ANZ AGRI
INFOCUS

COMMODITY INSIGHTS

WINTER 2023

ANZ

FOREWORD

Not only is Australian agriculture always travelling in a cycle of some kind, it is constantly being impacted by several different cycles at once. While the most prominent of these are clearly commodity prices and weather, more intangible ones, like industry sentiment, will also play a role. For the most effective long term planning, whether by individual business, or by the industry as whole, it is important to not only keep in mind that cycles will always continue to happen, but also that a low point in the cycle can still represent opportunity, and is probably an essential feature in building a robust and sustainable industry in the longer term.

As the Australian agricultural industry heads toward the second half of 2023, it is clear that most sectors are either experiencing the impacts of these cycles, or preparing for what may lie ahead.

The price cycle remains a major discussion point, with a number of industries, particularly grains and beef, now well below their multi-year high prices of the last year or so. While some observers may see this as a concern, it's important to note that these price highs were the result of extraordinary events, and were always going to be temporary. For grain, after the price surge prompted by the invasion of Ukraine, markets were always going to calm down, just as they do around price shocks. Similarly, while cattle prices surged as farmers sought to rebuild their herds on the ample green grass which came after the end of the drought, the herd was invariably going to reach a point where ample supply saw prices fall.

For both these sectors, as well as a number of others across the agri landscape, prices have essentially returned to their long terms averages, a point at which strategic agribusinesses who have planned accordingly will by and large be able to continue to operate profitably.

Importantly, a return to average prices is great news for the parts of the supply chain who are buyers – whether this is meat processors, food manufacturers, and even consumers. It is important never to lose sight of the fact that the food supply chain is an inter-linked ecosystem, in which all stakeholders need to operate well over time in order to sustain the collective, noting of course that boom times for one part can mean equally tough times for another.

In a similar way, the evolving predictions that the weather conditions across much of Australia may not provide a repeat of the past two years which delivered bumper crops and pastures shouldn't really come as a surprise to anyone, and should have been a part of strategic planning.

There is increasing discussion of a drier outlook, possibly with an emerging El Nino climate pattern, and while this is still speculative, many businesses across the supply chain will undoubtedly be factoring this possibility into their scenario planning.

Importantly, despite inevitable impacts of other factors, such as rising interest rates and inflation, both domestic and global demand for Australia's agri products remains strong. This trend looks likely to continue even in the face of a declining international economy and the potential of higher levels of Agri production in the northern hemisphere.

Overall, the transition from record prices and bumper seasons to average or below average conditions is something that every long term agribusiness has been through before, and which they will work through again as an inevitable part of this often challenging but ultimately rewarding industry.

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REGIONAL AUSTRALIA

OVERVIEW

This chapter is an extract from ANZ Agri Insight's new publication, "Regional – Making A Move", which discusses the current factors impacting regional Australia, particularly in the post-Covid period, and the outlook for the future.

- While many of our major cities struggled through Covid lockdowns and a slump in business activity as a result, Australia's regional economies have had a relatively strong three years
- With a booming agriculture sector, and the relatively muted impact of Covid in rural and regional areas combined with the rise in numbers moving from major cities, regional Australia has seen somewhat of a renaissance
- For many, this boom has been heralded as the start of a new wave of growth across our regions
- Others see the renewed interest in regional Australia as a result of unusual circumstances which could potentially reverse as businesses return to normal work patterns in major cities.

The full publication can be found at:
Regional making a move (anz.com.au)
https://www.anz.com.au/content/dam/anzcomau/pdf/regional-making-a-move-2023.pdf

FOREWORD

The Covid pandemic threw much of the Australian economy, ways of working and supply chains into a tumultuous time. Lack of worker availability, shipping and freight delay's, transport woes and lockdowns all typified the Covid period. And while we are now looking at Covid in the rear-vision mirror, the lessons and impacts for regional Australia still linger. The boost in population resulting from remote working and lockdowns across major cities, combined with a booming agriculture sector, and solid growth across employment in regional Australia has been heralded by some as the start of a regeneration across regional Australia.

But many questions remain, including whether the Covid pandemic merely highlighted an existing trend, or whether remote working will change the nature of employment in the regions in the long-term? What is motivating the increase in people moving to regional cities? And how does regional Australia ensure that the momentum and interest garnered during Covid is not lost as Australia's major cities return to 'business as usual'?

Data on population trends across the Covid period do highlight the fact that population growth in the 'regions' is not being reflected across all regional areas – in fact population growth is strongest in regional cities, but going backwards in remote areas. Also of interest is that regional population growth is strongest in the smaller, more densely populated States of Victoria, South Australia and Tasmania.

It seems clear that the growth in population in regional Australia cannot be soley attributed to a change in Australian's desire to live in the country, and that regional cities are importantly and increasingly being seen as a viable alternative to major cities based on access of lifestyle, health and education services, remote working and transport.

Behind the headline regional population boom over the Covid period, there are signs that the growth in regional Australia is a longer-term trend, with stronger growth in wages in regional Australia over the 5 years before Covid than in major cities, strong house price growth in the regions of denser populated States and very solid production and growth in key regional industries, most particularly, agriculture.

While the impacts of Covid are likely to fade in time, it is likely that regional Australia will be left with solid momentum for growth, and a renewed attractiveness for many for regional living. The next question becomes whether access to services, infrastructure and expertise in the regions will keep up with the expectations and requirements of new residents and growing industries.

REGIONAL ECONOMIC ACTIVITY

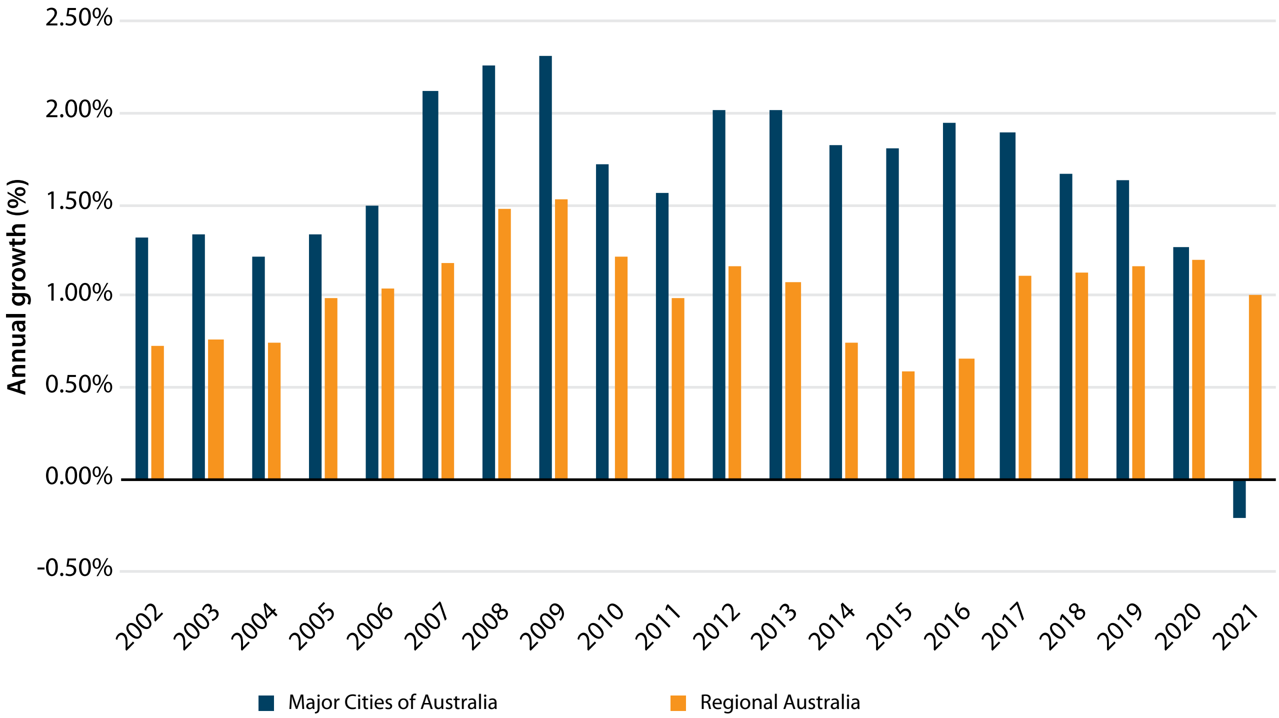
The Australian economy suffered significantly through the Covid period with contractions in key sectors such as tourism, transport, trade and construction. The domestic economy suffered significant losses throughout the Covid period, including two distinct downturns after the initial Covid wave and the subsequent delta wave. The Australian Bureau of Statistics estimated that up until late 2022, the Australian economy had lost $158 billion in GDP as a result of Covid. Across regional Australia, the impact of Covid on economic growth was mixed, with the mining sector remaining stagnant in the two years from 2020, and the agriculture, forestry and fisheries sector performing strongly. During that time, the key regional industries of agriculture and forestry and fisheries combined to contribute almost 1 per cent of Gross Domestic Product (GDP) growth across two years to the national recovery from Covid.

To put this in perspective, however, while the Australian agriculture sector has had a stellar last 3 years, which provided a much needed boost to the Australian economy over the Covid period, growth over the longer term remains small in comparison with the boom in the other major regional sector – mining.

GROWTH IN TOTAL EMPLOYED PERSONS, BY AREA

Source: ABS, ANZ

AUSTRALIAN POPULATION GROWTH BY AREA



Source: ABS, ANZ

REGIONAL EMPLOYMENT

With Covid lockdowns came the well documented shift of population to the regions, either in a work-from-home capacity or looking for new employment in the regions. This saw regional employment perform more strongly through the Covid period than employment in major cities, with the total number of employed in regional Australia growing an average of 0.48 per cent quarter-on-quarter for the two years from the beginning of Covid, compared with total employment in the major cities growing at an average of 0.18 per cent in the same time period. While the greatest falls in employment across the nation were felt in the initial May 2020 quarter, since that time, regional employment growth has outstripped employment growth in the major cities in all but two quarters.

REGIONAL POPULATION

Perhaps the most noteworthy impact of the Covid pandemic was the shift in population growth in the regions and away from major cities. In 2020-21, the population of Australia's major cities fell by 0.21 per cent, compared with an increase of 1 per cent, or 72,000 people, in regional Australia. Melbourne suffered the greatest falls in population, perhaps due to the protracted nature of lockdowns, while regional New South Wales and Queensland saw the strongest uptick in population growth. And while this was clearly below average for Australian major cities, the population growth in regional Australia was in line with the 10-year average. Over the longer-term, population growth in the major cities has grown at an average of 1.6 per cent per annum over 10 years and regional Australian growth has averaged 1 per cent per annum. Notably, however, there is also a longer-term decline in population in remote and very remote areas of Australia.

The Covid pandemic has highlighted the strength of Australia's regional and rural areas at a time where our major cities have had a significant setback. It has also revealed a series of trends towards growing wages, employment, population and house prices across many regional areas. However this cannot be claimed to be a nation-wide trend – with the regional boom over both Covid and in the longer-term being concentrated in the larger and denser populated States. Regardless, it does reveal both a willingness and desire for people to move to, or stay in, the regions – in contrast to the common belief that regional Australia was suffering from 'brain drain'. The question is how to capitalise on these opportunities and ensure that all regions can benefit.

GRAINS AND OILSEEDS INSIGHTS

OVERVIEW

- With much of Australia's cropping area being sown over the current period, some growers are still weighing up their crop balance based on factors such as weather outlook and input prices
- After two years of record crop volumes, early forecasts are for Australia's 2023/24 harvest to return to average levels, falling around 27 percent to 52 million tonnes
- 2023 grain exports are at record levels, driven by strong supply from last year's crop, as well as by healthy import demand, particularly from China
- Speculation continues around the potential for changes to China's tariffs on Australian barley, as well as whether current political differences between Canada and China may impact global canola trade.

Heading into winter, many Australian crop producers will have either finished planting their winter crops or be heading toward the tail end of it. For the major crops, most wheat and barley will already have been sown, with many canola crops up and growing on good early moisture.

As with other Australian agri sectors, the grains and oilseeds sector is heading toward the second half of the year with the uncertainty of a seasonal change from the last three bumper seasons ahead of it. Over those past three years, the wetter conditions brought about by the La Nina weather event has seen Australia produce three record crops in succession - both of wheat, and of overall winter crop volumes.

Looking ahead, concerns are growing around the potential emergence of an El Nino event, particularly from around July. In previous occurrences, this has seen a major reduction in rainfall over the winter and spring months, leading to reduced crop yields in many regions. Notably, some current forecasts are predicting a shift to a positive Indian Ocean Diopole (IOD), an event which could see dry weather over much of Australia.

If an El Nino were to eventuate, then its impact could be felt not just in Australia but potentially also across much of Asia. Such an event would see upward pressure on global grain prices, as impacted countries sought to procure supplies to make up for their domestic production shortfalls.

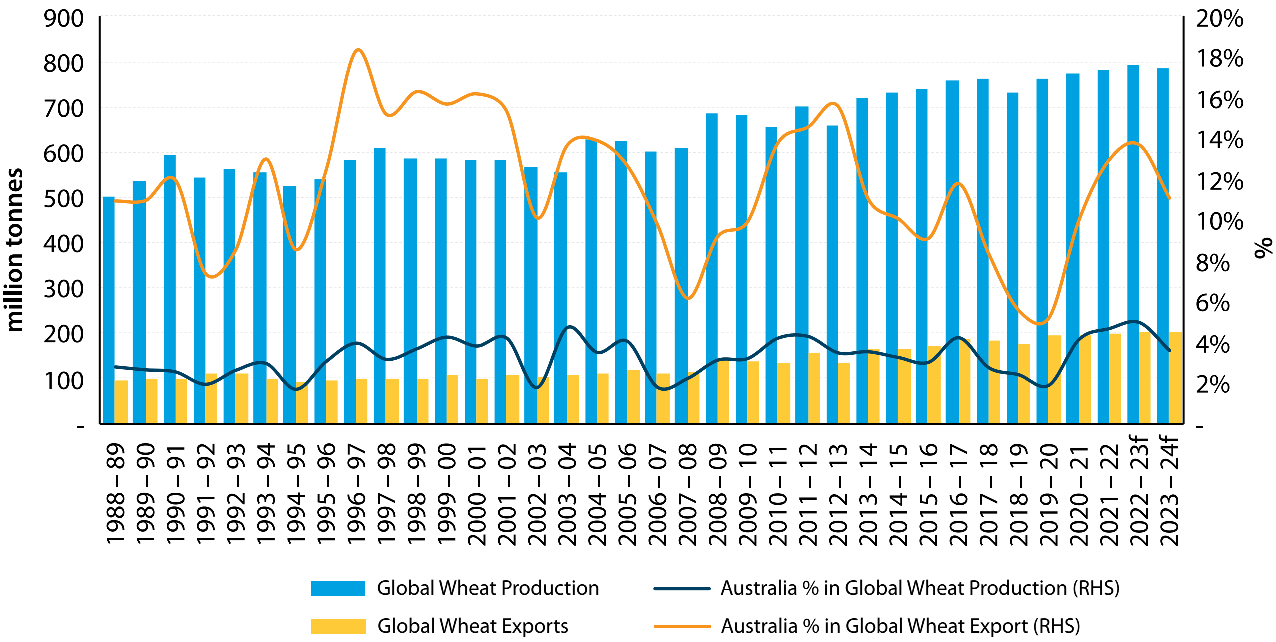
Despite these concerns, planting conditions so far in much of Australia have been positive, with good rains across Victoria and New South Wales contributing to excellent soil moisture levels.

Looking well ahead to the harvest, and accepting the potential for conditions to vary widely before the end of the year, Australia is currently forecast to produce a strong grain crop in 2023/24, albeit well below the previous record levels. ABARES is currently forecasting the overall grains and oilseeds crop to be around 52 million tonnes, which would be down around 27 percent on the previous year, but would still be the fifth biggest harvest ever.

EXPORTS

So far in 2023, the Australian grain industry continues to see strong export growth. As of the end of February, wheat and canola exports were at record pace. China remains Australia's largest wheat

AUSTRALIA SHARE OF GLOBAL WHEAT PRODUCTION AND EXPORT



Source: ABARES, ANZ

importer, taking over 25 percent of wheat exports, while exports also remain strong to Indonesia, Japan and Philippines.

Looking ahead, in terms of exports for the major crops for 2023/24, wheat is currently forecast to fall by around 20 percent to 22.5 million tonnes, barley to fall by 33 percent to 5.9 million tonnes and canola to decline by 27 percent to 5.1 million tonnes.

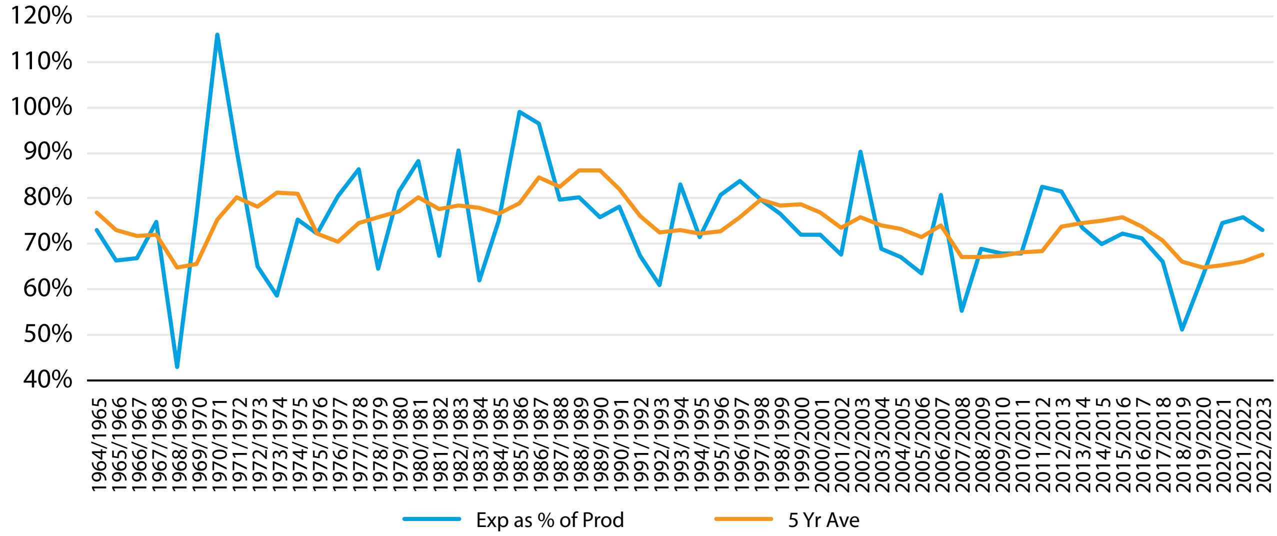
One interesting trend in Australian wheat has been the gradual decline in the share of wheat exported as a percentage of overall production. Looking at the five year average, the 2022/23 figure of 68 percent is the lowest for 15 years and the second lowest in 50 years. This is likely to be a by-product of the strong growth in overall wheat production, as well as a signal of increased domestic usage, for both feed and food.

Globally, wheat prices continued to decline in early May, when they dipped below the 600 USc/bushel mark for the first time since March 2021. A major reason for the decline has been the resumption of grain exports from the Black Sea Region, and the market having moved on from the initial panic of Ukrainian and Russian grain and oilseed supplies being lost to world markets for a considerable period. While the exports of grain from Ukraine have now continued relatively smoothly under the Black Sea Grain Export Initiative, albeit with Ukraine forecast to see a 20 percent fall in wheat production, Russia has continued to raise the prospect of the agreement ceasing at some point in future. Should this happen, global grain prices could well see strong upward pressure.

One development which may counter this is the outlook for strong crops in some major cropping regions in the Northern Hemisphere. Canada in particular is forecasting its biggest wheat crop in 22 years. In the US, last year's high wheat prices have seen a major jump in wheat plantings, in many areas which would normally have planted corn, although recent updates on the impact of drier weather increasingly point to a decline in the percentage of planted acres which will be harvested to around 67 percent, the lowest harvest ratio since 1917. In contrast, helped by a record yield forecast, US corn production is forecast to hit a record high.

One major development in global trade has been China taking the mantle of the world's largest wheat importer from Egypt. In 2023, China is forecast to import 12 million tonnes this year, the highest level since 1995.In particular, China has maximised the fall in global wheat prices to boost its imports, to a point where it now holds around 52 percent of the world's total wheat in storage. This partly reflects a big increase in feed use in China, associated with the fact that domestic support policies have pushed corn prices so high that many feed users are choosing to switch to cheaper imported wheat instead.

AUSTRALIAN WHEAT - EXPORTS AS % OF PRODUCTION - ANNUAL VS 5 YEAR AVERAGE

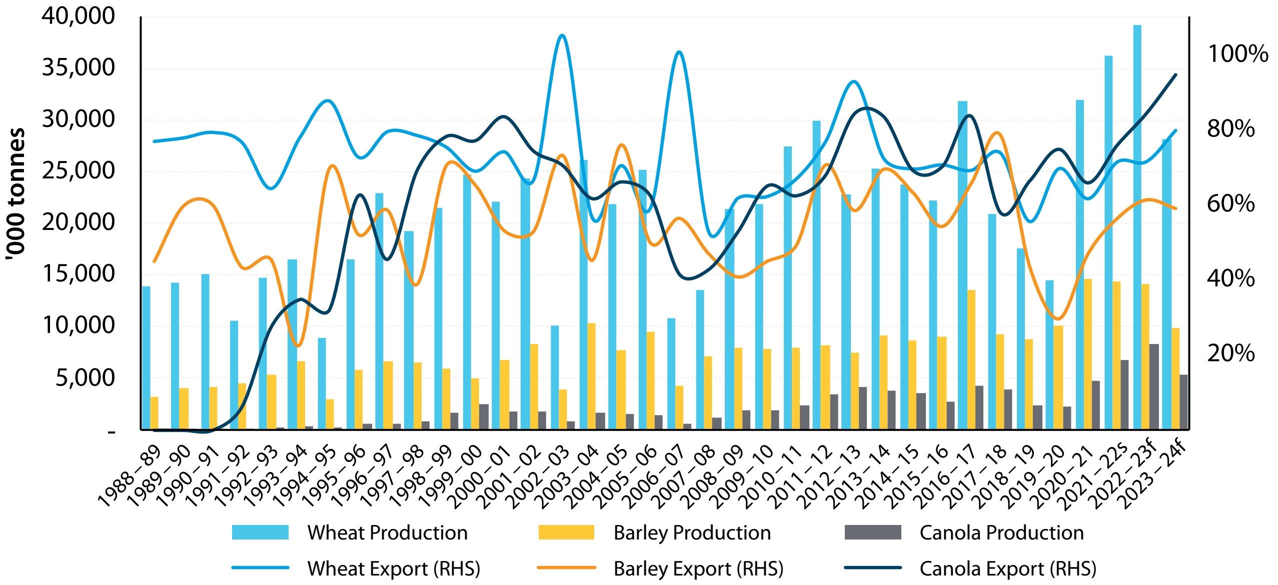


Source: USDA PSD, ANZ

Another area which will continue to be closely watched will be China's actions around the tariffs imposed on Australian barley in 2020. Australia suspended its appeal to the World Trade Organisation on the barley tariffs in April, after China pledged to conduct a review of the tariffs. Speculation continues as to the reasons for China's recent action, including the possibility that without Australian barley, China could not meet its requirements for both feed and malting.

For Australian growers still considering their planting options, this may see an increase in barley being sown, on the optimism of China demand returning. A further factor which may also have seen barley plantings increase has been the slide in canola prices, from their highs of the past year. Given its high input prices in comparison to barley, lower canola prices make it a less attractive option. That said, one factor which may alter this is any Chinese reaction towards Canada's recent expulsion of a Chinese diplomat. If China were to react with sanctions against Canadian canola, as they have in the past, then it could quickly put upward pressure on canola prices, as well as seeing strong demand for Australian canola.

AUSTRALIAN GRAIN AND OILSEED PRODUCTION AND EXPORTED SHARE



Source: ABARES, ANZ

FERTILISER INSIGHTS

OVERVIEW

- After fertiliser prices surged in the period after the start of the Ukraine crisis, they have now declined strongly, to around a two-year low
- This price fall is also partly due to a fall in gas prices, benefitting fertiliser manufacturers, and a build-up in global fertiliser inventories
- For Australian farmers, including cropping, horticulture and livestock producers, strategic use of fertiliser will be particularly important this season if forecast dryer conditions eventuate
- It will also be important for soil replenishment in cropping areas, on the back of two seasons of record production volumes
- Looking longer term, Australian manufacturers continue evaluate increasing domestic fertiliser production, which would reduce the strong reliance on imports.

Leading up to 2023, global fertiliser markets had experienced two very volatile years. In 2021, China, the world's largest supplier pf phosphate based fertilisers, had imposed restrictions on exports, causing prices to surge.

Early in 2022, Russia's invasion of Ukraine caused prices of urea to climb sharply. Not only is Russia a major exporter of urea, but the interruptions of supplies of Russian gas (a major component in urea production) to Europe caused further major disruptions in fertiliser production in other countries.

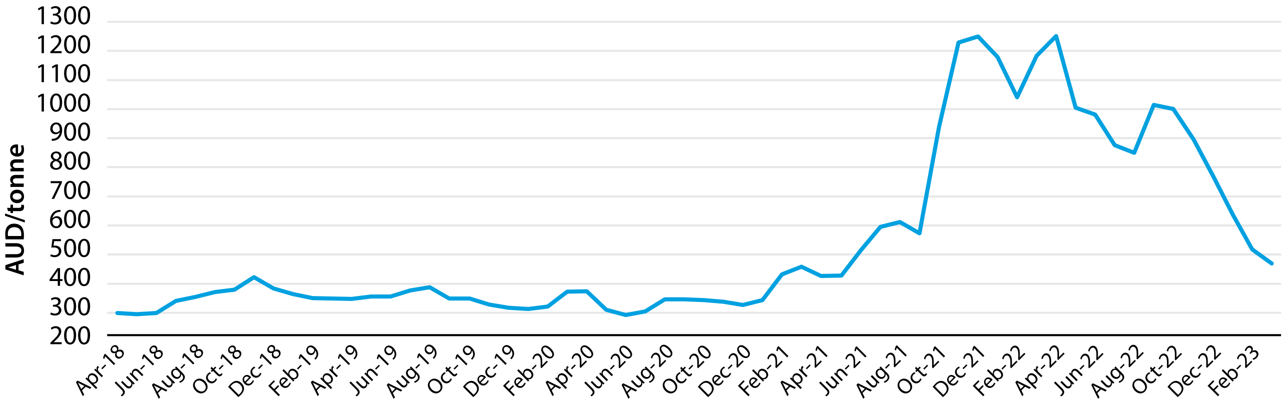
AUSTRALIAN FARMERS ARE HIGHLY RELIANT ON FERTILISER FOR A RANGE OF INDUSTRIES, WHETHER PROMOTING STRONG CROP GROWTH, BOOSTING PASTURES FOR LIVESTOCK PRODUCTION, AND TAILORING FERTILISER USAGE TO EXTRACT THE BEST LONG TERM RETURNS FROM PERMANENT AGRICULTURE, INCLUDING FRUITS AND NUTS.

The predictions of a potential El Nino bringing drier conditions across much of Australia have been growing since the start of the year, increasing the importance of farmers looking strategically at their fertiliser needs to best manage the season. At the same time, farmers must also be aware of managing input costs, particularly at a time of livestock and grain prices coming off strong highs.

For many crop producers, fertiliser application may be particularly important in 2023, as the impact of two years of high-yielding crops means that the need to replenish soils will be vital.

By May 2023, global urea prices had fallen to around US$350/tonne, slightly above their two-year low which had been seen in early April. This is in the wake of prices exceeding US$1,000/tonne in 2022. A fall in natural gas prices, following the high prices after the start of the Ukraine crisis, provided fertiliser manufacturers with the ability to lower both production and sales costs. This scenario was enhanced by a greater than expected availability of gas in Europe, as a result of a mild winter, combined with strong Liquid Natural Gas (LNG) imports.

UREA PRICES



Source: IndexMundi, ANZ
Note: Urea, (Black Sea), bulk, spot, f.o.b.

In addition, high inventories of fertiliser in Brazil, one of the world's largest agricultural producers, reduced the demand by that country on global supplies.

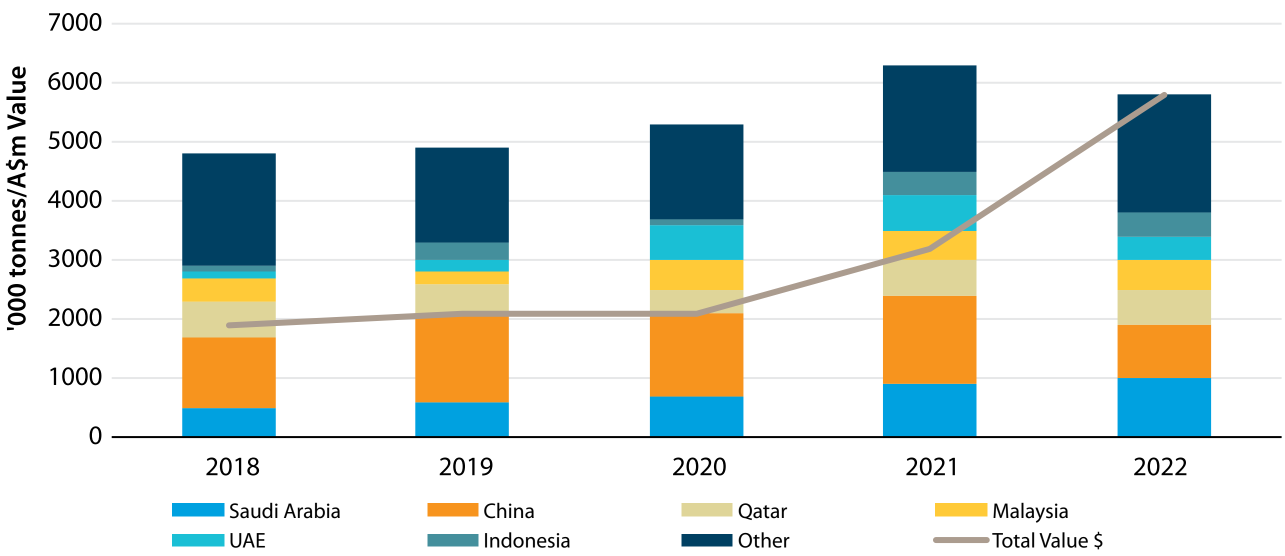
While prices have fallen strongly, market observers remain cautious around the potential for any major flare-ups in the Ukraine crisis to push prices up again. As a result, there is some feeling in the market that prices may have hit their floor for the time being.

Australia has traditionally been a major importer of fertiliser. Urea makes up around half of fertiliser imports, at around 2.4 million tonnes, with imports accounting for around 90 percent of usage.

Similarly, Australia also imports around 1 million tonnes of Diammonium Phosphate (DAP), with imports accounting for around 85 percent of usage. Imports are also high for Muriate of Potash (MOP), though imports are lower for NPK fertilisers and Single Superphosphate (SSP).

Following the impact of fertiliser export restrictions and supply chain disruptions over the past two years, Australia has seen a shift in the sources of its major fertiliser imports. Since 2021, the level of imports has fallen from China (-36 percent), Qatar (-18 percent) and the UAE (-31 percent). At the same time, fertiliser imports have lifted from markets including Bahrain, Morocco, the US and Trinidad and Tobago.

VOLUME OF AUSTRALIAN FERTILISER IMPORTS BY COUNTRY AND TOTAL VALUE, 2018 TO 2022



Source: ABARES, ANZ

In a bid to decrease the reliance on imports, focus is increasing on the development of new fertiliser manufacturing operations in Australia, including the recent commencement of a new urea manufacturing plant in Western Australia's Pilbara region.

CATTLE AND BEEF INSIGHTS

OVERVIEW

- Benchmark cattle prices have continued their ongoing decline, as the post-drought restocking competition appears to be over and the supply of cattle on the market continues to grow
- Despite the falls, prices are still not far off their medium to longer term averages
- The national herd is forecast continue to grow to around 24 million head, the same level before the drought-induced sell-off, although it is not predicted to return to record levels of around 26 million head
- Australia's beef exports continue to recover strongly, largely based on increased supply, but also due the US cattle herd decline both reducing that country's beef exports, as well as increasing its need for imports from Australia.

The Australian cattle and beef industry heads into winter 2023 facing a number of challenges, including ongoing price declines, the impact of economic conditions on beef consumption, and the flow-on effects of changes to global supply chains. Arguably, the industry's biggest challenge right now is the weather, particularly the uncertainty about the outlook over winter and spring, and the impact this will have on producers' strategies into the 2023/24 period.

The major talking point in the industry remains the ongoing decline in cattle prices. It was in late January 2022 that the industry benchmark Eastern Young Cattle Indicator (EYCI) hit a record price of 1185 cents/kg, as cattle producers rushed to rebuild their herds on their rejuvenated pastures following the end of the drought, and both processors and feedlotters competed hard on price to procure the supplies they needed for their own operations.

To put this in perspective, this represented a price rise of over 200 percent on the industry's low point in the drought, in March 2019, when a surge of producers offloading their cattle onto the market had seen prices fall as low as 390 c/kg.

The period since the record highs has seen prices fall even faster than they climbed. For example, to climb from 700 c/kg in April 2020 to 1185 c/kg in January 2022 took 21 months – which was seen at the time as a rapid rise. In contrast, it took only 15 months for the price to fall back to 700 cents, by April 2023, and at the time of writing, it has fallen further, below 640 c/kg.

So why have cattle prices been so volatile, and what does this mean for different stakeholders? The cause of the trajectory is largely a predictable market correction, following on from the post-drought rebuild. While prices surged upwards as producers continued to restock, inevitably herd levels were going to reach a point where not only did the urgency go out of the market, but that producers would be in a position to sell more of their cattle onto the market, while maintaining or increasing their own herd sizes.

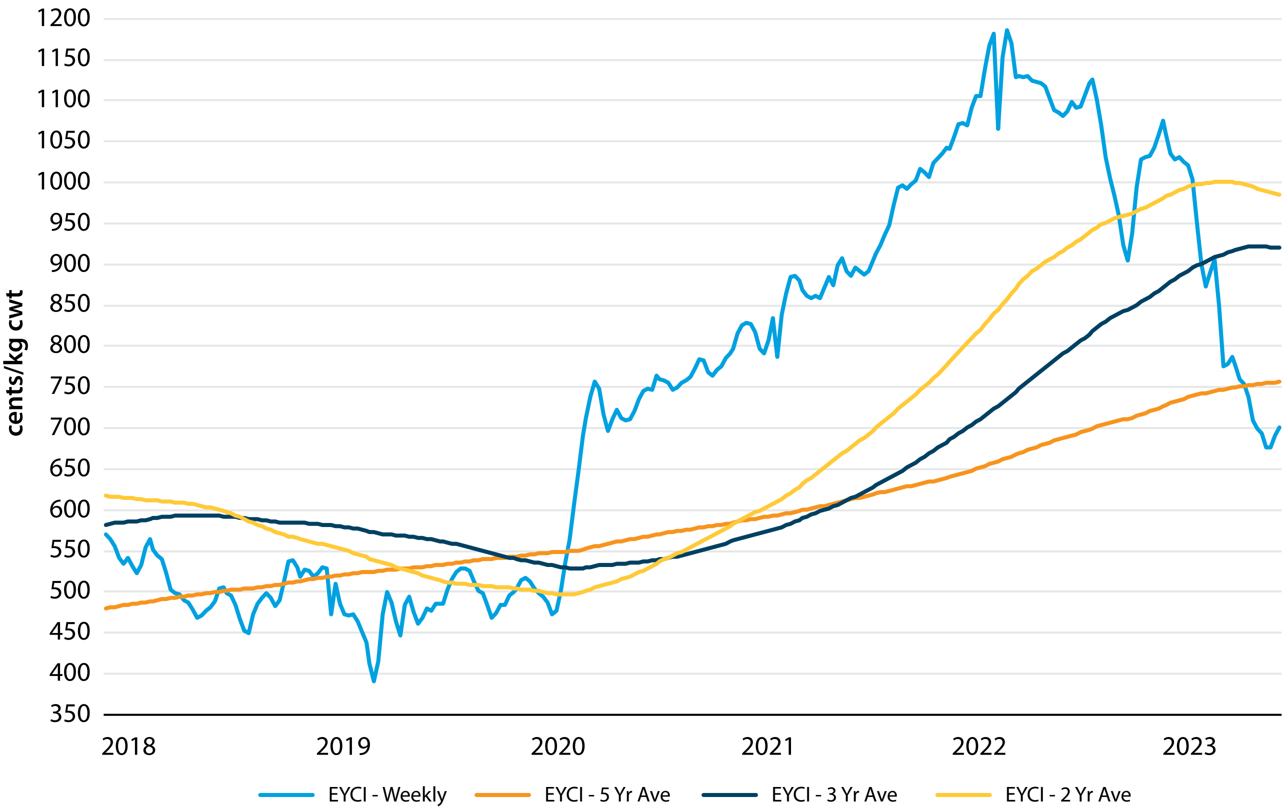
At the same time, the relatively good seasons up until now have seen a return to good cattle weights, with increasingly more animals ready for slaughter.

From this angle, despite the fact that prices have declined considerably from their peak of early 2022, they are arguably not at a level which should be causing most producers concern, particularly taking into account the build-up of the herd.

One way of looking this is to compare the weekly cattle price to longer terms averages, given that strategic planning, both for producers and across the industry, requires an approximate price projection, around which to base the forecasts for individual businesses.

Whether this price projection is based on a two, three or five year average, it is clear that benchmark prices have been above these levels for some time, providing a relatively long window of opportunity for producers to capitalise on.

EASTERN YOUNG CATTLE INDICATOR VS 2, 3 AND 5 YR AVERAGE PRICE



Source: MLA, ANZ

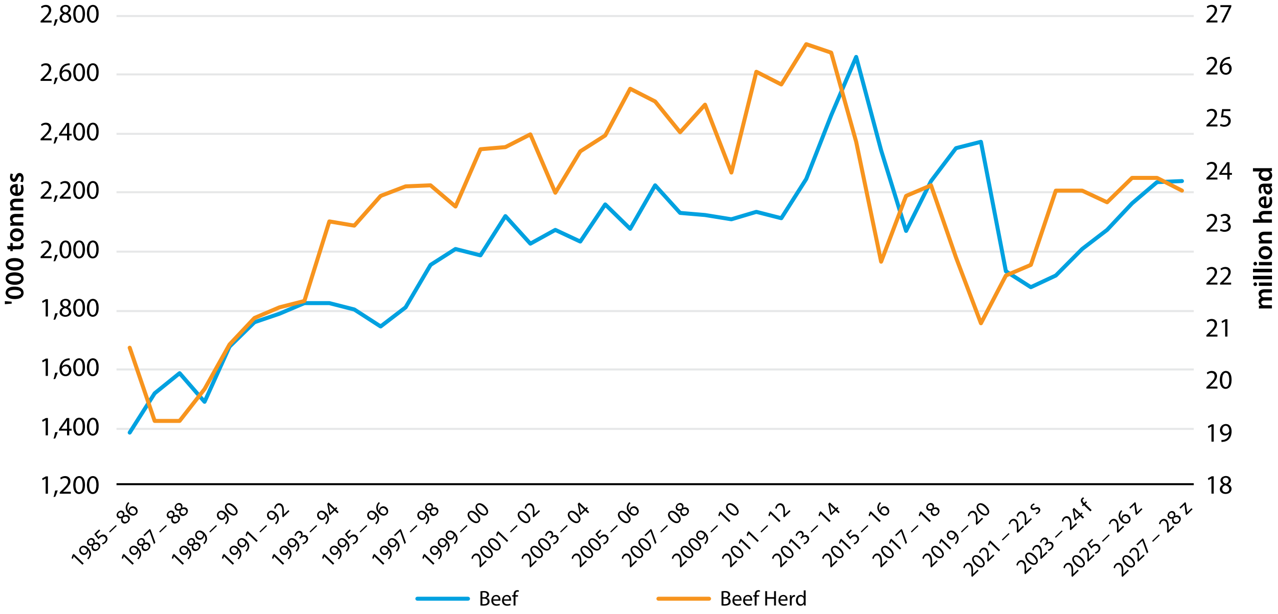
Additionally, the comparison with average prices also highlights the fact that despite the recent decline, current prices (at the time of writing) are still closer to the three and five year average than peak prices were, indicating that strategic producers are still likely to be close to their own operational forecasts.

Looking off farm, the impact of the decline from peak prices will have brought some relief to many cattle buyers, particularly meat processors, as well as feedlotters. As with producers, each of these major stakeholders has faced their own distinct challenges around costs and profitability over at least the past year.

For feedlotters, the cost of feed remains high, despite most global grain costs coming off their peak from the early stages of the Ukraine crisis. The impact of high feed costs has strongly reduced the potential returns on feeding lighter cattle over longer periods (around 100 days), and increased the focus by feedlotters on buying heavier feeder cattle.

For meat processors, the drop in cattle prices has reportedly seen some businesses move back into profitable territory for the first time since 2021. For processors, the positive returns are currently being felt around grassfed cattle, given that the longer term contracts for processing grainfed cattle mean that these will continue to be impacted by high feed prices for some time to come.

AUSTRALIAN BEEF HERD VS BEEF PRODUCTION



Source: ABARES, ANZ

One bright spot for both processors and feedlots has been around the issue of labour. While labour vacancies are still higher than optimal, a number of feedlots and processors are reporting that the gradual resumption of backpacker labour, as well as the growth of the Pacific Islander worker programs is going some way to alleviating the challenges.

WEATHER

Looking ahead, many cattle producers will be making strategic decisions based on their outlook for the season over winter and across the rest of the year. Having experienced two very good seasons since the end of the drought, it will not be overly-surprising to many in the industry that speculation around the emergence of another El Nino continues to grow, with the Bureau of Meteorology stating that the chances of it occurring in 2023 are around 50 per cent. This is despite many cattle regions in Australia having experienced good rains for around the first five months of the year.

If an El Nino emerges, bringing with it hotter and drier conditions, leading to less grass and reduced water levels in farm dams, then producers would be likely to reduce their own herds by selling more cattle and buying less re-stockers – a process which would have a downward impact on price.

Even if conditions are good over the winter months and beyond, the strong progress of the rebuild means that there is limited potential for strong price rises.

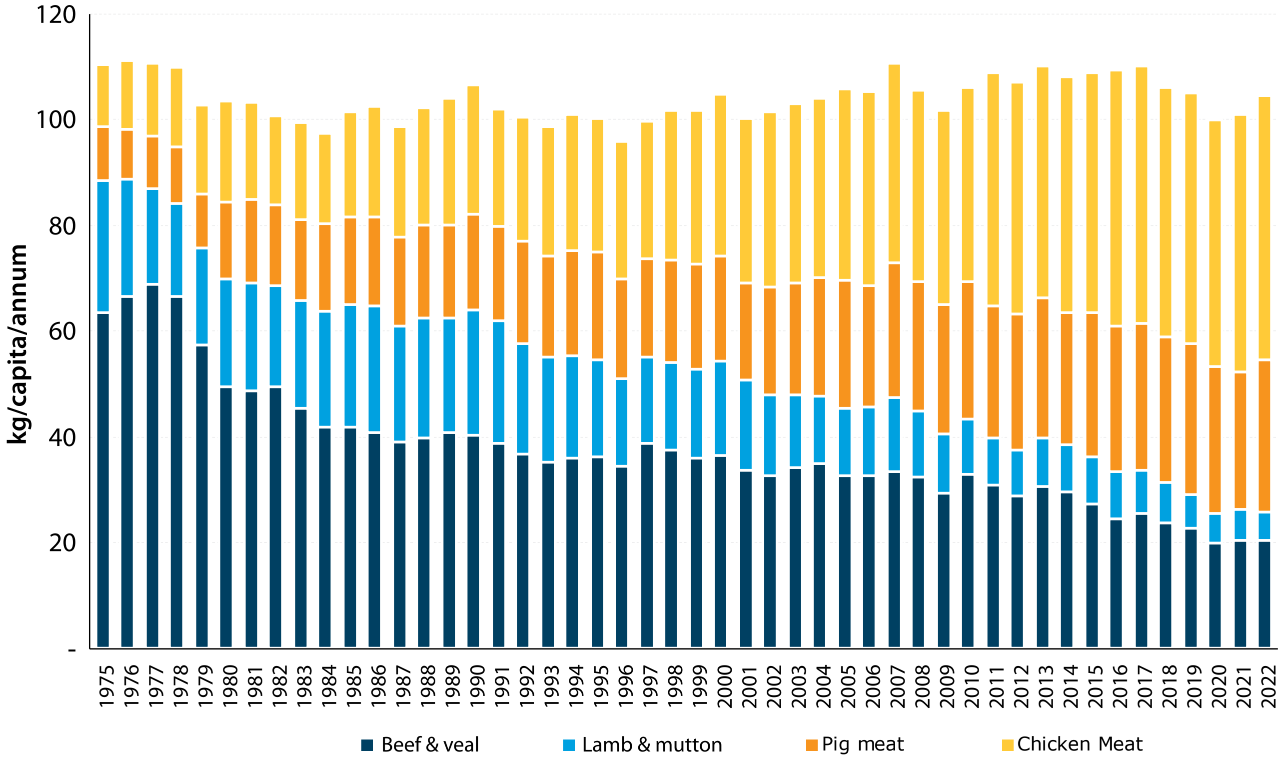
EXPORTS

Throughout 2023, Australia's beef exports have continued to rebound strongly from the previous year. This has largely been driven by larger availability of supply, combined with increased attractiveness of Australian beef as a result of falling cattle prices.

For the US, the impact of the drought, combined with the process of the herd cycle, will continue to impact imports of Australian beef, as well as competition in major markets. The US cattle herd is currently at its lowest point since 2015, and will take some years to recover. This has already led to US imports of Australian beef rising strongly this year, up over 40 percent, a pattern which is likely to continue for some time.

At the same time, the decline in US beef production is forecast to see its beef exports fall by around 13 percent in 2023, opening up more export opportunities for Australian beef, particularly in Japan and South Korea.

AUSTRALIAN MEAT CONSUMPTION PER CAPITA



Source: ABARES, ANZ

In terms of other markets, Australian beef exports to China also rose strongly, up 27 percent year-on-year in the first quarter, a figure which was boosted by the temporary ban on Brazilian exports to China due the discovery of a BSE case.

Beef exports to Japan are recovering at a slower pace, with first quarter figures similar to those of 2022, with US beef seeing an increase in market share. Positively, exports to South Korea surged by 31 percent year-on-year, a jump which almost saw that country become the biggest market for Australian beef in the first quarter of 2023.

SHEEP INSIGHTS

OVERVIEW

- Pressure continues to mount on lamb and mutton prices as heavy supply comes through saleyards and processing plants
- Quality is still attracting a premium with heavy discounts for lighter and restocker lambs
- Lamb exports for the year to April are travelling well, albeit with a large drop in demand from the US
- China set to overtake the US as Australia's highest volume lamb market – a position not held by this market since mid-2020
- The typical upside seen in prices through the winter months is not looking likely this year due to continued high supply
- Australia- UK Free Trade Agreement offers positive future high value market growth for Australian lamb and mutton.

The downward trend experienced in sheep and lamb markets throughout 2023 continues as we enter the winter months, as the market grapples with the key driving forces of supply, quality, export demand and processing capacity.

After several consecutive years of buoyant price growth, notwithstanding a few dips along the way, this now protracted price correction is perhaps best understood by taking a step back and remembering to the path that got the Australian sheep industry to where it is today.

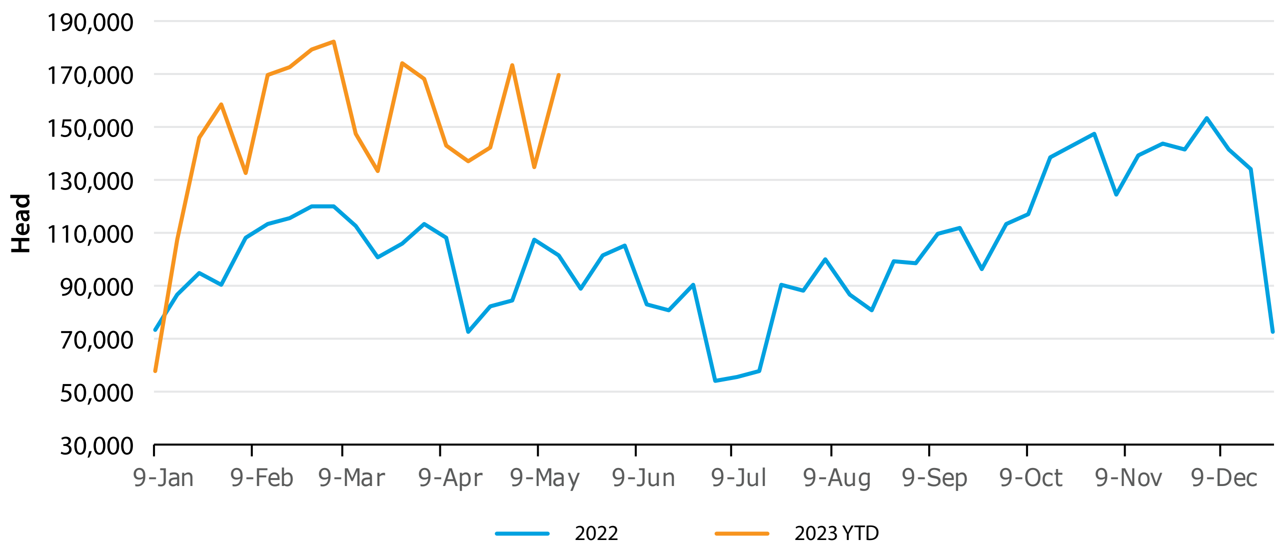
Australian sheep producers have benefited over the past decade by a growing global demand for lamb and sheepmeat. The OECD estimates that for the period 2011 to 2021, global consumption of sheepmeat grew by 21 percent. Much of this growth was in low value exports to developing nations, but to the great benefit of the Australian sheep industry, it was also matched by growth in developed high value export markets. As a long term and safe producer of sheepmeat with a large exportable volume, Australia was exceptionally well placed to take this opportunity. Although the most recent drought through the eastern seaboard was met by flock liquidation, demand was so strong that prices held firm, allowing producers to exit that drought period in a financial position that accommodated rapid restocking. To put that into context, according to latest MLA projections, producers have cumulatively added almost 15 million head to the national flock since the lowest point during the drought, in just three short years.

During this time, growth in world economies, an outbreak of Swine Fever in China's pig population, and the return to good seasons, fed both local and international demand for sheep. Now in early-mid 2023, flock growth has stabilsed - some would argue it has reached its sustainable limit - as supply pressure is experienced particularly across certain categories of sheep, including mutton and lower weight lambs.

SUPPLY

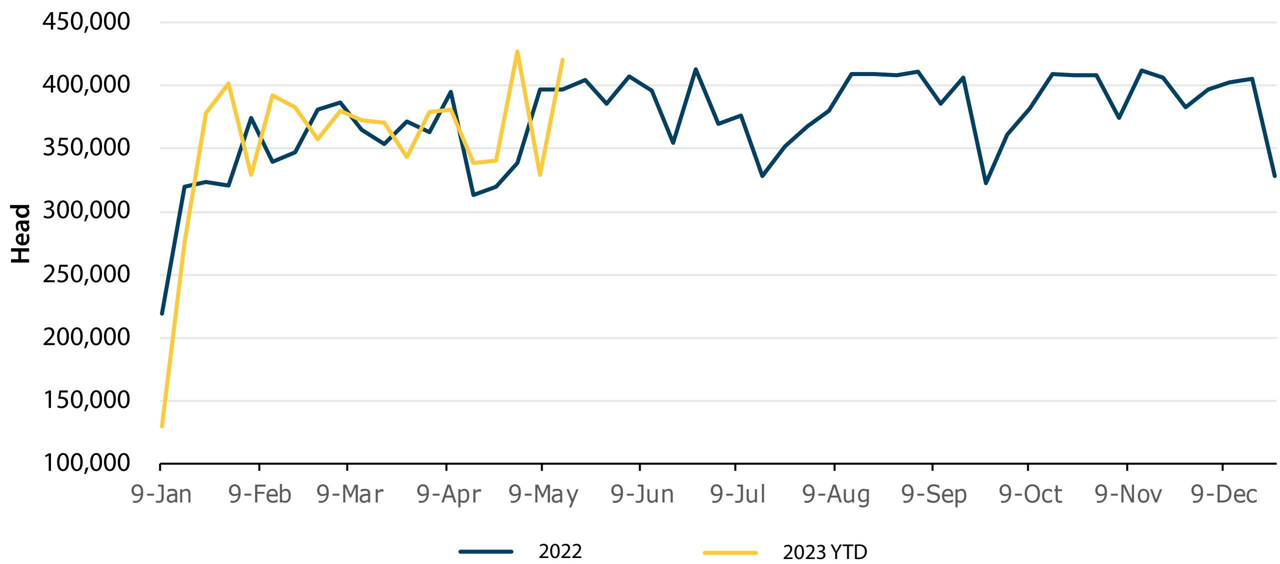
Throughput of both sheep and lambs through saleyards and over the hooks is trending considerably higher in 2023. National slaughter data for quarter one 2023 shows lamb slaughter up by over 600,000 head (growth of ~13 percent) on the same period last year, and for mutton, a staggering increase of over 830,000 head (~54 percent). Yardings of restocker type animals are also consistently high week on week, further pointing to continued high supply of heavier lambs through winter and early spring as these animals are finished in the paddock or on grain. While the supply of sheep and lambs would normally dip through the winter months based on trends of the past decade, the market largely anticipates that this may not occur in 2023, which could contribute to ongoing price pressure.

NATIONAL SHEEP SLAUGHTER - WEEKLY



Source: MLA, ANZ

NATIONAL LAMB SLAUGHTER - WEEKLY



Source: MLA, ANZ

QUALITY

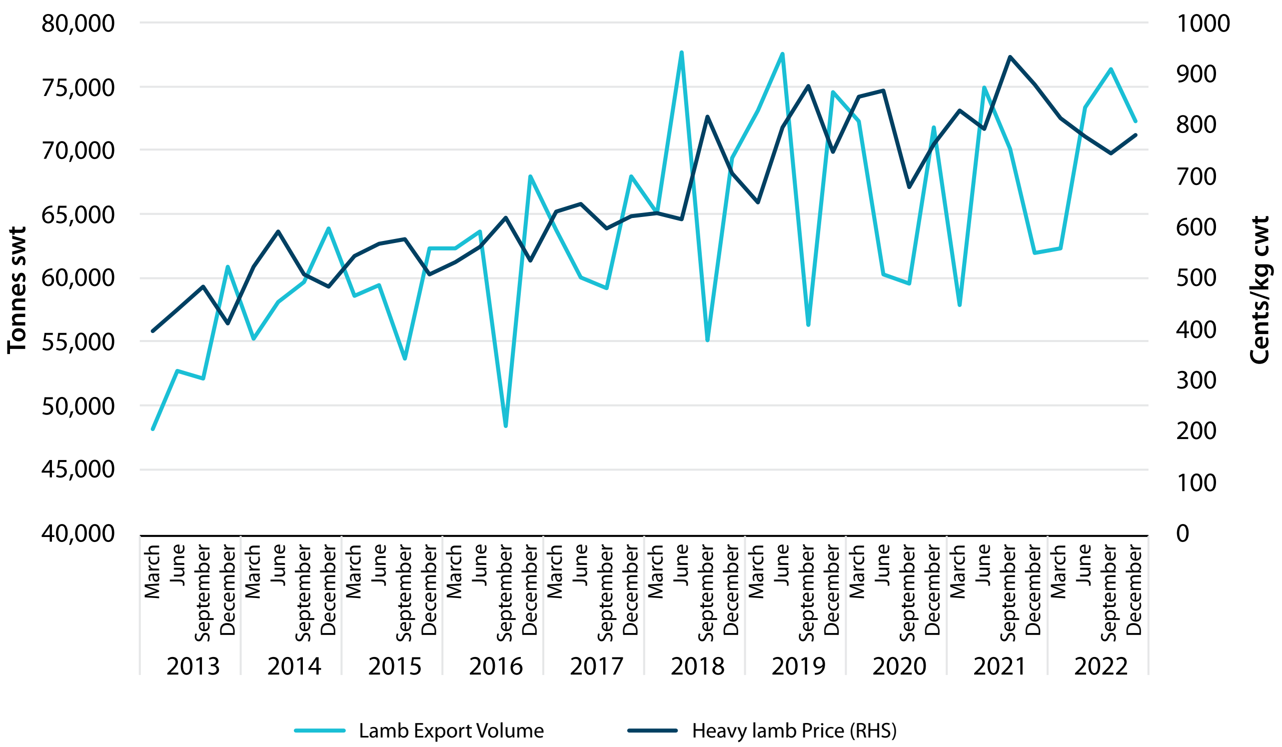
Heavy and well finished lambs are still attracting a significant premium in the market, trading at well over 100c/kg cwt above both light and restocker lambs at the time of writing. This is a stark comparison to 12 months ago, when pricing for lighter categories of sheep was on par, if not trading at a premium, to heavy lambs. This could be taken as a strong signal that flock growth has stabilised, with far less demand for restocking demonstrated throughout the country.

EXPORTS

In positive news, exports through to the end of April of both lamb and mutton performed well on a year-on-year basis, especially considering 2022 was a record year for exports. Overall, lamb exports were up 5 percent for the year to April when compared to 2022 volumes for the same period, driven by 30 percent year-on-year increases in exports to China, a huge 50 percent uptick in South Korea, and 32 percent to UAE. This overall increase was despite a significant drag coming from the US market, where exports were down 23 percent year-on-year for the first four months of the year. This downturn is significant on two fronts. Firstly, while as the US has, since around mid-2020, been Australia's largest export market by volume, it has also been Australia's highest value lamb market, driven by import prices that at times over the past 4 to 5 years have been more than double (on a per kg basis) that of our second largest market of China. At present, export data suggests that for the quarter to June 2023, we will see exports to China once again outpace exports to the US, as the US economy slows, and consumer spending on what is a typically a niche foodservice product in that nation, softens.

Positive news in the US market is however mutton imports. Along with a major recovery of 77 percent year-on-year for mutton exports to China, the US market recorded a 20 percent increase over the same period. This could demonstrate that the US consumer has developed a lasting taste for sheepmeat, switching to a lower value product as opposed to seeking complete alternatives when under economic pressure. The recovery in mutton exports to China was particularly welcome, playing a vital role in slowing the sharp drop in prices experienced in mutton markets since the beginning of this year.

AUSTRALIA LAMB EXPORTS AND HEAVY AND TRADE LAMB INDICATOR PRICES

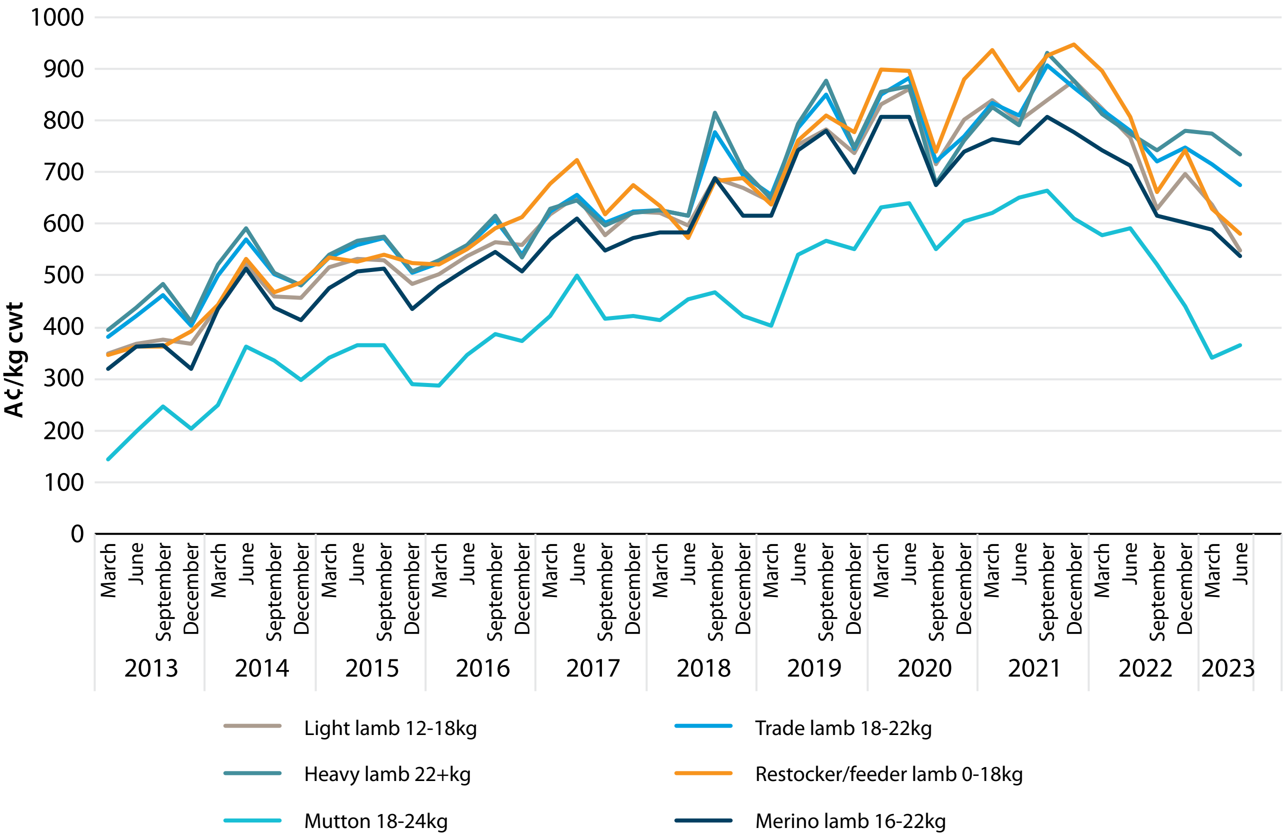


Source: MLA, ANZ

Other positive factors for exports include the finalisation of the Australia – United Kingdom Free Trade Agreement (A-UK FTA), which for sheepmeat will see tariff free volume increases from 25,000T per annum to 75,000 per annum over a 10-year period, with a safeguard provision in place from years 11 to 15. These are generous volumes in comparison to historical exports, which averaged around 9,500 tonnes per annum for the period 2020-2022.

Importantly, the A-UK FTA allows for larger volumes of trade to what is a high value, long term and developed market, with sheepmeat already a staple part of UK diets. For context, the average price of Australian sheepmeat exported to the UK throughout 2021-2022 was a little over $11 per kilogram, some 10 percent higher than the US export price for the same period. Historically, New Zealand lamb has been a larger supplier to this market than Australia, however the continued decline in sheep production in New Zealand remains evident and represents an opportunity for Australian product.

SHEEP AND LAMB INDICATOR PRICES - QUARTERLY



Source: MLA's NLRS

PRICES

As noted, the drags on price of high supply, softer export demand to the US, and varying quality of sheep on offer, are tipped to continue through the winter months, and perhaps into spring, particularly if forecasts for drier weather come to fruition and producers are not able to finish stock to heavy weights. Export demand for lamb and sheep meat is arguably the single most important factor to watch in price outcomes over the near term, with ANZ analysis suggesting export volumes over the past 10 years carry a moderate to strong correlation to the heavy lamb indicator price, when allowing for a two quarter lag between export volumes and those indicator prices. The sheer volume of supply and the local conditions will be the other major factors to watch, along with quality.

WOOL INSIGHTS

OVERVIEW

- Wool prices continue to trade within a relatively narrow band, although weakened overall through late Autumn
- Prices remain significantly back year on year for many micron categories
- Weaker buyer demand is underlying the price pressure however the quality finer wool types are receiving better price support
- Volumes processed through auction remain steady year on year and forecast gross wool production is also stable – indicating a stabilising national flock and wool cut
- Trade data for apparel imports suggests some improvement in key woollen garment markets.

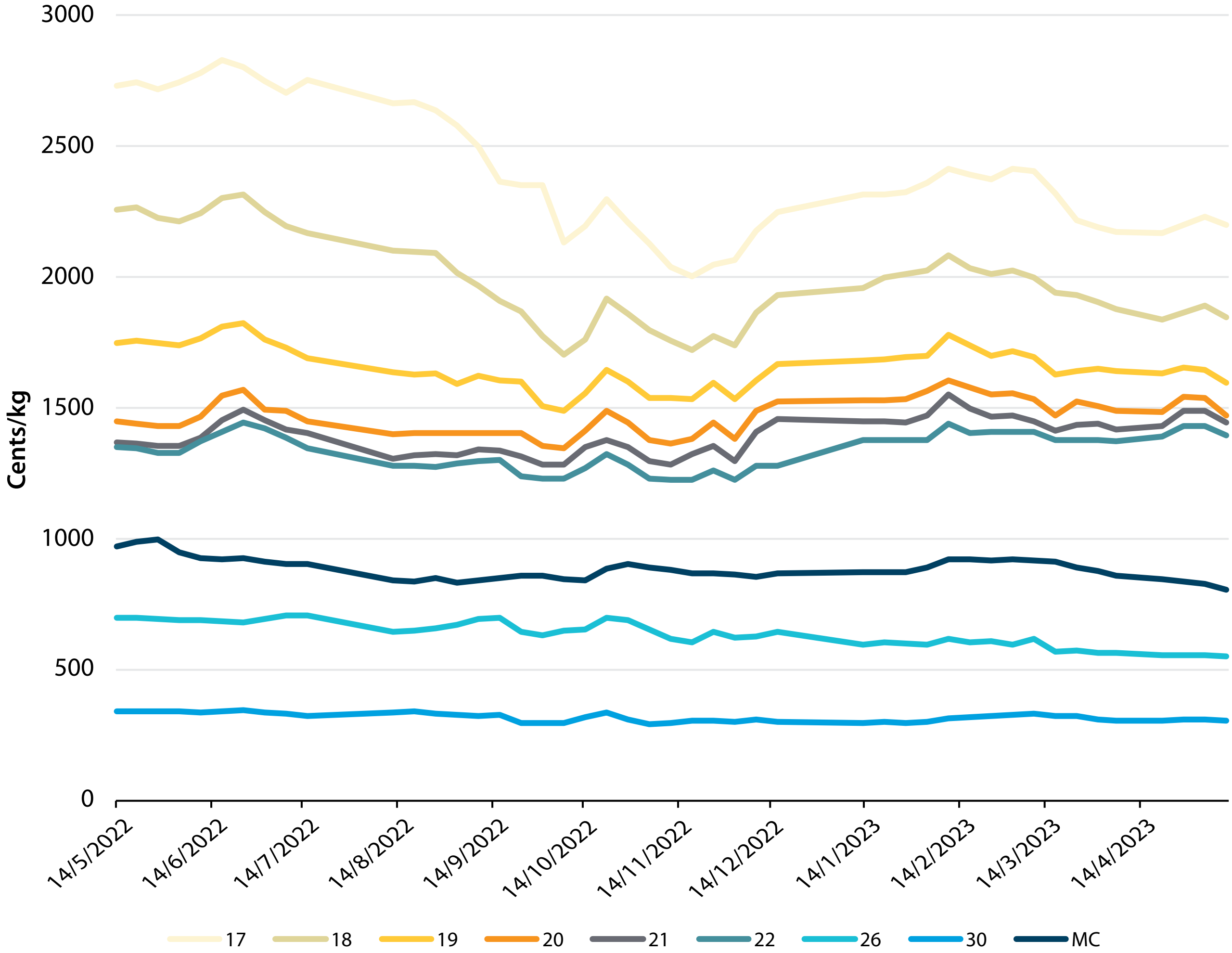
The Australian wool market continues to track lower heading into winter, with market reports from wool brokers and auction rooms generally commenting on weaker demand, thus holding back any significant upward shift in pricing from being a reality in the short term. Prices dipped slightly through late Autumn across all microns, and the Eastern Market Indicator (EMI) is currently trading around the low 1300 cents per kilogram mark, not considerably off the year to date average of around 1315 cents per kilogram.

When compared to 2022 prices, wool markets remain generally weaker, currently around 6 percent below the 2022 average EMI.

Micron price guides, as always, tell more of the underlying story – with 19-to-22-micron wool categories performing the most strongly compared to last year, all trading at or above year ago levels. Prices of around 1600c/kg for the finer end of this range and around 1400c/kg at the broader end have been achieved leading into winter.

Super fine wool types are trending considerably lower than last year, however, are still returning upwards of 1900c/kg, and have been more sought after in recent weeks. In the broader wool types of 26 to 30 microns, as produced by Australia's first cross ewe breeders, prices are still hovering around the 350c/kg mark, struggling in some cases to repay the ever-increasing cost of shearing, which is now reaching the $9-10 per head mark at full contract rates.

MICRON PRICE GUIDES



Source: AWN, ANZ

In terms of volumes of wool in the market, throughput year to date is largely level with 2022, at around 1.6 million bales at the time of writing. The Australian Wool Production Forecasting Committee has recently updated their forecast for total wool production for the season to around 324 million kilograms (greasy) – up just slightly on last year and indicating a stabilising of the national flock.

In positive signs for improvement in market demand in the near term, reports from wool industry representatives to China quote a notable investment in wool processing capacity since the Covid pandemic.

There has also been some significant recovery in wool apparel imports in major northern hemisphere markets, including Japan, US, Germany, France and Italy, to name a few, with many surpassing pre-covid import levels.

China's domestic demand, which is an extremely important factor for wool markets and responsible for the end use of an estimated 40 percent of Australian wool per annum, is more difficult to predict with a lack of available data, however improving shipping backlogs and increasing processor capacity are surely positive signs for the longer term.

DAIRY INSIGHTS

OVERVIEW

- The Australian dairy industry continues to contract, with national milk production levels down on the previous year, and the national milking herd continuing to decline
- The decline is being driven by a number of factors, including lack of labour, attractive offers for dairy land from beef producers, and the sheer hard work of running a dairy operation
- With the industry forecast to continue shrinking, this could pose increasing challenges for processors, retailers and exporters in terms of attracting adequate supply levels
- Globally, dairy product prices have remained strong, reflecting a continuing emergence from Covid restrictions, particularly in China, as well as the ongoing long term growth in many Asian markets of consumer dairy consumption

Australia's dairy production has continued to contract, with national milk production levels continuing their trend of being down each month on the previous year. While some agri sectors, such as grain, have seen their production figures fluctuate based on factors such as varying weather patterns, the outlook for the dairy sector appears far more structural, with the national dairy herd continuing to shrink. One positive in the industry is that yields per cow continue to climb, a trend which has resulted in national milk production levels declining at a slower rate than the level of the national milking herd.

Looking to the medium and longer term, the trend shows little sign of changing. According to the latest ABARES forecasts, the national milking herd will continue to decline until at least 2027/28, falling around five percent from current levels. While a fall of around five percent from the current herd size does not sound major, it is still almost fifty percent below the size of the herd twenty years ago, before it began its decline.

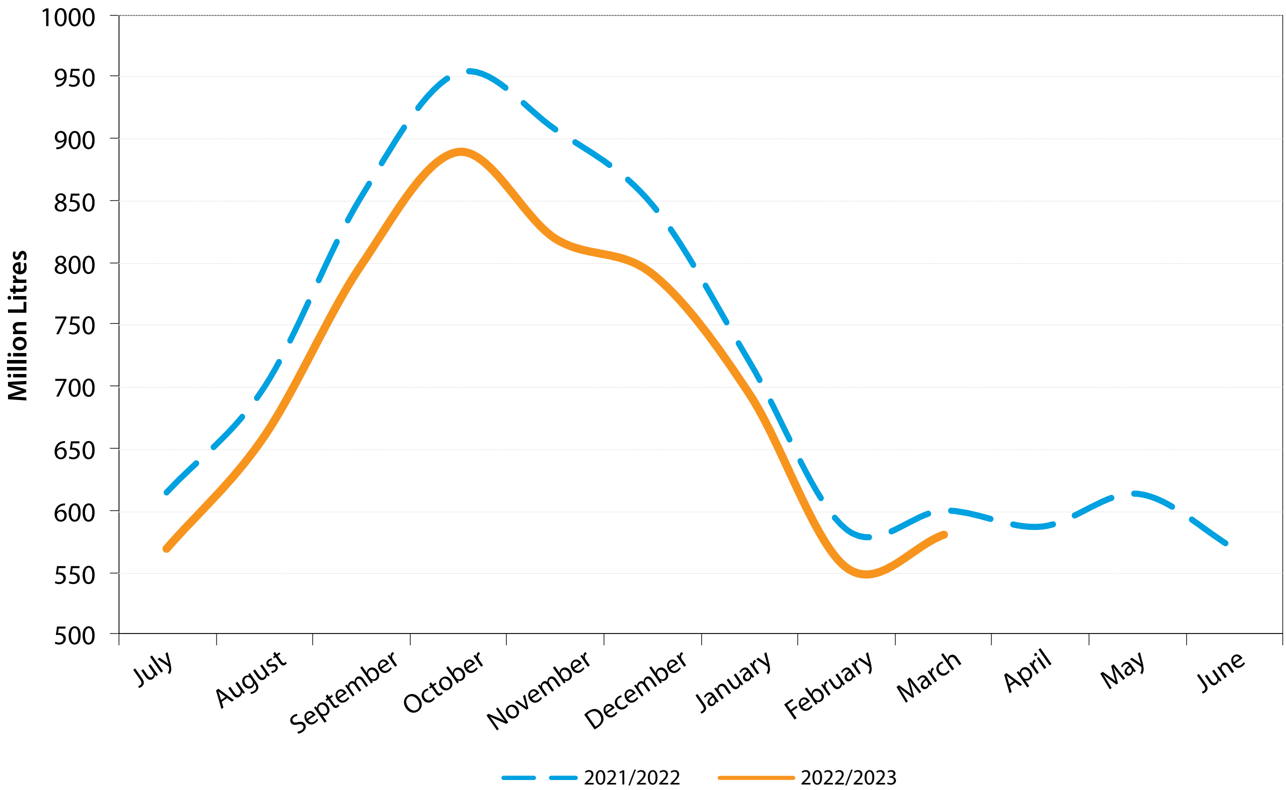
The ongoing contraction of the Australian dairy herd continues to create discussion around the causes, as well as what this may mean going forward, not just for dairy producers, but for the whole supply chain. Debate continues around whether the ongoing decline in the dairy herd and dairy farm numbers are due to the shortage of labour, the profitability of many producers, or the sheer hard work which is required to run a dairy farm, a factor which can put off many of the next generation of dairy farmers from staying in the industry.

In looking at factors which may see the decline stop, it may be worth comparing dairy to the sheep industry, where a long period of decline in the nation flock appears to have plateaued over the past decade, as those who are passionate about the industry choose not only to remain in it, but to pursue it innovatively.

Looking ahead, if the decline in the milking herd continues, and if the growth in cow milking yields slows or plateaus, then total milk production may decline to a point which impacts the viability of the current scale of milk processing operations in Australia, as well as the number of processors. Ultimately, it could even raise the question as to whether Australia would look toward importing milk, most likely from New Zealand, if this became necessary.

In terms of 2023 production levels, Australia's monthly milk production continues to be below average figures. While national production lifted 4.8 percent in March on the previous month, this was due to it being a seasonal uplift, rather than a structural turnaround. Overall, annual milk production is down over 6 percent on last year, and is running at over 8 percent below the five year average.

AUSTRALIAN MILK PRODUCTION - NATIONAL TOTAL 2021/22 & 2022/23

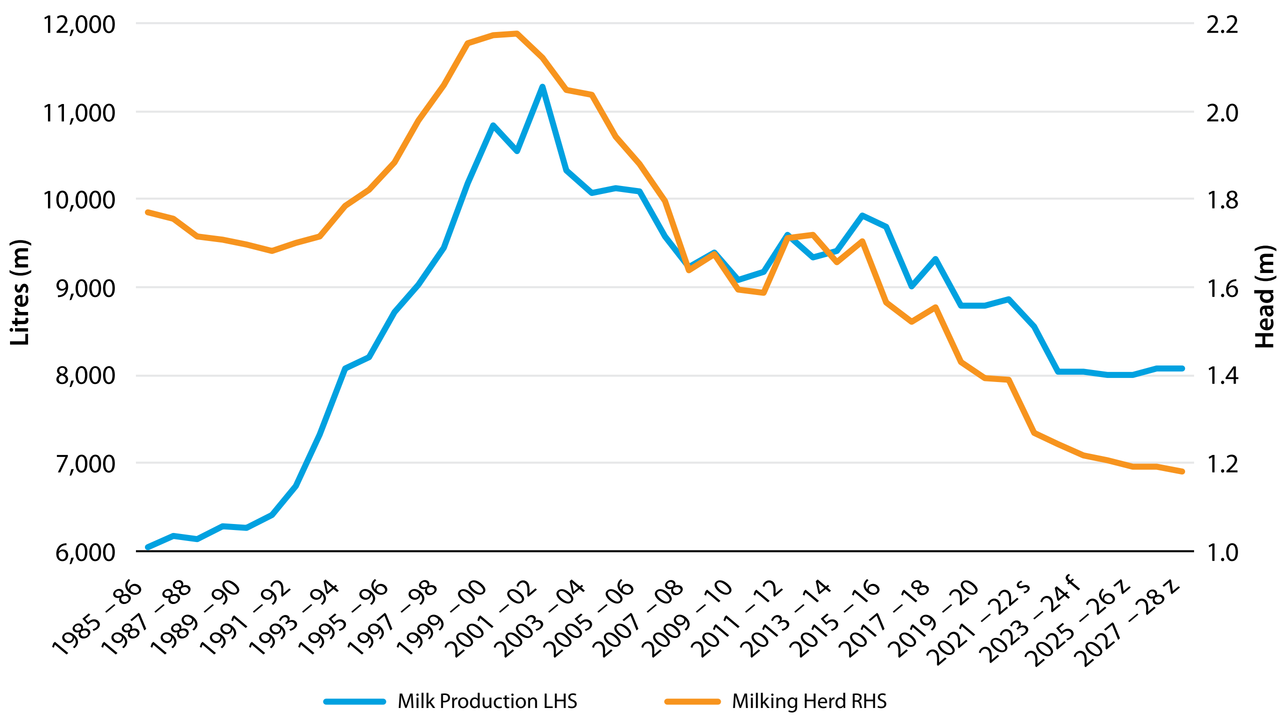


Source: Dairy Australia, ANZ

In Victoria, which accounts for almost 60 percent of Australia's milk, production was down around six percent, which was partly due to the flooding from 2022, as well as ongoing industry contraction.

Domestically, while milk consumption remains strong, it is yet to be seen just how much the cost of living pressures may impact consumption of dairy products. This would be most likely to impact discretionary products, as well as more expensive milks, finer cheeses, and expensive yoghurts.

AUSTRALIAN MILK PRODUCTION VS MILKING HERD 1985/86 - 2027/28F



Source: ABARES, ANZ

FARMGATE PRICES

At the time of writing, producers are looking ahead to processors releasing new season farmgate prices, by the deadline of 1 June 2023. A year ago, opening farmgate prices were around the $7-8/kg Milk Solids (MS) mark. That figure rose reasonably quickly with step ups to the current levels of around $10/kg MS.

This year, processors will need to take a number of factors into account. As domestic production continues to shrink, processors need to balance what they will need to pay to attract required supply. At the same time, they will also need to be mindful of not overpaying, so as to remain viable, as well as keeping their product prices competitive, for both domestic and export markets. The level of opening prices may well have an impact on the direction of the industry, if some farmers decide that they are better off selling to entities such as beef or horticulture producers, or changing to beef themselves.

GLOBAL

Globally, dairy prices have risen in the two most recent Global Dairy Trade auctions. Strong increases were seen in skim milk powder (SMP) and whole milk powder (WMP), butter and cheddar, while all categories are now above the five year price average. Buying has been especially strong from North Asia, as well as from the Middle East and South Asia. The increase in buying could be seen as a combination of the ongoing consumer recovery from Covid restrictions, combined with the continuing growth of dairy product consumption by consumers in those regions. Additionally, it may also be due to products having been at a lower price.

LOOKING AHEAD, GIVEN THAT THERE IS LITTLE SIGN OF A SHORTAGE OF SUPPLY OF DAIRY PRODUCTS GLOBALLY, IT REMAINS UNCERTAIN AS TO WHETHER PRICES WILL CONTINUE TO RISE AT THIS RATE.

COFFEE INSIGHTS

OVERVIEW

- Australians continue to be some of the largest per capita consumers of coffee globally
- Australia grows less than one percent of the coffee consumed domestically, with most imports coming from Brazil, Vietnam and Colombia
- Global coffee prices have felt some downward pressure, as markets worry that consumers may drink less in tight economic times, and as global supply is currently strong
- Looking ahead, the market is watching forecasts of a drier season with some concern, as it may lead to less production in some major coffee growing countries.

Of all the agricultural products consumed in Australia, one on which many people most rely is barely produced in this country. For most Australians, it is difficult to start the day without a cup of coffee – or two or three. Given that buying a coffee in the morning is a ritual for so many people, as they wait for ten minutes while the tattooed barista churns through the orders and heats the milk to a perfect temperature, changes in the price of coffee will often be a talking point. Heading further into 2023, this will especially be the case as people re-evaluate their spending as the cost of living increases.

In terms of consumption per capita, the US Department of Agriculture ranks Australians at tenth in the world, consuming the equivalent of around 4.5 kg of ground coffee per year. Apart from Canada, all the countries in front of Australia are European.

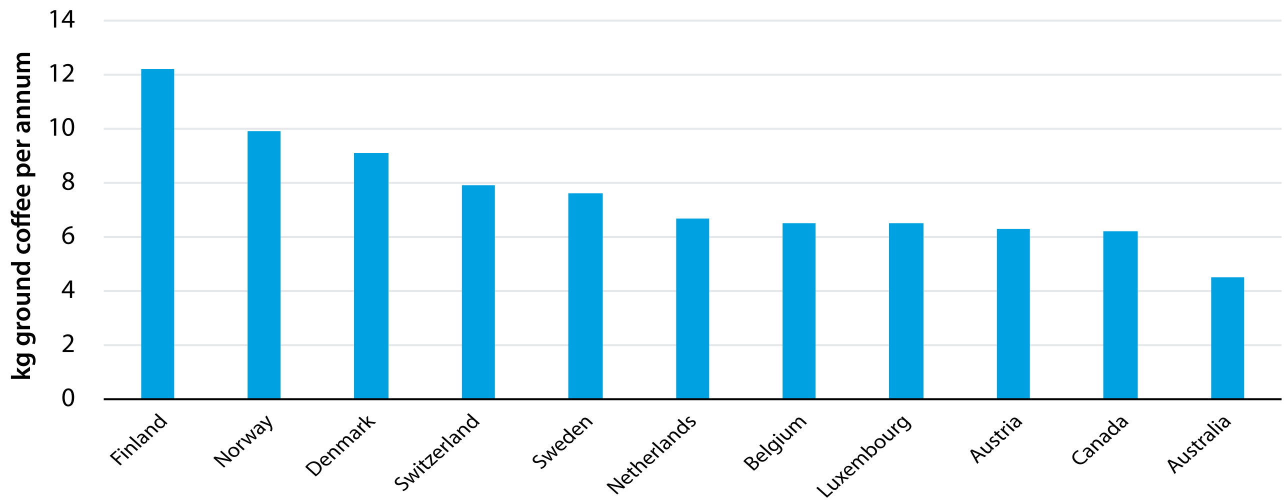
The world produces two major varieties of coffee - Arabica, which makes up around 60 percent of the world's coffee, and Robusta, which makes up around 40 percent. Arabica coffee is known for having a more complex and nuanced flavour, while Robusta is described as having a more bitter and straightforward taste.

Robusta contains around twice the caffeine of Arabica. As a result, Robusta is often used in blends to add caffeine content. In terms of growing regions, Arabica is grown in higher areas with cooler temperatures and greater rainfall, while Robusta is grown at lower areas, which are warmer and drier.

ON GLOBAL MARKETS, ARABICA NORMALLY FETCHES A HIGHER PRICE, PARTICULARLY DUE TO ITS SUPERIOR FLAVOUR.

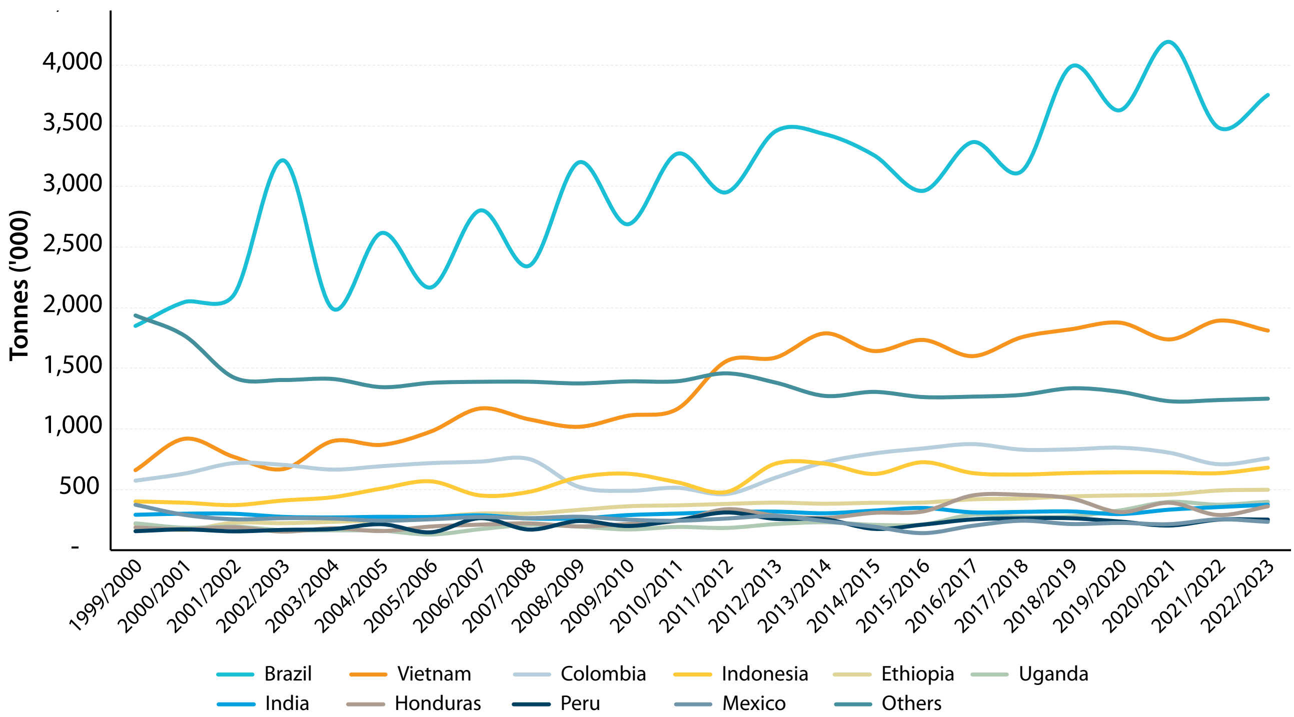
Globally, the world produces around ten million tonnes of coffee annually, with Brazil and Vietnam accounting for over half of this, at 36 percent and 17 percent respectively. Notably, most major coffee producers are developing countries, and coffee is sometimes described as the second most important commercial export from the developing world after petroleum. Similarly, Brazil and Vietnam also account for around half the world's coffee exports.

PER CAPITA COFFEE CONSUMPTION



Source: International Coffee Organisation, ANZ

KEY GLOBAL COFFEE PRODUCERS



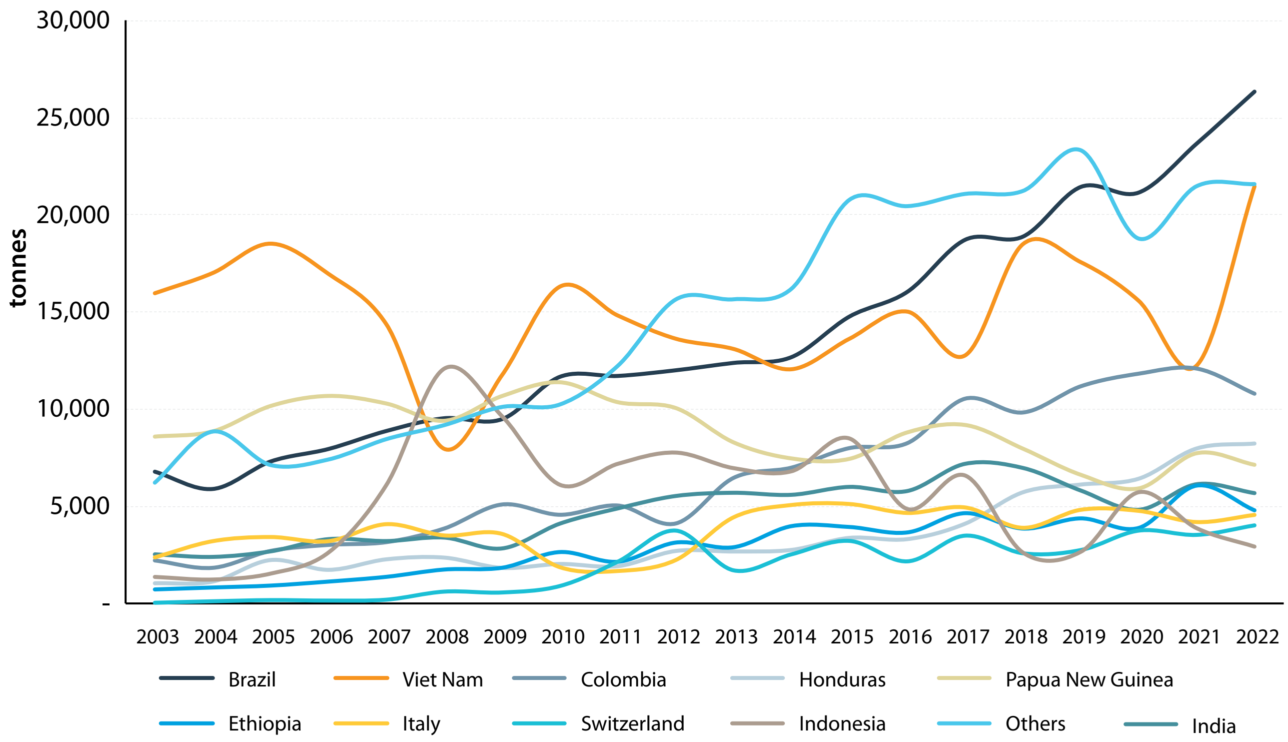
Source: USDA PSD, ANZ

In terms of imports, the EU and the US account for over half the global total. Notably, Australia is around the world's tenth largest importer of coffee, forecast to import around 132,000 tonnes of coffee in 2022/23, making up around two percent of global trade. Australia's imports are largely sourced from Brazil, with reasonable levels also being shipped from Colombia, Paua New Guinea, Vietnam, Peru and Ethiopia.

In terms of global prices, there are two major exchange contracts. The New York C Contract is the benchmark for Arabica coffee futures trading, is traded on the Intercontinental Exchange (ICE), and is based on the price of Arabica from a few selected origins.

Similarly, the London International Financial Futures and Options Exchange (LIFFE) traded Robusta

AUSTRALIA COFFEE IMPORT SOURCES



Source: TradeMap, ANZ

futures contract is based on Robusta prices from various origins. In addition, the International Coffee Organisation (ICO) publishes a daily composite price, which is an average of the prices of the two major exchanges and serves as a benchmark for coffee prices worldwide.

In terms of domestic production, Australia produces only around 1,000 tonnes of coffee per year, which makes up less than one percent of domestic production.

Most of the coffee grown in Australia is produced in Far North Queensland, particularly in the Atherton tablelands region, where the soils and climate are optimal. The majority of coffee grown in Australia is Arabica, although there are also some small scale plantings of Robusta.

Over recent months, global coffee prices have been impacted by a number of factors. On one hand, there has been some downward pressure on prices, as traders worry that tighter global economics times may reduce consumption. While there have been some concerns about a short term tightening of global supply, good rains in Brazil have many in the market feeling that these worries will be temporary, with strong harvests to come. In contrast, heavy rains in Indonesia, the world's third largest Robusta producer, are likely to see that country's coffee production fall by around 20 percent.

That said, the concerns around the emergence of an El Nino weather pattern which have impacted other agricultural forecasts have also raised concerns for global coffee production, particularly around the end of 2023.

All this leads to the big question of just how much the change in global coffee prices are likely to impact the price of your morning coffee, whether you have it with milk from an almond, an oat, or increasingly rarely, a cow. The answer – not much. The price of the coffee beans is a minor component in the overall cost of what is in the cup, balanced against factors such as wages, energy prices, rent and packaging. Certainly, a sustained increase in the price of global coffee will ultimately filter through in costs and contribute to a retail price increase, though this should not be the case with ordinary market fluctuations.

AUSTRALIAN ECONOMIC INSIGHTS

INTEREST RATE INCREASES ALMOST OVER

RBA nearing the end of its rate hiking cycle

Headline CPI fell from 7.8% y/y to 7.0% y/y in Q1 and quarterly inflation has now passed its peak. Trimmed mean inflation came in lower than expected, at 1.2% q/q. But services inflation and non-tradables inflation (growth in prices that are not globally determined) signal that there is still excess demand in the economy. This means that the types of inflation show households have more demand than businesses can keep up with, and means inflation may not come down to the 2-3% band particularly quickly. The RBA forecasts that inflation will be above 3% until the first half of 2025.

The RBA hiked the cash rate by 25bp in May, citing persistent inflation in services, "brisk" growth in unit labour costs and subdued productivity growth. We expect just one more 25bp rate rise in August to bring the cash rate to a peak of 4.10%.

Federal budget won't help or hurt inflation much

Stronger economic growth and government revenue pushed the budget into a $4.2bn surplus this financial year (2022-23), versus the October 2022 budget estimate of a $36.9bn deficit. This better starting point, combined with policy decisions that further increased revenues, improves the budget position over 2023-24 and beyond and offsets policy decisions that provide a net increase in the deficit of $20.6bn over the budget year and forward estimates. This means less net debt and interest payments over the medium term, compared with what was estimated in October.

While the budget included some cost-of-living relief, this was targeted to Australia's most vulnerable people and won't hit the "average" household. This, combined with the modest level of additional spending announced in the budget, means the budget won't have a big impact on inflation.

Biosecurity funding in the federal budget

The major budget measure related to the agriculture industry was $1.03bn of additional funding to strengthen Australia's biosecurity system. There was also approximately $300m committed to investing in practices to increase climate resilience, as well as around $41m for early detection and surveillance for biosecurity threats along Australia's northern coastline.

Labour shortage continues

Employment levels have returned to the pre-pandemic trend despite lower population growth in recent years. ANZ-Indeed Job Ads are 52.5% higher than pre-pandemic levels and the unemployment rate was steady at 3.5% in March, a 50 year low.

The unemployment rate has been even lower outside of capital cities, and job vacancies in the regions have grown more than in capital cities since 2020. The unemployment rate in regional areas averaged 3.4% in Q1, below the capital city average of 3.7%.

Wage growth in Q1 was 0.8% q/q, which added to a ten-year high for annual growth but didn't actually accelerate compared to Q4. However, of those who received a pay-rise, 35% received 4% or more, the highest share in over a decade.

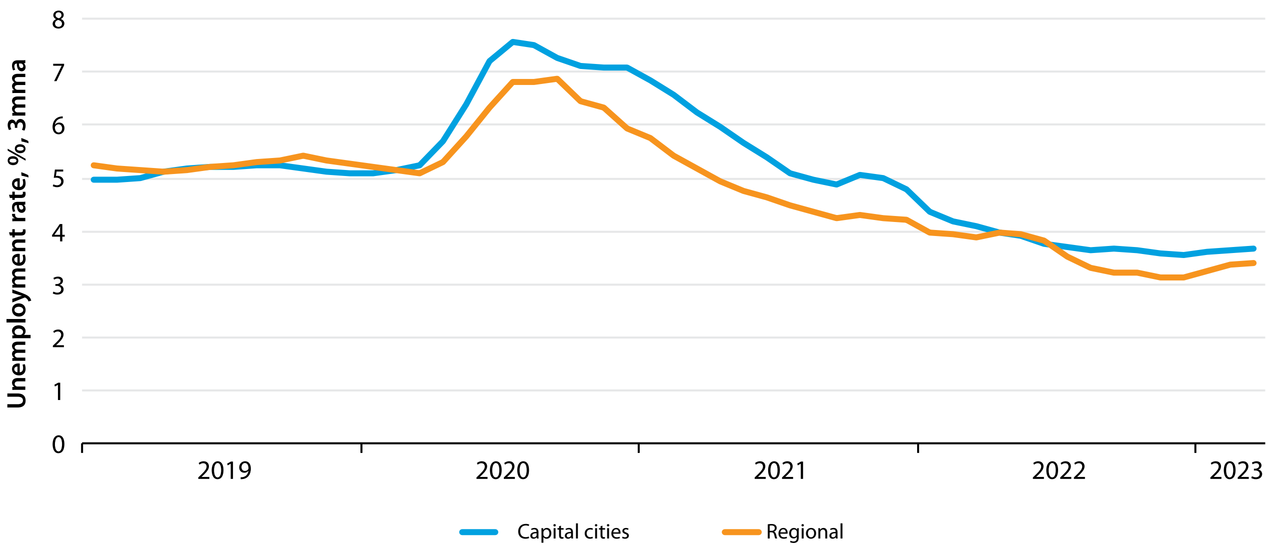
Households pull back on discretionary goods spending

As a result of very strong inflation, as well as the impacts of higher interest rates, households are pulling back on spending. Retail volumes fell 0.6% q/q in Q1 2023, mostly due to non-food retail categories like household goods. Dining/ takeaway, the only service within the retail sector, increased 12.6% y/y in inflation-adjusted terms in Q1, while total retail increased by 0.3% y/y. ANZ-observed spending to early May shows households are cutting back more broadly – including on discretionary services like dining and entertainment - in Q2.

Upside risk to modest growth forecast in China

China's Q1 GDP rose 4.5% y/y, supported by strong PMI and trade data. Our 5.4% forecast for 2023 GDP faces upside risks. GDP may approach 5% in the second half of the year if the recent positive trend in the property sector continues. The sector could contribute 0.3-0.5ppt to China's GDP growth in 2023 and also contributes to commodities demand, which increases Australian exports.

UNEMPLOYMENT RATE: CAPITAL CITIES VS REGIONS



Source: ABS, Macrobond, ANZ Research

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