

# Regional Economic Report

Autumn 2007

- Westpac – Charles Sturt University Agribusiness Index.
- Farm commodity prices are equal to the best we have seen in 20 years.
- Watch out for higher interest rates in 2007 and a robust Australian dollar.
- Sugar prices are being supported by rising demand but the potential for a significant rise in production remains a risk.

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## A positive outlook for regional Australia

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Global commodity prices have continued their relentless march north so far in 2007. Even farm commodity prices, as measured by the Westpac-NFF farm commodities index, are equal with the best they have been in over 20 years. And ABARE presented a fairly upbeat outlook for 2007/08 where many farm commodity prices would be supported by low stocks and rising demand, especially from the growth in the industrial demand of agric products, in particular for biodiesel and ethanol. As such, as long as it rains (and the Bureau of Meteorology has indicated that the El Nino event has ended), we expect the farming sector to make a healthy bounce from the drought driven lows of last year.

However, it seems every ray of sunlight in the economy has a dark shadow looming nearby. The strength of the Australian economy, which in part is due to the boost to incomes from the booming resource sector, encroaching on the limits of its productive capacity, thus lifting the risks for the inflation outlook. Consequently, we now expect the RBA to raise rates this year and again in 2008. This forecast for higher Australian interest rates, and for commodity prices to remain robust for the near term, is why we are forecasting the Australian dollar to trade at the top end of the US75¢ to US80¢ range to the end of the year. Good news for our importers (and those going overseas), not so good for our farmers and exporters.

In this report, we take a close look at some of the issues that we think will be key factors in the regional economy in 2007. Some highlights of the report include.

- The release of the Westpac-Charles Sturt University Agribusiness Index, which takes a very regional approach to analysing businesses. What the survey found was farmers are still optimistic about the outlook for 2007. It is interesting to note that while farmers, and to a lesser extent upstream processors, have been hit hard by the drought, downstream processors' activities have been supported by the robust demand from the cities.
- Biofuels are seen as the panacea for many ills including global warming and farm profitability. But what our research has found is that the viability of a biofuel industry is very dependent on government support or oil prices that are much higher than they currently are. As such, while the industry is set to grow and is one factor behind the rising demand for coarse grains, it does not mean that grain and sugar prices will now be driven by energy demand rather than the normal soft commodities cycles.
- Sugar exports were devastated by cyclone Larry and cane smut in 2006. Rising oil prices were a temporary boost for sugar prices but rising Brazilian supply soon took away most of the gains. Nevertheless rising demand for ethanol, and rising incomes in Asia and Russia, have lifted demand growth for sugar above its longer run trend and the real price has broken its long run down trend.
- There is no doubt that farm debt has risen because of the drought and some individual farms will be struggling to maintain viability under this larger burden. However, overall we found the financial health of the farm sector to be positive and are looking for a healthy bounce in farm production as the drought ends.

**Justin Smirk**, Senior Agribusiness Economist ph (61-2) 8254 9336

## Westpac – CSU Agribusiness Index

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We have released a new regional Agribusiness survey.

The first Westpac/Charles Sturt University (CSU) Agribusiness Index for Australia was released in February. The index is based on a nationwide survey of 1,200 businesses in the agribusiness sector and can be broken down to a state and regional level. The survey includes agricultural producers as well as suppliers to agriculture (upstream) and related transport, manufacturing, wholesale and retail businesses (downstream). The aim of the survey is to provide a timely snapshot of agribusiness across Australia.

Economic performance has been held back by the drought ...

The Economic Performance Index (EPI) is the average of results for business performance, employment and investment (capital expenditure). On average Australian agribusiness had a negative EPI in the December Quarter. This result was influenced by negative reports of business performance, investment and employment. Tasmania and Northern Territory were the only states/territories to report positive business performance. Agribusinesses in the Northern Territory also reported increased employment. Climate was the most significant influence on business performance, especially for producers and upstream businesses.

... but things are expected to improve.

Agribusinesses expect economic performance to improve in the March quarter, with improvements in business performance, capital expenditure and employment anticipated. Australia's score on the EPI looks far more positive in the March quarter, with expectations of improved conditions driving four of the seven states and territories from negative to positive territory.

Upstream and downstream producers dairy better than farmers.

Despite the negative performance experienced by producers, upstream and downstream businesses reported positive to good performance. Upstream businesses reported positive business performance in the December quarter, mostly influenced by climate, seasonal factors and consumer demand. The negative performance experienced by producers was overwhelmingly attributed to climatic factors. Downstream businesses' good performance was as a result of both seasonal factors and consumer demand. Contrary to upstream and downstream agribusinesses, producers expect improved performance in the March quarter.

Costs are rising ...

The majority of Australian agribusinesses experienced less than satisfactory profitability. Producers experienced poor profitability, while upstream businesses reported a less than satisfactory result. Downstream businesses reported good profitability.

On average, agribusinesses across Australia reported increased operating costs. Overall the cost of inputs was the most influential factor. The price of fuel was the second most commonly cited influence, followed by "other" factors which included the effect of drought conditions on prices.

Overall, agribusinesses reduced capital expenditure in the December quarter. Reduced expenditure was most prevalent in the producer sector, while downstream businesses were the only sector to increase capital expenditure.

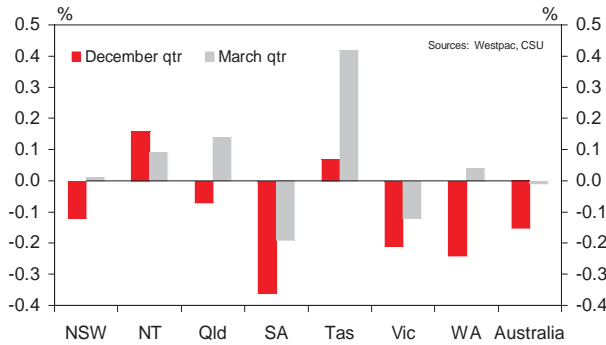
... but things are looking better for 2007.

All states/territories expect improved conditions in the March quarter, with Northern Territory and NSW looking to increase expenditure. On average, employment in agribusinesses declined across Australia in the December quarter. Northern Territory and Queensland were the only states/territories to report increased employment. Producers and upstream businesses reduced employment in the December quarter. However, all sectors expect to increase employment in the March quarter.

# Westpac – CSU Agribusiness Index

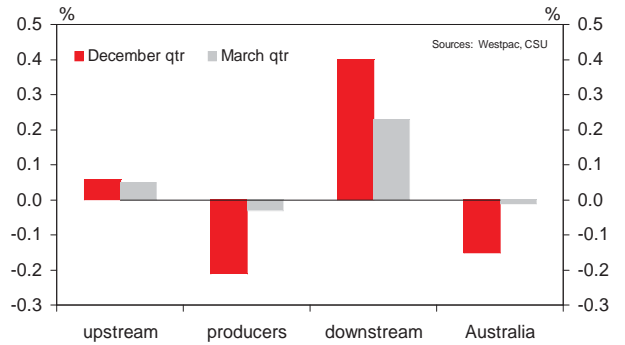
**Chart 1.**

**Westpac/CSU business performance index**



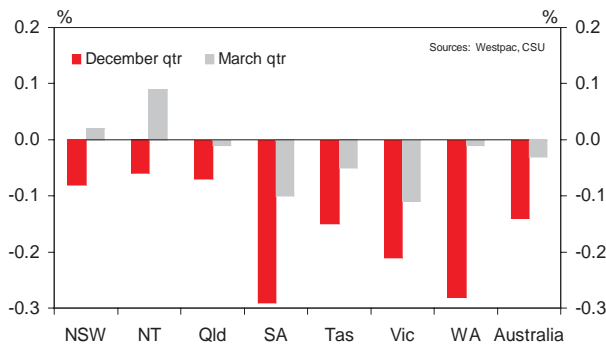
**Chart 2.**

**Downstream still with the best conditions**



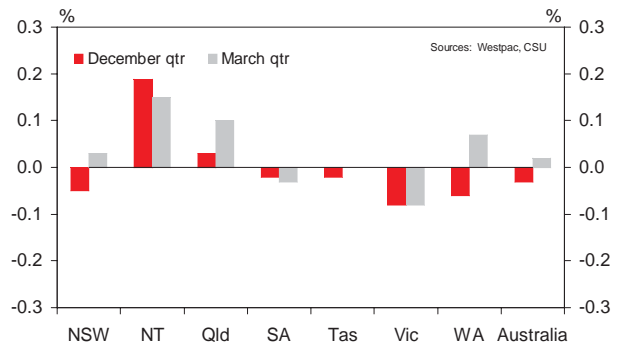
**Chart 3.**

**Capital expenditure**



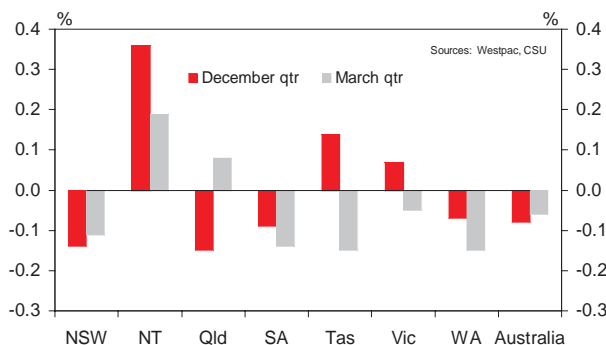
**Chart 4.**

**Employment**



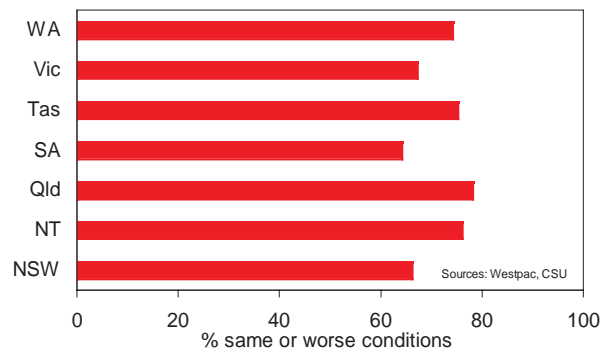
**Chart 5.**

**Stock levels**



**Chart 6.**

**Drought – is it as bad as the last?**



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## The interest rate and Australian dollar outlook

The RBA has indicated that rates may rise soon.

Recent statements from the Reserve Bank indicate that interest rates may be increased as soon as April or May. The puzzle regarding the true state of the economy went some way to being resolved by a robust Q4 national accounts update which indicated much stronger growth than had been portrayed in the past. That gave the Bank more flexibility to run policy off a much wider range of data rather than just reacting to the latest inflation read. As such, the Bank appears to have been unnerved by recent wage data which came in on the higher side of expectations. Effectively, the Bank has put us on notice that Westpac's forecast of higher rates could be delivered much earlier than we had anticipated. It is this interest rate view, along with near-term strength in commodity prices, that underpins our view on the Australian dollar we expect it to hold in the US75¢ to 80¢ range to the end of 2007.

Economic growth to remain firm in 2007.

Through the course of 2007 we expect the pulse of economic activity to firm. Falling vacancy rates; steady interest rates; and stable affordability should support a recovery in the housing market that was temporarily stalled by the series of rate hikes in 2006. Investors are also likely to be attracted back by the combination of rising rents and added caution in regards to the equity market in the light of the recent violent movements.

... unemployment to fall, wages to rise.

The lead indicators of employment continue to point to a very low unemployment rate. Labour shortages are manifest. We are even starting to see further evidence of upward pressure on wages. The wage price index shows annual growth of 4¼% compared to the official assessment in January that annual growth had slowed to 3.8%.

A recovery in the housing market will support stronger retail sales and place further stress on labour market capacity. Fiscal policy is also out to stimulate the Australian economy in 2007. With the government unlikely to produce a fiscal "surprise" on the scale of recent Budgets, a program of tax cuts and other spending will have to be financial by reduction in the current surplus - a genuine stimulus.

Recovery in housing will support consumption.

The currency markets have been extremely volatile in the lead up to this report. A sharp increase in risk aversion dating to a rout on the Shanghai stock exchange on February 27 hit global equity markets and sparked a reversal of the over-extended carry trade. The combination of these factors was clearly negative for the Australian dollar. It lost around 2½ per cent against the US dollar and 7 per cent against the yen since then the Aussie has broken through US80¢ and is looking strong for now.

Reaction to "Shanghai Flu" was short lived.

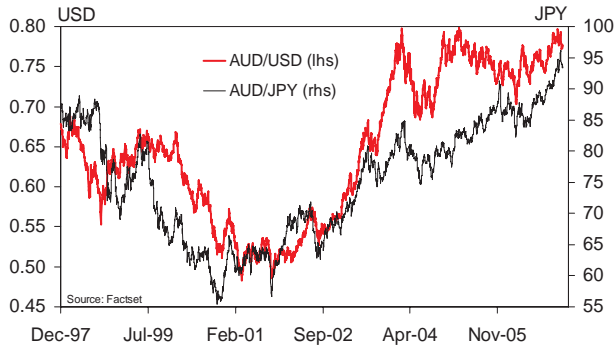
We see no reason to alter our medium term views based on these developments. Among the factors giving us confidence in a stable forecast profile are the following.

- A partial unwinding of the carry trade was already assumed in our profile. Our forecasts already incorporated a 9 per cent move in USD/JPY by March 2008, and a 12 per cent move in AUD/JPY.
- The macroeconomic fundamentals have not changed. So there is no reason to revise our existing monetary policy expectations. That is higher rates in Australia, rates on hold in the US.
- Base metals prices were insensitive to the volatility in other markets, implying that global demand conditions are solid and should remain so.
- Futures contracts for the Australian equity market "priced out" an on-going retraction, implying that the recent falls would be recaptured relatively quickly.
- The Australian dollar has, in the past, struggled to hold above 80¢.

# The interest rate and Australian dollar outlook

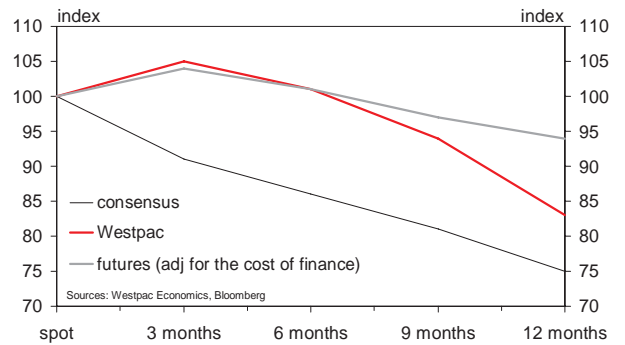
**Chart 1.**

**AUD/USD & AUD/JPY**



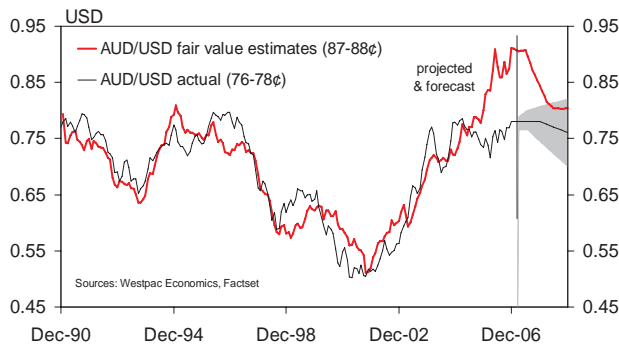
**Chart 2.**

**Base metals forecasts at March 2007**



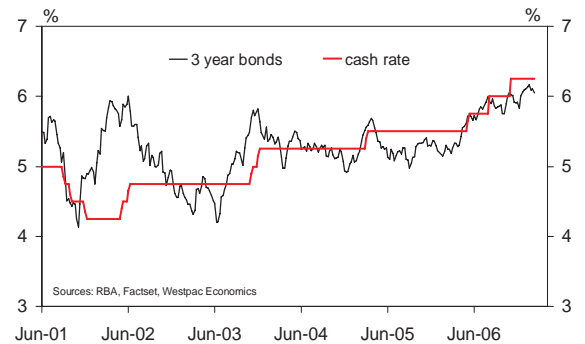
**Chart 3.**

**Actual, fitted & forecast Australian dollar**



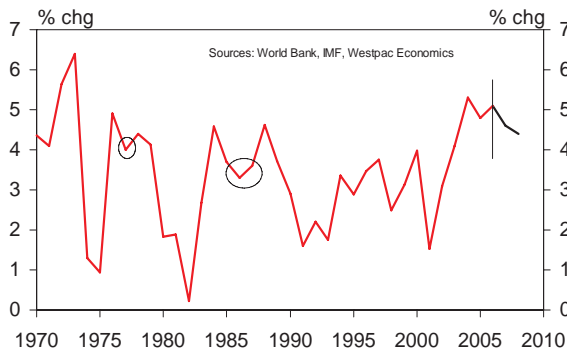
**Chart 4.**

**Australian interest rates**



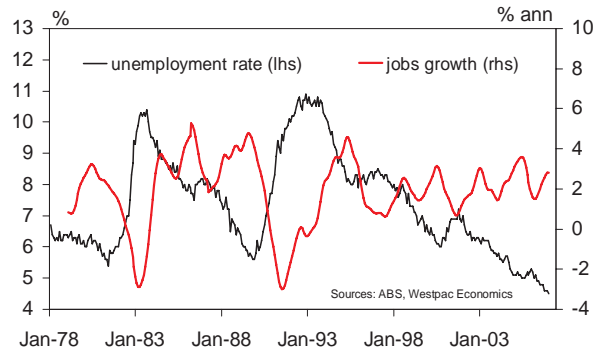
**Chart 5.**

**World growth: just a mid-cycle slowdown**



**Chart 6.**

**Labour market: unemployment falls to 4.5%**



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## World growth can ride out the current volatility

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We have not changed our view on the global economy.

Risk aversion spiked in late February, sparking a sell off in global equity markets and a sharp reversal of the over-extended carry trade. This was evident in the rapid rise of the yen on a number of fronts. We were not alarmed by these events. Indeed, we have been expecting the carry trade to unwind violently at some point. Our macro views on global growth, exchange rates and monetary policy are basically unchanged.

Current negative events in the US have been overstated ...

In the US, this year has seen significant volatility in both the financial markets and the economic data. Through it all, official rhetoric has focused on maintaining a "tightening bias". While the Fed is no doubt encouraged by the recent easing in inflation, prices are still rising faster than they would like to see. In addition Fed Chairman Bernanke has directly addressed the mortgage sector, claiming that prime mortgages remained strong with good credit quality, with no spillover from the problems of the sub-prime sector.

... as adverse weather has had a significant impact.

Adverse shifts in the weather has produced an ugly US data out-turn early in the new year. We are looking through this development to focus on the decent underlying momentum outside of housing. Housing itself has probably bottomed, and the sub-prime mortgage issue, which has dominated thinking in recent weeks, has been overblown. That said, the action in the mortgage market is the flip side of the excess of the housing boom and has the potential to get worse before it improves. As such we will continue to monitor incoming data for clearer signs that the recent softness is transitory.

The European economy is emerging from near stagnation.

The European economy has now clearly emerged from the period of near stagnation in the first half of this decade. Despite the headwinds of an appreciating euro, rising energy prices and more recently, a slowing US economy, the 13 member group surprised most forecasters by delivering its best growth performance for six years in 2006, of 2.8%. At the same time, slack in the economy, reflecting previous below trend growth, has helped kept inflation in check. The external stimulus from robust global growth has finally translated into consistently firmer domestic demand. This can be seen in the double digit growth of lending to the private sector, the lowest unemployment rate for decades and the tentative pick-up in household spending since late 2005. While there are risks out there, Europe is like a glacier - hard to get moving, but a force of some magnitude once in motion. Growth will moderate this year - our forecast is 2.3% - but that still represents a decent contribution to global growth.

Japan will not raise rates again until later in the year.

The Bank of Japan raised interest rates by 25bps to 0.50% at its February meeting. The move followed a robust economic growth report in Q1. However, other data have not been as encouraging so we anticipate that the Bank is now on hold until September. The July upper house elections are also a constraint on a near term move.

China and Asia will remain contributors to world growth in 2007.

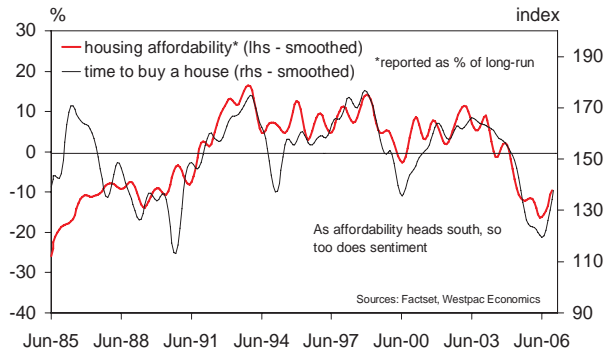
China grabbed the headlines early this year with a sharp sell off in the Mainland equity market which contributed to a marked increase in global risk aversion in late February and early March. We argue that developments in the equity market do not alter the underlying fundamentals. China will remain a strong contributor to global growth in 2007. Our GDP forecast remains at 9.4%.

Asian regional equity markets have been struggling of late, in line with a reduction in risk appetite around the globe. This does not alter our relatively constructive view on growth momentum across the region. We feel that the soft patch evident in the second half of 2006 will be worked through by Q2. The domestic demand outlook is mixed by jurisdiction, as is the anticipated path for monetary policy.

# World growth can ride out the current volatility

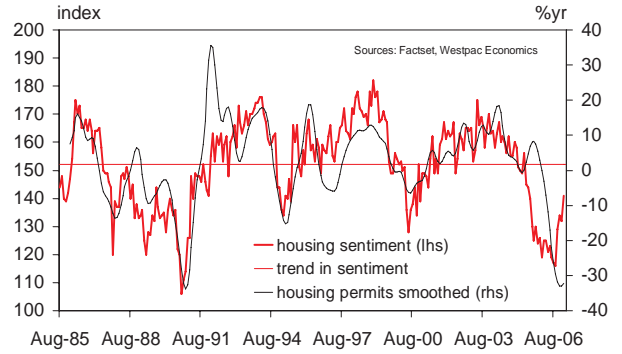
**Chart 1.**

### US housing sentiment & affordability



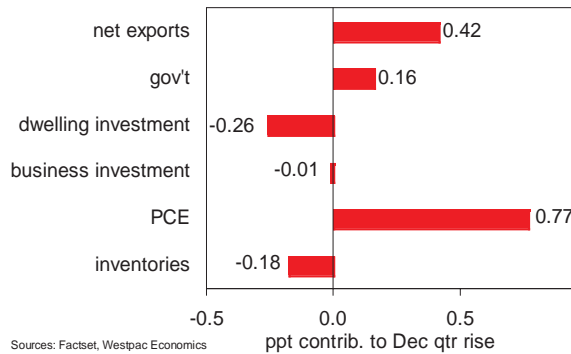
**Chart 2.**

### US housing permits have hit bottom



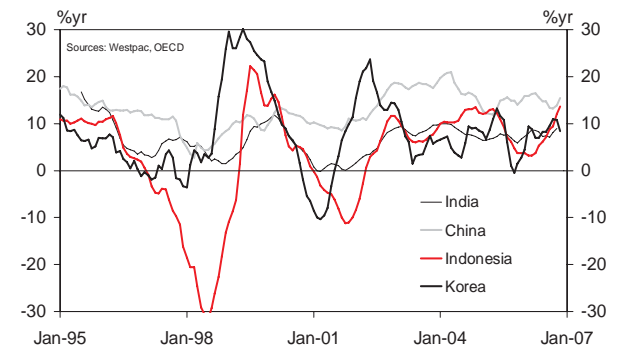
**Chart 3.**

### Contributions to 2006Q4 US GDP growth



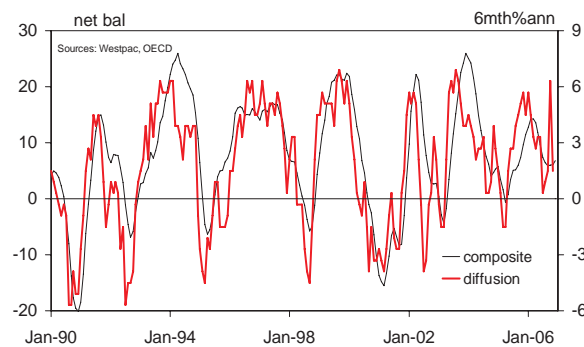
**Chart 4.**

### Leading indicators in Non-Japan Asia



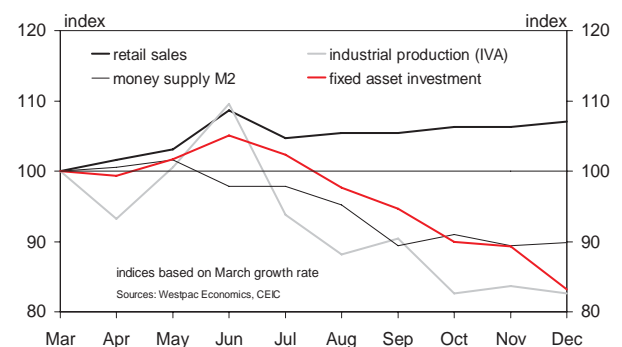
**Chart 5.**

### Leading indicators of global growth



**Chart 6.**

### China's second half deceleration



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## Coast-to-coast: the 'south-east' stirs again

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Recent data is supportive of our optimistic outlook ...

For some time now Westpac has had a somewhat unfashionable optimistic outlook for the Australian economy. The most recent data suggests that this optimism was well founded with a strong performance broadly across the nation, including a positive quarter for NSW and ongoing momentum in Victoria. That strength was not only on the demand side but also on production as implied by the strong employment performance across the states. Nevertheless, the divide between the resource rich states and the 'south-east' persists.

... affordability is still stretched in NSW ...

The key drags on the **NSW** economy (housing and business investment) eased somewhat in the fourth quarter. Sydney is still suffering from strained affordability in the housing market, suggesting there has not been a return to business as normal. However, there are some positives with housing construction broadly neutral in 2006; consumer spending also recovered in 2006 as employment growth supported household spending; business investment in NSW has stabilised; and, there are encouraging signs that non residential construction will strengthen.

... strong employment growth in Victoria.

The **Victorian** consumer has been a consistent performer over the last few years. Strong employment growth points to that being sustained in 2007. Unlike NSW, Victoria has also been reasonably well served by investment although that is slowing down at present. As with NSW, non residential investment appears set to rebound. Low vacancy rates in prime office space are certainly a factor behind the expected improvement.

Capacity is the biggest constraint on WA economy.

We maintain our long-held view that a sustained slowdown in the resource states is unlikely. For **Western Australia** in particular the most significant constraint on growth is capacity. With the unemployment rate at 3 per cent and little excess capacity in the capital stock, inflation pressures have built significantly. The surge in house prices has now put unbearable pressure on housing affordability which is likely to see the housing market slow significantly in the near future.

Queensland is poised for another construction upswing.

In **Queensland**, business investment and public expenditure have been the key growth drivers. Housing and consumer spending growth have slowed recently but that seems about to change, with the residential construction cycle in Queensland poised for another upswing. That should further support the consumer who is already benefiting from strong jobs growth and the income effects associated with the resources boom. Also, there is booming office construction in the Brisbane and Gold Coast regions with minuscule vacancy rates and strong demand on the back of rising white collar employment.

Growth continues to stutter in SA.

Growth continues to stutter along in **South Australia**. The main drag on activity continues to come from lacklustre business investment, which declined 4.5per cent in Q4 and 0.2 per cent over the year. Other components of demand have generally remained robust. However, the drag from investment, a downturn in international exports (drought has had a big impact here) and a sharp deterioration in labour market conditions suggest there is more weakness to come.

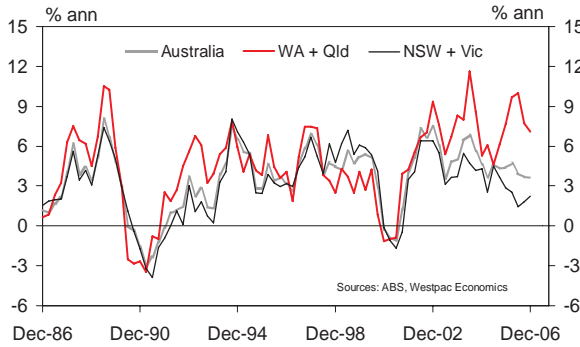
Tasmania takes a breath.

**Tasmania's** economy experienced a period of adjustment through 2006, after outperforming over the first half of the decade. A key factor is that population growth, after accelerating sharply, has eased back. That said, the state's population is still rising, a marked improvement from the late 1990s. State demand contracted by 5½ per cent over the first three quarters of the year, but enjoyed a partial recovery in the December quarter. Business investment, which retreated 30 per cent during 2006 from a record high and subtracted 4 per cent from state demand, stabilised at the end of 2006.

# Coast-to-coast: the 'south-east' stirs again

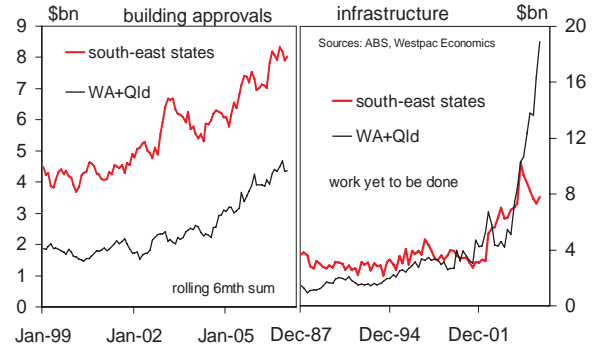
**Chart 1.**

**Domestic demand – the growth divide**



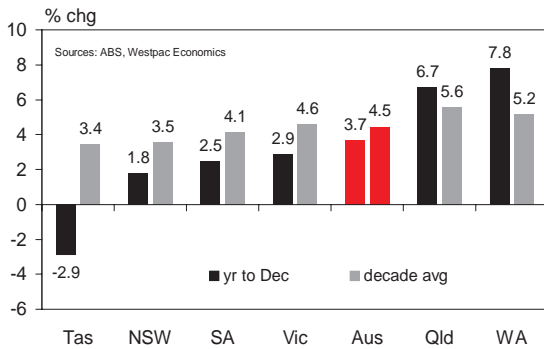
**Chart 2.**

**Non-residential construction**



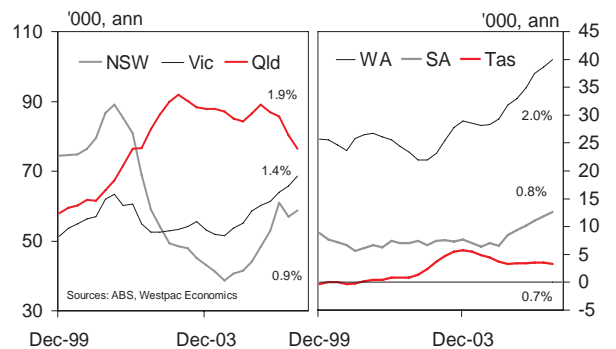
**Chart 3.**

**Demand growth - annual**



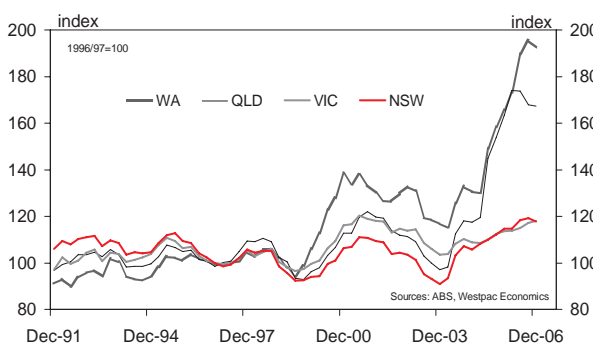
**Chart 4.**

**Population shifts**



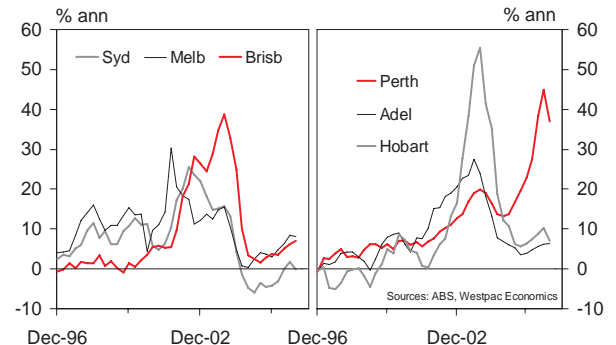
**Chart 5.**

**Export prices by state**



**Chart 6.**

**Established house prices: trended higher**



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## Global sugar production the main threat to prices

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The best is past for sugar prices ...

ABARE is forecasting the world indicator price of sugar to fall around 27 per cent in 2006/07 and then continue to decline out to 2009/10. We agree with the fundamentals of this forecast and see the current numbers as a correction to the more optimistic forecasts produced last year. Australian sugar production has also taken a hit in 2006/07 falling to 4.65 million tonnes due to the damage caused by cyclone Larry in early 2006.

... due to strong growth in production ...

It would be fair to ask, given the stronger demand outlook for sugar, particularly in regard to rising ethanol demand and production and the export limiting reforms in Europe, why are we not more optimistic about sugar prices. We have seen the impact that rapid growth in US ethanol production has had on corn prices. The answer, as we unfold below, is production. The current ABARE and USDA estimates suggest that sugar cane production can grow at a pace sufficient to satisfy the increased demand for both sugar and ethanol production.

... ethanol will have an impact ...

We saw the result of this dynamic in 2006. As oil prices rose rapidly, Brazil ramped up its ethanol production reducing sugar exports. For a brief moment, you could have argued that sugar prices were linked to the fortunes of the energy market. However, this reasoning forgets the ease with which farmers can respond to higher prices – by upping inputs as well as expanding land in production. Crude oil prices rose 150 per cent in 2005/06, but sugar prices rose around half of that. But when oil prices fell slightly more than 20 per cent, sugar prices fell almost 40 per cent, so while oil prices are still a good 100 per cent higher than in 2005, sugar prices are only slightly higher. As such, while new demand (ethanol) appears to have broken the trend decline in real sugar prices, it is only apparent at the margin. Overall, the fortunes of the industry are still being driven by its own supply and demand conditions rather than movements in energy prices.

... but not enough to prevent a decline in prices.

ABARE is forecasting sugar prices to decline in real terms out to 2010 due mainly to robust growth in global sugar production. In 2007/08 Brazilian sugar production is forecast to rise by around 5 per cent to 35 million tonnes. Even at current prices, sugar remains an economically attractive proposition for many Brazilian farmers. In addition sugar cane, from which 80 per cent of global sugar production comes from, does not need annual planting. As such, once cane is planted growers have little incentive to shift production to other crops as long as acceptable returns can be maintained. European sugar production is also unlikely to be significantly affected by lower world prices unless market conditions and/or government support programmes change to make substitute crops more attractive. Nevertheless, further EU production cuts due to a strengthening of current buyback arrangements is an upside risk to the price forecasts.

Current gov't policies focus on local ethanol production.

Ethanol does have the potential to support sugar prices by reducing the amount of cane available for sugar production. However, US government policies and subsidies are contributing to a massive expansion of ethanol production based on corn. Other countries, including Australia, are also looking at policies to lift domestic ethanol production. As such, this expansion in ethanol production is a significant impediment to Brazilian ethanol making an inroad into the global motor vehicle fuel market.

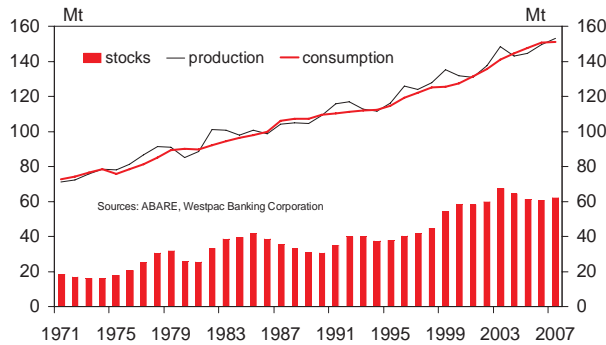
In 2007/08, Australian sugar production is forecast to rise 10 per cent as farms recover from cyclone damage and smut affected plants are replaced. As such, it is falling global prices that drag down the value of exports a further 12 per cent to less than a billion dollars. Due to the lack of land available to expand sugar cane production, particularly in Queensland, growth in the industry will be driven mostly by productivity. ABARE is forecasting Australian sugar production to grow by 4 per cent per year to around 5.3 million tonnes by 2011/12 when it will again be a billion dollar export industry.

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# Global sugar production main threat to prices

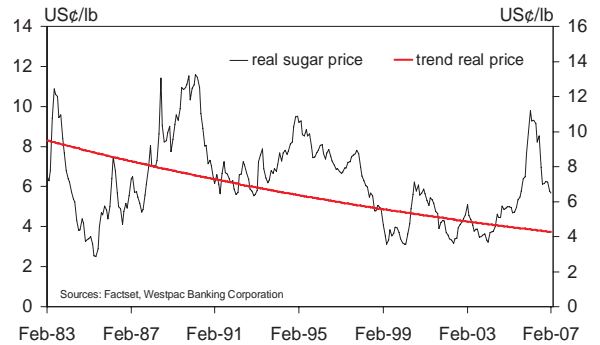
**Chart 1.**

**Production can easily outpace demand**



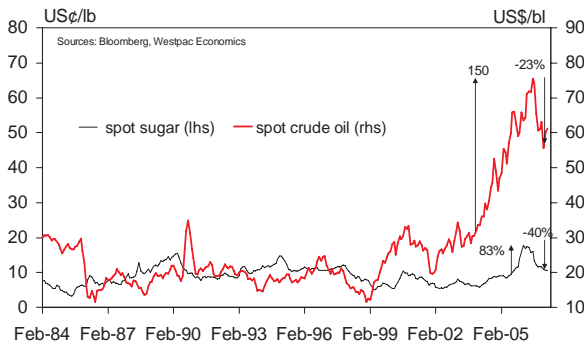
**Chart 2.**

**Real sugar prices broke the trend in 06**



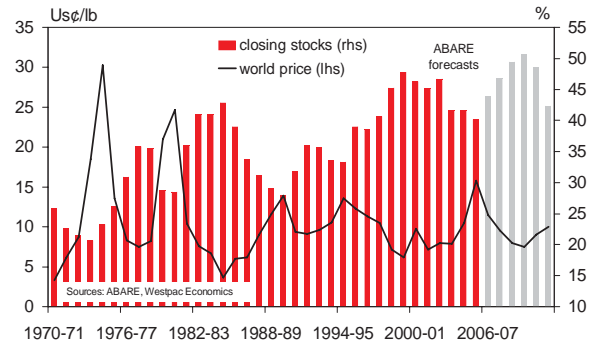
**Chart 3.**

**Oil boost to prices was temporary**



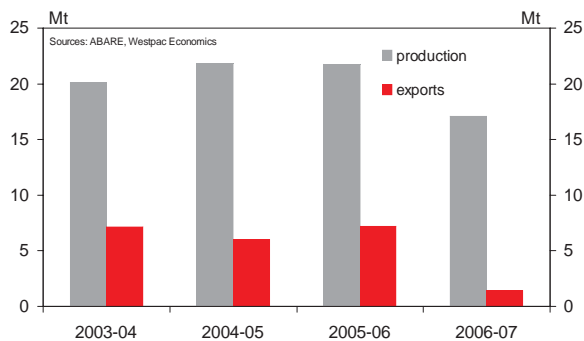
**Chart 4.**

**Sugar stocks starting to rise again**



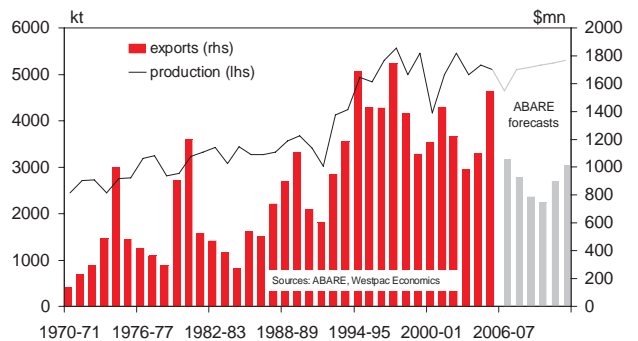
**Chart 5.**

**European sugar production**



**Chart 6.**

**Prices suppress value of Aust. exports**



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## Regional industries – biofuels & winter crop outlook

Biofuels have been painted as the panacea for many ills...

... but viability is dependent on high oil prices and government assistance.

Rising biofuel production is pushing grains prices higher.

Biofuel is just one percent of crude oil production but rising.

Production should bounce back from the drought.

### **Biofuels**

In response to a significant increase in crude oil prices, and rising concern for the environmental impact of burning fossil fuels, there has been growing global interest in the production of biofuels (ethanol and bio-diesel). For some countries, and Brazil has been a leader here, biofuels hold the prospect of replacing imported crude oil products and diversifying their sources of energy. For others, such as Europe, the appeal of biofuels is in their perceived benefits in reducing greenhouse gas emissions.

Under the current international environment, large scale biofuel production can only be undertaken with significant government subsidies. As such, the longer-term viability of the industry will be determined not only by the normal factors - that is the price of substitutes (crude oil), the local exchange rate and production costs (which naturally includes the price of the feedstock) - but also the level of government assistance provided. Quite naturally the lower global crude oil prices are, or the higher the production costs are, the larger the subsidy will have to be to maintain the viability of the industry.

Since peaking in mid-2006, oil prices are now about 20 per cent lower, averaging around US\$61 per barrel in March. As you can see from the table over, at current crude oil prices, significant government assistance is required to sustain longer-term biofuel production in many countries. A further constraint on biofuel production will be the cost of feedstock and the land availability to grow the feedstock. As most of the biofuel feedstock is also used for human consumption, either directly or via animal consumption, the usual agricultural influences such as climate, food and feed demand will have an impact on prices and thus the viability of the industry. As we have seen in the US, rising demand for corn for ethanol production, as well as robust livestock feed demand, has seen corn prices rise 15 per cent so far this year.

Currently, by IEA estimates about 14 million hectares or around one per cent of the available land is being used to produce biofuels. In 2005, biofuel production was equivalent to less than one per cent of global crude oil production. This is where there is a clear conflict evolving. Unless there is a significant technological advancement in either biofuel production (cellulosic ethanol is widely touted as the next major breakthrough) or crop yields, this increase in demand will place significant upward pressure on grain prices as the biofuel industry competes with human consumption and feed demand from the livestock industries. In such an environment, a biofuel industry can only remain economical with a higher level of government subsidies (that is assuming crude oil prices do not rise significantly).

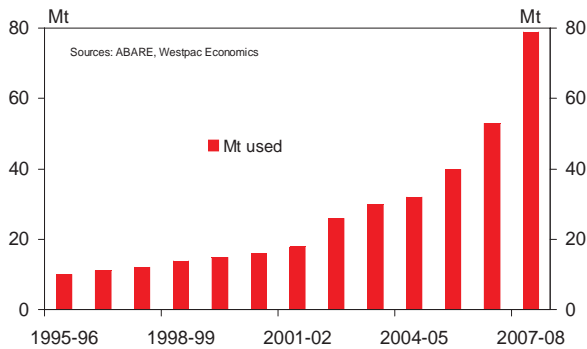
### **Winter crop outlook for 2007**

The last five years have been a period of extreme volatility for the Australian grains industry. Not only have we had two droughts, with the most recent period resulting in the winter crop production dropping to around 16 million tonnes, and a wheat crop of under 10 million tonnes, but we have also seen two record years where production has been greater than 40 million tonnes. The current drought has been particularly savage with the current summer crop production the lowest for around 20 years. Given a reasonable season this year, farmers have shown the ability in previous droughts to take advantage of the technological advances and productivity improvements to generate a rapid recovery in crop production. The latest climate outlook from the Australian Bureau of Meteorology indicated that the El Nino has ended but the Bureau notes that there is no swing in the odds to dryer or wetter conditions. Nevertheless, assuming average seasonal conditions ABARE is forecasting total winter crop production of 38.4 million tonnes.

# Regional industries – biofuels & winter crop outlook

**Chart 1.**

**US corn used for ethanol production**



**Chart 2.**

**Biofuel production in 2005**

	thousand barrel per day		
	ethanol	biodiesel	total
USA	254	5	259
Canada	4	0	4
EU	16	56	72
Brazil	277	1	278
China	17	-	17
India	5	-	5
<b>Total (world)</b>	<b>579</b>	<b>64</b>	<b>643</b>

Source: IEA

**Chart 3.**

**Estimated cost of fuel production (2005)**

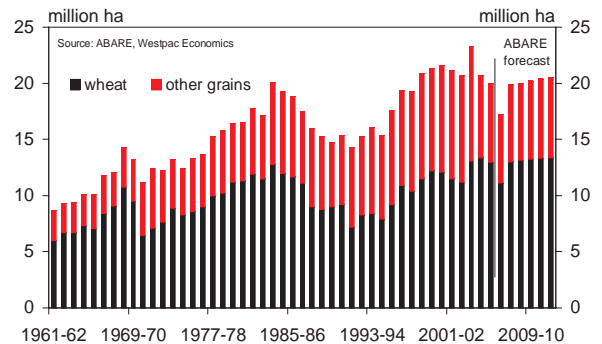
	feedstock	equiv. crude price US\$/bbl*
USA	corn	42-56
Canada	corn	53
EU	sugar beet	105
Brazil	sugar cane	16-38
China	corn & wheat	65-97
India	sugar cane	41-37

Source: IEA, ABARE

\*The estimate takes into account the conversion of crude oil into petroleum fuels, refining costs and the different energy content between biofuels and petroleum fuels.

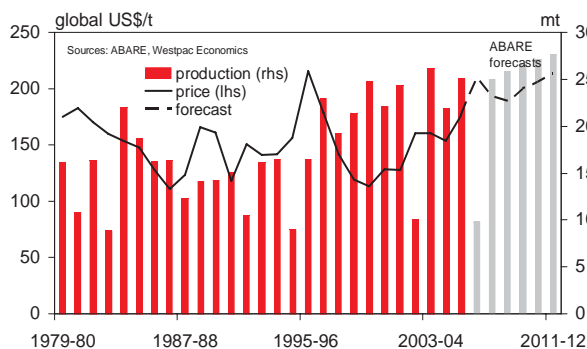
**Chart 4.**

**Cropping to recover from the drought**



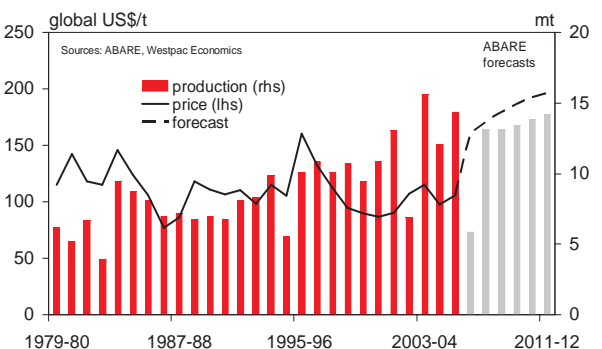
**Chart 5.**

**Australian wheat production**



**Chart 6.**

**Australian coarse grain production**



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## Regional industries – wheat, coarse grains & cotton

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Cotton consumption growth is driven by China and India.

### Wheat

ABARE is forecasting Australian grain prices to ease in 2007/08 as the drought conditions in Australia, and elsewhere, comes to an end. The drought has contributed to a significant rundown global stocks and thus a substantial rise in global and domestic wheat prices. For Australian farmers, ABARE is looking for a substantial improvement in production and thus a fall in local prices as some of the drought related pressures on supplies ease. They expect the pool return for Australian premium white wheat to decline by \$26 per tonne to average \$216 per tonne in 2007.

The medium term outlook is (for wheat prices) more positive than we have seen for a number of years. Stocks are currently low and there is expected to be little increase in their size in the near term. What we are now seeing is the continued productivity improvement in grain production, which is lifting supply and placing downwards pressure on prices, being offset by increased demand for grains, particularly from biofuel production but also from rising intensive livestock production. While the focus of this demand growth will be on coarse grains, the main use for wheat is human consumption, these factors will also help support wheat prices as it is increasingly being used as a substitute for coarse grains in livestock fodder.

Rising demand is supportive of coarse gains prices.

### Coarse grains

World coarse grains production is forecast to rise by around six per cent to over 1 billion tonnes in 2007/08 with a significant rise in production from the United States and Canada. Higher returns from corn relative to soybeans and other crops is expected to stimulate increased plantings. Australian and European production is also expected to bounce back from drought conditions while expanding production from China, South America and the Russian Federation will also contribute to the rise in global production. As we outlined earlier, there is expected to be a significant increase in the consumption of coarse grains in the US for corn based ethanol production. But as incomes and populations continue to grow in Asia and Latin America, so too will the demand for animal protein. As such feed use by the livestock industries is forecast to add to this rise in demand for coarse grains. This underpins ABAREs forecast for further rises in nominal coarse grain prices out to 2011/12.

Lower production a positive for oilseeds.

### Oilseeds

World consumption of oilseeds is expected to continue to rise in 2007/08 as the use of vegetable oils in processed food, and biodiesel production is expected to continue to increase. In addition, global production of oilseeds is forecast to fall around 2 per cent as the US, the largest soybean producer, cuts back production as growers switch from soybeans to corn. Production is also expected to decline from other major soybean producers, such as Argentina and Brazil, as seasonal conditions return to normal compared to very favourable in 2006/07. Offsetting some of the decline in soybean production will be a rise in canola production. Oilseed prices are expected to remain well supported in coming year.

Strong demand for cotton.

### Cotton

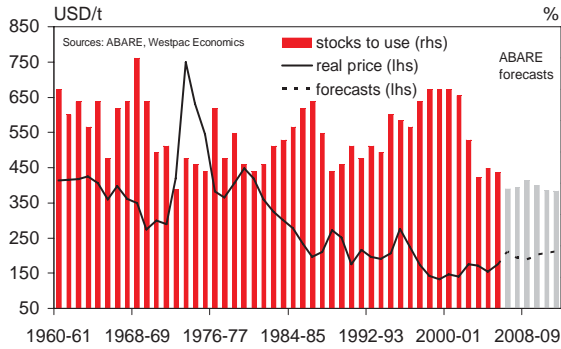
ABARE is forecasting the growth in cotton consumption to exceed production in 2006/07 leading to a decline in stocks. The rise in demand is being driven by rising textile production in China, India and Pakistan. With world production forecast to be relatively flat in 2007/08 at 25.3 million tonnes, stocks are forecast to fall to the lowest level in four years. On this basis ABARE is forecasting the Cotlook 'A' index to average US59¢ a pound in 2006/07 and US61¢ a pound in 2007/08. Given the positive global outlook, the only downside to this forecast is a large rise in production.

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# Regional industries – wheat, coarse grains & cotton

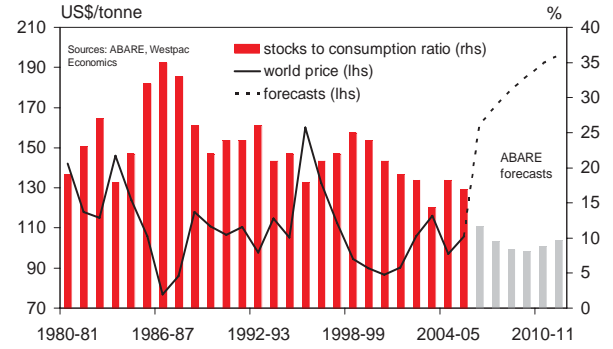
**Chart 1.**

**Low stocks a support for wheat**



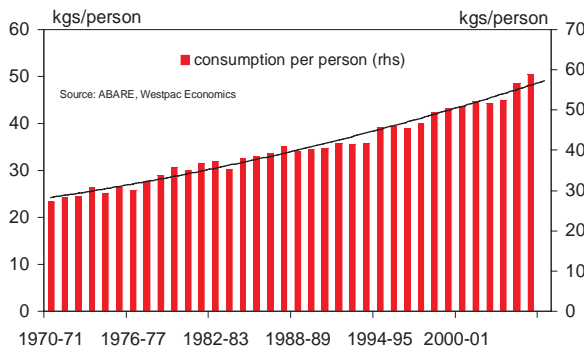
**Chart 2.**

**Coarse grains face upside demand**



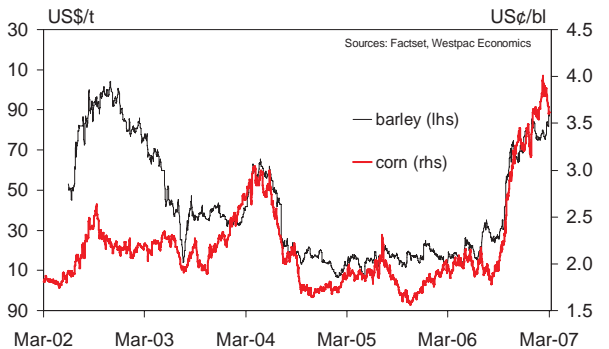
**Chart 3.**

**Oilseed consumption on the rise**



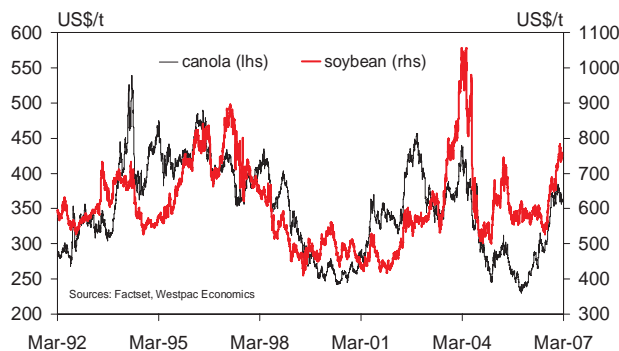
**Chart 4.**

**World corn and barley prices**



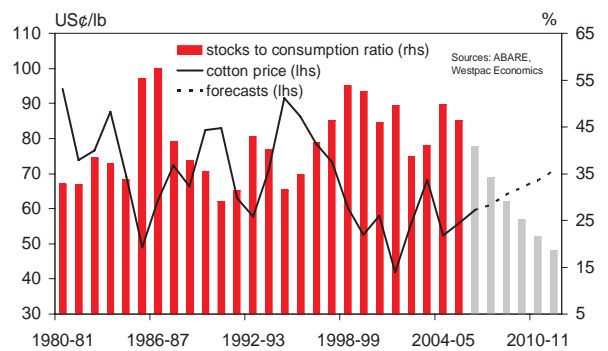
**Chart 5.**

**World canola & soybean prices**



**Chart 6.**

**Cotton stocks falling relative to demand**



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## Regional industries – livestock industries

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The outlook for beef remains bright.

### **Beef**

The outlook for beef prices is fairly bright in 2007/08. Drought conditions across much of Australian in 2006/07 resulted in an increase in slaughterings as farmers reduced the size of their herds. Given the assumption of a return of more normal seasonal conditions in southern Australia, there will be a greater retention of cows for heard rebuilding which will be a constraint on supply. Beef exports are expected to reflect the lower turn-out rates and fall in 2007/08 but recover though 2008/09 as supply increases and demand remains robust. The US is re-entering the Japanese market but its sales are unlikely to reach pre-BSE levels anytime soon as there is a shortage of US animals that meet Japan's strict import criteria. In addition, US producers have a long way to go in restoring Japanese consumers' faith in their product.

Dairy prices being supported by robust demand.

### **Dairy**

World dairy prices rose sharply in late 2006 and have remained at relatively elevated levels through the first quarter of 2007. The rise in dairy prices has occurred due to supply constraints in Australia, New Zealand and the European Union occurring at a time of rising global demand. The drought resulted in a sharp reduction in Australian supplies while New Zealand production was also hindered by poor seasonal conditions. Hot dry conditions in Europe, along with Common Agricultural Policy reforms, have constrained European milk production. Providing a partial offset has been rising production from Argentina, the Ukraine and China. World demand has continued to grow strongly, particularly in South-East Asia, Russia, the Middle East and North Africa. With global supplies expected to remain constrained in the short-term, ABARE is forecasting world dairy prices to average higher over the next two years.

Supply of sheep will fall as flocks are rebuilt.

### **Sheep meat and prime lambs**

As the drought deepened last year, sheep slaughtering rose as producers reduced the number of wethers and older ewes in their flocks. For adult sheep, developments in the wool market will guide the fall in the supply of meat sheep as flocks are rebuilt post the drought. The drought also had an impact in raising the supply of lambs being slaughtered in 2006/07 with many producers finishing lambs on failed crops. For the current season, the numbers of lambs available is expected to fall due to a lower number of ewes coming out of the drought. US demand for Australian lamb is expected to remain strong as the consumption of sheep meat continues to rise and the exports of New Zealand lamb to the US is forecast to rise only slightly due to continued strong demand in Europe for New Zealand lamb. All up, sheep prices are expected to remain well supported, it not strengthen, in 2007/08.

Drought has hit wool production.

### **Wool**

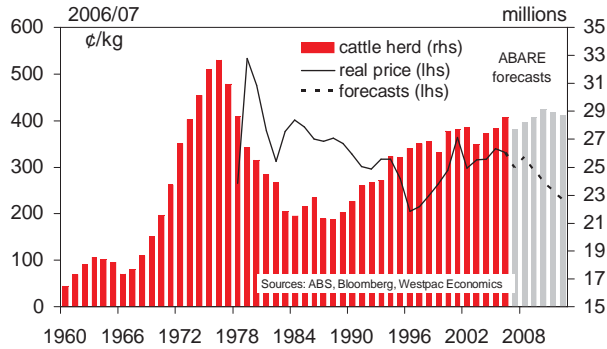
In the later half of 2006 wool prices rose sharply as concerns about the duration of the drought continued to build and stocks fell. However, in 2007/08 prices are expected to decline as competition from alternative fibres remains strong and the outlook for wool supply improves. The Australian wool industry has been declining over the past decade as low prices has seen an increase in the production of prime lambs and a movement in resources away from wool to cropping. The recent drought has also contributed to further declines in sheep numbers and wool production. For the near-term, the outlook for the industry is very much dependant on season conditions. But even assuming a return to normal conditions, farmers will still be weighing off the relative rates of returns of various enterprises, and their own financial situation, before investing in rebuilding their flocks. Given an average season, ABARE is forecasting wool production to rise slightly in 2007/08.

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# Regional industries – livestock industries

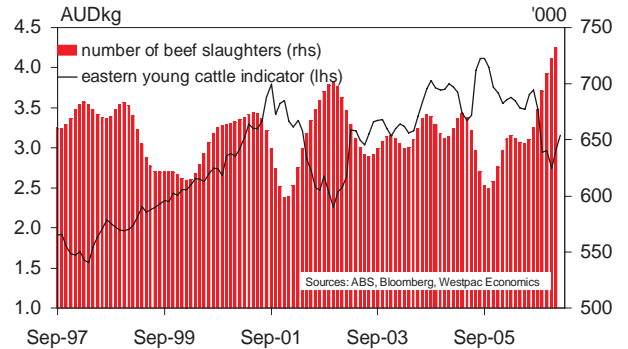
**Chart 1.**

**Beef prices has passed the best**



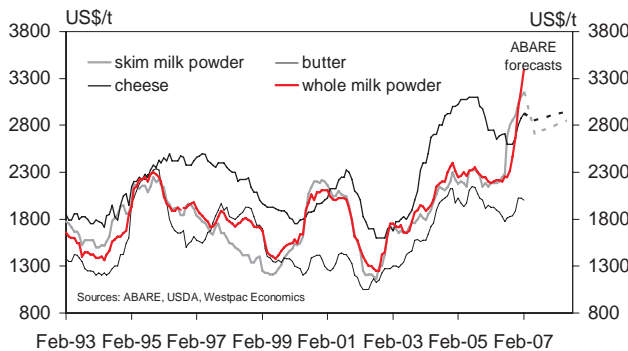
**Chart 2.**

**Beef prices and cattle slaughtering**



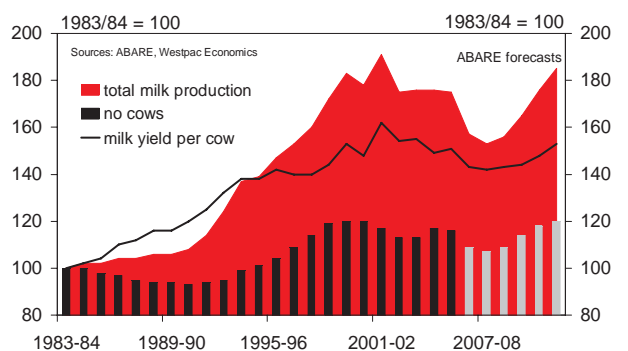
**Chart 3.**

**ABARE is looking for a small correction**



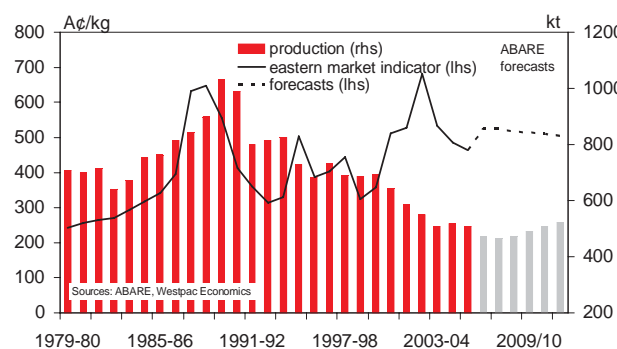
**Chart 4.**

**Dairy herd still has to be rebuilt**



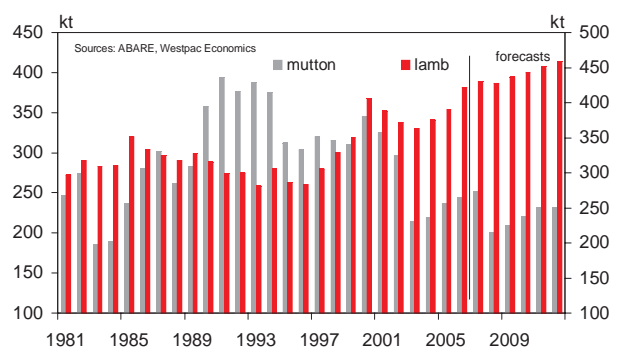
**Chart 5.**

**Falling wool production boosting prices**



**Chart 6.**

**Drought has hit adult sheep population**



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## Regional industries – wine & farm financials

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The drought has savaged wine grape production ...

### **Wine**

The drought has had a significant impact on the Australian wine industry with wine grape production forecast to fall by nearly 30 per cent in 2006/07. While this collapse in supplies should be a positive for grape prices as some wineries scramble to obtain supplies, the impact should not be substantial as current high stock levels means there is ample supply to meet current market requirements.

... but the fortunes of the industry still depends on exports.

Despite the significant swings in the domestic market with a more than 60 per cent of Australian wine production being exported, the economic outlook for the industry is very dependant on development in the global market. Given that global demand is expected to remain relatively flat, increasing world supplies should lead to increasing competition and declining prices. In such a competitive environment, Australian producers have to continue to become more efficient and continue their history of innovation if they are to maintain healthy rates of return. In the face of such intense global competition, ABARE is forecasting Australian wine exports to increase in the medium term, but at a decreasing rate, while the unit value of exports is expected to fall in real terms.

Australian farm commodity prices equal the best levels in 20 years.

### **Overall farm sector**

The last 12 months has seen a significant improvement in global prices for Australia's farm exports. While sugar and cotton prices have fallen quite significantly, all other commodities are either flat or significantly up in US dollar terms. All up, the US dollar value of the Westpac-NFF farm commodities index is up more than 13 per cent in the year to February taken global farm commodity prices to the highest level since early 1989. Even if you take into account the stronger Australian dollar, the index is up almost 8 per cent holding Australian prices on par with the best levels seen over the last 20 years. In terms of global prices, while this is about as good as it gets the outlook suggests we should not expect to see a significant deterioration in the near-term.

Farmers still have to rely on productivity for profitability.

Despite the recent rise in commodity prices, farmers export prices are still lower in real terms, than 20 years ago. That is, they have not matched the more general rise in the prices of goods and services. As such, Australian farmers have had to turn to productivity gains to maintain the competitiveness of their products on both global and domestic markets. Over the next few years farmers face a number of challenges including changes and developments in water and natural resources management, access to new biotechnologies, climate change, changing diets, the move to renewable fuels, all of which will have an impact on land use, the intensity of land use and agricultural productivity.

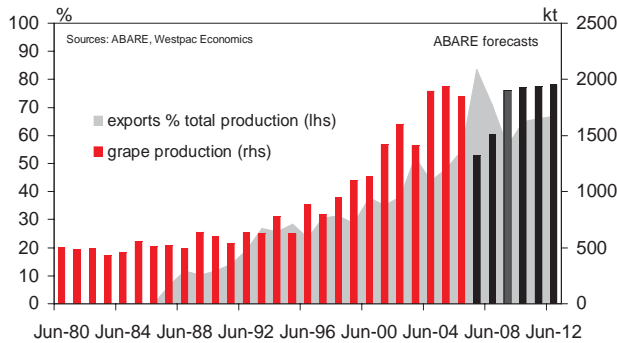
Farmers are still viable despite the drought.

Severe drought has devastated farm income across much of southern and central Australia. For 2006/07, ABARE is forecasting farm incomes to fall to the lowest level in over thirty years. Farm cash incomes for grain farms in NSW, South Australia and Victoria are estimated to have fallen the most but the lack of irrigation water has meant that the dairy industry has also been particularly hard hit. Australian farmers entered the current drought with relatively high levels of farm equity. However, a large number of farms recording negative cash incomes in 2006/07 and this will result in a significant increase in farm debt. While we do not expect this to represent a significant stress for the overall industry, many individual farms will struggle to remain viable with these higher debt levels. We also expect farmers to tap into their reserves of liquid assets to fund the current expenditure rather than rely on a further significant increase in debt.

# Regional industries – wine & farm financials

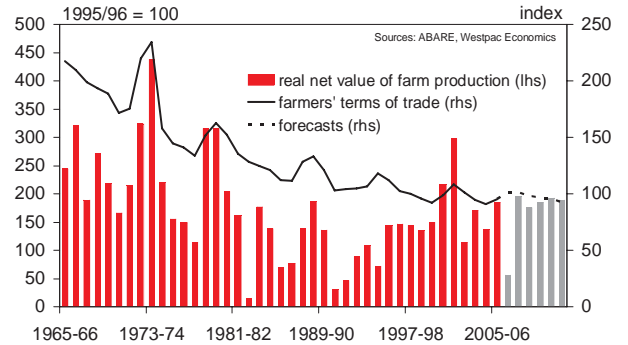
**Chart 1.**

## Exports are critical for the wine industry



**Chart 2.**

## Farmers terms of trade



**Chart 3.**

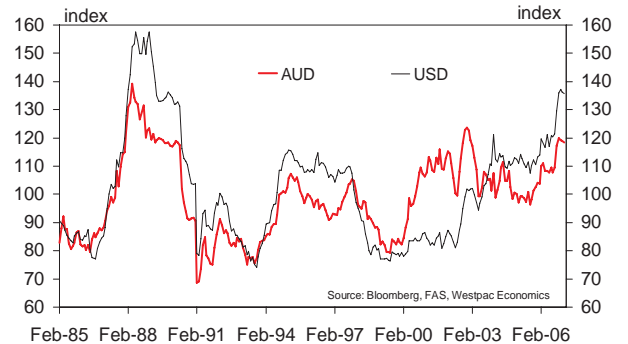
## Westpac–NFF farm commodities index

Australian \$	Index	Percentage change over		
	Feb-07	1 month	6 months	12 months
Wheat (AU c/bu)	610	0.0	16.2	22.9
Barley (AUD/t)	203	0.2	28.8	42.2
Canola (AU c/kg)	413	1.2	17.2	43.2
Cotton (AU c/lb)	68.9	-2.8	-6.2	-10.6
Sugar (AU c/lb)	13.6	-3.3	-22.6	-43.3
Beef (AUD/kg)	138	-2.0	-1.1	-4.5
Dairy price index (AU\$)	134	2.7	18.7	19.6
Wool (AU c/kg)	994	0.5	25.8	23.1
USD Index 94/95 = 100	136	-0.4	12.7	13.5
AUD/USD	0.782	0.0	2.5	5.3
AUD Index 94/95 = 100	118	-0.3	9.9	7.8

a) The indexes are calculated as monthly averages  
b) Data sources are Bloomberg, USDA FAS.

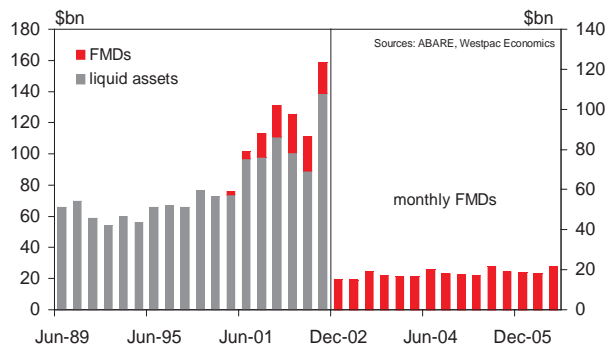
**Chart 4.**

## Westpac NFF Farm Commodities Index 1994/95 = 100 monthly averages



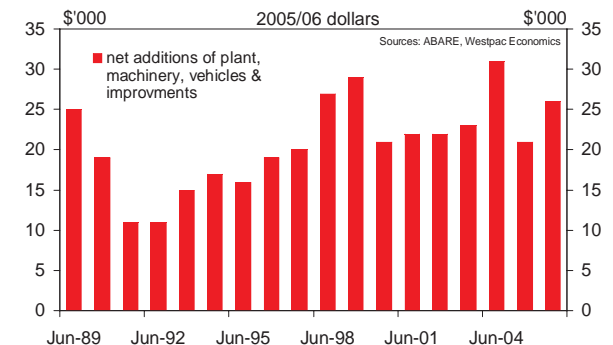
**Chart 5.**

## Farm liquidity higher than in 1990s



**Chart 6.**

## Capital investment remains solid



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## Regional industries – steel and steel inputs

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Steel production to grow slightly slower than demand.

### **Steel production and demand**

Global steel production is forecast to grow slightly slower than the growth in demand. ABARE is forecasting steel production to grow by 4.7 per cent per year out to 2012 while demand is expected to grow by around 4.8 per cent per year over the same period. However, this positive outlook masks significant differences between the regions. The majority of the growth in steel production is expected to occur in China but there is also an expectation of significant growth in India where a number of large steel projects are in the pipeline. US steel producers have been cutting production in response to the recent declines in steel prices. US producers can do this as they predominantly use electric arc furnaces which are relatively easy to shut-down and restart compared to the blast furnaces predominately used in China and India. Over the medium term, rising output from the lower cost producers in Asia and India will continue to pressure the competitiveness of the US steel industry. As such, growth in US steel consumption is expected to be met by imports. In the short to medium term, the most important driver of the growth in steel demand has been the urbanisation and industrialisation of China. China has doubled its demand for steel over the last four years and is expected to grow around 8 per cent per year to 2012. However, countries such as India, which also have rapidly rising demand for steel, are set to become increasingly important for the global demand for steel. The major downside risk to steel consumption is the Chinese Authorities' attempts to curb China's rapid rate of development. However, so far this has mostly been just tinkering around the edges.

Iron ore producers hold the upper hand for now.

### **Iron ore**

Iron ore producers were successful in negotiating higher contract prices for the Japanese fiscal year 2007/08. Contract prices for both fines and lump iron ore were lifted 9.5 per cent for the 2007/08 year which is the fifth consecutive increase for these contracts. Rising global demand, in particular from China, combined with the major iron ore producers running at full capacity, has been boosting scrap steel and spot iron ore prices thus giving the producers room to negotiate a higher contract price. Rising prices have seen China increase its domestic production of iron ore, but as Chinese deposits typically contain lower quality ore, they are more costly to access and process.

Rising iron ore prices have stimulated a significant investment in new iron ore production and transport capacity, much of which is expected to reach full capacity in 2008 or 2009. As such, from 2008 capacity utilisation rates are expected to fall and stock levels are expected to rise. While robust demand should hold iron ore prices steady in 2008/09, we expect iron ore price to fall around 20 per cent by the end of 2010.

Coking coal contracts fell in 2007.

### **Metallurgical (coking) coal**

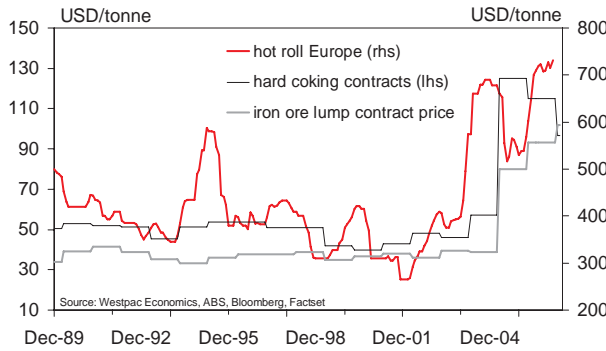
Unlike the iron ore producers, hard coking coal contracts were cut by 16 per cent in 2007/08. Contract prices for semi-soft and pulverised injection coals are expected to settle a little higher for 2007/08. Currently, short-term infrastructure constraints in Australia, combined with strong demand from Asian steel producers, are acting as a fillip for semi-soft coals. Over the medium term, coal prices are expected to come under downward pressure as supply increases and steel plants improve their efficiency and increase the use of pulverised coal injection. The increase in metallurgical coal supply will principally come from Australia and China while the greatest productivity improvements in steel blast furnaces will occur in China.

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# Regional industries – steel and steel inputs

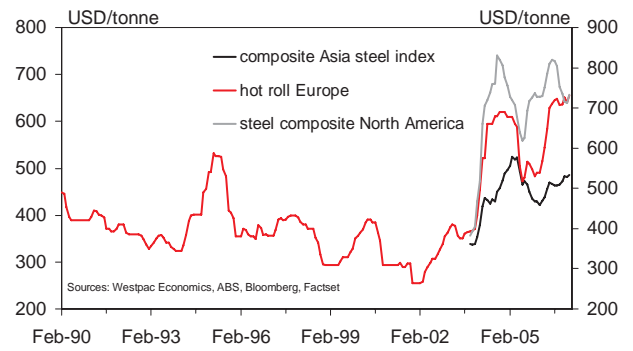
**Chart 1.**

**European steel has held the bounce ...**



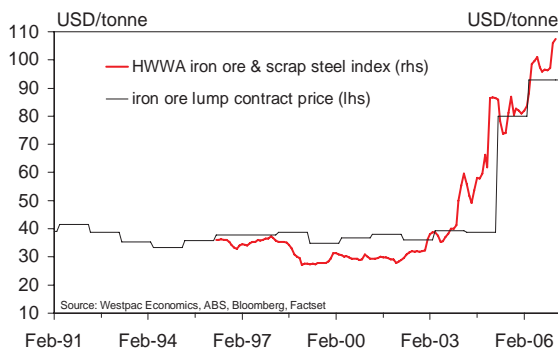
**Chart 2.**

**... while US steel has eased back.**



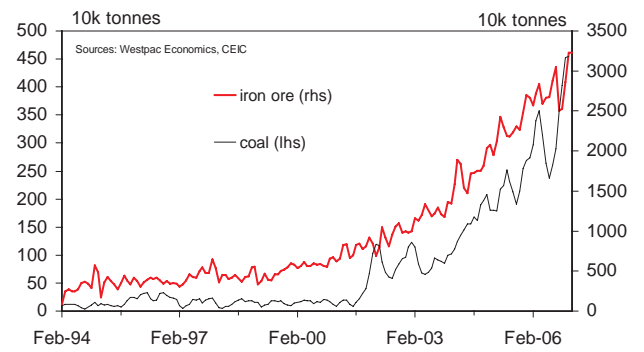
**Chart 3.**

**Scrap and spot iron have not eased back**



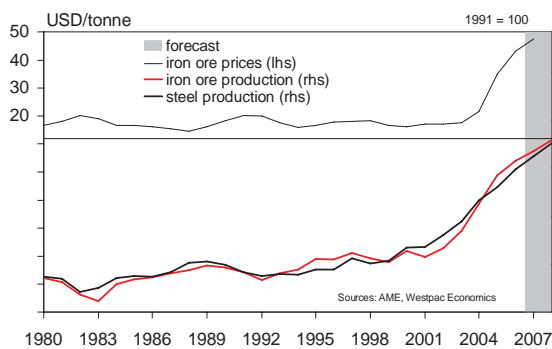
**Chart 4.**

**Chinese imports of steel raw materials**



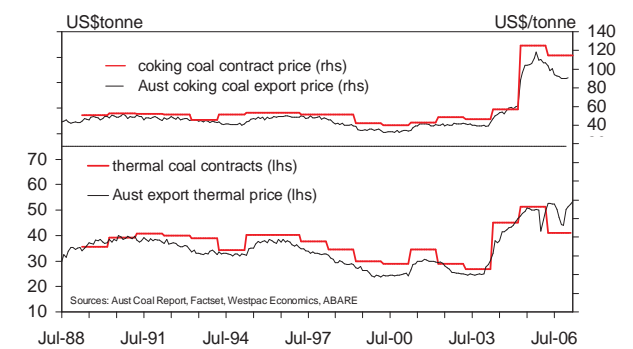
**Chart 5.**

**Iron ore production has lifted already**



**Chart 6.**

**Coal prices – thermal spot rising**



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## Regional industries – energy

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Energy prices remain extremely volatile ...

... as tight supply and robust demand clash.

... but rising supply will dent prices.

Supply has tightened and prices have firmed.

For the moment there seems to be no limit on how high prices can go.

### Crude oil

In 2006, when robust global demand in the first half of the year was then overlaid by concerns that the conflict between Israel and Lebanon could be a threat to supply security, this took oil prices to a high of US\$78 per barrel in July. From here, prices quickly retreated as there was some easing in the tensions and strong growth in non-OPEC oil output (which included a lift in output from the Gulf of Mexico where there was relatively mild hurricane season). Near the end of 2006, unusually warm weather resulted in weaker than usual US demand for heating oil. This took the oil price down to a low of US\$52 per barrel in mid January and along the way, OPEC responded with two production quota cuts which totalled 1.7 million barrels (about 5 per cent of 2006 oil production capacity).

Looking ahead, production from non-OPEC sources is forecast to continue to rise while OPEC spare capacity is expected to increase. While global growth is forecast to remain robust, it will be a touch slower than it was in 2006 and rising demand in developing economies is likely to be partially offset by lower demand from Europe, Japan and the US. While the potential is there for a very volatile year in oil prices, the risk to supply from a conflict over Iran's nuclear programme should not be understated. Without a supply shock, oil should be under US\$60 per barrel for the most of the year.

### Thermal (steaming) coal

In 2006, strong growth in coal fired electricity generation in Asia, and a reduction in exports from China and the Hunter Valley, did result in the spot price of Newcastle thermal coal being above US\$50 per tonne for most of the year. So far this year spot prices have averaged US\$54 per tonne due to strong seasonal demand from Asia, lower production from Indonesia due to the wet season and, a lengthening of the vessel queue off the port of Newcastle. Global trade in thermal coal is estimated to have risen by 7 per cent to 619 million tonnes in 2006 due to strong demand from Asia. Looking out to 2012, ABARE is forecasting thermal coal trade to rise by 3 per cent per annum to around 727 million tonnes. The key drivers of this increase in trade are an expected increase in imports by China, India, Korea and Malaysia. These countries have advanced plans to use coal fired power stations to meet growing electricity demand. China is the world largest producer of thermal coal but imports have soared due to the difficulties and cost of getting large quantities of coal from the north of China, where most of the reserves are located, to the rapidly developing south east. The US is also expected to be an important driver of growth in coal demand while growth from Japan and Europe is expected to be modest.

### Uranium

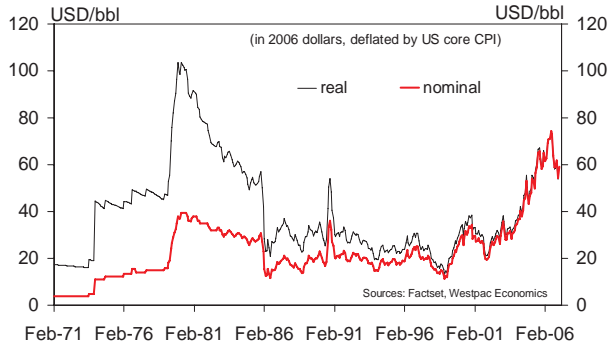
The global price of uranium oxide averaged US\$49 per pound in 2006, a 73 per cent increase on the average achieved in 2005. The real price of uranium oxide has had a twelve fold increase since late 2000 as a dwindling supply of stocks, increased concerns over the supply of secondary sources of uranium and the improved outlook for global nuclear electricity generation lit a fire under the market. Added to this mix in late 2006 was the announcement by Cameco Corporation that production from the Cigar Lake mine in Canada is expected to be delayed by at least a year following the flooding of a mine shaft. Despite their forecast for a substantial increase in uranium mine production in 2007, ABARE is forecasting prices to rise by 91 per cent to an average of US\$94 per pound. This reflects the expectations of a fall in secondary uranium supply and an increase in global reactor requirements in the current tight market. Production is expected to rise in the medium term and this should result in a modest pull back in prices.

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# Regional industries – energy

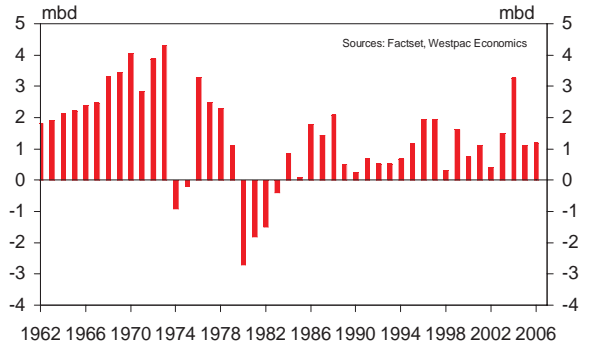
**Chart 1.**

**Real oil prices**



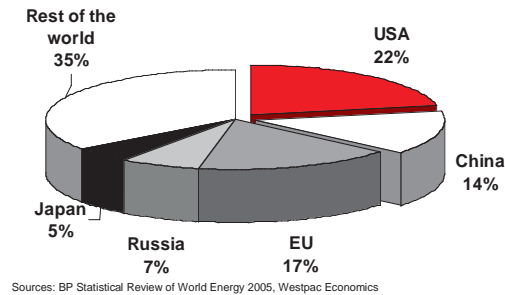
**Chart 2.**

**Growth in oil consumption**



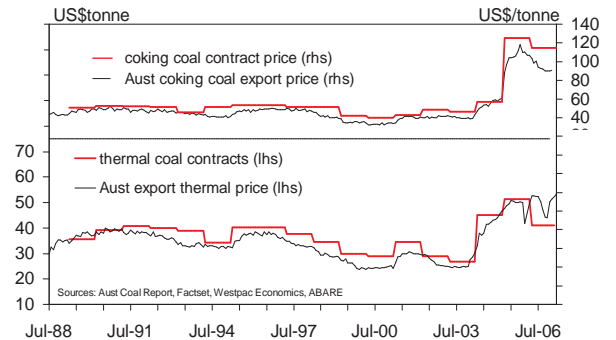
**Chart 3.**

**Total primary energy consumption**



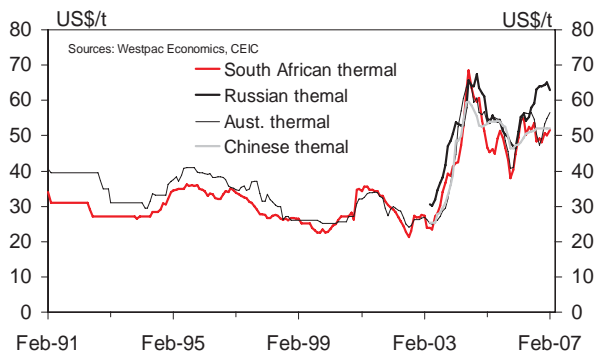
**Chart 4.**

**Coal prices – thermal spot rising**



**Chart 5.**

**Global thermal coal prices**



**Chart 6.**

**Uranium prices have exploded**



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## Regional industries – base metals outlook

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Base metal prices hit a new high in March ...

### **Near term remains positive**

Despite all the recent action in the financial markets, commodity prices did not waver. In fact, Westpac's base metals index hit a new daily high in late March and is yet to show any sign of toppling over. For the near term, continued robust global growth and the current lack of a significant supply response all suggest that commodity prices can, at least, hold their ground in the first half of the year. The slowdown in the US will be limited to the housing sector and as such, will have a minimal impact on the global economy. This will see global growth hold above its longer-run average and thus remain a positive for commodity prices. This can be seen in the recent weakness in base metal stocks on the LME which, for the moment, have stopped climbing and are threatening to retreat back to record low levels.

... but supply still poses a threat in late 2007.

### **But a supply surge is lurking out there**

However, it is clear that high commodity prices are encouraging a boom in investment in the global mining sector. You only have to look at what is going on in WA to get a feel for the magnitude of this development. But it is also a global phenomenon. Westpac's Global Mining Employment Index, which measures the level of mining employment in the major producing countries and is weighted by the share of global base metal production, bottomed in late 2002 and has been climbing steadily ever since. It is now back to levels not seen in almost a decade and if you think about the productivity improvement the industry has achieved since then, you can see why we think a surge in mine output is lurking just around the corner. And we are not the only ones to think so. AME forecasts for base metal production, which we compiled into an index weighted for Australian exports, suggest that while the growth in mine output has been slow to come online compared to previous cycles, it should appear in a meaningful way this year. It is also interesting to note that the growth in base metal production is forecast to run for a longer period of time compared to the 1980s cycle. If it was not for the solid growth in resource demand due to the urbanisation and industrialisation of China and India, such an output profile would suggest a very savages correction to commodity prices. Westpac believes that these demand factors suggest that the correction to commodity price cycle this time will be a relatively mild one.

Copper prices peaked in 2006.

### **Copper**

Through early 2006 copper prices continued to rise as labour disputes, natural disasters and other production disputes constrained production. As a result copper inventories remained low and price pushed higher. However, copper prices peaked in May 2006 and prices eased from there as the tight demand/supply balance eased. While supply did rise as a result of the resolution of some of the labour disputes, demand growth slowed as the US housing sector ended its boom run and construction activity began to contract. By early February, prices had fallen almost 40 per cent from the peak but around this point, copper inventories began to stabilise and then started to fall again. Along with continued robust demand, a surge in Chinese imports was a catalyst for a rally in copper prices. At the time of the report, copper prices bounced 25 per cent regaining some of the losses from the second half of 2006. From late 2007, we believe that a lift in supply and softer global demand will see copper prices fall around 13 per cent.

Chinese demand supporting Aluminium prices.

### **Aluminium**

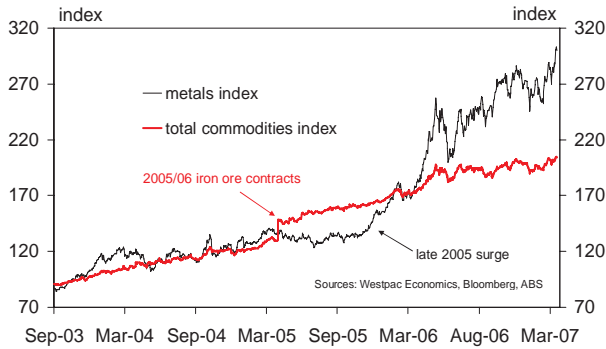
In 2006 aluminium prices were supported by continued strong demand from China and a fall in global aluminium stocks. In the medium term, continued rapid economic expansion in China should underpin strong global growth in aluminium demand. However, further out we do expect aluminium prices to ease as growth in aluminium production should be more than enough to sate the growth in demand.

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# Regional industries – base metals outlook

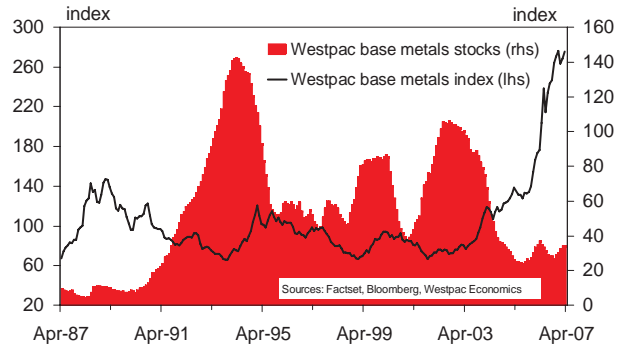
**Chart 1.**

**Commodity prices continue to rise in 2007**



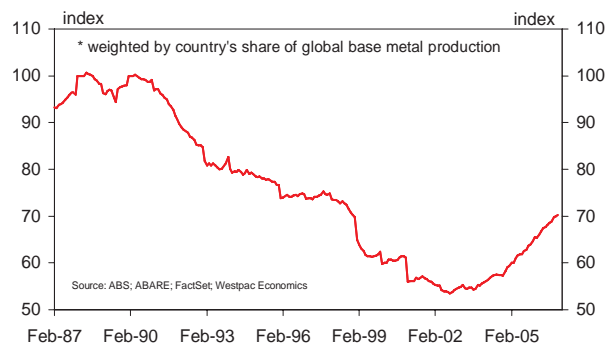
**Chart 2.**

**Westpac LME metals inventories index**



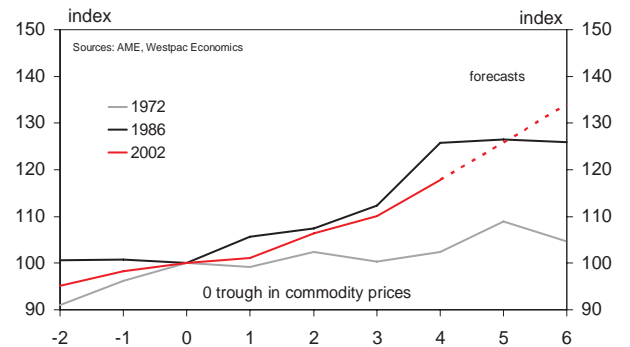
**Chart 3.**

**Westpac's global mining job index\***



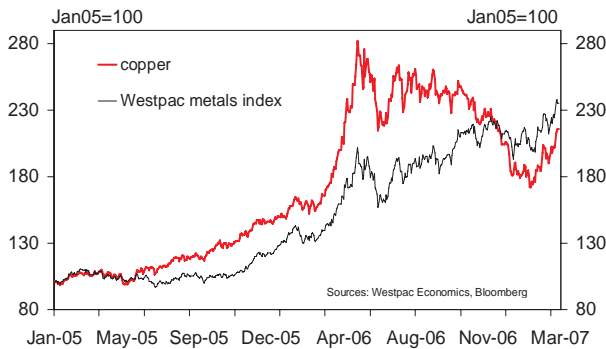
**Chart 4.**

**Base metals production cycle**



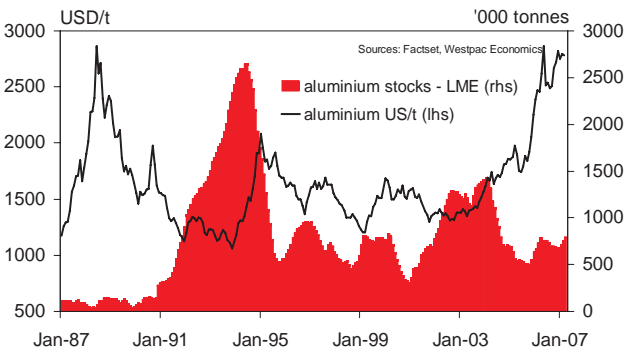
**Chart 5.**

**Copper has bounce off recent lows**



**Chart 6.**

**Aluminium stocks rising again**



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## Regional industries – base metals outlook

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Nickels stellar run continues in 2007.

### **Nickel**

Nickel had a stellar run in 2006 and by February 2007, prices were up 161 per cent from a year earlier. And the rise is yet to stop. The monthly average price for March, at the time of writing this report, was a further 12 per cent up on February. A range of supply constraints, from the long lead times to develop mines to the difficulties in finding skilled labour to develop and work the mines, and continued robust demand all contributed to tight market conditions, falling visible inventories and rising prices. In 2007, inventories have fallen to just 1.5 weeks of consumption and the situation looks to be getting worse before it will get better. The continued combination of supply disruptions and delays in the development of new projects is expected to continue to constrain growth in global nickel production at least through 2008. From there, the commissioning of new mines and the expansion of capacity at existing mines should result in an increase in supply, the rebuilding of inventories and an easing in prices. In addition recent developments in China also pose a risk for nickel prices. China in increasing the use of nickel pig iron, which contains less nickel and more sulphur and phosphorous than conventional ferronickel, in the production of low grade stainless steel. If this new Chinese supply is able to satisfy some of the demand more quickly than is currently expected, prices could fall even faster than we are forecasting.

China is a major producer, as well as consumer of zinc.

### **Zinc**

As with all base metals, zinc had a strong rally in prices in 2006. Prices peaked in November to be almost 140 per cent higher than where they were at the start of the year. Visible stocks held, such as inventories at the LME warehouses, hit record lows in 2006 but they found a base last December and have even risen slightly since then. The demand outlook for zinc remains very positive. Global consumption grew by 4 per cent in 2006 with strong demand from China. About two thirds of the global production of zinc is used to galvanise steel for applications such as roof sheeting, housing construction frames and car bodies. China has emerged as the world largest consumer, and producer, of zinc. Construction growth associated with the rapid urbanisation of the Chinese population, and strong growth in industries such as motor vehicle manufacturing, will continue to increase Chinese demand for zinc. However, China is also a significant producer of zinc and at the end of 2006 it actually became a net exporter of the metal. The clear uncertainty for the outlook is the potential for a substantially larger rise in production from China. Chinese production is from mainly small mines that are highly responsive to prices as they have relatively short lead times to start up. So the longer prices stay higher, the greater will be the proportional increase in Chinese production.

Gold prices rise as demand firms.

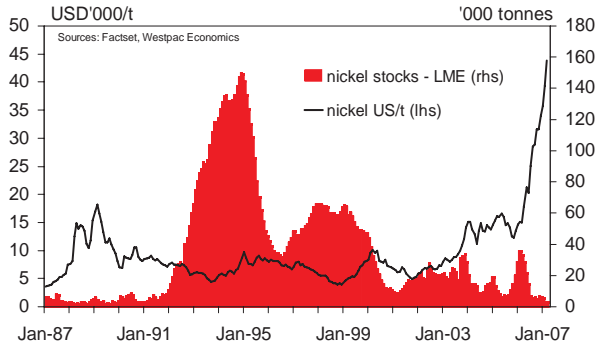
### **Gold**

From December 2005, gold prices surged 40 per cent to a peak around US\$730 an ounce in May 2006. Price did rise again into July as the rapid rise in oil prices, and the potential risk this posed to the inflation outlook, encouraged some investors to lift their demand for gold as a hedge against inflation. There are a number of factors that are supportive for gold in 2007. ABARE is forecasting only a modest recovery in mine production from last year's down turn and gold sales from central banks are expected to fall. On the demand side, it appears that producer de-hedging will continue and fabrication demand is expected to recover modestly due mostly to rising incomes in key consuming regions such as India and the Middle East. Given our expectation for a general easing in commodity prices in the medium term, and thus a reduction in the associated inflation risks, gold prices are projected to ease moderately.

# Regional industries – base metals outlook

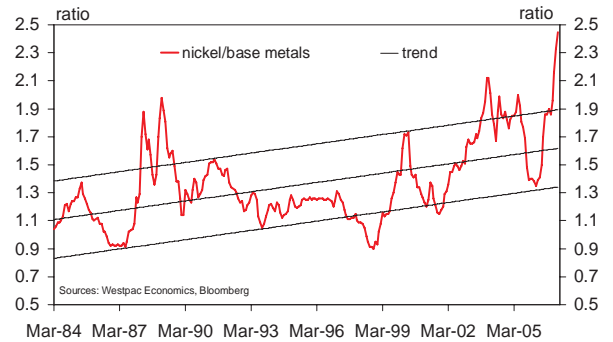
**Chart 1.**

**Nickel stocks are yet to find a base**



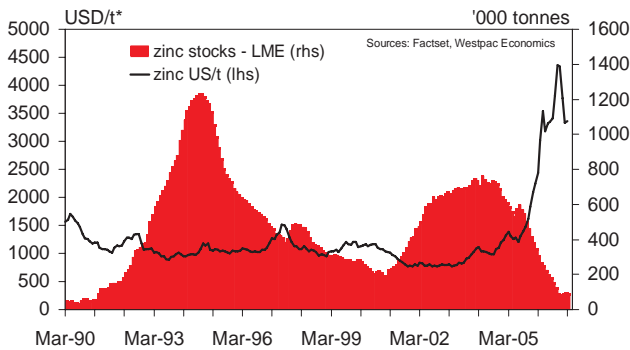
**Chart 2.**

**Nickel has broken its strong trend**



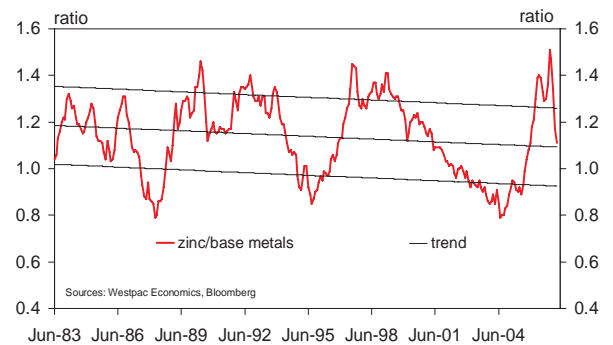
**Chart 3.**

**Zinc stocks nearing record lows**



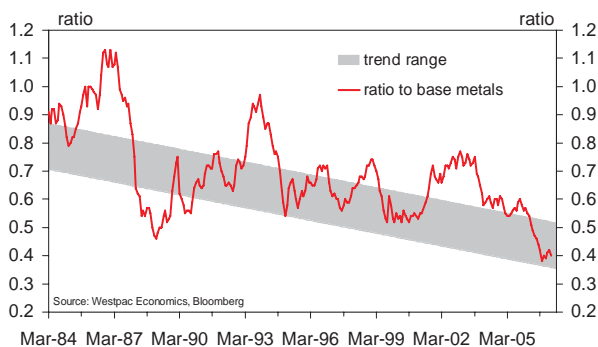
**Chart 4.**

**Zinc has return to trend relativities**



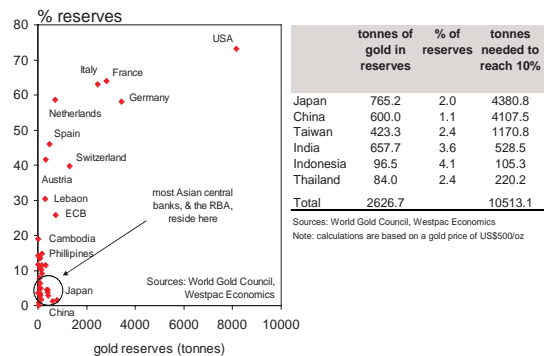
**Chart 5.**

**Gold still an underperformer to metals**



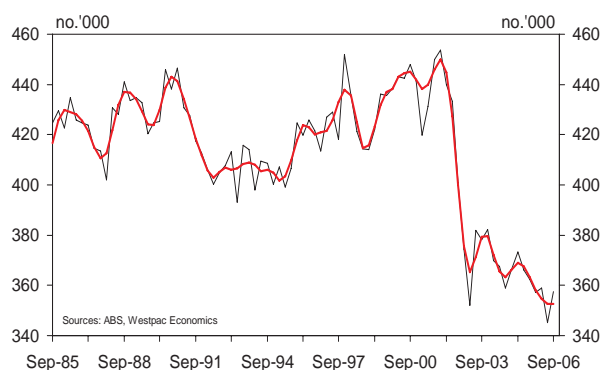
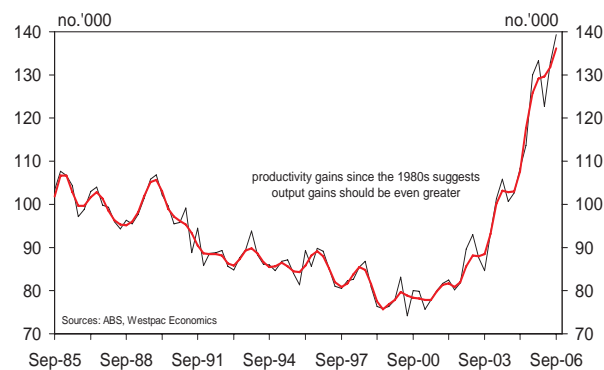
**Chart 6.**

**Asian CB holdings of gold are small**



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## Regional economic indicators & forecasts

**Chart 1.**
**Farmers are doing more with less labour**

**Chart 2.**
**Mining jobs hitting new highs**


### Commodity Forecasts

annual averages	2005	2006	2007	2008	2005%yr	2006%yr	2007%yr	2008%yr
<b>all commodities index#</b>	<b>149</b>	<b>187</b>	<b>195</b>	<b>168</b>	<b>32.9</b>	<b>25.8</b>	<b>4.3</b>	<b>-13.9</b>
<b>bulk commodities index#</b>	<b>197</b>	<b>219</b>	<b>221</b>	<b>199</b>	<b>62.7</b>	<b>11.0</b>	<b>1.1</b>	<b>-10.1</b>
iron ore (USD/t)*	35	44	49	39	62.3	24.9	11.4	-19.3
coal (USD/t)*	71	74	70	67	63.0	4.2	-5.1	-3.8
ave coking price (USD/t)	93	99	91	86	86.3	5.9	-8.1	-6.0
ave thermal price (USD/t)	49	48	46	47	30.7	-2.3	-4.0	2.4
crude oil (USD/bbl) NYMEX	57	67	59	55	39.6	17.6	-12.3	-7.7
gold (USD/oz)	448	610	633	600	9.0	36.0	3.8	-5.2
<b>WCFI**#</b>	<b>155</b>	<b>215</b>	<b>229</b>	<b>191</b>	<b>14.4</b>	<b>38.7</b>	<b>6.6</b>	<b>-16.4</b>
<b>base metals index#</b>	<b>135</b>	<b>226</b>	<b>263</b>	<b>202</b>	<b>14.9</b>	<b>67.3</b>	<b>16.5</b>	<b>-23.0</b>
copper (USD/t)	3590	6705	5885	4200	26.8	86.8	-12.2	-28.6
aluminium (USD/t)	1904	2587	2644	2225	10.5	35.9	2.2	-15.8
nickel (USD/t)	14690	23614	37638	26500	6.3	60.7	59.4	-29.6
zinc (USD/t)	1389	3256	3525	3275	31.3	134.5	8.3	-7.1
lead (USD/t)	959	1284	1558	850	10.9	33.8	21.4	-45.4
<b>rural commodities index#</b>	<b>72</b>	<b>85</b>	<b>91</b>	<b>79</b>	<b>-3.6</b>	<b>18.4</b>	<b>6.5</b>	<b>-12.7</b>
wool AUD¢/kg	766	814	961	805	-9.3	6.3	18.1	-16.2
wheat USD¢/bu	330	415	445	403	-6.9	25.9	7.3	-9.6
sugar USD¢/lb	10	15	10	9	32.4	47.0	-30.8	-14.4
cotton USD¢/lb	52	54	56	59	-7.7	4.7	4.2	4.4

All are in US\$/tonne unless specified.

#Chain weighted index.

\*Average Australian export prices fob - source ABS 5432 Merchandise Trade Exports

\*\*WCFI - Westpac commodities futures index.

The Westpac Commodity Indices can be sourced from Bloomberg at WCFI<GO>

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