

Domestic Wheat Outlook

Production forecasts increased.

Intriguing dynamics have emerged within the Australian wheat industry in recent months. The most influential factors currently affecting the local market are¹:

1. Old crop vs. new crop availability
2. East coast vs. west coast production disparities

Each year these dynamics have the potential to surface within the Australian industry. This is due to the vast distances between production regions, the associated variation in climatic conditions between those regions and differences in consumption patterns within the industry by region.

But this year, perhaps more than ever, these dynamics have surfaced. Our latest wheat production estimates for 2010/11, contained within this report, provide confirmation of this.

Highlights of latest domestic wheat production forecasts include:

- National wheat production is forecast to increase to 23.1mt. This compares to our July estimate of 22.2mt and last year's 21.4mt crop.
- East coast production forecasts have been raised to a record 13.9mt, up from our previous estimate of 10.9mt and the decade average of 9.2mt. The previous record, posted in 2005/06, was 12.2mt. We expect record crops in both NSW and Victoria.
- WA crop conditions are going from bad to worse, and as a result we have slashed 2.5mt from our July WA wheat estimate. We now expect the WA crop to come in at only 5mt, down from 8.2mt harvested last year.

Stock tightness imbalances to be countered.

Our new crop production forecasts will help counter inventory imbalances that had developed over the past 12 months. In the lead up to the upcoming harvest, east coast stocks are tight, particularly in NSW and Qld (just ask any consumer). It's the opposite situation in the west where large crops in 2009/10 rebuilt stocks. So some of the new crop losses expected in WA will be countered by higher beginning stocks.

Impact on prices.

Price movements show the evolution of these supply dynamics. Figure 2 shows that WA harvest prices moved sharply over east coast values as crop production potential started to wane from June. And Figure 3, in addition to highlighting the west coast premium for 2011 delivery, indicates the premium that old crop NSW wheat has over new crop supplies. This reflects the near term stock tightness on the east coast but expectations of record harvest potentials.

Figure 1: CBA 2010/11 wheat production forecasts, variation against decade average

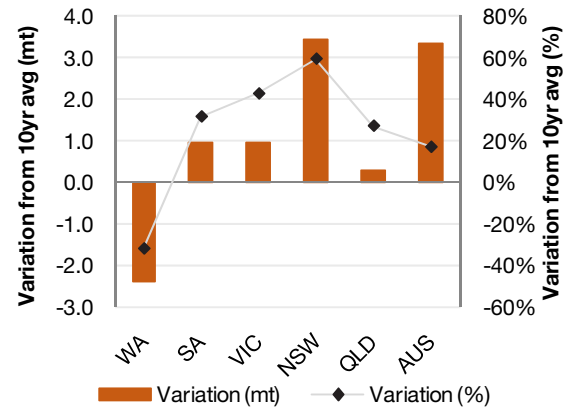


Figure 2: ASX wheat futures (2010/11 harvest)

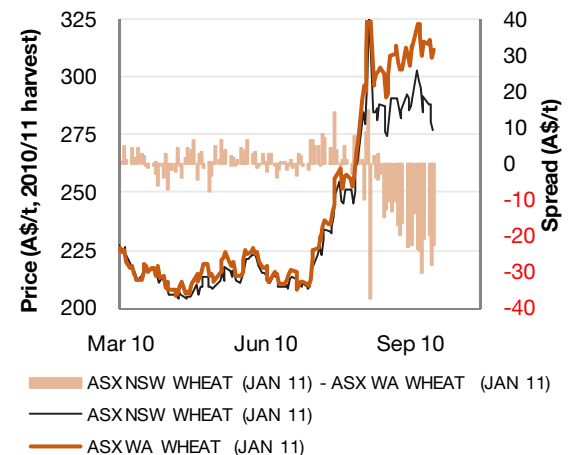
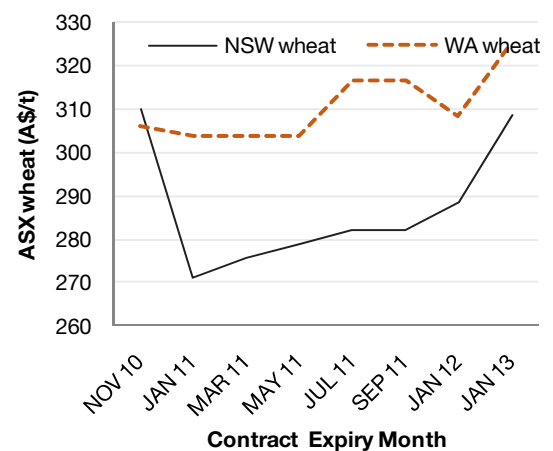


Figure 3: ASX wheat futures strip (at 24/9/10)



¹ Excluding the overarching influence of the strong international wheat market.



Australian wheat production forecasts

Australian wheat crop forecasts have been raised.

We have revised higher our domestic wheat production forecasts, reflecting some of the best seasonal conditions experienced across the eastern grain belt in recent memory. However it is not all one way traffic as crop conditions in WA turn from bad to worse.

Nationally, we have lifted our wheat production forecast to 23.1million tonnes (mt). This is up 0.9mt from our July estimate and higher than the 2009/10 crop of 21.7mt. Our latest crop forecast is significantly higher than the previous decade average of 19.7mt, but still shy of the 2003/04 record of 26.1mt. Our estimate falls short of ABARE's September crop forecast of 25.1mt.

Figure 4: CBA's Australian wheat production forecasts (mt)

mt	2010/11 (f)		2009/10	2008/09	2007/08	Avg (2000-09)	10 Yr Max		10 Yr Min	
WA	5.0	-2.5	8.2	8.3	5.8	7.4	11.1	03/04	4.0	02/03
SA	4.1	0.3	4.0	2.4	2.3	3.1	4.8	01/02	1.4	06/07
VIC	3.2	0.3	3.2	1.8	2.0	2.3	3.2	09/10	0.9	02/03
NSW	9.3	2.3	5.1	7.0	2.5	5.8	8.0	05/06	2.5	02/03
QLD	1.4	0.5	1.2	2.0	1.0	1.1	2.0	08/09	0.6	02/03
AUST TOTAL	23.1	0.9	21.7	21.4	13.6	19.7	26.1	03/04	10.1	02/03

As at 24 Sep 2010. Change from July estimate also presented.

The east coast crop is forecast to be a record.

Our improved production numbers reflect record breaking yield prospects across most regions in eastern Australia. Our latest estimates point to a record large crop in NSW (9.3mt vs. the prior decade high of 8mt) and Victoria (3.2mt, slightly above last year's record). We have also raised our forecast for Qld wheat production to 1.4mt from our previous estimate of 0.9mt.

Discussions with producers and other industry participants across eastern Australia reveal unanimous optimism for crop production potentials. Rarely, if ever, are such positive remarks received across such a large area. Reflecting this widespread optimism, our total east coast crop has been forecast at 13.9mt, up 3mt from our July forecast and 4.5mt larger than last year's crop. Our forecast, if realised would set a new east coast production record, smashing through the decade peak of 12.2mt set in 2005/06. Our forecast is slightly lower than ABARE's east coast estimate of 14.8mt, but despite the differences, the theme remains the same. That is, a record breaking east coast crop is in the making.

There are risks to these east coast production forecasts, with harvest still a few months away and the critical flowering/filling/maturing phase yet to come. The key risks to the east coast crop include locusts, rust damage, frosts and/or an untimely heat wave.

Widespread locust damage is not expected.

Of these risks, locusts will attract the most media attention. Although we do expect reports of damage due to locusts over the next month, which may include the complete wipe-out of some individual paddocks, we don't expect an Armageddon-like impact on the entire east coast crop. Literature indicates that major locust outbreaks have occurred in 1934/35, 1955, 1973/74, 1979, 1984/85 and 1993/94. Studies suggest that the aggregate production losses caused by locusts are generally less than 1%. The worst damage was reported to have occurred in the 1934/35 outbreak; however total losses were still estimated at only 2-4%. This would hardly put a dent in our record crop forecast, and technology to control locusts in the 1930's is hardly comparable to what is available today. To reiterate, we are not expecting widespread crop losses because of locust and we are optimistic about production potentials.

Like the eastern states, crop conditions in South Australia are favourable and excellent crop production potentials exist. We have revised higher our SA crop production forecast by 300kt to 4.1mt, which is only a touch below ABARE's estimate. If realised this year's crop would exceed the large 2009/10 crop of 3.95mt and the decade average of 3.1mt.

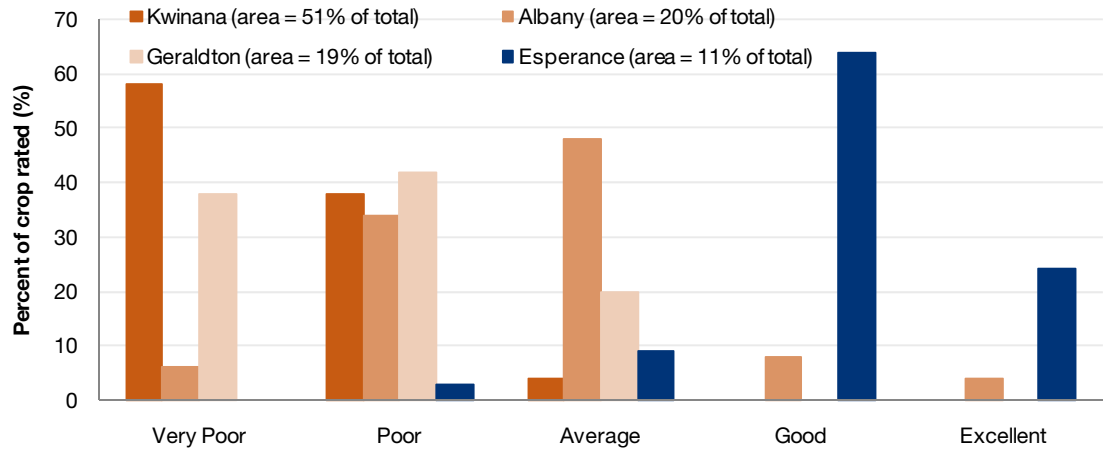
WA crop conditions have gone from bad to worse.

But our optimism regarding east coast production prospects does not span the Nullarbor, where crop prospects have gone from bad to worse. Drought like conditions across much of the state, but particularly in the vast Kwinana port zone, has decimated production potentials. In total, we now expect the WA crop to come in at only 5mt this year, down 2.5mt from our July forecast and 3.2mt below last year's 8.2mt crop. Our estimate is also more bearish than ABARE's 6mt forecast, but despite this we think there are still downside risks to our WA wheat crop forecast. In our opinion, only the Esperance port zone remains in satisfactory condition. This is consistent with the recent crop conditions report released by GIWA (see figure 5, following page).



The smallest WA crop over the past decade was the 4mt crop produced in 2002/03. It is possible that the record low crop could be challenged this season.

Figure 5: WA wheat crop ratings, GIWA (as at 17th September)



Source: GIWA, Commonwealth Research

Australian climate comment

WA has been in drought.

Figure 6 clearly indicates why WA crop production forecasts have declined, and why east coast prospects are excellent. Most of the WA grain belt has received “very much below average rain” from March through to the start of September. Conditions in the month of September have not offered any relief. In contrast, the rest of the Australian wheat belt has experienced above average rain and this has continued through September.

The next 3 months is tipped to be wet across the country.

The Bureau of Meteorology’s (BOM) latest 3 month season outlook (released 23rd September) favours the odds of wetter than average conditions across most of Australia from October through December. This forecast, particularly for the eastern states, is consistent with the incumbent La Nina season. The BOM suggests LA Nina will persist until early 2011.

Harvest rain could create headaches this year.

These conditions, if they materialise, may help ease ongoing production losses in WA, however the forecast rain will prove too late for many crops. For SA and the eastern states, these forecasts will offer a favourable soft finish, offering excellent yield potentials. But under these conditions high protein wheat may be relatively scarce. And there is a significant risk of harvest rain in the eastern states which could impact harvest progress, logistics and most importantly, grain quality.

Figure 6: Rainfall deciles (Mar to Sep)

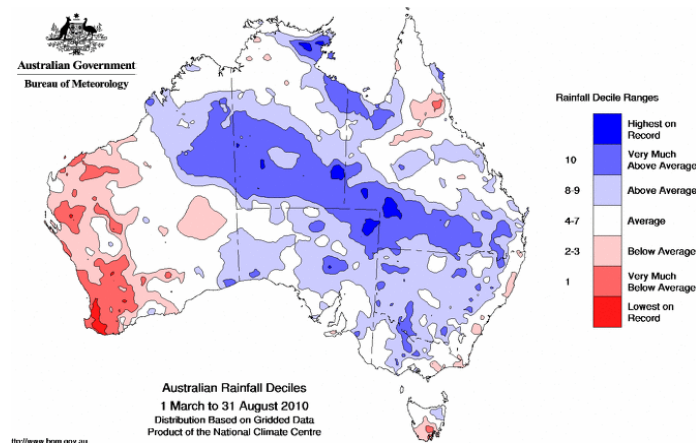
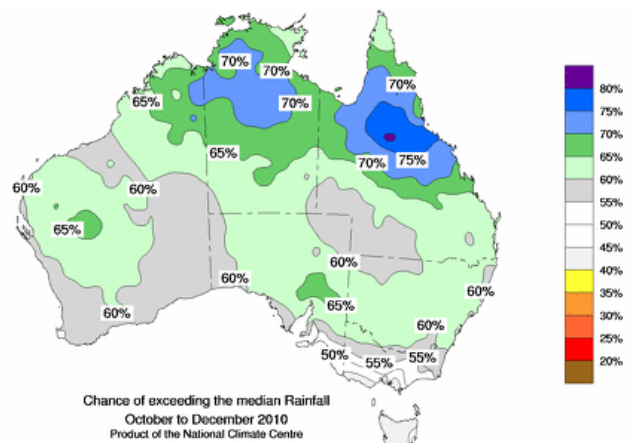


Figure 7: Three month rainfall outlook (Oct to Dec)





Australian wheat export opportunities

- *Australian wheat exports opportunities have improved due to Russian bans and improved domestic production prospects.*

The Black Sea drought improved local wheat exports opportunities this year.

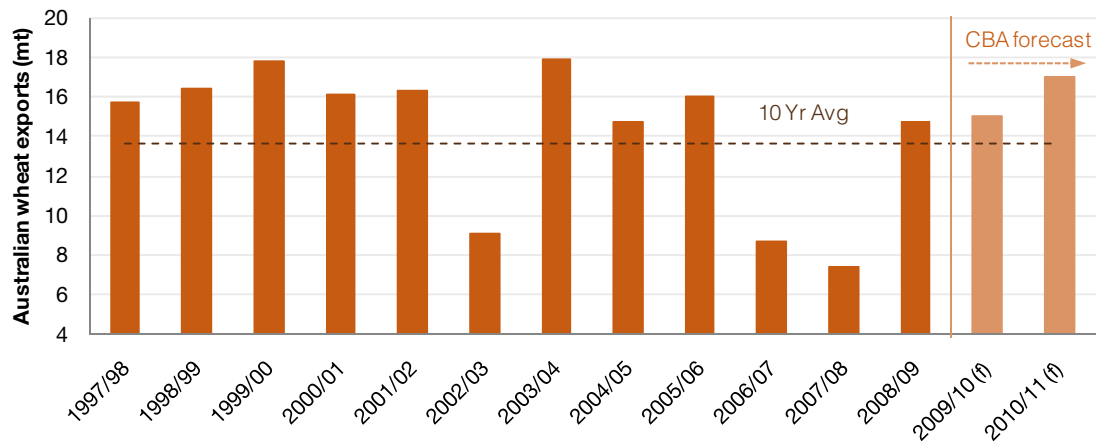
And the big national crop should ensure a strong export program next year.

Australian and American wheat producers have been the key beneficiaries of the FSU drought and the subsequent Russian wheat export ban. Consumers have been the losers. Prior to the evolution of the production woes in the northern hemisphere, Australian wheat was not price competitive. But since the removal of the cheapest source of wheat from the world market, Australian exports have jumped. As a result we have revised higher our estimate of Australian wheat exports for 2009/10 to >15mt vs. our early season estimates of <14.5mt (for the 12 months to 30th Sep 2010).

Additionally the improvement in national wheat harvest estimates has improved prospects for 2010/11 exports. But the regional composition of the crop does mean that export potentials are not as strong as a >23mt national crop would otherwise suggest. In particular crop prospects in the most important exporting state of WA are poor, while limited beginning stocks, a large local consumption base and constrained upcountry logistics should temper east coast exports.

In total, we forecast that exports could swell to 17mt next season. This would be the largest result since 17.8mt was exported in 2003/04 and 1999/00. Our 2010/11 forecast is 13% above the 2009/10 estimate, and 25% above the decade average of 13.5mt. Interestingly, our 17mt export program is 1.4mt lower than ABARE's optimistic estimate of 18.4mt. Yet we think there are downside risks to our estimate, particularly if WA crop conditions erode further and/or if the east coast encounters any significant logistics concerns over the next 12 months.

Figure 8: Australian wheat export estimates



Source: Commonwealth Research, ABS

Australian wheat ending stocks

- *New-crop production prospects to fix old-crop stock issues.*

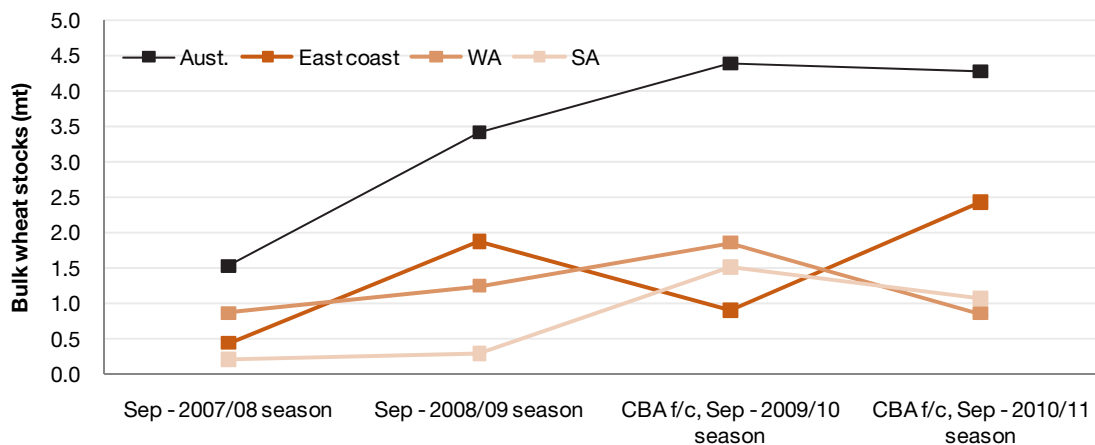
The large east coast production forecast has impacted our ending stock projections for the 2010/11 marketing year. Figure 9 (following page) indicates that east coast wheat stocks are expected to rebound by over 1.5mt in the 12 months to 30 Sep 2011. On the other hand, weak production forecasts and solid export demand is expected to result in a drawdown in WA wheat stocks over the course of 2011.

On balance, we believe downside risks to WA ending stock estimates remain for the coming year because of further possible production losses and strong export demand. Conversely upside risks exist to our east coast ending stock estimate due to capacity constraints.

These dynamics will continue to support the west coast price premium over the next 12 months.



Figure 9: Australian bulk wheat ending stock estimates (at 30 September)



Source: Commonwealth Research, ABS



Research

Commodities		Telephone	Email Address
Luke Mathews	Agri Commodities	+612 9118 1098	luke.mathews@cba.com.au
Lachlan Shaw	Mining & Energy Commodities	+613 9675 8618	lachlan.shaw@cba.com.au

Economics		Telephone	Email Address
Michael Blythe	Chief Economist	+612 9118 1101	michael.blythe@cba.com.au
Michael Workman	Senior Economist	+612 9118 1019	michael.workman@cba.com.au
John Peters	Senior Economist	+612 9117 0112	john.peters@cba.com.au
James McIntyre	Economist	+612 9118 1100	james.mcintyre@cba.com.au

Fixed Income		Telephone	Email Address
Adam Donaldson	Head of Debt Research	+612 9118 1095	adam.donaldson@cba.com.au
Philip Brown	Fixed Income Quantitative Strategist	+612 9118 1090	philip.brown@cba.com.au
Alex Stanley	Associate Analyst, Fixed Income	+612 9118 1125	alex.stanley@cba.com.au
Michael Bors	Credit Research Analyst	+612 9118 1108	borsma@cba.com.au
Steve Shoober	Credit Research Analyst	+612 9118 1096	steve.shoober@cba.com.au
Winnie Chee	Securitized Product	+612 9118 1104	winnie.chee@cba.com.au
Tally Dewan	Quantitative Analyst	+612 9118 1105	tally.dewan@cba.com.au
Kevin Ward	Database Manager	+612 9118 1960	kevin.ward@cba.com.au

Foreign Exchange		Telephone	Email Address
Richard Grace	Chief Currency Strategist	+612 9117 0080	richard.grace@cba.com.au
Joseph Capurso	Currency Strategist	+612 9118 1106	joseph.capurso@cba.com.au
Peter Dragicevich	FX Economist	+612 9118 1107	peter.dragicevich@cba.com.au

Delivery Channels & Publications		Telephone	Email Address
Monica Eley	Internet/Intranet	+612 9118 1097	monica.eley@cba.com.au
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New Zealand		Telephone	Email Address
Chris Tennent-Brown	CBA NZ Economist	+64 9374 8819	chris.tennent-brown@asb.co.nz
Nick Tuffley	ASB Chief Economist	+64 9374 8604	nick.tuffley@asb.co.nz
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