

## Agricultural commodity price preview: August 2011

- Agricultural prices have softened since March, but renewed supply tightness may lead grain and oilseed prices higher.

Agricultural commodity prices rallied to record levels in the first half of 2011, driven by fibre, feed grains, sugar and livestock markets. The CBA Rural Commodity Price Index (USD terms) surged 65% in the 12 months to April 2011, to be 20% above the previous record (Feb 2008). Prices also broke records in AUD terms, despite the dollar itself also breaking records. Supply tightness, driven by 2010's weather-induced production issues and biofuel's surging demand for ag commodities, was responsible for the record setting prices. Rallying global equity markets and a slumping USD also helped.

Since April, agricultural prices have softened, with the index currently 6% below its peaks. Ag markets began factoring in a supply response, a common reaction for annually-produced crops. Farmers lifted their area planted, aiming to capitalise on the high prices. Consumers responded to the higher prices by consuming less. The global economic outlook also deteriorated, with Europe's sovereign credit risks mounting and the US facing the risk of re-entering recession. The US S&P500 Index fell 20% from May to early August, while crude oil fell by 30% over the period. The cotton market proved the most sensitive to these factors, with prices halving since March. Other commodities also fell. Grain prices were off 20-35% from their highs, oilseeds were down by 10-15%, and sugar prices slumped 43% from January to May.

But despite farmers' best intentions, the increase in agricultural production has been disappointing. World crop weather has been challenging, to put it kindly, in key producing regions over the past 6 months. Dry conditions cut into European wheat, barley and rapeseed production, drought hit the US cotton and HRW wheat crop, while the combination of floods followed by dryness has hurt US corn and soybean crops. And Brazilian sugarcane output has suffered because of dryness and frosts.

Owing to the latest production issues and the relentless surge in ethanol's demand for corn, global feed grain supplies are forecast to fall to their tightest levels since 1973. US corn stocks are forecast to fall to their second tightest level ever. As a result, we believe world feed grain prices are likely post fresh records in the coming year, with Chicago corn prices likely to exceed US\$800/bu for the first time. High feed grain prices may to encourage further substitution into feed-wheat, and this will help support wheat values. Tight oilseed supplies in the US and Europe suggests that oilseed prices will rise. And the prospects for an intense battle for acres between corn and soybeans next season will provide further support for oilseed prices. Further production losses cannot be afforded.

The outlook for stronger global grain and oilseed prices is not without risks. The most significant risk is the global economic environment. Although we do not expect a GFC Mark II event to occur, we would be naive to ignore its present danger. If the global economy spirals out of control, ag commodities, no matter how tight their supplies, will get caught in the storm. The second major risk to grain markets is a change in US ethanol policies which materially affects US corn demand.

For the other commodities, we expect cotton, wool and sugar prices to moderate, while livestock prices may ease slightly. Local values will be constrained by our anticipation of a strong AUD, which we forecast at USD1.10 for much of next year.

Figure 1: Global commodity stocks (deviation from trend)

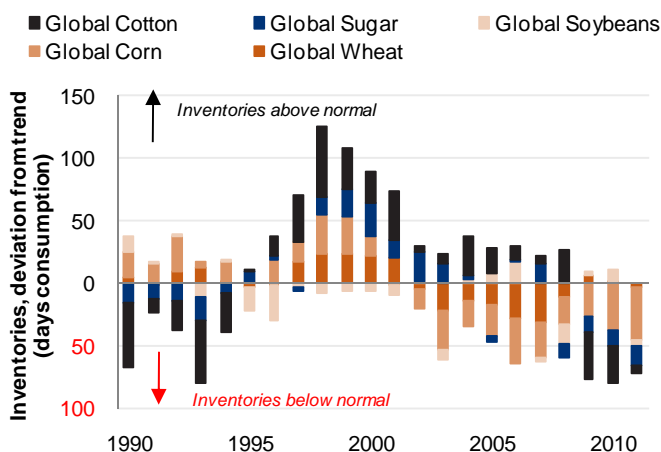


Figure 2: Agricultural commodity prices vs USD.

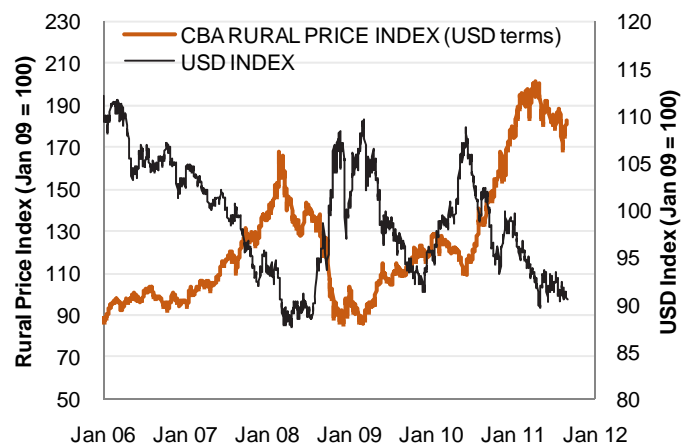




Figure 3: Global agricultural commodity price forecasts – Commonwealth Research

		Current at 30/08/2011	Actual (Quarter Average)				Forecast (Quarter Average)									
			Sep 10	Dec 10	Mar 11	Jun 11	Sep 11	Dec 11	Mar 12	Jun 12	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13	Dec 13
<b>North American Grains &amp; Oilseeds</b>																
Wheat (CBOT)	USc/bu	751	663	721	796	712	741	783	783	717	700	692	642	615	600	583
	US\$/t	276	243	265	292	262	272	288	288	263	257	254	236	226	220	214
	A\$/t	258	265	268	288	243	252	265	264	240	234	234	222	222	223	223
Corn (CBOT)	USc/bu	752	438	580	692	710	739	783	783	717	667	650	600	525	470	455
	US\$/t	296	172	228	272	280	277	288	288	263	245	239	220	193	173	167
	A\$/t	277	187	231	268	260	256	265	264	240	223	220	208	190	175	174
Soybeans (CBOT)	USc/bu	1432	1056	1288	1394	1358	1426	1417	1350	1333	1267	1200	1200	1167	1083	1000
	US\$/t	526	388	473	512	499	524	521	496	490	465	441	441	429	398	367
	A\$/t	493	422	478	503	463	484	479	455	447	423	406	416	422	403	383
Canola (ICE)	C\$/t	578	467	551	590	570	575	583	560	540	510	460	440	420	420	422
	US\$/t	592	448	544	601	594	594	606	587	568	537	478	451	423	409	398
	A\$/t	555	488	550	591	551	549	557	539	518	488	439	425	416	415	414
<b>Australian Grains</b>																
Wheat, NSW (ASX)	A\$/t	259	286	292	309	270	262	285	287	266	255	244	236	244	245	233
	US\$/t	277	263	289	314	290	284	310	312	292	281	265	250	248	242	224
Feed Barley (ASX)	A\$/t	213	243	202	221	210	217	225	227	206	205	197	196	204	205	193
	US\$/t	227	223	200	224	226	235	244	247	226	226	214	207	207	202	186
Sorghum (ASX)	A\$/t	235	236	235	231	223	227	235	237	216	215	204	196	197	195	183
	US\$/t	251	217	232	235	241	246	255	258	237	237	222	207	201	193	176
<b>Softs</b>																
Raw Sugar (ICE)	USc/lb	29.9	21.5	29.6	31.2	25.0	29.2	26.0	22.0	18.0	16.0	16.0	16.1	16.2	16.0	16.1
	US\$/t	659	475	652	688	551	644	573	485	397	353	353	354	356	353	354
	A\$/t	617	515	660	677	511	595	528	445	362	321	325	334	351	358	369
Cotton (ICE)	USc/lb	104.5	91.9	132.1	191.3	165.7	103.9	103.3	100.0	100.0	90.0	86.7	80.3	80.8	81.3	79.5
	US\$/bale*	522	459	661	956	829	520	517	500	500	450	433	402	404	407	398
	A\$/bale*	489	499	668	939	769	480	475	459	456	409	399	379	398	412	414
Wool, Aust (EMI)	A\$/kg	12.64	8.74	9.76	12.88	13.73	12.75	11.67	11.25	10.50	9.75	9.08	9.04	9.09	9.15	9.13
	US\$/kg	13.50	8.04	9.66	13.11	14.78	13.81	12.68	12.26	11.51	10.73	9.87	9.58	9.25	9.03	8.77
<b>Livestock</b>																
Cattle, Aust (EYCI)	A\$/kg	3.92	3.66	3.76	4.02	3.94	3.88	3.75	3.75	3.75	3.65	3.52	3.50	3.50	3.50	3.50
	US\$/kg	4.18	3.37	3.72	4.09	4.24	4.20	4.08	4.09	4.11	4.02	3.82	3.71	3.56	3.45	3.36
<b>Currencies (period end)</b>																
AUD/USD		1.07	0.97	1.02	1.04	1.07	1.08	1.09	1.09	1.10	1.10	1.08	1.05	1.00	0.98	0.95
AUD/CAD		0.98	0.99	1.02	1.00	1.03	1.05	1.05	1.04	1.05	1.05	1.05	1.03	1.00	1.02	1.02

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

Source: CBA Research



### Wheat

The world wheat crop for 2011/12 is forecast to come in at 672 million tonnes, up 3.7% or 24 million tonnes, from the weather-affected 2010/11 crop, making it the third largest crop in history. The largest production increase is in the FSU block, while US and European output has been curbed by unfavourable weather. World wheat ending stocks for 2011/12 are forecast at 189 million tonnes, a comfortable level when compared to the tight 2007/08 result of 126 million tonnes. Importantly, the world wheat stock-to-use ratio is pegged at 28% versus the 2007/08 result of 20%.

Even in the US, where wheat crops this year have been devastated by the Great Plains drought, total wheat supplies remain comfortable. The drought cut US wheat production by 6% to 2.1 billion bushels, the smallest crop since 2007/08. Although these production issues have resulted in a year-on-year decline in US wheat ending stocks this season, at 671 million bushels, US stocks remain more than double the tight 2007/08 result of 306 million bushels. The US wheat stock-to-use ratio for 2011/12 is forecast at 28.3%, a comfortable result compared to 2007/08 (13%).

Not all news is negative for wheat prices. Feed wheat consumption is forecast to jump nearly 11% in 2011/12 because of critically tight corn, barley and sorghum supplies. Livestock producers have switched to wheat as supplies of these other grains dwindled, a move made possible by the large supply of 'feed wheat' this year. As long as global corn supplies remain extremely tight, and corn prices remain high, world wheat values will remain supported. World wheat prices will also be supported by continued concern about this year's US HRS wheat crop and next year's HRW wheat crop. Winter wheat planting normally gets underway in the US in September, but drought conditions in the Great Plains must break before seeding can commence.

#### Australia's milling wheat supplies tight ahead of the 2011 harvest...

Australian wheat production prospects are mixed leading into the critical spring growing season. Further rainfall is needed in central NSW, northern NSW and southern Qld to sure-up production potentials. We currently forecast the 2011/12 Australian wheat crop at 23.5 million tonnes, down 11% from last year's record large 26.3 million tonne crop. The NSW wheat crop is forecast at 7 million tonnes compared to 10.6 million last year.

The record large 2010/11 east-coast wheat crop implies some production losses may be afforded this season, owing to large carry-out supplies. We forecast total wheat stocks will have *increased* by more than 2 million tonnes in the 12 months to 30<sup>th</sup> September 2011, with east coast stocks forecast to increase 3.5 million tonnes<sup>1</sup>. But Australian *milling wheat* stocks are forecast to *fall* by around 1 million tonnes. Therefore the room for production losses is not as large as headline inventory figure would suggest.

Current production concerns and tight milling wheat supplies in northern NSW and Qld should support prices in those regions. Relatively weak values are expected in southern NSW and Vic.

Figure 3: Global wheat production, consumption and stocks

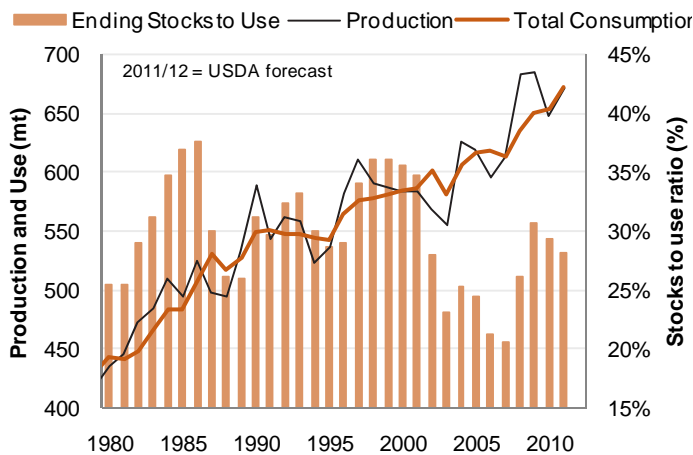
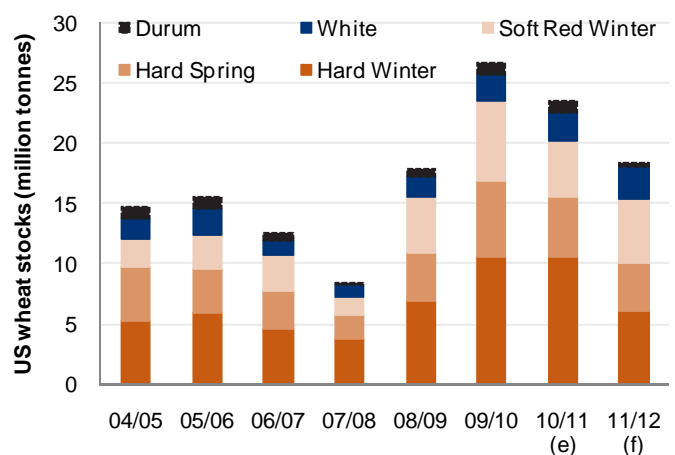


Figure 4: US wheat ending stocks by class



<sup>1</sup> The large increase in stocks is despite our expectation that exports for the year will be a near record at 19 million tonnes.



## Corn and coarse grains

World corn production is expected to rise by ~5% to a record 860.5 million tonnes in 2011/12 according to the latest USDA projections. However surging corn demand – which over the past decade has been fuelled by the US ethanol industry – has resulted in further contraction in global corn stockpiles. Global corn inventories are forecast to fall 7% this year to just 114.5 million tonnes, implying a stock-to-use ratio of just 13.2% - the tightest result since 1973/74.

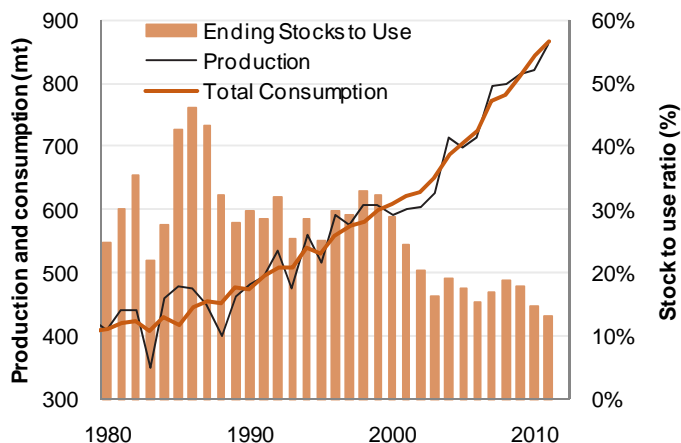
US corn inventories (stock-to-use) are forecast to shrink to just 5.4% in 2011/12, the second tightest result in history, because of the recent decline in US production prospects and a decade of surging corn consumption growth in the US ethanol industry.

The continued contraction in global corn stockpiles (and coarse grain stocks more broadly) is despite five consecutive seasons record-breaking world production. Over the past eight years, world corn consumption has surged by 179 million tonnes, or 26%, but just 20% of this growth is driven by increased livestock feed consumption. A staggering 80% of the total increase in global corn consumption over the period has been driven by increased 'food, seed and industrial' category – of which the US ethanol industry is the primary driving force. Global policy makers are likely to sharpen their focus on the influence of biofuels on global food price inflation.

Other 'feed grain' supplies are also critically tight. Global barley supplies (stocks-to-use) are forecast at just 16% in 2011/12, well below the 2009/10 result of 26%. Sorghum stocks are also tight. In the US, the world's largest sorghum exporter<sup>2</sup>, sorghum production is forecast to slump 30% because of the Texas drought. US sorghum exports are subsequently forecast to fall 27% and stocks are forecast to near-record tight levels. As a result of the global tightness in all feed grains, livestock producers have few options in terms of grain-type substitution in the coming 12 months.

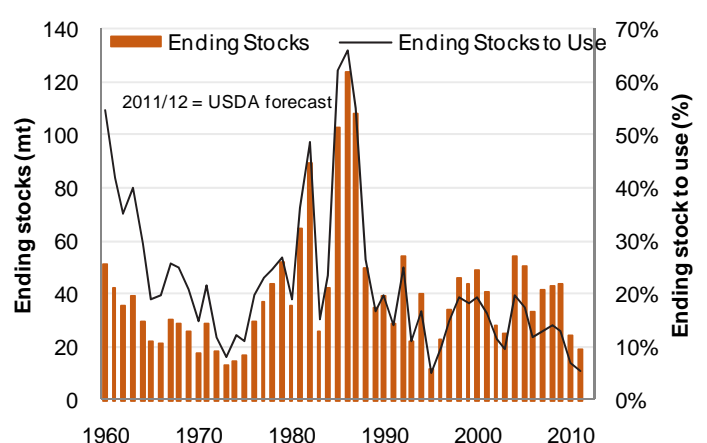
There are two main risks to corn prices over the coming 12 months. The first is a significant change in US ethanol policies which results in a reduction in the ethanol industry's demand for US corn. The second is a global economic recession which reduces the demand for transportation fuel, lower global meat demand and a widespread collapse of global commodity prices. In the absence of these risks materialising, we believe US corn prices are likely to set new records.

Figure 5: Global corn production, consumption and stocks



Source: USDA and CBA

Figure 6: US corn stocks



Source: USDA and CBA

## Oilseeds

Global soybean production is forecast to fall 2.5% to 257.5 million tonnes in 2011/12 because of smaller crops in US, Brazil and China. Against this smaller crop, the world soybean consumption is forecast to rise nearly 4% to 262.3 million tonnes, resulting in a 7.5 million tonne forecast contraction in world soybean ending stocks. The global soybean stock-to use ratio is forecast to fall from 27% in 2010/11 to 23% in 2011/12, the tightest level since 2008/09.

<sup>2</sup> The US has contributes 60-70% to world sorghum exports.



Current estimates for US soybean production and carry-out are bullish for prices. Poor weather has reduced US oilseed production prospects. The USDA recently cut its 2011/12 US soybean crop estimate to 3.06 billion bushels from 3.33 billion last year because of lower yields and lower area planted. US soybean ending stocks are forecast to fall to 155 million bushels in 2011/12, down from 230 million bushels last year. The stock-to-use ratio for US soybeans is forecast at just 5%, only marginally above the record tight result of 4.4% observed in 2008/09. The forecast tight US soybean carryout implies continued high US soybean prices.

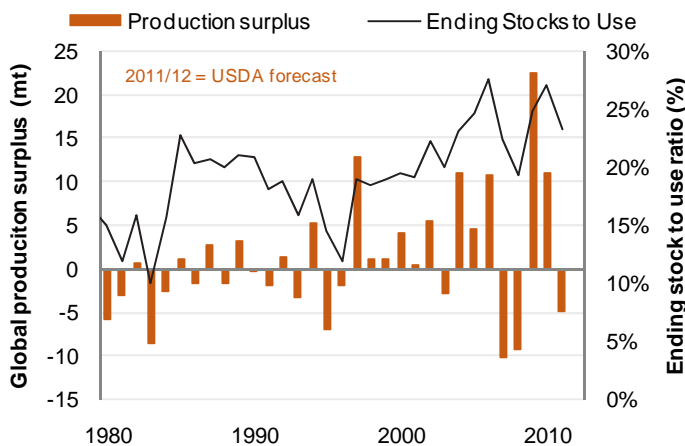
The supply situation in the rest of the oilseed complex is also tight, supporting higher prices. Canola production is forecast to fall 1.2% this year and ending stocks are forecast to shrink by 30% to 3.8 million tonnes, the tightest result since 2007/08. Higher cottonseed and sunflower seed production estimates provide somewhat of a buffer, but still, the USDA forecasts that global ending stocks of all oilseeds will fall 11% in 2011/12.

The level of consolidation in the global soybean market is risk for the entire oilseed complex. The US, Brazil and Argentina account for over 80% of global soybean production, and nearly 90% of global exports. As a result, possible production downgrades in any of these countries will have marked impact on prices. Further downgrades in production in North or South America are possible. Excessive heat and patchy rain throughout July means US production may come in below current forecasts. In addition, forecasts for a possible return to La Nina later this year may pose a risk to Brazilian and Argentinean production prospects.

In addition to the impact of tight supplies, oilseed prices will be buoyed by critically tight corn stocks, forecast high US corn prices, and our expectation that next year's 'fight for acres' will be intense.

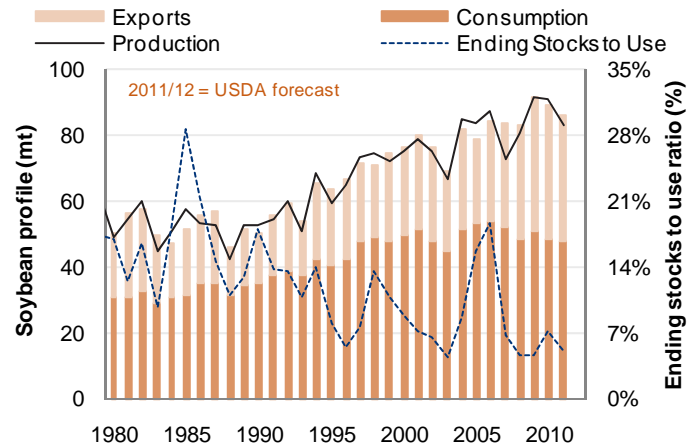
A possible catalyst for lower prices over the next 12 months, apart from global economic uncertainty, is slowing Chinese soybean consumption. China has been the primary driver of rising global soybean consumption over the past decade. Indeed, with domestic consumption growth forecast at 5.5 million tonnes in the coming year, China is expected to account for 60% of the global increase in soybean consumption. But if Chinese soybean consumption growth moderated to ~1.5 million tonnes, as it did in 2006/07 and 2008/09, the majority of the 4.9 million tonne global supply deficit would be overturned.

Figure 7: Global soybean production surplus and stocks



Source: USDA and CBA

Figure 8: US soybean profile



Source: USDA and CBA

### Sugar

The 10 cent rally in global raw sugar prices since May is almost entirely the result of widespread downgrades for Brazilian Centre-South production prospects. The 2011/12 crush has been disappointing, with year-to-date cane production (to 16<sup>th</sup> August 2011), at 297 million tonnes, down 12% year-on-year and sugar production at 17.4 million tonnes, down 11% year-on-year.

The disappointing Brazilian crush is the result of aging cane fields, drought, recent frosts and the adverse impact of flowing cane. As a result, Unica now forecast Centre-South cane production at just 510.2 million tonnes, 10% lower than their April forecast and 8.5% below the 2010/11 result.



Unica cut their sugar production forecast to 31.6 million tonnes, some 9% below their April estimate, and 6% below the 2010/11 result. It will be the first year-on-year decline in Brazilian sugar production since 2005/06. Other analysts have suggested that production could fall as low as 28 to 28.5 million tonnes.

Unica also lowered their 2011/12 Centre-South sugar export target to 22.3 million tonnes, 2.5 million tonnes below their initial estimate, and 2.3 million tonnes below the 2010/11 result. Brazil can be responsible for as much as 70% of global sugar exports during the middle of the year. Therefore the impact of Brazil's production and export revisions on world sugar prices is significant.

World sugar prices have also been supported by high domestic prices in China and speculation that Chinese imports could rise significantly in the second half of this year. Chinese authorities have been releasing strategic state sugar reserves this year in a bid to quell high domestic prices, and these reserves will need to be rebuilt in time. Over 1.7 million tonnes Chinese sugar reserves have already been sold, prompting the International Sugar Organisation's Peter Baron, to suggest that China's imports in 2011/12 may rise to a hefty 3 million tonnes. In addition, recent reports that China's top producing province, Guangxi, is in drought has further increased the market's focus on China's potential import requirements.

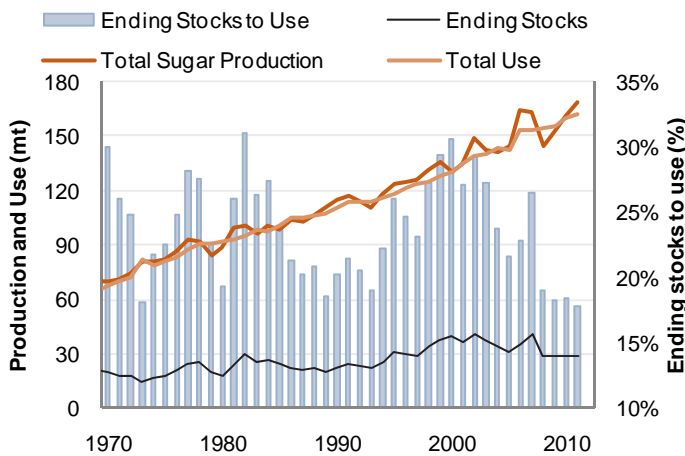
At times, strong crop prospects in India, Thailand and Europe have taken the focus away from the Brazilian production downgrades or China's high domestic prices. Despite the aforementioned production concerns, the world sugar market is expecting a sizable surplus of 4 million tonnes in the coming year according to the ISO's Peter Baron. We believe that this global supply surplus, driven by India and Thailand, will help drive sugar prices modestly lower over the coming 12-24 months.

*Australia's 2011 sugarcane crush gathering pace...*

Australia's 2011/12 cane harvest is roughly 45% complete (as at 26<sup>th</sup> August) according to Canegrowers CEO Steve Greenwood, a pace slightly behind normal because of disruptions created by harvesting the large quantity of tangled, fibrous standover cane this season. Greenwood suggested that total cane production could reach 27-27.5 million tonnes this season, roughly in line with last year's 27.3 million tonnes, despite a 7-8% increase in cane area.

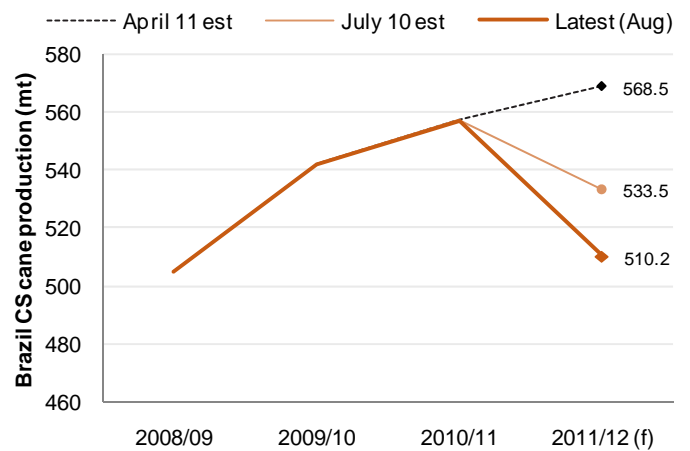
ABARES forecast Australia's total sugar output at 3.85 million tonne this year, only 200 thousand tonnes more than 2010/11 output, while exports are forecast to reach 2.5 million tonnes, 2% higher than 2010/11. The disappointing production response is largely the result of unfavourable weather last summer, headlined by Tropical Cyclone Yasi which struck the key cane producing region of Tully in February.

Figure 9: Global sugar balances



Source: USDA and CBA

Figure 10: Brazil Centre-South sugar cane production



Source: Unica and CBA



**Cotton**

Global cotton prices rallied 170% to US\$227/lb in the 12 months to March 2011, immensely higher than the recent average of US\$60/lb. But these exceptionally strong global cotton prices have partially fulfilled their objective. Cotton planting increased and consumption fell, and as a result, current prices are now back down around 100 cents.

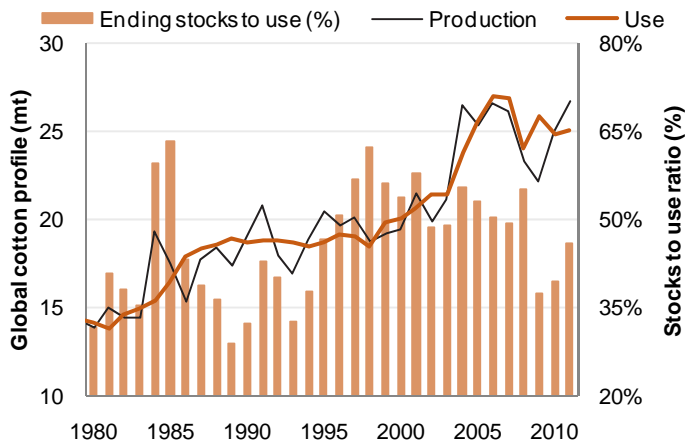
Global cotton demand has softened from Q1, forcing the USDA's to downwardly adjust their 2010/11 global cotton use by 8% from the January forecast (38.4 million bales) to their August forecast (35 million bales). US cotton export forecasts for the 2010/11 season were also downgraded sharply, by 9% over 8 months, as it became evident that global importers (i.e. China) began cancelling existing purchases. Indeed, from mid January to late July, US exporters experienced total 'net-cancellations' of previously sold cotton equal to 840 thousand bales. These cancellations equated to a massive 8% of the previous season's entire export program.

In addition to restricting demand, the record high cotton prices have started to achieve the required production response. US producers alone increased their cotton area planted by 25% this year; however production itself has been curtailed because of unfavourable weather. Globally, the USDA suggests that global cotton area (harvested) will increase 6% year-on-year in 2011/12, and production will increase 7% to a record 26.7 million tonnes. As a result global cotton stocks are forecast to rise 17% to 11.5 million tonnes, and the stocks-to-use ratio is forecast to improve from 40% last year to 46% this year.

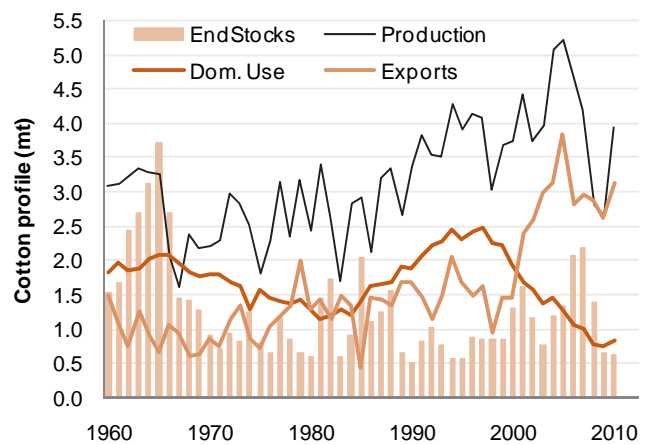
Although global cotton stocks are forecast to increase substantially in the coming 12 months, the final carry-out figure still remains historically tight, and therefore prices should remain at historically elevated levels. In 2008/09 the stock-to-use ratio was 55%. Finally, US cotton ending stocks for 2011/12, at 3.3 million bales, are still deeply below the high 2007/08 result of 10 million bales.

Figure 11: World cotton production, consumption and stocks

Figure 12: US cotton profile



Source: USDA and CBA



Source: USDA and CBA

**Wool**

Australian wool prices rose to record high levels in the first half of 2011 because of strong global wool demand and tight supplies. Global demand for Australian wool has been supported over the past 24 months because of sturdy economic growth, most notably in China, constrained New Zealand wool supplies, and exceptionally strong global cotton prices. Consequently Australian wool exports are forecast to rise 5% in 2010/11, despite continued tight domestic production. Sales of stockpiled wool allowed the strong export result.

In addition to uncovering stockpiled supplies, the recent high wool prices are likely to promote a flock rebuild effort. Australian wool production is forecast to rise 1.6% to 355 thousand tonnes in 2011/12, the first such rise since 2004/05, according to the latest ABARES estimates. The increase in output is due to a forecast increase in the Australian sheep flock – to 70.6 million head, nearly 4%

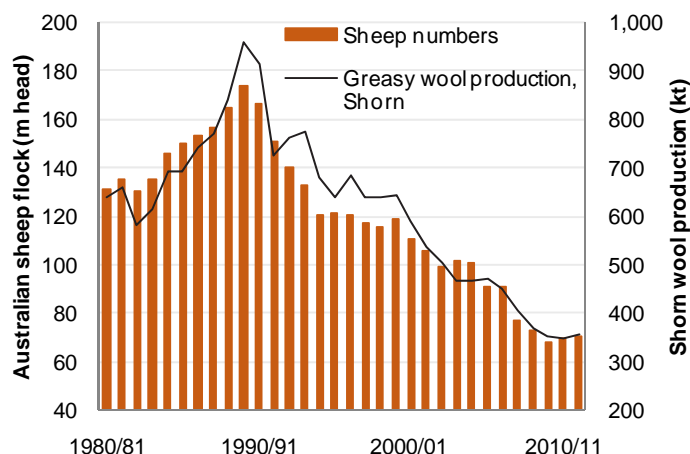


higher than the drought affected 2009/10 flock of 68 million – and an improvement in wool yields. In addition to the price incentive, this farm-gate supply response has been facilitated by improved seasonal conditions.

We believe that high wool prices and an assumed normalisation in seasonal conditions will facilitate continued flock expansion in the coming five years. However the rate of expansion may be subdued because of high lamb prices (which promote culling, rather than retention of wethers) and a structural change in farm-gate agriculture in Australia. Put simply, many farmers, irrespective of price, are not going to swing back into wool production. In addition, the composition of the flock is likely to continue gravitating toward dual purpose and speciality meat breed, limiting the production of fine merino wool.

In addition to a gradual increase in supply, there are two key risks for wool prices. Firstly, the sharp reduction in cotton prices in the past six months, down 60% since March, has increased the competition faced by wool in the fibre complex. Wool prices are likely to fall, otherwise, millers will increase the composition of cotton and polyester at wool's expected. Secondly, the current slowing in the global economy, including the real risk that the US and Europe re-enters recession, means total fibre demand may decline.

Figure 13: Australian sheep flock and wool production



Source: ABARES and CBA

Figure 14: Australian wool outlook (ABARES, June 2011)

	2009	2010	2011	%
	-10	-11	-12	<i>change</i>
Sheep numbers (million)	68.0	69.5	70.6	1.6
Sheep shorn (million)	82.9	80.0	80.5	0.6
Wool production (greasy)				
– shorn (kt)	352.7	349.5	355.0	1.6
– other (kt)	69.8	62.2	66.5	6.9
– total (kt)	422.5	411.6	421.6	2.4
Wool exports				
– volume (gr. equiv. kt)	428.2	449.5	440.1	-2.1

Source: ABARES

## Beef

Australian saleyard cattle prices (Eastern Yong Cattle Indicator) fell 12% to ~A\$3.70/kg during the June quarter. The weaker prices are due to increased export competition, tempered domestic restocker demand, the impact of the Federal Government's suspension of live-cattle export to Indonesia, and a general moderation in global commodity prices during the quarter. Values have partially recovered since July and, at ~A\$3.90/kg, are more than 16% above the decade average of A\$3.35/kg.

Despite the recent weather induced moderation in restocker activity, herd rebuilding activities are forecast to remain a central theme of the Australian beef industry over the coming seasons. ABARES forecast that the national cattle herd will increase 3% in 2010/11, which will be followed by and further 2% expansion in 2011/12. The beef cattle herd by the end of the 2011/12 season is forecast at 25.5 million head, up 1.5 million from the 2009/10 herd.

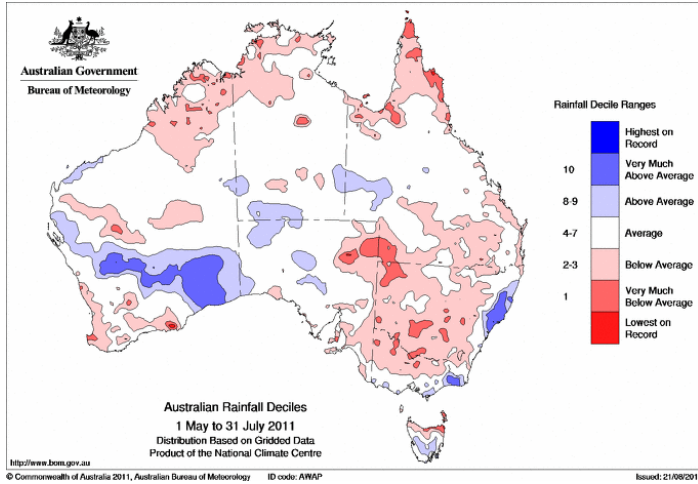
Global cattle slaughter rates increased in the first half of 2011 because of exceptionally high feed costs and poor seasonal conditions in the United States and Europe. This increased slaughter has slowed the global herd rebuilding program that was underway, increased near-term beef supplies, and increased export competition. But the increased cow and calf slaughter rates, particularly in the US, will restrict supplies in coming seasons.

The forecast domestic herd rebuilding program (assuming normal seasonal conditions), combined with constrained global meat supplies, should continue to support Australian saleyard beef cattle



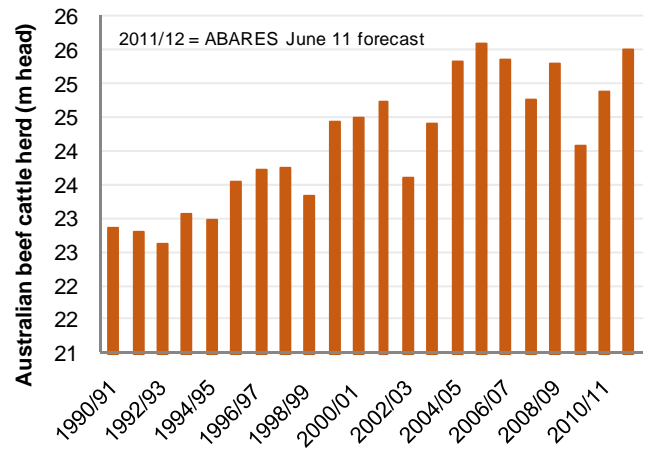
prices above historic averages. The primary downside risks to prices are a recession-induced decline in global meat demand, further appreciation in the Australian dollar, or a decline in Australian seasonal conditions.

Figure 15: Australian rainfall deciles (1 May-31 July 2011)



Source: Bureau of Meteorology

Figure 16: Australian beef cattle herd



Source: ABARES and CBA



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