

Agricultural Commodities – Mid Year Summary

Risk-on, risk-off...

- Global agricultural commodity prices have been variable in 2010 in line with wider macro markets.
- The near term international wheat market outlook is still weak due to abundant supplies.
- Sugar markets have been on a roller-coaster during the past 18 months. The ride has not yet finished.

Agricultural markets have been buffeted by the 'risk-on, risk off' market mentality

Macro-economic developments and jittery financial markets continue to impact agricultural commodity markets. Investor appetite for commodities has been buffeted by a continued swing between a 'risk-on' and 'risk-off' mentality.

European fiscal concerns, rescue packages and austerity measures pressured markets in early 2010. And economic developments of the past few months, including evidence of a slowdown in Chinese economic growth and soft US economic data, suggests the global economic recovery will be a slow grind. In this environment we are cautious about the prospects for near term agricultural commodity prices.

USD ag prices struggled in 2010

Agricultural commodity prices rallied strongly during the 2009 GFC recovery phase, but this year has not brought with it the same fortune. The CBA Rural Commodity Price Index (USD terms) declined by around 10% in the 6 months to 30 June 2010, yet was still around 10% above year ago levels. The Australian dollar remains a key driver for domestic prices, and it continues to moderate the swings in global price movements for local participants.

International wheat market fundamentals remain fragile.

International wheat prices remain under pressure, falling some 25% from January to early June. Prices have picked up from their lows in the past month, but near term fundamentals are still fragile with large stockpiles and continued export competition from aggressive and low price suppliers. International feed grain prices have recently bounced because of strong ethanol consumption, Chinese corn imports, and reduced US corn acreage estimates. These developments provide spill-over support to wheat markets.

Eastern Australia's winter grain crop conditions are great.

A primary focus of Australian grain producers over the past quarter has been the 2010 winter crop sowing program. Excellent seasonal conditions across much of eastern Australia allowed planting to progress favourably. Yield potentials are above average in most eastern regions, but those in WA are average at best. The total Australian wheat acreage this year is around 5% below 2009 levels.

Cotton markets remain firm.

International cotton prices doubled in 2009 before moving higher still in early 2010. The market has since consolidated around 80 US cents per pound (ICE 1st contact), which is significantly above the GFC low of 36 cents and well in excess of the decade average 54 cents. Cotton market conditions are tight, giving cause to high prices. But concerns about the stability of the global economic recovery prevented further gains. Improving global production prospect in 2010/11 should help ease the current supply tightness, while the fragile economic conditions suggests that further price gains may be difficult.

Sugar's wild ride is not quite done.

It has been an explosive 18 months in sugar markets. New York raw sugar futures surged to 30-year highs above 30 US cents per pound in Q1'10, influenced by the two largest consecutive supply deficits on record. But prices then collapsed 57% by May 2010 because of physical demand destruction, increased cane plantings, better than expected Indian production and strong early-season crush results in Brazil



Since May, the market has been supported by re-surfacing physical purchases, inventory rebuilding, tight physical markets and adverse weather in Thailand. The struggle between increasing global supplies and the required inventory rebuild will continue to play out over the next year. Our crystal ball suggests that higher global production will gain the upper hand, with global sugar prices softening further over the next 12 months.

Livestock stays strong.

Livestock values rallied in Q1'10 with the Australian Eastern Young Cattle Indicator increasing from \$2.80/kg in December to over \$3.50/kg by March. Prices have since stabilised around \$3.40-50/kg, up 10% from the prior 3-year average. Constrained supplies, improved seasonal conditions, strong restocker demand plus firm domestic/international red meat demand are the main factors supporting prices. Domestic lamb/sheep values have recently been at record high levels because of low supplies and very strong demand from both the farm and processing sectors.

Figure 1: Chicago wheat futures (1st contract)

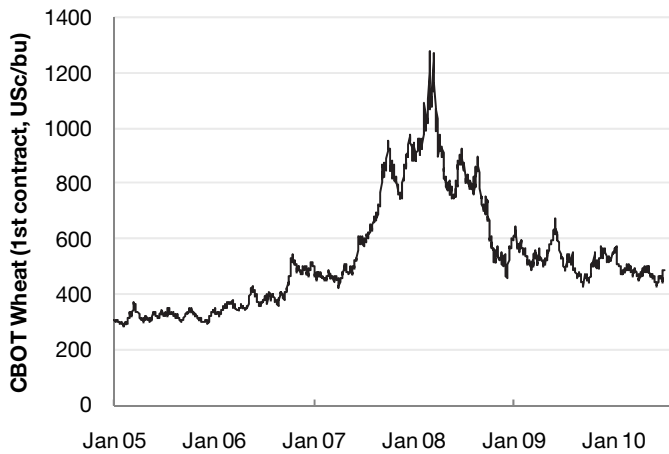


Figure 2: ICE cotton futures (1st contract)

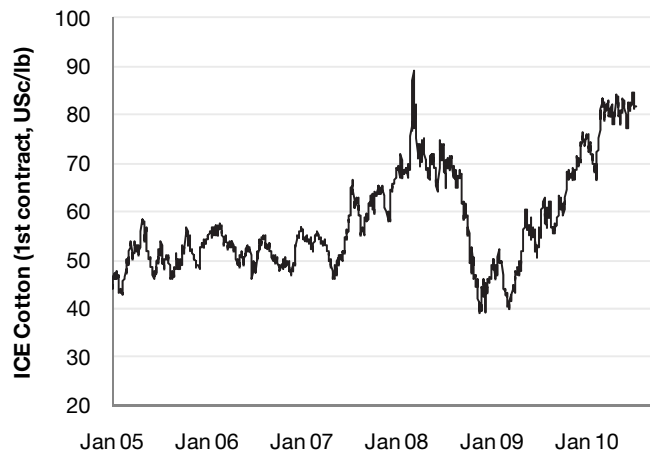
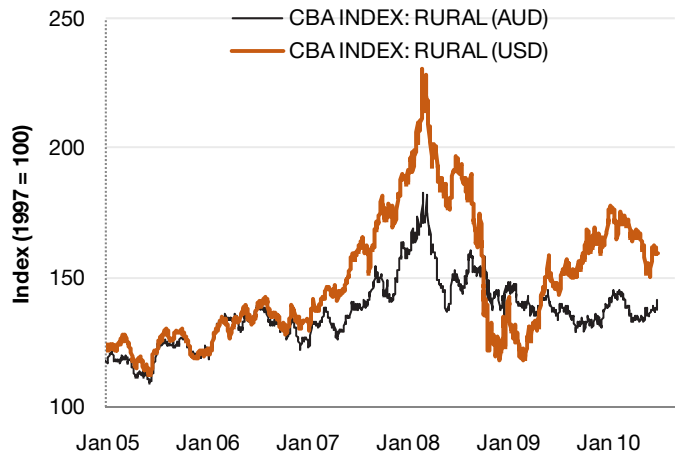


Figure 3: ICE sugar futures (1st contract)



Figure 4: CBA rural commodity price index





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