ANZ AGRI

INFOCUS

FEBRUARY 2021

COMMODITY INSIGHTS

FOREWORD

It goes without saying that the agri sector has begun 2021 in the midst of an unprecedented set of circumstances.

If 2020 was the year of COVID-19 disruption and the challenges this created for the industry, then 2021 is shaping up to be a year of cautious optimism. While COVID-19 will continue to play a role in the fortunes of the sector, good seasonal conditions will arguably have more impact and provide the basis for 2021 being a strong year for many stakeholders, right down to different agri supply chains.

Since the start of the COVID-19 disruptions in early 2020, Australia's agri sector faced many challenges, namely; a concerted and collaborative effort between industry bodies, agribusinesses and government saw the sector emerge from the peak of the disruption as one of the industries least affected.

HEADING INTO 2021, THE POTENTIAL FOR FURTHER DISRUPTIONS FROM COVID-19 IS EVER PRESENT.

Agribusinesses and industries need to accelerate their modernisation plans to further minimise any future impact on their business. In addition, the much discussed concentration risk to China continues to evolve, with our wine and live seafood exports being significantly impacted.

Away from COVID-19, most agribusinesses continue to be thankful for the ongoing excellent season. Coming off two years of severe drought in many parts of Australia, the sight of green paddocks in February in many places, or delayed harvests due to excellent conditions only served to further boost yields to near record territory has set many farmers up for one of their best years on record.

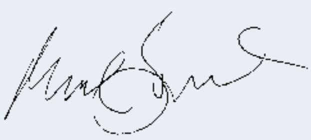
Through a positive combination of circumstances, most agri sectors are also seeing some of the highest returns in years.

Notably in grains, sheep and cattle, many producers will now find themselves in a fiscal position to consider debt repayment and possibly to implement new expansions or strategies on their operations, further enhancing the productivity of the sector.

While the high prices are a benefit for many, they also undeniably provide challenges for others, including re-stockers, feedlotters and processors looking for sustainable margins. Record prices also require re-examination of business strategies. Prices can fall and consideration should be given to where we are in the cycle, in what is a long-term, capital-intensive industry.

Globally, a number of the issues to watch closely in coming months include trade issues between Australia and China, the change of administration in the US and a pick-up in demand as consumers globally continue their economic recovery from the worst of COVID-19; a pick-up in demand may well flow back through Australian agri trade supply chains.

If 2020 was the year that the agri sector was taken by surprise, yet reacted admirably, then 2021 should be the year where it is positioned not just to build on what it has learned, but capitalise on the new opportunities available to it. If we could just get a follow-up season to assist.



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ALTERNATIVE MARKET INSIGHTS

OVERVIEW

- China is Australia's biggest agriculture export market and has been a huge part of the nation's export success to date. If exports to China decline further in the future, there are alternative markets which could be investigated
- Perishable items, where Australia has a high exposure to China, face more significant disruption and impact and are vulnerable to 'timing'
- Where the commodity has a strong domestic consumption base, the overall potential impact is reduced
- Where Australian produce is needed by China, and with no comparable substitution options, the likelihood of significant impact, while highly exposed, is reduced
- Commodities that are highly globally traded are less exposed due to the ability to redirect trade flows
- The outlook for China's demand for agricultural products is strong, with a strong economy and growing agricultural demand. China's growth will continue to boost demand for agricultural products across the world

TRADE TENSIONS WITH CHINA CONTINUE

As trade tensions between Australia and China extend into 2021, the message being heard by many exporters and producers is that the industry would be wise to look to diversify their export markets to protect them from potential future risks. This has raised the questions for many producers: What are the alternative markets for Australia's major agricultural exports? How much Australian produce can those markets take? And what loss in premium could there be?

With over one-third of Australia's agricultural exports going into China, Australian farmers might be forgiven for feeling a little on edge as a result of the current trading relationship between the two countries. To date, the strong season and livestock demand across the country continues to isolate Australian farmers from most major impacts of trade tensions, however, many exporters and producers are looking longer-term to develop alternative trading relationships and diversify away from a perceived over-reliance on exports to China.

As the Australian Government and newly appointed Trade Minister, Dan Tehan, look to markets such as India, United Kingdom (UK) and the European Union (EU) as potential for new or enhanced Trade Agreements, many exporters are also looking to new markets.

The question for most in the industry is what happens if the absolute worst case scenario eventuates and Australia no longer exports key commodities to China?

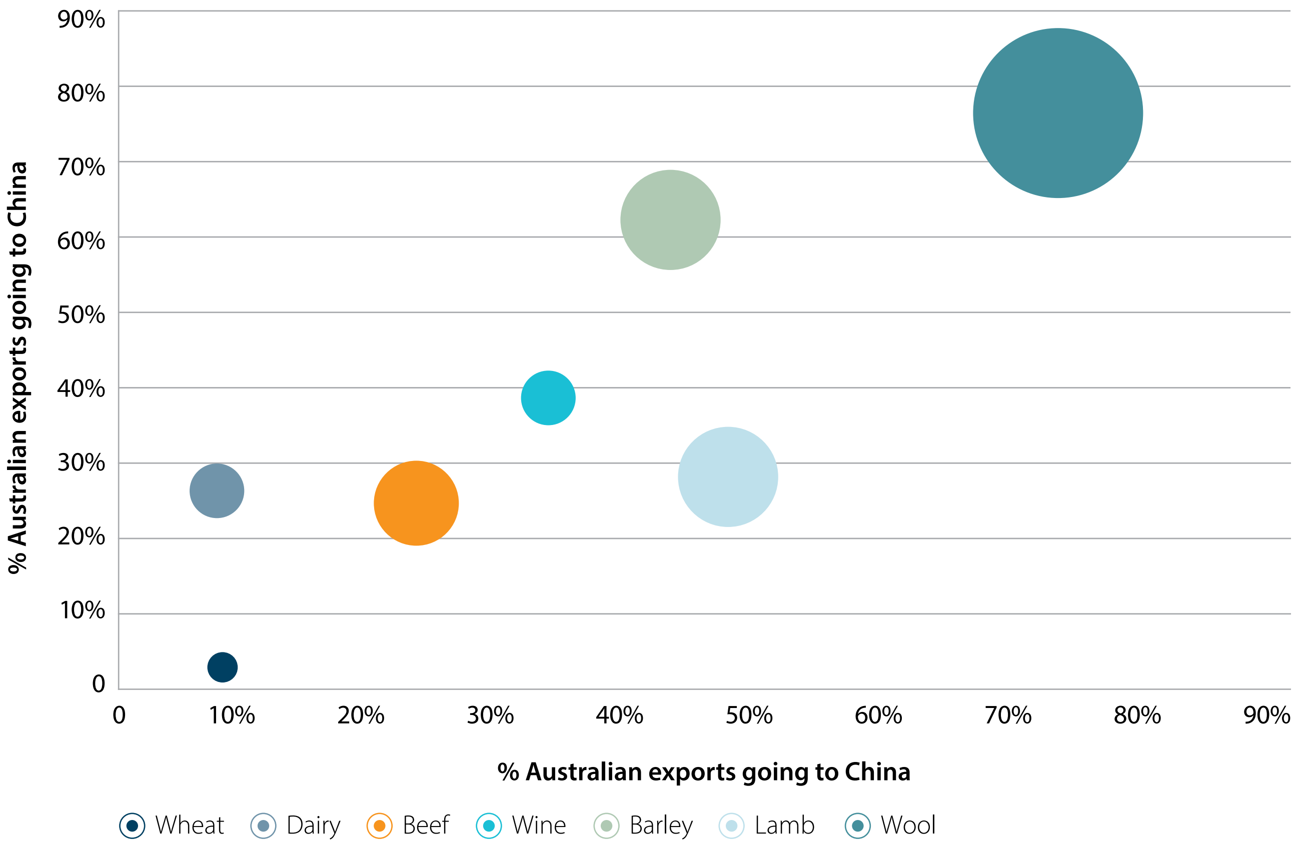
WHAT ARE THE ALTERNATIVE MARKETS AND ARE THEY IMPORTING ENOUGH TO FILL THE GAP?

The case of the recent increase in tariffs on Australian **barley** exports to China provides some guidance on how global trade flows may shift in a response to increased tariffs in the Chinese market.

While China takes approximately 22 per cent of all barley worldwide and 62 per cent of Australian barley exports in 2019, once China sought barley from other markets, there was sufficient global demand for Australia's exports to be redirected to Saudi Arabia, Mexico, Thailand and Vietnam.

HOW BIG IS CHINA'S DEMAND ON A GLOBAL SCALE?

Bubble size represents China's share of global imports



Source: UN TradeMap, ANZ

While barley producers have been shielded from the impact of losing the premium China market by the strong season and solid production, it has also opened avenues for building relationships with new markets.

Of key concern for many producers, understandably, is the **wool** market where China takes 64 per cent of all global exports and over 70 per cent of all Australian exports. A significant drop off in Australian exports to China would clearly result in a substantial loss in demand and lower prices, as there is no other country with the capacity or need to import all of Australia's clip each year.

On the flip side however, with Australia being the largest exporter in woollen yarn and fabric, China would also struggle to source alternative wool supplies from any other country. Depending on the current stock levels, China may not be able to maintain manufacturing output.

ALTERNATIVE MARKETS FOR HIGHLY TRADED GOODS

For other high-value industries such as **beef** and **wheat**, China remains an extremely important but relatively smaller importer on a global scale, taking 16 per cent of global beef imports and 3 per cent of global beef exports despite taking 25 per cent of Australian beef exports.

For the **lamb** industry, however, China takes 24 per cent of global imports and almost 50 per cent of Australian exports, meaning that exporters would face a significant amount in need to finding an alternative export market. However with China likely to turn to their next biggest import market in New Zealand, it is likely that more traditional markets such as the EU and UK, which currently takes a large amount of New Zealand lamb would open up for Australian producers.

ALTERNATIVES FOR HIGH QUALITY, NICHE EXPORTS?

In this give-and-take of global export markets, those highly commoditised products such as grain, dairy and, to a lesser extent, meat face a relatively easier job of finding alternative markets than more niche products such as wine and lobster.

While China's wine imports constitute almost 39 per cent of Australia's exports, China remains a small part of the global wine trade, making up just 2 per cent of global imports. The difficulty for wine exporters is that wine consumption is very much related to brand and reputation and is far less commoditised than grains or meat.

Wine exporters, for instance, face a very substantial loss in premiums should they have to seek alternative markets, with average prices for exports to China sitting 109 per cent higher than the average attained for other Australian wine exports.

While much of this will relate to the quality profile of wine consumed in China, it isn't to say that other markets won't attract similar premiums. For instance, the higher value markets of Singapore, Indonesia and Malaysia achieve prices for Australian wine exports of up to $13,000/cubic metre, albeit in much lower volumes.

EXPLORING ALTERNATIVE MARKETS SHOULD BE SEEN AS AN OPPORTUNITY FOR THE INDUSTRY

With the continuing uncertainty of trade with China leaving many in the industry nervous, it is clear that there are many alternative export destinations which may be explored. China will always remain a core trading partner, particularly for primary production goods, but if the industry has taken anything away from the past year's interactions, it is that Australia's clean, green and high quality produce is in demand across the globe and many of these markets are worth exploring as they grow and develop in the future.

WHAT ARE THE ALTERNATIVE MARKETS FOR AUSTRALIAN PRODUCE?

Commodity	Largest global importers	Largest importers of Australian exports
Barley	China, Iran, Saudi Arabia	China, Japan, Thailand
Wheat	Egypt, Indonesia, Turkey	Philippines, South Korea, Japan
Beef	China, United States, Japan	China, Japan, United States
Lamb	China, United States, France	China, United States, United Arab Emirates
Wool	China, Italy, Germany	China, Italy, India
Wine	United States of America, United Kingdom, Germany	China, United States of America, United Kingdom
Dairy	Germany, China, Netherlands	China, Japan, Singapore

Source: USDA PSD, ANZ

LOSS OF PREMIUM MARKET IN CHINA?

Commodity	Unit price for Australian exports to China	Average unit price for global exports from Australia	Difference
Barley	$AU374/t	$AU363/t	***-$AU11/t***
Wheat	$AU368/t	$AU374/t	+$AU6/t
Beef	Fresh: $AU13,207/t Frozen: $AU7,719/t	Fresh: $AU12,402/t Frozen: $AU6,965/t	Fresh: ***-$AU805/t*** Frozen: ***-$AU754/t***
Lamb	$AU6,759/t	$AU8,355/t	+$AU1,596/t
Wool	$AU11,441/t	$AU11,842/t	+$AU401/t
Wine	$AU8,253/cubic metre	$AU3,936/cubic metre	***-$AU4,317/t***
Dairy	Milk powder: $US3,608/t Cheese: $US3,804/t Milk and cream: $US891/t Butter: $US5,825/t	Milk powder: $US2,928/t Cheese: $US4,163/t Milk and cream: $US898/t Butter: $US4,847/t	Milk powder: ***-$US680/t*** Cheese: +$US359/t Milk and cream: +$US7/t Butter: ***-$US978/t***

Source: USDA PSD, ANZ
t: tonnes

Note: While China has been seen as a premium market for many goods, the above table highlights that this is not always the case, with China paying under the global average for wheat, lamb, cheese, milk and cream. Much of this clearly depends on the type of produce being sent to China, with lamb exports to China, for instance, including a high proportion of cheaper cuts.

WHEAT & GRAIN INSIGHTS

OVERVIEW

+ While the ongoing wet season may have slowed the harvest, the forecast remains on track for the largest grain crop ever
+ Demand remains strong both domestically and globally, particularly driven by feed needs
+ Despite the China trade issues, barley continues to perform strongly, particularly through feed purchases and Saudi exports

– The delayed harvest in some regions could, for some growers, reduce the potential size of a winter crop, such as oats
– Given the strong export demand, the industry will need to work to ensure that export bottlenecks don't disrupt trade
– Russia's export tax may add some short-term volatility to global wheat prices, while China's stockpiling may have the same effect in the medium to long term

In most years, many grain farmers across Australia would be having one of their quieter periods around February, however the relatively wet season has seen the harvesting period stretch far longer than usual. And while this season's grain crop will be one of the largest ever, events happening globally will also play out over coming months, with further benefits likely for Australian growers.

Within Australia, the wet weather has meant that harvesting has fallen well behind schedule in a number of Victorian cropping regions. Despite the fact that in a number of areas the crop has been unable to dry out enough to be harvested, the outlook for ongoing good yields has tempered any frustrations.

AUSTRALIA CONTINUES TO BE ON TRACK TO POST THE SECOND HIGHEST WHEAT CROP ON RECORD.

With a current forecast of 31.2 million tonnes, this would be more than double the drought-impacted crop of 2019/20, which only reached 15.2 million tonnes.

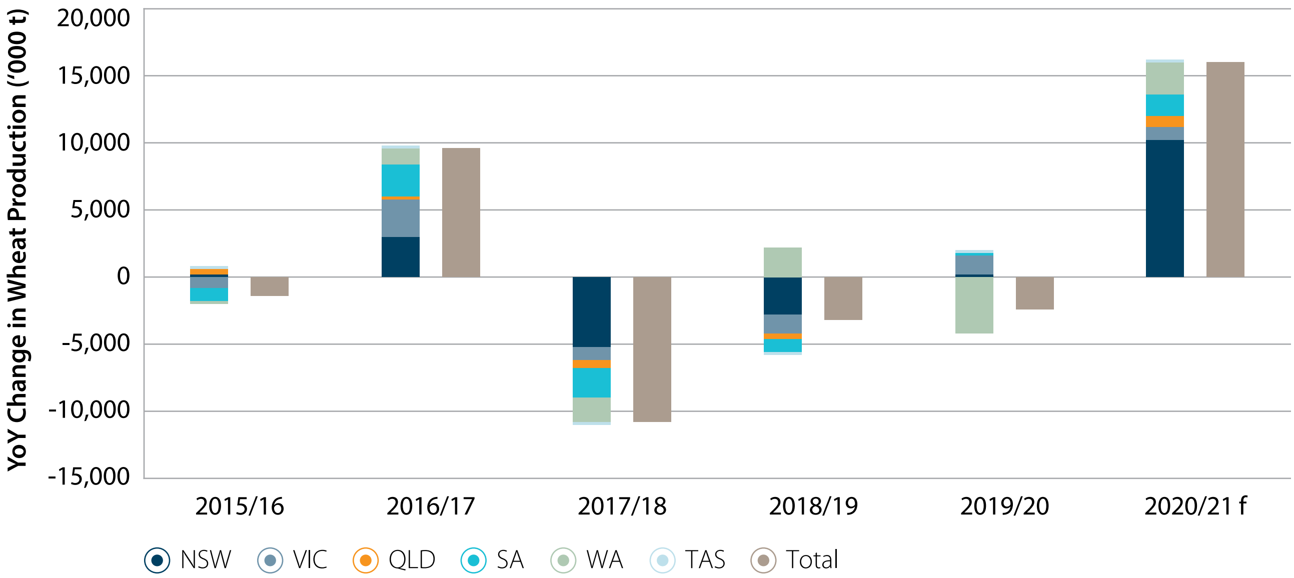
This year's crop has been boosted by both a strong rise in acreage, which grew this year by over 27 per cent to 13 million hectares, as well as a solid improvement in yield, which rose to a national average of 2.4 tonnes per hectare, up from the previous year's 1.5 tonnes per hectare.

This year's wheat exports are also likely to see a spectacular increase. From an initial forecast of 17 million tonnes at the start of the season, wheat exports are now likely to be around 20.5 million tonnes. Once again, this figure will be more than double the previous year's wheat exports of just over 9 million tonnes.

In terms of domestic grain demand, the good season resulting in a bumper crop has also resulted in excellent pasture conditions over much of Australia. On current estimates, domestic wheat consumption is forecast to fall by around 8 per cent to 8 million tonnes.

One further result of the bumper season may well be an increase in domestic end stocks of wheat in Australia, which have been depleted over the past few years of lean production.

NEW SOUTH WALES LEADS RECOVERY IN WHEAT YIELD ACROSS AUSTRALIA



Source: ABARES

Greater stocks would result in less nervousness about grain availability, reducing the upward pressure on prices heading out into the year, particularly before the next harvest.

Despite this, ongoing strong demand for grain this year is likely to ensure that stocks do not become too much of a price dampener. In particular, demand from feedlots is likely to remain strong, given the high numbers of cattle on feed, and the ongoing demand for grain-fed beef, particularly from South Korea and Japan.

One result of the high wheat volumes is likely to be an increasing switch to greater usage of wheat in feedlot rations, displacing the less widely available barley and the more highly priced sorghum.

The impact of the COVID-19 disruptions on consumer food-buying behaviour may also have ripple effects on grain prices, both in Australia, from any post-shutdown economic challenges, and in more disrupted offshore markets.

DOMESTIC BARLEY AND CANOLA CROPS

Away from wheat, the domestic barley and canola crops are also forecast to be the second highest on record, hitting 11.4 million tonnes and 4.2 million tonnes respectively. Despite the loss of the Chinese barley market due to new tariffs, barley exports remain strong, particularly to Saudi Arabia.

Globally, a bullish outlook for wheat production in the year ahead could potentially go some way towards keeping a lid on major price increases. While conditions may well change going forward, initial forecasts predict world wheat production hitting record levels, at 91 metric tonnes. These forecasts are based on major increases in the EU and US.

RUSSIA AND CHINA

In the short term, global grain prices will continue to be particularly impacted by the actions of Russia and China in global trade patterns. Russia's decision to impose a wheat export tax of A$80 per tonne from March until June this year has continued to impact prices, as global buyers have sought to procure supplies from new sources.

Australia may well be one of the major beneficiaries of this tax, as global buyers seek to access Australia's relatively reasonably priced, high quality wheat.

At the same time, China's ongoing major purchases of corn will also continue to ripple right through global grain and oilseed markets. China's purchases of corn from the US have increased sharply, driven by a poor recent harvest, a need to ensure reliable feed for China's rebuilding pig herd, and a quest to replenish domestic feed stockpiles and return to a greater level of feed security.

This could well have positive flow-on effects for Australia's wheat exports, as Chinese buyers seek to procure supplies to add to their feed mix.

BEEF INSIGHTS

OVERVIEW

+ The ongoing strength of cattle prices is great news for growers selling cattle
+ The ongoing wet summer season continues to provide ample pasture for most producers, greatly reducing supplementary feed costs
+ As the food service sector continues to open up in many countries disrupted by COVID-19 in 2020, consumer demand for beef may grow

– The longer the record prices continue, the greater concerns arise at the impact of a correction on the sector
– With the high prices being driven by restockers, feedlotters and particularly processors will find margins increasingly tight, and even negative
– Aside from trade issues with China which have impacted some processors, the ongoing recovery in China from African Swine Fever could see that country's beef import requirements fall further this year

With a forecast of a good season and ongoing high prices, the temptation is to say that the outlook for the cattle sector in 2021 is a strong one. While this is certainly the case for some, these factors could also present challenges to a number of players across the cattle and beef supply chain throughout the year.

It's now around a year since cattle prices started their surge upwards, with the Eastern Young Cattle Indicator (EYCI) having begun 2020 at around the 500 c/kg mark. It's worth reflecting that at the time it took less than two months for prices to rise above previous record levels of around 720 c/kg. After a minor price correction in March 2020, prices resumed their climb, albeit at a slightly slower rate, to the current point in the high-800s c/kg.

Interestingly, while it may feel like the industry has never seen a price rise like this before, the rapid climb is similar to the increase from January 2014 to August 2016, when cattle prices rose around 160 per cent, from around 280 c/kg to around 720 c/kg.

GIVEN THE RECORD PRICES AT THE START OF 2021, IS THE CATTLE MARKET HEADED FOR A MAJOR CORRECTION OVER THE COURSE OF THIS YEAR? POSSIBLY, BUT PROBABLY NOT.

In terms of the season, the weather outlook remains very positive for good rain for most cattle regions, meaning that grass is likely to be plentiful, hay and silage costs are likely to stay reasonable, and supplementary grain-feeding costs are likely to be low. As a result, many producers will be keen to continue to keep their properties as heavily stocked as possible.

On top of this, after months of successful cattle weaner sales, many producers will also be in an even better financial position to bid strongly against processors and feedlotters at cattle sales, putting more upward pressure on prices.

While a strong restocking process would normally see the rate of growth of the national herd increase, loosening the cattle supply pressure, the current high prices may have the opposite effect.

With the opportunity to take advantage of high saleyard prices, many producers may elect to sell more of their heifers than they would normally retain for breeding. Given that the forecast regrowth of the national herd was slowed by the high female slaughter rate during the drought, high heifer sales in 2021 could potentially keep cattle supplies tight for coming years.

The stark forecast for tight supplies will be particularly concerning for beef processors. Current forecasts from the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) are predicting the total cattle slaughter for 2020/21 to fall to around 7 million head, which would be the lowest total in over 30 years. As a result, overall beef production is forecast to fall to 1.9 million tonnes, the lowest since 1996/97, and a 21 per cent decline on 2019/20.

These falls are likely to have a major impact on export volumes, which are forecast to fall by around 22 per cent to 1.5 million tonnes in 2020/21. This would be coming off the back of a 15 per cent fall in beef exports in 2020.

This was largely driven by 34 per cent fall in exports to China, driven by both trade tensions and reduced demand for meat as a result of the Chinese pig herd's gradual recovery from African Swine Fever.

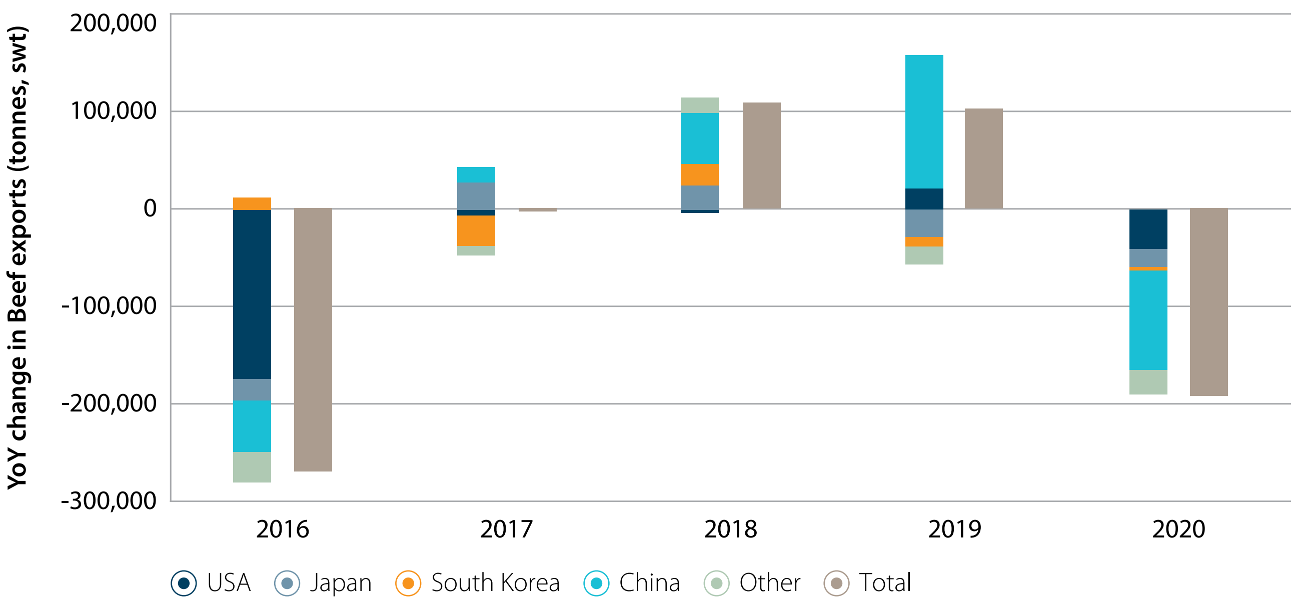
Despite this, Australian beef exports to China in 2020 were still the second highest on record.

Interestingly, the shift in trade patterns has seen Japan retake the mantle of Australia's largest beef export destination. Similar to many markets, the pandemic restrictions saw demand in Japan shift from food service to retail channels, resulting in only a 1 per cent fall in grain-fed beef exports to Japan.

The outlook for beef exports to the US in 2021 could be largely impacted by price, as well as by a change in COVID-19 disruptions on the food service sector. The relatively high exchange rate of the Australian dollar to the US dollar, currently at around 15 per cent on one year ago, continues to provide a challenge to US buyers, particularly in the face of cheaper alternatives. This is on top of the impact of tight Australian supplies limiting product availability.

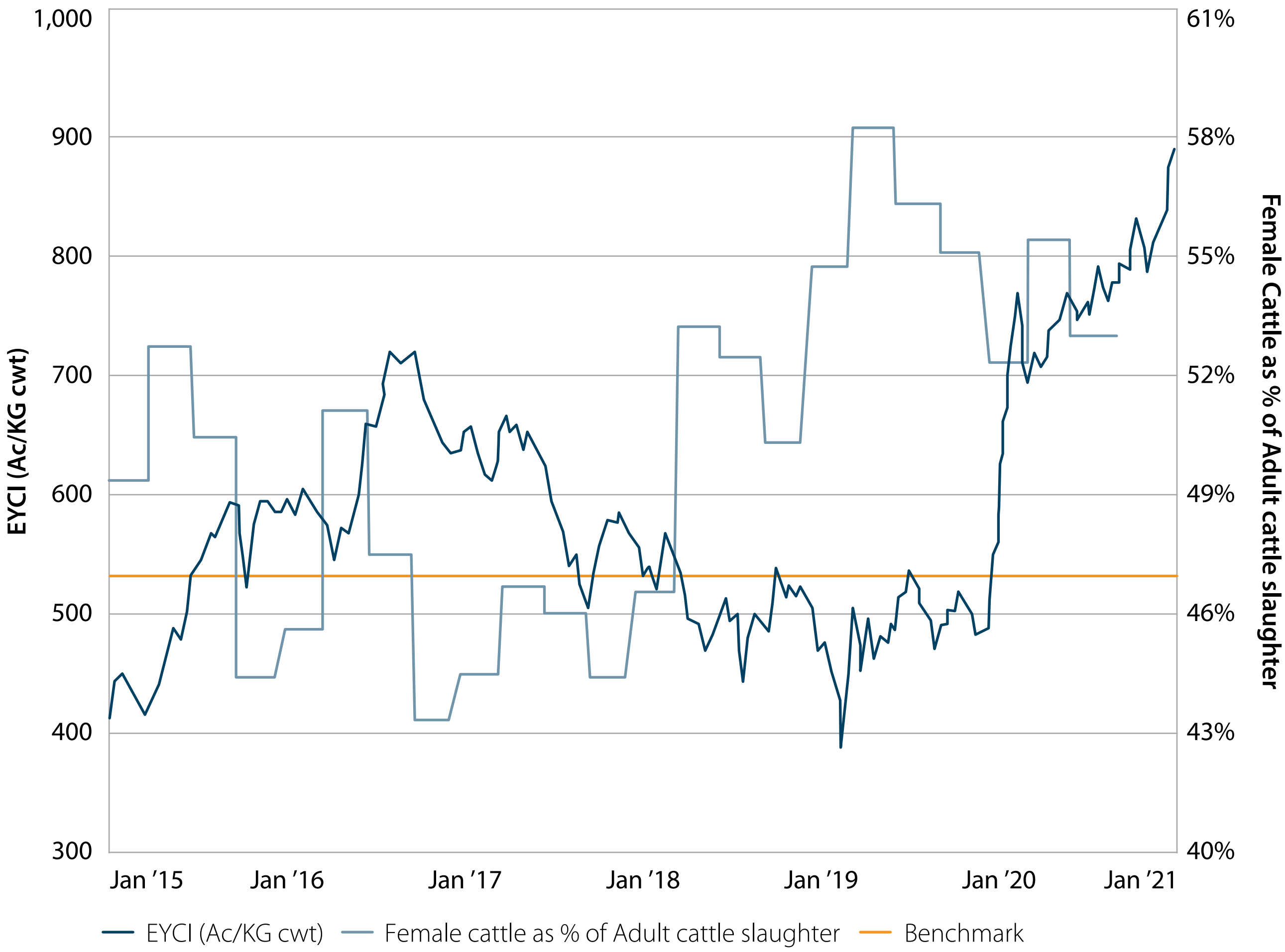
The outlook for exports to Australia's other major export market, South Korea, remain strong. Despite all the disruptions of 2020, exports to South Korea fell only 1 per cent last year. While tight Australian supplies may once again prove an issue going forward, Australian beef remains in high demand in South Korea, where it is regarded as both a superior quality to other imports, as well as being seen as a safe product.

BEEF EXPORTS TO FALL 15 PER CENT YEAR-ON-YEAR IN 2020



Source: MLA, ANZ

REDUCTION IN SLAUGHTER RATES COULD PUSH EYCI TO NEW HIGHS



Source: MLA, ANZ

Globally, beef prices in 2021 may remain reasonably high as the industry seeks to recover from a production fall in 2020. Around half of the production decline in 2020 was seen in India, due to severe restrictions across several states. While Indian beef does not tend to compete with Australian exports in most markets, any displacement to make up supply gaps could see upward pressure on prices across the board.

In terms of global competitors, Brazil looks set to remain the world's largest beef exporter in 2021, having come off a year where it was one of only two major global beef producers to see its export volumes rise – the other being Argentina.

Looking ahead for the Australian sector, the likely continuation of relatively high cattle prices will continue to ripple through the entire supply chain. While many restockers will continue to purchase cattle, an increasing number will find it difficult to compete, slowing the price growth. Feedlotters will also find the prices challenging, though an abundance of relatively cheaper feed will make their economic outlook more reasonable.

For processors, margins are likely to continue to remain very tight. While they will need to keep operating to meet domestic and export orders, it is likely that their operating capacities and outputs will remain lean and well below peak levels.

Finally, these prices will ultimately need to find their way to the retail shelf, although any beef price rises are likely to be minimal as retailers seek to avoid consumers reducing their beef purchases on a value basis.

SHEEP INSIGHTS

OVERVIEW

+ After a year of ups and downs, saleyard prices are performing well on the back of continuing restocker demand and returning export demand
+ Providing good seasonal conditions and restocker demand continue, 2021 may see the National Trade Lamb Indicator (NTLI) reach a peak challenging the 1,000c/kg mark
+ Restocker demand and the low national flock will continue to support prices into the foreseeable future

– ABARES lamb exports is forecast to fall by 9 per cent
– Western Australia continues to destock, having been impacted by ongoing dry conditions
– Annual volumes of Australian sheep meat export to China declined by 11 per cent over the 2020

It wouldn't be summer in Australia without a new lamb advertisement and Sam Kekovich on our television screens, and thankfully, unlike in the ad, most state borders have already come down. While the lamb slaughter rates for January didn't exactly match up to Sam's enthusiasm, the Eastern States Trade Lamb Indicator (ESTLI) certainly did with a strong opening.

While there was a small lift in recent slaughter numbers they were well below the five-year average. The Meat and Livestock Australia (MLA) Sheep Industry Projections are forecasting the Australian lamb slaughter to lift 800,000 head in 2021 from what was possibly the lowest levels in a century in 2020.

The favourable seasonal conditions on the east coast, with recent rains and drought broken across much of the country, have supported the ongoing flock rebuilding which started late last year. MLA expects the national flock to grow to around 67.3 million this year. This is just over 5 per cent growth from last year, the lowest base in over 100 years.

Meanwhile the West is continuing to destock with dry conditions expected to continue. It is estimated that 2 million sheep were transported from WA to eastern Australia last year.

STRONG RESULTS FOR THE NTLI

Opening trade for restocker lamb was a huge 319 cents higher in 2021 at 957 c/kg compared to the year prior when trade lamb sat 64 c/kg above the price of restocker. The inversing and widening gap between trade lamb and restocker lamb prices reflects the demand from producers as opposed to processors.

Similarly, the price of mutton opened 16 c/kg higher than in 2020 as producers retain breeding ewes for flock rebuilding.

ABARES is forecasting a fall of around 10 per cent to the low-700s over this year. The reduced demand expected in 2020–21 is driven by the inflated demand from the now-fading African Swine Fever which resulted in reduced pork supply and the negative effect on the global economy of measures to contain the spread of COVID-19.

ABARES lamb exports are forecast to fall by 9 per cent to $8.76 per kilogram. Similarly, the average price of mutton exports is forecast to fall by 6 per cent to $7.04 per kilogram. While overall sheep meat exports are expected to fall by 9 per cent to 418,000 tonnes, driven by declining mutton, this is partly offset by a 5 per cent increase in lamb exports.

MLA is forecasting lamb exports to grow 10 per cent in 2021 to 290,000 tonnes shipped weight. This would be a new annual lamb export record, with MLA predicting lamb exports will continue to grow each year for the next three years, increasing 25 per cent to 331,000 tonnes in 2023.

CHINA HAS RETAINED THE TOP DESTINATION

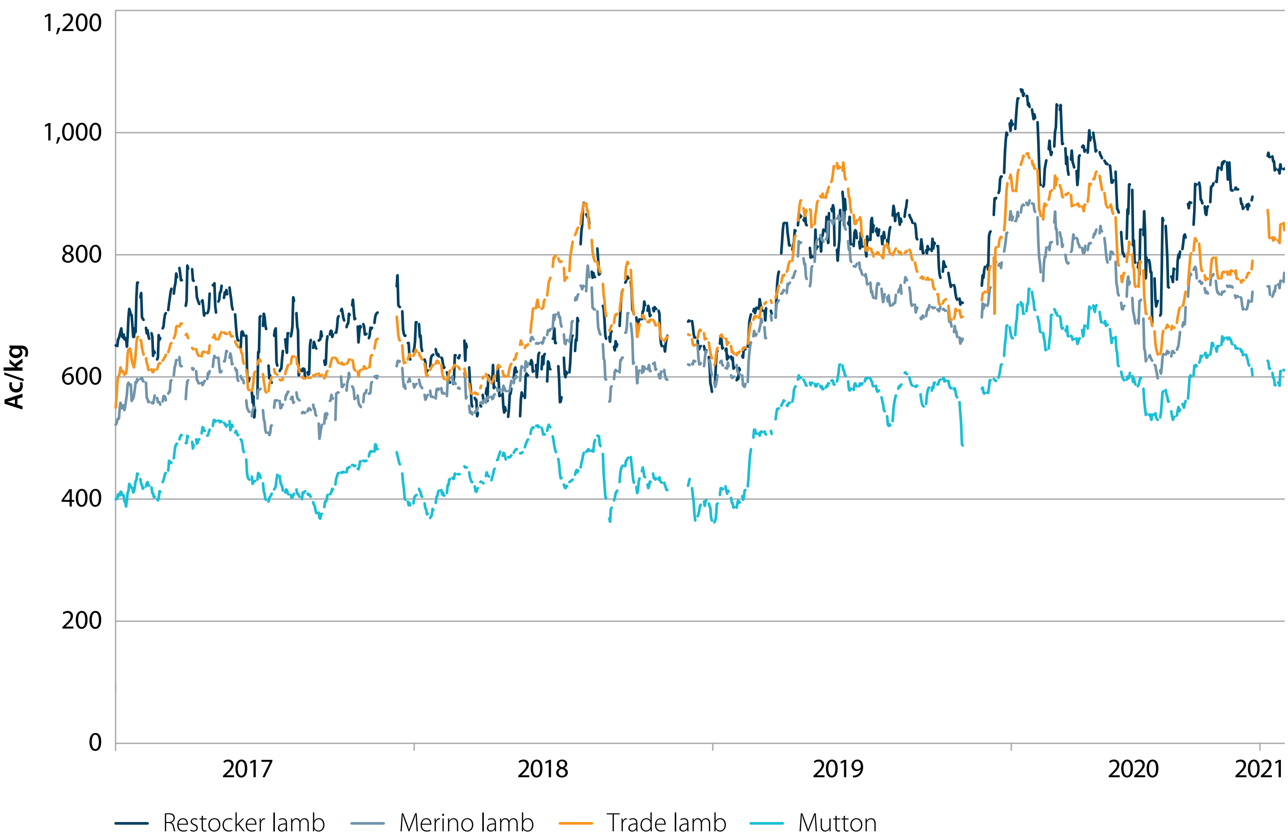
Annual volumes of Australian sheep meat imports to China declined by 11 per cent over the 2020, the US is coming in a very close second with 23 per cent of the volumes.

Australia accounted for 44 per cent of China's total sheep meat imports with New Zealand providing most of the balance. Combined, the two countries make up over 70 per cent of world sheep meat exports, so it would be unlikely that, should China review sanctions, they would be able to find an alternative market to supply the quantity needed.

Kuwait is Australia's top destination for live sheep exports, at around 41.6 per cent of total flows in 2020. The next two destinations are Qatar and Jordan, holding 22.2 per cent and 16.4 per cent respectively of market share. However, with the Qatari Government ceasing its subsidy on Australian sheep meat will have a significant impact on volumes, going forward.

Live sheep consignments to Kuwait in the months leading up to the moratorium showed the last four months of the year flows were 28 per cent under those seen in 2019. It is early days, but could signal that Kuwait is considering reducing its reliance on Australian sheep to ensure their food security.

DEMAND FOR RESTOCKER LAMB DRIVING PRICE RISES AT THE SALEYARDS



Source: Meat and Livestock Australia

TALE OF TWO COASTS

East coast mutton slaughter opened the season 32 per cent below the five-year average trend. While it's a slow start, it is expected there will be some small gains limited by the focus on flock rebuilding.

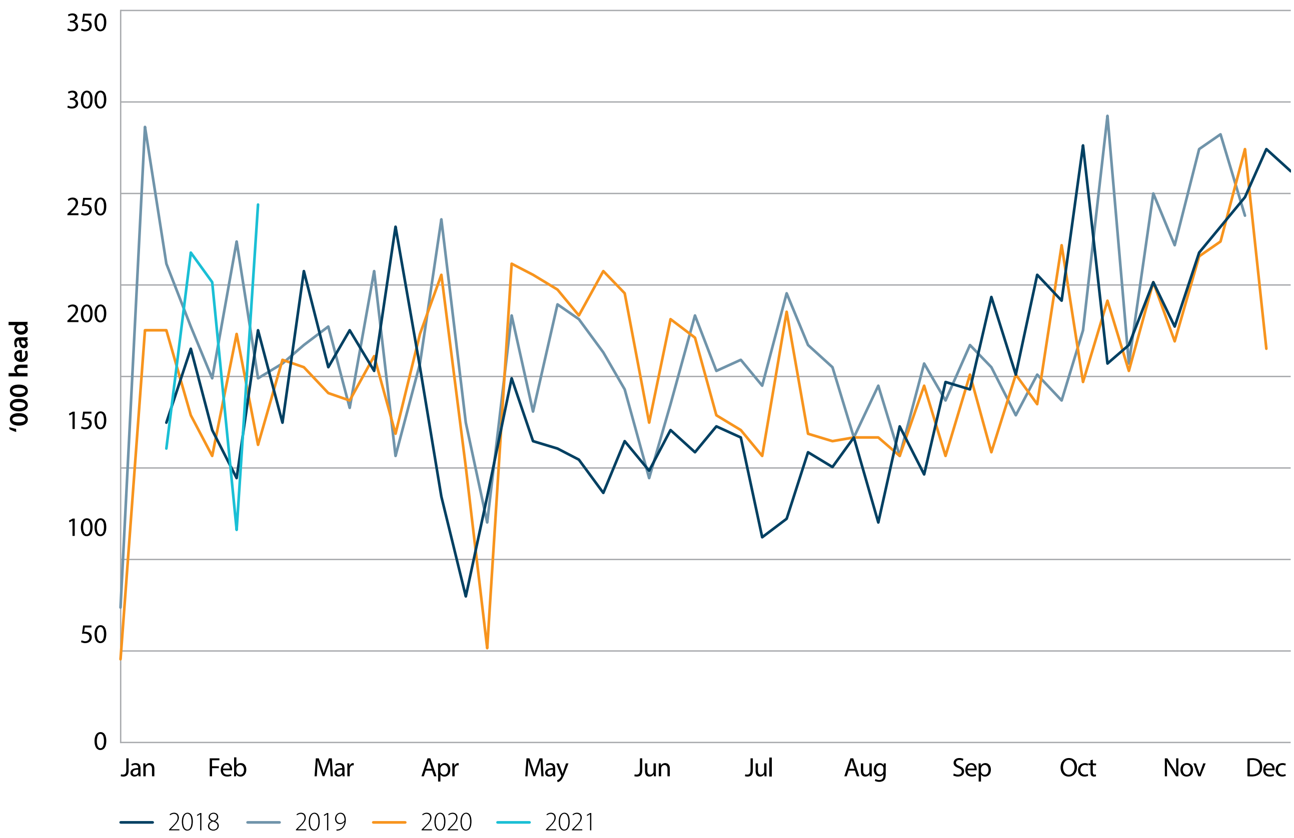
Slaughter rates in the west however, are down substantially. The ongoing drier conditions have seen around 2 million sheep shipped across the Nullarbor to eastern states.

Saleyard prices are holding firm in the new year. However, the price spikes in early 2020 have seen the NTLI drop just below prior-year levels. The NTLI is now sitting at over 846 c/kg almost as a result of a strong ESTLI of 862 c/kg compared to WA at 713 c/kg.

DEMAND FOR RESTOCKER LAMBS AND EWES EXPECTED TO CONTINUE IN 2021

Looking forward at expectations for 2021, the improved weather will see the focus on flock rebuild and subdued slaughter to continue, which should see strong upward pressure on prices.

WEEKLY LAMB YARDINGS BOUNCED BACK AFTER THE SHORTENED WEEK ENDING 29 JANUARY



Source: Meat and Livestock Australia

WOOL INSIGHTS

OVERVIEW

+ Continued strong interest from Chinese buyers has helped support prices
+ The forecast of a slight increase in production for 2020/21 will also provide support for prices across the shearing season
+ Strong seasonal conditions have seen good production in the eastern states

– Low flock numbers mean production and supply will remain relatively constrained into the future
– Lack of shearer availability has meant a return to longer shearing intervals for some producers
– Australia's on-farm stockpile of wool may dampen prices when producers decide to re-enter the market

The Australian wool market rounded out the first month of 2021 with exceptional gains for the first three trading weeks. The Eastern Market Indicator gained 135 Ac up until the end of January, although opened February with a slight drop. Gains were shared across all microns, although the strongest gains and most interest was in the fine and superfine microns which have had limited supply in recent years due to a decline in flock numbers and recent strong seasons.

DEMAND FROM CHINESE BUYERS HAS SUPPORTED PRICE INCREASES

Much of the recent price increase appears to have come as a result of increasing speculation of a large order from the Chinese Government for uniforms. While interest from Chinese buyers has been strong, it cooled in the first week of February as an apparent price ceiling was reached and buyers pulled back. While demand from China appears to have strengthened in the first few weeks of 2021, industry analysts have also reported that demand is also being driven by a desire for quick shipment and delivery.

This may suggest a number of things, including a diminution of any stockpile held in China or an increase in demand for woollen fabric and clothes as global economic growth starts to improve.

Offerings have started higher in 2021 as producers start to reduce their stockpile held on farm, which some estimates have put up to 350,000 bales. However with the total number of bales offered for auction up only 4,700 on the same time last season, it is likely to be long process before that stockpile is eroded.

TRADE TO CHINA REMAINS UNSCATHED TO DATE

To date, Australia's wool trade to China has remained unscathed by ongoing trade tensions and, indeed, in early January, the Chinese government increased Australia's wool import quota by 5 per cent to over 38,000 tonnes. While this increase was agreed to under the China–Australia Free Trade Agreement, it has been taken as a positive sign by most in the industry that wool exports may not suffer from the same issues as many other agricultural exports to China.

WOOL PRODUCTION GROWTH IS SUBDUED ACROSS THE COUNTRY DUE TO FLOCK NUMBERS

The most recent wool production forecasts were released at the end of 2020, predicting a 1.1 per cent increase in the Australian wool clip in 2020/21. Strong seasonal conditions have seen good production in New South Wales, Victoria, South Australia and Tasmania and supported the growth. However, wool in Western Australia is forecast to fall as the numbers of ewes being shipped east and dry conditions reduce WA's output.

It is also estimated that the number of sheep shorn across the country will decline by 5.5 per cent in 2020/21. This is due lower sheep numbers and a reduction in shearing due to a lack of shearers, and which is offset by a 7.7 per cent increase in yield per head.

THE NEW YEAR HAS BROUGHT STRONG GAINS ACROSS MICRONS

Source: AWN, ANZ
f: forecast p: projection

COTTON INSIGHTS

OVERVIEW

+ ABARES forecasts a 9.5 per cent increase in demand for cotton as a result of the expected uptick in consumer sentiment
+ La Niña has peaked with wetter conditions expected to continue through to April
+ Stock to use ratios in the US and globally (ex China) is expected to drop back from the highs of 2019/20

– ABARES forecasts cotton prices to reach their lowest levels (in real terms) since 2001/02

– Australian current export volumes remain low as the recent bumper crop is ready for export

– Uncertainty and volatility likely to continue in the market where the influence of stockpile movements remain leading factors

The generally good rain through December across much of the country's cotton producing landscape has seen an increase in production. For parts of Queensland, the cooler weather conditions and rainfall really started to show in the second half of December with some decent storm systems rolling across. Meanwhile much of Queensland are still yet to see the above-average rainfall that was hoped.

Although La Niña appears to have peaked, we do still expect the effects to continue through to April. Unfortunately, there is still not enough water in the system to see yields at the five-year average.

ABARES forecasts productions have increased to 2.2 million bales however this remains 35 per cent below the 10-year average.

COVID-19 CONTROL MEASURES HAVE REDUCED CONSUMER DEMAND AND DISRUPTED ALL PARTS OF THE TEXTILE SUPPLY CHAIN

EU, the US and Japan are responsible for importing 61.5 per cent of the global apparel imports. Vaccinations in EU and US, along with continued stimulus packages, are expected to support a recovery in spending which, it is hoped, will align to the Northern Hemisphere spring/summer buying.

Mill-use has been at a 10-year low, however, with many of the processing countries – China, Vietnam, Bangladesh and Turkey – seeing a recovery, this has improved with mills rebuilding inventories. There are concerns that this demand is more a 'catch-up' following COVID-19 shut downs rather than being driven by a real improvement in retail demand.

At the start of this season, China had stocks which equated to 98 per cent of a year's domestic demand. This is a huge stockpile, which, when domestic production is added to the equation, is pointing towards reduced import requirements.

As a result, ABARES forecasts cotton prices to reach their lowest levels (in real terms) since 2001/02.

The world cotton price is forecast to average US67 cents per pound in 2020/21, down by 6 per cent from 2019/20.

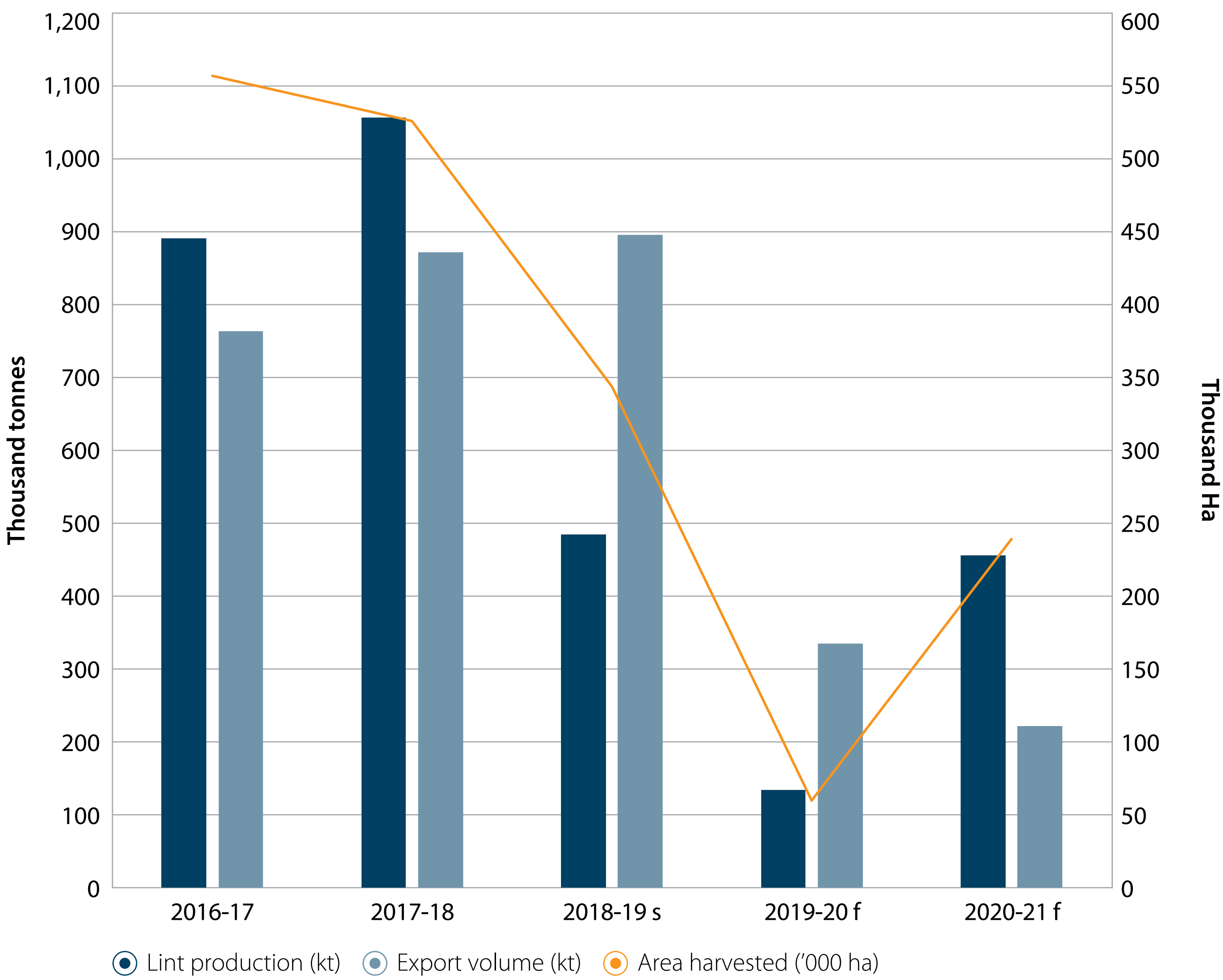
While China is by far the leading spinning centre and the major importer of Australian cotton, markets such as Indonesia, Bangladesh, Malaysia and Vietnam are driving the recovery in milling and represent a combined 32 per cent of exports.

Australian current export volumes remain low as the recent bumper crop is ready for export. The industry will need to focus on marketing the quality and consistency of the product to grow market share in the growing Southeast Asia markets.

Should Australia need to seek alternate markets, increasing volume to those we already hold strong export relationships with would result in significantly less discounting compared to other markets, for example, Turkey or Japan.

Domestically, favourable water availability may see producers looking to forward offers of around $530/bale currently on offer for 2021 crop, to secure a level of profitability for the upcoming season. While longer term price forecasts remain closer to $500/bale, below the solid prices of over $600 a bale seen in recent years, the focus on improved efficiencies in production by the local industry means it remains at a profitable level.

ABARES FORECASTS A 9.5 PER CENT INCREASE IN DEMAND FOR COTTON AS A RESULT OF THE EXPECTED UPTICK IN CONSUMER SENTIMENT



Source: ABARES
f: forecast p: projection

DAIRY INSIGHTS

OVERVIEW

+ Global dairy prices continue the strong finish to 2020 into 2021
+ Global consumption is currently keeping in line with strong global production, particularly in the US and EU
+ Australian exports have held up relatively well through the second half of 2020, growing almost 8 per cent year-on-year in volume

– The decline in Australian exports of Infant Milk Formula to China has eroded the total value of Australian exports which had declined almost 4 per cent in the second half of 2020, year-on-year
– Years of drought and high cull numbers has seen the Australian dairy cattle herd decline to historic lows and constrained the rebound in production
– A higher than normal decline in dairy business numbers in Victoria may flag a further contraction in production in coming years

The global dairy industry has continued its impressive finish to 2020 into the new year, recording continuing increases in global dairy prices which now extend back to November 2020. The latest Global Dairy Trade (GDT) auction showed a strong 1.8 per cent growth across commodity sectors, following two impressive results of 4.8 per cent and 3.9 per cent to start the year. Price increases have been seen across most categories, with the strongest demand coming for the milk powders. Butter prices have also seen strong increases over the past few months. As a result, the GDT reference price now sits at $3,614USD/MT – the highest since mid-2014.

STRONG GLOBAL PRICES HAVE NOT RESULTED IN INCREASING AUSTRALIAN FARMGATE PRICES

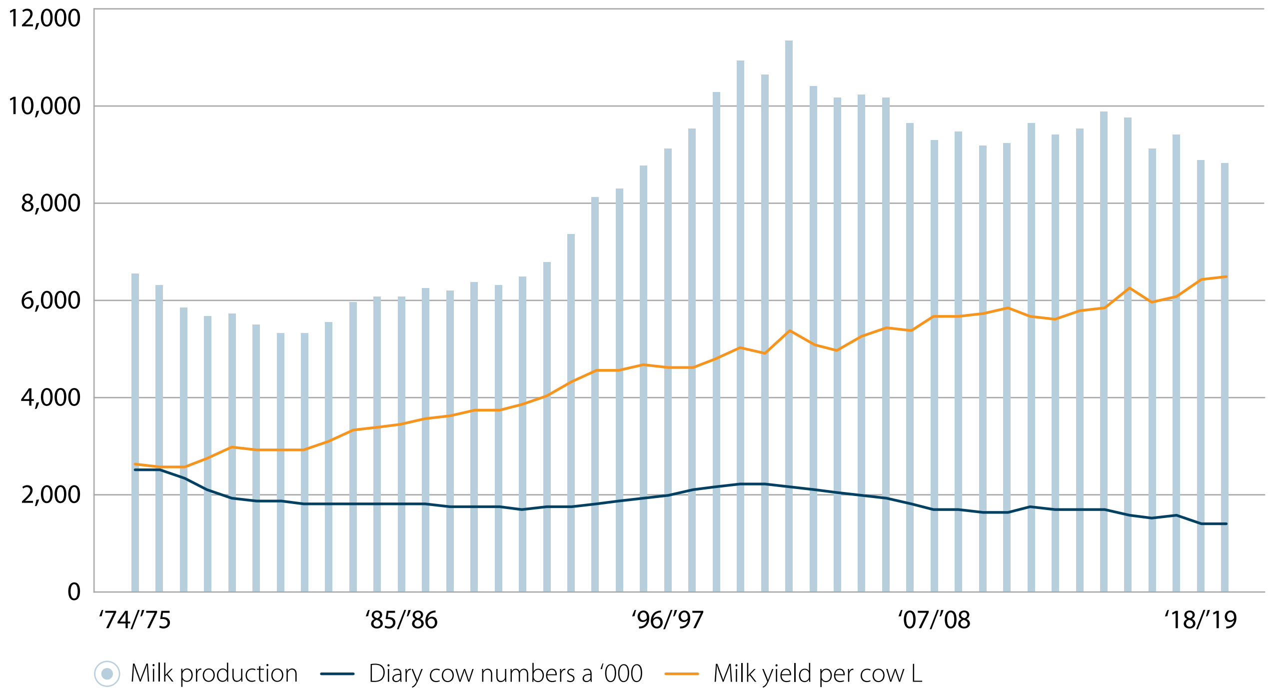
The strong GDT auction results have Fonterra New Zealand lifted their forecast farmgate milk price range up by 20c a kg to $6.90 to $7.50 per kg. Recent calls in the Australian industry for the major processors to follow the lead of Bulla Dairy Foods, which announced a farmgate price increase of $0.10/kg of milk solids, and provide step-ups to their producers, have not been met with success.

Some in the industry, however, have noted that the industry environment is now significantly different from the times when step-ups were a relatively common. Processors are now bound by stricter pricing contracts and competing in a lower supply environment, meaning any price increases out of the contract cycle are increasingly unlikely.

GLOBAL PRODUCTION STRONG

Global production finished 2020 unexpectedly strongly, particularly in the US and EU, but also in Australia and New Zealand, with US production increasing almost 3 per cent year-on-year to the end of 2020. To date, global demand throughout the pandemic remains relatively strong and is keeping pace with the production increases. However, as forecast consumption is expected to soften in the US, as government-subsidised food boxes ends in April, there is some room for prices to soften later in the year.

AUSTRALIA'S DAIRY HERD AT HISTORIC LOWS



Source: ABARES, ANZ

AUSTRALIAN EXPORTS LOOK SOLID, BUT PREMIUM MARKET TO CHINA BEING ERODED

Australian exports have held relatively firm in the second half of 2020, with butter, milk and skim milk powder exports all showing solid growth year-on-year. Whole milk powder exports are down, however this is, in part, due to the triggering of safeguard measures for increased tariffs on Australian exports to China.

Australian exports of Infant Milk Formula (IMF), which is one the largest exports to China, have dropped off as the value of the Australian brand is reported to have been eroded in recent years. While China constitutes a large and high-value export destination for IMF, in the last nine months of 2020, dairy industry analysts Fresh Agenda reported that "the value of Australian IMF trade in US dollar terms is down 41 per cent year-on-year". Early signs in 2021 are slightly positive for the IMF market, however, it is not clear whether it will rebound to previous heights.

AUSTRALIAN PRODUCTION PLATEAUED

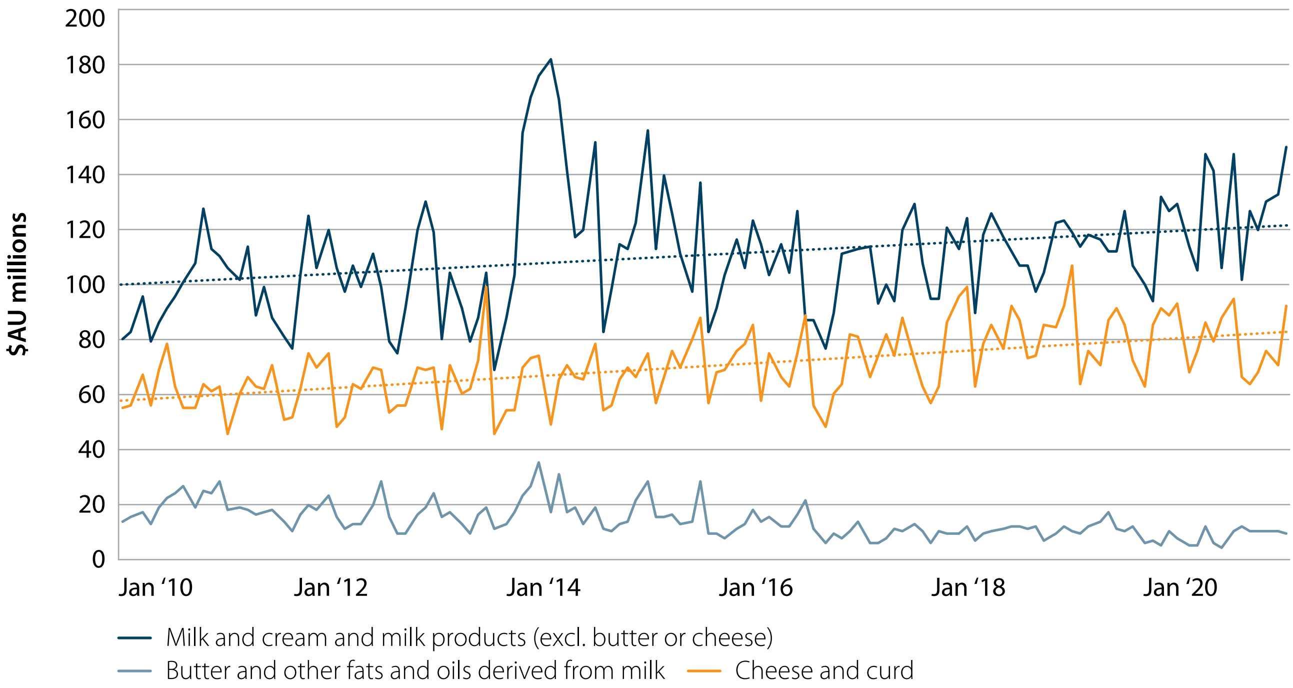
Australian production grew strongly through spring, however some natural constraints have meant that this growth has now plateaued. Dairy Australia has forecast that milk production will fall towards the bottom of the 1 per cent to 3 per cent growth range for 2020/21.

While milk production conditions remain strong due to good seasonal conditions, with many producers now able to readily access cheaper feed, the number of producers leaving the industry, as well as the low domestic dairy cattle herd, have put a cap on production growth. Access to labour across the COVID-19 period lockdown has also meant that production fell off towards the end of 2020. Dairy Australia have suggested that milk production has plateaued due to lack of investment during the consecutive drought years, which restrained business performance and investment, including fertiliser use or herd growth.

More concerning, however, is the continued decline in dairy business numbers which in Victoria alone have declined 11 per cent in the last year, based on relatively low farmgate milk prices and low producer confidence.

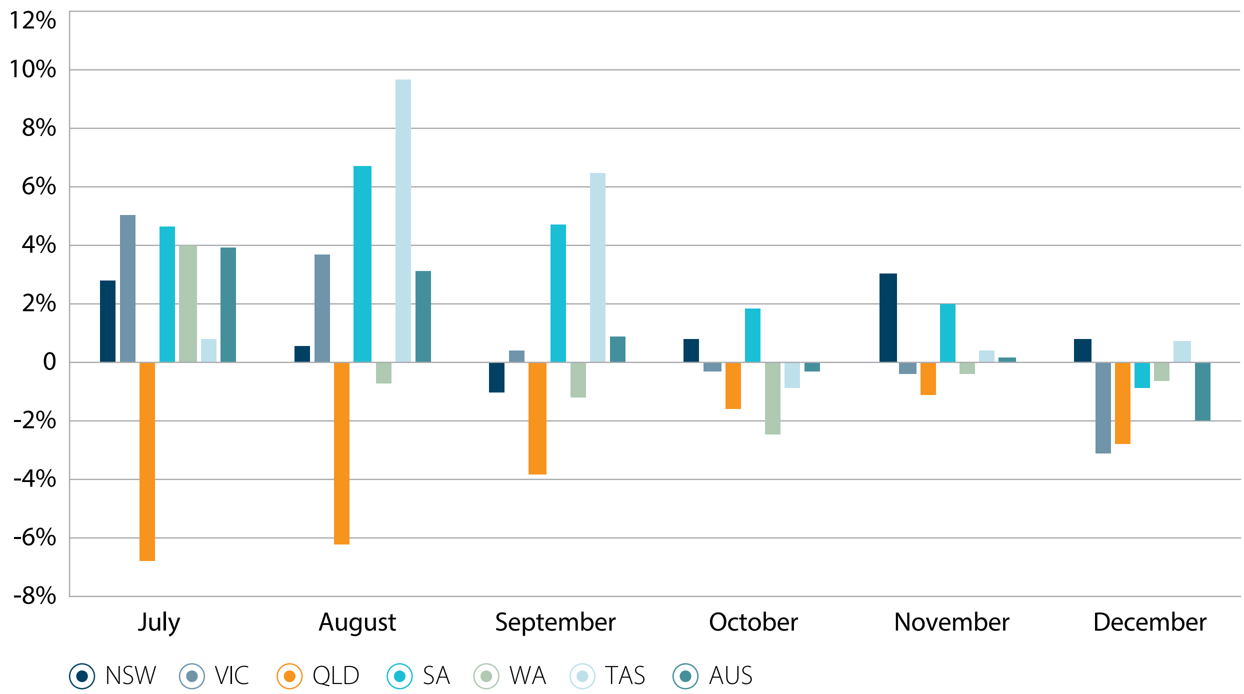
Australia's dairy cattle herd numbers are sitting at historic lows, now sitting at just under 1.4 million head. This was based primarily on very high cull numbers during drought times which have limited the industry's ability to respond to good environmental conditions, meaning that any growth in milk production will have to come from an increase in per cow yield.

AUSTRALIAN EXPORTS STEADILY INCREASING



Source: Dairy Australia

AUSTRALIAN PRODUCTION RECOVERING IN MOST STATES EXCEPT QUEENSLAND



Source: Dairy Australia

WINE INSIGHTS

OVERVIEW

+ The ongoing recovery form the drought will continue to lift wine grape production levels.
+ Domestic demand likely to recover as community restrictions ease, and local premium wine prices fall
+ Domestic wine producers will continue to explore new market opportunities outside of China

– The recent new tariffs on Australian wine exports to China will continue to see exports to that market vastly reduced.
– Significant slowdown in global economic activity which led to a double-digit fall in world wine consumption has widened the gap between supply and demand, leading to a global surplus
– Reflecting global conditions, red wine grape prices may see a sharp fall in 2020/21

Of all the Australian industries impacted by the recent trade tensions with China, arguably the one most impacted has been the wine industry. (This is with the possible exception of Australian rock lobsters – which go perfectly with a Margaret River Chardonnay.)

Given that the decision by China to impose new high tariffs on Australian wine came in November 2020, it had only a marginal impact on the overall wine figures for the whole of 2020. However, the immediate impact it had in the last few weeks of the year provided an indication of how it may play out in 2021 and beyond.

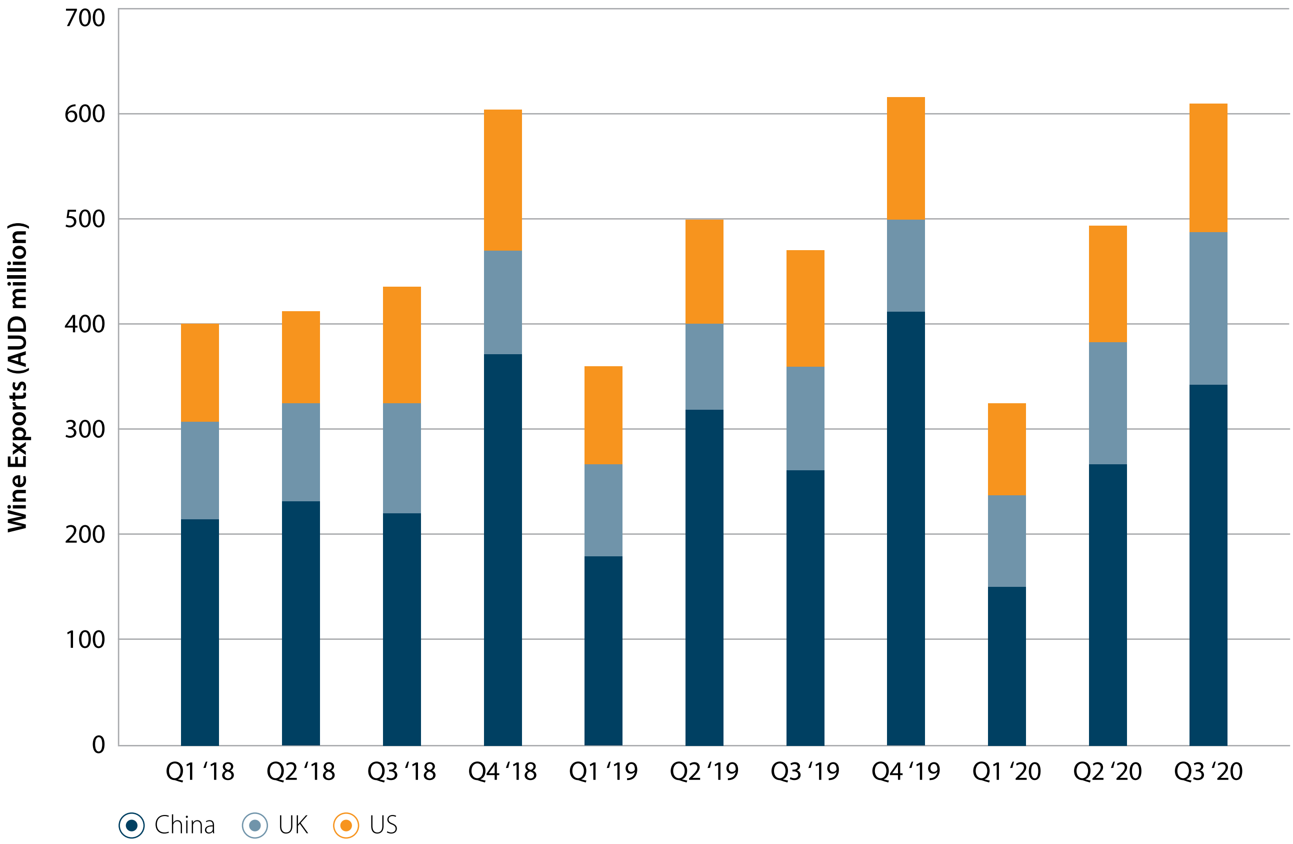
Like a number of other industries, Australia's wine production sector comes into 2021 still in a long-term recovery mode, particularly as a result of the drought. Domestically, wine grape production in 2020 fell to 1.3 million tonnes, the lowest volume since 1999/2000. The fact that overall vineyard area had remained steady at around 116,000 hectares emphasised the role of reduced yields in the production decline.

Looking to the year ahead, a return to more favourable conditions is forecast to see wine grape yields reach around 12.1 tonnes per hectare in 2020/21, just above the 10-year average. This yield would bring Australia's overall wine grape production back to 1.4 million tonnes.

Assuming that Australia sees fewer COVID-19 related disruptions this year than last, the domestic demand story for wine may well improve markedly, reversing the impact of last year's lockdown restrictions impact wine consumption at bars and restaurants, as well as on cellar door sales.

In terms of wine exports, the fact that the tariffs on imports to China occurred so late in the year meant that the overall annual volumes were barely affected. Encouragingly, overall wine export volumes actually increased marginally, to 747 million litres, while the average price of one litre free on board (FOB) fell only slightly to $3.87.

WINE EXPORTS TO FACE HIGH DISRUPTION WITH CHINESE TARIFFS



Source: ABARES, Wine Australia

WINE EXPORTS TO CHINA SURGE ON ANNOUNCEMENT OF TARRIFS

One interesting export pattern to look back on was the surge of wine exports to China in September and October last year. Just prior to the imposition of the tariffs, wine exports hit a record 12 months year-on-year figure of $3.1 billion, going past the previous record of $3 billion set in 2007.

China announced in August that it was launching anti-dumping investigation, and that a number of Australian wine companies had until mid-November to complete the questionnaires.

In a sign of the expectations of the market of the outcome of the investigation, wine exports surged over the next two months prior to November, increasing by 23 per cent on the same period the previous year.

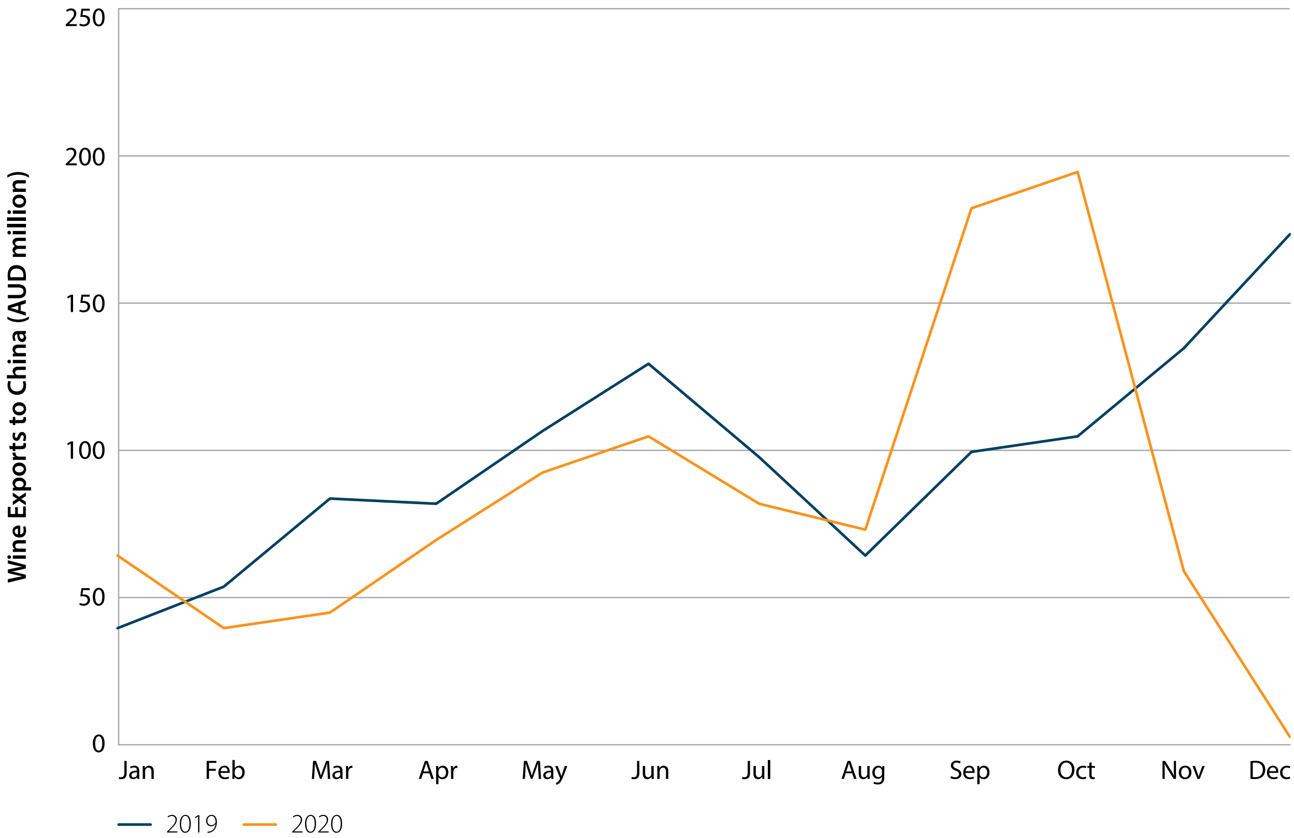
With the imposition of the tariffs in November, wine exports to China fell sharply, crashing to negligible figures in December.

Looking ahead, without a change in policy on the tariffs, it seems unlikely that wine exports will show any reasonable recovery for some time. For Australian wine producers who have been largely reliant on exports, there is no glossing over the fact that this could make 2021 a challenging year.

The industry will now ramp up its efforts to increase exports to other markets, particularly the UK, EU and US. The restrictions on travel may make this challenging, with winemakers unable to personally promote their products, while other traditional tasting campaigns will also be restricted. A further challenge in a number of these markets is that competing wine from countries such as Spain, Chile and Argentina not only have established reputations, but compete at lower price points.

This is different from the Chinese market, where Australian wines are viewed as far more of a premium product than these competitors.

EXPORTS TO CHINA RALLIED HIGH BEFORE TARIFFS KICK IN



Source: Wine Australia

In 2020, China had been Australia's largest wine export market, accounting for 40 per cent of total export value. However, the fact that it also only accounted for around 14 per cent of volume exports reflects that the average value of wine exported to China was $11.0 per litre.

One slight positive out of this impact may well be for Australian consumers. With a reasonable percentage of Australia's premium red wines now unable to find a market in China, they are likely to hit the shelves in Australia.

Given the limited size of the domestic market, wine producers may be forced to reduce the prices at which these reds would normally retail, in a bid to shift merchandise, generate ongoing revenue, and hopefully, for them, lift the share of Australian red wine in the domestic beverage market.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THE AUSTRALIAN ECONOMY IS RECOVERING. FAST.

Almost all of Australia's economic indicators show that the economic recovery from our recession in the first half of last year is well underway.

Over the second half of 2020, the number of Australian residents with jobs increased by 557,500 and the unemployment rate fell from its peak of 7.5 per cent in July to 6.6 per cent in December. The recent surge in the ANZ job ads index suggests that we may see the unemployment rate dip below 6 per cent this year, though ANZ Research is a little more cautious about the near-term outlook given the end to JobSeeker in March.

Reflecting the rebound in the labour market, ANZ Roy Morgan consumer confidence has recovered to its long-term average, after a period of extreme negative consumer sentiment through pandemic and lockdown conditions.

And with more work and confidence, our spending is back on track. Retail volumes were 9.2 per cent higher in Q4 than Q2 and monthly housing lending was 50 per cent higher in December than June. The resurgence of investor housing lending in particular – which was up 37 per cent in December compared to June – was one of the clearest indicators that risk appetite and expectations for economic growth are returning.

POLICY SUPPORTS WILL BE IN PLACE FOR A WHILE

While there has been rapid improvement across economic activity in Australia there is, to quote the RBA Governor, "still quite a way to go."

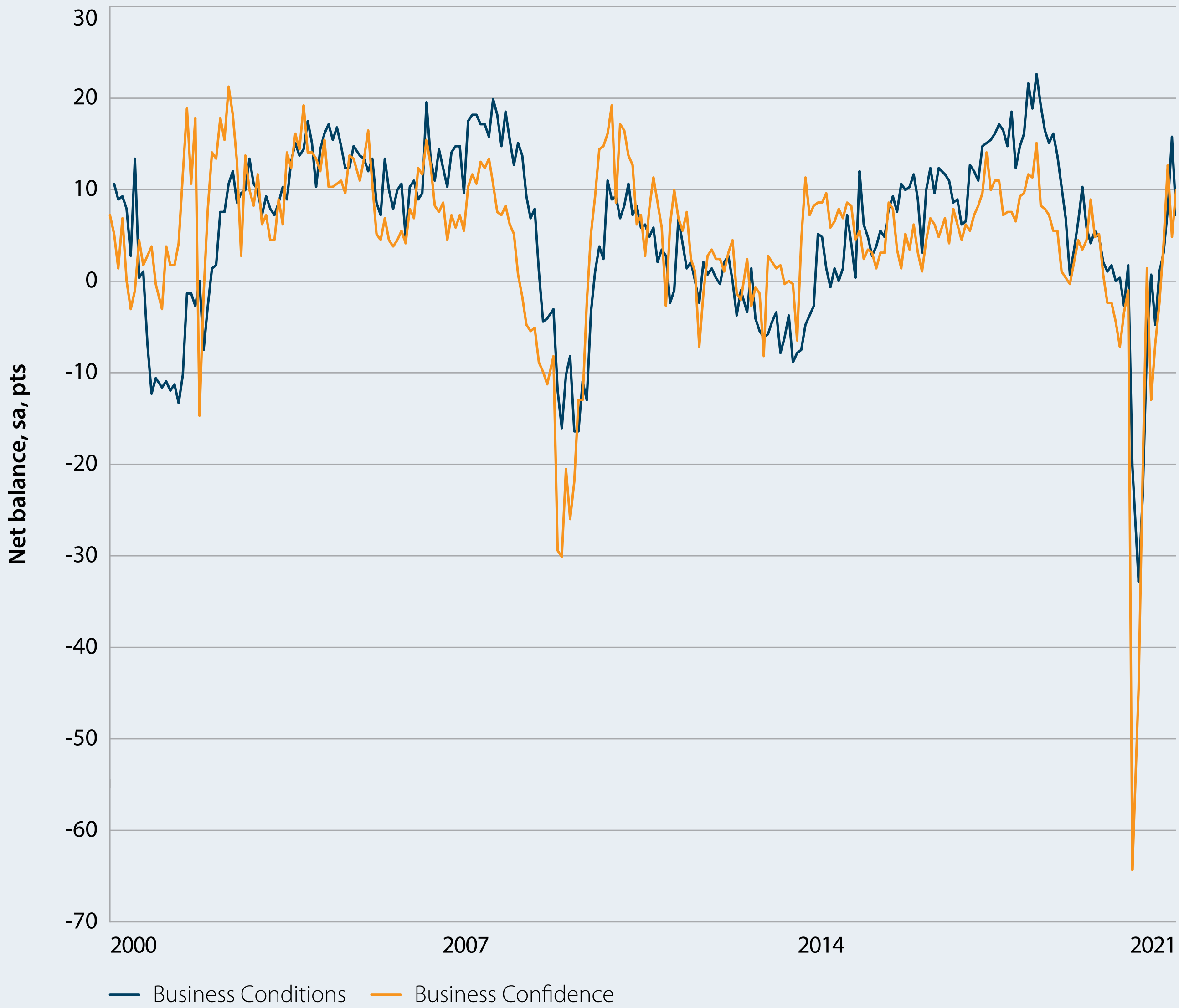
As of December, there were 112,000 fewer people in full-time work compared to before the pandemic. Overall slack in the labour market is still elevated, which is likely to keep wage growth depressed for some time.

This means we are far from reaching the RBA's inflation target band of 2–3 per cent, with the RBA forecasting that inflation will only be 1.75 per cent by mid-2023. On this basis, we expect the RBA to continue to provide low borrowing costs. The RBA expects to keep the cash rate at its record-low of 0.1 per cent until at least 2024, and announced recently it would extend its quantitative easing program when the current one ends in April, adding another $100 billion of liquidity into the economy from that month.

Government policy is also likely to stay stimulatory for a while. HomeBuilder was extended until March, but will bring benefits past the March quarter for residential construction activity. Infrastructure spending and business investment tax breaks by the federal government, along with low borrowing costs, should also help to continue the economic recovery and raise risk appetite in the near term.

Having said this, some government support will come to an end – such as JobKeeper. Despite the looming end to this program, business conditions and confidence are now both in positive territory after extreme declines at the beginning of the pandemic.

BUSINESS CONFIDENCE STARTS THE YEAR WITH A DROP FOLLOWING STATE MINI-LOCKDOWNS



Source: NAB, Macrobond, ANZ Research

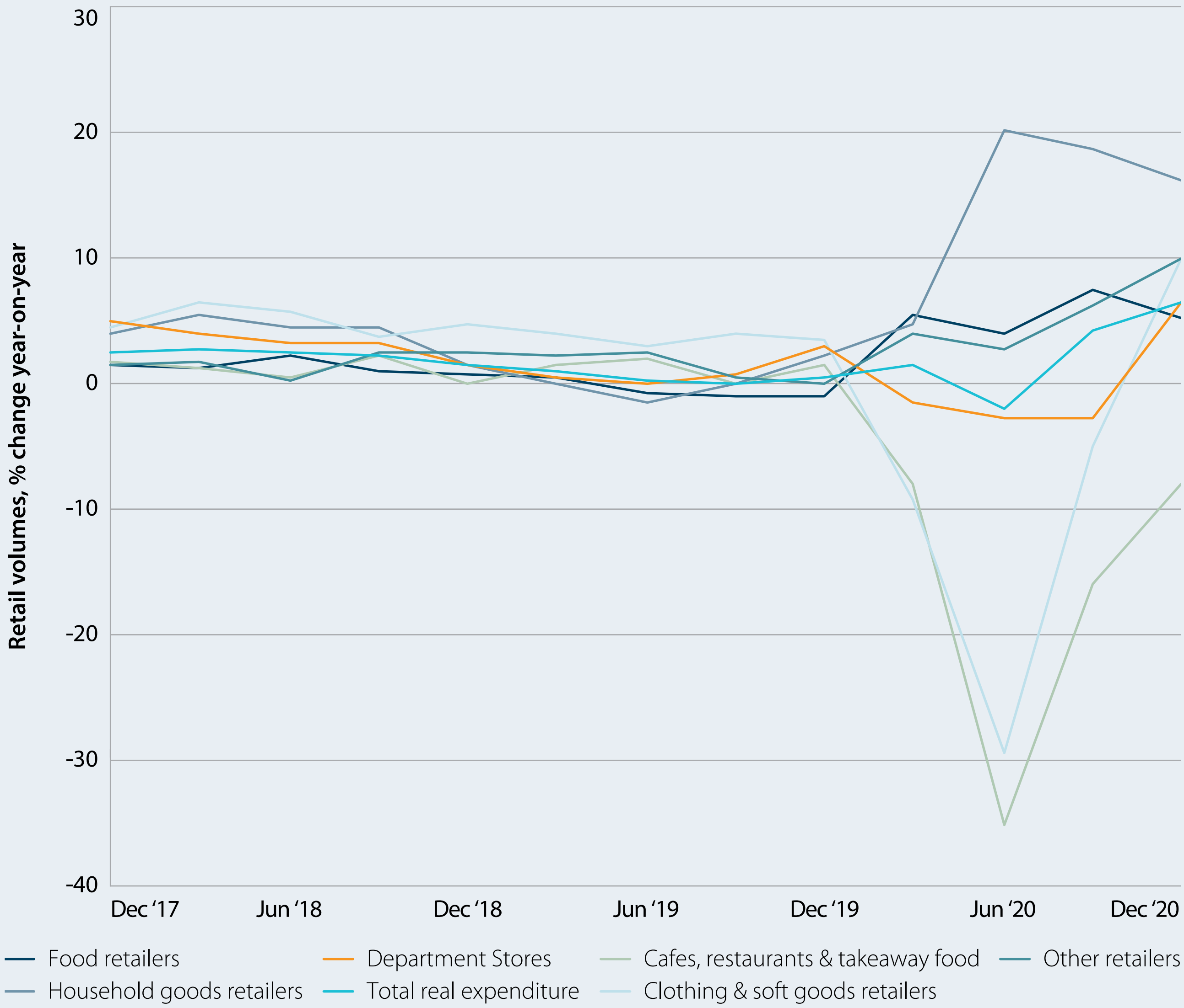
AUSTRALIAN RESIDENTS ARE "BUYING MORE" WHILE THEY CAN'T "DO MORE"

Remote working and lack of access to travel has turned the focus of spending for many residents inward, to the home. While spending on home upgrades is past its peak, we are still seeing stronger annual growth rates compared to pre-pandemic. Furniture (+36 per cent year-on-year for the week to 31 January) is particularly strong.

We expect strong retail growth to continue while borders are closed, since access to other types of spending are limited. This may be a positive sign for production of retail inputs, including timber.

In the past, Australians travelling overseas contributed more to the global economy than was contributed by international tourists visiting Australia to the local economy. This means that we may actually see much more spending by Australians travelling within Australia while borders are closed. It's important to note though, that Australians who travel within the country are unlikely to spend as much as they would if they went overseas. Still, this will provide an important boost – especially to regional Australia.

CONSUMERS SPENDING ON HOUSEHOLD GOODS SPENDING OVER EATING OUT



Source: NAB, Macrobond, ANZ Research

RURAL EXPORTS POWER ON DESPITE TRADE DISPUTE

Agriculture exports have weathered the pandemic well despite trade difficulties, including import restrictions by China. In December, rural exports were up 18.4 per cent month on month as cereal exports surged, reflecting good growing conditions in Australia's wheatbelt and less supply from global competitors. But as the Australian dollar continues to appreciate (we expect it to hit 0.82 USD by the end of the year) we may lose some of our competitive edge when it comes to selling agriculture products overseas.

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