Australia’s agriculture and forestry sectors are on track for a solid year, with sheep and wool particularly standing out as they continue to enjoy record prices.

For the dairy industry, while recent corporate issues have unquestionably created challenges for many producers, renewed activity in competition for milk going forward could see some positives for dairy farmers, despite some global headwinds emerging.

Beef, sugar and cotton all appear headed for a stable year – however all are impacted to some degree by factors such as strong global supply, herd numbers and local seasonal conditions. However, the pickup in beef prices in recent months also suggests higher prices for Australian cattle have been embedded in the market and may now represent a permanent shift.

As wheat growers prepare for harvest time, the outlook varies markedly from paddock to paddock and region to region. Most Victorian wheat growers and some in southern New South Wales are in for a strong harvest compared to the rest of the nation. Growers in Western Australia and South Australia have suffered through dry conditions which may be eased by late rains. Growers in the remainder of NSW and wheat-growing areas of Queensland are in for a tough harvest season, however, after a very dry winter.

In this edition, we have also looked at the trends and driving factors in the forestry industry – which, while not much talked about in recent years, is growing in strength from year to year. However, there are major supply issues emerging for the industry as the number of new hardwood and softwood plantations being established has dropped to virtually nothing, despite the strong performance of the global market, particularly for pulp wood.

This raises issues for both farmers and governments as plantations reach maturity and much land is returned to pasture – what is the best use for land and what commodities are likely to return higher prices into the future? Perhaps the stronger performance of the global market and dwindling domestic supply may spur some farmers to re-plant.

In other news, look out for ANZ’s latest Insights paper on the Australian Wine industry which looks at changing tastes both here and globally and how that is impacting a highly successful Australian agribusiness sector.

Thanks for joining us again for this publication, and we look forward to hearing any thoughts or queries you may have.

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WHEAT & GRAIN INSIGHTS

Just a year ago, wheat producers across Australia had experienced such an optimal season, that there were barely enough sausage bags, bunkers, or trucks to store or transport the record crop. This year, many growers are facing up to a crop which will not only fall from those heights, but is likely to be well below even average production results.

On an overall basis, the national wheat crop is forecast to fall around 43 percent from 35 million tonnes last year to 20 million tonnes in 2017/18, impacted by a combination of poor rainfall and high temperatures across most wheat growing areas. However, despite the significant fall in production, exports are likely to decline at only half that rate, falling around 22 percent from 23 million tonnes last year to 18 million tonnes in 2017/18. High stocks from last year’s record harvest are likely to fill some of the gap, although ending stocks may well fall to their lowest levels since 2008/09.

On a State by State basis, the outlook for wheat production varies markedly. For many Victorian farmers, plus some in Southern NSW, the season had seen good rainfalls. Yet just as harvest was imminent, a major frost event in Victoria in early November is likely to have significant impact on many crops. While the full impact is yet to be finalised, reports are that some growers have lost between 30 to 70 percent of their crops, with worse possibly to come. In Western Australia and South Australia, the season has been dry from the start. That said, later rains in WA have made the outlook somewhat better, and some areas of the Goldfields-Esperance and Mid-West regions could ultimately good results.

It is in NSW, as well as the wheat-growing areas of Queensland, where the outlook is the toughest. After a very dry winter, NSW is likely to record its smallest crop in ten years, while Queensland is also likely to see production levels right down.

In terms of Australian wheat exports, last year’s record crop resulted in exports for the first seven months of 2017 exceeding the total amount for 2016. Indonesia remains by far Australia’s largest market for wheat exports, driven by strong demand from the domestic food sector. In particular, demand is driven by the Indonesian noodle industry’s preference for Australian standard white, as well as attractive pricing and supply proximity.

For India, bad weather conditions have seen the country rapidly grow to become the second largest destination, closely followed by the Philippines. Looking ahead, however, forecasts for better rain in India may see a reasonable fall in exports to that market.

Globally, wheat production is forecast to remain strong at 751 million tonnes, a very marginal decline from 2016/17, driven by high production from China, the EU, South American and particularly the Black Sea Region. Global exports are expected remain strong at 182 million tonnes, having grown by around 60 percent over the past decade.

Record wheat supplies from the Black Sea Region will continue to flow into key Asian markets and will be competitively priced compared to Australia wheat. For some major importers, particularly Indonesia, while their preference may be Australian wheat, the large price differential may see them increasingly turning to the Black Sea product.

Amongst other crops, the season has generally reflected the tough conditions faced by wheat growers. Barley, oats and canola have all seen falls in production; not just from last year’s record crop, but for barley and oats, below a regular five-year average. One bright spot continues to be pulses, which were only slightly down on production, apart from a much lower acreage.

AUSTRALIAN WHEAT AREA VS SHEEP NUMBERS

In terms of Australian wheat exports, last year’s record crop resulted in exports for the first seven months of 2017 exceeding the total amount for 2016.

Source: USDA

AUSTRALIAN WHEAT EXPORT MARKETS

Source: USDA
The path of cattle prices over the past three years, compared to the rest of the decade, provides a fascinating indicator as to how much the industry has changed and raises the question of whether there has been a permanent shift in the market.

If we look at the Eastern Young Cattle Indicator (EYCI) since the start of 2011, we see a period in two distinct parts. Until the end of 2014, the EYCI moved within a reasonably narrow band, between 300 and 400 cents, and while price movement may have been seen as somewhat volatile at the time, in hindsight, it was a steady market.

If we average out the EYCI in 2011–14 and 2015–17, the average difference around 52–2.50 is stark. For many in the sector, a rise of some kind was inevitable, as the herd cycle reached a low point and a period of tight supply approached. However, it is debatable as to whether many would have forecast how strong the impact of global demand and competition from key importers would have been on price.

Looking forward, the question will be as to whether these high levels are the ‘new normal’. Every sector in agriculture has seen a similar level of sustained prices followed by a return to previous levels, wheat and dairy are perhaps the two most recent examples. As Chinese demand for good quality beef stays strong, other markets continue to compete for the Australian product despite competition from players such as the US and South America. With the improbability of a sudden supply dampener (annual cattle production levels will never unpredictably spike in the same way as a record wheat crop) the potential implications of long term differences around $2–2.50 is stark. For many in the sector, a rise of some kind was inevitable, as the herd cycle reached a low point and a period of tight supply approached. However, it is debatable as to whether many would have forecast how strong the impact of global demand and competition from key importers would have been on price.

As Chinese demand for good quality beef stays strong, other markets continue to compete for the Australian product despite competition from players such as the US and South America. With the improbability of a sudden supply dampener (annual cattle production levels will never unpredictably spike in the same way as a record wheat crop) the potential implications of long term high prices are a factor for which all players along the beef supply chain should continue to factor into their strategies.

Over the course of 2017, particularly in the latter part of the year, Australian cattle prices have continued to be impacted by weather. In particular, the lack of rain in northern cattle regions has had a strong impact on the EYCI. As rainfall remained limited through the winter, the very high prices from the start of the year continued a downward trend, as farmers destocked.

With the arrival of recent rains, cattle producers in Northern Australia began to hold back stock as the grass re-emerged. As a result, the EYCI reversed its trend of a downward fall from around February to early August, before starting the upward trend, back to the levels of mid-June. Within the feedlot sector, strong overseas demand saw activity remain high. In the June 2017 quarter, a record number of 1.1 million head were on feed. Interestingly, during this period, the turnover rate for cattle declined slightly over the previous quarter, to 74 percent. As a result of this, cattle are being kept on feed for longer periods, while grainfed cattle are taking up an increased proportion of slaughter cattle.

Partly due to these factors, combined with an average overall weight increase in adult cattle carcasses, the industry is likely to see an increase in total beef production to 2.2 million tonnes cwt, an increase of 3 percent on the previous year.

While production may be rising, overall beef exports are likely to see more restrained growth, possibly around 1 percent. This is a particular result of increased pressure from record US supplies. In Australia’s three key markets – Japan, South Korea, and the US – strong volumes of American beef will continue to put pressure on the Australian share of those markets.

The Chinese beef market remains a challenging one for Australia, both from a regulatory and competitive angle. The most notable regulatory impact was felt in the banning of exports from a number of Australian processing plants for several months over apparent irregularities in labelling, an issue which saw exports to China decline considerably at the time.

From a competitive angle, the opening up of China to US beef continues to be watched closely by the Australian industry as a potential long-term challenge. That said, doubts remain over the capacity of the US to supply the required volumes of HGP-free beef, as required by China.

In terms of overall exports to China, South American beef, particularly from Brazil and Uruguay, has surpassed Australia to become China’s biggest supplier. That said, the South American product is largely commodity beef, so is providing minimal competition with the higher quality Australian product. Overall, China’s import volumes continue to remain strong with an expected increase of 11 percent year on year in 2017/18.

For live cattle exports, volumes are forecast to remain unchanged through 2018, after declining around 22 percent to 900,000 head in 2017. High cattle prices, the high Australian dollar and competition from Indian buffalo meat in Indonesia – the largest live export destination – are likely to limit exports in 2018.
The Australian sheep meat industry continues to perform strongly despite the market’s history of taking a downturn as new season lambs are placed on the market.

The strongest prices have been found in the restocker/feeder lamb categories which has gone from parity with trade lambs in mid-September to sitting almost 60c/kg higher at latest look. Interest has also taken off for Merino lambs and light lambs, while the trade lamb prices have moderated slightly in the past few weeks. Despite this, trade lamb prices are still sitting almost 12 percent higher than the same time last year and have maintained their strength throughout spring to date.

Nationally, lamb slaughter levels have continued to increase and are sitting 8 percent higher than the same time last year, primarily on the basis of increased slaughter rates in Victoria and South Australia, while slaughters are in decline in Western Australia. Of interest for efforts to rebuild the national flock, mutton slaughters are almost 18 percent higher than the same time last year, with a large increase in New South Wales (69 percent) and Victoria (26 percent), while South Australia and Western Australia has shown marked declines in mutton slaughters.

In a growing sign of the pressure on red meat processors to maintain solid supply lines for lamb and mutton, the over-the-hook prices across the light, trade and heavy lamb markets have sat either on par or higher than the saleyard prices throughout July, August and September with saleyard trade lamb prices only recently returning to higher than the OTH heavy trade lambs.

A major part of the strong demand and prices story is very strong export demand, which while subdued for the first part of 2017 now sits 54 percent higher than this time last year. The largest increases in exports were to the United States, China, the Middle East and South Korea. This comes at a time where our major export market competitor, New Zealand, suffered another drop in the number of breeding ewes which fell 1.9 percent for the year, to 17.4 million head. New Zealand exports have also been reported to be down 2.5 percent from the previous year.
Wool prices continue to grow strongly, with a growing premium being paid for fine and superfine categories, as well as a smaller increase for crossbred wool, skirtings and carding wool. Across the board, prices sit comfortably higher than this time last year, with few signs of downside risk.

In a major milestone for Australian wool producers, the weekly total value of wool sold has passed the billion-dollar mark by week 17 of the season for the first time since 2002. This means that the total weekly value sits 22 percent higher than at the same time last year.

The Eastern Market Indicator continues to be supported by a weaker Australian dollar against both the US dollar and the Euro in recent weeks. Indeed, most gains across most finer micron classes in recent weeks can be attributed solely to the change in the exchange rate. However, while that may seem to be ‘glass-half-empty’ it does show the very encouraging sign that international buyers are willing to maintain the prices they currently pay without falling back on a weaker Australian dollar that offsets the high prices for merino wool.

Wool prices are coming solely for the ultra and superfine end of the market, there is considerable strength in the market for cardings, merino skirtings and oddments perhaps, as processors seek to offset the high prices for merino wool.

In short – the translation of the weaker dollar directly into price gains for wool producers shows strong and resilient demand in the wool market, despite many saying that the price ceiling for processors has been reached.

The story which has dominated 2017 has continued to play out in recent months as price gains are concentrated on the finer micron merino wool classes, while coarse micron and crossbred wool fail to make many, if any, gains. As an indicator, the southern micron market price for 16.5 micron wool is 45 percent higher than this time last year, 23 micron wool is 7 percent higher while 32 micron wool has lost 21 percent in value. However, while strong prices are coming solely for the ultra and superfine end of the market, there is considerable strength in the market for cardings, merino skirtings and oddments perhaps, as processors seek to offset the high prices for merino wool.

Continuing weakness in global sales and a decline in recent Global Dairy Trade Index for the third auction in a row have increased pressure on prices paid to farmers.

While the big news in Australian dairy remains the proposed sale of Murray Goulburn to Canadian company Saputo to complement their Warrnambool Cheese and Butter acquisition, and what requirements the Australian Competition and Consumer Commission is likely to impose, global prices and production are also impacting farmers’ outlook. Australian farmers can also expect some competition for their milk from processors as the Murray Goulburn transfer progresses and rebuilding a supply base becomes a new owner’s focus.

Over the past few months the global dairy price has been dominated by the high prices for butter, which has seen skim milk powder (SMP) prices bottom out and whole milk powder (WMP) prices stagnant since the beginning of the year. However, the so-called ‘butter bubble’ in the European Union appears to have reached its peak, with butter prices declining 2.5 per cent and 3.6 per cent in consecutive Global Dairy Trade auctions, and by United State Dairy Export Council (USDEC) estimates, 13.2 percent in Europe in the last month.

This has not translated into momentum for milk powders as the most recent November Global Dairy Trade auctions saw falls for the third auction in a row with the GDT index falling 3.5 per cent, and WMP falling by 1.5 per cent. SMP prices showed a slight recovery of 1.2 percent. The price decreases have reportedly stemmed from weaker demand from Chinese buyers of milk powder. However, the persistently low SMP prices have stemmed from talks that the EU is considering changing its SMP inventory buying by reportedly replacing the floor price buying with a tender system, lacking either a fixed price or a guaranteed price. SMP prices are likely to remain volatile and be a source of instability in the market until EU intervention ceases.

Australian milk production fell slightly below this time last year in September, however it is tracking relatively closely to 2016/17 production. Meanwhile, US production estimates have been revised upwards due to higher production per cow and, calendar year to date, US production sits 1.6 percent higher than 2016. Milk production throughout the world is strong as the Australian spring and summer supply enters the market are likely to temper any future price rises, however domestic factors may well protect Australian farmers from any downside risk in the short term.

**AUSTRALIAN MILK PRODUCTION**

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*Source: USDEC*
Both harvested area and yield were reduced this month, lowering the US production estimate by 640,000 bales – which provides some insight into the impact of cyclone season on the US crop.

This drop in US production figures was more than offset by increases in Brazil, Argentina, Mexico, and the EU, which resulted in an overall small reduction in end stocks in 2018. This had minimal impact on price outlook however, as the story continues to be dominated with questions over China’s anticipated imports, which the USDA describe as the major wildcard in the global cotton market. There has been considerable speculation that China is set to loosen its cotton import restrictions despite not having changed their current quota level.

In the meantime, a decision by the Government of Gujarat in India to pay a bonus of INR100 per 20 kg for cotton to be paid to farmers over and above the minimum support price in the lead up to an election has pushed the cotton futures market higher temporarily. However, while this is likely to push prices for Indian cotton higher, it may also offer easy competition for Australian cotton in the Asian market.

Domestically, local farmers will be cheered by a weaker Australian dollar and this, which combined with USDA’s increase in anticipated Australian exports due to ‘robust early-season’ trade, has given upside potential to current cotton prices.

With the US cotton harvest halfway through, the latest USDA cotton crop forecasts have US cotton production estimated at 21.1 million bales which is 3 percent below the previous forecast but still 4 million bales above the 2016 crop.

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Source: USDA
A year ago, Australia’s 2016/17 sugar production had hit 5.1 million tonnes, a rise of around 4 percent on the previous year, pushed upwards by improved seasonal conditions and a period of high world prices in 2016. As a result of the cyclones, however, production this year is likely to fall by around 6 percent to 4.8 million tonnes, despite the planted area remaining the same as the previous year, at around 34 million hectares.

A major impact of the decline in domestic production is likely to be a fall in Australia’s exportable surplus of sugar. This is forecast to decline by around 7.5 percent, from around 4 million tonnes in 2016/17 to 3.7 million tonnes in 2017/18. In terms of importers, the key markets are likely to remain South Korea (36 percent), Japan (16 percent), China (8 percent) and Malaysia (7 percent).

Globally, sugar production for 2017/18 is likely to remain strong at 180 million tonnes, driven by improved seasonal conditions in Brazil, the European Union, China, India and Thailand. The impact of the large global crop is already being felt in a sharp decline in world sugar prices.

Regionally, Indonesia may well see an increase in raw sugar imports from Australia. Indonesia largely imports sugar from Thailand and Brazil, however, raw sugar imports from Brazil are likely to be curtailed in next year due to reduced spread between Brazil and Thailand sugar prices.

China – a growing sugar trade partner of Australia – is likely to see its imports fall due to high stock levels, and high domestic production. In addition, the move by China in May 2017 to impose additional tariffs on sugar imports over set quota (1.94 million tonnes) will further limit its imports in 2017/18.

**SUGAR INSIGHTS**

The impact of tropical cyclones which hit Queensland in March 2017 continue to be felt in the sugar sector, particularly in reduced yields for this year’s crop.

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**SUGAR PRICES**

Source: USDA

**MAJOR EXPORT MARKETS (KILOTONNES)**

Source: USDA
The Australian forestry industry is now in its fourth consecutive year of growth with harvest levels reaching record volumes last year – and while the industry has been one of the quite achievers in recent years, global conditions are now very favourable.

A recent Australian Bureau of Agricultural and Resource Economics (ABARES) report on Australia’s forestry industry has found that the sector continued to grow in 2016–17 despite a softening in domestic demand, supported by strong international demand. While residential building commencements decreased, exports reached a record $3.4 billion.

Production in Australian forestry is evenly split between hardwood and softwood production, with hardwood (eucalypt) production focused in Victoria, Western Australia and Tasmania and softwood (conifers) plantations primarily in New South Wales, Victoria and South Australia. Australia’s primary exports products are pulpwood and woodchips, with sawn timber being directed to the residential construction industry.

In recent years, the volume and value of timber production has increased strongly, primarily on the basis of a strong domestic construction industry and despite a strong Australian dollar and poor global demand for export products. However, with a slight drop off in housing construction expected in the short term, woodchip and roundwood exports have boomed.

Globally, sawlog and pulp prices have been recovering since 2012 and pulp prices now sit at their highest level since 2000. In the first half of 2017, the global hardwood fibre price which makes up the largest part of Australia’s exports, has increased strongly in Brazil, Indonesia, Australia and Chile. In contrast, the softwood fibre and global sawlog prices have, recently, remained relatively flat.

Despite this strong outlook for Australia’s export market and prices, and for the long-term demand from domestic construction, the Australian forestry industry is facing the question of whether it can take advantage of the stronger global market, given high local demand for housing materials and a failure to establish new plantations to provide supply into the future.

As the plantation forests stemming from managed investment schemes and companies such as Great Southern, Timbercorp and Gunns are reaching harvest time, the industry is now struggling to meet demand as a result of years of failure to establish new plantations. Indeed, new plantations have fallen to almost nothing since 2010 and the total area under plantation is in decline. As a result, the industry will either have to rely on access to native timber or increase sawnwood imports, which comes with its own difficulties, or will be forced to convince those landowners with existing plantations that it is in their interest to replant.
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