

NAB grains outlook

Some large unanticipated 'big picture' challenges overhang the world economic outlook and bear close monitoring and management by farmers.

Globally, the US housing collapse and the associated global financial turmoil has added to financial costs – in terms of short-term finance as well as longer term credit and equity premiums – and in particular lowered equity prices. Until recently, high and rising oil and other commodity prices have unexpectedly added to business costs.

In Australia's case, the China-driven commodity boom and associated prolonged domestic expansion has until recently pushed Australia up against capacity constraints, and led to higher domestic inflation. In response, the Reserve Bank of Australia (RBA) had significantly tightened monetary policy, before downside risks to global activity emerged mid year and the RBA began to move towards a less restrictive monetary policy.

More generally, there is a great deal of nervousness across business and financial markets at home and abroad.

Implications for grain growers

Despite the current economic slowdown and the associated reduction in demand across the board, the medium term outlook for the grains industry is very positive.

In the short term, the impact will be mixed, with decreased economic activity expected to reduce grain prices, but also farm input costs.

But grain growers can expect prices to remain high in historical terms over the next five years, as the demand for food, protein and energy continues to rise.



Frank Drum.

GLOBAL TURBULENCE AND THE FARM BUSINESS

The recent global economic and financial turbulence has left many farmers wondering how this will affect their business. National Australia Bank's (NAB's) Agribusiness Economist, Frank Drum, has prepared the following outlook for the Australian grains industry.

NAB's current forecast is for farm incomes to increase by around 10 per cent in 2008–09 to \$5.5 billion. While the cost of fuel, fertiliser and chemicals is still high, this has been offset to some extent by increased winter crop production.

In recent seasons, grain prices have been high as a result of a reduction in global stocks due to the explosion in demand for biofuels and production disruptions – drought has affected major production regions, including Australia, the European Union and the United States.

This year's increase in grain production across the globe is expected to result in higher ending stocks. For example, world wheat production is estimated to increase by 70 million tonnes in 2008–09, which will result in a 20 per cent increase in global wheat stocks.

This increase in stock levels, combined with the slowdown in demand, is likely to result in grain prices averaging lower in 2008–09 than last season.

Despite this, prices are expected to remain near historically high levels, particularly as demand for food, protein and

energy continues to rise in line with an increasing world population and greater affluence in emerging economies.

With global grain prices remaining above long term average levels, the incentive to plant cereal crops remains, but reflecting potential problems with credit availability we are expecting global grain plantings to be slightly lower than this season.

NAB's economic and financial outlook

Following a very strong economic performance in the past four years, NAB forecasts global real income/output (GDP) growth to slow to 3.6 per cent in 2008 and only 2.5 per cent in 2009. Major economies are anticipated to slow further due to lags associated with negative wealth effects from lower equity and house prices. This is despite tentative signs of a peak in financial turbulence following the announcement of bank rescue packages and the likelihood of supportive monetary and fiscal responses.

Recessions are forecast for the US, Europe, Japan and UK, while growth moderates in developing economies. Importantly for Australia, Emerging East Asia slows from over four per cent in 2008 to three per cent in 2009. While Chinese forecasts have been lowered due to the indirect effects of the global turmoil, China appears set to sustain growth at a relatively strong pace of seven to eight per cent per year.

In the near term, Australian growth looks set to be sustained at a slower pace. Following an above trend rise of 4.25 per cent...26 ▷

WHEAT OUTLOOK

- Domestic wheat production to be between 19–21 million tonnes;
- World production to increase in 2008–09; and,
- Global wheat stocks to increase by 20 million tonnes.

World wheat prices have fallen significantly over the past three months as hedge funds and other speculators have pulled out of futures markets. But prices are expected to remain above long term averages over the next 12 months supported by sustained demand from emerging countries and relatively tight stocks.

OILSEEDS OUTLOOK

- Domestic production to increase significantly;
- Global oilseed production set to remain high; and,
- Oilseed prices expected to fall.

Weaker demand for crude oil in developed countries has resulted in prices falling over recent months. After peaking above US\$140/barrel in July, oil prices halved to just under US\$70/barrel in late October.

This has decreased the cost competitiveness of biofuels as an alternative fuel, placing downward pressure on grain prices, particularly oilseeds and corn – the main feedstocks used in biofuels production.

<25...GRAINS OUTLOOK

cent in 2007, NAB forecasts GDP growth to slow to about 1.25 per cent in 2008 and two per cent in 2010.

Put another way, Australian economic performance goes from overdrive in 2007 to first gear, on average, and even lower gears for some non-resource related and interest rate sensitive businesses!

Inflation outlook

Turning to the inflation outlook, it is clear that the consumer inflation will remain high in the near term as higher purchase costs and a lower \$A feed through to retailers. Little can be done about this near term outlook.

Looking further ahead, sustained slower demand and recent large falls in commodity prices (notwithstanding the impact of the lower \$A on imports) will fundamentally see inflation slow significantly during 2009. Our forecasts have core inflation near the top of the RBA target by late 2009 and a return to around 2.5 per cent during 2010.

Such economic and inflation prospects are likely to see the RBA ease monetary policy aggressively. In NAB's view, official cash rates are likely to be cut from a recent peak of 7.25 per cent to around 4.5 per cent by mid 2009. The federal government has already announced a spending package to support low income families, pensioners and first home buyers. Further spending announcements – especially with



NAB expects the price of fuel and fertiliser inputs to fall over the next 12 months.

respect to infrastructure – are also likely. Medium-term issues related to water and climate change will also bear watching.

Given the uncertainty on global activity and financial markets, the Australia dollar

appears to have overshot fundamentals. That said, NAB suspects that overshooting will continue for some time. Our commodity, activity and interest rate movements are consistent with the US/\$A around mid 70s US cents. NAB forecasts the US/\$A rate staying below 70c till mid 2009 before fundamentals reassert themselves – with the currency expected to be back to around 75c by late 2009 and somewhat higher again in 2010. ■

COARSE GRAINS OUTLOOK

- Global coarse grains production to increase in 2008–09 but stocks remain tight;
- Recent rains boost barley crop; and,
- Domestic feed-grain prices to ease in 2008–09.

World coarse grain production is forecast to increase to almost 1.1 billion tonnes in 2008–09 as rising global barley production offsets marginal falls in the production of corn, sorghum and oats.

Good rainfall throughout northern NSW and Queensland during September boosted prospects of a significant increase in barley production across the region this year. Combined with significant on farm storages of last season's record sorghum crop, this will place downward pressure on feed grain prices and lift feedlotter margins.

INPUT PRICES

- The cost of fuel and fertiliser is expected to fall over the next year. Slower global income growth will result in weaker demand for energy and grains over the next 12 months. An expected decline in plantings will result in reduced fertiliser requirements, placing downward pressure on fertiliser prices.

Energy consumption is also expected to slow as a result of the economic crisis, which will lead to lower demand and prices for both oil and natural gas. Natural gas is the major feedstock in the production of ammonia – and therefore nearly all nitrogen-based fertilisers.

Unfortunately, this decrease in demand will be countered to some extent by the lower value of the Australian dollar and increased export taxes on fertiliser from China.

The Australian dollar is now forecast to average around US74 cents in 2008–09, which will substantially reduce the purchasing power of fertiliser importers.

In a bid to protect their domestic farmers and production, China – which supplied 45 per cent of Australia's imported nitrogen based fertiliser in 2007–08 – is now taxing all fertiliser exports at between 100 and 150 per cent.

NAB CONTINUES TO BACK AGRIBUSINESS

The outlook for agribusiness remains strong, despite turmoil on global financial markets and predictions of slowing growth or even recession in many world economies.

NAB's Head of Agribusiness for Northern Australia, Tim Keith, says that NAB will continue to back its customers along the agribusiness supply chain.

"In a world where capital is constrained, many customers have asked where they stand.

"We know, for instance, that significant amounts of capital are needed to plant next year's crop and to re-stock in areas where the season has improved.

"NAB Agribusiness believes the fundamentals underpinning the sector have not changed and we will continue to provide financial support for agricultural enterprises," Tim said.