ANZ AGRI
INFOCUS
OCTOBER
2020

COMMODITY INSIGHTS

ANZ

FOREWORD

As harvesters get going across the country, the outlook is bright for an industry strongly rebounding from prolonged drought, COVID-19 and bushfires.

The wheat and crop forecast looks strong across much of the country after late rains in the south-east, beef prices are buoyant and even those sectors where concerns over the COVID-19 were lingering – namely sheep and wool – are showing good recoveries or at least, signs of life. This time of year can be anxious for grain growers depending on location – one more finishing rain, no late frost, and no rain interrupting harvest. But on most objective measures, our major commodities are looking good.

There are however, mixed messages from the producers themselves – total outstanding loans to industry has increased 9 per cent on this time last year. This debt total of $80bn, likely combines factors of strong investment demand and high land prices, but also droughts inhibiting the ability to pay down debts through seasonal cycles. A longer discussion for another time, but the positive side of this for most farmer borrowers, is that we are experiencing the lowest interest rates in a lifetime. And despite the good seasonal conditions driving improved confidence in many areas, farmer confidence is otherwise influenced by some areas doing less well, and an overall backdrop of COVID-19 uncertainty.

We have recently celebrated International Day of Rural Women which focussed on the resilience of rural women in the face of the COVID-19 pandemic. We can also look more broadly at the resilience shown by the Australian industry and the strong return to growth made in the face of the pandemic. While agriculture has often been painted as risky in light of droughts, natural disaster and volatile commodity markets, the industry has shown high resilience in the face of the pandemic. We now have strong prospects, despite the challenges faced.

On a commodity basis, the wheat crop is looking good across New South Wales in particular, but has also been boosted by late rains in Victoria and South Australia. And despite concerns that the strong national and international crop would lead to downward pressure on prices, global prices have to date, defied that prediction. Cattle prices continue to hit new highs off the back of seasonal conditions and restocker demand, while, as expected, sheep prices have rebounded strongly as restocker demand restarts and new season's lambs filter into the saleyards. The strong spring is also boosting Australian milk production for the first time in a long time, although global prices are somewhat subdued due to strong global production.

Even the wool industry, which has gone through one of its toughest years in recent history, has seen the Eastern Market Indicator arrest the large price falls and recover to at least breach the 1,000Ac/kg mark. While some of those gains are off the back of reduced offerings, reports indicate the possibility that the market has found its floor.

Mark Bennett
Head of Agribusiness & Specialised Commercial, Commercial Bank

@bennett2_mark

WHEAT & GRAIN INSIGHTS

OVERVIEW

- + Global grains prices have shown strong increases, reaching an 18-month high on the back of strong consumption and export demand
- + There are very good prospects for a strong winter wheat harvest, particularly in New South Wales where the harvest is expected to be over 300 per cent higher than in 2019–20
- + The outlook for barley and canola harvests are also looking very strong, while barley prices remain firm despite Chinese actions to increase tariffs on Australian exports
- – Strong global prices have yet to filter through to the domestic market, as the prospect of the second highest harvest on record in Australia continues to keep a lid on Australian prices
- – Stocks-to-use ratio for wheat is expected to hit a record high, although almost all of that is due to massive stock piles in China
- – Competition from high quality-Canadian wheat is likely to put some direct pressure on Australian wheat prices

As the winter crop harvest gets underway across the country, all indications are there for a strong wheat harvest across Australia's grain-growing areas. When combined with the recent increase in global grains prices off the back of trade demand, the outlook is very positive for grain growers. Some concerns still exist about the possibility of untimely rainfall in New South Wales, however to date that has not come to fruition. Similarly strong outlooks for barley and canola harvests are also adding to the optimism. However, strong increases in the global price of grains have not filtered through to domestic prices as yet.

Global grains prices have jumped strongly since August on the back of the July United States Department of Agriculture (USDA) forecast of lower than anticipated production and consumption. Export prices have increased strongly for all countries, but was strongest for wheat from the United States, which was driven primarily by strong export demand from China. Exports prices across all major wheat producers increased strongly, even in Canada and Australia where very strong crops are anticipated. As a result of the strong production year forecast for 2020/21, competition is expected to be strong between producers, particularly for high-quality wheat out of Canada which has ramped up its export markets in recent years through new Free Trade Agreements.

The most recent USDA forecast for global wheat production saw a slight increase in global production for 2020/21 with larger forecast crops in Australia, Canada and the EU which was offset by a slight increase in consumption of feed wheat.

GLOBAL GRAINS PRICES HAVE JUMPED STRONGLY SINCE AUGUST ON THE BACK OF THE JULY UNITED STATES DEPARTMENT OF AGRICULTURE (USDA) FORECAST OF LOWER THAN ANTICIPATED PRODUCTION AND CONSUMPTION

Despite this, USDA forecasts for 2020/21 see ending stocks of wheat increasing by 0.8 per cent and a record global stocks-to-use ratio of almost 43 per cent. While such a high stocks-to-use ratio appears to be a strong indicator that global prices will decline into the future, it must be remembered that the vast majority of stocks are being held by China who account for over 51 per cent of global stocks, and in the past three years have accounted for 96 per cent of the increase in global stocks.

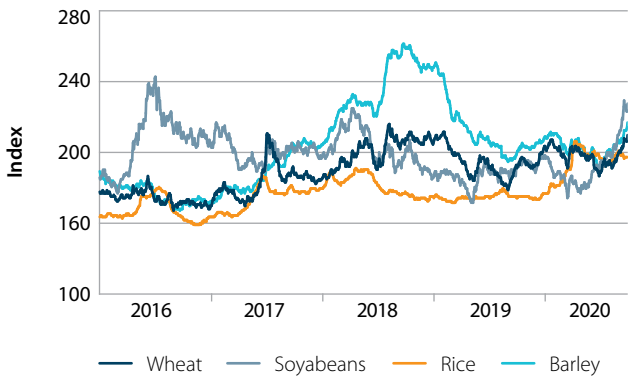
Those strong global wheat prices have not translated to domestic prices, however, as both milling wheat (APW, Port Adelaide) and feed wheat (ASW, Port Adelaide) remain around 5 per cent below levels seen in 2019 and 2018.

Despite this, Australian grains producers are looking at a strong year, based on production levels. The latest crop report from the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) reveals a strong harvest ahead, with wheat production forecast to increase by 91 per cent to 28.9 million tonnes, barley production is forecast to increase by 25 per cent to 11.2 million tonnes, and canola production is forecast to rise by 47 per cent to 3.4 million tonnes.

Similarly, global coarse grain production is expected to reach new record levels, increasing almost 6 per cent in the last year, most of which comes through the increase in corn production in the United States and Brazil. A record global corn harvest, combined with relatively stable global barley crop, would normally see some downward pressure on overall coarse grain prices. This year, however, this is yet to eventuate, with strong bidding for corn in the US based on concerns over the impact of recent storms and weather on the corn harvest also supporting global barley prices. Australian concerns over the impact of increased tariffs on Australian barley exports to China do not seem to have eventuated, as global trade flows shift to accommodate the almost immediate cessation of Australian barley exports to China. In its stead, the Saudi Arabian market appears to be opening up to Australian exports, as Black Sea exports are diverted to China.

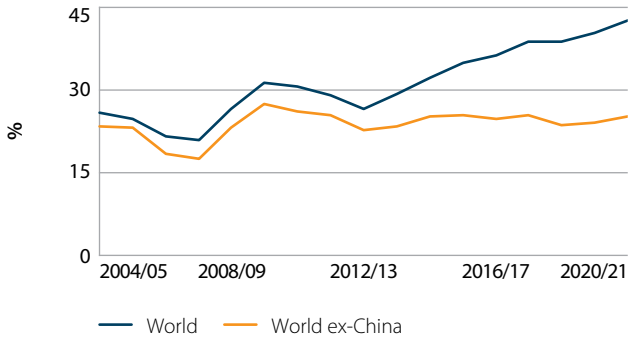
Global oilseed prices have seen the strongest rises in recent weeks, as demand from China and slower processing in Argentina put pressure on supply. However, those increasing global prices, similarly to wheat prices, have not translated to large increases in the domestic price which, while not going sky high, still sit at stronger levels than either wheat or barley at just 1 per cent below the levels seen at the same time last year. In the medium term, ABARES is forecasting a solid drop in canola prices, which does not seem to be materialising as yet.

GLOBAL GRAINS PRICES



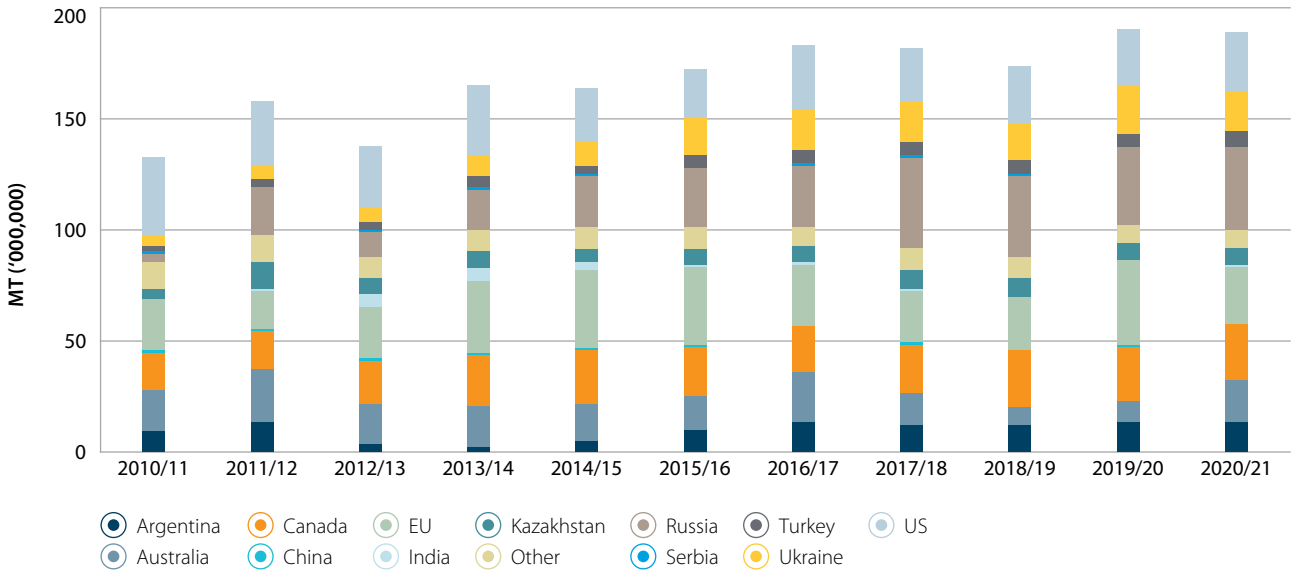
Source: International Grains Council

GLOBAL WHEAT STOCKS-TO-USE RATIO

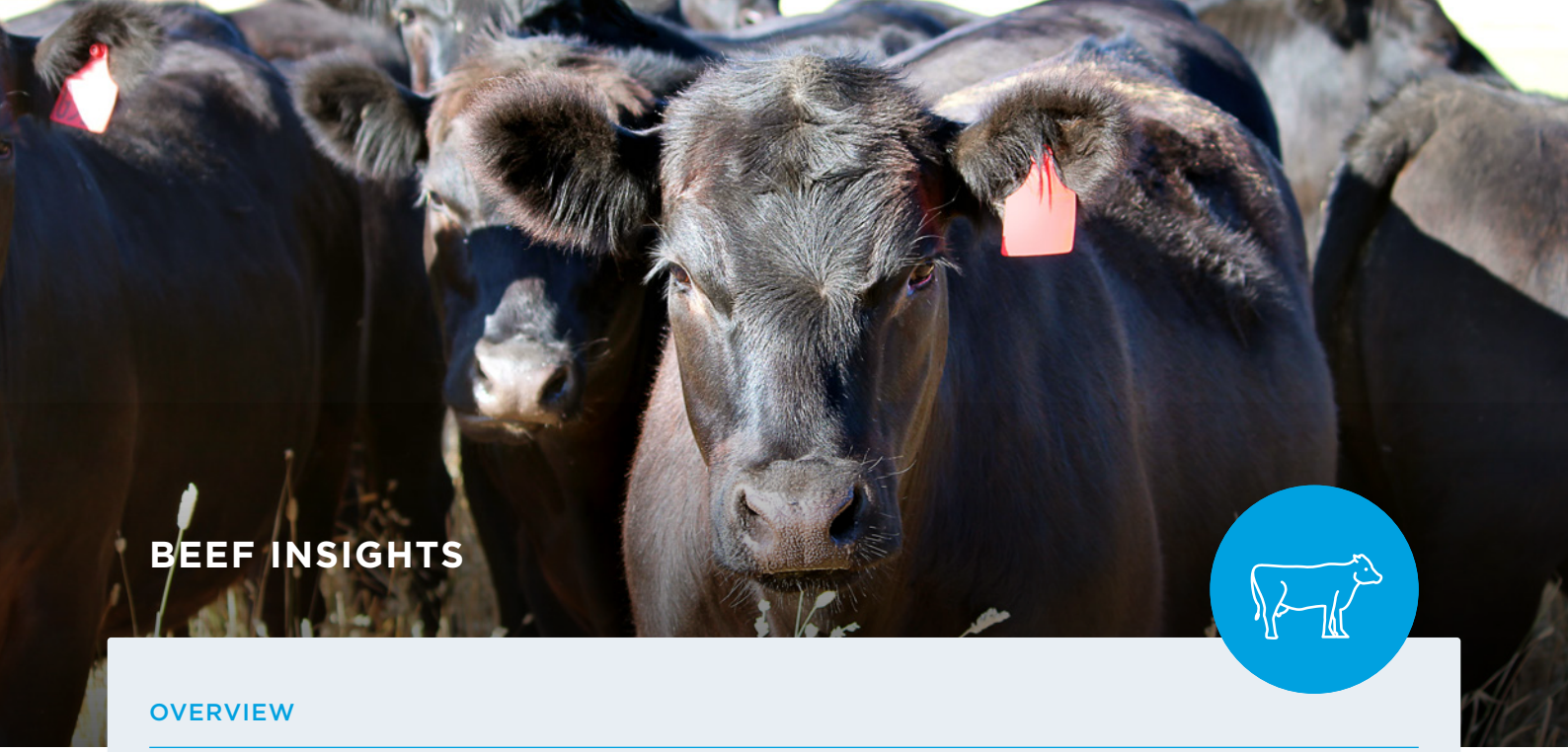


Source: USDA PSD

GLOBAL WHEAT EXPORTS



Source: USDA PSD



BEEF INSIGHTS

OVERVIEW

- + The strong season has meant ample pastures in much of Australia for restocking
- + Those selling cattle continue to benefit from the record prices
- + Domestic demand for beef has remained strong through the COVID-19 period
- – Exports to all major markets are down, with South American competition growing
- – Concerns grow on the impact of long term high prices for retail prices
- – China's issues with a number of Australian processors remain unresolved

As the end of 2020 draws closer, things are hotting up in the Australian beef sector in more ways than one. Right across the supply chain, from the paddock to the BBQ, the coming summer months will impact prices, margins and strategies. Add in the current factors of COVID-19 and geopolitics, and the coming few months could put the Australian beef sector in a position it has never seen before.

Taking into account the disruption to the Eastern Young Cattle Indicator (EYCI) caused by COVID-19, cattle prices have now been at record levels for seven months. The EYCI went above 700 c/kg on 20 February this year, a benchmark which had only been reached previously in August to October 2016. At that time, cattle numbers had fallen to their lowest level in over 20 years, leading to a price squeeze as processors sought to secure supply.

For over half a year, since the EYCI crossed the 700 c/kg mark, many in the market have been forecasting an imminent correction, yet prices have remained stubbornly high. Initially, the price surge was largely attributed to cattle producers seeking to restore their operations following the arrival of drought-breaking rains. As the disruptions caused by COVID-19 dragged on for months and trade issues with China arose, many felt that prices had to start a downward trend at some stage, yet they have remained defiant.

So why have high cattle prices refused to subside, and what might happen going forward?

While clearly a number of grazing areas of Australia are increasingly in need of good spring rains to provide their pastures with a level of certainty heading into summer, many areas continue to see better levels of feed than they have in years. While in some years, a high price for hay may convince some farmers to cut these paddocks for feed, this year's ample grain crop and low feed demand don't make this the most attractive option economically. Instead, many cattle producers are, for several reasons, seeking to rebuild their own herd numbers and are willing to pay top dollar to do so.

For some, the reduction in scale of their herd during the drought will have been so great, that unless numbers are increased again quickly, it could take many years to rebuild their operations to what they were. This is particularly relevant given the record high level of female slaughter seen in the national herd through the drought.

Many farmers may also be hoping that prices stay high for some time, even if not quite at current levels, and could be looking for short-term fattening opportunities, or even toward the market remaining high well into next year.

While the national herd continues to go through a vital rebuilding phase, supply of stock on the market will remain tight for some time, reducing the chance of a major price fall.

In terms of demand, domestic demand has remained strong throughout the COVID-19 crisis, and is likely to grow as Australia gears up for the Christmas and summer BBQ season, even with the COVID-19 disruptions.

In terms of export demand, numbers are certainly down to all key markets, yet strong enough to maintain confidence in their fundamentals. In September 2020, Australian beef exports were down around 30 per cent on the same time for the previous year. This has largely been driven by availability; low slaughter numbers have meant fewer products available for export.

Clearly the most prominent market for trade disruption has been China, to where September 2020 beef exports were down around two-thirds on those a year ago. This fall was driven by a combination of the current Chinese bans on a number of Australian processors, the triggering of a higher safeguard tariff on Australian beef exports to China, and strong competition from South American exporters.

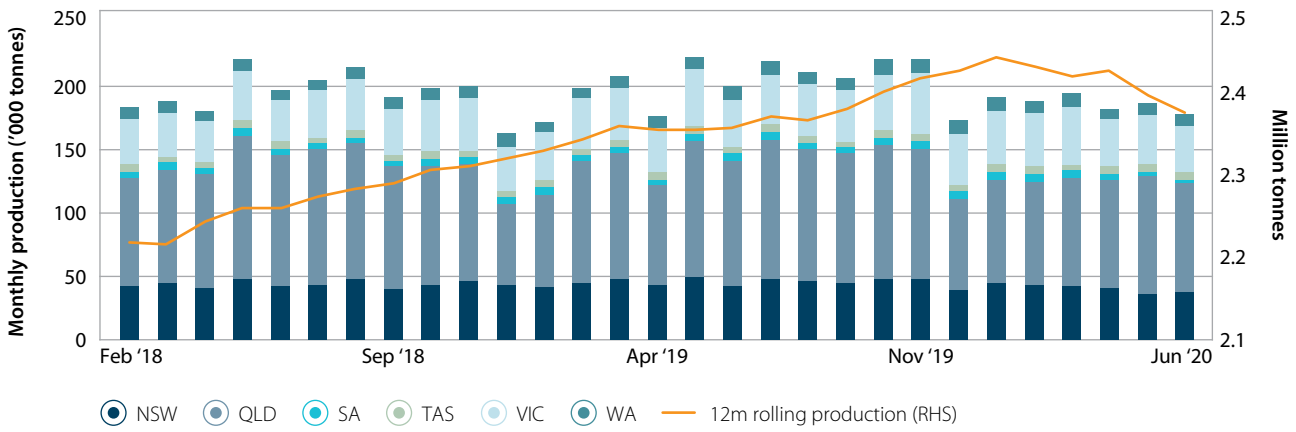
Exports to Japan and South Korea were both around 16 per cent down on the previous year, largely due to competition from the US.

For the US market itself, year-on-year exports were also down around 20 per cent, impacted by strong US domestic supplies, and cheaper competition for grinding beef from South American exporters.

The other major players in any substantial movements in cattle prices could well be Australia's meat processors. For some time now, processing industry representatives have been arguing that the EYCI remains too high for processors to sustain cattle purchases while not passing on the premium to retailers. The fact that some processing plants have shut down for the time being or reduced output is clearly related to this. However, processors are also in a position of needing to continue to supply exporters, to refill their own inventories, and to supply supermarkets, butchers, and potentially a reopening food service sector for the summer.

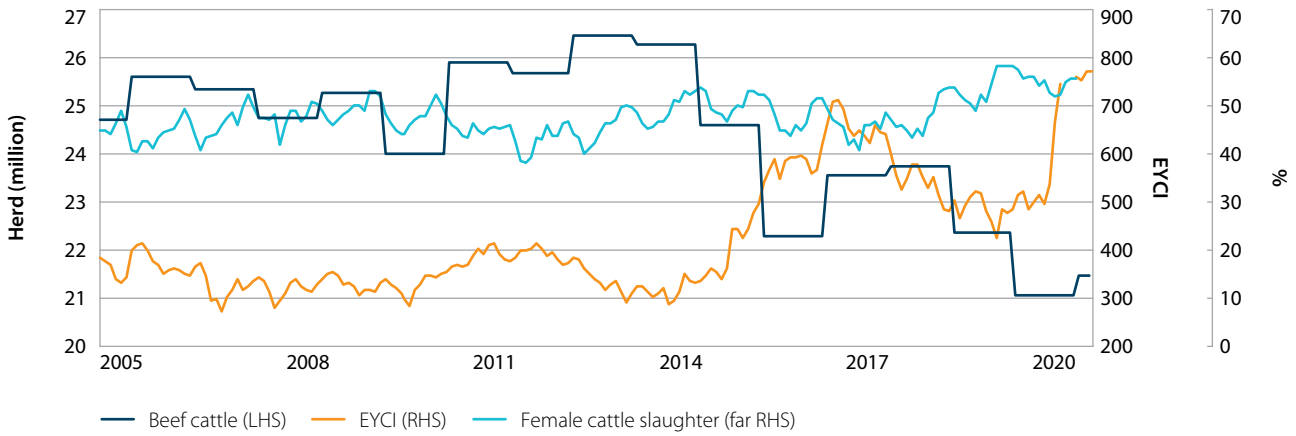
Ultimately, if cattle prices stay high, there's every possibility that your summer steak may well carry a higher price tag too.

AUSTRALIAN BEEF PRODUCTION



Source: MLA

AUSTRALIAN BEEF CATTLE HERD, EYCI AND FEMALE SLAUGHTER RATE



Source: MLA

SHEEP INSIGHTS

OVERVIEW

- + Prices have rebounded strongly in recent weeks as restockers return to the market on the back of good seasonal conditions
- + The return of exporters to the market have helped support demand for heavy lambs
- + An increase in Victorian processing to almost full capacity have helped build over-the-hook prices and processor demand
- – A long, slow national flock rebuild is expected as numbers are expected to hit a record low of 63.8 million
- – While prices traditionally trend lower between now and Christmas, questions still remain over how much the spring flush may push prices down
- – Meat and Livestock Australian forecast a continued downturn in domestic consumption of lamb per capita in Australia

As expected, the arrival of spring has seen a strong rally in lamb prices as producers look to restock and rebuild flock numbers. Late August and September saw very strong increases in the saleyard prices, particularly for restocker lambs. While over-the-hook prices sit below levels seen in previous years, it is being reported that processors are finding supply increasingly tight and prices should increase further in coming weeks. While restocker demand will continue in the medium term, the flip side is a relatively slow national flock rebuild.

Saleyard prices have recovered strongly in September and early October and hit levels higher than the same time in 2019. This was led by large increases in restocker lambs which jumped 24 per cent from their lows. Good seasonal conditions have resulted in good lambing and marking rates, as well as lower slaughter rates and strong demand from exporters, processors as well as restockers have all led to price increases.

The National Trade Lamb Indicator (NTLI) now sits higher than the same time in 2019. Mutton prices have also performed relatively well and rebounded on the back of a reduction of ewes in saleyards as producers look to rebuild flocks. Prices have also been supported by the return to almost full capacity for Victorian abattoirs following the loosening of lockdown restrictions. The drive to rebuild flock numbers is also being driven, in part, by the high cattle price, with some producers choosing the relatively cheaper sheep to restock.

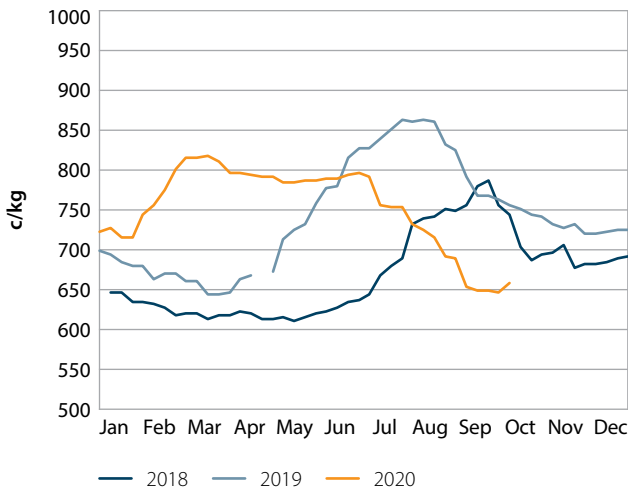
Low supply is the key factor currently influencing the market, with processors finding it difficult to secure supply after several years of drought. However, with over-the-hook prices currently sitting below both 2018 and 2019 levels, there is some room to move for prices to go upwards. Yardings have been low in recent months as low prices have resulted in producers holding stock back in the paddocks, however recent price increases has produced a strong increase in numbers at the saleyard. Similarly, while slaughter rates are down as a result in reduction in exports and domestic demand through the closure of food service outlets, the spring flush is likely to boost supply as demand recovers. With an expected strong season of lambs starting to hit the market in coming weeks, prices are likely to fluctuate somewhat as the market finds a balance between increasing supply, restocker demand and the start of a return to normal for exporter and domestic demand.

Export demand has recovered strongly since July with total Australian lamb exports 7 per cent higher in September than the same time last year. The strongest recovery has come from exports to the US with exports up 25 per cent on September 2019 while Papua New Guinea and Malaysia have also been strong. On the flip side, exports to China are down 28 per cent in the same time, while exports to the Middle East have declined as a result of the drop in passenger flights to the region.

Meat and Livestock Australia (MLA) recently released the September industry projections for the Australian sheep industry. The MLA outlook indicates that low national flock levels, reduced slaughter and production rates could dominate the landscape for the coming years – resulting in limited supply of livestock to offset any reduction in demand from export markets as a result of COVID-19. The MLA forecast sheep slaughter to drop to 6.3 million head in 2020, a reduction of 33 per cent on 2019 levels, with lamb slaughter falling 6 per cent on year-ago levels. As a result, they have forecast decline of 3 per cent and 31 per cent for lamb and mutton production, respectively.

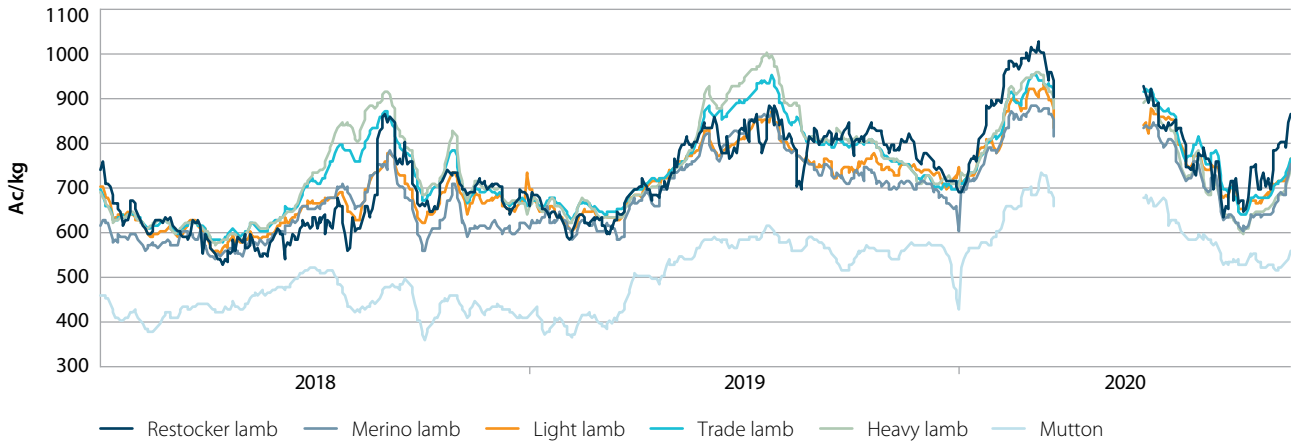
The MLA also sets out a long and slow recovery in national flock numbers, with numbers falling another 3 per cent in 2020 to just 63.8 million head before rebuilding to just under 72 million by 2023. They have also forecast a strong return to export demand as the world recovers from the COVID-19 pandemic and export buying returns to normal. The MLA does, however, flag a continuing drop in domestic per capita consumption of lamb down to under 6 kg per capita per year.

NATIONAL OVER-THE-HOOK PRICE



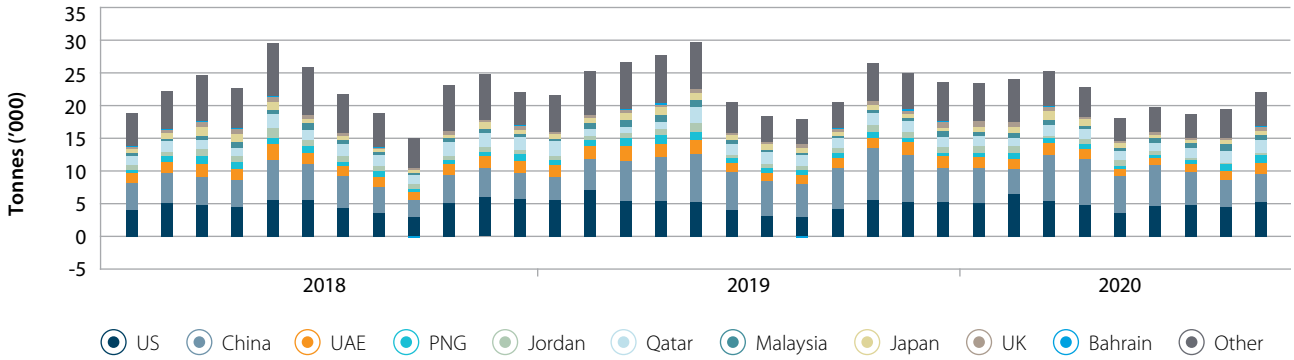
Source: MLA

NATIONAL SALEYARD PRICES



Source: MLA

LAMB EXPORTS



Source: ABS

WOOL INSIGHTS

OVERVIEW

+ September's historic lows appear to have turned a cornerwith the Eastern Market Indicator (EMI) edging back around the 1,000 c/kg mark
+ The EMI appears to have rebounded after hitting an 18-year low of 858 c/kg
+ Demand has remained steady in the Superfine (less than 18.5 micron) Merino range, reflecting buyers' interest in the higher quality premium wool

– The COVID-19 pandemic continues to disrupt global supply chains, reduce processor demand and impact retail demand through lower global growth
– Low prices have led many producers to withhold bales from auction – potentially building up a national supply backlog and adding to uncertainty over future prices
– In the longer term, wool supply is likely to remain restricted as lower prices see producers moving towards meat breeds

With the peak-shearing period getting underway in many wool regions of Australia, the news that wool prices may have hit the bottom will be welcomed by growers.

In early September, the benchmark Eastern Market Indicator (EMI) dropped to 858 c/kg, the lowest level in 18 years. However, by the start of October, this had risen back above 1,000 c/kg, including the biggest one-week gain for the past year.

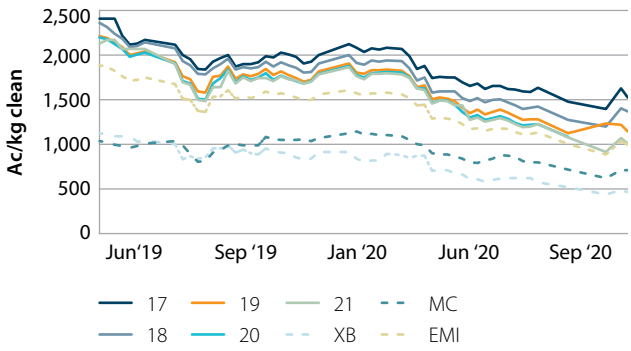
Offerings dropped significantly through early September raising the prospect that producers were stockpiling their wool, in the hope of prices rising. Interestingly, while offerings improved in the latter part of September, it wasn't until October's higher volumes on the market saw the increased bales impact prices with reduced clearance rates. The question remains as to how much more the market can absorb as increased volumes are offered for auction..

Although COVID-19 and reduced global growth continues to disrupt the highly trade-focused wool supply chain, demand during October returned with increased activity from the Chinese manufacturing sector.

With China buying around 75 per cent of Australia's greasy wool, the market is at risk of being impacted in the ongoing trade tensions. As Australia is by far the largest supplier of wool to China, finding a trade partner to replace volumes and quality would be extremely difficult. One possibility is that stocks held in China, combined with a reduced demand for office-wear, could see China temporarily reduce buying. At the same time, exporters remain open to opening and growing trade to new and alternative markets, including Europe and India.

The wool industry is currently heading into the all-important northern hemisphere Autumn/Winter season and there are hopes that retail sales will start to increase, particularly in Europe, as consumers stock up on warmer woollen clothing. This optimism is dependent on many key regions not being impacted by the second wave of lockdowns which are starting to be seen across Europe.

WOOL PRICES BY MICRON



Source: AWN, ANZ

In terms of clothing categories, demand in the market remains strong, particularly for premium wools, with once-small wool categories, such as active, performance wear and lounge wear, growing. As consumers change their habits from formal work wear to more versatile 'work from home comfort', athleisure wear (the term for clothing which can be worn during athletic activities, in the workplace or in other social or casual settings) is now the fastest growing sector in global textiles and a great opportunity for wool suppliers.

Lower wool prices are also opening up the fibre to a new generation of wool wearers, through making wool attractive to retail buyers from more budget conscious brands such as H&M and Uniqlo.

Finally, the impact of COVID-19-related travel restrictions upon the movement of shearers has become more optimistic with the announcement that New Zealanders entering Australia can avoid quarantine in some states. How this works in practice, given the low levels of inbound arrivals, and how they will move around the country is yet to been seen.

SUGAR INSIGHTS

OVERVIEW

- + This year's good rain is already boding well for next year's cane crop
- + The 2020 cane crop may well be up on last year
- + While final sugar production may be down, the forecast is only just the below 30-year average
- – Strong rains during the remainder of the cane harvest may be a major disruption
- – Disputes continue over India's subsidies for its sugar industry
- – The relatively high AUD is impacting Australian exports

At this time of year, the Australian sugar cane industry is in the home stretch of the harvest period, with over half the crop already off. As the harvest heads toward completion, cane growers have been looking to the forecasts of a La Niña with mixed feelings. While heavy rain over the coming months would be disruptive for the harvest, it would also provide a good moisture base, looking ahead to the 2021 crop.

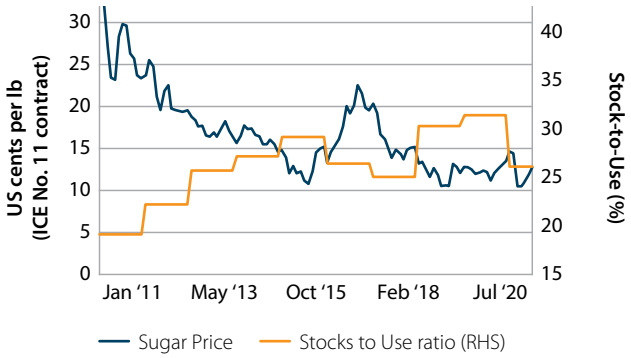
Unsurprisingly, rain has played a major role on the outlook for this year's crop. As a result of good winter rain, this year's cane crop is currently forecast to reach 30.9 million tonnes, which would be up around 1 million tonnes on the previous year. That said, as overall sugar content is slightly down on last year's figures, 2020 raw sugar production is currently forecast to be almost unchanged from last year's figure of 4.28 million tonnes.

While Australia's sugar cane crop is almost entirely grown in Queensland, around 5 per cent harvested in northern New South Wales. Given that the NSW sugar areas have been more impacted by the drought than the regions north of the border, it is foreseeable that mills in NSW may have to truck in supplies from Queensland to allow them to keep operating.

The forecast raw sugar production figure of 2.28 million tonnes reflects the volatility of Australian sugar production over the last 30 years. The figure itself would be the fourth-lowest annual total since 1992. However, given that the past three decades have swung between highs and lows in three quite distinct cycles, the figure itself is only 10 per cent below the average production figure over that time.

Globally, while sugar continues to be impacted by COVID-19 and geopolitical disruptions affecting most other commodities the price outlook remains reasonably bearish, with prices forecast to remain at around 11 to 13 USc/lb for the foreseeable future. While oil prices have risen markedly from their lows of April/May 2020, they are still at a level which has seen Brazilian sugar volumes remain on the world market, rather than be utilised for ethanol.

GLOBAL BENCHMARK SUGAR PRICE VS SU RATIO



Source: Bloomberg

In addition, an anticipated strong cane harvest from Brazil will reduce the size of a forecast global deficit, and reducing the likelihood of substantial global price increases going forward.

In terms of other global impacts, concern remains within the Australian sugar industry over the use of sugar export subsidies by India. The issue of export subsidies has been a contentious between the two countries for the past few years. In 2019, Australia, together with Brazil and Guatemala, lodged a joint request with the World Trade Organisation's Dispute Settlement Body, seeking to investigate whether India's high domestic prices and export subsidies were in breach of WTO obligations.

In its defence, India has contended that its subsidies for the transport and marketing of sugar are justified under a 2015 WTO ruling, which allowed developing countries to provide such incentives until 2023. In addition, India also argues that its domestic subsidies are justified under a WTO exemption which provides for securing farmer livelihoods in a time of surplus.

NUT INSIGHTS

OVERVIEW

- + Almond exports remain strong, particularly to China
- + While almonds remain the dominant nut category, macadamia production and exports are growing strongly
- + The focus of global corporate investors on the Australian nut sector remains strong
- – Uncertainty over water policy impacts nut investment
- – The full impact of COVID-19 disruption on the nut market remains to be seen
- – Impacts on travel and workplaces may reduce recreational nut consumption

Arguably, no other Australian sector encapsulates as much of the growth of corporate investment into agriculture as the nut industry. On its own, the industry has continued to enjoy strong growth in terms of production and exports, across different major varieties of nuts. Even more notably, Australia's nut industry has continued to attract increasing levels of corporate investment, both from domestic investors and fund managers, as well as inbound foreign capital.

While nuts have been harvested commercially in Australia for around 200 years, it is largely in the last 20 years that the industry has rapidly grown in strength and size. Australia's nut exports now account for just over one-third of all edible horticulture exports (i.e. total fruit, nuts and vegetables). In 2018/19, Australia's nut exports hit a record $1.1b – higher than Australia's fruit exports had been only three years earlier.

Looking ahead, these export figures are forecast to see a minor drop in 2019/20 and 2020/21, given the COVID-19-related demand uncertainties in the major export markets.

Of all the nut varieties, almonds continue to remain the dominant category. In 2018/19, almonds accounted for three-quarters of the volume and two-thirds of the value of Australia's total nut exports. Notably, the second-largest export category is now made up of macadamia nuts.

As an indication of the premium received for macadamias, while they make up 16 per cent of the volume of total exports, they account for around 26 per cent of total value. Walnuts and pistachios account for less than 2–3 per cent of both export volume and value.

For both almonds and macadamias, the primary export destination is China. In 2019/20, Australian almond exports to China grew by 26 per cent, driven tariff advantages as the US-China trade dispute worsened. China accounted for over 50 per cent of Australia's overall almond exports in 2019/20, followed by India, the Middle East and Europe. For macadamia nuts, Greater China (including Hong Kong) takes up around half of all exports, followed by Vietnam, Japan and the United States.

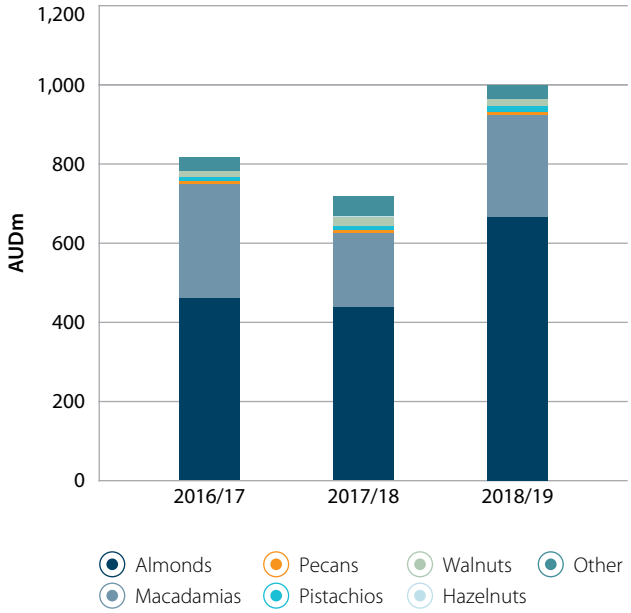
While Australia's almond production has nearly tripled in the past decade, it still represents only around 7 per cent of world production, which is dominated by the US, at around 80 per cent. On current plantings, Australia's almond production is forecast to grow from 104 kilotonnes to 160 kilotonnes, as the 29 per cent of non-crop-bearing orchards commence production.

In simple terms, the focus of corporate investment on the nut industry is based on a number of fundamentals. In an age of global, middle-class consumers seeking healthier diets, nuts are largely seen as a health food, high in protein, while being largely unprocessed. In terms of a production crop, they are arguably less hands-on than an annual rotational crop, thus minimising expenses, although they still require expert management. In terms of competition, for a number of nut categories, particularly almonds, there are few competitors apart from the US or, more specifically, California.

This factor on its own works in favour of Australian crops, which are harvested at a different time of year, thus increasing their marketability. Finally, given that a large number of Australia's nut production assets are structured with water allocations or entitlements, an investment in the sector can also be seen as an investment in water. Interestingly, the continuing uncertainty over Australia's domestic water policy could be seen as both a negative and positive for this argument.

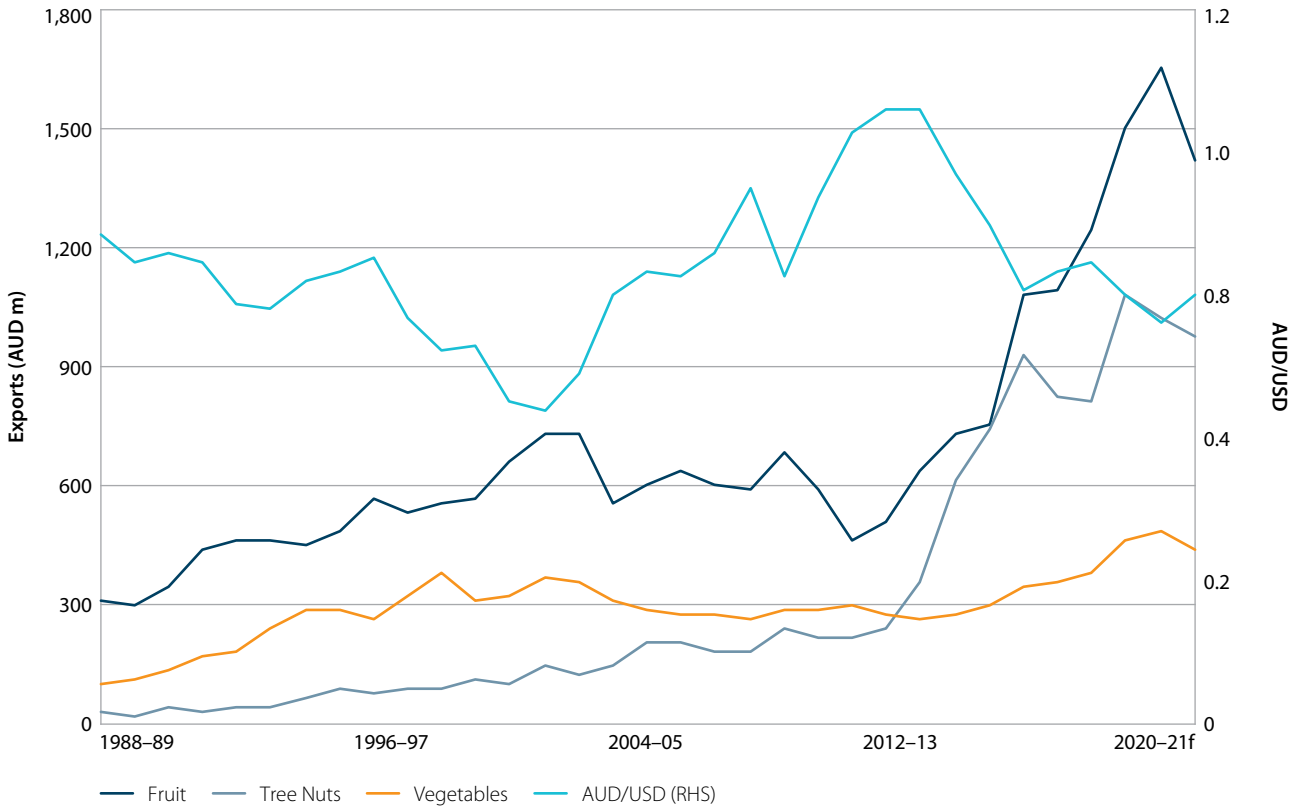
Although large-scale farms contributed strongly to production growth, around 70 per cent of almond properties are still 100 hectares or less. Given the nature of this industry structure, it is reasonable to expect that this will continue to see a trend in consolidation going forward, driven by the ongoing flow of investment, as well as a quest for increases in production efficiency.

COMBINED AUSTRALIAN NUT EXPORTS 2016/17 – 2018/19



Source: AgSurf, BOM

AUSTRALIAN HORTICULTURE EXPORTS BY VALUE VS AUD/USD RATE



Source: Dairy Australia

DAIRY INSIGHTS

OVERVIEW

- + Australian milk production will see its first volume increase in three years
- + Ongoing good seasonal conditions have improved pastures, while reducing fodder costs and requirements
- + Overall dairy consumption levels have been minimally impacted by COVID-19
- – Dairy cow numbers have fallen in the important production regions of Northern Victoria and Western Victoria
- – Strengthening global production may put downward pressure on prices
- – The strong Australian dollar has muted the opportunities for exporters

Could it be that the Australian dairy industry is finally starting not just to arrest its long-term production decline, but to climb its way back to production levels not seen over the past two decades? Despite many of the challenges to the industry being thrown up by factors including COVID-19 and the current geopolitical dynamics, the latest forecasts indicating a potential rise in national milk production is being seen by some in the dairy industry as a sign that the sector could continue to strengthen over the coming years, heading back to production levels rarely seen in the last fifteen years.

Looking back, the Australian dairy sector hit its record milk production level of 11.3 billion litres around 20 years ago, in 2001/02. That year also saw record production highs for cheese, whole milk powder, and close to a record high for butter production. This figure came at the peak of an era of rapid growth in the dairy industry – over the previous 15 years, production had almost doubled, having been around 6 billion litres in 1986/87. But almost as fast as it grew, the dairy industry saw a subsequent period of decline over the following decade, as production continued to contract, falling to 9 billion litres by 2009/10.

Arguably, the past decade has been the most volatile in the Australian dairy industry's history. As industry participants are well aware, driven particularly by Chinese demand for Australian dairy exports – or at least the promise of it – milk production recovered to almost 10 billion litres in 2014/15.

The subsequent production downturn can be partly attributed to the fall at the time in global prices impacting farmgate prices, as well as a period of processor corporate upheaval. However, it also needs to be acknowledged that a major factor in this decline was the growth in fortunes of the beef industry and, to a degree, the sheepmeat industry, with a reasonable amount of dairy land changing uses for meat production.

Looking ahead in late 2020, the industry has a feeling of cautious optimism. Many dairy-producing regions are continuing to feel the benefit of this year's rains, which has not only reduced supplementary feed requirements, but seen fodder costs fall. In a further boost for dairy farmers, the recent tightness of supply and subsequent completion amongst processors had seen relatively strong opening farmgate prices, in turn providing farmers with further capital to grow their operations.

Overall, Australia's milk production level in 2020/21 is forecast to see its first rise in three years, breaking back through the 9 billion litre mark. Overall, growth is forecast to be strongest in Tasmania, Gippsland and South Australia. In Northern and Western Victoria, while the greater availability of feed has meant that individual per cow yields are up, overall cow numbers have fallen. For both these regions, this may arguably reflect a move to meat production on a number of what were former dairy farms.

In terms of demand, the effect of COVID-19 on dairy products has been mixed, although there are undoubtedly still further impacts ahead. As consumers were forced to increase their level of cooking at home, sales grew for products such as butter, which saw a rise of almost 20 per cent in the year to August 2020, as well as a rise in products such as everyday cheeses and plain yoghurts, at the expense of the flavoured yoghurts and speciality cheeses which would normally be consumed in workplaces or for entertaining.

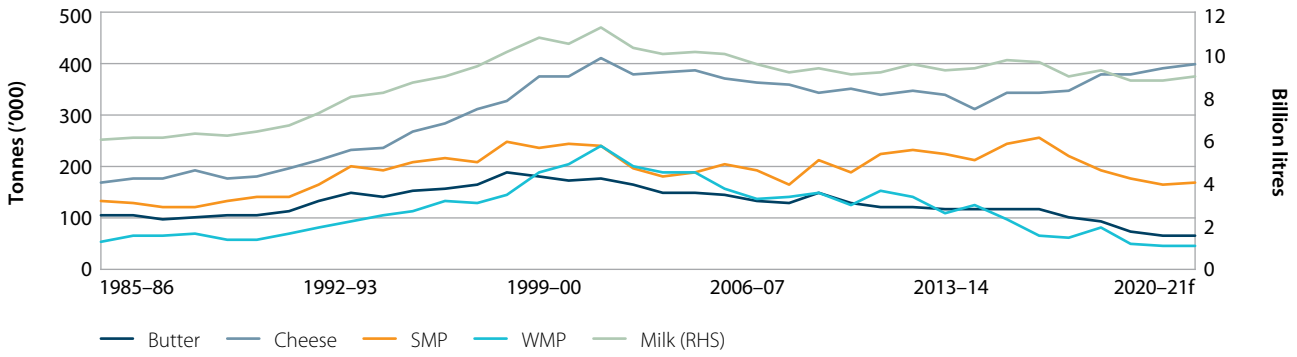
While farmgate prices and ongoing demand have been cause for optimism in Australia, the recent growth in global production is undoubtedly some cause for concern. Both New Zealand and the US are forecast to see increases in production this year, with overall global production growth driven by factors such as good seasons, as well as a reduction in some countries in government programs designed to curb overproduction of milk.

While the impact of slowing economies in a number of major milk-consuming countries is yet to fully play out, there remains some concern that any notable reduction in consumption levels could lead to global dairy stocks rising, with resultant downward pressure on price.

In terms of global prices, two recent price rises consecutive on the Global Dairy Trade have been interpreted by some in the industry as showing that global demand has remained strong, despite the economic impacts of COVID-19. For Australian exporters, the relative strength of the Australian dollar remains a hindrance to a strong growth in exports.

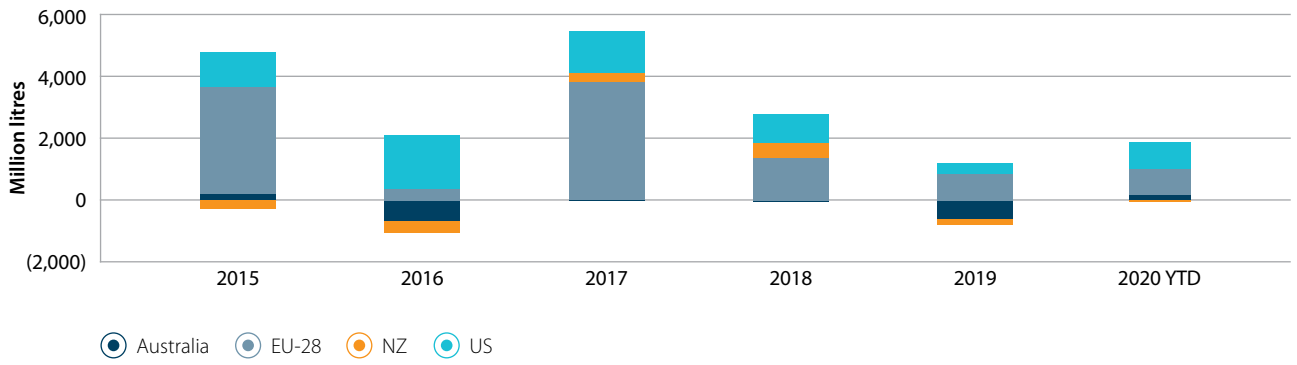
One major talking point in the Australian dairy industry that will continue to be debated for some time has been the release of the Australian Dairy Plan, a strategic plan brought together by a number of senior industry stakeholders and producers. Broadly speaking, the report particularly focuses on increasing dairy farm profitability through a range of strategies, which the report predicts would see a strong increase in overall production. In addition, the report also seeks not only to bring new people into the sector, but enhance the flow of investment back into the industry. Unsurprisingly, the Plan has created some debate in the dairy industry, with some arguing that the proposed new structures of the industry bodies do not allow for adequate representation of individual producers.

AUSTRALIAN DAIRY PRODUCTS PRODUCTION BY CATEGORY 1985/86 – 2020/21F



Source: Dairy Australia

MILK PRODUCTION – YEAR-ON-YEAR CHANGE



Source: USDEC

GLOBAL AGINVESTING INSIGHTS

OVERVIEW

+ COVID-19 related disruptions have renewed the importance of food security, increasing the focus of investment on agri supply chains
+ Sustainability in agriculture will continue to shape investment decisions, but returns will remain a key yardstick
+ A detailed understanding of new markets like India will be vital to providing new investment opportunities
– Recent geo-political dynamics will continue to impact the food/agri trade as a part of coercive diplomacy
– Uncertainty over many domestic water markets and structures provides a deterrent to investment
– While COVID-19 may be new kind of black swan event, the future may well hold more such disruptive events, emphasising the need for new strategic planning.

Each year, around 800 representatives from across the landscape of agricultural investment gather in New York for the Global AgInvesting conference. The event, which has been running for 11 years, is aimed at enhancing the flow of new investment into many different areas of agriculture right across the world. In terms of investment targets, this ranges from production farmland, including livestock, rotational crops and permanent crops, through the supply chain, to processing logistics and retail.

A rapidly increasing component of the agri investing landscape is the growth of all facets of agtech. The combination of investor appetite, the ongoing fundamentals of food demand, the growing need for innovative food production and rapid advancements in technology and rapid advancements in technology have seen this area receive a level of attention arguably not witnessed since the original tech boom of the 1990s.

This year's event was different in a number of ways. With the impact of COVID-19, the event was held online, and later in the year.

What was evident from this year's event was that the repercussions of COVID-19 have had a number of impacts on the agri investment landscape, which will potentially change the direction of the space.

Most notably, as COVID-19-related disruptions to global agri supply chains added to concern over food security or food certainty by some countries, the competition to invest in agri supply chain assets has become even stronger.

Related to this, while institutional investors in agri have previously been large scale funds, the number of smaller (e.g. sub US$1b) funds either expressing an interest or entering the space has continued to grow.

As part of this year's event, ANZ was invited to deliver the closing address, which traditionally sees a number of issues raised for the industry to continue to discuss and evaluate, as part of the decision-making process on investing in the sector.

This year, the closing address raised the following discussion points, many of which will be covered in upcoming ANZ FBA Insights publications:

Impact And Agriculture Won't Meet Halfway

- While sustainability has arguably become a compulsory component of agri investments, opinions still differ on its links with returns.
- Industry trends towards adoption and innovation of structured sustainability practices have lessons for us all.
- Regulations will change the future on environmental aspects, so stakeholders must be prepared.
- Ultimately, agri investment will still be about returns.

MOST NOTABLY, AS COVID-19-RELATED DISRUPTIONS TO GLOBAL AGRI SUPPLY CHAINS ADDED TO CONCERN OVER FOOD SECURITY OR FOOD CERTAINTY BY SOME COUNTRIES, THE COMPETITION TO INVEST IN AGRI SUPPLY CHAIN ASSETS HAS BECOME EVEN STRONGER

Namaste India

- In sophisticated agri, you need to know about your end market – domestic and export.
- Over the past 30 years, many participants have become expert on China and, to a degree, Japan and Korea.
- 30 years ago, we knew relatively little about the Chinese market compared to today, but we learned.
- India is one market you need to get to know – the growing giant middle class, will want imported products.
- Importantly, market participants still have much to learn about Indonesia.

Work Hard To Understand Water

- Arguably regulators in most markets will up their water focus.
- It will be important to balance the potential for regulatory change in this space, particularly by region.
- We are likely to see water IP, technology and market structure demand accelerate even faster.

The Weaponisation Of Food

- In changing geopolitical times, food will increasingly become part of coercive diplomacy.
- Will food security (or the perception of it) stretch the social contract between governments and people?
- How will this impact net exporters of food?

Everyone Has An Opinion

- How impacted is policy and investor reaction by consumer sentiment, or to organised online action?
- Will this rise, and what should you do?
- Do the media understand enough about agri – and should you play a role in helping to expand their knowledge?
- What will be the impact on food and agri companies and investors of heightened consumer self-awareness i.e. What they eat? Where they eat? How is it produced? From where is it sourced?

Landing in Treacle

- The process of executing an agri investment can still be a cumbersomely bureaucratic process.
- In particular, for offshore investors in Australia, the due diligence journey from the desktop to the dirt can be a very complicated one.
- Investors need to understand that the unique variables are very different from any other asset class.
- The importance of finding someone you can trust on the ground is paramount.

The Inevitability Of Black Swans

- COVID-19 may be a new kind of black swan event (i.e. a surprise disruption), but these are far from unknown in agriculture.
- Looking to the future, are more unpredictable occurrences predictable?
- Hypothetically, what would many current industry stakeholders have done differently had they known about COVID-19?
- Can agri managers plan for the next one – or should they?

Processing Segment Remains Attractive

- In addition to production agri, as well as agtech, the supply chain has many attractive investment options for the new investor.
- Food processing remaining attractive compared to other value segments.
- Beverages remain a strongly performing space ahead compared to other sub-sectors.
- In emerging markets, it may be beneficial to look at options in organised versus unorganised retail.

ANZ ECONOMIC UPDATE

RATES

The theme over the last few months in rates markets has been one of low volatility and stability. This has been driven by the still abundant amounts of liquidity in the system from Central Banks and the lack of interest rate differentials globally. More recently, rates markets have seen more price action as Europe experiences a second virus wave and in the US, markets start to price in a Biden led blue wave victory in the US election. This type of election result would likely see more US fiscal stimulus which would put pressure on long-end yields to rise. However, we don't think the Fed would allow yields to rise materially and would step in and increase their QE program if necessary to keep a lid on them.

In Australia, we think rates are likely to move lower from here, particularly on a relative basis as the RBA eases further. We think as soon as November, the RBA will cut its policy rates (Yield Curve target, Term Funding Facility rate and cash rate target) from the current 0.25 per cent down to 0.1per cent. We expect the RBA to keep the target cash rate at 0.1 per cent for at least the next 3 years.

FOREIGN EXCHANGE

Recent months have been relatively poor for risk sentiment, and the AUD was no exception falling over 3 per cent from September highs. Concern over the shape of the post-lockdown growth path was reignited as global data momentum faded, fresh restrictions were imposed in Europe and the probability of another US fiscal package fell.

Anxiety about the US election helped drive a more defensive posture in FX markets. In a lot of ways, such a correction has been a healthy signal in the context of a rally that has barely paused since March. The valuation stretch in equity markets had reached historic highs, which sits oddly when most countries' unemployment is still about twice what it was before the pandemic. We expect nuances around the election results to carry somewhat more weight than the choice of president, with the possibility of a 'blue wave' a major upside risk for cyclical assets. Domestically, the RBA has introduced a new headwind for the AUD as speculation mounted over the potential for a micro-cut or an expansion of the bond buying program.

FX AND CENTRAL BANK POLICY RATE FORECASTS

FX Forecasts	Current	Dec '20	Mar '21	Jun '21	Sep '21	Dec '21
AUD/USD	0.71	0.73	0.75	0.75	0.75	0.75
NZD/USD	0.67	0.65	0.65	0.65	0.65	0.65
AUD/NZD	1.07	1.12	1.15	1.15	1.15	1.15
USD/JPY	105	107	107	107	107	107
EUR/USD	1.18	1.21	1.20	1.18	1.18	1.15
USD/CNY	6.72	6.85	6.82	6.78	6.73	6.70
AUD/EUR	0.60	0.61	0.61	0.63	0.63	0.63

Rate Forecast	Current	Dec '20	Mar '21	Jun '21	Sep '21	Dec '21
RBA cash rate	0.25	0.10	0.10	0.10	0.10	0.10
Feds fund rate	0.25	0.25	0.25	0.25	0.25	0.25
RBNZ OCR	0.25	0.25	0.25	-0.25	-0.25	-0.25
10y ACGB yields	0.74	0.65	0.60	0.75	0.75	1.00

CONTACTS

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

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

AUTHORS

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

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

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

VIVEKA MANIKONDA
Senior Analyst, Institutional Client Insights & Solutions
T: +91 8067 953 036
E: vivekasri.manikonda@anz.com

DISCLAIMER

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

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

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

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

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

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

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

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

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

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

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

2. Country/region specific information:

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

Australia and New Zealand Banking Group Limited (ANZ) ABN 11 005 357 522. 10.2020 AU23534

anz.com