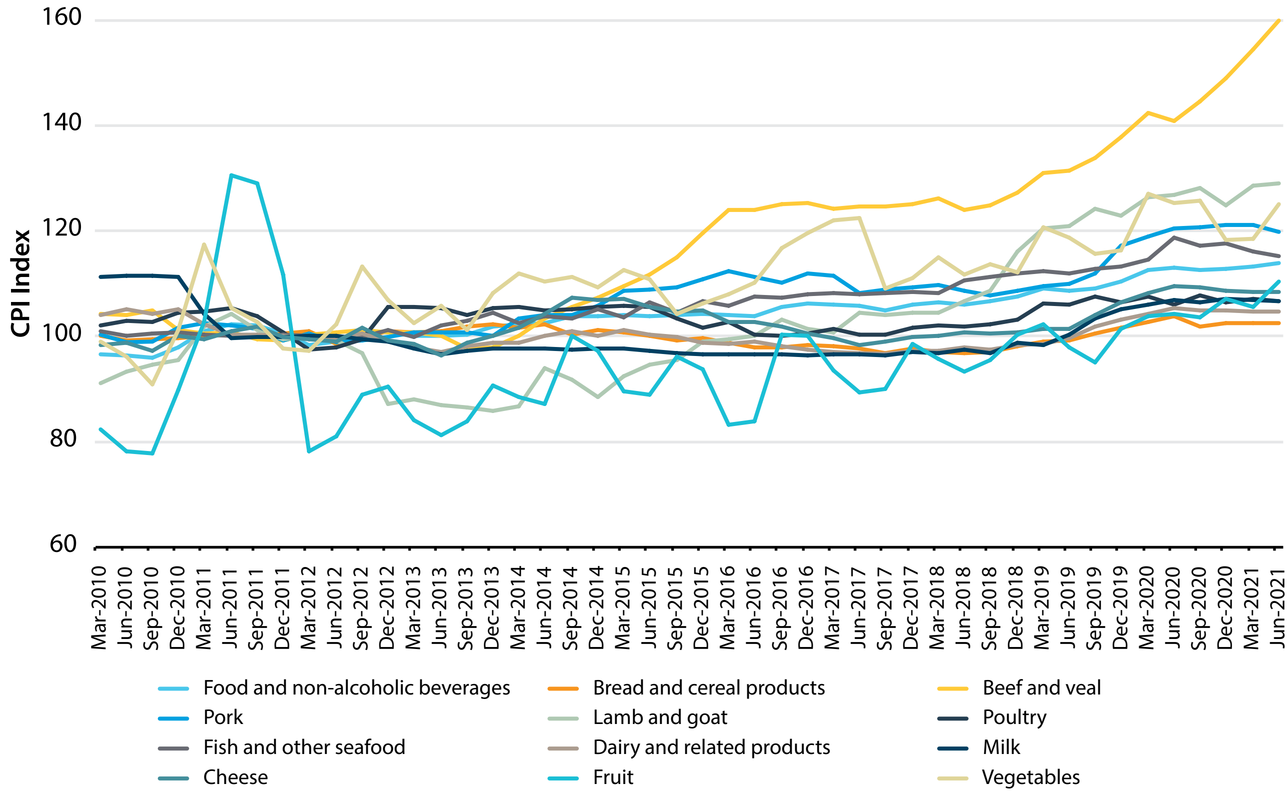
Increasing global commodity prices, increasing oil prices and the reopening of the global commodity is seeing food prices on the rise, both in Australia and internationally. The world has benefitted for many decades from improvements in agricultural productivity and trade resulting in lower food prices. But as commodity prices surge across the globe and new standards of production are introduced across multiple jurisdictions – is the era of declining food prices over? Is an increasing cost of our supermarket shop the new norm?

For many years, the price of Australian red meat – particularly beef – remained remarkably level, regardless of drought, livestock prices and the low herd numbers. Since early 2019, however, the impact of skyrocketing livestock prices and restocker demand for both sheep and cattle have resulted in one of the largest rises in recent history in supermarket and retail beef and lamb prices.

It had long been surmised that retailers believed Australian consumers had a price ceiling for red meat and that further price rises would result in a fall in consumption. To date, that does not appear to be the case – but is that just a factor of the COVID-19 lockdowns, or is there another trend at play?

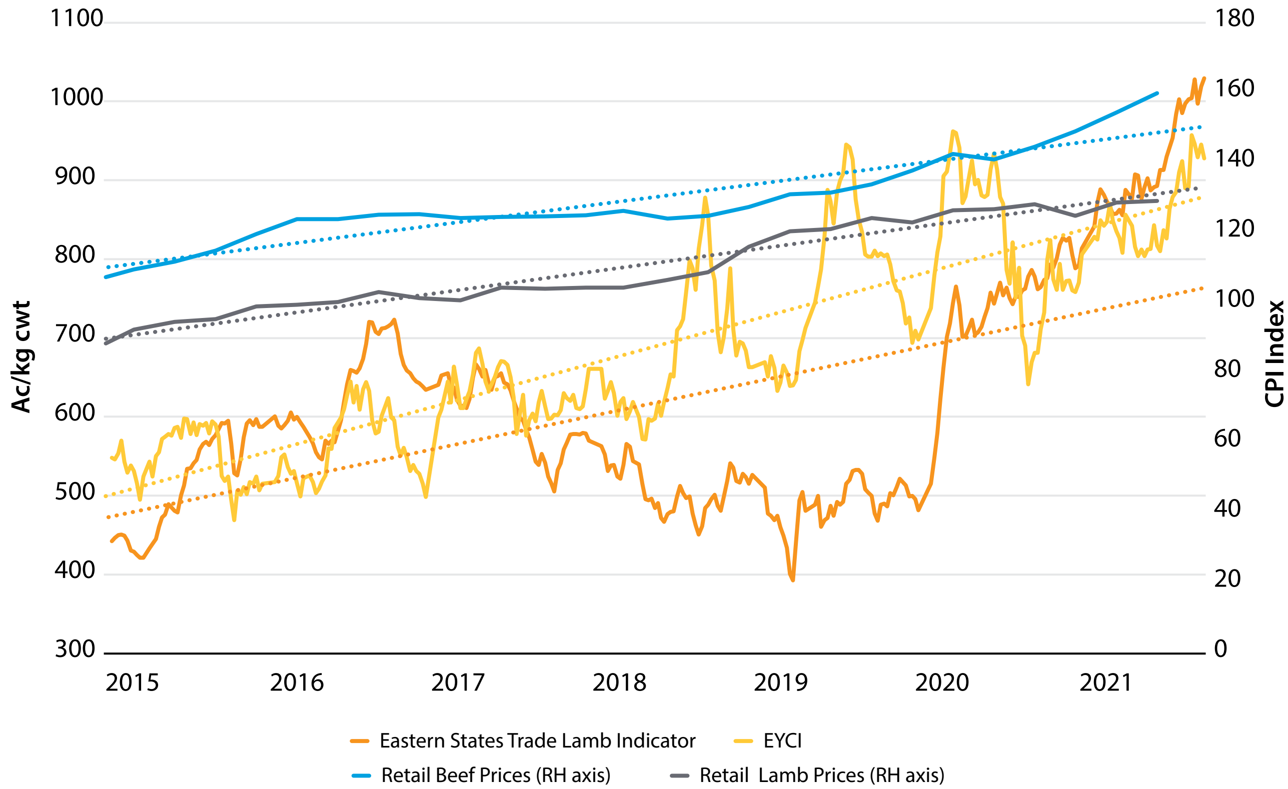
Retail beef and lamb prices have risen strongly in recent years on the back of the skyrocketing Eastern Young Cattle Indicator (EYCI), saleyard prices and restocker demand. Where red meat retail prices had remained steady for almost two years until 2018, that trend broke as pressure on processors mounted. In the past year alone, retail beef prices have risen over 13 per cent, while lamb prices have risen just 2 per cent in that time. Chicken prices remain low and steady, rising just 0.6 per cent in the year, while pork prices have fallen around 0.6 per cent.

AUSTRALIAN BEEF PRICES SPIKE AFTER A LONG PERIOD OF NO GROWTH



Source: Australian Bureau of Statistics, ANZ

DOMESTIC RED MEAT PRICES RESPONDING TO STRONG RESTOCKER DEMAND AND PRICES

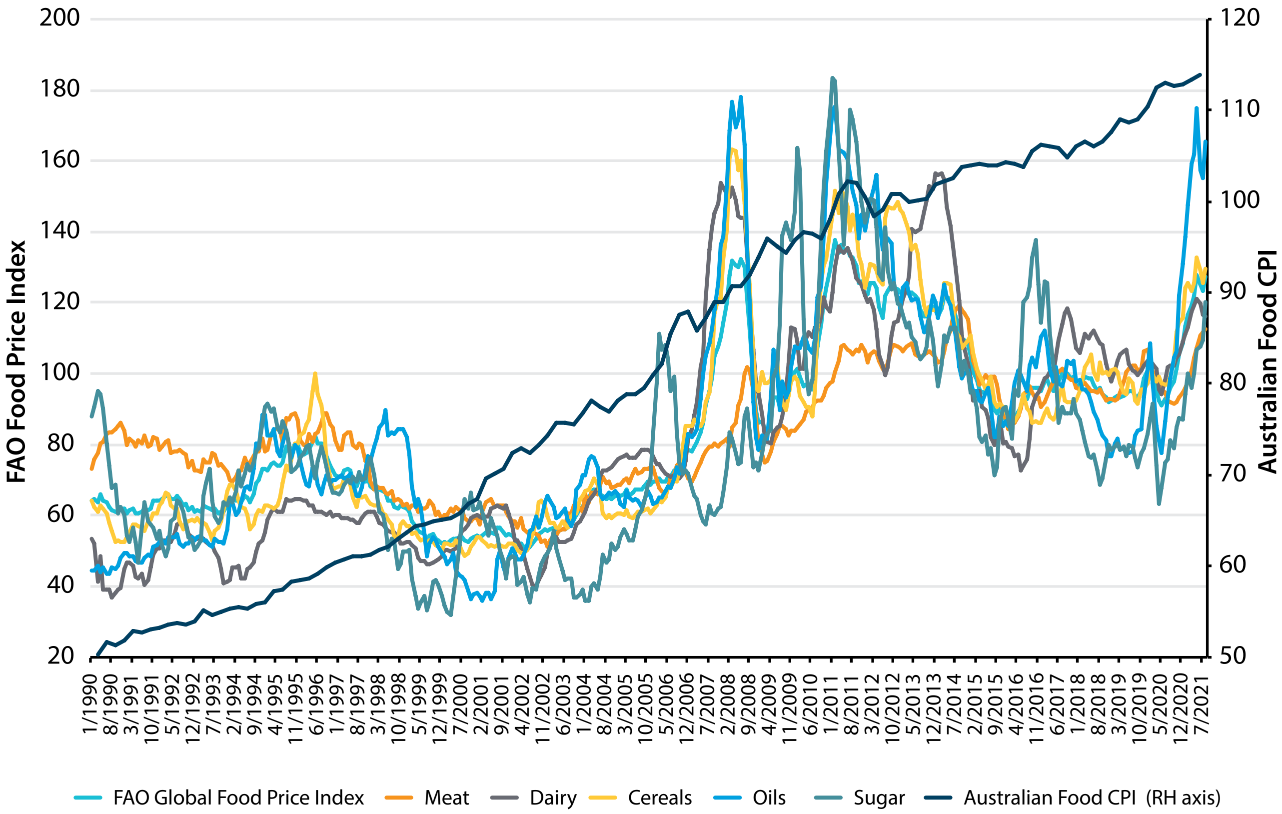


Source: ABS, MLA, ANZ

If we take a longer-term look at retail red meat prices, however, it becomes clear that the plateau in prices between 2016 and 2018 were the odd years out, and retail prices tend to move in tandem with indicator saleyard prices – meaning that as the EYCI and to a lesser extent, the Eastern States Trade Lamb Indicator (ESTLI), continue to rise unabated, we should continue to see increases in meat prices on supermarket and butchers' shelves.

So what does this mean for red meat consumption? The long-term decline in per capita beef consumption in Australia has been well documented, with ABARES predicting further falls into the future, despite their longer-term forecasts for falling saleyard prices. To date, the strong price increases of the past few years don't seem to have dampened enthusiasm for beef. Anecdotally, however, consumers are increasingly moving to lower-priced cuts such as mince, while viewing premium cuts such as steak as a luxury item rather than for everyday consumption. Lamb consumption, on the other hand, remains relatively stable, with longer-term forecasts of slight increases in per capita consumption. With beef prices rising faster than lamb, lamb is also becoming a more attractive alternative for some consumers.

AUSTRALIAN RETAIL FOOD PRICES REMAINING RELATIVELY STABLE DESPITE GLOBAL VOLATILITY



Source: FAO, ABS, ANZ

Also of interest is the relative stability of cereal and grain products on the supermarket shelves, despite significant increases in global wheat prices as a result of drought in North America. Retail bread and cereal product prices now sit just over 2 per cent higher than they did over 10 years ago. Dairy prices, particularly cheese retail prices, have fallen slightly on the back of cooling global prices.

Outside of red meat prices, the other retail food prices making headlines are the price of fruit and vegetables which have increased by over 5 per cent in the last quarter alone. This is due to two primary factors – the ongoing labour shortages for picking caused by Covid -19 restrictions, and the lack of international shipping capacity for those fruits and, in particular, vegetables that are imported into Australia. While beef prices may be making the greatest headlines, the price of fruit and vegetables is perhaps the more interesting story as it highlights Australia's reliance on the importation of certain, cheaper fruits and vegetables.

While the increase in the costs of many food staples is likely to impact lower-income earners, particularly at a time where petrol prices are also increasing, the upward pressure on retail prices may continue for the foreseeable future if international conditions continue. A comparison of Australian food CPI with international food prices shows that, understandably, Australian food prices are more stable than global food prices, particularly those in developing nations. That said, it is also true that the long-term decline in the percentage of Australians' household budgets being spent on food has plateaued. Since 2011, that percentage hasn't fallen below 9 per cent and just before Covid -19, it appeared to be increase. As food prices rise both globally and domestically, reversing the trend of decades, all indicators are that Australian consumers will face higher food prices in the future.

PERCENTAGE OF AUSTRALIANS' HOUSEHOLD EXPENDITURE ON FOOD SLOWLY ON THE WAY BACK UP – EVEN PRIOR TO COVID-19

Source: ABS Cat 5206.0, ANZ

FERTILISER INSIGHTS

OVERVIEW

A combination of factors, largely outside of Australia, has seen fertiliser prices climb to their highest levels since 2008, with indications that they could stay at inflated levels well into 2022.

On most measures, the outlook for agriculture heading into 2022 remains very strong. The weather forecasts continue to point to a good season, while across almost all soft commodities, particularly grains and livestock, prices look to remain high for some time.

A large part of agriculture is about planning, and at this time of year, many farmers are already well into planning their strategies and budgets for 2022, if not beyond. Grain producers are already thinking about next year's crop, while livestock farmers will be planning upcoming spring lamb and summer cattle weaner sales, as well as preparing next year's farm numbers.

One looming challenge over this period, which will be common to producers across cropping, livestock and horticulture, will likely be around fertiliser, both in terms of price, as well as availability.

Fertiliser is a fundamental input for many Australian agricultural producers, and as such, forms an important part of the food supply chain. For grain producers, fertiliser is often applied after a crop has been sown, to aid in crop growth in the months until it is harvested. For livestock producers, fertiliser application creates stronger pasture growth, to provide not only larger animals for sale but optimal conditions for breeding.

Fertiliser usage in Australia has continued to evolve through the changes in agriculture over the decades, driven by factors including droughts, changes in agronomic practices, and shifts between cropping and livestock. Looking ahead, it is likely that further changes will take place over the coming decade, particularly driven by factors around sustainability, carbon farming and increasing alternatives to traditional synthetic fertilisers.

With imports accounting for most Australian fertiliser supplies, local distributors and customers will always be vulnerable to offshore impacts. Regarding current fertiliser price rises, one major part of this has been due to the effects of Hurricane Ida, which hit Louisiana in the US at the start of September. The hurricane caused major damage to local fertiliser production facilities, including the largest nitrogen facility in the world. While most of Australia's Urea is imported from the Middle East, with most diammonium phosphate (DAP) and monoammonium phosphate (MAP) imports coming from China, the sizable loss of supply from global supply chains as a result of the hurricane has been a major contributor to fertiliser prices, as customers look to lock up supply.

A second major driver of fertiliser price rises has been caused by the rapid rise of gas prices in Europe, which have been driven up by a combination of circumstances including tightening Russian gas supplies to Europe, as well as lower than forecast levels of renewable energy generated. As a result of gas prices rising by up to 14 times their normal levels, some major European fertiliser plants have been either forced to close or raise their prices accordingly.

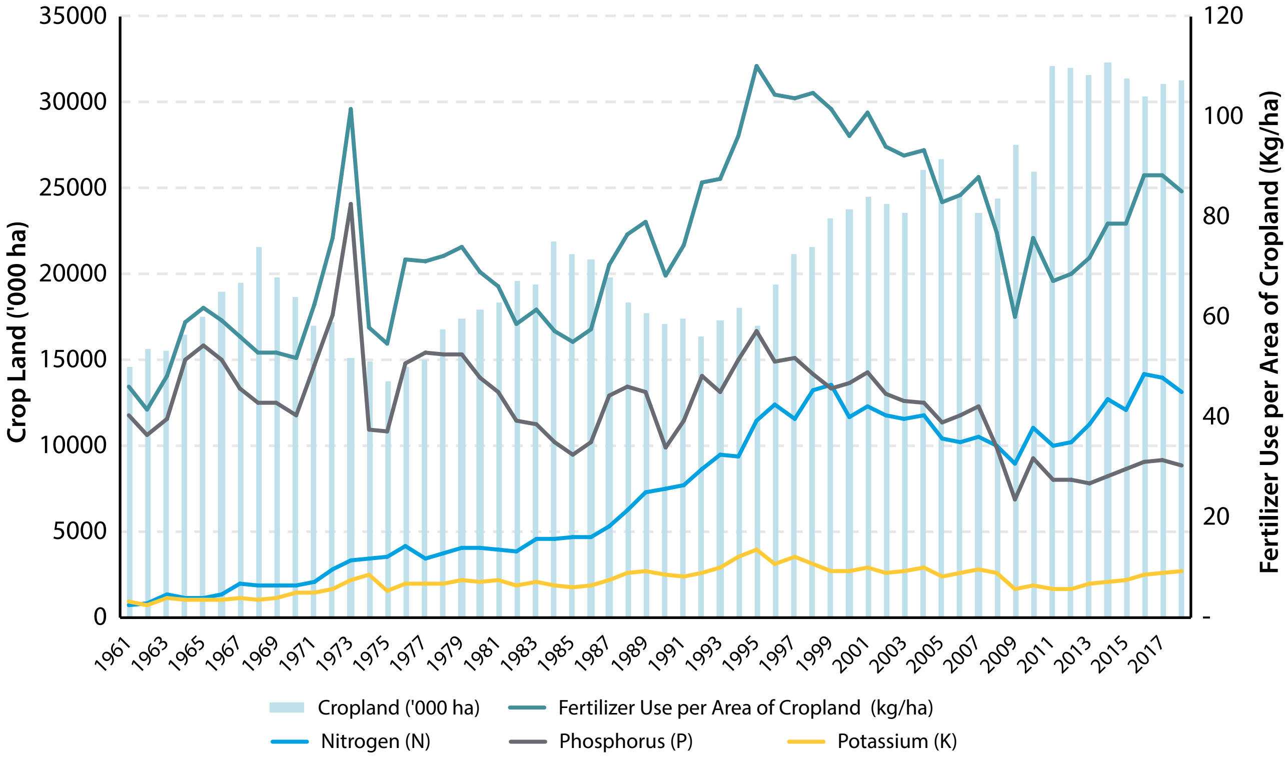
The third major factor impacting fertiliser prices has been steps taken by China, to minimise the impact of fertiliser price rises on its domestic farmers. As part of a move to secure domestic fertiliser supplies, China has moved to limit exports, including through increasing inspections of fertiliser exports, as well as through local governments asking State-Owned Enterprises (SOEs), who make up the majority of fertiliser production, to cease exports.

So what could this mean for Australian producers, as well as for the wider food supply chain? On current forecasts by some industry observers, this combination of factors could see fertiliser prices remain elevated until at least the second half of 2022. As such, many producers will need to very closely look at their business plans for the coming year, balancing their potential fertiliser costs against their projected near-term revenue, particularly from the coming harvest or stock sales.

In addition, given that a reasonable number of producers may look to reduce their fertiliser purchases due to cost, they will also need to factor impacts from this, including potentially lower crop yields, lower stock carrying capacity, and increased feed costs to make up for possible pasture quality reductions.

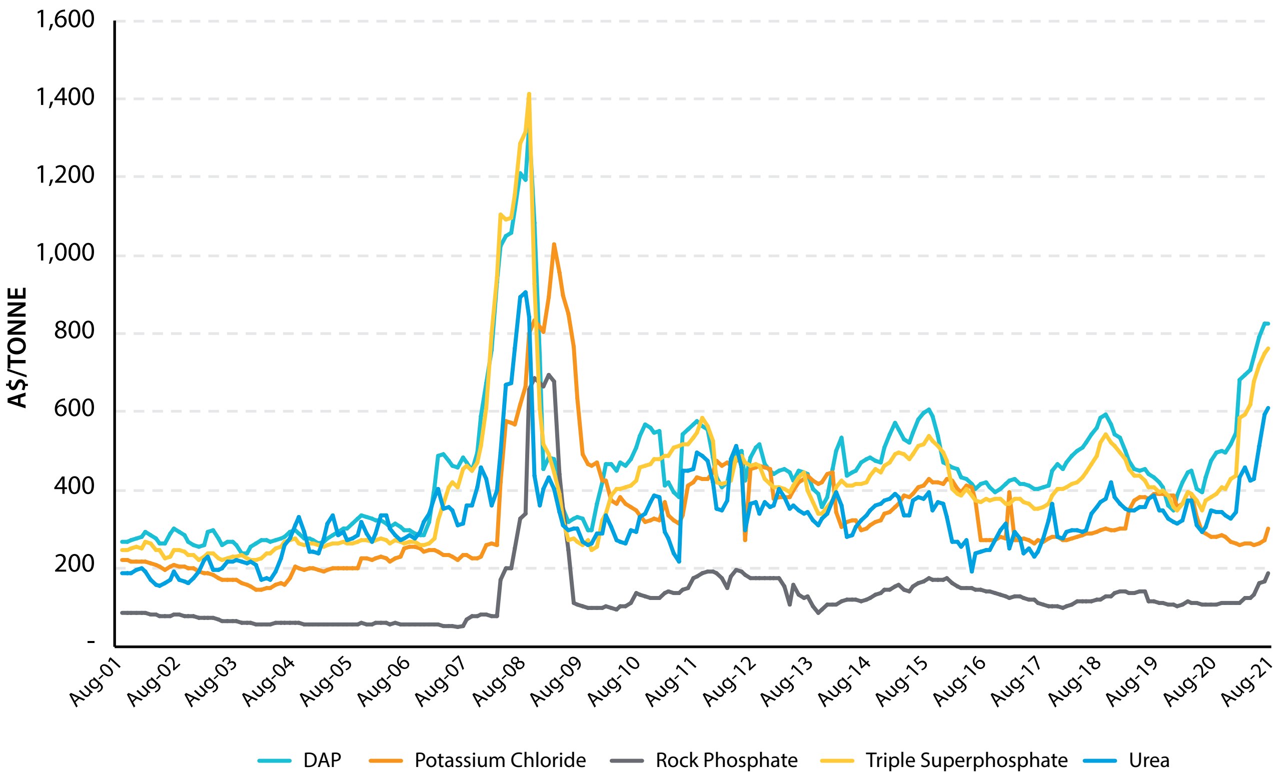
One potential impact would be an impact on industry profitability, which could take some of the heat out of the ongoing rural land price rises. Given that grain and livestock producers are primarily price-takers, there is little opportunity for them to pass on increased costs to processors, and ultimately consumers. However, since the fertiliser price rises and volume reductions are a global issue, there is a possibility that this may impact global grain production to some degree, particularly in markets where producers are more cost-sensitive, including the Black Sea Region and the EU. If this were to happen, and global grain prices were to see upward price pressure in the coming year, then there is certainly a chance that it could translate into some degree of food inflation. With much of the world's grain supply being used for animal feed, it is also foreseeable that this could be felt in global meat prices too.

AUSTRALIAN CROPPING ACREAGE VS FERTILISER USAGE



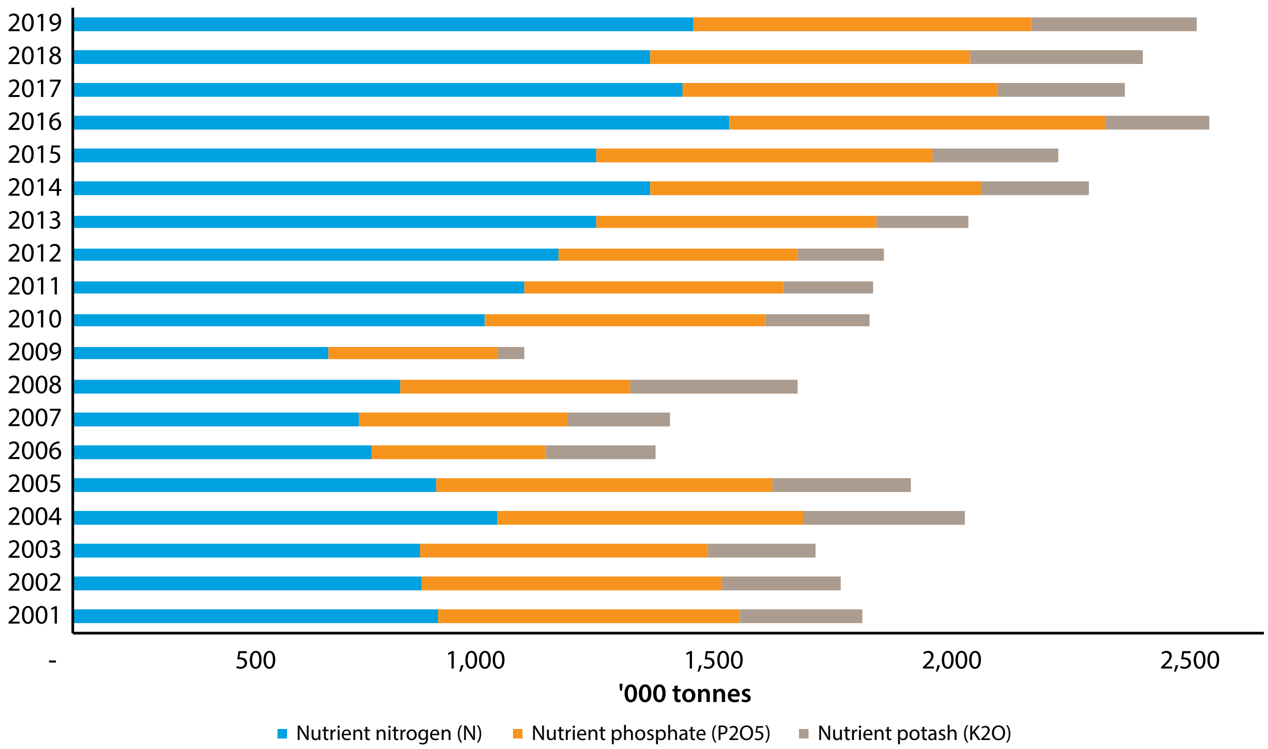
Source: FAO, ANZ

MONTHLY FERTILISER GLOBAL PRICES



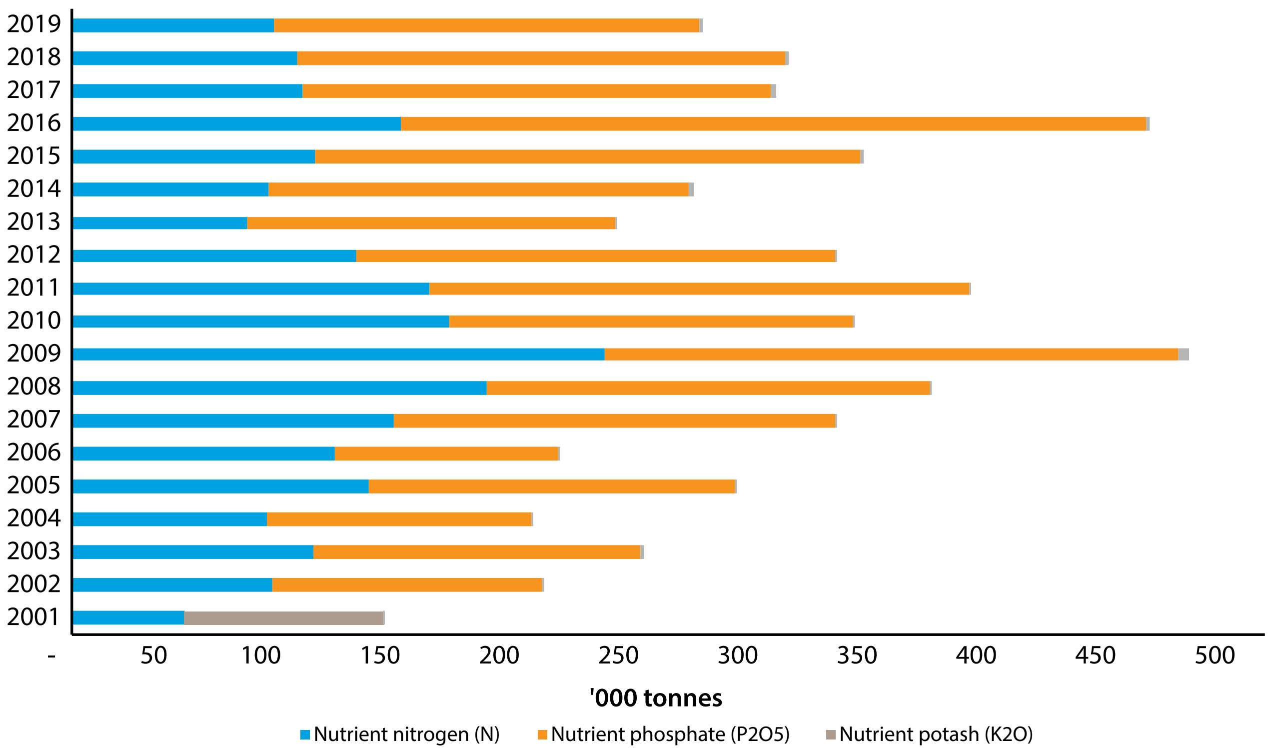
Source: Bloomberg, IndexMundi, ANZ

AUSTRALIAN FERTILISER IMPORTS



Source: FAO, ANZ

AUSTRALIAN FERTILISER EXPORTS



Source: FAO, ANZ

BEEF INSIGHTS

OVERVIEW

- + The outlook for ongoing good rain will keep feed levels high, prompting further restocking
- + Uncertainty of beef supply from Brazil and Argentina will likely increase demand for Australian beef exports
- + Ongoing strong demand will mean producers are optimistic for good results from upcoming weaner sales

- - Ongoing high cattle prices may start to deter domestic consumers from higher-priced beef
- - Cattle prices may start to fall as producers offload cattle in advance of dryer summer weather
- - A continuation in high grain prices may start to challenge feedlot economics

With the cattle industry's benchmark Eastern Young Cattle Indicator (EYCI) hitting a new record almost every week, it is worth reflecting on just how much cattle prices have risen over the past two years, and also on how much the industry now appears to take the ongoing high levels almost for granted.

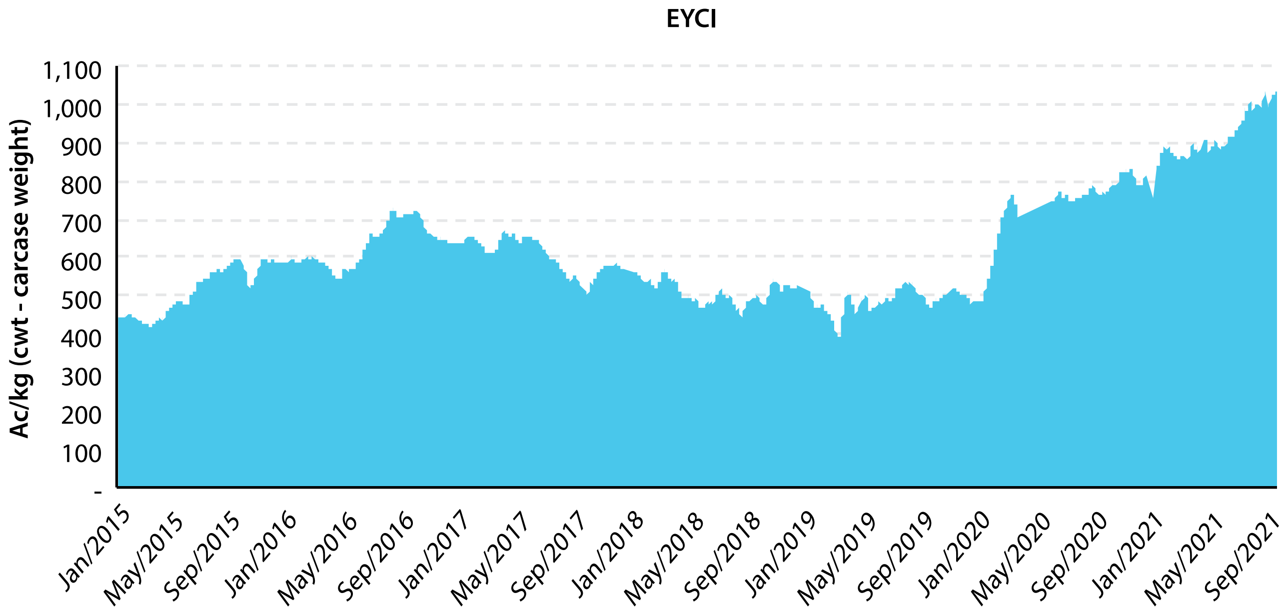
The start of October 2021 saw the EYCI climb to an all-time high of 1,042 c/kg. To put this figure in perspective, this is up 118 per cent on the figure from the start of 2020, when the EYCI sat at 477 c/kg, as the good rains around that period saw a surge in buying by restockers, balanced against a cattle herd which had been decimated by the drought at the time. Looking back over the past two years, it could be argued that to some degree, a "new normal" had been reached by March 2020, when the initial price surge hit 766 c/kg. Since that period, while the rate of cattle price rises has slowed, the upward trend has continued almost unabated, and while each month has seen many industry observers predicting the end of the price rises, it has yet to eventuate.

While there are several factors impacting the overall rise in cattle prices, the fundamental drivers continue to be a combination of the ongoing herd rebuild, combined not only with global beef supply levels, but nervousness by global importers over the reliability of supply from some of the major global exporters.

The initial concerns about stability in global beef markets had come from the decision by the Argentine government earlier this year to temporarily stop beef exports, in an attempt to dampen the rapid levels of domestic beef price rises, and to ensure adequate supplies for the domestic market. Even when the ban was lifted, the conditions imposed on the industry by the Argentine government meant that previous export levels were considerably restricted, resulting in major markets such as China needing to find replacement beef supplies from other markets.

More recently, the recent temporary suspension by Brazil of its beef exports, after the discovery of Bovine Spongiform Encephalopathy (BSE - commonly known as Mad Cow disease) in a small number of cows in its domestic herd led to even further nervousness in global beef markets.

EASTERN YOUNG CATTLE INDICATOR



Source: MLA, ANZ

Notably, while a similar BSE discovery in Brazil in 2019 had seen China's suspension of imports from that country last only two weeks, the current suspension has now stretched to around a month (at the time of writing). To add to this, the ban on Brazilian beef imports has stretched to many other countries, with Egypt, Saudi Arabia, Russia, Indonesia and Iran all now having banned Brazilian beef.

For a number of these countries, this move is a major one – Brazil supplies around 56 per cent of Egypt's beef imports and around 38 per cent of Saudi Arabia's - and could be seen as an indicator of how seriously this issue may impact world beef trade flows for some time to come. Even if and when the ban is lifted by different countries, it will still likely see major global importers looking to increase their focus on beef exporters with strong food safety records. Unsurprisingly, Australian producers, processors and exporters are likely to be beneficiaries of these moves.

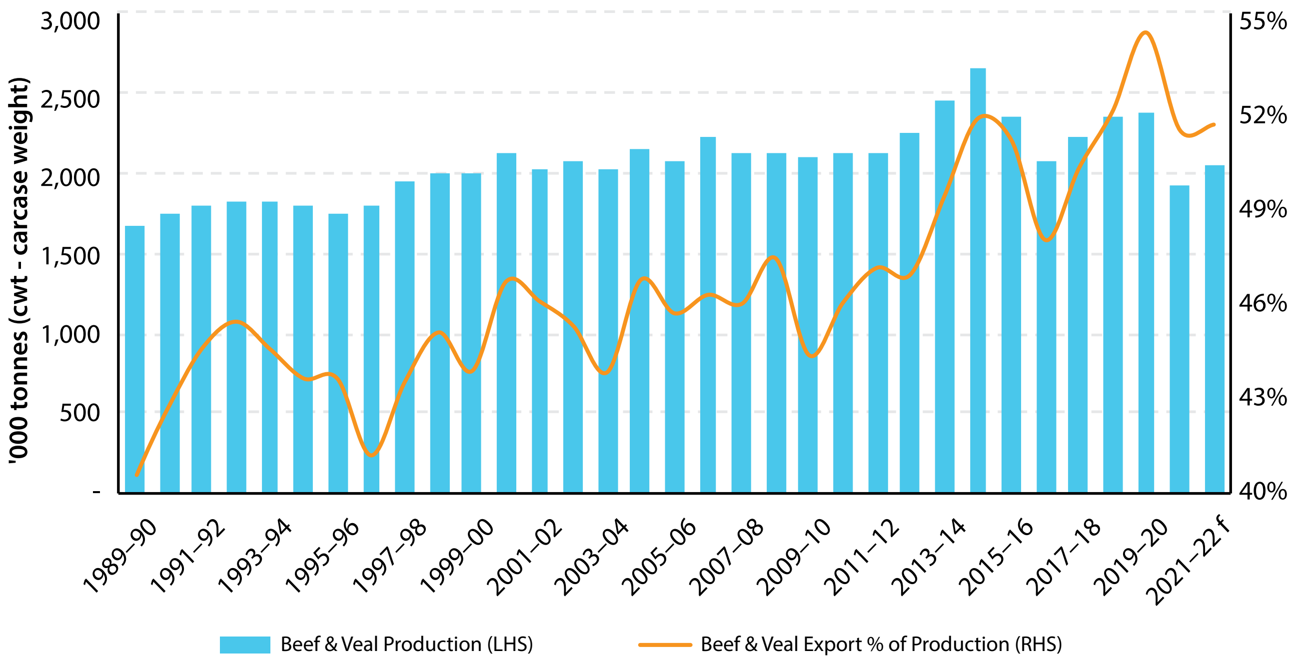
Within Australia, this confidence in the ongoing global demand for Australian beef will be one of the factors continuing to drive restocker activity, as well as strong demand from feedlots. Over the past month, restockers have accounted for around 40 per cent of cattle purchases, compared to around 50 per cent for feed lotters and around 10 per cent for processors. Notably, the highest prices have been paid by restockers, at around 70 c/kg higher than the EYCI, while processors were paying around 130 c/kg below.

While the winter period in many cattle-producing regions brought ample rain, colder temperatures across many areas saw feed growth not as strong as expected, though well above drought levels. Forecast warmer weather, combined with good rain forecasts over coming months may well see feed growth surge, a development likely to see strong restocker activity continue.

Recent MLA data has shown that producers are seeking to balance the opportunities from these prices, while at the same time continuing to build their own herds. As a result, several lighter cattle are being sold onto the market, while the percentage of female cattle being sold is also higher than the earlier forecast. Overall, this is likely to see the rate of the herd rebuild slowing from earlier forecasts, a trend which again sees the potential for longer-term higher prices.

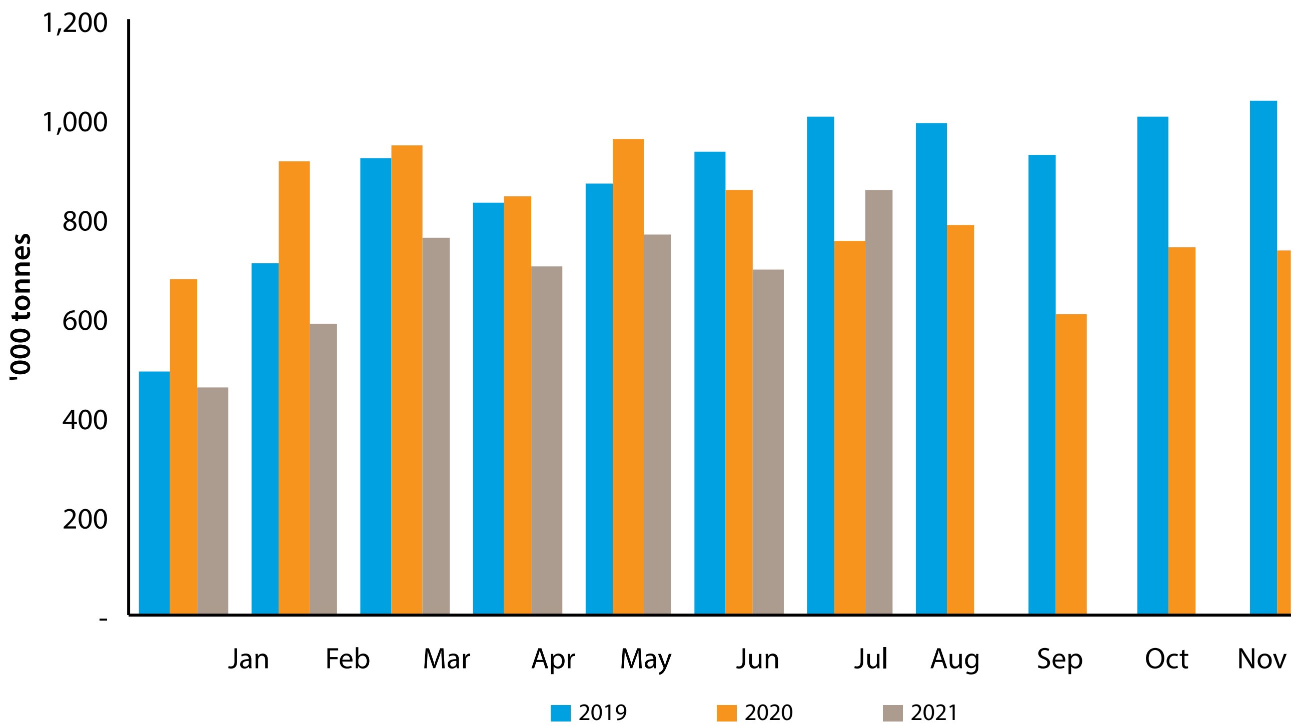
Looking further ahead, the weather will play a role in price forecasts for the period heading into 2022. As conditions get drier around the end of the year, the industry would normally see a rise in cattle numbers coming onto the market and a slight price reduction. Given that this has been the case over the past two years, it is reasonable to expect some easing of prices in the coming months, with prices perhaps likely to head up again early in the new year during the weaner sales period. However, given the unpredictability of the market caused by international occurrences, any prediction is a brave one.

AUSTRALIAN BEEF PRODUCTION LEVELS



Source: ABARES, ANZ

AUSTRALIAN MONTHLY BEEF EXPORTS 2019-2021



Source: ABARES, ANZ

WHEAT AND GRAINS INSIGHTS

OVERVIEW

+ Seasonal conditions around Australian cropping regions are mixed in some areas but a record harvest is forecast for canola, second-highest on record for wheat and third-highest harvest on record for barley
+ Lack of supply of high-quality milling wheat out of northern America is likely to boost demand for Australian exports
+ Global high prices across most crops mean strong competition for land between different crops – meaning that no single commodity is likely to see an influx of plantings into 2022

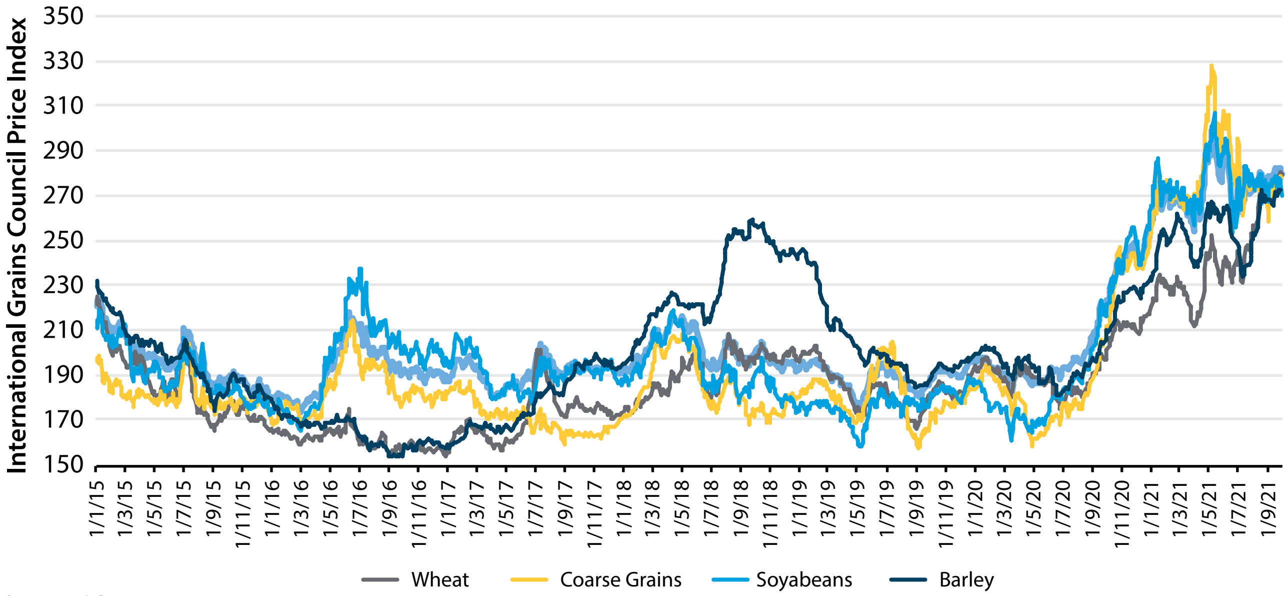
- USDA has confirmed that the 2021 US wheat harvest is likely to be the smallest US wheat crop since 2002
- Despite overwhelming concerns over a lack of global wheat supplies, the most recent global USDA update saw a forecast increase in global wheat supplies, however, that is being outpaced by the increase in demand and stocks being held by major exporters which are expected to fall heavily
- Some concerns of localised weather conditions across certain parts of Australia may hamper the country's ability to reach the forecast harvest, with WA authorities downgrading forecasts

As the harvest begins in northern Australia and works its way down the east coast, the fortunes are looking up for Australian cropping. High global grains prices are combining with the forecast for the second-largest domestic wheat harvest on record to set Australian croppers up for another exceptional year. While global production remains on track to increase this year, the forecast stronger increase in consumption combined with a global shortage in high-quality milling wheat is likely to drive strong export demand for the Australian harvest.

Global wheat prices were pushed higher again by shrinking global supplies, with more downgrades to the Russian, US and Canadian crops in the most recent USDA update report – and further downgrades expected in coming months. The recent USDA Small Grains Summary confirmed that the 2021 US wheat crop is forecast to be the lowest since 2002, making significant cuts to forecast 2021 US wheat production estimate. Both winter and spring crops have been significantly impacted by drought conditions. Total wheat production is estimated to decline more than 182 million bushels (around 5 million tonnes) or 10 per cent from 2020.

The report also confirmed the suspicion that US grains stocks had declined significantly on the previous year – wheat stocks are down 18 per cent, corn stocks are down 36 per cent, soybean stocks are down 51 per cent. There appears to be significant nervousness in the industry that supplies from, and stocks held in, the major wheat and grain exporting nations is falling – leaving those stocks held by major exporters, and therefore notionally more available to the global market, to hit their lowest level since 2012–13.

GLOBAL GRAINS PRICES CONTINUE TO RISE

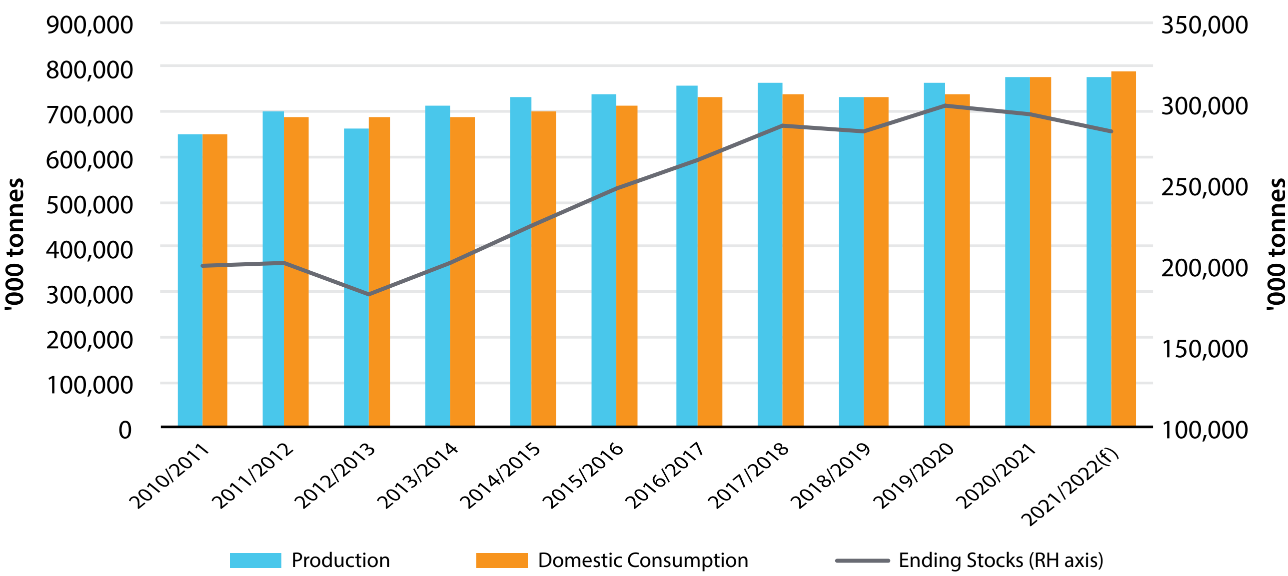


Source: IGC, ANZ

The poor 2021 cropping year in the northern hemisphere is already impacting the prospects for 2022, with estimates already filtering through of a decline in plantings in Russia. As a result, international wheat futures have been surging recently.

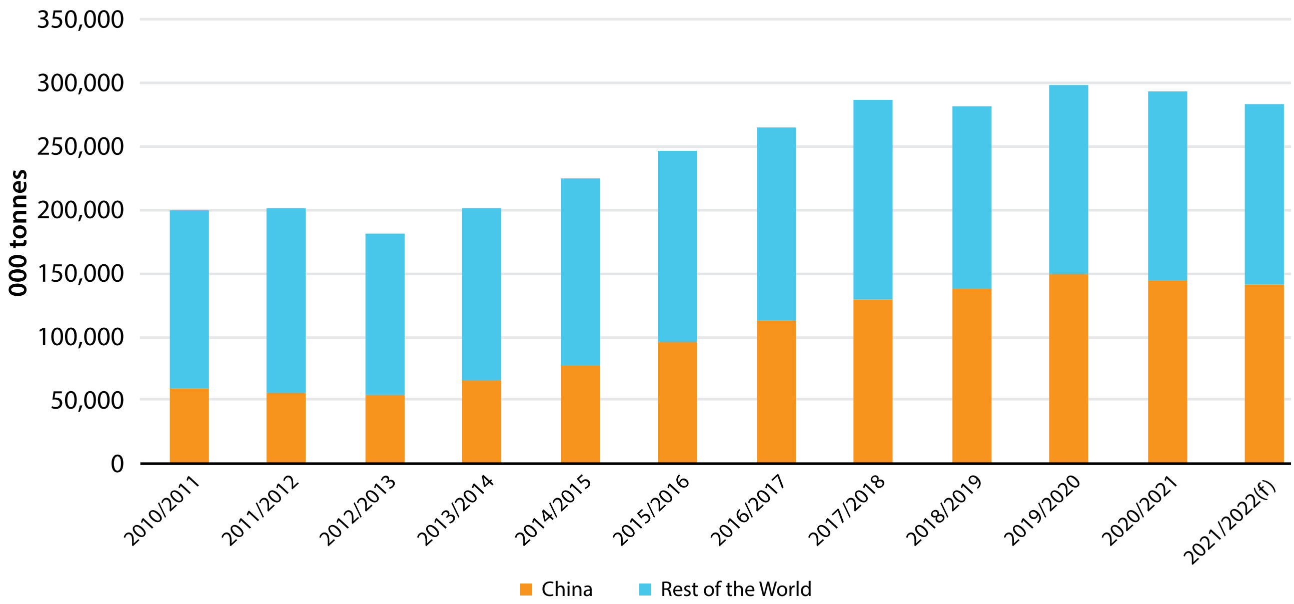
Despite all the talk being around dwindling supplies, the September USDA global update forecast an increase in total global wheat supplies - based on significant increases to the Australian, European, Chinese and Indian crops. Dry conditions in Argentina saw a downgrade in their forecast harvest. The upgrades in forecast global wheat harvest in September of 3.4 million tonnes more than offset the subsequent downgrade in the US harvest of 1.4 million tonnes which has accompanied the recent surge in wheat futures.

GLOBAL WHEAT PRODUCTION IS STILL EXPECTED TO RISE, BUT CONSUMPTION HAS OVERTAKEN SUPPLY



Source: USDA, ANZ

CHINA'S WHEAT STOCKS ARE EXPECTED TO FALL AGAIN FOR THE SECOND CONSECUTIVE YEAR



Source: USDA, ANZ

The current forecasts to date are for the second-largest Australian wheat crop on record – however there are concerns that local weather conditions will take some tonnage off that harvest. Dry and frosty conditions in Western Australia have seen local harvest forecasts drop, while drier conditions in South Australia may impact harvest. Spring finishing rains across the eastern seaboard are likely to provide a solid finish for much of the Queensland, New South Wales and Victoria wheat and barley crops.

CANOLA PRICES ARE CONSISTENTLY STRONG AS THE GLOBAL ECONOMY GETS BACK ON TRACK

Australian canola production is expected to reach record levels this year, coinciding with the lack of supply out of Canada. As a result, global stocks have fallen by almost 25 per cent this year and are expected to fall even further next year, keeping upward pressure on prices. Alongside this, global soybean production – which can be a substitute for canola oil – is forecast to reach a new record, keeping canola prices under some control. Also impacting vegetable oil prices is the strong demand for vegetable oil for biofuel in face of rising oil prices and the global economic recovery.

DOMESTIC BARLEY PRICES HOLDING UP WELL, DESPITE LACK OF ACCESS TO THE CHINA MARKET

Global demand for feed barley is being supported by strong demand from China, meaning that global consumption is expected to be higher than production. Demand from China for feed grain is primarily stemming from the rebuild of the national pig herd after African swine fever. 2021-22 is also expected to see global barley stocks fall to record low levels as production falls in Russia and the EU. All these factors are supporting strong global prices – albeit that Australian produce is still selling at a slightly lesser price as a result of not accessing the China market. Australian producers are set to take advantage of low global supply and strong demand, with production in 2021-22 expected to be the third-highest on record.

SHEEP INSIGHTS

OVERVIEW

+ The ongoing good season continues to drive restocking activity
+ This demand has seen ongoing upward pressure on prices for restocker and trade lambs and older ewes particularly twin bearing
+ A recent softening of the Australian dollar could boost demand for mutton and lamb exports

- The continued high price for restockers could challenge producers plans for flock levels
- Domestic consumption of both lamb and mutton remains lower than the industry would ideally prefer
- Covid-19 disruptions have meant further cancellation of country trade events

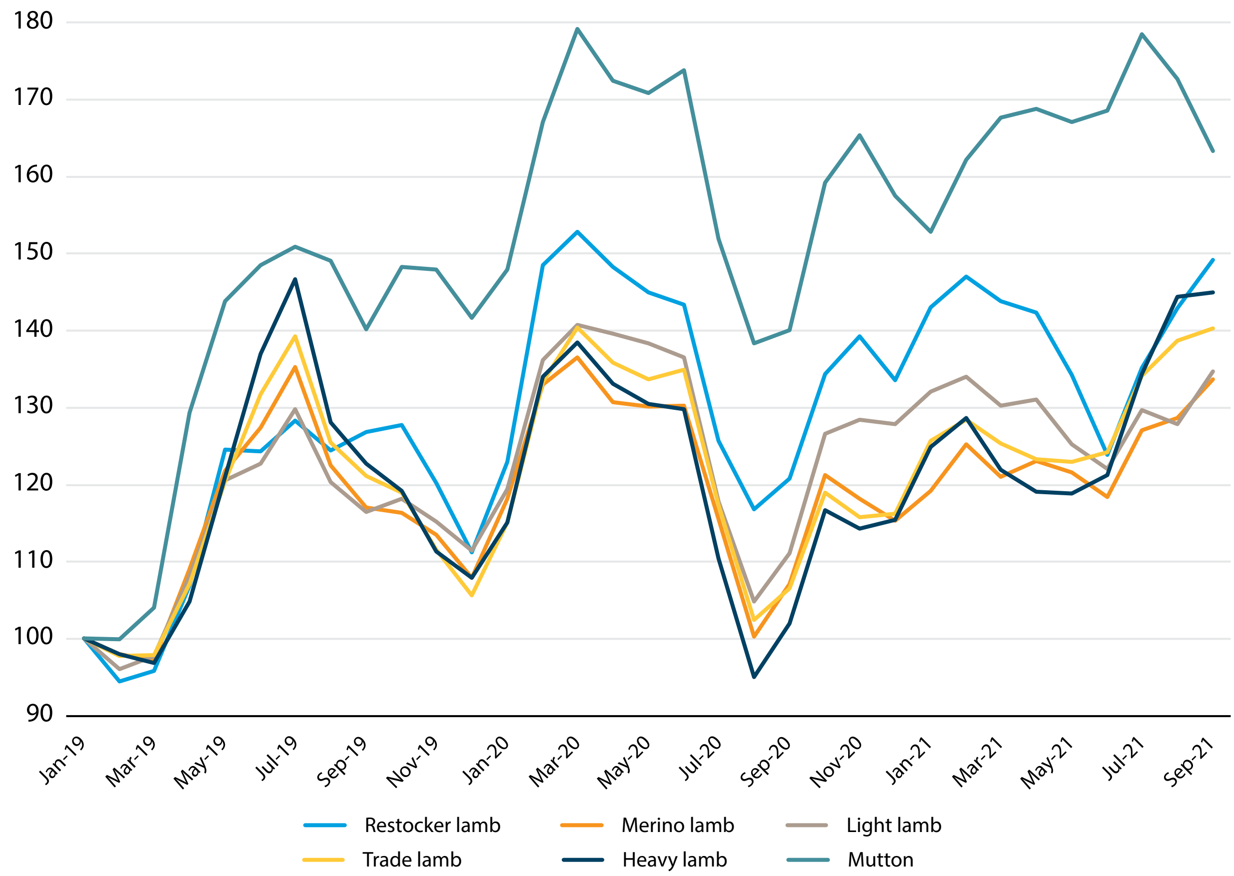
As the year heads into the warmer months, most sheep producers are continuing to enjoy a very good season, both in terms of conditions, as well as prices. For the many producers who have finished or are in the final stages of spring lambing, this year's good weather has seen some of the best lambing percentages for some time, with ewes and lambs in better average condition than the past few years. At the same time, ongoing enhancements in pregnancy scanning technology have resulted in some producers making enhanced operational decisions, such as grazing management for twinning mothers, resulting in further lambing percentage and condition gains.

At the saleyards, prices continue to be at or near record levels, as processor demand remains strong. The fact that the season has varied across different regions has seen a disparity in new lamb conditions. In areas that have seen cooler and wetter weather, many lambs are still short of slaughter condition, further pushing up the prices paid by processors to ensure adequate supply.

While sheep prices have been generally strong, the major potential challenge in the coming months may be to the processing sector itself. As happened in 2020, recent weeks have seen several meat processing plants, particularly in Victoria, impacted by Covid-19 in different ways. Some plants have seen new Covid-19 cases among employees, which on its own could well impact processing capacity, and as such, the number of stock processors will purchase. In addition, new workplace regulations around Covid-19, including requiring processors in Victoria to operate at 80 per cent capacity, could well see an even stronger fall in lamb prices than the traditional "spring flush reduction" at this time of year, as more lambs come onto the market.

According to modelling by Meat and Livestock Australia (MLA), with Victoria accounting for around 50 per cent of the national lamb slaughter, and with the 2021 lamb volume up around 450,000 head on the ten-year average, an extended reduction in processing capacity could see slaughter volumes

AUSTRALIAN COMPARATIVE LAMB/SHEEP PRICE TRENDS (JAN 2019=100)



Source: MLA, ANZ

cut by between 250,000 and 645,000 lambs. The higher figure is a worst-case scenario, and when potential situations like this arise, it is usually the case that the industry and regulators find a way of minimising the impact. That said, there is still a reasonable potential that the combination of the spring flush and reduced processing capacity to some degree could see smaller lambs over the coming months not reaching prices resembling those enjoyed by the industry for much of this year.

Looking further ahead, it is also traditionally the case that following the end of year fall in lamb prices, they are likely to rise again. As such, producers with smaller lambs may need to make decisions on how long they will hold onto stock, taking into account potential feed costs going into summer, as well as condition changes from drier pastures.

COULD LAMB BE THE NEW BLACK?

As a boost to the export fortunes of Australian lamb, it is now being described by some in the industry as the "new Wagyu" given its niche position, particularly in the US market. Similarly, an increasing number of Japanese consumers are finding a taste for the distinctive meat. As a lower-fat, high protein and high-iron substitute for other meats, lamb is attractive both for its health qualities and as being uniquely Australian. This has seen Japan become the fifth largest market for chilled Australian lamb exports.

These factors all make lamb particularly attractive to health-conscious younger buyers looking for the next 'new' thing. In addition, Australian lamb, particularly marketed with a focus on its high degree of traceability, is also increasingly able to market provenance can fetch premiums in some markets looking to sell the Australian story.

WOOL INSIGHTS

OVERVIEW

+ After the price dip of the last year, the ongoing wool price rises have been welcomed by growers
+ Opening up of major economies is driving consumer spending, which will favour luxury products such as wool
+ Expectations of a cooler European winter are likely to bump up demand for woollen clothing

- The wool market's renowned unpredictability is causing some nervousness after the mid-year auction break finishes
- With purchases for European winter garments largely already sold, there may be a reduction in demand
- Farmers selling sheep skins are seeing increased competition from synthetics, challenging historic high prices

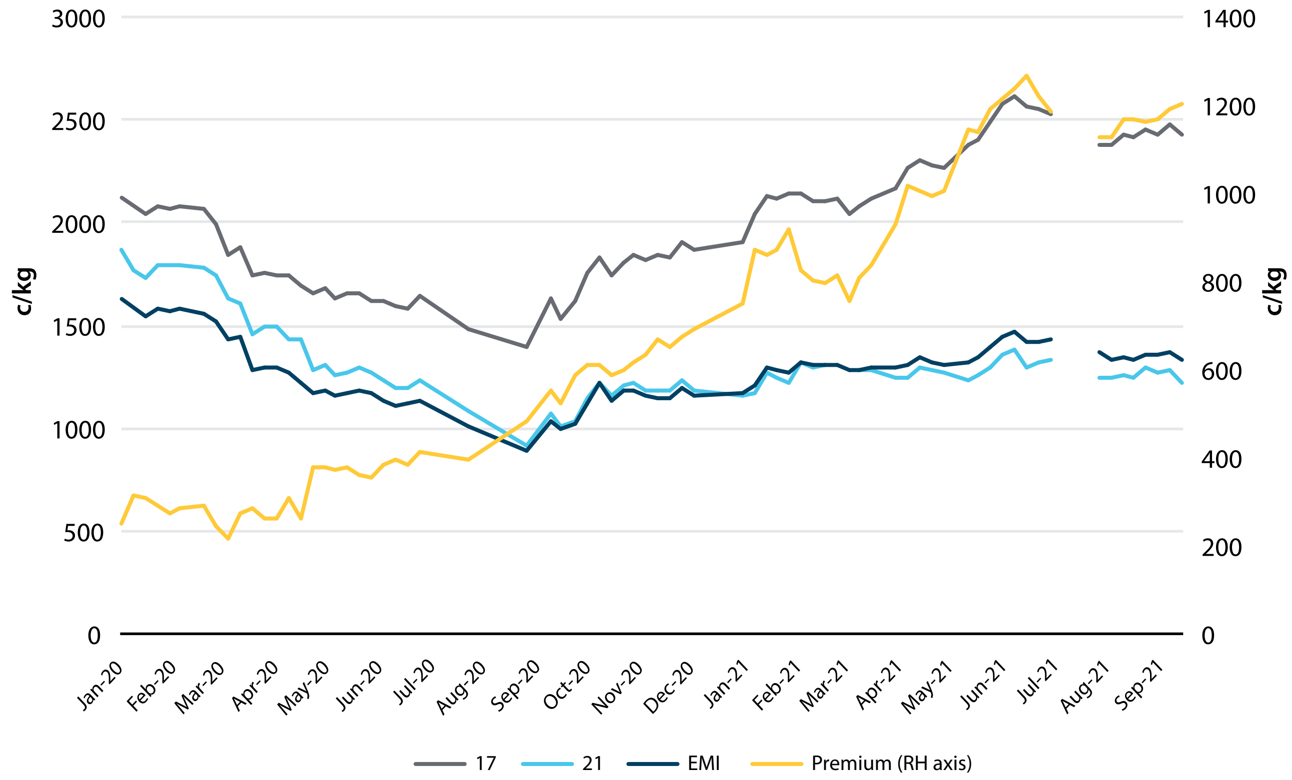
The benchmark Eastern Market Indicator (EMI) has shown some volatility after the return from winter break, as Australia's reliance on the China export market is seeing prices bounce around based on a market that has become increasingly nervous as a result of the falling iron ore price. Despite this, the recent record prices for some studs for their merino rams could be seen as a sign of longer-term confidence in the industry. With COVID-19 impacting most of the regular agricultural shows, many of these sales are now occurring online, with tech-savvy breeders showing rams by any means necessary, including social media.

Over recent weeks, the EMI dropped off following the mid-year recess, before steadily increasing over the past two months. There was a small drop again at the start of October with some uncertainty around Chinese processing capacity. Mirroring the EMI demand drop, the gap between 17 and 21 micron wool reduced briefly following the mid-year recess, although this premium has returned to around the same levels at 1202Ac/kg.

In recent weeks, the EMI has had good weeks and not so good weeks. Most recently, rumours of power rationing in China saw prices fall as buyers became unsure of the medium-term throughput and operation of Chinese mills. This fall had come after strong gains had been made on the back of increased European interest ahead of the northern hemisphere winter.

Australian auctions cleared over 860,000 bales in the first half of the year, up by 52 per cent on last year. Much of the auctioned wool was focused around the fine and superfine – 88 per cent of Australian wool exports were below 24 microns in the first 6 months of 2021. Demand for ultrafine wool is pushing up prices, separating it further from coarser wool which remains comparatively flat. Concerns over the amount of wool being offered for sale - as producers look to clear their stores built up after prices fell – have recently seen some welcome push-back from producers as prices drop, as well as an increasing removal level of bales for auction.

PREMIUM OF 17 MICRON OVER 21 MICRON



Source: AWEX, ANZ

DAIRY INSIGHTS

OVERVIEW

- + The impending change in ownership structure around Fonterra Australia will provide a strong indicator of the market's confidence in the sector
- + A competitive investment process could potentially spur renewed wider investment in the dairy supply chain
- + The good season, combined with improving per-cow yields, will see overall milk production rise
- - While the good season has reduced water and fodder input costs, ongoing high grain prices may start to impact producers
- - The US government's new subsidies for dairy feed may increase US competition with Australian dairy exports
- - While Australian dairy production and processing has been relatively unhindered by Covid-19 disruptions, logistic and freight issues may impact goods reaching domestic and export customers

CORPORATE CHANGE WILL HAVE INDUSTRY IMPLICATIONS

The announcement in late September 2021 by Fonterra that it is reviewing the ownership of its Australian operations has signalled the start of a process that could have very deep implications for the course of the entire domestic dairy sector over the next five to ten years. While the decision on its own could see changes ripple through the supply chain, the upcoming process over coming months, and the broader outcome could potentially be seen as an indicator of the level of confidence in the Australian dairy industry.

Fonterra first entered the Australian market in 2005, four years after the company was created in New Zealand from the merger of the country's two largest dairy cooperatives, as well as the NZ Dairy Board, which had been the company's single desk export body. The decision at the time by the NZ government to allow the creation of a company which would have an overwhelmingly dominant share of the domestic dairy industry and exports, on the basis that it would create greater benefits for the country's dairy producers, was one which continues to impact discussion around competition policy in the agribusiness sector. In Australia, the company now has around 16 per cent of the milk processing sector, processing facilities in Victoria and Tasmania, and many well-known consumer brands of dairy products.

Following Fonterra's announcement in September 2021 that it will undertake an "ownership review" of its Australian operations, it is widely expected that the company will move on to an IPO, although at the time of writing it was yet to be known whether Fonterra will seek to retain a majority stake.

How the process plays out over the coming months will be a very important indicator for how the investment community views the Australian dairy landscape, and to a degree, the wider domestic agribusiness sector.

Initially, it will be telling to see which kinds of entities seek to compete for the company. While local specialist dairy companies would have the most experience in managing the operations, most of these would presumably be ruled out due to competition issues. As such, if other international dairy companies without an existing major presence in Australia were to bid, it could be seen as a vote of confidence in the local dairy industry's future. Similarly, a move by one of the major private equity firms, or by one of the major international pension funds, would send the same message. This would be further emphasised if the price is pushed higher, depending on the eventual process.

A change in ownership could also potentially see a revival of sorts of investment upstream into the dairy farming sector itself. A vote of confidence in the sector as a whole – in terms of the potential long term value of both the domestic and export sales potential – could well see an increasing focus by larger investors onto dairy farms, which has arguably diminished over the past five years in favour of stronger investment into beef, grain and horticultural opportunities.

This new investment focus would also inevitably bring with it an increased investment into dairy farm infrastructure, including milking facilities, water and pasture, as investors sought to increase efficiencies, reduce labour reliance, grow the potential for product innovation and increase profitability.

DOMESTIC OUTLOOK

On the domestic front, the recently released Dairy Australia Situation and Outlook Report has highlighted the relatively strong current position of the industry, despite the challenges of the Covid-19 disruptions. In particular, a combination of strong farmgate prices, combined with flatter input cost prices, particularly as a result of the good season, have put dairy producers in one of the strongest positions for some years.

In terms of input costs, the ongoing good rainfall in many dairy regions has kept irrigation water prices in many regions at low levels. In addition, not only has the good season reduced the need for large feed inputs, but with the volume of hay on the market, it has kept fodder costs reasonably low. This comes at the same time that tight global fertiliser supply has seen fertiliser costs increase, although ongoing forecasts for good rain are likely to see lower fertiliser requirements for many dairy producers than normal.

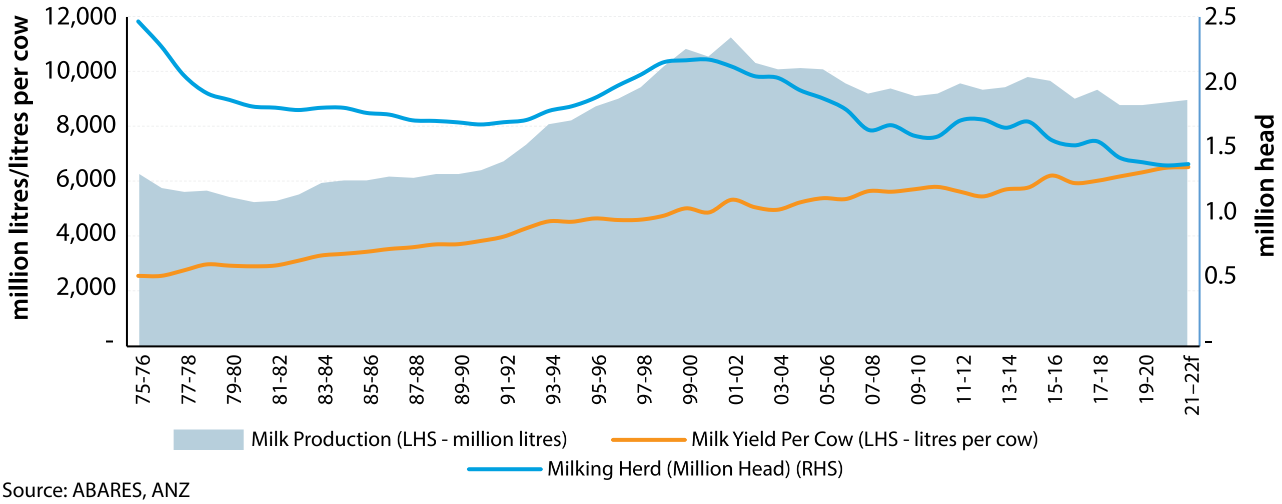
In terms of domestic milk production, while the wetter start to the season in mid-2021 saw a temporary fall in production, with July production levels down around 3.5 per cent on the previous year, the outlook for the 2021/22 season is for a slight increase in overall production, rising around 2 per cent. While there will inevitably be many variables over the coming year, this would see a national milk pool of around 8.9 to 9 billion litres.

In terms of consumer demand, following the initial panic-buying of dairy products at the start of the Covid-19 disruptions in 2020, consumer behaviour has largely returned to normal – as a result, sales of fresh and long-life milk have fallen by 1.4 per cent and 7 per cent respectively this year, coming down from last year's inflated levels. At the same time, while sales of plant-based beverages have certainly increased – these would include examples such as soy, almond and oat-based kinds of milk – it would appear that they can co-exist in the market with dairy-based products.

At a global level, while dairy demand took a hit in several regions as a result of Covid-19 lockdowns, recent figures would indicate that purchasing interest is now growing again from major markets, especially from South East Asia and the Middle East/North Africa region. For Australia, this saw dairy exports grow by around 12 per cent in the year to July 2021.

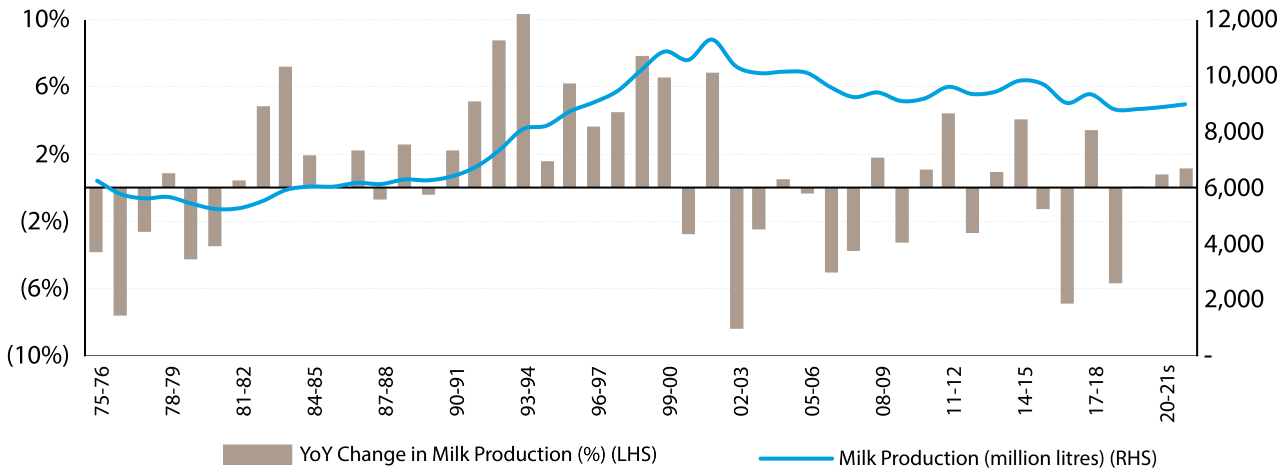
In terms of global competitors, production levels and outlook remain strong, driven by different factors. With the American dairy industry facing high feed costs, the US government has launched a new feed subsidy scheme, which is likely to see US dairy production rise by over 2 per cent in the coming year. Similarly, the good season in New Zealand has seen a strong rise in per-cow production levels, resulting in a record domestic production level. In contrast, hot weather in Europe has seen that region's overall production levels fall, a figure which has balanced out overall global production growth forecasts to under 1 per cent.

AUSTRALIAN MILK PRODUCTION VS COW HERD AND YIELD



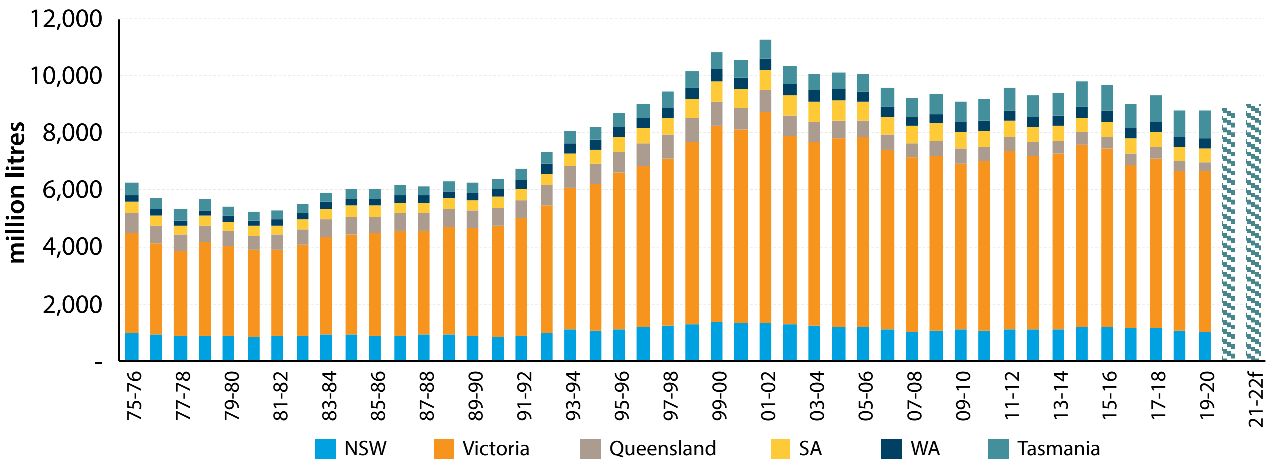
Source: ABARES, ANZ

YEAR ON YEAR CHANGE IN AUSTRALIAN MILK PRODUCTION



Source: ABARES, ANZ

AUSTRALIAN MILK PRODUCTION BY STATE



Source: ABARES, ANZ

AUSTRALIAN ECONOMIC INSIGHTS

What goes down must come up: the economy will rebound after lockdowns

RESTRICTIONS ARE WEIGHING HEAVILY ON ACTIVITY, FOR NOW

NSW and Victoria account for more than half of Australia's economy, and their lockdowns could push GDP down by 3.3 per cent in Q3 2021. In NSW, 210,000 people have lost work since the Delta lockdowns began and we expect to see more employment losses across NSW and Victoria when the September data comes through. ANZ's spending data also show that households spend around 30 per cent less when they are in lockdown.

RECENT DATA HIGHLIGHTS SURPRISING ECONOMIC RESILIENCE DESPITE THE LOCKDOWNS

Consumer confidence fell in the early weeks of the current lockdown but is picking up as prospects for reopening become more certain. Business conditions have already lifted from the lows in July and are above their long-run average, even in locked-down NSW and Victoria. Moreover, ANZ Job Ads declined by less than 7 per cent over the past three months, compared with a 64 per cent decline in the first shutdown last year. All this suggests businesses and households are confident about the outlook and are likely to resume spending once mobility restrictions lift.

TRADE HAS ALSO BEEN RESILIENT

Australia's trade balance surged to a new record high in August, surprising analysts and the market as exports rose sharply. A very strong lift in coal and LNG exports more than offset a sharp decline in iron ore exports. The recent strength in rural exports continued in August, with exports up 11 per cent month on month (m/m). This reflected rises across the board, in particular from cereal grains (up 17 per cent m/m) and wool and sheepskins (up 59 per cent m/m). We now expect the AUD to average 0.75 USD over 2022, which should continue to support Australia's export competitiveness.

FISCAL SUPPORT IS HELPING ECONOMIC GROWTH AND INVESTMENT

The federal government's temporary full-expensing scheme is helping support strong growth in machinery/equipment investment, while there is a large pipeline of major projects construction on both the private and public side. There is a strong chance of further fiscal stimulus in the coming months to cement the rebound.

EMPLOYMENT AND ECONOMIC ACTIVITY ARE LIKELY TO REBOUND

With NSW and Victoria's roadmaps for reopening in mind, we expect spending to rebound solidly in Q4. The unemployment rate is likely to rise, from 4.6 per cent in Q3 to 5.2 per cent in Q4 (quarterly averages), as people recommence active searches for work. From there, we think unemployment will drop to 4.3 per cent by the end of 2022.

When we broaden the outlook to total economic activity, we expect 1.4 per cent year on year (y/y)growth through 2021. We then see growth rebounding strongly to 4.8 per cent y/y over 2022, as the economy reopens and movement restrictions become less frequent and intense.

THE EMPLOYMENT REBOUND WILL ULTIMATELY HELP WAGES GROWTH, BUT INFLATION IS STILL A WHILE AWAY

The rebound will likely see a swift return to the pre-lockdown situation where businesses were having substantial difficulty finding enough suitable labour. Underemployment should fall back to its pre-lockdown mark and hopefully further in 2022. This will ultimately help lift wages growth and inflation.

But it'll be a slow road. With annual wages growth not expected to get to 3 per cent until late 2023, we expect underlying inflation to reach only a little above 2 per cent by the end of 2023. Given this and the Reserve Bank of Australia's (RBA's) caution on moving the cash rate, monetary policy is set to remain stimulatory for some time, and we expect the cash rate to sit at 0.1 per cent until 2024. Bond purchases are set to continue until August 2022.

THE RISKS TO THE OUTLOOK ARE CONSIDERABLE

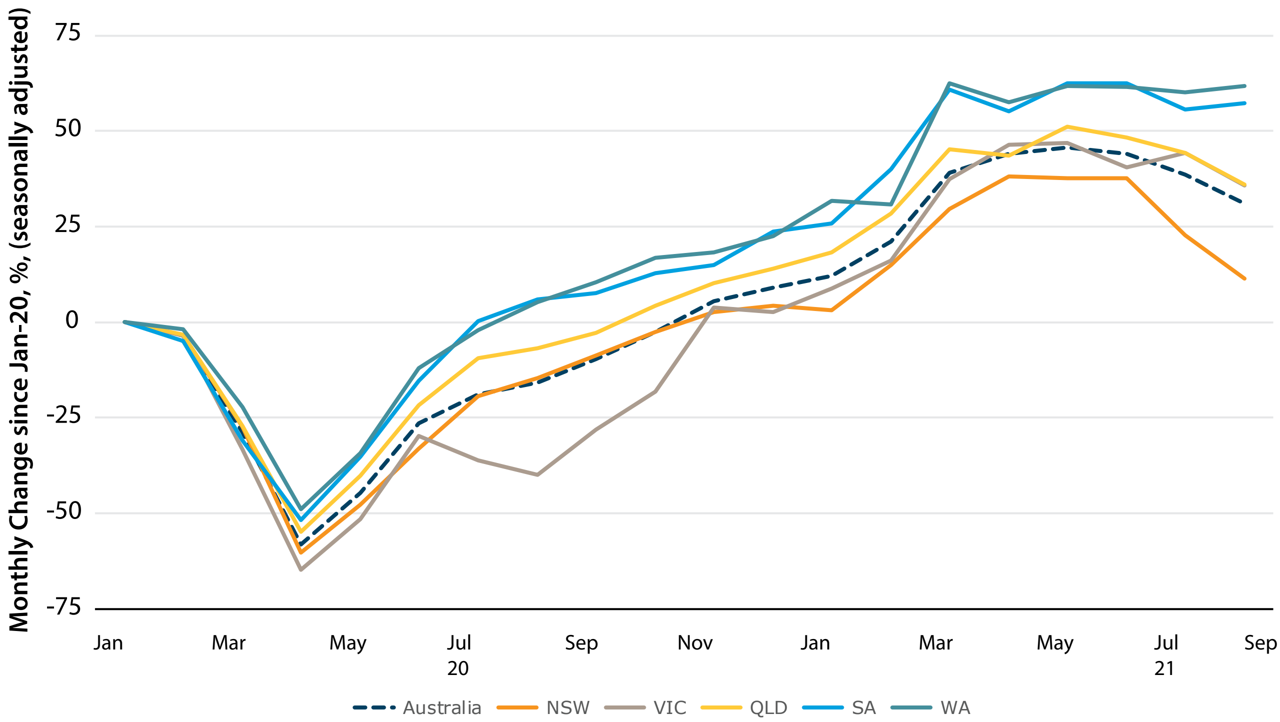
What could make things worse than we expect?

In short: more COVID-19. The possibility of a more virulent strain that prompts further shutdowns would hit our GDP and employment growth forecasts.

What could make things rebound more than we expect?

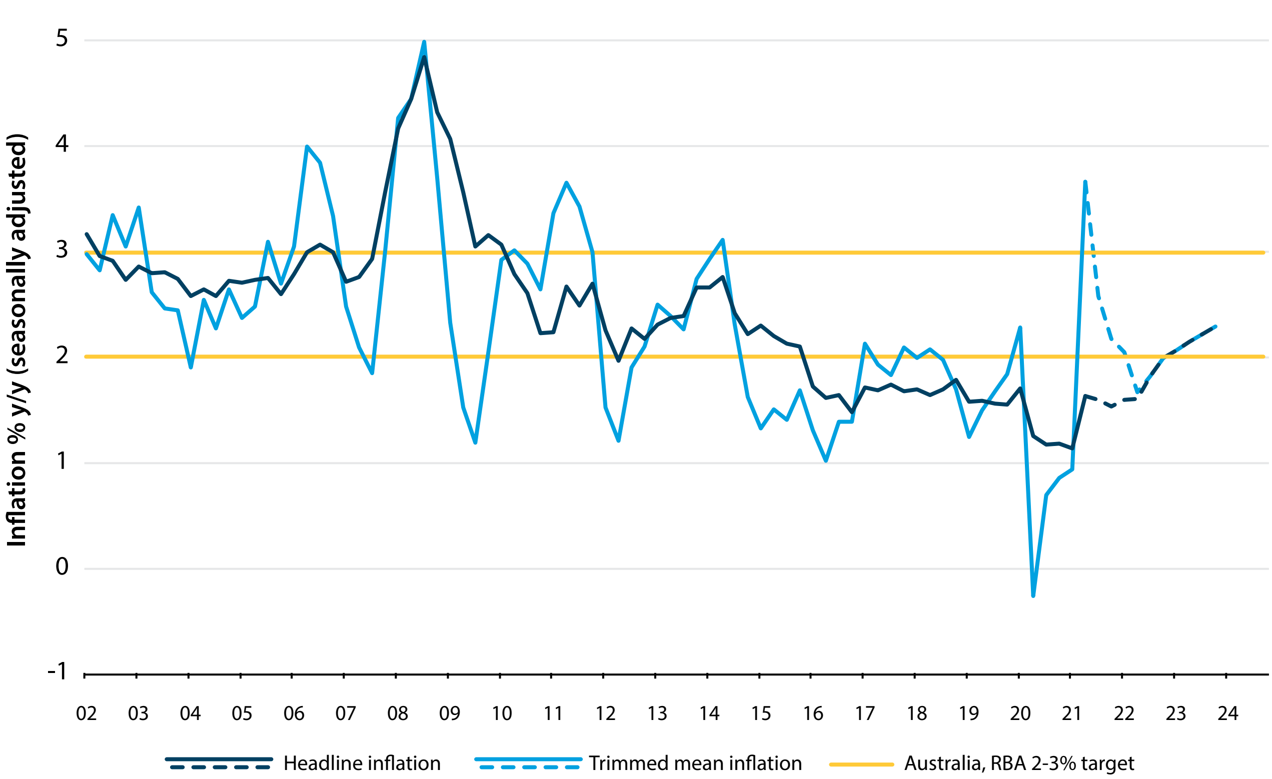
Spending could outpace our expectations reflecting pent-up demand and improving confidence, and the risk that inflationary pressures emerge earlier than we are currently forecasting.

THE NUMBER OF JOBS ADVERTISED ON THE INTERNET IS STILL FAR HIGHER THAN BEFORE THE PANDEMIC



Source: National Skills Commission, Macrobond, ANZ Research

MONETARY POLICY FORECAST TO REMAIN ACCOMMODATIVE OVER THE NEXT FEW YEARS AS INFLATION SLOWLY REACHES THE TARGET BAND



Source: RBA, Macrobond, ANZ Research

CONTACTS

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

IAN HANRAHAN
Head of Food, Beverage & Agribusiness, Australia – Institutional Banking
T: +61 7 3947 5299
E: ian.hanrahan@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

BRYONY CALLANDER
Associate Director Agribusiness Research, Commercial Banking
T: +61 3 8654 2563
E: bryony.callander@anz.com

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

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

Australia and New Zealand Banking Group Limited (ANZ) ABN 11 005 357 522. Item No. 98034 10.2021 WZ112291

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