A new year prompts reflection on the year just passed and what might lie ahead. In agribusiness, 2018 will be remembered for below average rainfall up until the last month of the calendar year, the smallest winter crop for a decade on the east coast, record high wool and lamb prices, and high feed costs.

This report focuses on 2019 and highlights influential themes for the year ahead, as well as our expectations for agricultural markets and the wider economy.

In 2019 expect subjects such as Brexit, economic slowdown, trade disputes, European Union free trade negotiations and elections to play a prominent role in markets. For the agricultural sector, the year ahead is likely to be one where production and prices depend heavily on rainfall. A ‘good’ season would see graziers switch to herd and flock rebuilding, with prices subsequently supported. Also, the increasing value of horticulture exports and historically low milk production are likely to be key themes in 2019.

The price forecasts presented in this report have been calculated using an Auto-Regressive Integrated Moving Average model. The model projects a range of values based on trend, volatility, cyclical and seasonal patterns in the historic data. The forward estimates are current to mid-December 2018, future market conditions may cause actual prices to move across and outside of the forecast range.
The 2018 calendar year commenced with relatively high optimism amid synchronised global growth, and in January we saw stock exchanges reach record highs in a range of countries. However, as the year unfolded, sentiment declined and uncertainty increased. Much of this divergence can be linked to US trade policy, which admittedly was consistent with President Trump’s election promises, but its impact was underestimated by the markets.

Global growth is likely to average just below four per cent over 2018, which is the fastest pace seen since the 2010/11 rebound post the financial crisis of 2007/08. However, growth appears to have peaked around this level. Advanced economies have achieved a growth rate of around 2.5 per cent this year, and emerging economies closer to five per cent. Beyond the impact of trade tensions, the global growth trajectory is challenged by rising US interest rates (which in turn have impacted funding costs for a range of markets) and uncertainty in the European Union, especially related to Brexit negotiations and the new Italian government’s fiscal plans.

Commodity prices had been holding on to solid gains in the first half of the year until a sharp sell-off in the oil price in October, which coincided with another bout of volatility in equity prices. The lower oil price appears to be driven by higher than anticipated production, rather than just lower expected demand next year. This may not be predictive of an even sharper slowdown, but it is likely to keep inflation around the globe subdued at a time most central banks would prefer to see a higher inflation rate. This fall in oil prices coincided with a decrease in bulk commodity prices, although Chinese steel production demand is persistent.

Looking ahead to 2019, the expected themes for the global economy include:

- Trade developments and economic policy responses arising from the US – China dispute, which may include China placing on hold measures addressing debt, shadow banking and risks in their property market, some of which may impact commodity prices.
- The US stock ‘bull market’ is approaching 10 years, which is a record-long upswing. As US rates rise there is a growing risk that this cycle may be drawing to a close, which would add volatility to a range of markets. US official interest rates are likely to rise to around three per cent next year, which will challenge equity valuations, and the accelerating pace of technology disruptions will add further volatility to valuing businesses.
- Brexit, Italy and a rising populism in the EU may also add to volatility. Also, the European Central Bank is expected to end their asset purchase program and to exit negative interest rates later next year. A decade on from the financial crisis, the unwinding of stimulus is still evolving.

While we may face the prospect of a slowing global economy, it is decelerating from a recent high. The path of the US dollar as their cycle approaches a possible turning point is going to be important. As US rates rise, the US dollar should remain strong, but if the US economic cycle peaks more quickly it may also cause a volatile reversal. Volatility in equities is likely to match this trend.

The domestic economy appeared healthy in 2018, exhibiting strong economic and jobs growth, but failed to deliver in a number of other areas, especially asset prices and household wealth. Annual Australian GDP growth picked up to 3.1 per cent in the second quarter before slowing in the third quarter to 2.8 per cent. While its recent downward revision was a surprise, growth still compares favourably to Australia’s international peers.

The jobs market also performed strongly throughout the year, with an increase of around 25,000 jobs per month on average and the unemployment rate improved from 5.5 per cent at the start of the year to five per cent, its lowest level for over six years. Despite the falling jobless rate and a rising participation rate, wages growth was the missing link indicating that there was still spare capacity in labour markets.
The Wages Price Index rose marginally this year. However, real average earnings, after years of close to two per cent gains in real terms driving improved standards of living, have barely improved since 2013, so wages growth is not keeping ahead of living costs. This disconnect between economic growth and perceptions of household wealth is not being helped by falling asset prices, most notably housing prices and equity markets. While housing prices are not falling in all areas, and there is considerable variation between capital cities and between regional properties, the decline in Sydney and Melbourne is significant. From peak to trough, Sydney is now off 9.5 per cent, close to its record decline in 1989 to 1991, and Melbourne is similarly down 5.8 per cent on average since its peak in November 2017. These falls need to be put into the perspective of the preceding rises, and thus far have mainly been driven by falls in investor lending rather than ‘owner occupier’. All the same, softening housing markets may be indicative of risks ahead in credit growth, and also risks to household consumption and discretionary spending. From an agricultural perspective, farm land as an asset class has averaged annual growth in median price per hectare of 5.2 per cent nationally over the last five years. Strong competition for farm land driven by fewer listings is leading to higher prices, a trend that looks set to continue into 2019.

Other emerging themes for the domestic economy in 2019 include:

- A budget surplus is likely to be announced on the early Federal Budget date of 2 April. This earlier date is due to the Federal election likely to be held in May. Being back in surplus underscores the relative strength of Australia’s fiscal position and Australia’s relatively low levels of government debt (as a percentage of GDP).

- Infrastructure investment and public spending: the infrastructure pipeline is already at high levels and is likely to build over the course of 2019, which should help the private sector and jobs growth.

- The Federal election may cause uncertainty to build around changes to policy, including changes to negative gearing, capital gains tax concessions and franking credits.

- The global slowdown and trade challenges leaves the outlook for China and other key trade partners in doubt, although we still expect China to achieve a soft landing and still show strong demand for agricultural products.

- The tightening in lending standards which has been underway for some years via APRA regulatory policy (enforcing lower levels of investor and ‘interest only’ lending) may start to spread from the housing market to having an impact on business lending (SME and agribusiness), in the wake of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Looking towards 2019, the lower level of the Australian dollar is likely to continue to help export markets, and given the benign outlook for inflation (especially with the recent fall in the oil price), the RBA official cash rate is likely to remain at its current record low for much of the year. Growth is likely to be a little slower and offshore risks abound.
Cattle

Australian cattle producers entered 2018 with intentions to retain stock and rebuild herd numbers, but seasonal conditions have been poor in many regions. Many producers opted to destock in response to low rainfall and high feed costs, which led to slaughter rates trending higher, up 10.2 per cent for the year to October. Increased supply combined with weaker restocker demand led to an easing in prices. The Eastern Young Cattle Indicator (EYCI) fell 22 per cent from a high of 567c/kg in March to a low of 445c/kg in August. Prices reached their lowest point since April 2015. Even so, the annual average price of 509c/kg is still high from a historical perspective at 15 per cent above the 10-year average.

Prices eased but avoided a collapse in part due to growing export demand, particularly from China, Japan and South Korea. The support from export markets was surprising given 2018 was a record year for global beef production and exports. Fortunately, demand rose to absorb the higher supply. Australian export volumes were up 12.5 per cent for the year to October, but despite this Australian beef still attracted a 2.7 per cent increase in average unit value.

Cattle prices in 2019 will be supported by lower supply and continued strong export demand. Supply should be lower than 2018 with producers looking to manage current herd sizes until seasonal conditions improve. An improvement in conditions will allow producers to retain stock, particularly females, tightening supply further. Global supply and demand factors should offer some support for Australian prices with import demand expected to match another record year of beef production and exports. Import growth is expected to be strongest from China but also from traditional markets of the US, Japan and South Korea.

The competitiveness of Australian beef exports to Japan will benefit from a 12.5 per cent tariff advantage over the US thanks to the Comprehensive and Progressive Agreement for Trans Pacific Partnership (CPTPP) coming into effect. However, growth in exports out of the US and tighter supply from Australia is likely to see the US continue to capture market share in Japan and South Korea at Australia’s expense. Nonetheless, both countries will continue to be high value markets for Australia and high export prices should persist. Australian exporters may also benefit from growing demand from China, particularly in the premium segment where the US has very low market share. Export markets will experience competitive pressure, but the strength of demand should give some assistance to domestic prices in Australia.

Seasonal conditions will be the most significant factor driving the direction of prices in 2019. Dry conditions would see prices continue to ease and follow the lower 68 per cent confidence interval, falling below 500c/kg. Significant rainfall would see a return to herd rebuilding activity. A tightening of supply and strengthened restocker demand would see prices rise along the upper 68 per cent confidence interval towards 600c/kg.

Sources: Meat and Livestock Australia, Ag Answers
Cropping

In 2018 we saw a 30 per cent increase in the value of Chicago Board of Trade (CBOT) wheat futures in Australian dollar terms and domestic values have responded with Newcastle APW wheat firming 60 per cent year-on-year. Strong premiums have been built into domestic markets, reflecting the east coast feed grains shortage and in turn supporting local values at levels above export parity.

If widespread rain eventuates in 2019, subsequent pasture rejuvenation and a move by livestock producers towards restocking may result in reduced demand for feed grains. However, even with rainfall, the severity of the east coast feed grain deficit makes it difficult to see any meaningful changes to domestic supply and demand pressures until late 2019.

Barley markets have followed a similar trend to wheat in 2018, with Port Adelaide feed barley values up 45 per cent year-on-year. China's recent anti-dumping investigation into Australian barley exports has brought an air of uncertainty to barley markets. While these claims are not expected to be upheld, China is a significant trade partner accounting for 75 per cent of Australia’s barley exports in the 12 months to October 2018. Continued access to the Chinese market will be a key determinant of barley values in 2019.

Oilseed markets, and soybeans in particular, remain weighed down by the uncertainty of the China – US relationship. This pressure has also spilled over into global canola markets. In 2019, we will be paying close attention to growing season conditions in Europe and Canada, which account for a combined 55 to 60 per cent of global canola production.

In pulse markets, Indian import tariffs remain a key challenge to values. Australian trade officials in India see no easing of trading restrictions until the end of 2019 at the earliest. Although Australian chickpeas have been able to find homes in alternate export markets (including Pakistan and Bangladesh) burgeoning global stocks of lentils have driven strong competition in export markets. In the absence of opportunities into India, lentils continue to price as a protein source in domestic feed rations. Domestic feed markets also continue to underpin values for lupins and field peas.

Faba bean values shot to new heights in 2018, reflecting strong Egyptian demand for Australian product against a backdrop of poor production globally. We expect Australian values to ease in mid-2019 following the harvest of the new season crops across Europe.

In summary, domestic feed markets are expected to be the key driver of values in 2019. An estimated 3.5 to four million tonnes of grain will be brought in to the east coast from South Australia and Western Australia over the 12 months to October 2019, in order to meet domestic demand ahead of the 2019 season crop. A return to average conditions would see an Australian wheat crop in 2019 of 24 to 25 million tonnes, a 50 per cent increase on the 2018 season, but five per cent below the five-year average. Notwithstanding any significant developments in offshore markets, we would expect the current price environment to continue into late 2019 when the new season crop, if successful, may bring some supply side relief to the domestic balance sheet.

The Indonesia – Australia Comprehensive Economic Partnership Agreement is expected to come into effect by 2020. This will include provisions for duty free imports of up to 500,000 tonnes of feed grains from Australia to Indonesia, increasing by five per cent annually. While Indonesia has typically been an important trade partner for Australian milling wheat, Indonesia consumes 17 to 18 million tonnes of feed grain annually. For this reason, feed grain markets in Indonesia could present a significant opportunity for the Australian grains industry over the longer term.

Sources: Profarmer Australia, Australian Crop Forecasters, USDA, Ag Answers
Dairy

Australian milk supply is down four per cent due to dry seasonal conditions and high input prices. We expect 2018/19 milk production to finish at nine billion litres. Production in most states will be lower this season. However, Tasmania is growing supply due to more favourable seasonal conditions combined with higher farm gate milk prices, and South Australia is continuing its return to 2015/16 supply levels.

Looking ahead to the first six months of 2019, we expect the Global Dairy Trade skim milk powder price to average around $2,600/tonne, 2.2 per cent lower than the current December price. The average Global Dairy Trade cheddar price for the first half of 2019 is forecast to be $4,100/L, which is 4.9 per cent lower than the current December price. Downward price pressure is expected to come from increased milk production in New Zealand. This will be partially offset by more modest growth in milk supply in the EU and a decrease in supply from Australia.

Export demand has become more consistent – driven largely by China. With milk supply falling, the scenario for Australian exporters is essentially doing the same volume of trade with less milk. This creates strong competition for milk and the prospect of higher farm gate prices. Milk powder exports for the 2018 calendar year are expected to finish 2.6 per cent higher by volume, driven by a 14 per cent increase in exports to China. The volume of cheese exports is expected to end 2018 1.2 per cent higher. Demand for exports is expected to remain stable in 2019 however volume and value of exports could be lower due to falling milk production in Australia.

We are expecting an average farm gate milk price of $6.10/kg MS in southern dairy states this financial year. However, given supply is low, the average price could climb further. Before the milk price drop of 2016, the farm gate price averaged $6.24/kg MS which isn’t far away from the current average indicating milk prices are trending higher.

Sources: Global Dairy Trade, Dairy Australia, GTIS, Ag Answers
Vegetable prices in Australia increased gradually during 2018 as a result of not having the seasonal overlap across production regions experienced in 2017. We expect the weighted average price index for vegetables to increase by around one per cent during the first half of 2019. Demand for vegetables in the domestic market is consistent, prompting the industry to look to export markets to boost demand in 2019.

The value of Australian vegetable exports is expected to finish 2018 at $281.5 million, 13 per cent higher than 2017. This increase in value was spread across several countries. Australia’s largest market by value is Singapore, where export value increased four per cent due to an increase in broccoli and cauliflower exports. Exports to Saudi Arabia rose by 53 per cent in value, due to an increase in carrot exports. Other top performing commodities included tomatoes, potatoes and onions. We expect five per cent growth in the value of vegetable exports in 2019. There could be further upside if emerging markets repeat the buying pattern shown in 2018.

Potato exports grew 35 per cent by volume and 33 per cent by value in 2018. The Philippines and Thailand are two emerging potato markets, importing $2.83 million and $2.79 million of Australian potatoes respectively. These markets are not regular importers and it remains to be seen if they grow again in 2019.

Carrot exports have increased 3.8 per cent by value and 6.3 per cent by volume during 2018. This growth came from Japan and Saudi Arabia. Saudi Arabia is becoming a major importer of Australian carrots, with consistent growth in value over the last three years, making it an important market in 2019.

Sources: AusMarket, ABS, GTIS, Ag Answers
Horticulture – fruit

The weighted average fruit price index showed less fluctuation across 2018 compared to 2017. We expect moderate growth in the fruit price index of five per cent for the first half of 2019. Domestic fruit consumption is growing, coupled with increasing export exposure which is likely to create more demand for fruit in 2019. This could have a positive impact on price.

The value of Australian fruit exports is expected to finish the 2018 calendar year seven per cent higher than 2017. The increase in value has largely come from China, which is up 25 per cent due to growth in fresh orange exports, which were 37 per cent higher in 2018. We expect Australian fruit exports to increase by 10 per cent in value in 2019 due to growing citrus, stone fruit and cherry exports to China and Hong Kong.

In the domestic market, mango production has been more consistent this season. As a result, domestic prices for Kensington Pride mangoes were up 18.7 per cent. Price is expected to remain consistent into early 2019.

Table grape production is expected to increase by 18 per cent during 2018/19. Harvested area is forecast to be nine per cent higher and favourable seasonal conditions are expected to lift yields. International demand is strong particularly from China and Japan. The volume of exports to China were 1.4 per cent higher in 2018, retaining the 37 per cent growth of 2017. Japan imported 29.9 per cent more table grapes in 2018, lifting imports above 10,000 tonnes for the first time. We expect three per cent growth in the export value of Australian table grapes in 2019.

Sources: Ausmarket, ABS, GTIS, Ag Answers
Horticulture – nuts

The export value of Australian nuts increased in 2018 largely due to higher prices. The value of nut exports is expected to end 2018 around $813.5 million, which is 10 per cent higher than 2017. Given the higher prices being paid for Australian nuts, we are forecasting the value of exports to grow by five per cent in 2019. There may be further upside if volume increases to key markets, such as India for almonds and China for macadamias.

Macadamia exports were down 12.6 per cent by volume in 2018 due to lower quantities being exported to Vietnam and China. Export price per kilogram has increased particularly for shelled macadamias, up 24.5 per cent to $22.38/kg compared to 2017. This is largely due to increased demand from Japan which is a high value market compared to China.

Almond exports have increased 2.5 per cent by volume in 2018 driven by demand from China. Price per kilogram is up by 14.1 per cent compared to 2017.

Almond milk is the fastest growing category in the non-dairy milk market. As consumers transition to almond milk, it would be reasonable to assume that their preference will be directed at almond milk made from Australian almonds. While this may not produce market shifting growth for Australian almonds in the short term, it will aid demand diversity by providing an additional use for almonds.

Sources: GTIS, Ag Answers
Sheep

Australian lamb and mutton prices continued their exceptional run in 2018. Lamb prices averaged higher for a sixth consecutive year, and mutton recorded a fifth year of growth. The value of Australian sheep meat exports is set to hit a record high for 2018 with strong demand driving high prices.

In 2018, the Eastern States Trade Lamb Indicator (ESTLI) averaged 684c/kg, 9.3 per cent higher than 2017, and included a record high of 884c/kg in late August. While prices were strong, dry seasonal conditions led to a 2.4 per cent increase in lamb slaughter for the year to October which flowed through to export markets. The value of lamb exports was 13.1 per cent higher for the year to October, supported by increased demand and lower Australian dollar.

National mutton prices averaged 443c/kg in 2018. This was only one per cent higher than 2017, but displayed remarkable resilience under the weight of a 29 per cent increase in slaughter for the year to October as many producers reduced flock numbers in response to dry conditions. Export markets absorbed the increased supply, led by China where mutton exports nearly doubled in value.

Lamb and mutton markets are expected to be characterised by tight supply and strong export demand in 2019, leading to higher prices. Supply will be lower in 2019 for several reasons. Firstly, the high sheep slaughter rates of 2018 will not be repeated as producers will be looking to manage current flocks until seasonal conditions improve. Secondly, the increased sheep slaughter in 2018 will have reduced the national flock, meaning fewer lambs are available in autumn, and fewer ewes to be joined for lambing later in the year. Significant rainfall could further stem the supply of sheep if it allows producers to retain more stock to rebuild flocks.

While supply will tighten, demand is showing no signs of weakening. Growing consumption in the US and Middle East will continue to provide strong demand for Australian sheep meat exports. But continued growth to China will be the market to watch in 2019 after showing incredibly strong demand in 2018. Australian exports will continue to benefit from lower volumes exported from New Zealand and a low Australian dollar.

Rural Bank modelling forecasts the ESTLI to spend much of 2019 above 700c/kg. The seasonal trend in lamb prices means they will drop below 700c/kg at times, but expect to see a seventh consecutive year of growth in the average annual price. Mutton prices are expected to see a greater increase than lamb prices, driven by a larger decline in supply. Expect to see mutton prices regularly exceeding 500c/kg.

Sources: Meat and Livestock Australia, Ag Answers
Wool

For the first two thirds of 2018 the wool market continued to trend higher as it had done during 2016 and 2017. The Eastern Market Indicator (EMI) climbed to record nominal highs, peaking at 2116c/kg in mid-August before closing the calendar year at 1849c/kg.

After retreating from the record high during the second half of 2018, the EMI found support above 1750c/kg (80th percentile). The record nominal price highs were equivalent to the fourth highest inflation adjusted prices since the 1930s.

The three year long wool bull market has both supply and demand drivers. On the supply side, the Australian sheep flock and wool production have dropped to historic lows, limiting the volume of wool supplied. Dry conditions throughout 2018 and less stock on hand have also contributed to tighter supply. The number of bales offered is lower by 18 per cent, year-on-year. Similarly, New Zealand’s sheep flock has been in decline for a decade, contributing to the tightening of supply on the world market.

On the demand side, the value of Australian wool exports increased to $3.9 billion (+22 per cent) in 2017/18, which was entirely due to higher prices, indicating strong demand. Although it is only mid-season for northern hemisphere apparel sales, the recent support in the wool market at 80th percentile prices (which is approximately the price level accepted by the apparel market in the last northern hemisphere winter) suggests continued strong demand for wool products.

The market fundamentals that pushed wool prices higher over the past three years are expected to remain at a similar setting in 2019. On that basis, the EMI is expected to track within the 68 per cent confidence range of the forecast.

In 2019, the theme in Australia will be fewer sheep shorn, less wool cut per head and therefore less wool produced. Estimates are for six to 10 per cent less wool produced in 2018/19 compared with the previous year. There will be no supply shock to the wool market. The Australian flock rebuild stalled during the 2018 winter as the dry conditions in New South Wales made it difficult to continue to grow numbers. Beyond 2019, the Australian sheep flock and wool production could take years to establish a strong growth trend.

There are several demand side variables impacting the wool market that deserve close attention in 2019. The health of the global economy will influence the wool demand, as Australian wool is largely consumed in China, Europe and the USA and demand is exposed to luxury spending patterns.

The US – China trade dispute and Brexit both have the potential to undermine global growth and confidence, which could have indirect consequences for wool demand. Looking just at the Chinese economy, growth and sentiment could be softer in 2019. The China stock market has been under pressure in 2018, with the Shanghai Composite down by 27 per cent year to date and the Chinese currency has dropped by seven per cent compared with US dollar.

Australian wool auctions resume in the week commencing 7 January 2019.

Sources: ABARES, AWEX, AWTA, Ag Answers
For report enquiries:

AG ANSWERS
P 1300 796 101
E  ag.answers@ruralbank.com.au

For banking enquiries:

RURAL BANK
P 1300 660 115
W ruralbank.com.au

ELDERS
P 1300 618 367
E bankmarketing@elders.com.au