

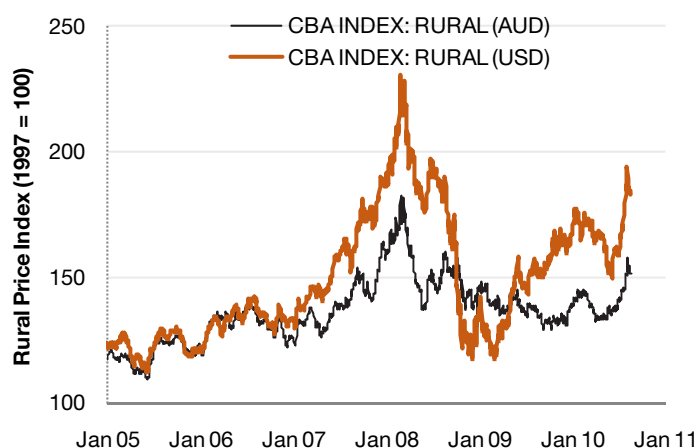
## Ag commodity price outlook – Q3 edition

- In this report we provide a summary of recent price action for the main agricultural commodities, plus our outlook for prices through the next 18-24 months.

### Highlights include:

- World wheat prices ran up too hard in response to the Black Sea production crisis, but nonetheless the 12 month outlook for global prices has improved significantly.
- Coarse grain prices should remain well supported because of tight global stock levels and strong demand. Barley prices in particular have received excellent support because of crop problems in Canada, Europe and the Black Sea.
- The oilseed market outlook remains unusually uncertain, but forecast record soybean supplies should weigh on prices.
- Cotton prices are expected to remain strong despite an uncertain global economic outlook, driven by the tightest global supplies since 1994/95.
- International sugar prices are currently very high, but values are likely to erode over the next 12 months as the market swings back to surplus.
- Livestock markets (beef and lamb) have been buoyed because of excellent east coast seasonal conditions. La Nina should result in continued above-average rain which will support prices.
- Wool prices have lacked direction this year but they remain at a high level. Australian wool supply in 2010/11 is likely to fall to its lowest level for 80 years.

Figure 1: CBA rural commodity price index



- *The CBA Rural Commodity Price Index tracks daily movements of wheat, cotton, beef, sugar and cotton prices which are weighted in accordance to the export earnings.*

Figure 2: Currency markets, AUD/USD





Table 1: CBA Agricultural Commodity Price Forecasts

		Current	Actual (Quarter Average)				Forecast (Quarter Average)										
		at 20/08/2010	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10	Mar 11	Jun 11	Sep 11	Dec 11	Mar 12	Jun 12	Sep 12	Dec 12	Mar 13
<b>North American Grains &amp; Oilseeds</b>																	
Wheat (CBOT)	US\$/bu	685	486	534	477	471	673	642	617	600	547	520	510	513	540	558	577
	US\$/t	252	178	196	175	173	247	236	227	220	201	191	187	189	198	205	212
	A\$/t	282	210	217	195	199	276	266	259	257	242	228	220	222	233	241	250
Corn (CBOT)	US\$/bu	415	337	394	360	360	409	430	447	437	430	425	410	400	400	400	402
	US\$/t	163	133	155	142	142	154	158	164	160	158	156	151	147	147	147	148
	A\$/t	183	155	172	157	163	171	178	188	187	190	186	177	173	173	173	174
Soybeans (CBOT)	US\$/bu	1017	1054	1026	935	959	1035	967	942	900	900	900	900	900	900	900	904
	US\$/t	374	387	377	344	352	380	355	346	331	331	331	331	331	331	331	332
	A\$/t	419	455	417	382	404	424	401	396	386	398	394	389	389	389	389	391
Canola (ICE)	C\$/t	448	407	404	379	395	457	450	447	420	400	400	400	400	415	415	417
	US\$/t	431	376	381	362	379	448	444	435	403	374	377	374	370	384	384	386
	A\$/t	484	442	422	403	435	500	501	498	470	451	449	440	436	452	452	454
<b>Australian Grains</b>																	
Wheat, NSW (ASX)	A\$/t	280	235	216	208	202	270	264	254	254	242	229	225	229	243	253	265
	US\$/t	250	200	195	187	176	242	234	222	218	201	192	192	194	207	215	225
Feed Barley (ASX)	A\$/t	263	182	147	143	153	247	234	224	224	202	189	185	189	203	213	225
	US\$/t	234	154	133	129	133	221	208	196	192	168	159	158	160	173	181	191
Sorghum (ASX)	A\$/t	240	187	213	196	190	234	224	214	214	192	179	175	179	193	203	215
	US\$/t	214	159	192	176	165	210	199	187	183	159	150	149	152	164	173	182
<b>Softs</b>																	
Raw Sugar (ICE)	US\$/lb	19.5	22.4	24.1	23.5	15.8	18.6	16.0	14.2	12.3	11.5	12.0	13.0	13.0	13.0	13.4	13.6
	US\$/t	429	493	532	519	347	410	353	312	272	254	265	287	287	287	296	299
	A\$/t	482	578	589	578	400	457	398	358	317	305	315	337	337	337	348	352
Cotton (ICE)	US\$/lb	88.0	59.0	71.3	77.4	81.8	85.0	87.5	85.0	85.0	80.7	76.3	72.0	70.0	71.0	74.0	75.3
	US\$/bale*	440	295	357	387	409	425	438	425	425	403	382	360	350	355	370	377
	A\$/bale*	494	346	395	430	470	474	493	487	496	486	454	424	412	418	435	443
Wool, Aust (EMI)	A\$/kg	8.74	8.15	8.68	9.13	8.85	8.85	9.00	9.00	8.83	8.75	8.75	8.58	8.50	8.50	8.83	9.04
	US\$/kg	7.79	6.96	7.84	8.22	7.72	7.94	7.98	7.86	7.57	7.26	7.35	7.30	7.23	7.23	7.51	7.68
<b>Livestock</b>																	
Cattle, Aust (EYCI)	A\$/kg	3.68	3.27	2.94	3.36	3.45	3.57	3.43	3.40	3.40	3.33	3.30	3.30	3.30	3.30	3.30	3.31
	US\$/kg	3.28	2.79	2.65	3.03	3.01	3.21	3.04	2.97	2.91	2.77	2.77	2.81	2.81	2.81	2.81	2.82
<b>Currencies (period end)</b>																	
AUD/USD		0.89	0.88	0.90	0.92	0.85	0.90	0.88	0.87	0.85	0.82	0.85	0.85	0.85	0.85	0.85	0.85
AUD/CAD		1.04	0.94	0.94	0.93	0.90	0.90	0.90	0.90	0.89	0.89	0.89	0.92	0.92	0.92	0.92	0.92

Note: Cotton bales refer to Australian bales (500lb or 227kg)

Source: CBA Research



**Wheat – “Russian drought pushes prices higher, but for how long?”**

The Black Sea drought improved the global wheat price outlook, but the market initially ran up too hard.

- The global grain landscape has changed drastically in the past few months. Throughout H1’2010 global wheat prices remained under pressure because of comfortable old season stocks. Concerns over Canadian and European production prospects soon morphed into a rampant price rally as Black Sea crops were decimated by drought. Speculative short covering helped fuel the rally.
- Chicago wheat futures surged from under USc500/bu in June to a peak above USc800/bu in early August, providing price opportunities for producers that looked like a fanciful dream a few months earlier. Prices have since come back down to ~USc680/bu.
- From May to August, global wheat production forecasts for 2010/11 were slashed from 672 million tonnes (mt) to 646mt, falling significantly below global consumption requirements of 665mt, resulting in a steep downgrade to global ending stocks. The worsening crop outlook culminated in the world’s most significant low-price exporter, Russia, introducing a wheat export ban from August through to December.
- How long will the gains persist? And can even higher prices be expected in the near term? The answers largely depend on the winter crop program in the Black Sea. The same drought that stripped tonnes from the current wheat crop has threatened planting for the upcoming 2011/12 winter wheat crop. However, the most recent weather reports suggest that the drought is easing and World Weather expects adequate planting rain to be received this season.
- If the Black Sea crop is favourably planted, international wheat prices should come under pressure because of large stockpiles in other parts of the world, particularly the United States. At a global level, wheat stocks for 2010/11 are forecast at 175mt, down from earlier forecasts around 200mt, but still significantly higher than the 2007/08 stocks of 123mt. Over time, we expect global prices to downwardly adjust to these still comfortable stock levels; but the 12 month wheat price outlook remains brighter than it did 3 months ago.
- But the outlook is far from certain. Firstly, it is possible that more production downgrades could occur, particularly in important exporters such as Argentina and Western Australia. Secondly, we are hearing the EU export availability will not reach the USDA forecast because of production issues. Thirdly, market talk is that Russia may now import up to 5mt of grain. And finally, the 2011/12 northern hemisphere winter wheat crop is far from planted.
- Australian wheat prices are also likely to come under a degree of downward pressure, however like the international market, the outlook for local wheat values is now much stronger than 3 months earlier. WA wheat prices should continue to build a premium over east coast values because of production concerns and improved export market opportunities.

Figure 3: CBOT wheat price forecast (quarter average)

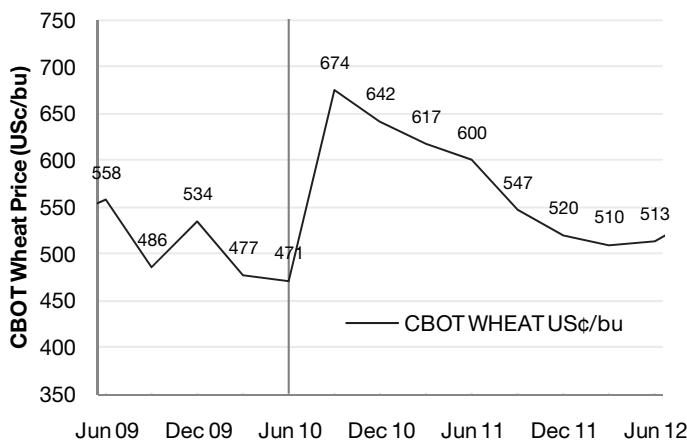
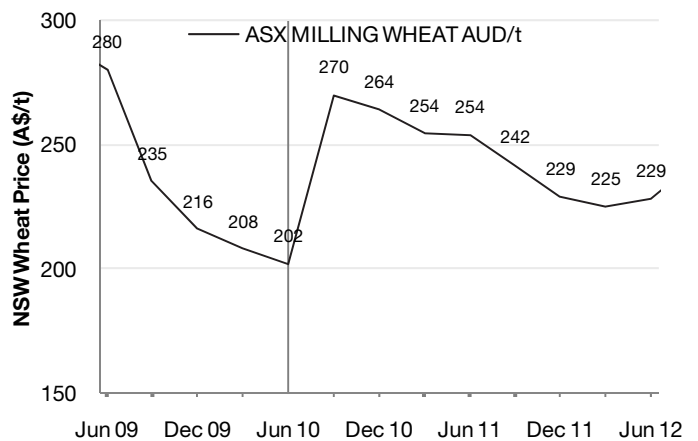


Figure 4: ASX NSW wheat price forecast (quarter average)





**Coarse Grains –“Crop problems support prices”**

Russian, European and Canadian production issues have pushed prices higher.

- International coarse grain prices declined from January to June 2010 before rallying strongly in July. US corn futures (Chicago, nearby contract) jumped 25% from June to current values around USc410-420/bu, significantly higher than the decade average of USc297/bu.
- Other coarse grain prices world have also moved higher. European malting barley futures (Euronext Liffe, Nov 10 contract) rallied nearly 40% since June 30; while ASX feed barley futures (ASX, Jan 11 contract) surged 70% in the past few months to current values around \$270-280/t.
- Crop production downgrades, outside the US, have fuelled the appreciation in coarse grain prices. Since May, prospects for 2010/11 coarse grain production (non-US) have been slashed from 775 ½ m tonnes to 753mt. Significant downgrades occurred in:
  - Canadian spring barley because of excessive rain;
  - Russian, Kazakhstan and Ukraine (barley and corn) because of devastating drought; and
  - European barley because of a combination of heat and excessive rain in different regions.
- Those crop concerns have offset expectations for a huge US corn crop, which the USDA has forecast to achieve record yields and record total output.
- Also helping buoy global prices, despite the USDA’s forecast record US corn crop, are tight beginning stocks, expanding US corn export opportunities, and fears that unfavourable late season weather in the US could pull yields lower. Finally, reduced wheat production and associated higher prices has encouraged the substitution from wheat into coarse grain feeding.
- Globally, coarse grain ending stocks for 2010/11 have been cut significantly, mainly because of tighter barley supplies. Furthermore, despite large US crop forecasts, corn stockpiles in the US are expected to fall to the lowest level since 2006/07. These tight stocks should continue to support coarse grain prices.
- In Australia, barley prices should remain supported because of the tighter international supplies and improved export opportunities. Old-crop prices will remain strongest in NSW and Qld where supplies are tightest; however excellent east coast production prospects are likely pressure prices from December.

Despite a huge US corn crop, prices should remain supported.

Figure 5: CBOT corn price forecast (quarter average)

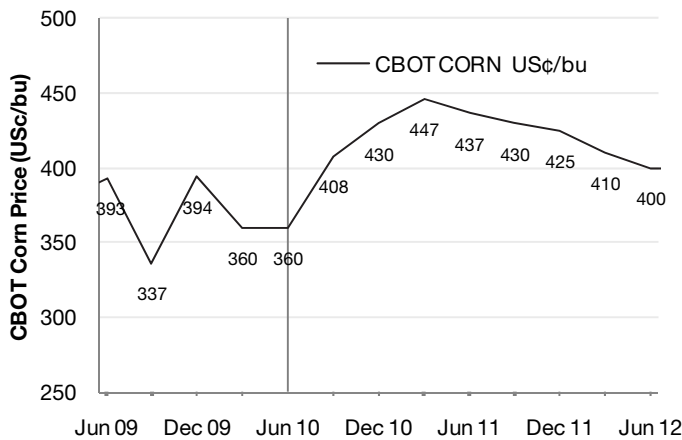
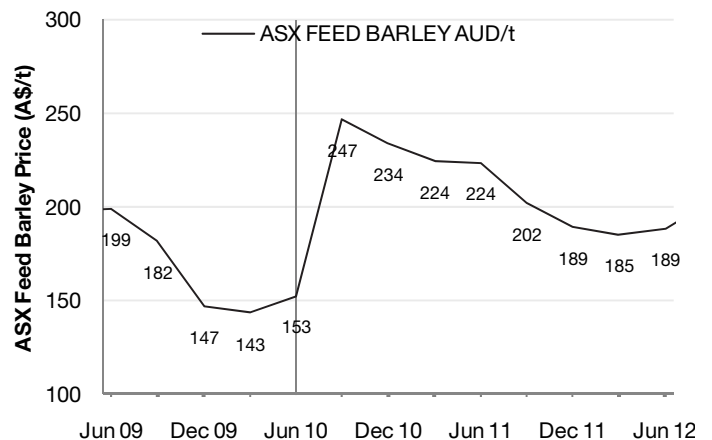


Figure 6: ASX barley price forecast (quarter average)





The global oilseed price outlook is unusually uncertain. Record US soybean production is being met by insatiable Chinese demand.

**Oilseeds – “Chinese demand counters record supplies”**

- The outlook for the international oilseed prices remains unusually uncertain. Forecast huge US soybean crops have, to date, been countered by insatiable Chinese demand, the Argentinean-Chinese soybean oil trade dispute, and downgrades to global canola/sunflowerseed crops.
- Chicago soybean prices (nearby futures contract) continue to exceed US\$1,000/bu, well above the 10 year average of US\$750/bu. Canadian canola prices have recently rallied to ~C\$450-470/t after floundering in H1’2010 between C\$370-390/t. Product prices have rallied strongly from June with soybean oil, soybean meal and palm oil prices all now at high levels.
- The strength in the oilseed complex is despite substantial production increases and growth in global soybean supplies. Strong demand growth, particularly from China, and the associated reliance on US supplies is the major supportive influence to the for soybean prices. Chinese soybean import demand is expected to surge by another 5% this year to a new record of 52mt.
- US soybean production for 2010/11 is forecast to reach record proportions this season, allowing US ending stocks to more than double, albeit off a low base. Global soybean production in 2010/11 is forecast to nearly match last year’s record, and output will again outstrip demand. This production surplus will swell the global soybean stockpile to a record which should, in time, place pressure on soybean prices.
- The canola balance sheet is more constructive for firmer prices. Canola production is not meeting initial projections in many regions, including Canada, Europe and the Black Sea. The 2010/11 global canola (rapeseed) crop is now forecast at 56¼m tonnes, down initial forecasts of a record 60½mt crop. Canadian production prospects have been revised lower by 15% while forecasts of the European crop have lowered by 7%. Globally, there will now be a significant canola deficit in 2010/11, resulting in a contraction in stocks.
- These lower supplies should continue to support canola prices and vegetable oil prices.

Figure 7: CBOT soybean price forecast (quarter average)

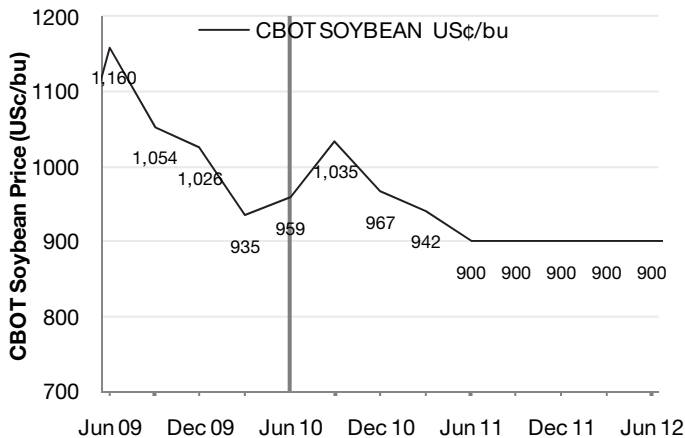
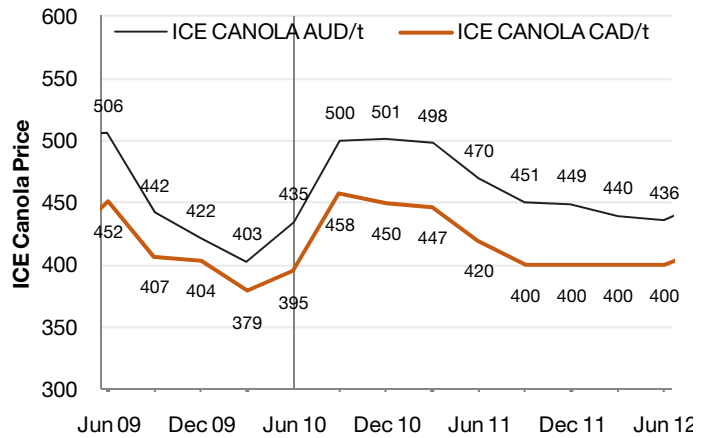


Figure 8: ICE canola price forecast (quarter average)



Despite an uncertain economic outlook, global cotton prices should stay strong because of limited supplies.

**Cotton – “Global supplies at tightest level since 1994”**

- Global cotton prices remained firm throughout the first half of 2010 trading around US\$80/lb. This is significantly higher than the GFC low of US\$40/lb and the decade average of US\$55/lb. Looking forward, the three key factors participants that will drive prices are the global economic outlook, the near term supply tightness and the new crop production outlook.
- Of all the ag commodities, cotton is arguably the one most significantly influenced by global economic conditions. Fragile near term global economic growth prospects remain of significant risk to international apparel markets. We expect the global economy to undertake a slow grinding recovery, at best, over the next few years.



- But global cotton supplies are very tight, and this is helping support prices. In 2008/09 and 2009/10 world cotton production fell 15% below consumption requirements resulting in a sharp reduction in global stocks. In the US, the world's most important exporter, stocks fell to 2.9m bales in 2009/10 from 10m bales in 2007/08 due to dwindling production.
- Higher cotton prices were needed to arrest the decline in production, and the strong prices of the past 6 months have encouraged increased plantings. The USDA has forecast global cotton output will rebound by 16% this year to 116m bales.
- But despite the larger crop, there is still expected to be a global production deficit of 4m bales in 2010/11. Most importantly, global stocks expected to fall to tightest level since 1994/95, when prices averaged 88 cents and peaked near 120 cents. On top of this, production concerns have arisen in Pakistan, India, China and US. Global supplies are in no position to take a production hit, meaning prices should be well supported through the next 12 months.

Figure 9: ICE cotton forecast (USD) (quarter average)

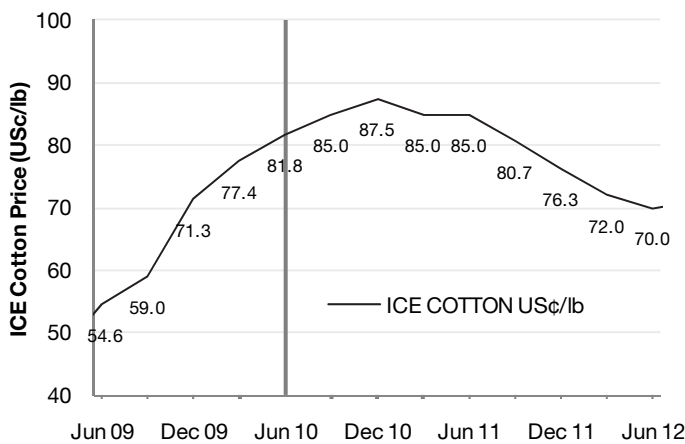
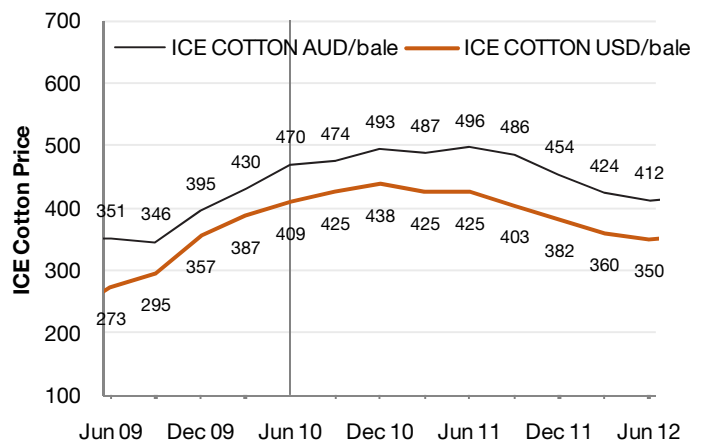


Figure 10: ICE cotton forecast (AUD) (quarter average)



**Sugar – “Huge crops should pressure prices”**

Sugar prices should come under pressure as the supply squeeze dissipates.

- The roller coaster in global sugar market continues to play out. So far in 2010 raw sugar prices (ICE nearby contract) have surged to 30 year highs above USc30/lb, collapsed to 13 cents, before rallying to the current range of 17 ½ to 20 cents. Current sugar prices are nearly double the prior ten year average and within striking distance of the Feb 2006 peak of USc19.73/lb.
- The recent recovery in prices is due to the continued near term supply squeeze, following the two largest global supply deficits on record. Despite expectations of a return to surplus this year, the sugar market has been reliant on Brazil to meet demand over the past few months. Therefore any issue, perceived or real, with Brazilian crushing or logistics supported prices.
- We predict that prices will come under downward pressure as the market's supply squeeze dissipates in Q4'2010. In particular, the upcoming Indian cane crush is expected to result in sugar production of at least 25mt, with some estimates as high as 28mt. This would dwarf their domestic consumption requirements of around 23mt, and easily surpass the drought affected crops of the prior two years. Most importantly, a 25mt plus crop will allow significant Indian exports next season following two consecutive years as the world's most important importer.
- Furthermore, global output will continue to swell into 2011/12 as the farmers continue to respond to the current high pricing. This rebound in global supplies is the key driver of our forecast for weakening international sugar prices. Adverse weather, such as the Pakistan floods or Russian drought, remains the main source of upside risk to prices in the near term, however these aforementioned issues should now be priced in.
- Long term sugar prices are likely to be supported by expanding Asian demand and competition from the ethanol sector.



Figure 11: ICE raw sugar forecast (USD) (quarter average)

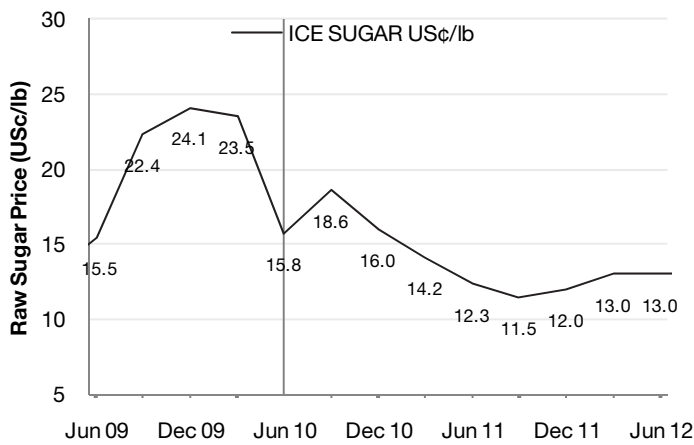
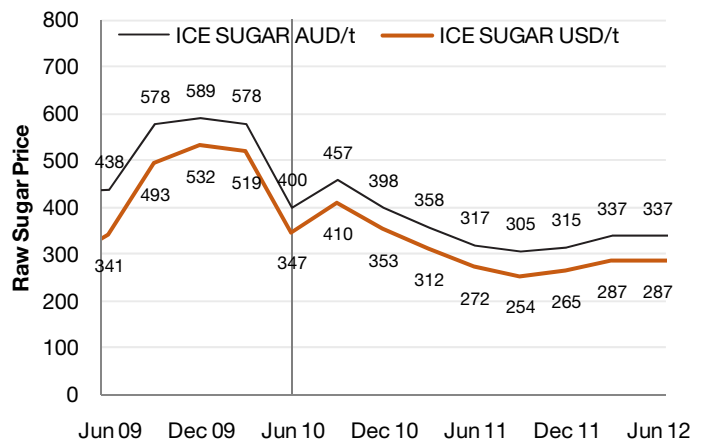


Figure 12: ICE raw sugar forecast (USD) (quarter average)



Australian cattle prices have rallied in 2010 because of strong restocker demand.

### Beef – “Better weather results in better prices.”

- Australian cattle prices (Eastern Young Cattle Indicator, EYCI) rose strongly in Q1'2010. After dipping below \$2.80/kg in December 2009, the EYCI traded mostly between \$3.40-3.50/kg from March to July 2010. From mid-July, prices rose further to current values around \$3.60-3.70/kg; the strongest level since August 2006 and significantly higher than the 10 year average of \$3.30/kg.
- Excellent seasonal conditions throughout eastern Australia have prompted strong restocker demand, while declining grain prices in H1'2010 encouraged feedlot placements. Export demand remained solid, despite a strong Australian dollar. In USD terms, the current EYCI at ~US\$3.30/kg, is at the highest level for a decade and 40% above the decade average.
- The current La Nina suggests more favourable east coast weather through to Christmas. Such a scenario will support both restocker demand and final carcass weights, which is positive for prices through spring and into summer.
- An indication of the improved seasonal conditions this year is MLA's forecast that the national cattle herd will expand by 1.5% in 2010/11. Furthermore, MLA forecast that improved returns and normal seasonal conditions over the coming years will result in the national herd growing 6% to 29.7m head by 2015.
- But the outlook is not without risks.
  - The Australian dollar remains high and US competition into the Korean and Japanese export markets has intensified following the lifting of recent BSE trade restrictions.
  - The recent decision by Indonesia, our largest live-cattle export market, to limit allowable export weights to 350kg, has the potential to dislocate the northern beef industry. The decision is likely to result in increased supplies moving into southern domestic markets. *However recent export statistics suggest that alternative live-export markets, in particular the Middle East, are being uncovered.*
  - The recent jump in grain prices may result in lower cattle on feed placements.
- MLA have noted that recent years of declining cattle herds in important beef trading regions of North and South America, Europe and New Zealand should support global beef prices in 2011.

### Wool – “Remaining strong despite the high Australian dollar.”

- Australian wool prices declined modestly this year but still remain at a high level. At \$8.73/kg, the current Eastern Market Indicator (EMI, at 18th Oct) is 7% off its January 2010 highs, but around 8% above the level of a year earlier and significantly higher than the GFC low of



\$7.23/kg. The EMI is still trading above the 10 year average of \$8.40/kg despite a persistently strong Australian dollar.

- In USD terms the current EMI (US\$7.80) is 30% above its decade average (US\$6.00/kg), and only 15% off the decade peak of US\$9.20/kg (Jan 2008).
- Although firm, the Australian wool market appears lost for direction. Market news has been lacking for much of the past 6 months, and themes of the recent years continue to play out. These are:
  - The declining sheep flock, the continued shift away from merinos, and the continued decline in the age structure of the flock is constraining premium wool supply. According to the Australian Wool Production Forecasting Committee (16th Aug) shorn wool production in 2010/11 will fall slightly to an 80 year low of 340kt (greasy).
  - Demand continues to be dominated by large Chinese buyers, who have not shown any meaningful consistency with their purchasing patterns. Wool continues to lose market share to synthetics and cotton in the apparel market.
  - The overall fibre/apparel market remains fragile given the uncertain economic outlook. A struggling US economy and debt ridden Europe is not a conducive environment for strong apparel demand.
- Supportive for Australian wool prices is the tight global cotton supply and our subsequent forecast for strong international cotton prices for the next 12 months. Wool producers' profitability should continue to be buoyed by strong lamb/mutton prices.
- In the past week, newswires reported that South Africa has "halted raw wool and mohair exports to China because it couldn't guarantee they were from areas free of Rift Valley fever" (Bloomberg, 17th Aug). We do not know how long the ban will be in place; however South Africa is the 3rd largest wool exporter, which makes this space worth watching.

Figure 13: Aust EMI price forecast (quarter average)

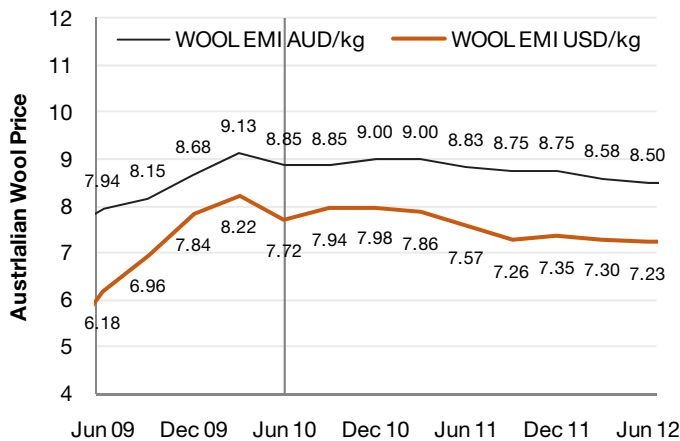
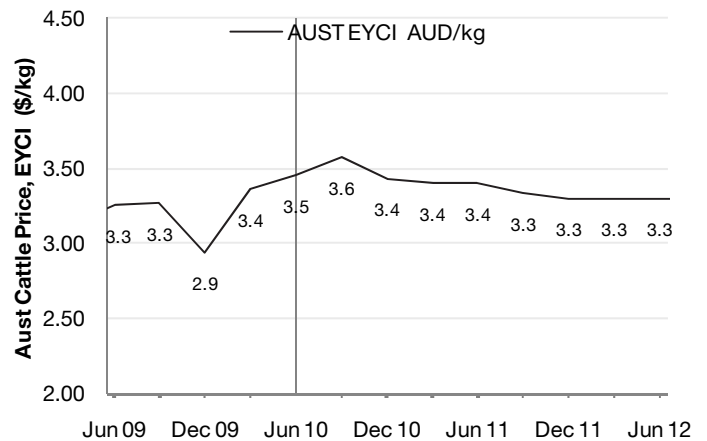


Figure 14: Aust EYCI price forecast (quarter average)





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## Commodities: Agri Updates

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