

Overview

Feature article on wheat: In this Regional Economic Report the focus is on the wheat industry with a feature article from Justin Smirk that takes a longer term perspective. Rising incomes in the developed world, and in China in particular where the potential to lift production is constrained by fully allocated land and water resources, suggests we could see a rising trend in wheat prices just as we expect to see in the hard commodities. But history provides a clear warning against following such optimism blindly. Wheat completely missed the last "super-cycle" as the post war increase in demand collided with the Green Revolution which significantly lifted global productivity and suppressed prices. Research into agriculture has fallen with prices but this is turning following the food riots last year. And GMOs have the potential to lead another revolution.

Turning to the agricultural sector more generally, the improving demand environment is a major plus, with the world economy now in recovery mode and with global growth in 2010 forecast to be a healthy 3%, revised up from 2.5% back in July. Varying supply conditions and prospects across the commodities is also a critical factor. For the grains, it is generally a case of abundant supply, whereas for sugar a supply deficit has ignited a price surge. Another major influence is the surge of the Australian dollar. The higher Australian dollar is a headwind for exports of Australian commodities, particularly for the beef market where there is increased competition in our key Asian markets from increasing US supplies.

The Westpac-NFF commodity price index, an index of global agricultural prices, stabilised at elevated levels over the six months to October as global demand conditions improved (see chart below). The Index was at 120 in October, a level comfortably above average prices experienced over the first seven years of this decade – exceeding that average by 12%. Not surprisingly, the Index is down from the lofty heights of 2007/08, a period in which there was an element of excess in many global markets.

Movements in the Westpac-NFF Index over the last half year have understandably been greatly different when calculated in US dollar terms. The Index on this basis has rebounded 24% over the six months to October. This has been a period of general US dollar weakness and Australian dollar outperformance, inspired in part by the global recovery theme. The Australian dollar has climbed from US72¢ in April to US90¢ in October. This sharp movement reinforces the importance of managing currency risk, a point we have stressed in past Reports. While forecasting currencies is fraught with danger, the Aussie is expected to remain at elevated levels, in part the flip side to Australia’s relatively strong economic performance.

Supply and stock levels of agricultural commodities are also critical to the outlook. The grain markets have generally been characterised by abundant supply, a theme apparent when we published our last Report, back in July. Wheat prices in particular have lost altitude, declining 25% over the last half year as estimates of the 2009/10 crop were upgraded to be only a fraction below the record crop of last year. Developments in the dairy market provide an interesting contrast. Restocking of supply chains on positive signals and expectations of demand recovery, together with a further contraction in the main supply regions of the world is creating a situation where availability of fresh production seems insufficient for current demand levels. Our sub-Index of global dairy prices is up 16% in the three months to October (or up 31% in US dollar terms).

The Australian farm sector enjoyed a welcome rebound from drought in 2007/08. Farm incomes benefitted greatly from the strong jump in farm output over the second half of calendar 2008, with output climbing 27% (see chart below). This translated into a lift in Australian rural export volumes, with a 17% increase in the March quarter 2009, a rise of almost \$1bn. For now, the seasonal outlook appears to be mixed. The Bureau of Meteorology back on 3 June issued a press release warning of an increased risk of El Nino in 2009. The Bureau’s update of late October pointed to a mixed rainfall outlook, suggesting that the “national outlook for rainfall shows a mixed chance of exceeding the median rainfall over the late spring to mid-summer period (November-January). Drier than normal conditions are favoured for southeast Queensland and much of NSW, whereas above average three-month totals are favoured in the central and western NT, and northeast WA.”

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Westpac-NFF commodity price index



Farm output

