Economics & Markets Research

Australian Agribusiness

Fertiliser Market Update

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World prices in freefall….

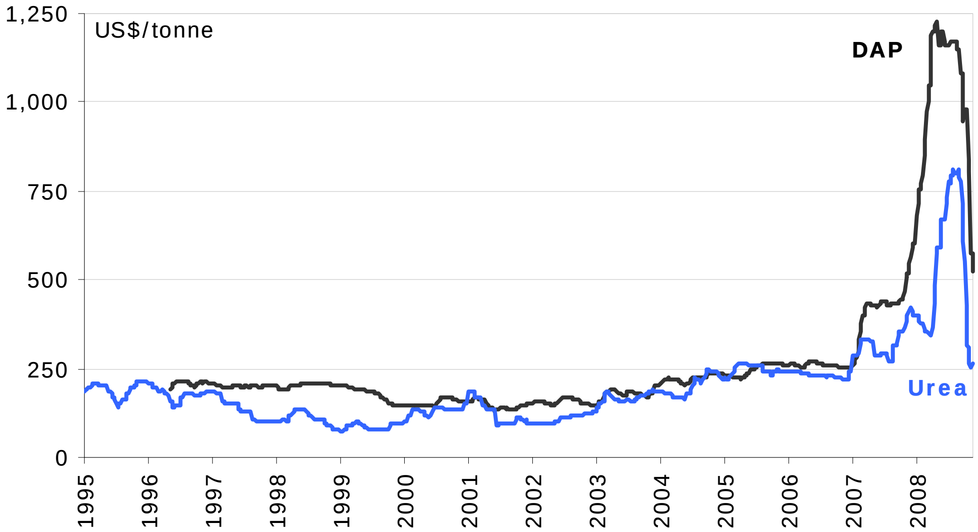
The fall in global fertiliser prices has been nothing short of breathtaking. In the space of just a few months, the world price of diammonium phosphate (DAP) has fallen by 60% while prices for urea have fallen by 55%.

With such extreme price movements in such a short space of time, a common theme has emerged across countries. Wholesalers/retailers have been caught with high priced fertiliser inventory bought at the top of the market. Suppliers with these expensive stocks have been reluctant to lower prices until this higher priced inventory is cleared, despite the dramatic slide in prices. On the flipside, farmers are only too aware of the slump in prices and have been delaying purchases until retail fertiliser prices start to fall.

The strong interest within the Australian agribusiness sector between global fertiliser prices movements and Australian farm gate fertiliser prices has been illustrated by recent government scrutiny. In July 2008, the Australian Competition and Consumer Commission (ACCC) released a report on the examination of Australian fertiliser prices. The ACCC concluded that it had not been provided with any evidence suggesting a likely breach of the Trade Practices Act by any participant in the Australian fertiliser industry. And in the last month an interim report was released by the Senate Committee reviewing the Australian fertiliser industry's structure and competitiveness.

Within the Australian farm gate sector, the interest in fertiliser prices was highlighted in December 2008 in the Australian rural press. A new fertiliser company, Direct Farm Inputs, gained significant prominence by advising it was importing DAP fertiliser for January/February 2009 delivery at a retail price of around A$1,000 per tonne. Anecdotal reports indicated that this was well below the price other suppliers were advertising DAP fertiliser at for prompt pick-up. This was further played out in the rural press in subsequent weeks with reports that the advertised price of existing supplies of DAP/MAP had fallen by over A$600 per tonne.

Chart1. Global fertiliser prices (US$ / tonne)



Australian fertiliser imports

An analysis of fertiliser imports into Australia over the last 6 months highlights the situation that sellers of imported fertiliser have faced.

From July to November 2008, DAP and MAP fertiliser imports were approximately 110,000 tonnes at an average Free On Board (FOB) price of A$1,330-1,380 per tonne. Adding ocean freight, insurance and wholesale/retail margins to this FOB price translates to a retail price to farmers of around $1,600 per tonne – consistent with the advertised price in early December 2008.

Even for November 2008 imports, the average import FOB price for MAP/DAP was still rising. This is consistent with the A$ import parity price peaking in October and allowing for delivery times from key exporting countries.

A compounding factor has also been the high level of phosphate fertiliser imports leading into the 2008/09 season. Based on ABS data, the volume of DAP and MAP fertilisers reached 895,427 tonnes in 2007/08, well above the level of imports in recent seasons (see chart 2) and at double the price of the 2006/07 season average.

Compared to phosphate fertiliser imports, the price of urea imports has been less volatile. The average import FOB price of urea fertiliser in Australia in 2007/08 was A$436/tonne, up just 28% year-on-year.

Chart 2. Australian DAP & MAP fertiliser imports

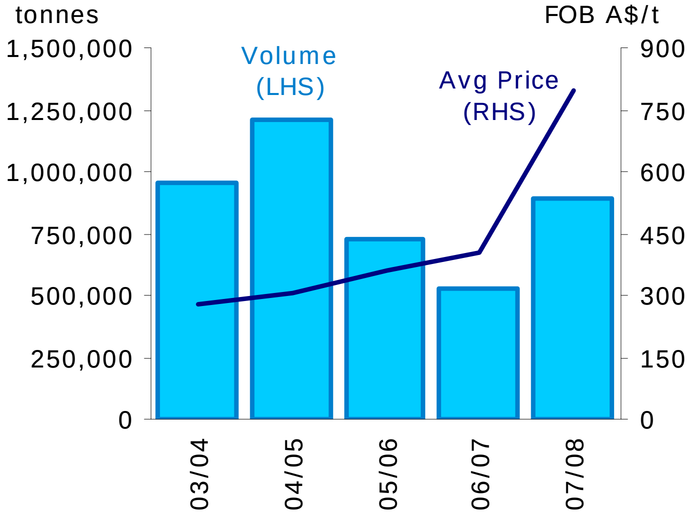


Chart 3. Australian Urea fertiliser imports

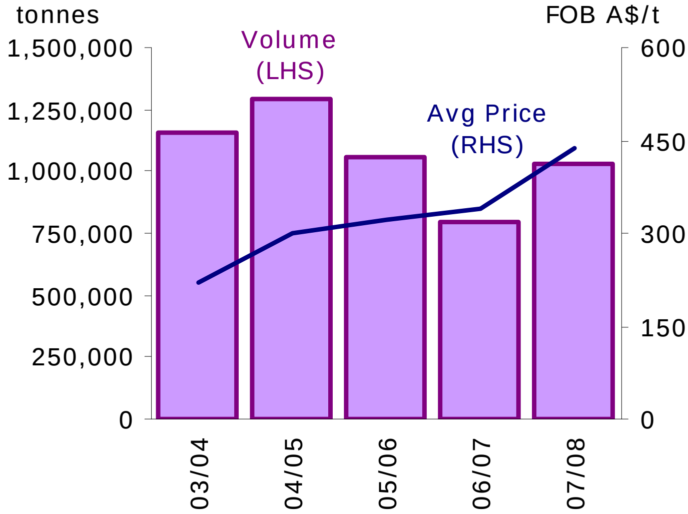
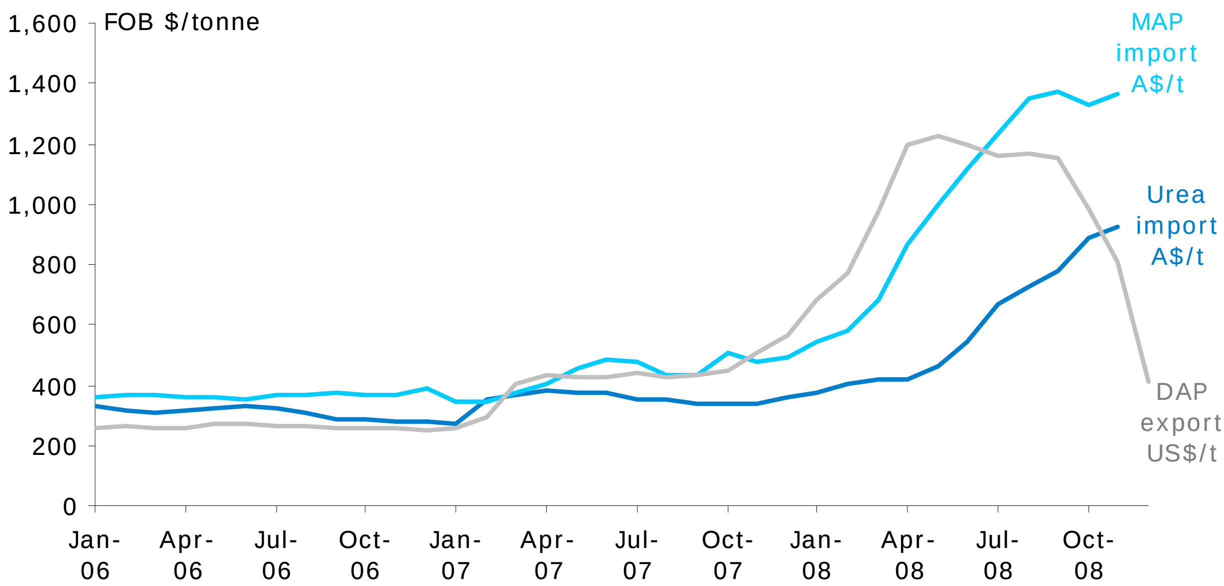


Chart 4. Monthly FOB trade fertiliser prices



Where to from here?

A combination of factors point to lower fertiliser prices in Australia in 2009 compared with 2008, but China's ever changing export policy on fertiliser will remain a wild card.

Freight rates to remain low….
Given import parity pricing (which includes freight costs) is the main driver in domestic pricing of Australian fertiliser, lower freight costs translates to lower Australian fertiliser prices (all else being equal). And freight rates have collapsed over the last 4 months. With little likelihood of a return to the heady heights in bulk dry freight rates reached in mid-2008, fertiliser freight rates are likely to average much lower in 2009 compared with 2008.

Oil prices will continue to flounder….
Particularly importantly for urea prices, oil and energy prices are not expected to rebound significantly in 2009. Natural gas prices, which are closely linked to global oil prices, is a key input for ammonia which in turn is used to make urea and ammonium phosphate fertilisers. ANZ forecasts are for crude oil prices to continue to flounder at around recent levels, averaging US$40 per barrel in 2009. Crude oil prices are expected to be particularly weak in the first half of 2009, with an increasing likelihood that prices will fall back to the US$30-35 per barrel range in the March 2009 quarter. This should help contain fertiliser prices in 2009, especially in the first quarter.

International prices back to 'pre-bubble' levels….
In late December 2008, the DAP FOB US Gulf price had fallen to around US$400/t, a 60% decline since mid-October 2008. The last time DAP prices were at these levels were in the first quarter of 2007. Urea US Gulf FOB export prices had fallen to below US$250/t by December 2008 and were back to 'pre-bubble' levels of late 2006. Given the dramatic fall for most agricultural commodity prices in 2008 and no prospect of prices returning to these record highs, global fertiliser demand should be modestly weaker in 2009. With global fertiliser prices back to pre-bubble levels, it seems relatively safe to assume that prices are close to more sustainable price levels.

Watch China's policy on fertiliser exports….
China's involvement in world trade for fertiliser has been an important factor in increasing the volatility of fertiliser prices in recent years. Up until 2006, China was a net importer of phosphate fertilisers but in 2007 it not only became self-sufficient in its phosphate requirements, but actually became a significant exporter of DAP, MAP and TSP in that year.

In April 2008 the Chinese Government imposed an additional 100% export duty (in addition to an existing 30-35% duty) on DAP, MAP and urea to restrain exports and reduce domestic prices for Chinese farmers. This policy adjustment sent a shudder through the global fertiliser market and was a contributing factor to global fertiliser prices jumping so sharply in the first half of 2008. But this was not the end of it, in late August 2008 a further step-up was announced on China's export duties on nitrogenous fertilisers taking the total export tariff to 175%.

However after staying away from exporting fertiliser for nearly a year by pricing itself out of the global market, the Chinese government has done a back-flip. With China's export policy on fertiliser depressing local prices (domestic DAP and MAP prices are reported to be 30% below the international market), China's domestic fertiliser producers were caught between rising feedstock prices and an inability to pass this through the pipeline. Not surprisingly, China's domestic fertiliser industry has suffered, resulting in the government announcing a cut in the export tariff in an attempt to re-invigorate the sector.

The latest policy splits the fertiliser export tariff rate in China between the high and low season, with the low season (November/December/January and June/July) tariff just 10% on urea, DAP and MAP if the export price is below a certain level (see table 1). If the price is above this level the export tariff jumps to 110% in the low season.

Table 1. Off-season Fertiliser Export Tariff Rates for China

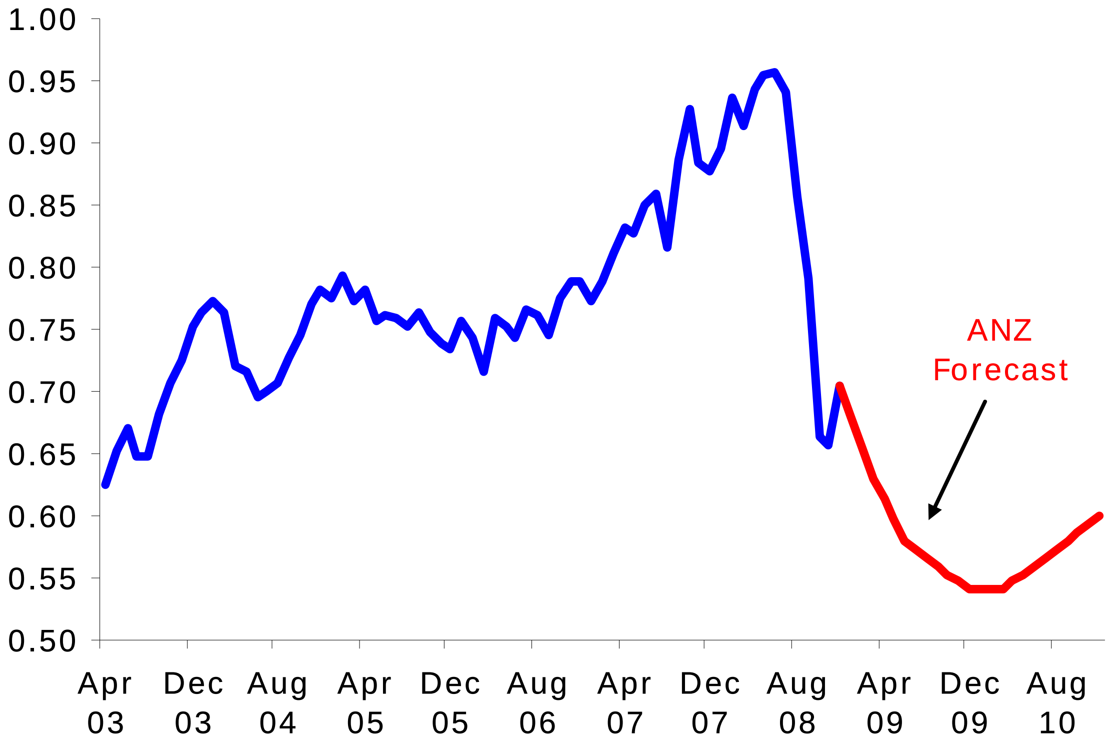
	Urea	DAP	MAP	TSP
Base Price Rmb/t	2300	4000	3700	3100
Export Tariff Below Price	10%	10%	10%	10%
Export Tariff Above Price	110%	110%	110%	110%
Base Price conversions				
US$/t	337	586	542	454
A$/t	478	830	768	644

This change which is reported to have been in effect since December 2008, combined with reports of high stocks of phosphate fertilisers in China and the world MAP/DAP price well below China's tariff base rate in US$ terms (therefore the export tariff rate is only 10%), is a strong incentive for significant amounts of MAP/DAP to be exported in the immediate period. This has no doubt been a factor in driving global fertiliser prices lower recently. This policy change should help keep global fertiliser prices depressed through to the end of January 2009, but beyond this it is difficult to gauge how much fertiliser from China is likely to be exported for the remainder of the year. One unknown is to what extent China's domestic fertiliser industry has/is rationalising with the latest period of low profitability, which influences capacity and ultimately dictates the amount of surplus available for export.

A weaker A$ may work against domestic fertiliser prices….

Assuming global fertiliser prices stabilise at around current levels for 2009, a key driver of domestic fertiliser prices will be exchange rate fluctuations. While the A$/US$ exchange rate is likely to remain highly volatile, ANZ forecasts are for further weakness in the A$ against the US$. By the end of 2009, our modelling forecasts the A$ will have fallen to 54 US cents. This would be a negative for Australian fertiliser prices (falling A$ equals more expensive imports), with a near 25% devaluation of the A$ (from 71 US cents to 54 US cents) adding around A$200 per tonne for DAP and A$100 to urea prices for Australian farmers at current world prices.

Chart 5. AUD/USD exchange rate



ANZ Australian import parity price series

To illustrate the impact changing global fertiliser prices and currency movements have on Australian import prices, we have constructed an Australian import parity fertiliser price series for DAP and urea.

The assumption is that the Australian fertiliser market tends to be driven by import parity pricing which drives retail prices. That is, the price that fertiliser can be imported into Australia is a key determinant for Australian fertiliser prices. With around 35% and 60% of all phosphate and nitrogen fertilisers consumed in Australia imported respectively, plus some domestic production exported in off-peak periods, this assumption appears reasonably valid. The ANZ import parity prices calculated are effectively a US Gulf CIF (Cost Insurance Freight) price converted to Australian dollars and so does not include wholesaler/retailer margins.

A note of caution is warranted when interpreting these results and relating them to likely changes in retail prices for the following reasons:

- We have used weekly global fertiliser prices and currency movements, making our series more volatile than actual fertiliser prices at retail. Indeed this is the case with many agricultural products, prices tend to fluctuate less at retail than the underlying input costs imply.
- We have not accounted for the delay between when fertiliser is purchased overseas to arriving and being made available for distribution and sale in Australia. This influences commercial decisions on when retail prices are adjusted, especially considering fertiliser imports can be 'lumpy'. Peak import volumes of phosphate fertilisers are in the first half of the calendar year (January to June), while for urea the peak importing period is Q2 each calendar year (April to June).
- For much of 2008, our analysis shows that manufacturers/wholesalers/retailers were not raising prices as fast as the import parity price was rising. That is, sellers delayed increasing prices such that prices were consistently below what import parity pricing indicated for most of this period (see chart 5). Normally the import parity price should trade below the retail price given margins need to be added. This indicates the limitations in using import parity prices when global prices are highly volatile as has been the case for the last 12 months.
- While based on valid assumptions, the costs we have used for importing (freight, insurance etc) are theoretical and may differ from actual costs.

Chart 6. DAP price comparison: ANZ import parity price vs retail price in SE Australia

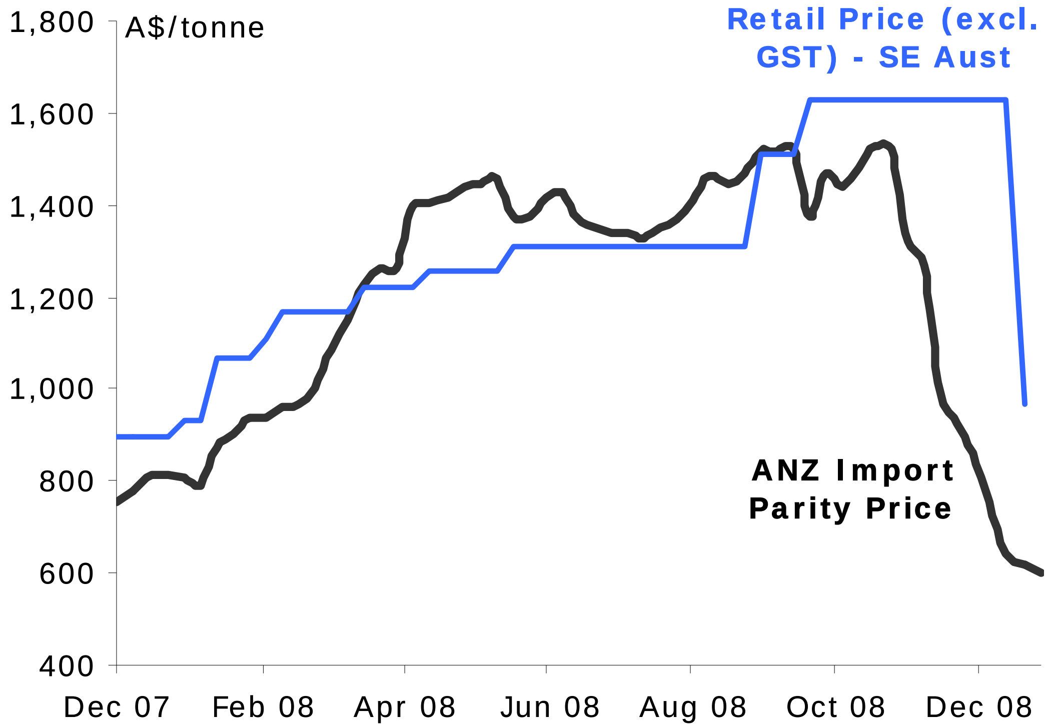


Table 2. ANZ Calculated Import Parity Prices – last 2 years

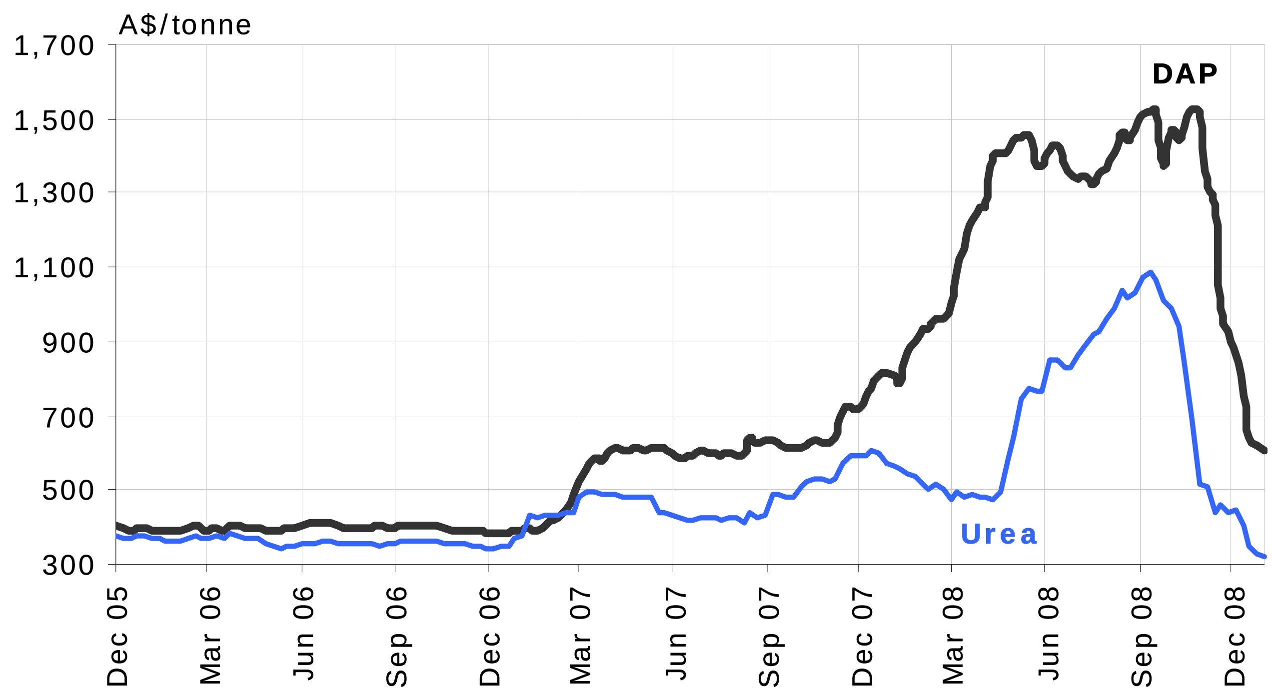
UREA	Jan 07	Feb 07	Mar 07	Apr 07	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Month Ending Price ($A/t)	432	479	485	479	430	428	425	434	484	520	593	573
Monthly Change		11%	1%	-1%	-10%	0%	-1%	2%	12%	7%	14%	-3%

UREA	Jan 08	Feb 08	Mar 08	Apr 08	May 08	Jun 08	Jul 08	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08
Month Ending Price ($A/t)	514	477	484	641	766	826	962	1032	986	514	439	318
Monthly Change	-10%	-7%	1%	32%	20%	8%	16%	7%	-4%	-48%	-15%	-28%

DAP	Jan 07	Feb 07	Mar 07	Apr 07	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Month Ending Price ($A/t)	417	524	602	611	602	605	593	632	612	628	719	813
Monthly Change		26%	15%	2%	-1%	0%	-2%	7%	-3%	2%	15%	13%

DAP	Jan 08	Feb 08	Mar 08	Apr 08	May 08	Jun 08	Jul 08	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08
Month Ending Price ($A/t)	936	1005	1260	1442	1372	1352	1369	1470	1468	1521	925	603
Monthly Change	15%	7%	25%	14%	-5%	-1%	1%	7%	0%	4%	-39%	-35%

Chart 7. ANZ Calculated Import Parity Prices – last 3 years



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