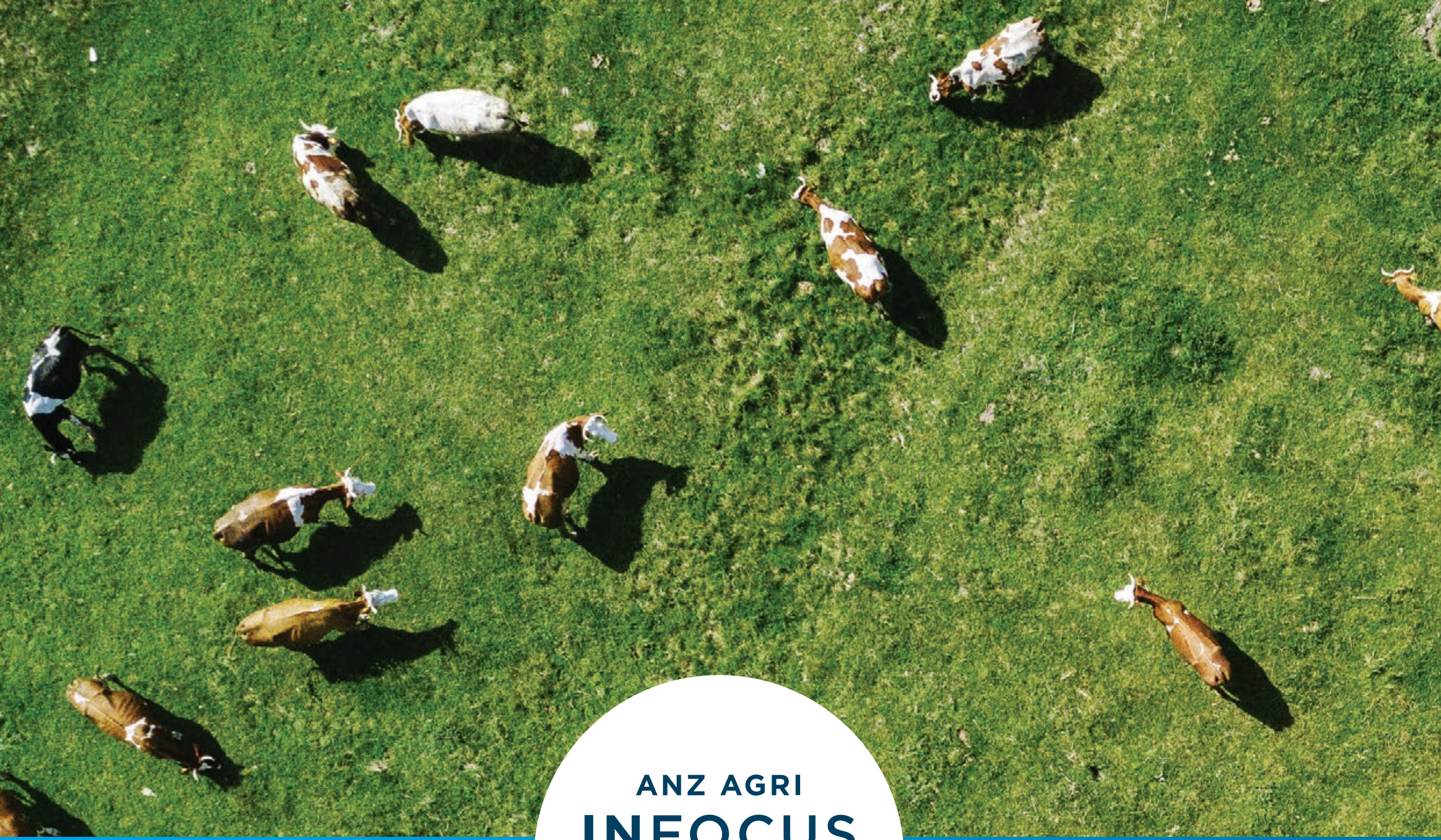

ANZ AGRI
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JULY
2020

COMMODITY INSIGHTS

FOREWORD

As economies around the world emerge from the 'induced coma' of COVID-19 lockdowns, and the full impact of the pandemic on global economic growth becomes clear, the Australian and global agriculture industries are moving into a new phase.

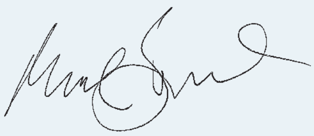
Low global growth and trade tensions, rather than interrupted supply chains and lockdown provisions, will likely guide consumer demand and future prices.

The latest outlook from the World Bank suggests a contraction of over 5 per cent in the global economy. While the outlook for many industries is gloomy, agriculture is a brighter light on the horizon with global agricultural commodity prices remaining relatively stable in the face of the pandemic. In Australia, the outlook is relatively upbeat with a strong season and low livestock numbers among many reasons for producers to feel optimistic. However, this is tempered by global risks on the horizon including simmering trade tensions with China. While the Australian agriculture industry is understandably nervous that the Chinese Government will extend trade restrictions from the Australian barley and beef industries to other major Australian exports, to date, the Chinese export market has held up strongly.

A strong start to the cropping season has most producers looking forward to good returns, however, wheat prices are facing some downward pressure from strong global production and stocks, although this is tempered by concerns over the United States (US) and the European Union (EU) seasonal conditions. For beef and sheep producers, livestock prices are being supported by low herd and flock numbers and the drive to rebuild national stock numbers after the drought. While Australian cattle and sheep prices remain strong, internationally cattle and sheep prices have fallen in response to COVID-19. Similarly, the Australian dairy industry, while experiencing lower opening prices than last year, is being insulated from global trends as processors compete for limited supply. Wool and cotton producers are facing into the headwinds of falling global economic growth, as demand for both wool and cotton clothing is strongly correlated with economic growth levels and consumer confidence.

While strong domestic prices and production should signal a good financial season for producers, risks on the global horizon raise a series of difficult questions for many producers. How much and for how long should beef and sheep producers invest in restocking while global prices are looking subdued? What should wool producers consider the new 'norm' for the Eastern Market Indicator? Will government efforts to support dairy prices in the US and EU lead to longer-term downward pressure on prices? And what of the AUD? At low levels it has provided valuable insulation, but at closer to 70c than 60c, we are more exposed to global characteristics.

Across all these questions, and more, many producers are cautiously optimistic as COVID-19 washes through the global economy.



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Commercial Bank

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WHEAT & GRAIN INSIGHTS

OVERVIEW

+ Australian grain has continued to attract strong global demand, based on reliability of supply and a favourable AUD
+ Recent rains typically herald a good season and could well signify a big increase in domestic grain production
+ As oil prices lift, more corn will go back into ethanol, increasing the demand for Australian grains for feed exports

– Undoubtedly, the imposition of tariffs by China on Australian barley is being watched cautiously by exporters of other grains and oilseeds
– The Black Sea Region remains an improving competitor and, despite some trade restrictions, will continue to pursue Australia's major markets aggressively
– While there is some current nervousness over US and EU weather, strong crop production globally could lead to higher stocks and downward price pressure

It's certainly not often that Australian grains would dominate the headlines in this country, particularly barley. However, recent trade events have reiterated how important grains are as a major export, as well as a strategic geopolitical commodity. Yet while governmental interaction over exports such as barley, canola and wheat have continued to play out, in the background, overall prices have started to look more positive than they have for some months.

When the impacts of COVID-19 first started to be felt in global soft commodity markets, some market observers were intrigued that most grain and oilseed prices actually fell, at a time when a global crisis would normally have been expected to see them rise. Early on, it seemed that the market had learnt from the past and was now experienced enough to realise that stocks of most major grains and oilseeds were relatively high, and that the production outlook for most major exporting countries was good, meaning little potential for tight supply. Even more promising was the relative lack of reaction from markets when Russia announced grain export restrictions, indicating again that the market players understood that this was largely a token gesture.

As COVID-19 began increasingly to impact the countries of Europe, global grain prices largely headed upwards; as the market decided that this may be the region with potential for panic buying, global wheat prices gradually trended downwards from late March. As of early June, however, momentum shifted, and upward price pressure began to be driven by two main factors.

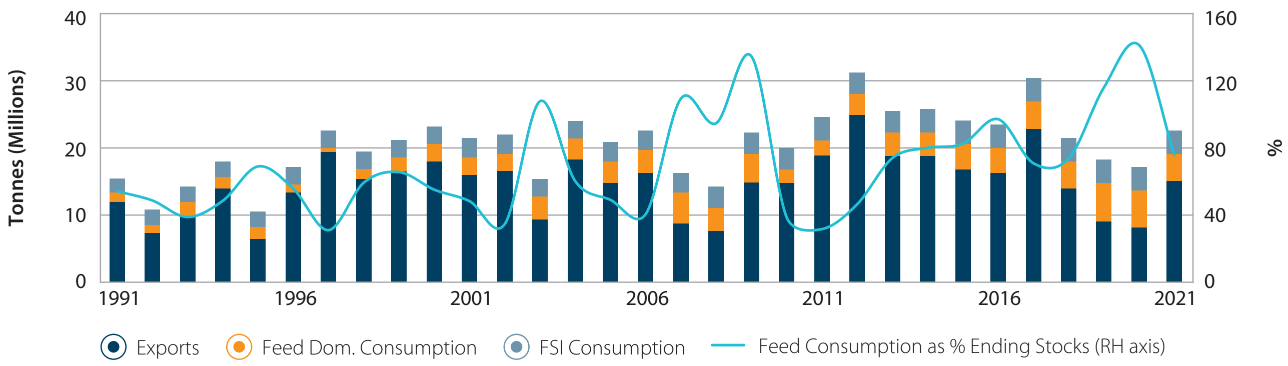
Firstly, the flattening or fall in the COVID-19 trend in many countries, combined with the easing of lockdown restrictions, is building confidence in many countries where demand conditions are likely to improve. This would be felt across foodstuffs, oils and demand for feed. In addition, the forecast recovery in oil prices would again see reasonable volumes of corn diverted to ethanol, leading to price strengthening across corn and alternative grains.

The second factor boosting the outlook for global grain is the poor weather outlook in some parts of the US, where cold weather not only delayed plantings, but has led to forecasts for reduced yields. Similarly in Europe, while the poor weather outlook has improved, wheat production for 2020/21 is still forecast to be down almost 10 per cent on the previous year, to 140 million tonnes.

For Australian producers, upward pressure on wheat prices would be especially welcomed in light of forecasts for strong domestic wheat production growth in 2020/21. According to the latest US Department of Agriculture (USDA) forecasts, wheat production is currently forecast to hit 23 million tonnes, up a full 50 per cent on last year's drought-impacted crop. Similarly, USDA predicts Australian wheat exports for 2020/21 will climb by almost 80 per cent to 14.5 million tonnes.

In terms of wheat demand, it is interesting to look at the long-term trends for wheat usage, to discuss where the Australian sector should focus in terms of markets and products.

AUSTRALIAN WHEAT DOMESTIC CONSUMPTION & EXPORTS



Note: Year 2021 refers to marketing year 2020/21 (Oct–Sep) 2. FSI (Food, Seed and Industrial)
Source: USDA PSD

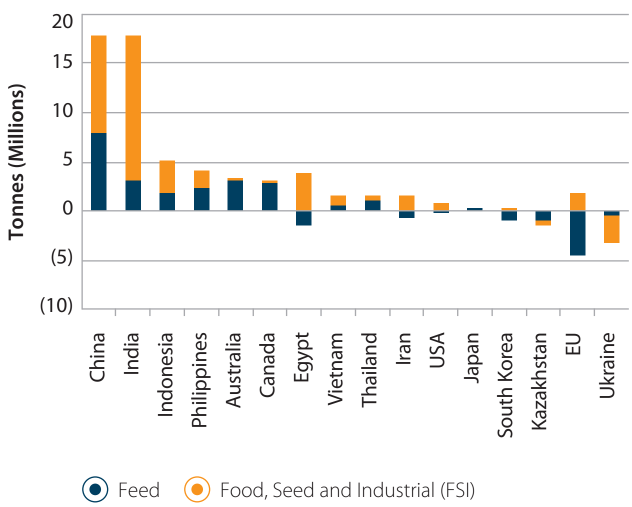
Over the decade since 2009/10, world wheat consumption has been largely driven by an increase in food, seed and industrial (FSI) usage of around 74 million tonnes, which is more than three times faster than feed usage, which has grown by 20 million tonnes. The slow increase in feed use can be largely explained by wheat's relatively low cost efficiency as a feed grain, compared to either corn or to soybean meal. In terms of the FSI growth, the bulk of this continues to be attributable to growing middle class incomes in Asia, seeing a move to wheat-based food products, away from the traditional rice.

Unsurprisingly, the strongest growth in wheat food usage has been driven by China and India. Interestingly, Australia has seen some of the world's strongest growth in feed usage, driven by drought conditions diverting cattle to feedlots, as well as by the growth in beef export markets.

Among Australia's key grain export markets, the Philippines continues to see a greater increase in feed use of wheat, compared to Indonesia and Vietnam, where FSI consumption increased.

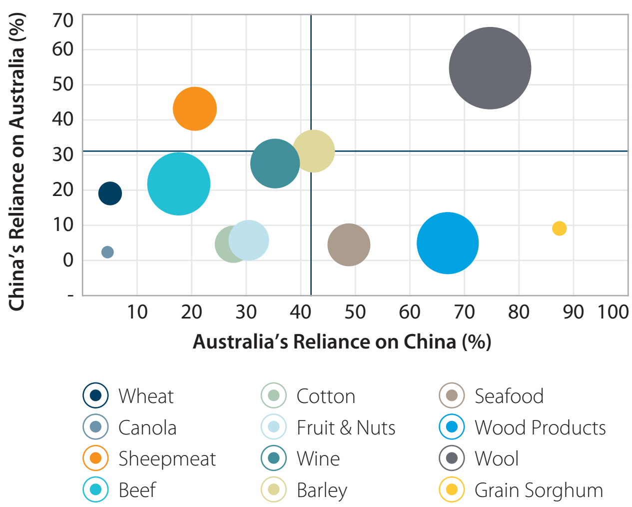
Finally, the implications of the recent imposition of new tariffs by China on Australian barley will continue to unfold. Arguably, the reaction from many barley growers was measured, factoring in the likelihood of a reduction in forecast prices, but in the knowledge that global import demand by the time of harvest was likely to give time for new markets to be found, should the situation remain unchanged, and price falls likely to be measured. The longer-term impact will be more felt next year, when planting intentions will take account of the situation that time, and may possibly see a strong reduction in next season's domestic barley output.

WHEAT CONSUMPTION 2019/20 VS 2009/10



Source: USDA PSD

AUSTRALIA–CHINA BILATERAL TRADE RELIANCE



Note: Bubble size represents average bilateral trade value for 2017–19
Source: UNComtrade, Trademap, ANZ

BEEF INSIGHTS

OVERVIEW

+ Improved seasonal conditions continue to underpin strong steer prices and support a long awaited restocking opportunity for breeding enterprises
+ Beef exports have rebounded after initial demand shock, and reduced production capacity in the US has aided Australian exports into key exports markets
+ The move to online sale platforms has allowed buyers to continue to access markets, reducing any negative impact on prices

– Uncertainty remains over US and South American production and processing returning to full capacity. A strong return would impact global supplies and be influential for Australian beef prices
– Feedlotters are facing tightened margins as restockers compete for supply, and encounter reduced demand from high-value grainfed markets inhibited by social restrictions
– High domestic steer prices may put pressure on producers future profit margins

The Australian beef industry has shown its adaptability over recent months, ensuring buyers are still able to access markets and allowing the supply chain to operate largely uninterrupted by the COVID-19 pandemic.

Due to social distancing, throughout the lockdown periods of the pandemic, Meat and Livestock Australia (MLA) have established an interim market indicator, the 'CV19 indicator' – a weighted seven-day rolling average of prices to replace EYCI and WCI. These CV19 indicators dropped an average 40c/kg lwt through April after reaching record levels in mid-March. However, strong domestic buyer competition has resulted in another upward trend since late April. The return of reporting on the EYCI in June, saw it climb to over 760c/kg in mid-June – some 60 per cent higher than the same time in 2019.

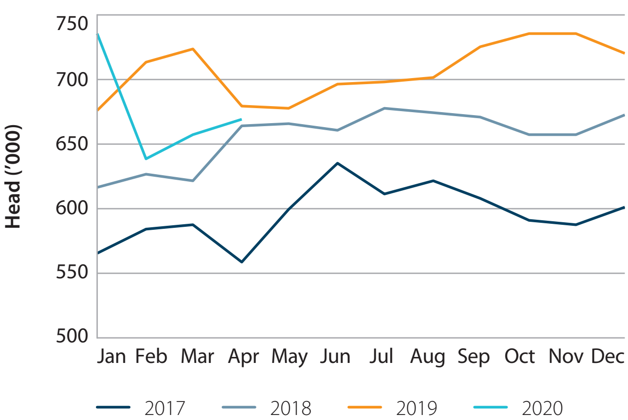
Prices for liveweight vealer steers recovered quickly with demand from restockers and backgrounders backed by favourable seasonal conditions. At 420c/kg lwt at end of May, some 100c higher than in mid-April, equating to $1,150 for a 280kg steer, producers may question when it becomes uneconomical to carry the risk of restocking with these lighter cattle.

Feeder steer prices experienced a flatter recovery as demand contracted from foodservice outlets and other traditional high value grainfed markets. Heavy steers, however, may have been hotly contested by processors to meet domestic and also export demand, partially to fill the gap left by countries impacted from plant closures and supply interruptions.

Live exports to Indonesia for the calendar year to April were back 22 per cent compared to 2019 as COVID-19 slowed abattoir activity. On the contrary, live exports to Vietnam were up 55 per cent for the same period, driven by African Swine Fever (ASF) diminishing local meat supplies.

Breeding stocks are following similar upward price trends to young cattle, as seasonal conditions present an opportunity to restock for the first time in over two years, or longer for some producers.

CATTLE SLAUGHTER BY YEAR



Source: ABS

Evidently, cattle slaughter figures are down 8 per cent April year-to-date in comparison to same period in 2019 as favourable seasonal conditions have encouraged producers to hold back the limited stock on hand.

An interesting dynamic that arose from the COVID-19 pandemic was a movement to online beef sales as lockdown measures restricted the foodservice trade. The hoarding behaviours of March 2020 resulted in higher sales of lower-value beef cuts, underpinning butchers' sales growth of 39 per cent over a three-month period.

The growth in domestic demand for certain beef cuts, particularly lower value beef, has challenged processors' ability to maintain pre-pandemic margins. If this continues the premium previously gained from high value beef cuts may impact processor purchasing activity, particularly in the high value grainfed sector.

In the grainfed sector, the number of cattle on feed fell by 12 per cent for the March quarter. Feedlotters are facing tightened margins with increasing price pressure from restockers and reduced demand for high-value cuts.

Over the hook cattle prices tracked upwards in April/May with QLD/NSW leading the lift. However the highest prices have been seen in VIC, where overall prices were 50c/kg cwt higher than the same time last year.

Globally, despite strict lockdown restrictions, there remains strong demand for quality protein and international markets are seeking Australian beef to fill gaps left particularly constrained by diminished US supply.

The value of Australian beef exports increased 22 per cent year-on-year for the first quarter of 2020, triggered by favourable exchange rates and rising domestic beef prices as the quantity of beef exported experienced a slight decrease on year ago levels.

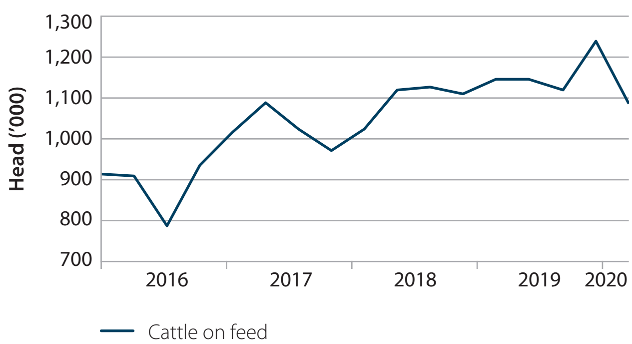
For the US, which remains both an export destination and export competitor for Australian beef, a reduction in supply and unforeseen deviations to prices has played out over recent months.

Plant closures and a prioritising of domestic customers caused US wholesale prices to double, making it more profitable to place higher value cuts in the local grinding meat market than export markets. US beef production for the month of April was down 21 per cent on April 2019 figures, and shipments to Asian markets declined significantly, with a forecast decline of around 15 per cent for the second quarter of 2020.

Looking forward, a market to watch is South Korea, currently Australia's fourth-largest red-meat market, where increased demand for higher value beef cuts has been evident throughout the pandemic period. Chilled beef exports destined for retail and online sales increased 15 per cent year on year ending April.

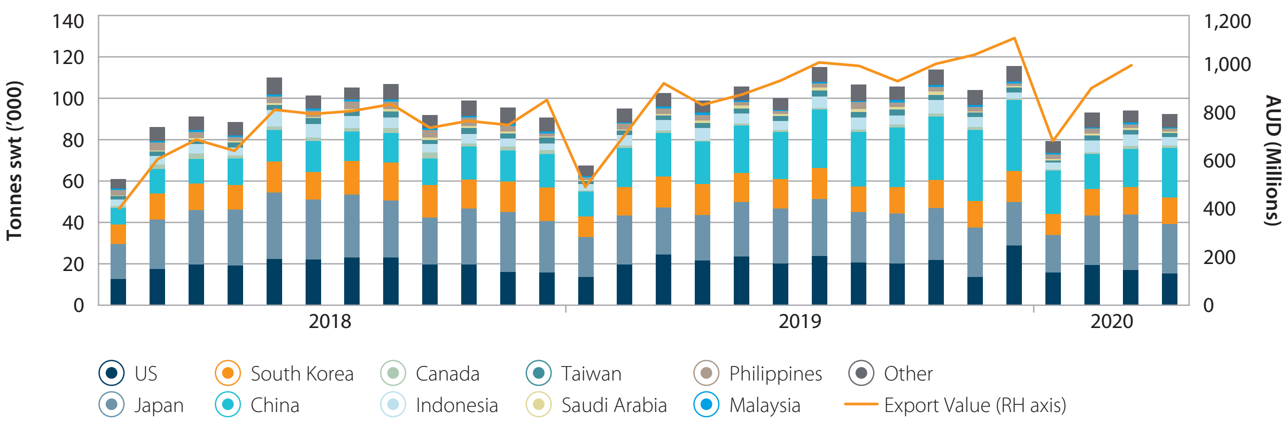
Another dynamic to throw into the mix is South American beef production, also impacted by plant closures and economic downturn. Brazil has experienced a 21 per cent drop in the local currency resulting in very competitive beef prices in the global market. Exports from Argentina to China dropped 15 per cent in March 2020 from last year's record levels as strict lockdowns have slowed beef production, impacting the availability of beef for export and also skewing retail demand which may result in high volumes of frozen beef being available later in the year.

CATTLE ON FEED



Source: ALFA/MLA feedlot survey

AUSTRALIAN BEEF EXPORTS



Source: MLA

SHEEP INSIGHTS

OVERVIEW

+ Sheep and lamb prices are holding firm on the back of strong restocker demand and low supply
+ Exports to China continue to grow strongly despite trade tensions
+ Restocker demand is likely to dominate prices in the short to medium term, despite concerns over recession and global economic growth

– Yardings and slaughter rates have dropped significantly, resulting in a drop in national sheepmeat supply
– Australian lamb prices are now higher than our export competition after New Zealand, UK and US prices all fell as a result of COVID-19
– Exports to the Middle East and United States have declined on the back of low oil prices, poor economic growth and the COVID-19 pandemic

The Australian sheepmeat industry continues to hold firm in the midst of the COVID-19, as demand from restockers continues to support prices, combined with low supply as producers seek to either retain flocks on-farm or further fatten following strong rain fall. While concerns exist over the impact of trade tensions between China and Australia, to date, this has not been reflected in lamb or mutton exports to China. However record low oil prices have led to reduced demand from the Middle East while competition from New Zealand lamb has seen some erosion of market share.

Lamb and sheep yardings have plummeted in May across the nation, with lamb yardings for the month sitting almost 52 per cent below the previous three-year average. Similarly, sheep yardings in May were 58 per cent below the three-year average. While all states have suffered a drop in yardings year-on-year in May, the reduction in sheep yardings was most pronounced in Victoria and New South Wales. Lamb yardings, however, have only fallen 5 per cent in Tasmania and 33 per cent in Victoria.

Similarly, slaughter numbers have dropped significantly, with April 2020 data showing a 0.2 per cent decrease in sheep slaughter on March 2020, but a 32.1 per cent decrease in sheep slaughter on April 2019. Lamb slaughter figures show a 5.7 per cent decrease from March 2019 and a 5.8 per cent decrease since April 2019. This reflects a broader industry trend towards retaining older ewes while maintaining lamb turnoff to take advantage of strong lamb prices. Whilst in the short term, this should support production, it does raise longer-term impacts from an ageing flock.

The most recent MLA sheep projections underline the fact that low sheep supply will be a key aspect of the Australian industry for years to come as producers seek to rebuild the national flock. As a result, and with the national flock at its lowest level in over a century, sheep slaughter is forecast to decline by 30 per cent to 6.5 million head in 2020 while lamb slaughter is anticipated to decline to 20.6 million head, back 5 per cent on 2019 levels.

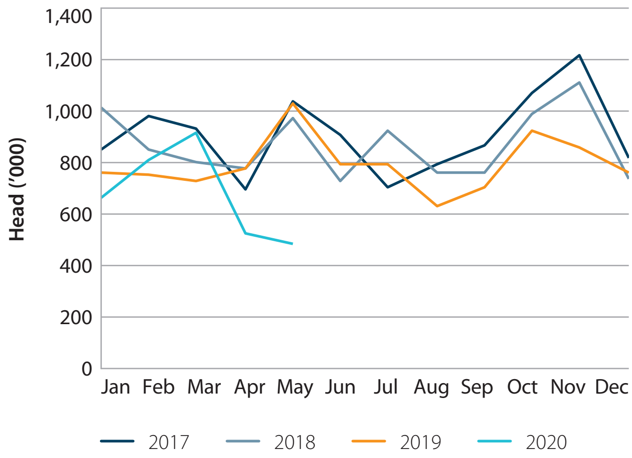
This large drop in yardings and available stock has led to strong support for prices. Whilst MLA suspended reporting of the National Trade Lamb Indicator and their saleyard series during the COVID-19 pandemic (which resumed in early June), their alternative series has seen restocker, processor and mutton values hold up strongly in the period since March – despite some added volatility in the market due to relatively low supply. All three categories of sheep suffered from a sharp drop in prices in mid-March but now all three categories sit higher than the same time last year. The strongest interest has been in restocker lambs which currently sit over 20 per cent higher across the nation than this time last year. While processor lambs have not quite recovered to levels seen in February, they are currently showing strong gains on the back of increasing quality and tight supply.

In a similar story to the Australian beef industry, a disconnect has emerged between global and local sheep prices as a result of restocker demand in Australian supporting prices in comparison to our major export competitors, which have suffered a drop in prices.

Strong supply, high processing costs and uncertainty around COVID-19 have led to a drop in prices in New Zealand which hasn't been mirrored in Australia. While the Australian sheep flock is the largest in the world outside of China, and dominates much of the global trade in sheepmeat, it does not mean that Australian sheepmeat doesn't face strong competition – particularly from New Zealand where the national flock is focused on meat. Despite this disconnect with global prices, low flock numbers are likely to be the biggest driving factor for the Australian industry.

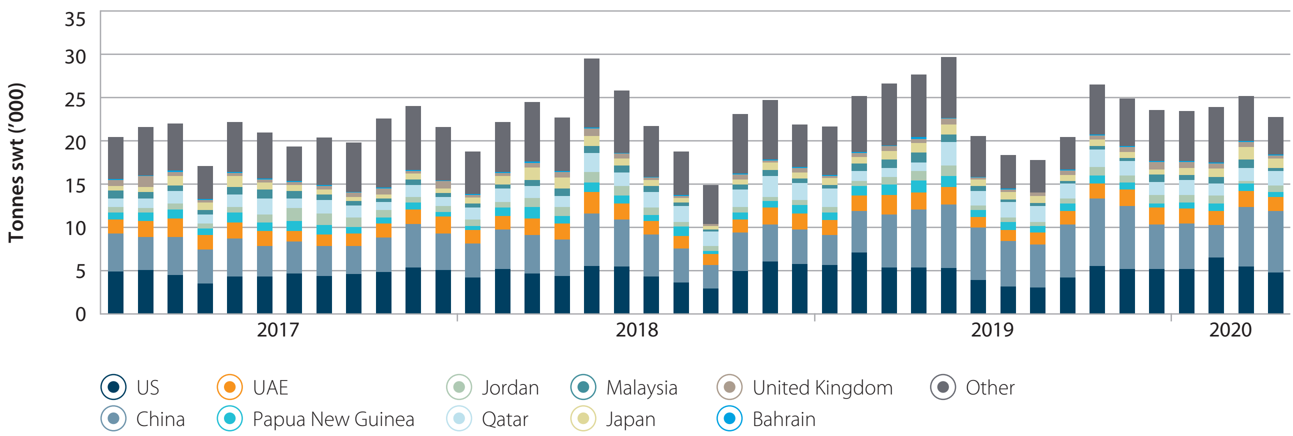
Trade tensions with China have led to concerns that the Australian sheepmeat industry will suffer similar pushback from the Chinese government. However, to date, Chinese imports of Australian lamb have increased 6 per cent year-on-year in April. COVID-19 is impacting lamb exports overall, which have fallen 18 per cent year-on-year in April, due to reduced consumer demand . Exports to the Middle East are also suffering from a reduction in the oil price which has impacted local consumer demand, as well as tightening lockdown rules.

LAMB YARDINGS



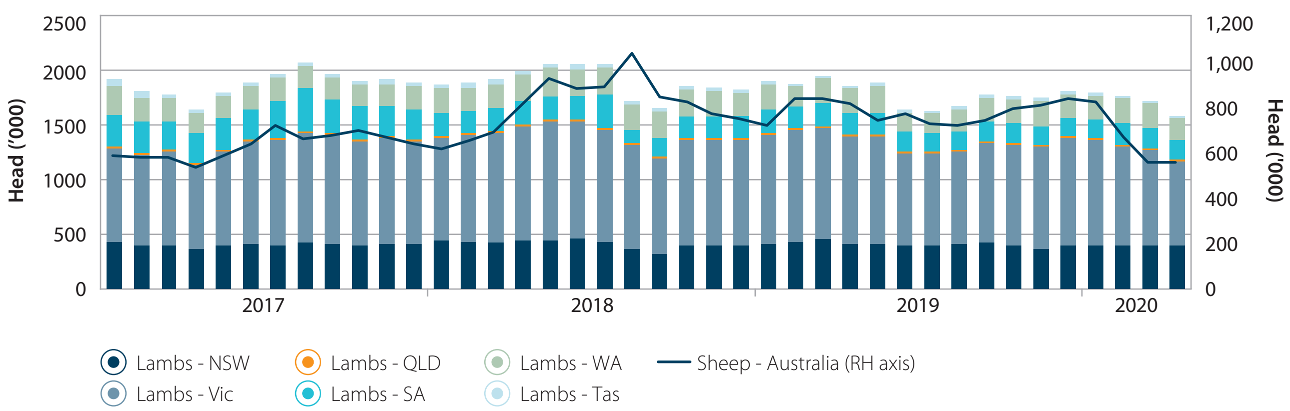
Source: MLA

LAMB EXPORTS BY DESTINATION



Source: MLA

SLAUGHTER



Source: ABS

WOOL INSIGHTS

OVERVIEW

+ After the drought, the forecast good season should mean better growing conditions for producers
+ The fall in wool prices from last year may persuade some manufacturers to come back into the market
+ With many sheep producers turning more toward meat options, tighter wool supplies may lift prices

– The longer the economic slowdown lasts, the more concerning consumer demand for wool will be
– With many producers having held wool back from sale, no strong rise in prices will become a worry
– Exporters will be nervously watching current trade dynamics, hoping that wool remains unaffected

At first glance, the Australian wool industry could be seen as being in a somewhat concerning predicament. Wool prices are well down on last year, and the ongoing strength of the sheepmeat industry is seeing sheep producers increasingly switching away from wool production. At a trade and economic level, the impact of COVID-19 on the demand for wool both domestically and globally continues to be of concern. Despite all this, many in the industry are seeing positive signs gradually emerging over the rest of 2020.

After sliding for a number of months, domestic wool prices have recently begun to see a mild recovery. As of the start of June, the Eastern Market Indicator (EMI) had risen marginally to 1,183 Ac/kg, seeing prices rise for two weeks in a row for the first time in a while. This was coming off a low base, with the EMI having fallen to 1,155 Ac/kg during May, the lowest level since 2015.

In a further sign of some strengthening in the wool market, the price rise in US Dollar (USD) terms was actually stronger than the local increase, due to a recent strengthening of the Australian dollar (AUD).

From a longer-term perspective, the recent rise was still well down from the 1,887 Ac/kg reached at the same time last year, as well as around 9 per cent below the 10-year EMI average of 1,298 Ac/kg.

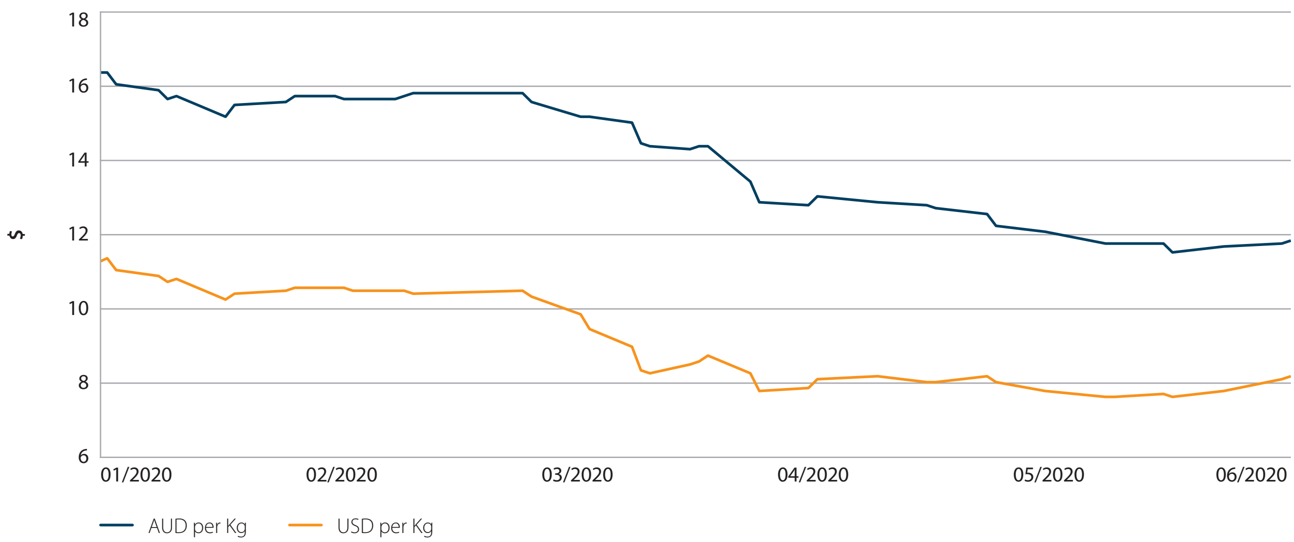
In terms of demand, the mid-term outlook for wool is justifiably concerning. The recessionary outlook in many countries is likely to see consumers turning away from discretionary products, which could include woollen clothing, in favour of cheaper fibres.

The brighter outlook, however, comes from current and forecast supply, which is often noted by industry observers to be a greater driver of price than demand. The start of June saw the lowest national offering, 15,735 bales, since the Australian Wool Exchange (AWEX) records began in 1995, although admittedly this low figure was partly due wool sales only taking place in Sydney and Melbourne.

More broadly, it seems apparent that the low EMI is convincing many producers to hold their wool from sale, either in storage or on farm. For some producers, the incentive could also be due to waiting for the next tax year. If this trend continues, supply may remain constrained for some time, and while new season wool later in the year would reduce this tightness, the ongoing shift to a greater proportion of meat sheep may see this fall lower than previous years.

In addition, a further incentive for upward price pressure may come about as an indirect result of this year's weather. As a result of last year's drought, supplies of superfine wool increased. In contrast, the relatively good season in many regions may see larger volumes of lower micron wool, further pushing up prices of the higher microns, and raising the EMI.

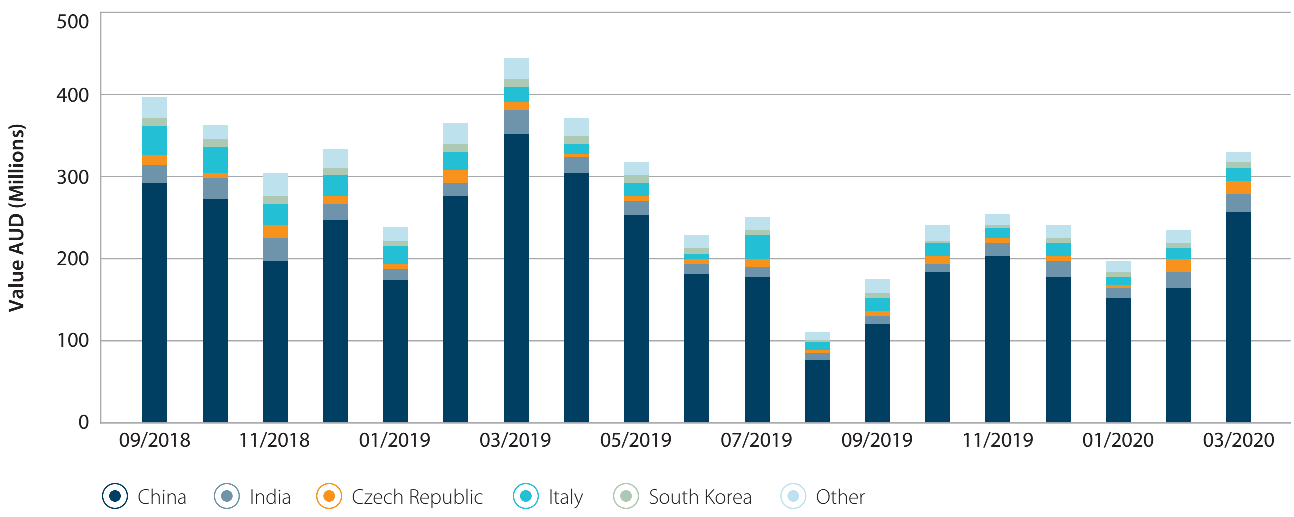
AUSTRALIAN WOOL SPOT PRICES EASTERN REGION (AWOLRIE INDEX)



Note: Latest data available up to June 3, 2020
Source: Bloomberg

DESPITE FALLS IN THE EASTERN MARKET INDICATOR LEADING SOME PRODUCERS TO HOLD BACK WOOL FROM AUCTION, LOWER PRICES ARE PROVIDING INCENTIVE FOR SOME PROCESSORS TO RE-ENTER THE MARKET

AUSTRALIA MONTHLY EXPORTS



Note 1: Latest data available up to March 2020
Note 2: HS Codes - 510111/19/21/29/30, 510310/20/30, 510400, 510510/21/29, 510610/20, 510710/20, 510910/90
Source: Trademap, Capital IQ

COTTON INSIGHTS

OVERVIEW

+ Australian cotton harvested area for 2020/21 is tipped to more than double from last season, as rainfall replenishes soil moisture profiles and on farm storages
+ Forecast recovery in world economies post COVID-19 should equate to increased demand for cotton apparel and textiles
+ Australian cotton proven to be significantly more efficient and sustainable than in years gone by

– Global supplies of cotton are ample, with record stocks outside of China forecast this season
– Powerhouse producers and exporters, the US and Brazil, will enter the 2020/21 season with both high stocks and a solid production outlook
– Uncertainty and volatility likely to continue in the market where the influence of stockpile movements and the US–China Trade Relationship remain leading factors

Following the poor production season of 2019/20, Australian cotton producers are looking forward to a better year ahead after significant rainfall was received across most of the country's cotton-producing areas. While planting and production looks set to rebound domestically this year, the flow on impacts of COVID-19 leave a big question mark over world demand for cotton apparel, and therefore, the price for Australian cotton for the 2020/21 season and beyond.

ABARES current forecast remains at a harvested area of around 150,000ha for the upcoming season, up from a record low of around 60,000ha last year. This represents a significant increase, however also remains well below the cotton harvests of previous years, demonstrating the relatively slow pace of recovery out of severe drought conditions.

As Australia commences its journey back to increased production, across the rest of the world cotton trade for 2020/21 is forecast to grow significantly. Brazil, India and the US are set to combine strong domestic crop production with high carryover stocks from previous years. USDA suggests a 7 per cent increase in global exports next season, and an overall 2 per cent increase in global ending stocks, with stocks outside of China forecast to reach a record high of around 65 million bales.

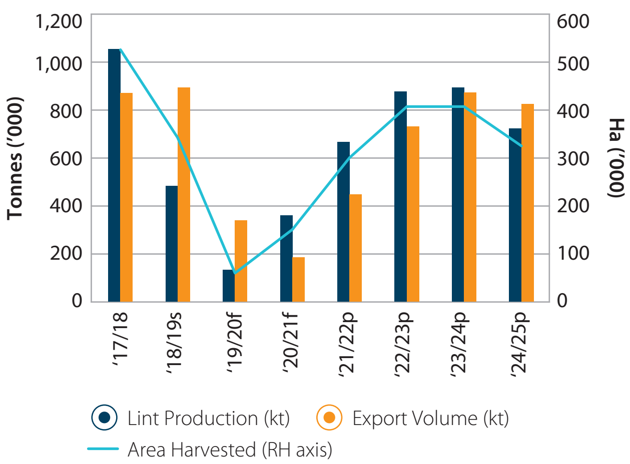
While China will still account for around one third of global stocks, this represents a historically low proportion, with India holding the lion's share of growth. As Australia's major export market, China's stock levels have historically held more relevance to Australian cotton prices, due to Australian cotton's superior quality characteristics compared to the Indian product.

In positive news, an anticipated increase in the global cotton trade over the 2020/21 season is expected to be underpinned by a recovery in demand for cotton apparel and textiles, driven by economic recovery post COVID-19. The level of recovery is difficult to predict, as demand for cotton apparel and home furnishings is highly correlated to gross domestic product (GDP) in each importing country.

With large crops and continued subsidised production costs, the US and Brazil are likely to capture most of the benefit of any increase in global demand for cotton. Australian exporters will need to continue relationships built on quality and consistency of product to maintain market share with the relatively small quantity of Australian cotton likely to be available compared to major competing nations.

Domestically, favourable USD exchange rates and water availability may see producers looking to forward offers of around $535/bale currently on offer for the 2021 crop to secure a level of profitability for the upcoming season. While price forecasts remain below the solid prices of over $600 a bale seen in recent years, they remain at a profitable level in what is an increasingly efficient production system.

AUSTRALIAN COTTON AREA, PRODUCTION & EXPORTS



f = forecast, p = projection
Source: ABARES

DAIRY INSIGHTS

OVERVIEW

+ The global dairy market is has been showing positive signs after the initial hit from COVID-19
+ Domestic opening prices remain relatively solid, despite dropping on last year's prices, and show further room for step-ups as processors balance global risks and need to secure domestic supply

– Government interventions in the EU and US to support dairy producers may prolong the impact of COVID-19 for the global market
– The impact of declining global economic growth will impact both the size and type of demand for dairy goods, as consumers possibly move to lower value dairy products

The global dairy industry has been one of the most profoundly impacted industries throughout the COVID-19 pandemic, as demand for manufactured dairy products in the EU and US crashed during lockdown. For the Australian industry, a lack of domestic supply is still weighing on processors' minds as factory capacity remains unfulfilled; meaning competition for producers and supply remains a key factor in the market. The announcement of Australian opening milk prices, the first such announcement under the new Dairy Code of Conduct, showed processors treading the fine line between attracting producers and accounting for the uncertainty surrounding the impact of COVID-19.

The first of June saw the deadline for the announcement of next season's opening prices under the new Dairy Code of Conduct. All processors' opening bids were around to \$6.40/kgMS mark, although Fonterra's opening price of \$6.06 was quickly revised to \$6.40 when it was made clear they weren't on par with their competition. Saputo and Bega also offered \$6.40 with Bega offering an additional 15c for northern Victorian operators. Burra Foods offered an average of \$6–\$6.40/kgMS while Australian Consolidated Milk offered a \$6.60 average for conventional milk.

Opening prices have dropped on last year's prices and while processors have clearly retained the ability to deliver step ups later in the season, the uncertain global environment and lower global prices have all been cited as the reason for the reduction in offered prices.

Most recently, the Global Dairy Trade auctions from mid June saw the average price rise 1.9 per cent on the previous auction to \$US2,979/MT. This comes on top of the previous auctions which saw just over a 1 per cent increase. Despite this, the GDT index is trading just above the lowest level since early 2019, and prior to this, late 2016.

The implementation of lockdown measures across the world came at a time when the EU and US were coming into spring and production levels were particularly strong – with the EU producing 4.6 per cent more in February 2020 than the previous year, and the US producing 5.4 per cent more in the same period. As a result of the closure of restaurants and food service outlets, the price of cheese and butter, and as a flow-on effect, skim milk powder (SMP). From the GDT auction results, cheddar prices fell over 20 per cent since mid-February. Milk powders have shown the strongest growth in the most recent GDT auction rising 3.1 per cent for SMP and 2.2 per cent for whole milk powder (WMP). Overall, SMP has felt a slight larger fall in price since February than WMP, although SMP is now higher than this time last year, while WMP sits almost \$200/MT below last year's levels.

Price movements in the Oceania region have been less impacted by those in the US and the EU where, even though prices have recovered somewhat from the falls in March, there are many longer-term risks facing the market.

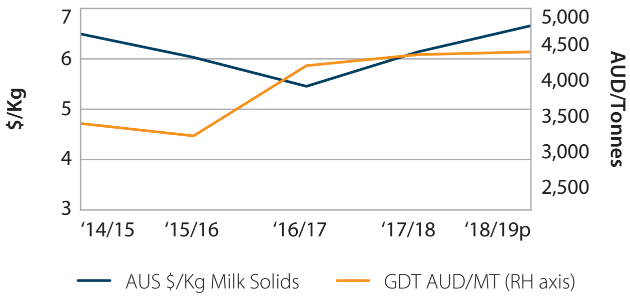
Firstly, in response to the COVID-19 lockdowns, the European Commission has provided funding support for the storage of SMP, butter and cheese to allow for the temporary withdrawal of products from the market for a minimum of two to three months, and a maximum period of five to six months. While this move will help reduce the amount of produce available in the short term, it also adds an element of uncertainty for between two and six months' time when such produce returns to the market – possibly even to export markets. In the US, a range of support measures have been announced including financial assistance administered by the USDA which, while needed in the short term, also has the potential to skew the supply market.

In Australia, the impact has been less pronounced, in part due to the ongoing competition between processors for milk supply. Domestic production across the country is picking up steam on the back of strong rainfall and good conditions, with production in April 2020 up 6.4 per cent on April 2019. However year-to-date, production is still down 1.2 per cent on the previous year. Production remains strongest in Tasmania, followed by Victoria, however, year-to-date is down 13 per cent on 2019 in Queensland.

Across the board, Australian dairy exports have fallen in the past year in tonnage – but increased by 5.8 per cent by value. In quantity terms, exports have fallen in all the major dairy products in the year to March, including butter (-37.5 per cent), SMP (-36.2 per cent), cheese (-24.6 per cent) and WMP (-9.1 per cent). In values terms, butter, cheese and SMP have all fallen, however WMP has risen in the year to March by 3.5 per cent.

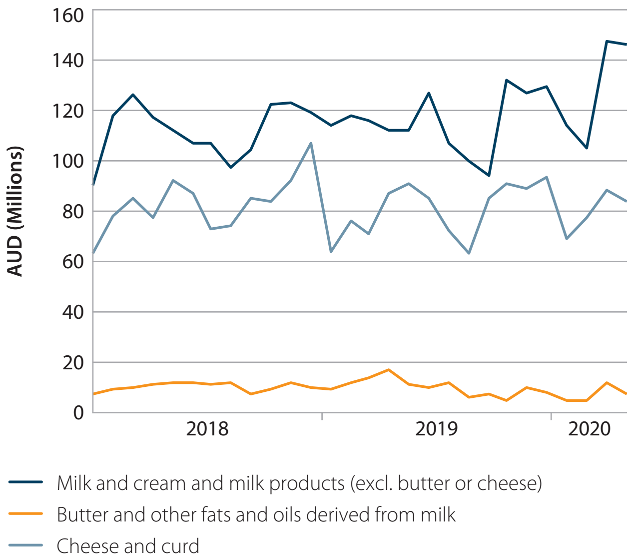
While global prices have rebounded in recent weeks and markets are showing strong signs of recovery, there are a number of risks still on the horizon – which Australian processors have factored into their opening prices. These range from how production will rebound in the EU and US after significant government interventions to the unknown of how consumers will consume and dine once lockdowns are a thing of the past – will they return to old habits, or will some continue to eat in and shy away from restaurants?

AUSTRALIAN FARM GATE PRICES AGAINST GLOBAL DAIRY TRADE



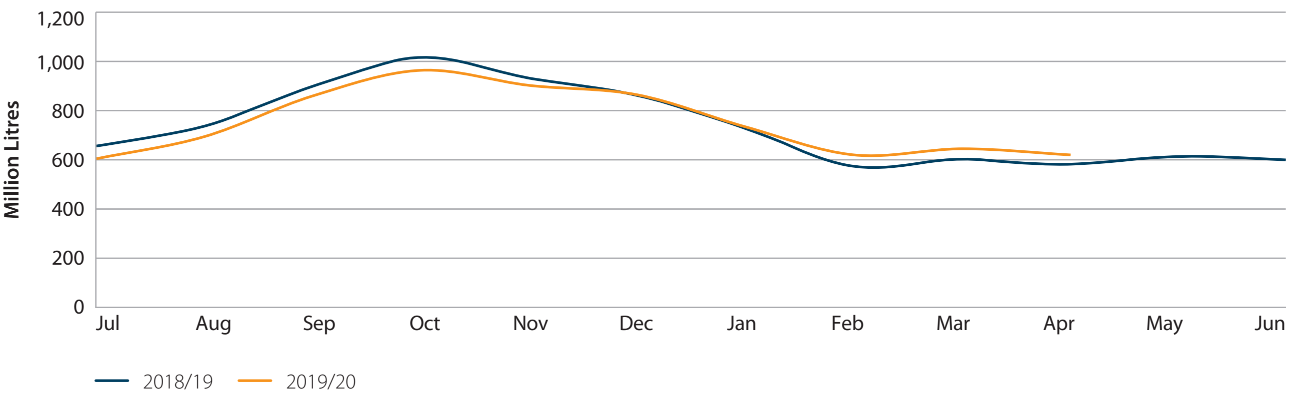
Source: Global Dairy Trade

AUSTRALIAN DAIRY EXPORTS



Source: ABS

AUSTRALIAN MILK PRODUCTION



Source: Dairy Australia

RICE INSIGHTS

OVERVIEW

+ Forecasts for the 2020/21 season are for a significant recovery in domestic rice plantings and production
+ Global rice prices spiked significantly through March–April as key exporting nations imposed rice export quotas
+ March–April global trade disruptions and panic buying led to increased demand for Australian rice

– 2019/20 was one of the most challenging rice seasons on record, with just 4,000 hectares planted and estimated production of around 40,000 tonnes

– The profitability of Australian rice production systems remains heavily reliant on the price and availability of irrigation water, which has been limiting in recent seasons

– Forecast high production in China, the US and Thailand to contribute to very strong global production for 2020/21 and record high ending stocks, which will impact prices

Australian rice production is a relatively small industry on a tonnage basis, producing on average 520,000 tonnes of rice annually over the past 15 years. As a heavily regulated and specialist crop, rice production fluctuates significantly from year to year as growers balance water availability and price along with their agronomic rotational needs and commodity prices in order to determine plantings.

Due its reliance on irrigation, the vast majority of Australian rice is produced from the Murrumbidgee and Murray River valleys of Victoria and NSW. On average, Australia exports around 300,000 tonnes of rice per annum. However, like production, exports also vary greatly from season to season and domestic stocks are carefully managed in an effort to maintain consistency of supply.

Exports are key to profitability through the Australian rice supply chain, with the superior quality and value added characteristics of the Australian product attracting premium pricing in a diverse range of markets. With such a limited production area, and a strong export focus, Australia relies on rice imports to meet domestic demand, importing around 50 per cent of apparent domestic consumption each year over the past 10 years.

The 2019/20 growing season has been particularly challenging for rice producers, with the high costs and low availability of irrigation water resulting in a very small 4,000-hectare planting and an estimated production of around 40,000 tonnes.

FOR PRICE OUTLOOKS, THE RECENT VOLATILITY IN THE MARKET HAS PERHAPS OVERSHADOWED THE OTHERWISE NEUTRAL OR POSSIBLE DOWNWARD PRESSURE AHEAD FOR PRICES OF RECORD GLOBAL STOCKS, FORECAST HIGH PRODUCTION AND COMPETITIVE TRADE CONDITIONS THROUGH 2020/21.

This represents the smallest Australian rice crop since the 2007/08 drought. The low plantings came at an inopportune time, with domestic demand for rice skyrocketing through March and April due to panic-buying behaviours induced by uncertainty surrounding the COVID-19 pandemic. Globally, a similar phenomenon saw rice prices increase dramatically through April in particular, driven largely by some key export markets announcing restrictions on trade in order to protect their own food security, along with logistical trade disruptions at some key ports.

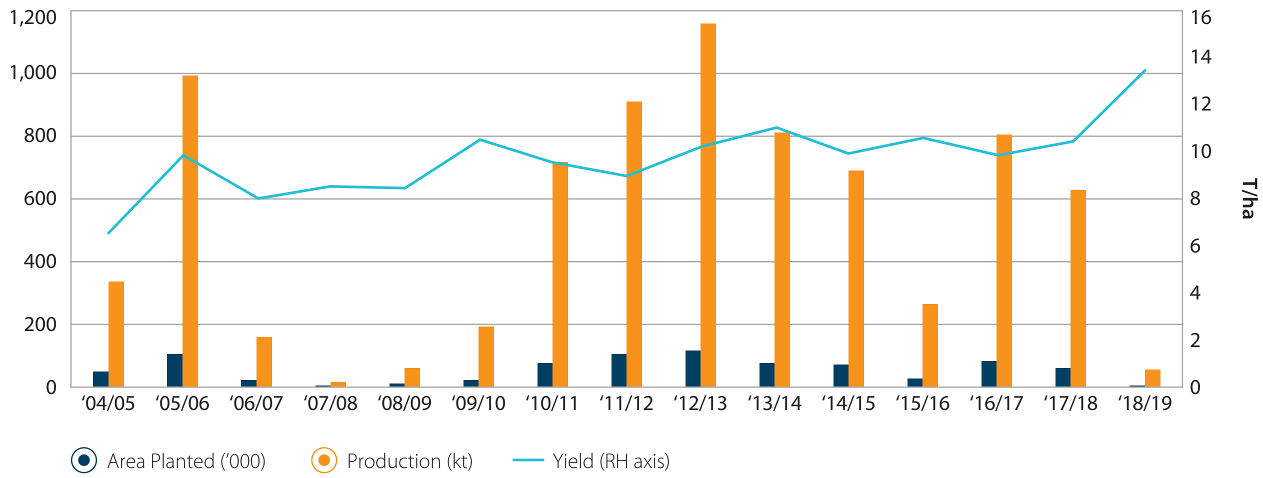
Vietnam, the world's third largest rice exporter, was a major contributor to the global price reaction, due to strict export quotas being imposed during April. Global prices have since started to ease as trade flows re-open and the Vietnam quota was lifted in full during May.

For the season ahead, global rice production is forecast to be up by around 8 million tonnes to produce a total crop of over 500 million tonnes. The increased production is expected to be driven by increased plantings and improved yields through China, Thailand and other parts of south east Asia, and the US. A poor season in the Philippines is forecast to see that nation's import needs rise significantly in 2020/21, to maintain its place as the world's largest importer of rice in front of the EU and China.

Global rice consumption and trade are also forecast to rise for the season ahead, albeit at a slower pace to production, resulting in an anticipated 2 per cent rise in ending stocks and a record high global stock level of over 180 million tonnes. India has increased its stockpile substantially over recent years, however China remains the majority stock holder, maintaining ownership of around 65 per cent of the world's rice.

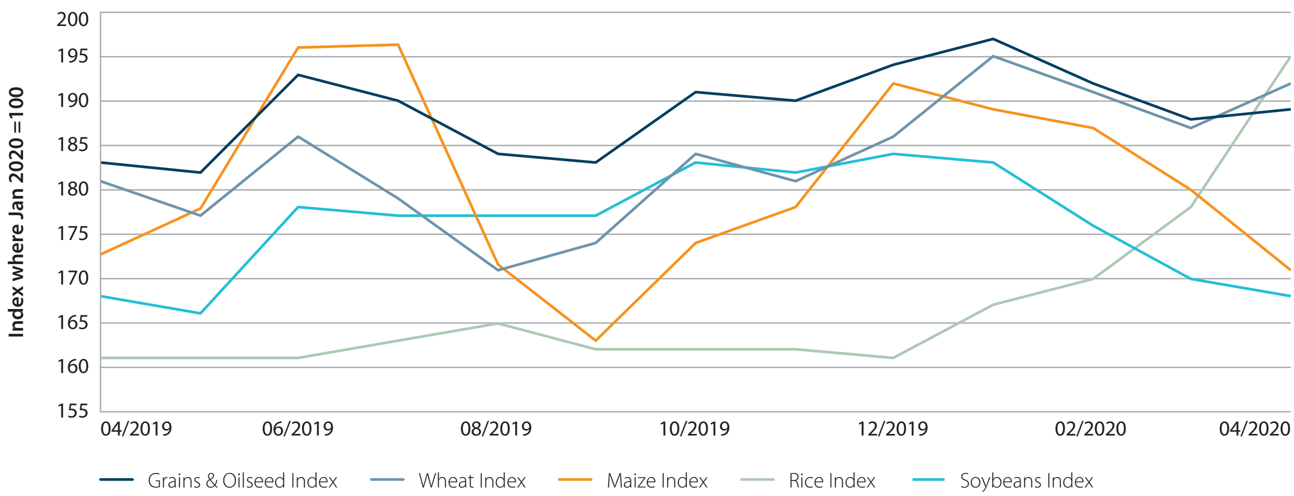
For price outlooks, the recent volatility in the market has perhaps overshadowed the otherwise neutral or possible downward pressure ahead for prices of record global stocks, forecast high production and competitive trade conditions through 2020/21.

AUSTRALIAN RICE PRODUCTION AND YIELD



Source: ABARES

COMPARATIVE MOVEMENTS IN GLOBAL GRAIN PRICES



Source: International Grains Council

MEAT PROCESSING INSIGHTS

OVERVIEW

+ The almost uninterrupted workflow of the Australian meat processing sector throughout the COVID-19 crisis has highlighted the industry's resilient structure
+ Increased domestic demand for meat products for home consumption throughout the COVID-19 period, offsetting wholesale decline, has benefited meat processors
+ A silver lining to some current processing slowdowns of shutdowns may be the opportunity to undertake repairs or upgrades, leading to improved future efficiencies

– Near record high prices for cattle, due to low supply and restocking, have greatly reduced margins on meat processing
– The issue over meat labelling with China has created uncertainty for a number of processors
– Any upsurge in meat output from US and Brazilian processors, as they emerge from COVID-19-related processing slowdowns, could challenge Australian beef exports to domestic markets, impacting local processors

The Australian meat processing sector's position as a world leader in its field has rarely been more evident than in the recent COVID-19-related food panic buying period. While some logistical challenges saw some supermarket shelves short of certain meat products for a brief period, the meat processing sector continued to operate uninterrupted. This ensured that stakeholders, from cattle producers, right through to butchers, supermarkets and beef consumers, were impacted as little as possible. This is in contrast to meat processors in the US and Brazil, where interruptions to operations had major effects across their supply chains that will continue to be felt for some time.

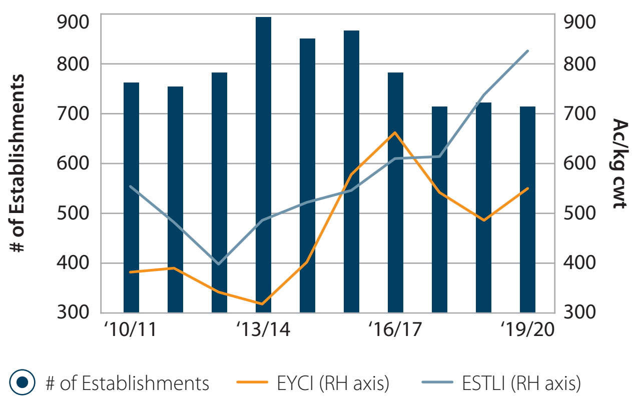
While the impact of COVID-19 alone will cause lasting changes to the domestic meat processing sector, it is just one of several major challenges facing the industry right now, and arguably one of the smallest. Domestically, the industry is staring at the challenges of very high cattle prices and a prolonged herd rebuild, while the challenges of major export markets, particularly China, have been widely documented. At the same time, these same challenges are also providing the sector with some timely opportunities.

Structurally, the Australian meat processing sector forms the backbone of Australia's meat export market, including beef, lamb, mutton and goat, which, in 2019/20, is worth around $13.8b, a huge rise from the 2009/10 meat export market of $5.6b. While the value growth of 146 per cent far outstrips the volume growth over the same period of 29 per cent to 1.6 million tonnes, the growth in capacity utilisation at processing plants has allowed Australian exporters to capture this new demand.

While meat exports have grown strongly, profitability in the meat processing sector has remained an ongoing challenge for many operators.

Structurally, the industry has continued to follow the path of many other industries, seeing a reduction on overall players accompanied by an increase in output. Over the past decade, the number of processing plants has fallen by around 6 per cent, though overall capacity has increased.

CONSOLIDATION OF AUSTRALIAN MEAT PROCESSORS



Note: EYCI – Eastern Young Cattle Indicator; ESTLI – Eastern States Trade Lamb Indicator
Source: IBIS, MLA

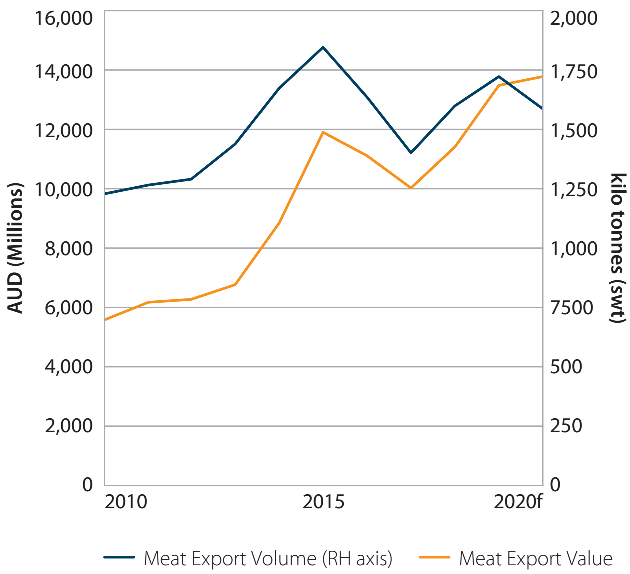
According to a 2017 Australian Competition and Consumer Commission (ACCC) report on the sector, a minimum scale of roughly 400 head of cattle per day was the benchmark to achieving good levels of efficiency.

COVID-19

The ongoing operations of Australia's meat processors during the COVID-19 period were largely the result of quick, collegial and decisive work shared across companies, industry bodies and governments. The decision to designate the sector as an 'essential service', and implementing measures early on for worker safety ensured not only did processing continue, but that integral adjoining logistical steps, such as cross-border transport of cattle and meat, were also exempted and allowed the supply chain to continue operating from the farm to the retail meat shelf. In the contrast, the US meat processing sector saw major shutdowns, caused by factors such as worker safety and industrial relations actions.

The consequences of this saw major build-ups of stock unable to be processed with pig and cattle producers particularly affected, and leading to a subsequent surge in meat supplies, impacting both domestic and export markets. Similar issues and consequences are still being felt within the Brazilian meat processing sector.

AUSTRALIAN MEAT EXPORTS VOLUME VS VALUE



Note: Meat includes Beef & Veal, Lamb, Mutton and Goat Meat
Source: ABARES

DOMESTIC

With a major component of a meat processor's profitability being influenced by the price of live cattle or sheep, the current period is a challenging one. The national cattle herd is being impacted by a series of factors which are likely to see upward pressure on cattle prices for some time to come. After cattle producers across Australia offloaded a huge number of their cattle during the drought, including a record number of females as part of the slaughter, the rebuilding period of the herd cycle will be longer than usual, leading to a period of relatively short supply. This is on top of the current post-drought period of restocking, as many cattle producers either hold their cattle back from markets or bid against processors, to rebuild their own herds.

With domestic cattle prices back at around record levels at the start of June, meat processors face the prospect of being unable to pass on any reasonable margin to meat buyers. As a result, some processors have taken the not altogether unexpected step of closing plants or reducing operations until cattle prices fall.

EXPORT

While the domestic sector will usually see reasonably predictable demand levels for meat, the greater uncertainty for meat processors clearly lies with the export landscape, in the areas of regulation, demand and competition.

In terms of regulation, the recent bans by China on several meat processors for apparent meat labelling irregularities highlight a major risk for export-focused processors. Whether due to labelling or other non-tariff measures (NTMs), larger processors run the risk of not only unexpectedly losing a major source of revenue, but also for an unpredictable period of time.

While the outlook remains unclear, many processors will be hoping that the current beef trade dynamics with China are solved relatively quickly, similar to the beef export labelling issues which occurred in 2017.

Additionally, processors are also closely watching consumers demand in key markets, and how it may effect them. Aside from China, the impact of COVID-19 on export demand from Japan and South Korea appears minimal at this time. However, bigger queries remain over the US market, where the surge in meat availability following the reopening of a number of processing facilities may flow into the country's domestic market, reducing the demand for Australian exports, particularly manufacturing beef.

The flow on from the US meat build-up could also lead to concern about competition in some of Australia's major export markets, particularly in Asia, where heightened competition from not only the US but South American meat exporters could potentially reduce demand for Australian meat, further impacting processors.

UPSIDE?

Despite these challenges, the current quieter period for some processors arguably presents a time of opportunity. As they pull back from operating at full capacity, some processors will take the rare chance to undertake major repairs or upgrades of their operations. For some, this could include the adoptions of new technologies into their processing lines. For these processors, forgone revenue in the current short term could be a trade-off for increased efficiencies and lower costs in the longer term.

ANZ ECONOMIC UPDATE

RATES

Globally, rates have fallen sharply as markets responded to both the significant impact on economies from COVID-19, as well as the associated significant amount of monetary policy easing implemented by central banks around the world. Locally, AUD rates have also collapsed following the fall in global rates and substantial easing by the RBA. Though, the distinct approach by the RBA of introducing Yield Curve Control (YCC) at the 3y tenor has resulted in some idiosyncrasies in the AUD rates market. Namely, a much steeper government bond curve compared to other nations like the US. We don't think this steeper curve is likely to disappear soon and expect it to steepen into year-end as ACGB issuance continues at an elevated rate. However, in 2021 we think from a lack of progress on inflation and unemployment, the RBA will not only extend the Term Funding Facility (TFF) but also introduce a quantity based approach for ACGB and semi purchases at the 10y part of the curve. This will flatten the yield curve and prevent additional underperformance of AUD rates. In addition, with unemployment likely to remain elevated and inflation subdued, we think the cash rate is likely to remain at 0.25% for a few years.

FOREIGN EXCHANGE

Domestically, Australia's handling of the global health crisis has laid the foundation for improving consumer and business conditions. However, an environment of increasing geopolitical tensions between the Australian Government and Beijing, and the possibility of a premature withdrawal of fiscal policy measures will introduce burgeoning risks that may yet have implications on Australia's path to recovery.

More importantly for the currency, the RBA's implementation of YCC over the three-year ACGB only has resulted in Australia offering the steepest curve across the G10. While this has, and will continue to, provide support to the AUD – we think that scope for upside from current levels is more limited.

From here, as per our global view, we think the worst case scenario of cash flow impairments, solvency risks and geopolitical tensions have been taken off the table for now. With tail risks diminished, flows back into Asian and EM growth markets will benefit the AUD. The pace of the global recovery however will be an ongoing uncertainty. With conflicting forces at hand, we expect the AUD to remain range bound, trading alongside risk sentiment while unlikely to see significant disconnect from fair value.

FX AND CENTRAL BANK POLICY RATE FORECASTS

FX Forecasts	Current	Sep '20	Dec '20	Mar'21	Jun '21
AUD/USD	0.68	0.70	0.70	0.70	0.70
NZD/USD	0.64	0.65	0.65	0.65	0.65
AUD/NZD	1.06	1.08	1.08	1.08	1.08
USD/JPY	107.00	107.00	107.00	107.00	107.00
EUR/USD	1.12	1.16	1.14	1.14	1.11
USD/CNY	7.10	7.05	7.00	6.95	6.90
AUD/EUR	0.60	0.60	0.61	0.61	0.63

Rate Forecast	Current	Sep '20	Dec '20	Mar'21	Jun '21
RBA cash rate	0.25	0.25	0.25	0.25	0.25
Feds fund rate	0.25	0.25	0.25	0.25	0.25
RBNZ OCR	0.25	0.25	0.25	0.25	0.25

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