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INFOCUS

COMMODITY INSIGHTS

AUTUMN 2023

ANZ

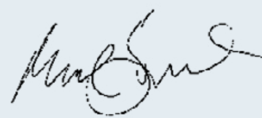
FOREWORD

The Australian agriculture sector has been experiencing a subtle shift in buoyancy in the last 12 months. Anecdotal cases of 'never been so good' have given way to concerns around input costs and their availability. Record saleyard prices have given way to 'pretty good but not where they were'. And interest rate increases that were 'coming' have 'arrived', with a heightened focus now around where and when they will peak. And what of rural land prices?

It feels like the industry has transitioned from FOMO (fear of missing out), to ONO (or nearest offer). Regardless, a degree of cooling and caution makes some sense. If 'lowest-ever' cost of money was part of driving investor appetite, rising interest rates would logically have the oppositive effect. It's fraught to generalise. Clean cropping conditions in WA might still look like 'best ever', but flood impacts on the east coast could mean 'worst ever'.

The overall picture is probably an inevitable point in what has been a very positive growth period. And that's not to say growth can't continue in 2023, but it's likely to have less profitability about it. Especially considering that a third 'best ever' season for a lot of areas would be an optimistic expectation. So with things seemingly coming off the boil, why would we feel optimistic for 2023? For all the same reasons we've had such a good run. Rising population and rising capacity to spend on safe and better food and fibre, with the addition that the Covid-19 pandemic has driven food security imperatives in Australia's key consuming markets. Agricultural production in a number of northern hemisphere countries has been difficult for the past couple of years, so global supply is coming off a low base. The fact that a growing population, even with a tightening economic outlook, will demand more food. And our industry in many places has a carry-over of financial strength, a strong moisture profile, and strong water storage for next season's crops.

Of course there are many more considerations. One being the cost challenge and the related issue of labour cost and availability. Some of this is explored through the following commodity chapters. And we all know that a new season will have a lot to do with the next outcome. There's no reason to expect anything worse than an average growing season at this stage. And on that basis, things still look pretty good. Let's hope we are talking about a strong and timely autumn break when we produce our winter report.



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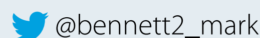

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2023: TRENDS, OPPORTUNITIES, AND RISKS FOR THE YEAR AHEAD

OVERVIEW

As we enter 2023, the global trends and factors influencing the Australian agricultural industry will be major determinants for farmers' bottom lines. Since 2020, the international influences of China, Covid, climate and conflict have crossed over with consecutive La Nina seasons in Australia, creating for many producers, the perfect scenario of high prices coupled with high volumes of production.

2023 is shaping up to be a year of change back towards 'normal', as these global events begin to exert less influence on markets – however what is 'normal', and what does that mean for domestic producers?

GLOBAL TRENDS TO WATCH

Global Economic Growth

Underlying all drivers of agricultural commodity pricing will be the spectre of global inflation, interest rate rises and falling economic growth. Concerns across Europe over energy supply and prices, as well as the cost of living crisis across much of the globe, will weigh on global growth and demand. The World Economic Forum recently forecast that global economic growth would fall sharply to 2.9 per cent in 2023, down from 3.2 per cent in 2022. Global inflation is anticipated to stay stubbornly high throughout 2023 at 6.6 per cent, which is down from 8.8 per cent in 2022. With inflation remaining the key focus for most developed economies, economic growth is expected to suffer as a result.

One major potential impact for Australian agricultural producers is lower demand, particularly for more luxury products such as wool, wine and seafood. Staple goods are also expected to suffer a moderation in consumer demand as food prices continue to bite. On the flip side, global uncertainty may prompt some countries to increase imports of staple goods to secure supply, particularly commodities such as wheat, sugar and dairy.

China's Re-opening and Economic Growth

China remains one of the major influencing factors on global economic growth. The recent end of the 'zero Covid' policy in China and a subsequent surge in Covid cases throughout the Chinese winter is already having ramifications for the nation's economic growth. As China's economy starts to pick up again after re-opening, there is some hope for an end to the drop in property markets, manufacturing and consumer demand. The speed of an economic recovery will, however, be offset by the impact of any Covid outbreaks. Regardless, the reopening of ports and supply chains into China is likely to have a positive impact on demand for construction, consumer and agricultural goods, particularly wool and cotton. As the world's economy struggles with falling economic growth, a stronger Chinese economy may help weather the worst of global economic conditions.

On a domestic front, the trading relationship between Australia and China continues to show signs of repairing, with glimpses of hope for

a resumption in trading in key commodities including wine and rock lobster. While the potential return of Chinese demand and premium prices would prove to be a boon for some Australian commodities, the Australia-China trading relationship has undergone a fundamental shift – with Australian producers and traders seeing significant benefit in diversifying their trading partners and expanding into new markets.

Global Commodity Prices

Global food prices hit historical peaks in 2022 as a result of the war in Ukraine, freight rates and actions by some governments to restrict trade in key commodities. While these prices have declined throughout much of the second half of 2022, they still remain relatively high and will continue to impact global food price inflation.

That said, **global soft commodity prices** are expected to continue to ease as the supply of grains and oilseeds out of the Black Sea region improves. Wheat and grain prices are generally expected to come off their 2022 highs, while remaining historically strong, and other soft commodities are also anticipated to moderate as a result of sluggish international economic growth.

The Global Container **Freight Rate** Index spiked in late 2021 and since showed solid declines almost to pre-pandemic levels. DP World has outlined their expectations that 2023 will see freight rates drop a further 15 to 20 per cent as a result of the decline in global economic activity and demand and supply chain disruptions resulting from the war in Ukraine and Russian sanctions.

Following a dip in **oil prices** late last year, oil and energy prices are expected to remain around current levels, which is historically fairly high. With OPEC announcing their decision to cut crude oil production in the face of the declining global economy, oil prices are not anticipated to fall significantly.

Russian war on Ukraine

The conflict in Ukraine continues to impact supply chains across the globe, most particularly introducing considerable uncertainty around access to grain and vegetable oil exports out of Black Sea ports. Under the Black Sea Grain Initiative, Russia, Ukraine, Turkey and the United Nations have agreed to the export of Ukrainian foodstuffs out of the Ukraine ports of Chornomorsk, Odesa and Yuzhny/Pivdennyi, and the safe passage of Russian foodstuffs and fertiliser. The agreement was set to expire in November 2022, however on 17 November 2022, the agreement was extended for a further 120 days. This still leaves uncertainty around the surety of supply of grain, sunflower oil and fertiliser after the expiration of the extended agreement, which may further impact global food price inflation both directly and indirectly through the cost of fertiliser.

Climate

Perhaps the greatest uncertainty going forward in 2023 is climate. As drought and weather events dominated agricultural markets throughout 2021 and 2022, in particular in northern America and Europe, Australian producers are understandably nervous about a quick turnaround on the stellar three years of La Nina fuelled production. With the reasonably low likelihood of another La Nina season, the Bureau of Meteorology currently has the Southern Oscillation Index returning to a neutral phase in the first quarter of 2023. Longer-range forecasts are often unreliable, however a return to an El Nino phase is commonly associated with lower rainfall and warmer conditions in southern Australia. With drought conditions persisting across almost one third of the United States, wheat and cattle production are still under heavy stress. However, winter storms coming into 2023 have already improved soil moisture and with expected improvements in storages from snow melt, the outlook is improving.

OF COURSE, NONE OF THIS MEANS THAT AUSTRALIAN PRODUCERS ARE NECESSARILY ABOUT TO FACE DROUGHT CONDITIONS – BUT THERE IS CLEARLY SOME ADDITIONAL UNCERTAINTY AND CAUTION IN PRODUCERS' DECISIONS FOR THE YEAR, AS EVIDENCED BY THE DROP-OFF IN CATTLE RESTOCKING ACTIVITY AS ONE EXAMPLE.

WHEAT AND GRAINS INSIGHTS

OVERVIEW

- The 2022/23 overall winter crop could potentially be the largest on record, as could the production volumes for wheat, canola and lentils
- The heavy rains in late 2022 will strongly impact crop volumes from NSW, which are likely to be markedly down
- Most pulse crops are likely to see reduced volumes, although this will be partly due to reduced plantings, as growers increased their focus on major crops
- Prices for all major crops are well down from the highs of last year, with the reasonable production forecasts from the Northern Hemisphere likely to limit substantial price increases
- Australian grain growers will face increasingly high crop input costs, but will probably still plant a large crop, particularly given the reasonable weather outlook.

The Australian cropping sector is potentially poised to see its third record harvest in a row. While the late harvest in some regions means that final production numbers are still some way off, many in the industry are predicting record production levels for wheat, canola and lentils, which may push the overall crop above last year's all-time high. While the temptation will be for most grain growers to look towards planning another major crop for the coming year, the issue of rising costs will have many farmers redoing their sums in more detail than they have for some time.

The variation in the harvest volume, yield and quality, by different regions and different crops, highlighted the impact of the diverse growing conditions across the country, from the heavy rains in Eastern Australia to the largely optimal season in the South and West. In particular, despite the high overall national crop production levels, the NSW winter crop fell by around 30 percent, or around six million tonnes, as a result of the late season floods. In contrast, every other major crop producing State saw a rise in production, with South Australia seeing an increase of over 30 percent on the previous year's total, of almost 2.7 million tonnes.

In terms of individual crops, the national wheat crop continues to appear to be on track for its third successive record. This is particularly noteworthy, given the pessimistic forecasts which were being made around the time of the 2022 floods. Forecasts for the 2022/23 wheat crop vary markedly, and while some observers have tagged the crop at similar to the 36.4 million tonne crop of the previous year, others in the industry have forecast final volumes of up to 42.1 million tonnes.

Once again, forecast production by State varies widely. While the NSW wheat crop fell by around 30 percent, wheat production levels in Queensland, Victoria and South Australia are forecast to climb by 18 percent, 29 percent and 45 percent respectively.

The overall national barley crop is currently forecast to remain largely unchanged, with a slight fall to around 13.4 million tonnes. Once again, while NSW is forecast to see a fall of over 30 percent in barley production, this will be largely evened up by strong increases in Victoria and South Australia.

In terms of the third major crop, canola, national production is forecast to be slightly up, by around four percent, although given that harvested acreage is up ten percent, this is the only one of the major crops to see a reduced yield. While NSW again saw a fall of around 35 percent in canola production, a similar rise in production in Western Australia compensated for this.

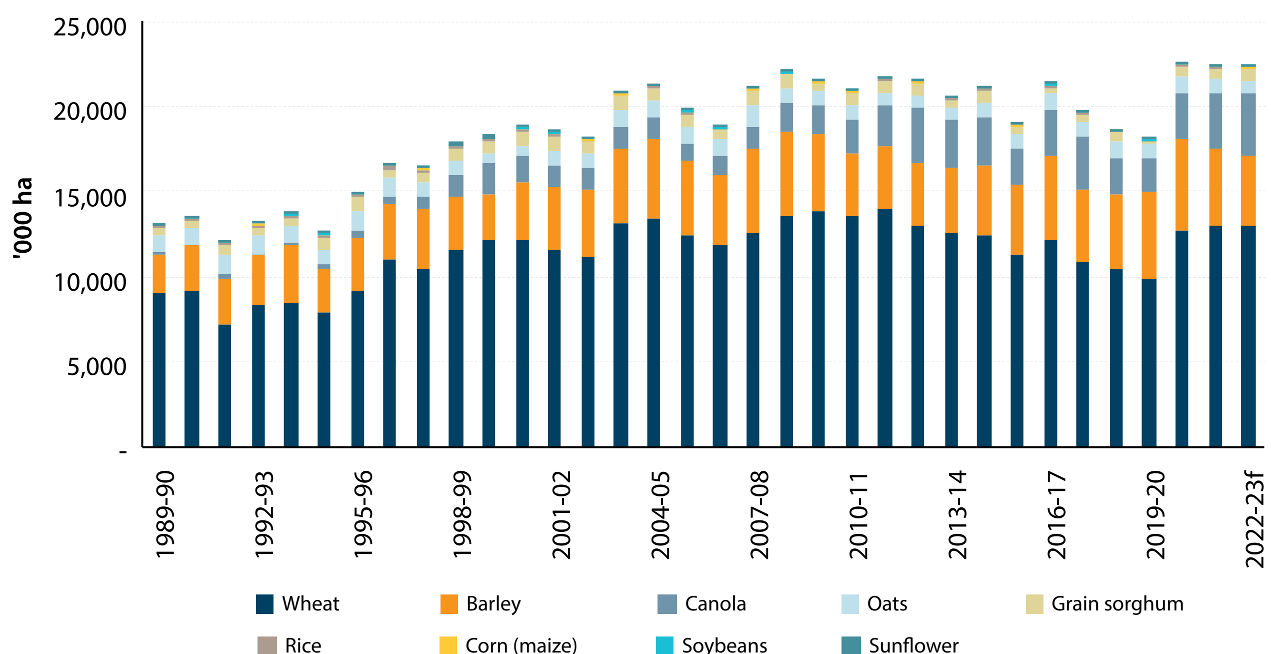
For pulse crops, while lentils are likely to see a record harvest, exceeding one million tonnes for the first time, chickpeas, faba beans and lupins are all forecast to see reasonable falls in production. While some of this is certainly the result of floods, the fact that the crops are forecast to decline in states outside NSW would indicate that many farmers had lifted their concentration on the major crops, in a bid to take advantage of the high prices around the time of sowing in 2022, driven by the Ukraine conflict.

In terms of prices, most major grains are now well down from their peaks experienced around mid-2022, at the height of concerns about grain and oilseed availability as a result of the Ukraine conflict. Global wheat prices have fallen around 40 percent since that period, and have the potential to see further downward pressure, given the strong crop forecasts for Australia, Russia, and other major producers.

Global canola prices have also fallen over 30 percent over that period, with the possibility of further price dampening as a result of a forecast strong Canadian crop. One factor which may push up canola prices could be the opportunity for increased imports by China, not only spurred by increasing consumption in the post-Covid reopening, but also as a result of China seeking to reduce soybean imports and needing to replace this with another oilseed.

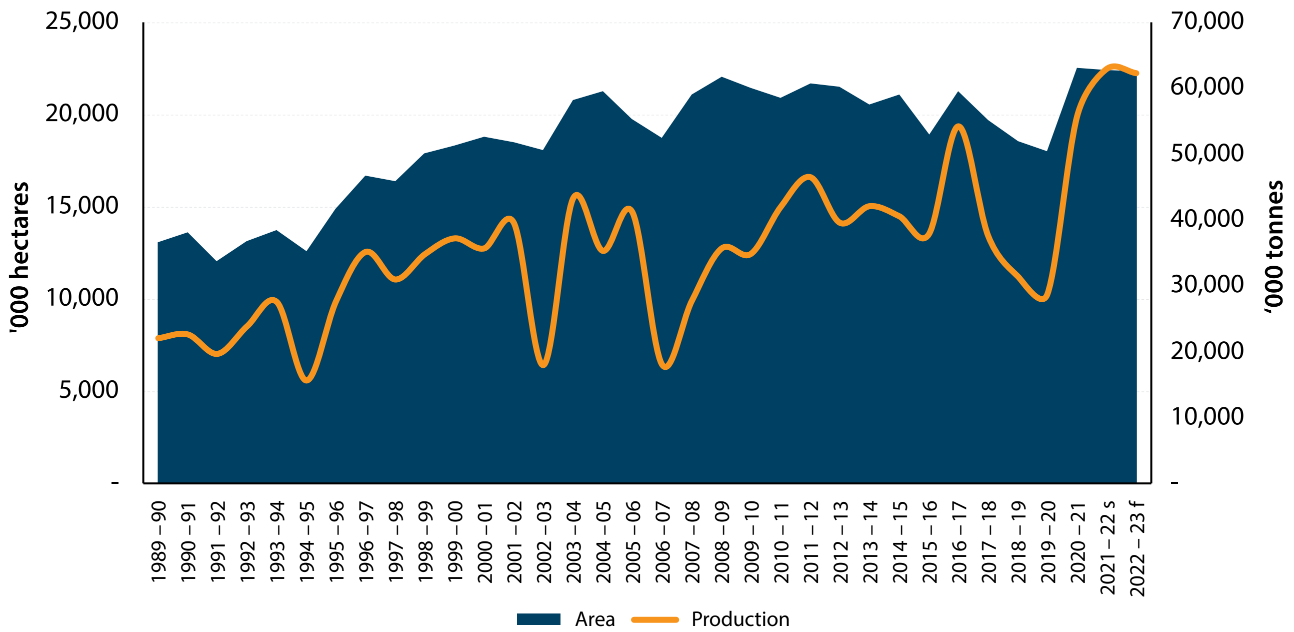
Looking ahead, for Australian croppers, the issue of balancing high costs against the potential for yet another big crop is one which will require increasing scrutiny by many farmers. Given inflationary pressures, prices for most inputs, seed, machinery, fuel and other costs are all likely to be noticeably higher than last season. This will be accompanied by the impact of interest rate rises on farm debt. Given these factors, however, and then fact that high costs will also impact any alternative to a major crop, such as increasing farm sheep numbers, it is foreseeable that a large crop will again be planted in 2023.

AUST GRAIN AND OILSEED AREA 1990-2023F



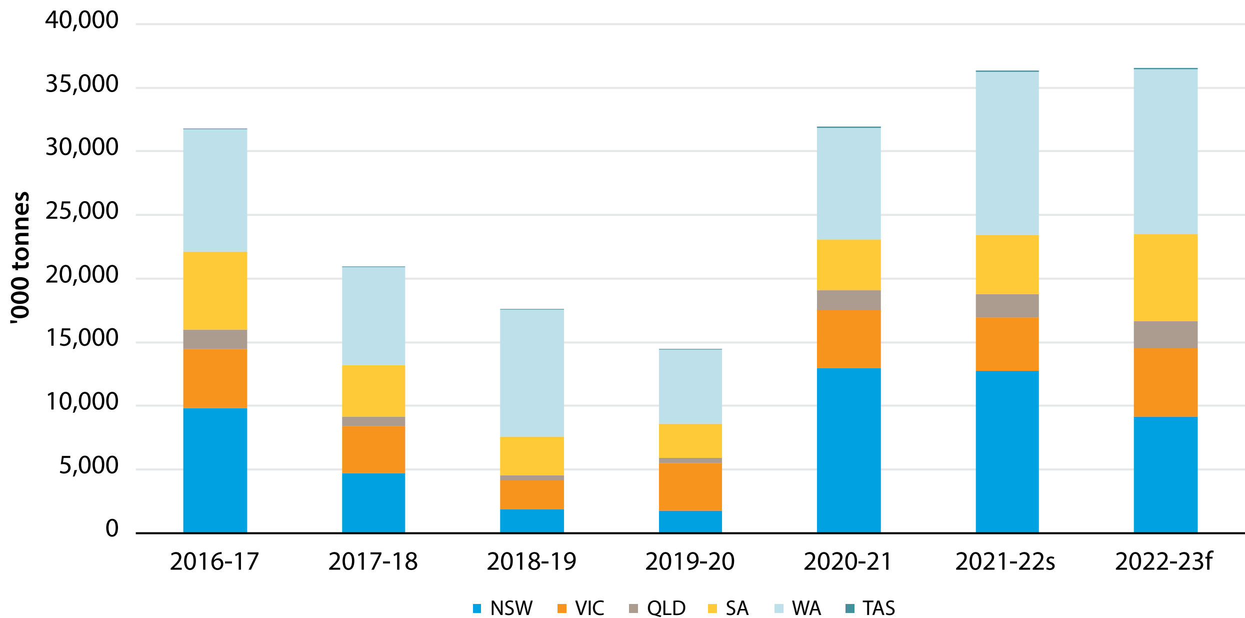
Source: ABARES, ANZ

AUSTRALIAN CROPPING AREA VS. WINTER CROP PRODUCTION



Source: ABARES, ANZ

AUSTRALIAN WHEAT CROP BY STATE



Source: ABARES, ANZ

OVERVIEW

- After five years of price volatility caused by drought sell-off and subsequent restocking, prices may finally be levelling out
- The difficulties for meat processors in attracting labour may impact their cattle volume purchases, and subsequently prices, as well as the beef supply available for export
- With a reasonable weather forecast ahead at this stage of 2023, there may be a degree of restocking activity on the market, though increasingly at the right price
- Beef exports have been sluggish, though there are optimistic signs for later in the year, particularly for the China and US markets
- On current forecasts, the Australian cattle herd will peak in 2025 at around 30 million head, before beginning to decline.

The Australian cattle industry is always subject to outside influences – weather, global competition, economic – and each of those look likely to play a very strong role in the path of the sector into 2023 and beyond. That said, the cattle herd is also always at some point of a cycle, and while a rise in numbers from a cyclical low will push prices upwards, as farmers restock and compete with processors, the opposite will happen when the herd reaches a certain high. The question for the industry now is just how close the next turn in this cycle will be, and what it will mean for not just farmers, but all players in the beef sector.

Australian cattle prices have been historically volatile over the past six years, impacted particularly by the drought, and the subsequent recovery period. Having gone through these phases, many in the industry are now watching carefully, in a bid to predict what the major drivers will be in 2023.

Looking back, 2018 and 2019 saw prices pushed down across both years, as cattle producers continued to sell off stock as the dry weather continued, and feed availability worsened. When the drought conditions began to ease in early 2020, prices rose rapidly, more than doubling over the two years, with the EYCI climbing from around 500 c/kg in early 2020 to almost 1200 c/kg by the end of 2021.

Looking back over 2022, it could be argued that this finally saw prices return to a "new normal", as the easing of restocker activity saw the EYCI decline to around 850 c/kg. 2022 may also have provided an indication of where cattle prices may go from here, with a level of volatility suggesting that buyers were still happy to keep building their herds but were more likely to hold out until they felt prices had fallen low enough to represent value.

Through the early months of 2023, the EYCI has slightly declined even further, to around 750 c/kg, its lowest level since mid-2020.

Looking ahead over the year, however, there are a number of factors which could suggest that prices are unlikely to fall too much further. While it appears the wetter conditions of the La Nina may have finished, there is still no indication of overly dry conditions for the foreseeable future. Similarly, while restocker activity has slowed since the post-drought rebuilding period, many producers are showing a

level of confidence in continuing to build their herds. That said, just as seen in 2022, restockers appear increasingly likely to hold back from purchases if they feel prices are too high, but jump back in on a reasonable sign of prices falling.

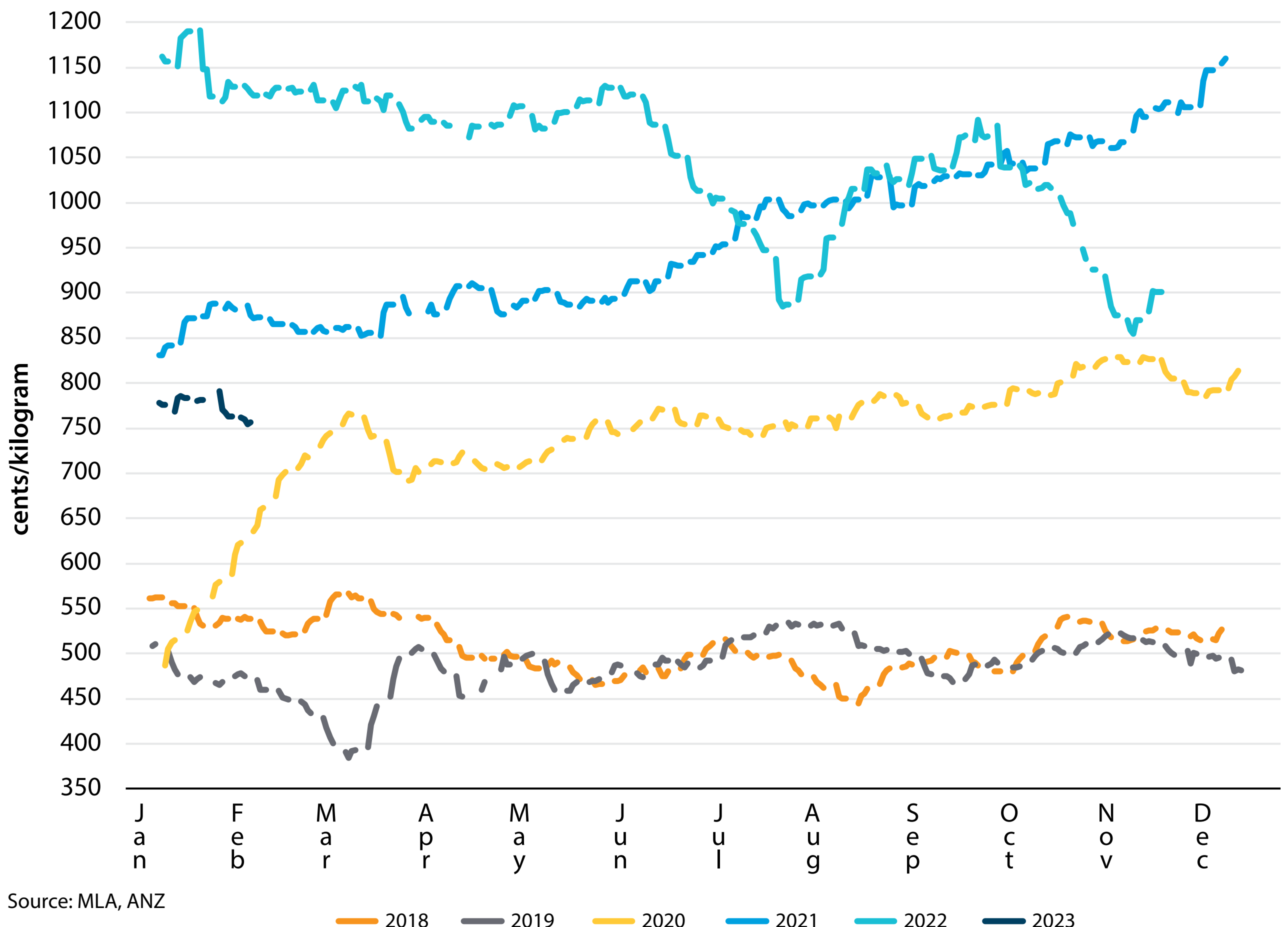
In addition to restockers, feedlot activity also remains strong, providing further competition in the market. This has been particularly highlighted by recent prices for feeder steers continuing to climb, to now sit above the five-year average.

While these factors can be seen as positives, there are also issues ahead of the industry which may limit the upward potential for strong price rises. In particular, the meat processing sector continues to struggle to attract the labour required to achieve optimal processing capacity. Given that there are no major signs of this shortage alleviating, processing activity in the market could well remain lower than it would otherwise have been.

Looking ahead, the most recent Meat and Livestock Australia (MLA) forecasts predict that the cattle herd still has around three years of growth, before it enters the next downward cycle. In 2023, the national cattle herd is forecast to reach 28.8 million head, its highest since 2014, driven by a strong growth rate of around 4.5 percent, partly as a result of a major drop in the female slaughter rate since the drought period. This growth is likely to slow over the subsequent two years, with the herd forecast to reach almost 30 million head in 2025. Following this, the herd is forecast to begin to decline, based on factors including a presumption of drier weather, as well as the herd having exceeded a level of optimal supply.

In terms of exports, the industry will be looking for signs of confidence, having come off a very lean 2022, where beef exports fell to a 19-year low, particularly as a result of limited availability of beef due to processor labour shortages, as well as restocker and feedlot competition for cattle.

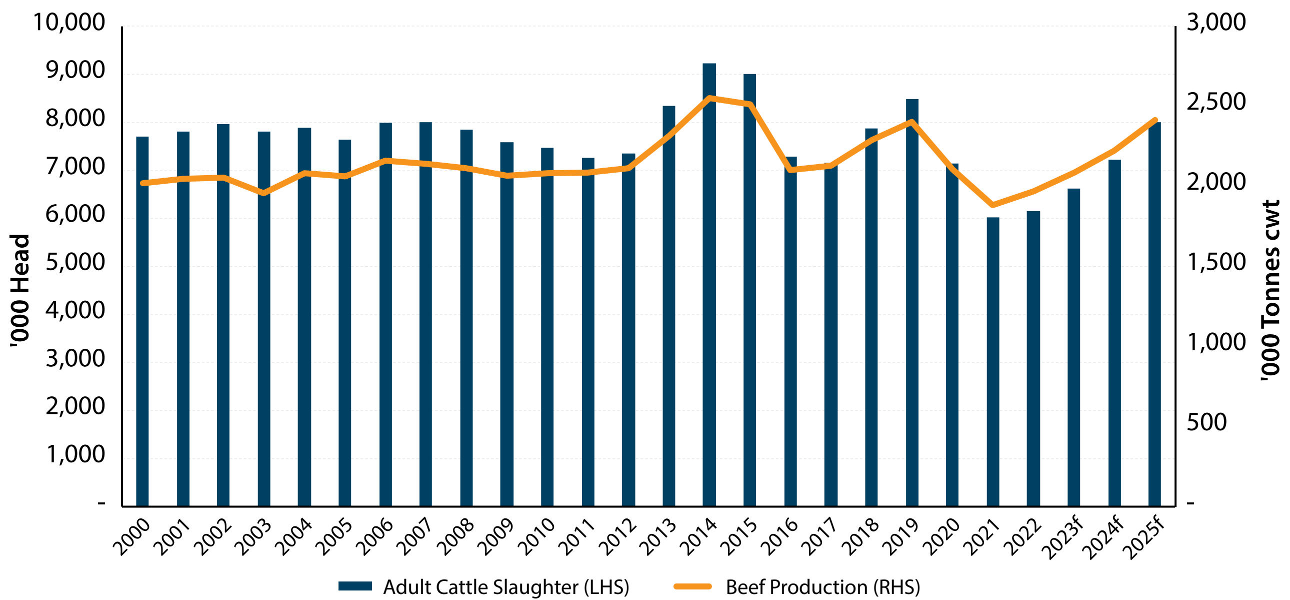
EASTERN YOUNG CATTLE INDICATOR 2018 - 2023



Source: MLA, ANZ

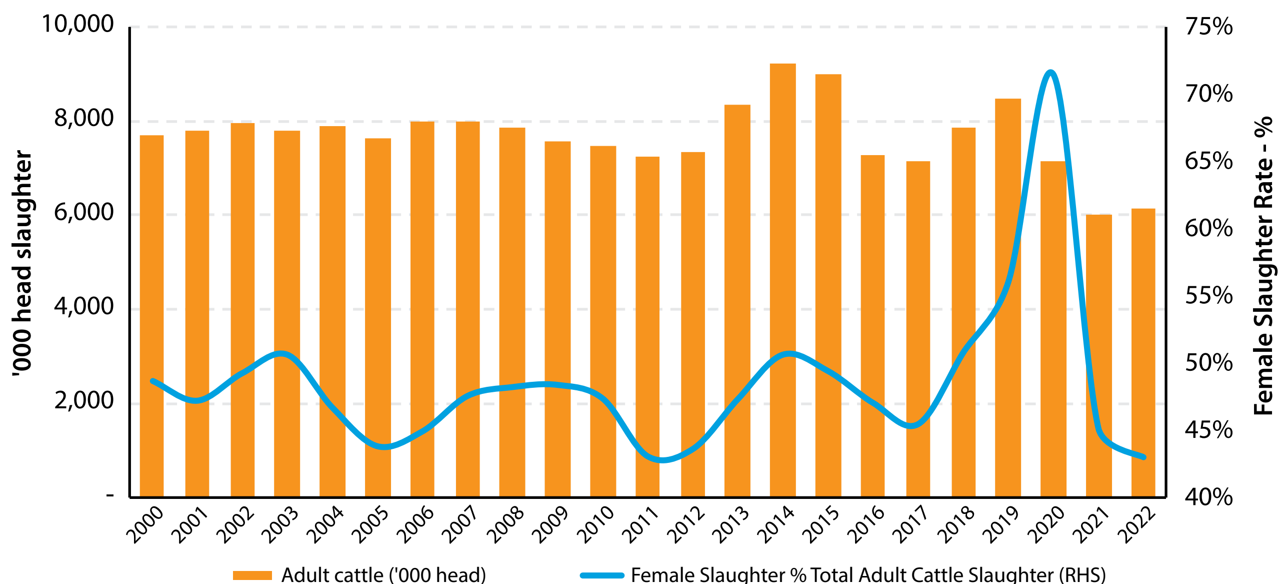
Given the herd growth, and the easing in prices, it is foreseeable that processing output may lift, helping to grow exports in 2023. While the four major export markets all have different characteristics, there is particular confidence in demand from the US, as their herd nears the end of its liquidation phase and heads toward rebuilding, as well as China, where the ongoing post-Covid opening up should see consumer demand for beef increase. In all major export markets, there may be some concern over the impact of reduced economic growth on consumer beef consumption, though this is unlikely to be a major hindrance on demand.

AUSTRALIA CATTLE SLAUGHTER VS BEEF PRODUCTION 2000 - 2025F



Source: MLA, ANZ

AUSTRALIAN ADULT CATTLE SLAUGHTER NUMBERS VS FEMALE SLAUGHTER RATE



Source: MLA, ANZ

(Note:The female slaughter rate (FSR) is often used as an indicator of the cattle herd cycle. An FSR of below 47 percent usually signals a herd is in a rebuilding phase, while an FSR of 47 percent and above usually indicates a herd is in a liquidation phase.)

SHEEP INSIGHTS

OVERVIEW

- Prices for heavy lambs continue to find support, with fewer heavy lambs available for buyers
- Trade lamb prices are following suit however trading margins remain profitable, particularly in NSW
- Yardings are up on 2022 levels, and prices are holding, indicating the strong underlying demand for lamb
- Lamb exports continue to drive industry profitability with 2022 export volumes finishing the year 7 per cent up on the prior year
- Mutton exports continue to come off from their peak as demand softens throughout Asia.

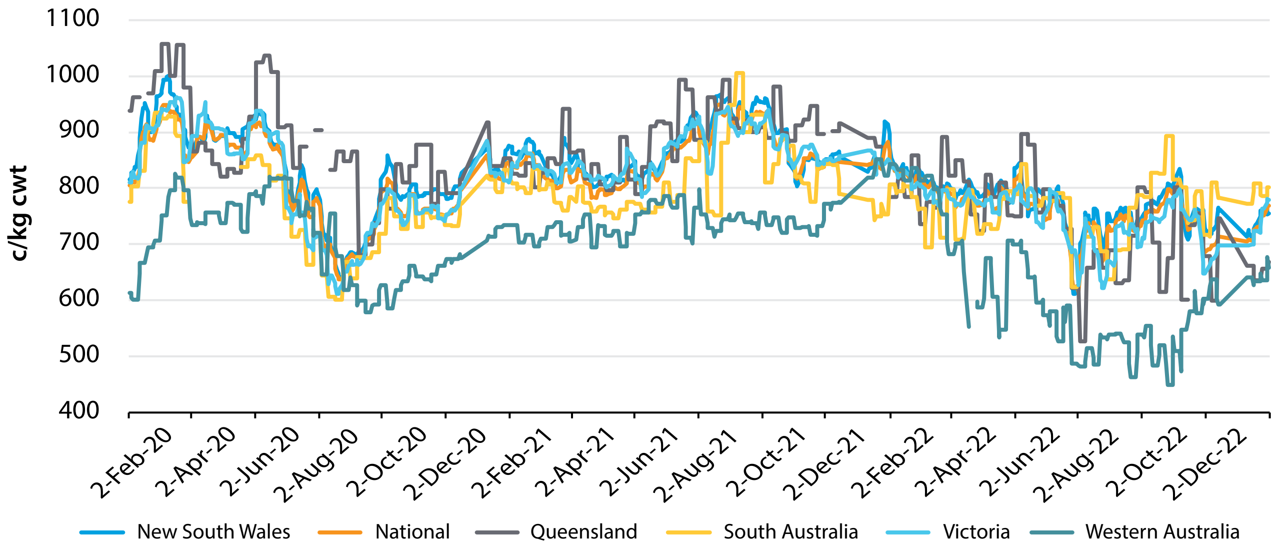
The national sheep market has started 2023 with some volatility, however overall solid performances across national saleyards. Behind this is an undersupply of quality lambs leading to strong demand for heavier animals, which in turn is pulling trade lamb prices up. In good news for the sector, these prices are in tandem with strong yardings, indicating there is true underlying support for prices at current levels. The strong demand for heavy lambs also provides a good indication that there isn't a 'glut' of heavy lambs expected to hit the market in coming months. Lamb exports are also looking positive, with export demand up around 7 per cent to the end of 2022. The story is very different for mutton however, as saleyard prices continue to fall and export demand is also on the decline.

Despite an initial fall in the National Trade Lamb Indicator (NTLI) price to commence the year, prices have rebounded well, although not yet back to the levels seen at this time of the year in 2022 or 2021. Part of this increase is seasonal, as new season's lambs are sent to market in southern States, and processors and fatteners seek to secure supply. And while this year's indicator prices have not rebounded to prices seen in prior years, quality, fattened lambs are in strong demand.

By State, the largest falls in the Trade Lamb prices were felt in Western Australia and Victoria. Western Australian prices have staged a very solid comeback, and while they continue to lag behind east coast prices, this is not unusual at this time of year, particularly as there is no large number of sheep coming across the Nullarbor.

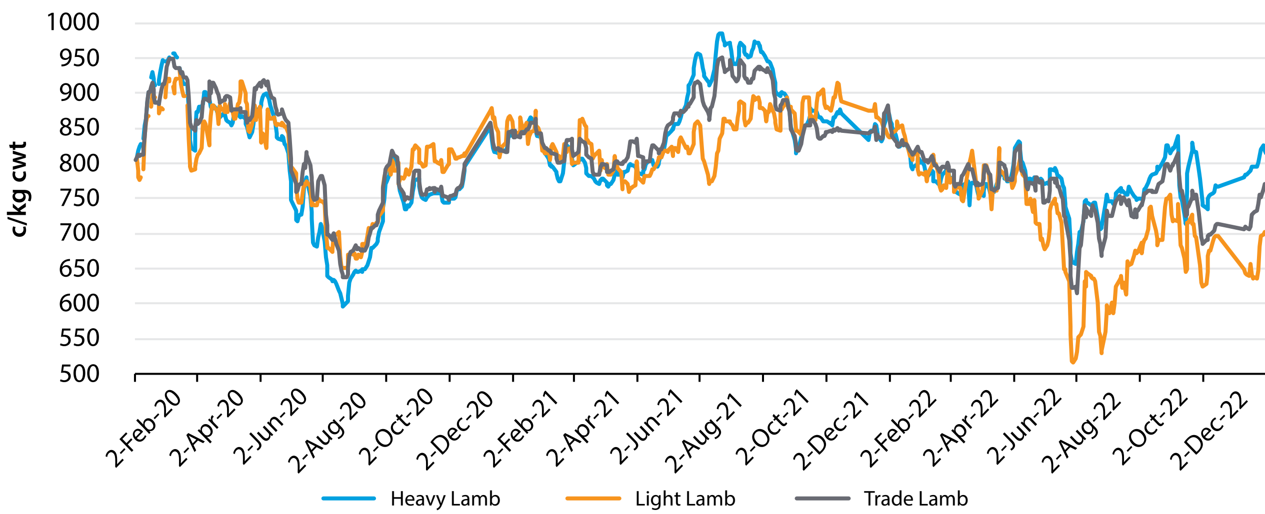
This year has seen a real split between categories of lamb. This time in 2022, there was only 17c/kg cwt between heavy and light lambs, whereas this year there is around 114c/kg cwt between the two categories. As a result, heavy lambs are currently receiving only around 50c/kg less than this time last year, while light lambs are receiving almost 150c/kg less than this time last year. This is largely due to poor spring feed growth in some major sheep producing areas of the country, combined with producers' desire not to be 'caught' by the lack of processor capacity which hit last year and left many with lambs retained over winter months. The margin per kilo between heavy and light lambs is most pronounced in New South Wales, where dry weather across Christmas and the beginning of the year has seen demand for lambs for fattening, and supply of fat lambs, both fall.

SALEYARD PRICES OF TRADE LAMBS BY STATE



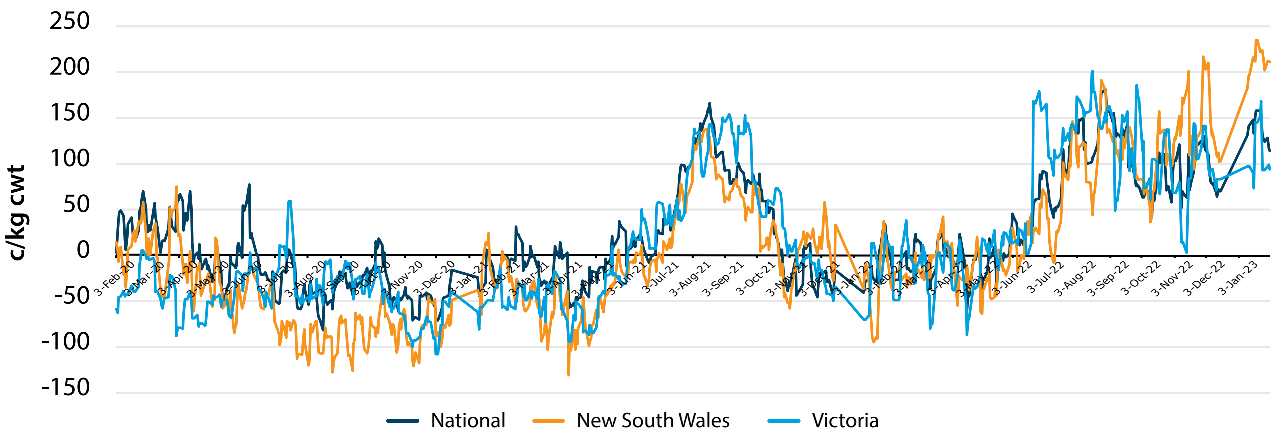
Source: MLA, ANZ

NATIONAL SALEYARD PRICES BY CATEGORY



Source: MLA, ANZ

SALEYARD PRICE MARGIN: HEAVY LAMB V LIGHT LAMB

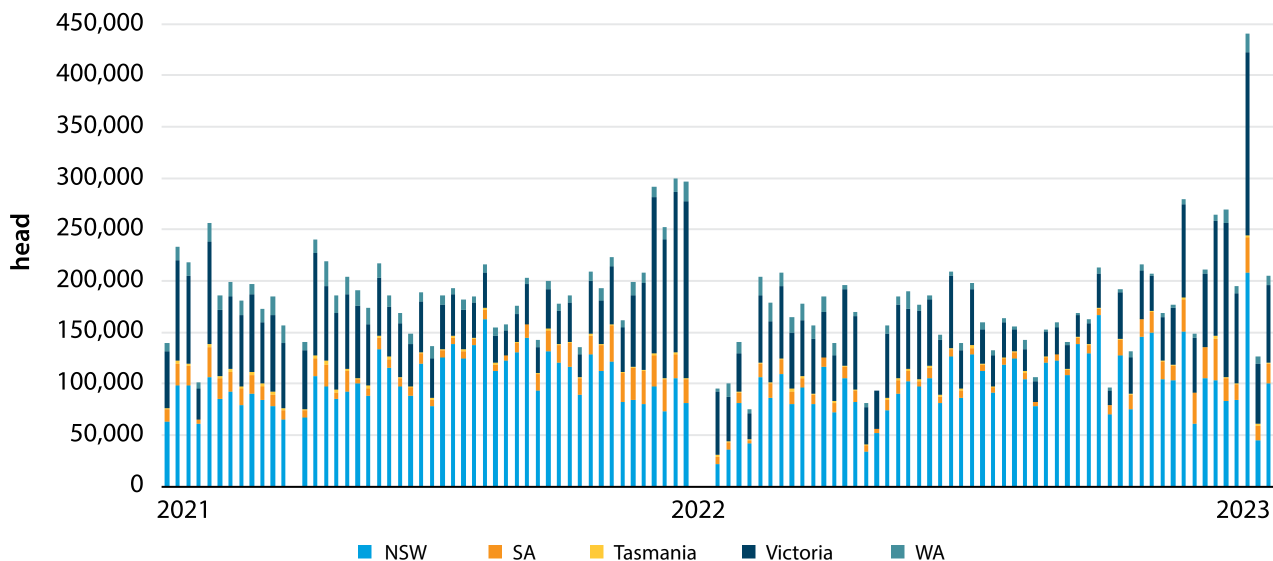


Source: MLA, ANZ

Yardings have been understandably volatile throughout January, given the mid-week timing of Australia Day, however in general have been up on last year, with total yardings for the first four weeks of the year up almost 135 per cent on 2022. Yardings were up most significantly in South Australia (189 per cent), New South Wales (144 per cent) and Victoria (136 per cent) – where rain events across spring and the late arrival of warm weather made for poor spring growth. Yardings have increased less significantly in Tasmania (70 per cent) and Western Australia (29 per cent) where spring delivered more growth on which to fatten.

Strong prices for heavy lambs and, following suit, trade lambs, despite large increases in yardings, provides a good indication that buyers aren't holding out for an expected glut of heavy lambs to hit the market any time soon. This isn't to say that the low number of yardings in 2022 hasn't resulted in additional lambs in the system – as 2022 saw almost 1.4 million fewer lambs than the 10-year average go through the saleyards. It is more that these additional lambs have been retained on farm for restocking and rebuilding flock numbers.

YARDINGS BY STATE



Source: MLA, ANZ

Lamb exports finished out 2022 strongly, up 7 per cent for the year. In December, the total volume was up over 5 per cent year on year, with Australia's largest market remaining the United States, despite the declining economic growth in the US leading to both lower demand and prices for lamb. This, combined with the relative lower cost of US beef as their herd continues to liquidate, has meant that the US market has lost its lustre from just a year ago. Export demand from China, however, has recovered well and was up almost 15 per cent year-on-year in December, while exports to the Middle East remain relatively stable. Mutton exports are a different story, however, with total exports rounding out 2022 almost 10 per cent down on the previous year, as the impact of African Swine Flu in Asia wanes.

WOOL INSIGHTS

OVERVIEW

- A relatively steady EMI over the past two years disguises the underlying trends in micron-based price spread
- The end of the zero Covid policy in China is a positive for wool demand, which is supporting prices across some categories
- Global economic slowdowns and continued cost of living pressures in the Northern Hemisphere are likely to continue to keep overall pressure on prices
- High volumes of coarse wool from Australia and key market competitors continue to flood the global market, keeping prices at long term lows.

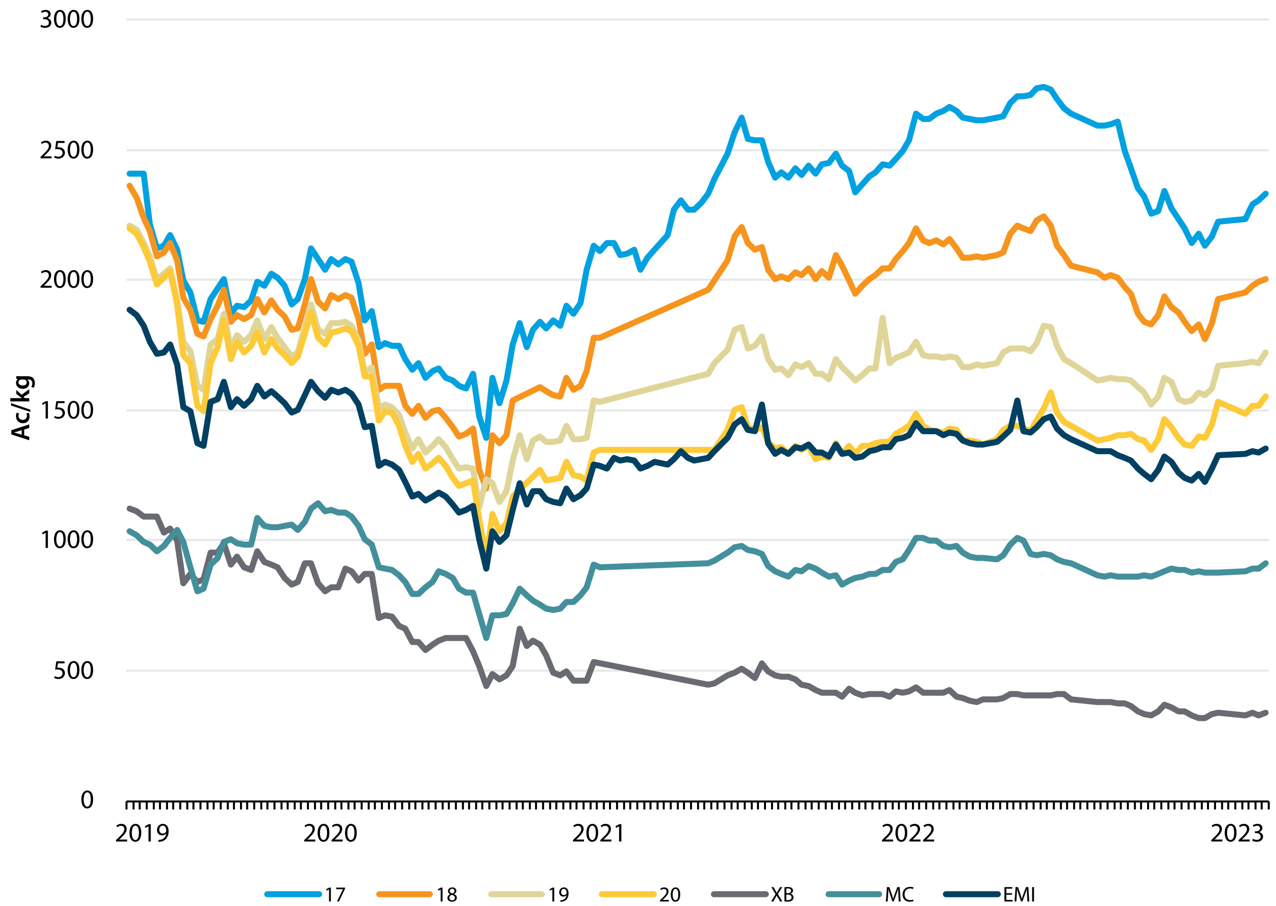
The Australian wool market has had a positive beginning to 2023, following on from a strong end to 2022. While the Eastern Market Indicator (EMI) price has stayed relatively stable for a number of years now, the finer end of the micron spectrum has seen some volatility in response to shutdowns in Chinese manufacturing over 2022 and subsequent removal of China's zero Covid policy. On the other end of the spectrum, crossbred wool prices remain in the doldrums with no indications of any price improvements in the future. Lack of labour availability and a wet season has also seen an oversupply of long wool which is impacting processor demand. Concerns over global economic growth as we come out of the northern winter have pulled wool prices lower for many months and will continue to push prices down for the foreseeable future.

If we were just looking at the EMI over the past two years, we may be forgiven for thinking that the Australian wool market has been in the midst of a period of unusual stability – with the EMI trading within a little over a 300c/kg range. This is perhaps obscuring the whole story, however, as the super fine end of the micron spectrum has seen greater ups and downs during that time – although more ups than downs – while the crossbred end of the market appears to be sitting solidly - arguably intractably - at historic lows. The combined effect on the indicator price is what we are seeing when looking solely at the EMI.

With most movement being seen in the 17 and 18 micron sectors, prices are now sitting off their highs of a few months ago, but remain at very strong levels. Behind these price falls of recent times has been consumer and manufacturing activity in our primary market of China where lockdowns prior to December stifled wool demand, however the subsequent removal of zero lockdown has more recently led to a recovery in the market. With17 micron wool now trading at over 2,300c/kg, prices are still around 15 per cent below the levels seen late last year, although the market is showing good signs of positive sentiment returning in China.

While concerns over global economic growth and lower demand for luxury woollen products going forward sit in the background, particularly as we come out of the northern hemisphere winter, the current sentiment from buyers appears

WOOL PRICE BY MICRON



Source: AWN, ANZ

to be focussed on returning to pre-pandemic manufacturing capacity and rebuilding stocks. As a result, concerns of global economic growth, particularly in Europe, may not yet have been factored into the current wool price.

While it is well-known that crossbred wool prices have hit the doldrums over the past three years, there hasn't been a huge amount of focus on the 'why'. To put the quantum of the price decline into perspective, in early 2019 crossbred wool was selling at around 1,100c/kg. Today, that price has fallen by almost 70 per cent to just over 340c/kg. Much of that sharp decline was put down to Covid and a decline in processing demand and capacity in China. However, given that decline was evident before Covid hit, it's more likely that something fundamental has happened to the crossbred market. In short, it appears that a global oversupply of coarse wool stemming from an increase in farming sheep for meat rather than wool has saturated the market. Major coarse wool producers across New Zealand, South Africa and Uruguay have all suffered similar declines in prices. In short, the market seems to be waiting for a supply-side response from producers as they either move to shedding breeds or move to other land uses, bringing down total volume before prices improve.

DAIRY INSIGHTS

OVERVIEW

- Global dairy supply grows steadily, with strong production out of the European Union in particular
- The impact of the re-opening of China is yet to be seen on either demand or global pricing, however there may be some improvement in sight
- Global prices have dropped to well below their March 2022 peaks with the GTD index currently 35 per cent lower than this time last year
- Domestic production continues to fall, lowering Australia's export surplus and buffering domestic prices somewhat from international trends
- Processors continue to compete for a shrinking volume of Australian milk, putting pressure on margins for export-oriented processing in particular
- Higher domestic prices maintain a profitable bottom line for producers; however volatility and costs of production have never been higher.

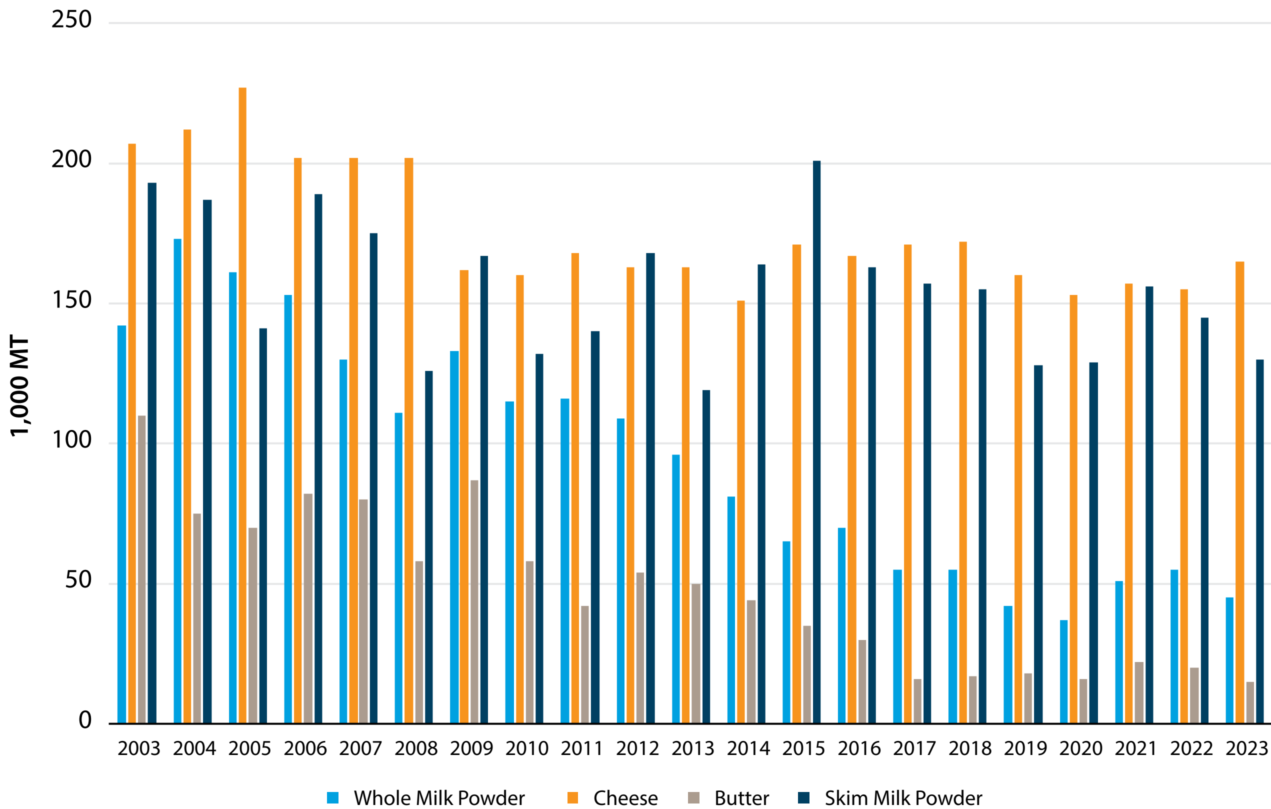
2023 has started off with a very different outlook to that which began 2022. While the start of 2022 was characterised by booming global prices, as a result of reduced global production levels, and strong domestic competition for supply, 2023 has started with a much more bearish outlook. Weakening global dairy prices have shifted sentiment in the global dairy industry to one of caution. With steadily growing global supply, and concerns over future consumption due to China's patchy growth now dominating, global dairy prices have entered 2023 with a series of falls. Domestically, the decline in Australian milk production appears to be continuing unabated, despite the excellent prices of recent times, catching processors between the diverging domestic and global markets.

The Global Dairy Trade (GDT) auctions have started 2023 the way they ended 2022, with a series of falls in prices across a range of products. The most recent decline in GDT prices saw the average price decline to levels not seen since early 2021. Declines are being felt across the board with the GDT Index now sitting 35 per cent lower than the peaks reached in March 2022. These declines have been driven by a number of factors including weak China consumer demand and global food price inflation as well as higher than anticipated production figures, particularly in the European Union. Any impact from the re-opening of China from lockdown and increased demand from Chinese buyers back in the market has not yet hit, and while China is currently going through the shadow lockdown of Covid outbreaks, some upward price pressure may eventuate as China stabilises and growth improves.

While the declining global market creates a clear disconnect between global and domestic milk prices, the Australian dairy industry's decreasing reliance on the export market means that global prices do not automatically flow through to the farm gate in a way they may have in the past. Indeed, the domestic market is the most lucrative market for most processors and as Australian milk supply shrinks, the global market becomes less and less central to opening prices. That being said, for those processors who are set up to manufacture goods for the export market, the decline in global prices will squeeze their bottom line.

On the flip side, the decline in Australian milk supply continues to be the source of competition between processors and retailers to ensure supply. Most recently, Coles offered large price increases to those producers who are willing to sign multi-year deals. Indeed, the most salient factor for opening prices may ultimately be the response of Australian consumers to ongoing food price inflation, including dairy goods, and how domestic demand holds up in the face of reduced consumer spending capacity.

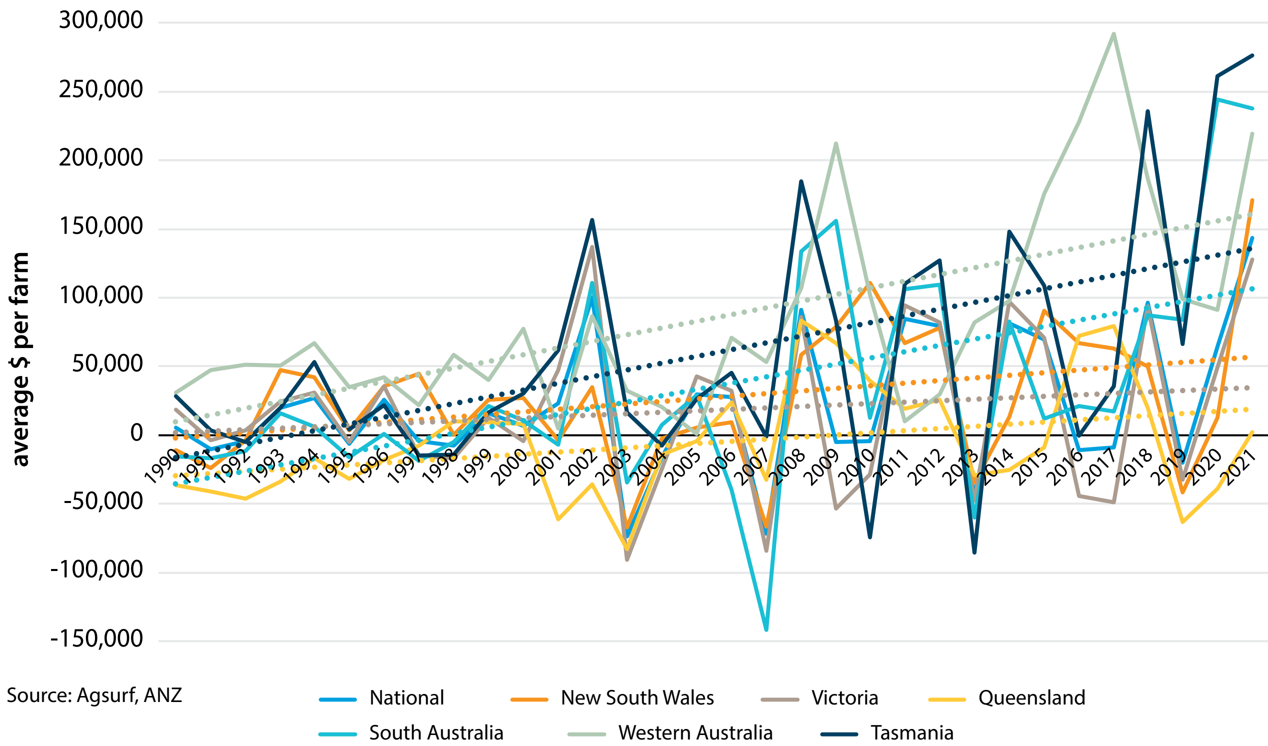
AUSTRALIAN DAIRY EXPORTS BY PRODUCT



Source: TradeMap, ANZ

The continued decline in Australian milk production does not appear to be abating, despite excellent milk prices with many factors continuing to weigh on production. The increasing cost of inputs is the most obvious factor weighing on dairy farm profitability – and as a high input industry, profit margins in the dairy industry are very reliant on input costs. The current high input prices however, do not explain the longer-term decline in the Australian milk supply. In short, it appears to be a long-term trend governed by the retirement of a generation of dairy farmers, with a lack of both new generation of farmers and labour coming through the system, and a shift towards 'easier' high-return industries such as beef and lamb production. And while there have been claims that it is a lack of profitability that is driving exits from the market, data from ABARES on dairy farm profitability shows growth in profits in all States, to differing extents, although it also shows a significant increase in volatility in profits since deregulation.

DAIRY FARM PROFITS (AVERAGE) BY STATE



Source: Agsurf, ANZ

To that end, turning around the downward trajectory of Australian milk supply does not appear to be reliant on a market response to higher prices – instead, it is a feature which is likely to be around for the foreseeable future. This will clearly impact Australia's position as a dairy exporter – which, coming at a time when production in New Zealand is also in decline – will leave an unrealised opportunity in the Asia market for the Australian dairy industry. Regardless, 2023 is likely to be a year of tighter margins for processors, particularly those who are export oriented, putting downward pressure on domestic prices, being balanced by the lack of local supply.

COTTON INSIGHTS

OVERVIEW

- The Australian cotton crop appears on track to be around five million bales, making it one of the largest ever
- The 2022 floods are likely to see a sizeable variation between State production levels, with NSW markedly down, while Queensland will be up
- Assuming a return to normal growing conditions for the 2023/24 season, the industry will be hoping for a change from the usual sharp volatility in production
- While global cotton prices have been flat, concerns over production interruptions and export bans may well see them rise.

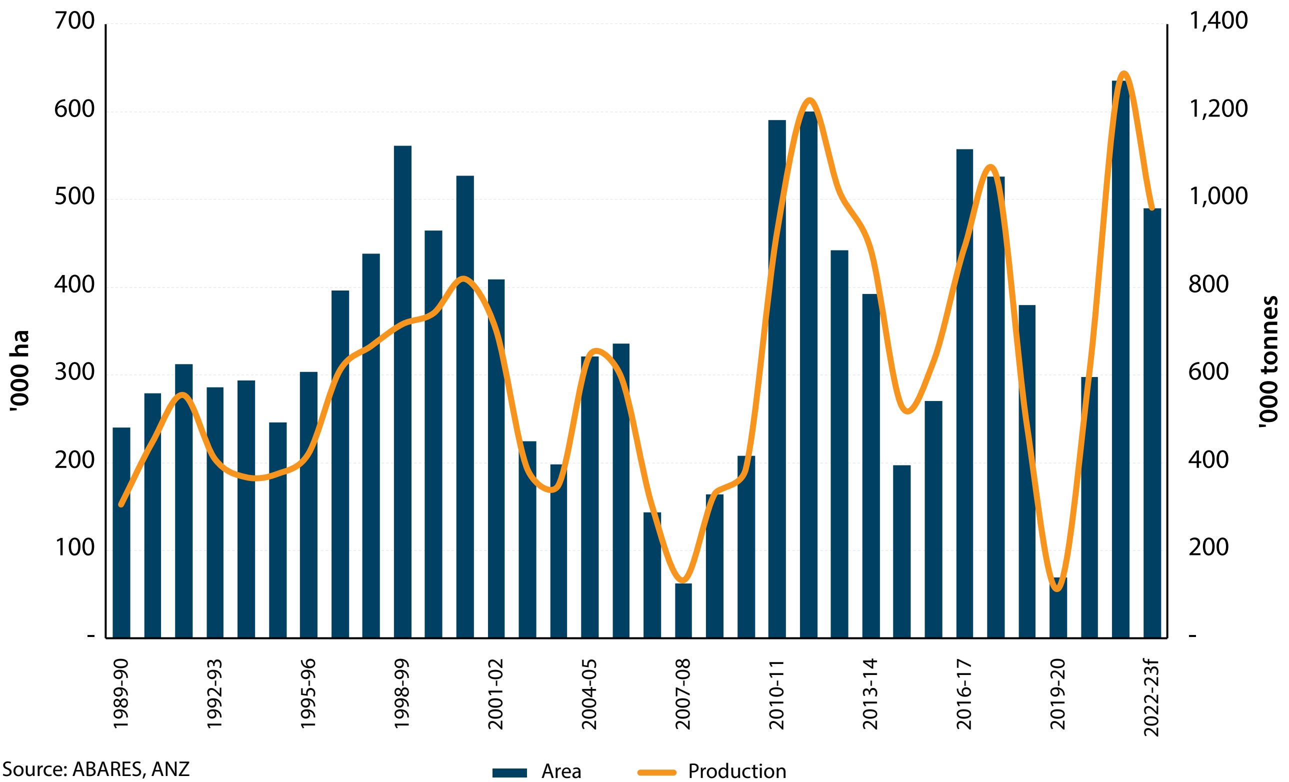
While the Australian cotton industry is yet to harvest the 2023 crop, many in the industry are already looking well ahead into the future. While nothing is certain until the harvest is complete, forecasts remain that the 2023 harvest will be around five million bales, making it the third largest ever. Despite this, the local cotton industry has a history of very volatile production levels, and many in the sector will be evaluating a number of factors as they weigh up their farm strategies. These will not only include the selection of off-season crop, and a close monitoring of long-range weather forecasts, but an evaluation of the current global economic conditions on export demand.

Domestically, in a similar way to Australia's grain outlook, while the overall production forecast remains high, the impact of the major rainfall in late 2022 will have a widely varying impact by region. According to ABARES, the forecast harvest figures from NSW and Queensland will be markedly different. In NSW, the cotton harvested area for 2022/23 is currently forecast to be down around 40 percent on the previous year, to 246,000 hectares. Even considering the drought-hit years of 2019/20 and 2020/21, this would still be below the five-year average.

In contrast, Queensland's harvested cotton area in 2022/23 is forecast to be up almost seven percent on the previous year, to 228,000 hectares. This would be almost 80 percent above the five-year average. In a sign of the strong growing conditions, production is forecast to rise even further, by around eight percent.

The Australian cotton crop has a history of strong volatility of production levels, far more so than the already volatile overall national grain and oilseed crop production levels. The cotton volatility levels are almost entirely weather-driven, given the relatively concentrated growing area of most of the national crop, in NSW and QLD. For this reason, the cotton industry will be looking ahead to late 2023 and into 2024 with a close eye on the weather patterns. Given the early reports that the wetter La Nina pattern may have finished, cotton growers will carefully weigh up their options before making decisions on their planting mix for the next season. That said, with the next season still some time away, the current assumption would be for average growing conditions.

AUSTRALIAN COTTON HARVEST AREA VS PRODUCTION



Source: ABARES, ANZ

In terms of cotton prices, a combination of conditions could potentially see prices start to head up again in coming months. After reaching a decade-high of almost 160 US cents/pound in mid-2022, global cotton prices had fallen over 40 percent, to sit at around 90 USc/lb by February 2023. Looking ahead, the market will potentially factor in a surge in demand for cotton from a number of manufacturing importers, as they predict strong growth in consumer usage driven by both the post-Covid recovery, as well as looking toward the end of the current economic slowdown in a number of countries.? At the same time, there are also concerns over global supply levels over 2023, particularly as a result of recent floods in Pakistan, the world's fifth largest cotton producer, which may have wiped out around 40 percent of the country's crop. In addition, there are also concerns that India may impose restrictions on its cotton exports, in a bid to keep domestic prices down.

Overall, given the potential for prices to stay high, as well as no major outlook of overly dry weather at this stage, the domestic cotton industry is likely to be looking optimistically towards a third good season in a row.

SUGAR INSIGHTS

OVERVIEW

- The current Australian sugar crop looks set to be the highest in four years, with the potential for even higher the following season
- Global sugar prices have been strong, due to interruptions to production in Brazil, India and the EU, although may dampen during the year when supply increases
- Globally, the market is optimistic about increasing demand as China re-opens, and the world plans for growing consumption levels later in the year as economic conditions improve
- With major sugar importers likely to seek high volumes to sure up their stockpiles, Australian exporters could see strong demand later in the year.

With the sugar cane harvest having finished, Australia's cane growers find themselves in a reasonably strong position, with a good balance of a strong domestic crop, combined with tight supplies globally – in some ways, not unlike the grain industry. With forecasters predicting a production level of around 4.4 million tonnes, this would represent the strongest crop in four years. Given the strength on the market, it is likely that sugar cane acreage and production could be poised for reasonable cyclical growth.

Globally, sugar prices hit a six year high in January 2023, breaking through 21 US cents/pound (USc/lb) on the benchmark Intercontinental Exchange (ICE). This was more than double the price of around 10 USc/lb which sugar had fallen to, at its most recent low in April 2020.

Sugar prices had been driven upwards based on supply concerns around some of the world's largest sugar producers and exporters, as well as forecast demand increases in major consumption markets. In the EU, which is the world's third largest sugar producer, the summer heat, combined with the impact of high energy prices on sugar processing, saw the region slip into a sugar deficit.

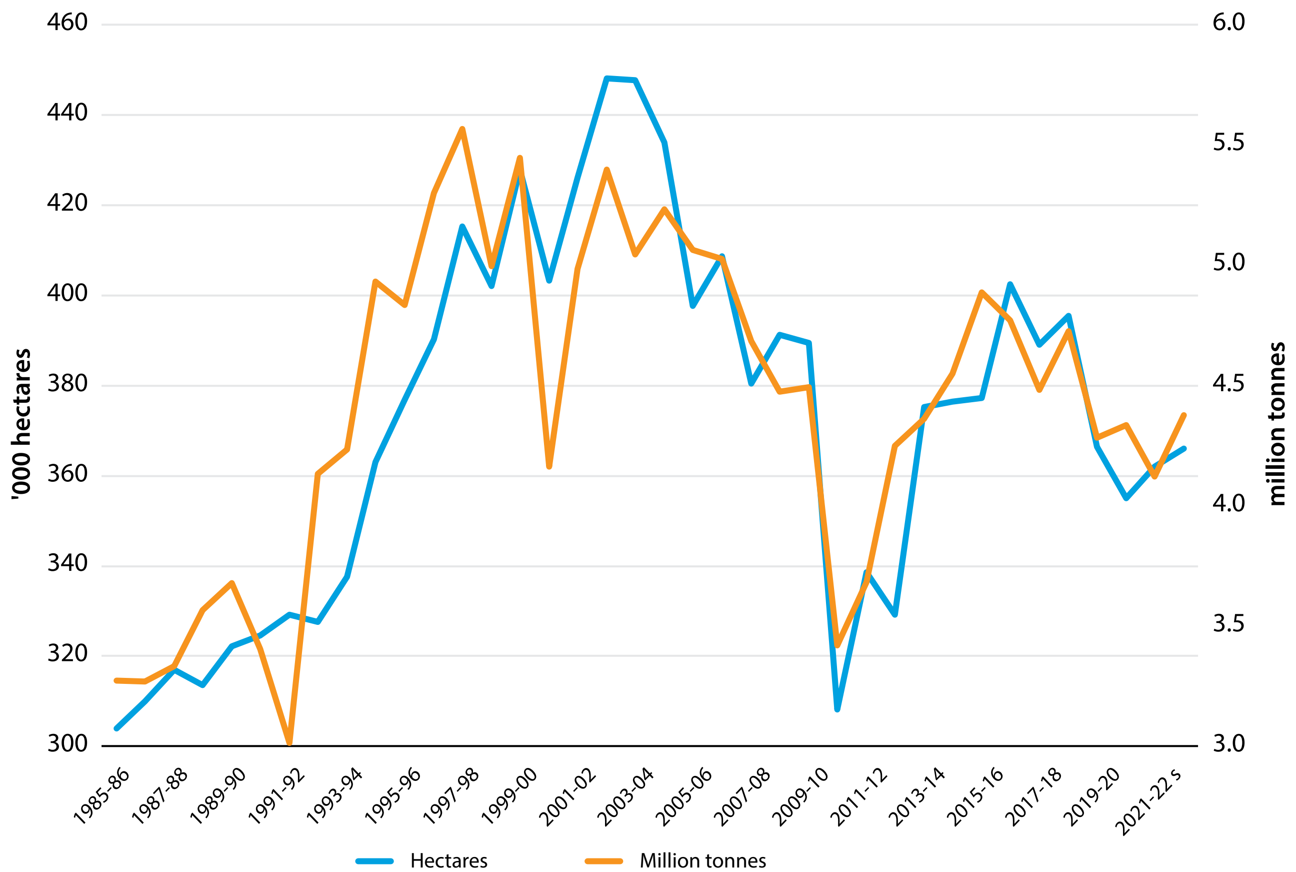
In Brazil, the world's largest producer, the sugar harvest and production process were also delayed by weather, although this was too much rain rather than too little. In addition, in India, which vies with Brazil as the top global sugar producer, hot weather also saw production fall.

The impact of these disruptions, in sending sugar prices to multi-year highs, is one contribution to the current global pattern of food inflation, with sugar being a key ingredient in a large proportion of the world's processed foods.

Additionally, market signals out of India have also pushed prices higher, as the country not only looks to divert some its sugar cane production into ethanol, as part of its biofuel policies, but also appears likely to cap its sugar exports for the year, to meet domestic demand.

Looking ahead, the signals are that these price highs may be coming to an end over coming months. Brazil is forecast to produce a larger crop than last year, although the harvest is not scheduled to begin until around April. In addition, the Brazilian sugar export outlook will also revolve around future moves in global oil prices – if these

AUSTRALIAN SUGAR AREA VS PRODUCTION



Source: ABARES, ANZ

rise considerably, then more Brazilian sugar will be diverted to ethanol, further tightening global sugar supplies.

In terms of global demand, the biggest drivers right now continue to be the post-Covid recovery in a number of markets. The reopening of Chinese production and retail is likely to see a surge in demand for sugar, and with the country's domestic stockpiles diminished, import demand will be strong.

For Australian producers, this is likely to generate strong demand for exports for much of 2023, particularly as major users such as Indonesia scramble to access supply.

Even when the forecast global production comes online later this year, which should return the world's sugar supplies into surplus, it is likely that market nervousness will buffer any major falls in sugar prices for some time to come.

AUSTRALIAN ECONOMIC INSIGHTS

2023 IS THE YEAR OF THE SLOWDOWN

Inflation escalated in the December quarter

Australia's headline inflation rose to 7.8 per cent year-on-year at the end of 2022, its highest rate in 32 years. Non-tradables and services inflation accelerated, both annualising around 8.5 per cent year-on-year. These measures better reflect demand-driven pressures and locally-sourced inflation, which means they are more closely watched by the RBA for cash rate decisions than the headline figure. The part of inflation the RBA can't control - global pressures – are likely to ease through 2023 as global growth moderates.

Market expectations shift as RBA warns of more rate hikes – plural - ahead

The RBA hiked the cash rate 25 basis points to 3.35 per cent at its first meeting of the year. Along with the decision, the RBA statement spelled out that further rate hikes – plural – are coming. We continue to expect that the cash rate target will rise to 3.6% in March and then to 4.1 per cent by May 2023.

Neither ANZ nor the RBA think that underlying measures of inflation will come back into the 2-3 per cent target band before late 2024 or early 2025. This makes a rate cut in 2023 or the first half of 2024 unlikely. We expect the first RBA rate cut to happen in late 2024.

Household spending will moderate this year

Retail volumes fell 0.2 per cent quarter-on-quarter in Q4 2022, driven by a shift in household spending away from retail spending and towards travel, entertainment and other services, as well as moderation in real consumption growth due to rising interest rates and inflation.

We expect aggregate spending growth to be slower in 2023 than 2022, as rising interest payments reduce discretionary spending for households. We also expect a further shift to services spending.

ANZ-observed spending in January and early February showed a clear shift in spending towards travel services and away from discretionary goods (e.g. furniture, electronics, clothing).

Stronger population growth in 2023 should somewhat offset the slowdown in per-household spending and will be key to Australia avoiding recession.

GDP growth will slow but the unemployment rate will remain low.

We expect GDP growth to slow through 2023, from 2.6 per cent year-on-year at the end of 2022 to 1.5 per cent year-on-year to the end of 2023. There are signs that business conditions are starting to turn down, and businesses are deeply pessimistic about the outlook.

But despite this, we expect more wage growth in 2023 (4.35 per cent year-on-year vs 3.4 per cent year-on-year expected for 2022). The RBA's business liaison showed around a third of firms reported wage increases above 5 per cent in the December quarter and a lower average upgraded their wage forecasts in their February outlook. We also expect a still-low unemployment rate in 2023. With 444,200 job vacancies recorded in November (around double the pre-pandemic level) and businesses still in hiring mode, it's hardwe are unlikely to see a sharp rise in the unemployment any time soon. According to NAB survey results, 90 per cent of firms are reporting labour rate (3.7 per cent as a constraint on their output. at January) rise much more in the short term.

China's reopening a win for Australia's GDP

China's reopening could add 0.4 percentage points to Australia's GDP growth over the next two years, and we expect at least 50,000 Chinese students to arrive in Australia. The return of tourists is likely to be more gradual. In contrast, we think there's limited upside for Australia's goods exports. We expect the AUD to drift up to 75c USD by the end of 2023.

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