Australian Agriculture Outlook

2018

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Australian Agriculture Outlook 2018

In Australian agribusiness, 2017 will be remembered for record wool prices, large global wheat stockpiles, lacklustre milk prices, great conditions for vegetable production and one of the best years to be a sheep producer.

As the new year gets underway, our thoughts naturally turn to what lies ahead. There are several agribusiness trends that we expect to see play out over 2018:

1. **Growth in horticulture exports**
2. **The sheep industry to enjoy another exceptional year**
3. **Wool prices to hold on to 2017's gains**
4. **The world wheat market to remain under pressure from high ending stocks**
5. **Milk prices to edge higher**
6. **Cattle exports facing strong competition in key markets.**

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Horticulture

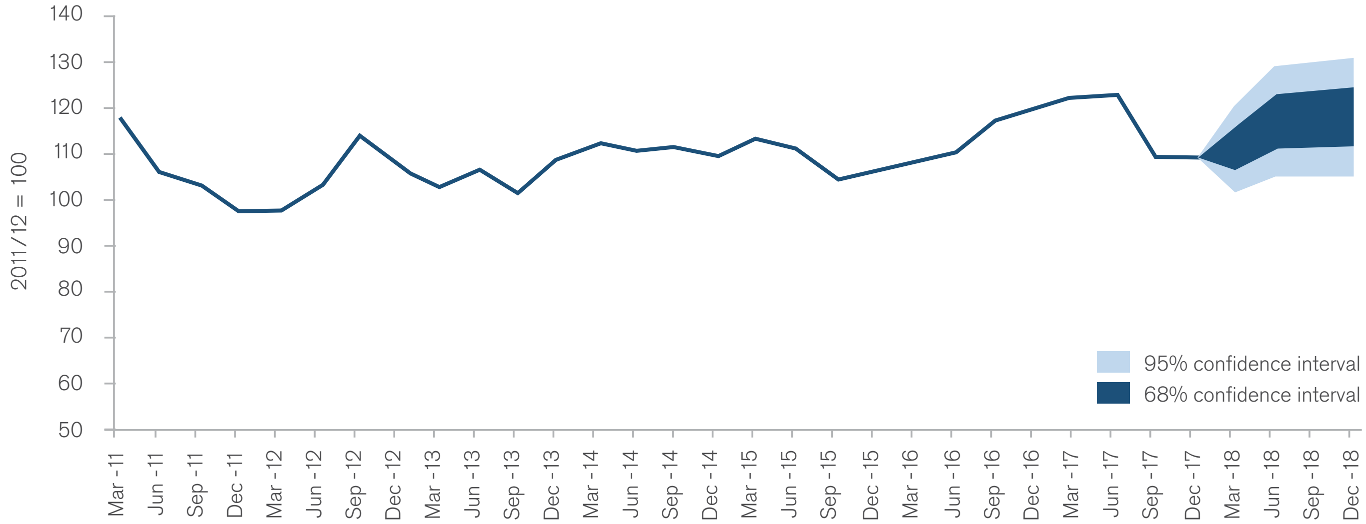
Expected growth in exports

The weighted average vegetable price index for eight capital cities in Australia has had a near continuous positive trend since its introduction in 1989. Severe weather events are usually what causes fluctuations in the index. This was the case in late 2016 with high rainfall preventing the sowing of potatoes and then cyclone Debbie disrupting the supply to some markets in early 2017. These two events caused strong positive growth in vegetable prices around the country. Vegetable prices in Australia have since decreased sharply in the September quarter of 2017. This was due to an early spring in Queensland, and warmer than usual conditions along the east coast which saw increased production for many vegetable crops including carrots and capsicums. Based on our model, Ag Answers expects vegetable prices to increase slightly by around 1.6 per cent during the March quarter of 2018, and then by around 5.6 per cent across the remaining quarters of 2018. This would result in vegetable prices returning to a level similar to that of the June 2017 quarter before the early spring weather increased supply.

Vegetables with growing export exposure such as asparagus, cauliflower, celery and broccoli are most likely to show positive price growth in 2018. The quantity of broccoli and cauliflower exports has averaged 31 per cent growth year on year for the last five years. Singapore is Australia's largest market for broccoli and cauliflower, accounting for 70 per cent of the volume exported in 2017. Broccoli prices were 20 per cent higher at the Melbourne wholesale market for December 2017 compared to December 2016. Cauliflower prices have eased slightly as a result of increased supply.

The weighted average fruit price index for eight capital cities in Australia follows the same positive trend as the vegetable index. The last few years haven't grown at the pace of the vegetable price index and that's largely due to fewer supply disruptions and increasing domestic production. Based on our model, Ag Answers is expecting moderate growth of between 2-10 per cent for 2018. Domestic fruit consumption is growing. Combine this with increasing export exposure and there is likely to be more demand for fruit in 2018 which could have a positive impact on price.

Australian Vegetable Price Quarterly Index

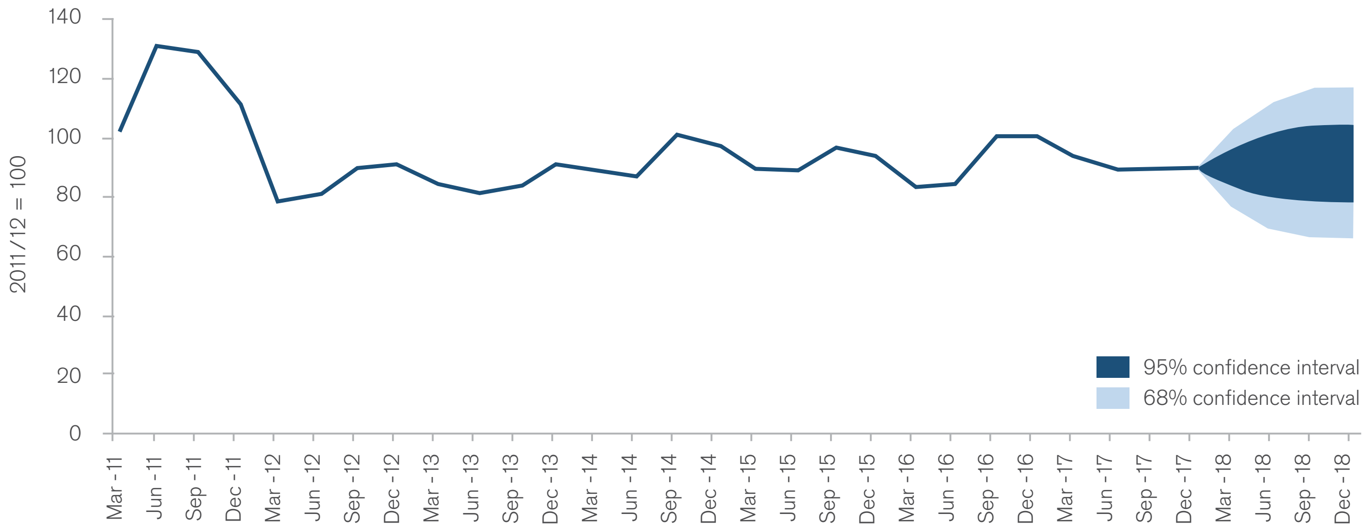


Horticulture
(continued)

A couple of fruit categories to watch in 2018 will be avocados and oranges. Avocado production has increased significantly in the last decade. Plantings grew from 2,640 hectares in 2011 to around 3,848 hectares in 2016. Production is expected to increase again in 2018, as the yield of younger trees increases. The popularity of avocados has grown as a result of marketing and the café culture of Australians which is spreading across every age demographic. Average wholesale price for avocados at the Brisbane market increased 78 per cent in 2017 compared to 2016. December 2017 prices were 17 per cent higher than December 2016. Horticulture Innovation Australia is funding a research and development program for avocados which is forecast to increase the value of the industry by as much as $212 million and could see 10 per cent of production being exported by 2021.

Navel oranges are also increasingly being exported to China and Japan. China has now overtaken Japan as Australia's largest market for oranges. Fresh orange exports to China increased 59 per cent in 2017 compared to 2016. Plantings are growing, but are constrained by the time it takes nurseries to grow new trees, this could be beneficial for price especially if demand continues to grow. In November 2017, China recognised South Australia as being fruit fly free, which could see an increase in exports from South Australia in 2018.

Australian Fruit Price Quarterly Index



Data: Ag Answers, Aus Market, USDA, Horticulture Innovation Australia, ABS

Sheep

An exceptional 2018 ahead

Australian sheep producers had a fantastic 2017. High lamb and mutton prices throughout the year, which remarkably resisted the usual seasonal decline, registered the highest closing prices on record. Ag Answers expects demand to continue to outpace supply, driving a sixth consecutive year of higher average annual lamb prices, including a new record high price early in the year.

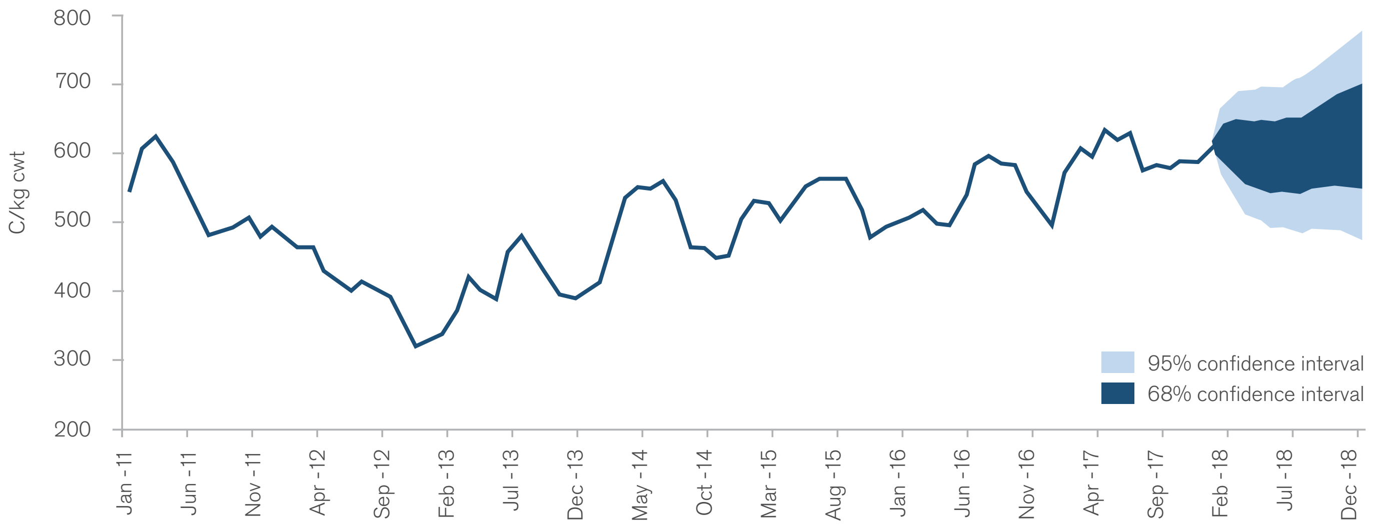
Lamb prices almost always decline in spring as supply increases when new season lambs are sold. That supply trend was observed in 2017 with weekly lamb slaughter tracking closely to the same period in 2016. Prices however were relatively steady and then climbed through December, with the national trade lamb indicator (NTLI) closing at 661c/kg. The combination of increasing supply and steady to increasing prices point to strong demand, particularly export demand.

Ag Answers modelling forecasts the upwards trend in the NTLI to continue in 2018, driven by ongoing growth in demand outpacing production which is expected to remain similar to the past two years. Slaughter levels for the start of 2018 are expected to tighten, continuing to follow the trend seen 12 months ago. This should push prices higher, possibly above the Ag Answers 68 per cent confidence range and into record territory above 700c/kg carcass weight.

One of the factors which supports the likelihood of prices reaching this unprecedented mark of 700c/kg and potentially holding there for a short period of time is the exchange rate. The only other time lamb prices were in this current range was a brief peak of 650c/kg in 2011, a time when the Australian dollar was at parity with the US dollar. If the NTLI were to average 700c/kg over the course of 2018, at last year's average exchange rate of 77c, the NTLI would average 539USc/kg. This would be the second highest annual average on record, but still down 30USc/kg on 2011, so not beyond the realms of what has been paid before. Therefore, the effects of higher Australian lamb prices on international demand will be softened somewhat by a relatively low dollar.

The exchange rate, seasonal conditions and slightly higher production in New Zealand will be factors to watch in 2018, but Ag Answers expects that 2018 will be another exceptional year for Australian sheep producers.

National Trade Lamb Indicator



Data: Meat and Livestock Australia, Ag Answers

Wool

Prices to hold 2017 gains

It is an exciting time to be in the wool industry. Wool prices set record highs in 2017 and the fundamentals of the wool market suggest that the market will remain strong.

The AWEX Eastern Market Indicator set a new record in mid-December 2017, reaching 1765 cents per kilogram clean. This follows three years of wool prices trending higher which is translating into wool growers enjoying the best returns for decades.

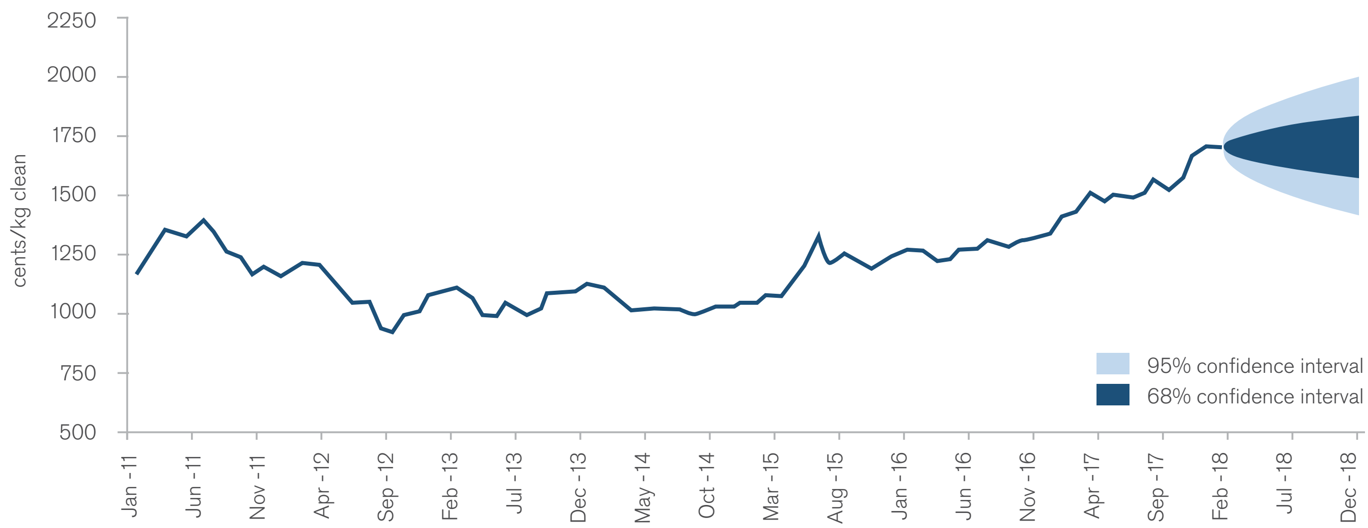
There will also be no supply shock to undermine the market. Wool stored on-farm is limited and Australian wool production has been in a 23 year period of decline. The lagged and slow process of increasing the size of the flock and therefore wool production means that building supply will take time. Unusually for the wool supply chain, there appears to be very little wool stockpiled at any point of the chain, removing the buffer effect of stocks from the market.

Demand from China is strong and further assisted by the Australian dollar. China accounts for almost 80 per cent of wool exported from Australia. Declining wool stocks in China have helped boost the Australian market, building on demand for woollen apparel associated with rising incomes. The Australian dollar has been trending lower since September and some commentators suggest that it will fall further, which would add support to Australian wool prices.

We expect the wool market to remain strong. Current bullish market factors suggest that wool prices are more likely to range in the upper half of our forecast range based on an auto regression model, perhaps between 1720 and 1850c/kg clean. If so, that could see the EMI average around 1800c/kg clean in the 2018 calendar year.

In 2018, expect to see farmers allocating more resources to sheep and wool production.

AWEX Eastern Market Indicator



Data: Ag Answers, AWEX, AWI, ABARES

Crops

Global wheat market to remain under pressure

Most global crop markets begin 2018 well supplied and stocks of some crops are close to record highs.

There is no shortage of wheat. Global wheat production is expected to remain historically high and continue to outpace world consumption. Accordingly, global wheat stocks are expected to rise to record levels in 2018. This will keep pressure on the wheat prices and take time to unwind to a point that global wheat prices establish a growth trend.

Local wheat prices, normally instep with the global price, seem to have been buoyed by concerns about the volume and quality of Australian production in 2017/18. Expect local prices to head towards the global price again once domestic demand is satisfied.

Our expectations for domestic wheat prices based on an auto regression model, in this case illustrated by the price for APW1 delivered to Newcastle, are for the wheat price to drift toward the lower half of our forecast range perhaps between $245 and $300/tonne.

Unlike wheat, global canola stocks will drop to the lowest level in five years in 2018 making canola prices more susceptible to any production surprises that may emerge. All being equal, local canola prices can be expected to continue trading close to the average as they did in 2017, but be alert to changes in global production performance in 2018 which will set the market in a new direction.

Policy changes early in 2018 in some of Australia's major crop export markets are likely to have an impact on Australian growers.

The Government of Japan will relax controls on rice production in Japan in March 2018. With the noodle market in mind it is expected that some Japanese growers will grow less rice in favour of wheat. On one hand, this may increase competition in the noodle wheat market in one of Australia's major export markets, on the other hand, it boosts a segment of the market where Australian wheat, especially from Western Australia, can excel given its protein and provenance attributes.

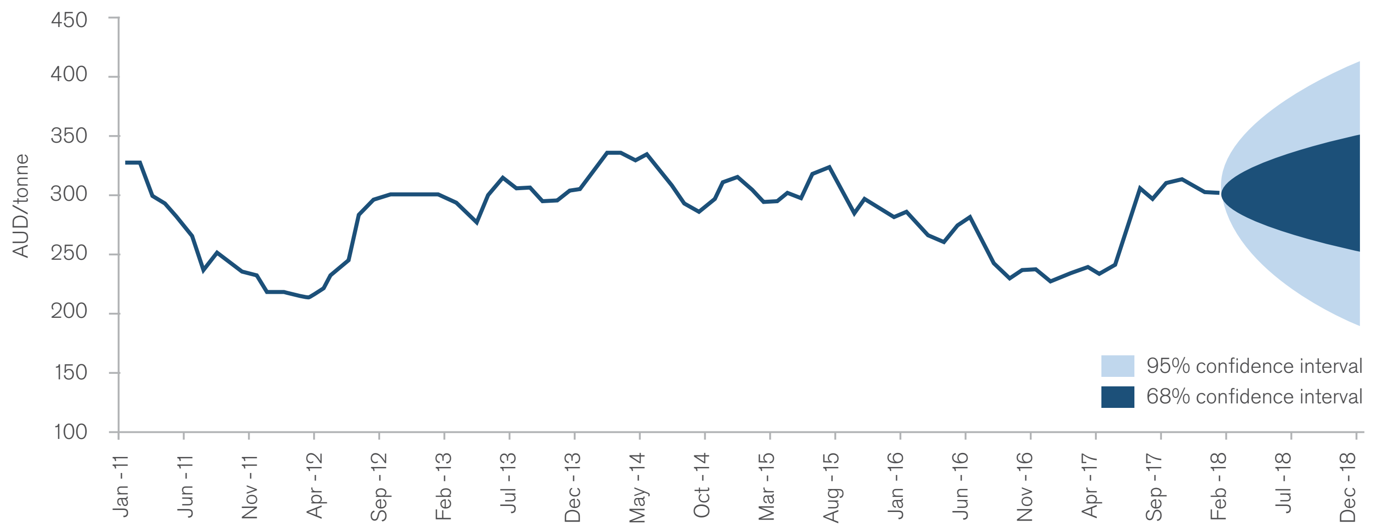
Turning to pulses, the Government of India in recent months imposed tariffs of between 30 and 50 per cent on pulse imports. The impact on Australian pulse markets was already apparent in 2017, however the inclusion of chickpeas and lentils in late December has boosted price uncertainty even for shipments currently in transit.

The introduction of the tariff reflects the Government of India's attempt to manage pulse prices in a now well supplied market after Indian farmers responded to their government's campaign to boost local production.

That's no consolation for Australia's pulse crop producers, who now face price and demand uncertainty from the world's largest importer of pulse crops. What we can be certain about is the Indian Government's propensity to pull and push the tariff lever in an attempt to manage Indian domestic prices. For example, just last year the Indian Government cut its wheat import tariff from 25 per cent to zero per cent, in that case to the benefit of Australian wheat export performance.

At this stage, at a global level, it appears that the supply of most crops will at least meet demand, keeping prices under pressure in 2018.

Wheat (APW1 delivered Newcastle)



Data: Ag Answers, Profarmer, USDA.

Dairy

Milk prices to edge higher

The outlook for pasture growth has improved with rain in November and the beginning of December. It is likely that the rainfall in December, particularly in Victoria and southern NSW, downgraded some crops to feed which will make it cheaper for dairy farmers to keep feeding cattle. The milk price is around the $5.30-6/kg MS range and the global market looks like it could stabilize in the second half of 2018. All of these signs point to milk supply growth and profit for farmers.

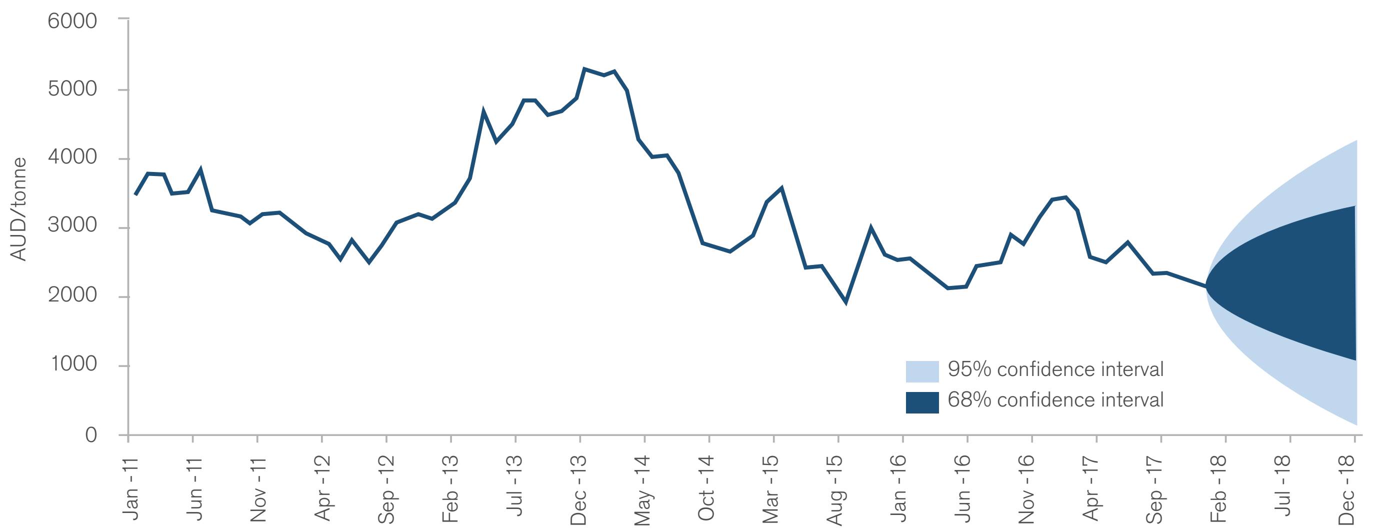
The global dairy price index decreased by 3.5 per cent in December. Skim milk powder (SMP) was down 0.5 per cent in December. Auction results for SMP continue to move up and down with more variability since October. This could signal a floor has been found and balance is slowly restoring. With the current market factors considered, Ag Answers expects the global SMP price will land in the range of $1,455-2,270 for the first half of 2018. The second half of 2018 could be more positive as the stockpile in the European Union should have reduced further and lower farm gate price will constrain growth in the region. New Zealand supply may also be constrained as a result of a dry spell which is bordering close to drought in some regions. The increasing demand from China for milk powder, and the chance that India will buy milk powder in 2018, could also lead to demand balancing with supply in the second half of the year.

Therefore, from July to December we expect SMP prices to sit in the range of $2,270-3,084/tonne. This estimate would result in an average SMP price of $2,481/tonne for the 2018 calendar year which is 9.3 per cent higher than the current price – albeit 7.6 per cent below the 2017 average price. This could suggest flat farm gate milk prices for the first half of 2018 but a more positive outlook for 2018/19 prices. There is definitely demand for Australian milk powder in China with 2017 exports forecast to increase by 52 per cent compared to 2016. The first half of 2018 is traditionally when China buys most of its milk powder from Australia. We will be watching to see if the momentum of 2017 can be maintained.

Latest statistics show national production to November 2017 was up 3.1 per cent. National production for November 2017 was up 4.3 per cent compared to 2016. To November, 2017 increases were South Australia (seven per cent), Tasmania (seven per cent) and Victoria (3.8 per cent). Given 2016/17 was such a tough year these increases have realigned supply close to 2015/16 levels.

Globally, all eyes are on the European Union and the 400,000 tonne stockpile of SMP, however Ag Answers is also interested in India. India doesn't import skim milk powder regularly but when they do it is in large quantities. India is a huge consumer of SMP and figures show they are eating into their stock pile, something that is prompting Ag Answers to think that India will need to buy SMP in 2018. History tells us they could buy between 20-35,000 tonnes in the calendar year. This is something the dairy industry would welcome as it would reduce world SMP stocks more quickly, bringing supply and demand closer to balancing.

Global Skim Milk Powder



Source: Ag Answers, Global Dairy Trade, Dairy Australia

Cattle

Exports to face strong competition

The Australian cattle industry is likely to be characterised by increased slaughter and production and subsequently an easing of prices in 2018. The outlook is highly dependent on whether seasonal conditions support producers increasing herds.

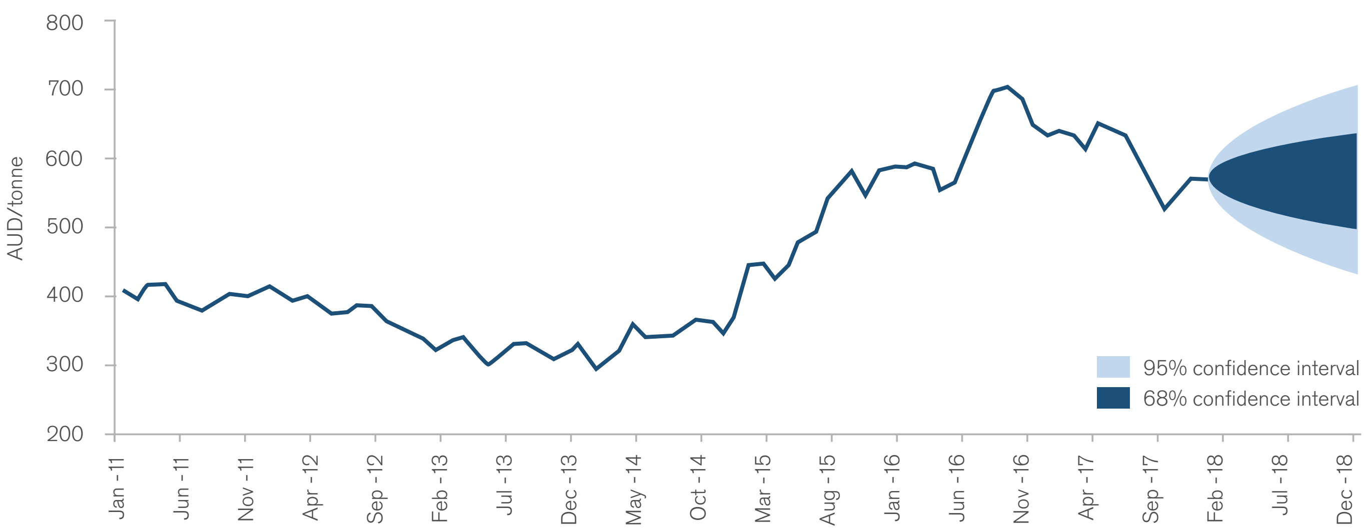
Production for January to October 2017 was up 34,000 tonnes compared to 2016, a result of heavier average carcass weights rather than increased slaughter. An increase in herd size was recorded which is expected to lead to slaughter rates trending upwards in 2018, further boosting production.

Growth in Australian beef production in 2018 will contribute to a new record in global beef production. This outlook is largely driven by record high production expected in the US, China and India, and the second highest production level for Brazil. This will flow through to exports which are expected to hit 10 million tonnes for the first time. Exports will increase to China, Japan and South Korea where consumption is outpacing domestic production.

In addition to record global beef production and exports, 2018 is also set to see global pigmeat and poultry achieve records for production and exports. The result should be a highly competitive global meat marketplace for Australian beef to find its way onto consumer's plates.

Ag Answers modelling suggests an average EYCI of 572c/kg in 2018, down five per cent from 2017. With an increased supply of cattle and weakening restocker demand, it is more likely that the market will track closer to the lower end of the 68 per cent confidence interval range and drift below 500c/kg in late 2018, the first time below this mark since June 2015. Whilst lower than the previous two years, an average in the mid-500s would still be the third highest annual average on record, competing with 2015's average of 509c/kg.

Eastern Young Cattle Indicator



Data: Meat and Livestock Australia, Ag Answers