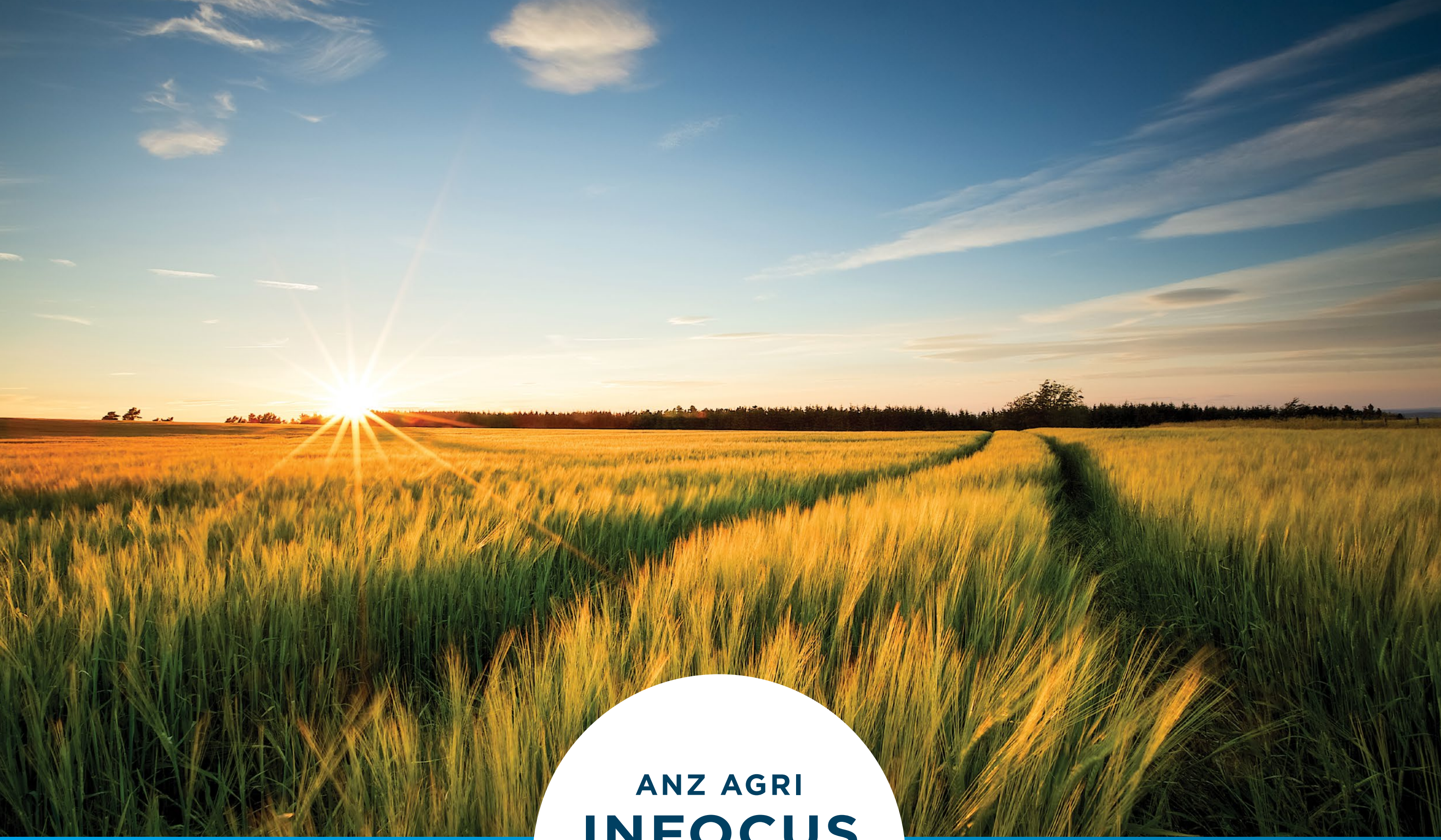

ANZ AGRI

INFOCUS

DECEMBER
2021

COMMODITY INSIGHTS

FOREWORD

As Australia heads into the summer of 2021/22, many parts of the country are emerging from Covid-related disruptions which have impacted the past two years. And as communities across the country open up, the optimism around the outlook for 2022 continues to grow, albeit tentatively with the new Covid variant Omicron being confirmed in the last week of November.

Looking back, 2021 has generally been a good one for most sectors of Australian agriculture. For most producers, the season has been good, with steady rain and reasonable weather conditions providing good growing conditions, particularly for livestock. That said, the storms and rain in cropping zones through November have been generally unwelcome, with the full extent of damage still playing out.

Most impressively, despite the early concerns of the potential impact of Covid on the sector, prices for almost every agricultural commodity have remained very strong and are showing little signs of any marked decrease.

For the summer period, the strong livestock prices look likely to continue, as demand stays strong across the three main buying categories. With recent rains generating good feed for this time of year, restocking activity is likely to be recharged. At the same time, the increasing demand for beef from domestic and export markets will see both processors and feedlotters continuing to compete strongly for what remains a tight supply of animals.

As the agri sector looks further out across 2022, it is vital that it remains vigilant and prepared for the re-occurrence of any Covid-related disruptions. Particularly as new variants appear and a number of countries in Europe are now seeing, despite high vaccination rates, a resurgence in Covid cases across communities which is leading some governments to take measures which could again cause disruption to supply chains.

One area which is likely to remain a challenge for the sector will be labour. Even with travel in and out of Australia gradually opening up, it is likely to be a considerable amount of time before the volume of visitors, especially backpackers, returns.

The tight labour market has not only meant that different industries are competing for the same small pool of available workers, but that the resulting wage pressure is adding significant cost to many agribusinesses, which includes the potential for lost income if harvest of product lines cannot be completed to time or standard.

In terms of exports, it seems likely that Australia's export supply chains will be disrupted for some time, especially in terms of reduced freight space and availability. Some industry observers are predicting that it may be years before the disruptions across global supply chains, particularly in shipping, are finally rectified. And on the positive side, the return of international passenger flights starts to restore some of the lost air freight availability for higher value items.

A number of export-dependant primary industries will also have their eyes wide open to the potential for geopolitical impacts on trade arrangements, and how to plan for these. As the recent banning of an additional Australian meat processor has emphasised, there remains a real possibility of unexpected trade disruptions on Australian agri exports by China, as well as impacts from US, UK and EU trade agreements.

In terms of domestic demand for Australian agri products in 2022, the signals are already strong. As almost all levels of restrictions are lifted, and consumers head back to restaurants, pubs and parties, especially over summer, demand for almost all food and beverage products are likely to rise.

Arguably, the most exciting outlook lies at the farm production level, where ongoing developments in areas such as agtech and sustainable management practices will allow for even further opportunities, as the industry powers into the future.

While 2021 has been a challenging year for many Australians, it has also been one in which the agri sector has more than shown the resolve, the resilience, and the innovation for which it is renowned. Heading into 2022, the future looks even more exciting again, hoping of course, that the weather plays a productive role.

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BEEF INSIGHTS

OVERVIEW

+ Record cattle prices show little sign of falling sharply
+ Retail demand for beef is staying high despite high cattle prices
+ Export demand for beef remains strong

- The US beef export focus on the China market will increase the competition in that space
- Major damage to the domestic grain crop could negatively impact feedlot economics
- Ongoing high cattle prices could make 2022 tough for smaller processors

Generally speaking, one would think that prices in different agricultural commodities would usually follow some kind of approximate cycle over the course of a year. For example, while there will always be some kinds of external variables, grain prices in Australia tend to dip in the middle of the year when the Northern hemisphere harvest comes on line, while lamb prices also tend to fall in spring, as the surge of lambs come onto the market.

With cattle prices having continued to trend upwards since the start of 2020, seemingly hitting new record highs almost every week, the market continues to look for some indicator of when the price rises will stop. As industry observers are well aware, every month for the past two years, many analysts have been calling "peak cattle", but on each occasion, prices have kept rising.

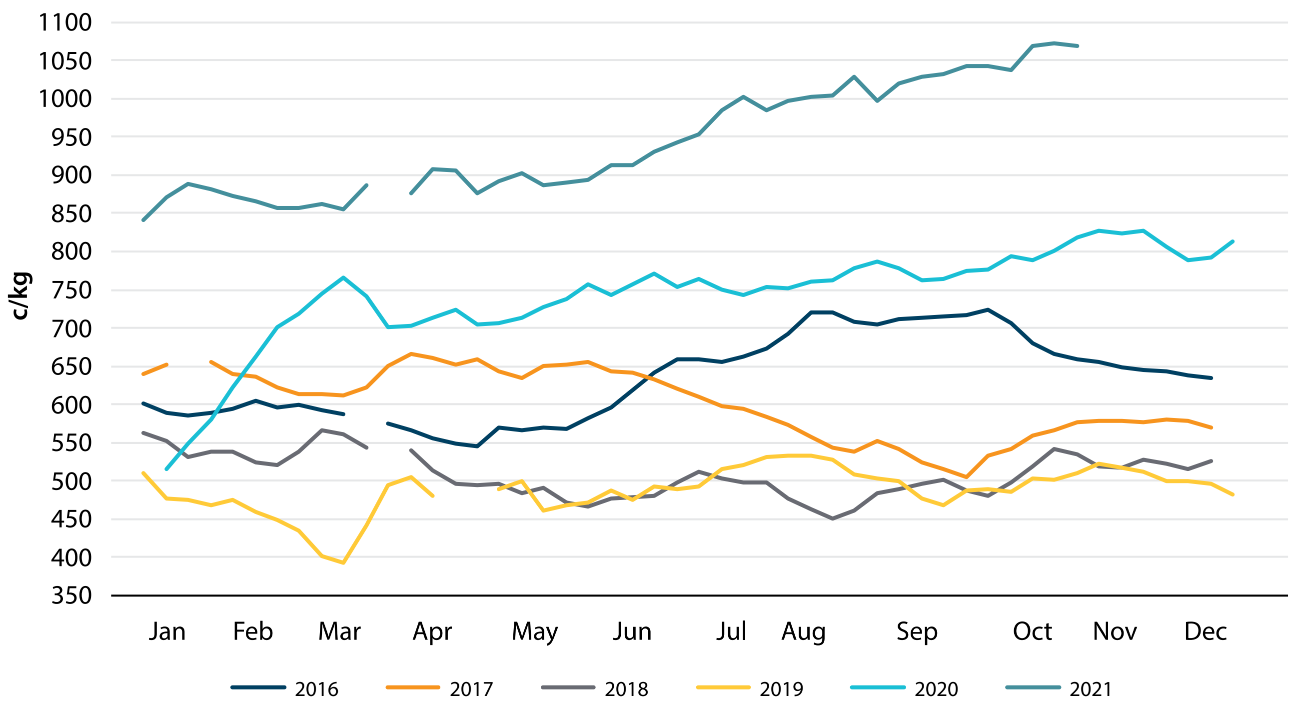
RESTOCKING, RAIN, AND EXPORT DEMAND

With the EYCI sitting at around 1100 c/kg at the time of writing, it is important to look at which factors are likely to impact prices going forward, including whether there are any cyclical indicators. In particular, it is important to look at the ongoing impact of the three major factors behind the surge in prices over the past two years - restocking, rain, and export demand.

To look for a sign of where restocking activity may go, it's probably best to ignore 2020, particularly the early months. At that time, the EYCI had been sitting stubbornly low for around two years, below where it had been for a lot of 2015. The ongoing drought meant that the feed simply wasn't available for many cattle producers to either grow their herds, or even maintain them at the same size, leading to the gradual national herd contraction. When the rain did start to fall in late 2019 and early 2020, this triggered the rapid price rise, as producers took advantage of the ample grass to restock their properties, while processors were forced to raise their bids to keep up a reasonable beef supply for domestic and export markets.

Putting aside 2020, almost every other year has seen cattle prices decline to some degree around the December to February period, as producers face the summer months of reduced feed, and look to keep their grain and hay expenses to a minimum.

EASTERN YOUNG CATTLE INDICATOR 2016-2021



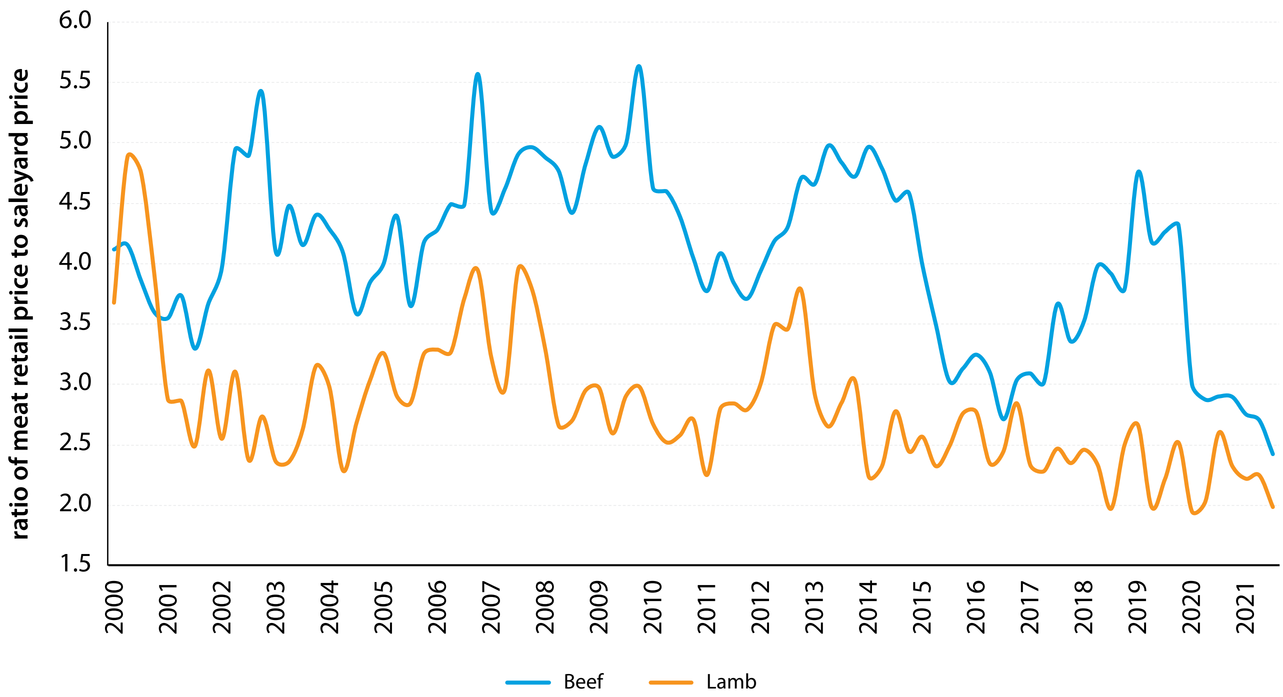
Source: MLA, ANZ

With another La Niña confirmed, the current longer-range forecast is for good rains across much of Australia over coming months. That said, it is also likely that many cattle producers may reduce their restocking activity, at least for the medium term over the summer months. In addition, with prices at their current highs, many producers may also look to pause their restocking activities and grow their herds on-farm instead.

One further area which may be impacted is the level of feedlotter activity in the cattle market over the coming months. While restocking initially accounted for the bulk of cattle buying, feedlotters are now the predominant buyers in the market. However, given the recent storms across a number of parts of Australia's grain growing regions, it is possible that a degree of crop damage could see grain prices rise, on the back of a reduced national harvest. This could potentially impact the attractiveness of feedlot economics and reduce the buying pressure from these operators.

The ongoing impact of high cattle prices has had differing impacts on the fortunes of processors and feedlotters. On their own, the high cattle prices have continued to see the price of beef on retail shelves climb at a steady rate. However, when the ratio of beef retail prices to the EYCI is taken into account, it is clear that the margins between the two are at their tightest point for at least 20 years. For beef processors, this will continue to see different operators looking at a range of ways to work though this, including reducing operating capacity and laying off staff. For some processors in tighter positions, given that retail beef prices can only rise so far before it markedly impacts demand, it makes the need for cattle prices to fall even more imperative. Should cattle prices stay high, then it could mean that 2022 may see further rationalisation in the processing sector, as margins become unsustainable for some operators.

RATIO OF BEEF AND LAMB RETAIL PRICE TO SALEYARD PRICE AT OR AROUND LOWEST POINTS IN 20 YEARS



Source: MLA, ANZ

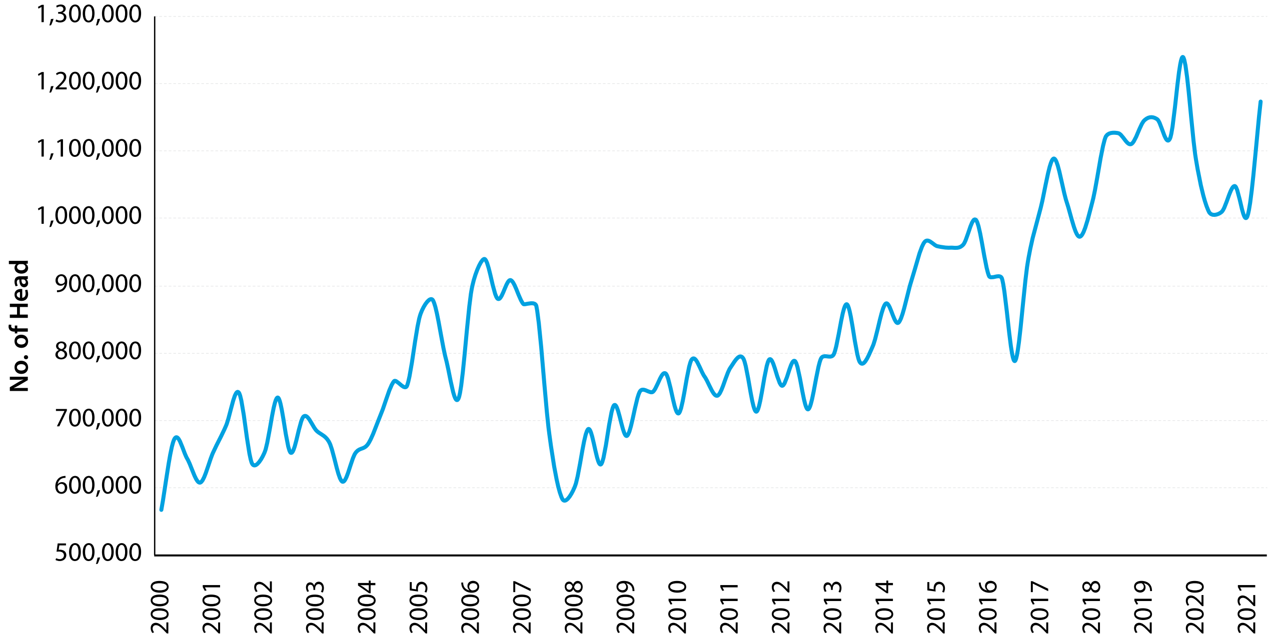
At the same time, the fact that some of Australia's largest beef processors have continued to expand, particularly across other animal proteins, has emphasised the strength of some of the bigger players. In particular, the acquisitions by JBS of Huon Aquaculture and Thomas Foods International of the Darling River Goat Exports Plant highlights a trend in the animal processors seeking to capitalise on their skills and networks in the protein supply chain, as well as diversifying their exposure away from mostly cattle and sheep.

Looking ahead to 2022 and beyond, it will be important to watch what other animal protein assets may come onto the radar of major processors, as they potentially diversify even further. At the same time, given the likely resurgence in demand for meat from consumers in many major markets as they emerge from Covid lockdowns, the impact of disruptions on Australia's beef export competitors, and the ongoing reputation of the local product for quality, food safety and reliability, it will also be notable whether new players seek to enter the Australian processing sector. The absence of some major global processing names from the local market would suggest this is a possibility.

In terms of feedlots, it is notable that the most recently quarterly figures saw the second largest number of cattle on feed in Australia on record. This came after a strong decline of feedlot numbers through 2020 and into 2021, arguably due to the intense competition from restockers for buying cattle, and through ample grass reducing the reliance on feedlots. Given the recent relatively attractive grain prices, as well as availability, combined with strong demand for grain-fed beef, both domestically, as well as from Japan and South Korea, feedlot economics are currently attractive for many operators.

It is likely that feedlot numbers could stay strong into 2022, particularly though the summer months, as beef demand stays robust. One signal to watch will be grain prices, but even a moderate rise in these could still keep feedlot margins attractive.

AUSTRALIA CATTLE ON FEED



Source: MLA, ANZ

EXPORTS STEADY

In terms of exports, Japan and South Korea continue to remain steady markets for Australian beef. Given the preference by consumers in these countries for grain-fed beef, it does add strength to the outlook for the domestic feedlot sector. Interestingly, while overall beef export volumes have fallen in the latter part of the year, beef export values have hit an 18 months high. While this was partly the result of a rise in the Australian dollar, it should also be taken as a sign of the attractiveness of Australian beef to global buyers, given that they are still willing to pay the premium for the product.

Given a number of the issues which have beset some of Australia's major global beef export competitors this year, part of that premium will be based on Australia's reliability as a supplier. In particular the ban by China on Brazilian beef imports due to BSE cases has yet to be lifted. The fact that this saw Brazil's beef export revenue fall by over 30 per cent year-on-year to October reiterated the importance of strong domestic biosecurity measures by major beef producers – not the least Australia.

GRAINS INSIGHTS

OVERVIEW

+ Global grains prices continue to climb as concerns rise over Russia's export quota
+ Some analysts are predicting a record Australian wheat crop, in part supported by recent rain
+ Strong global prices are likely to continue to be passed on to Australian producers as global demand grows and the Australian harvest comes in

- Rain events across much of the grain producing areas of Australia has raised concerns over the harvest – and with more still to come, the harvest is not yet in the bag
- A strong increase in demand for high protein milling wheat may be impacted by untimely rain
- High fertiliser prices continue to put some dampener on the outlook for the coming season

It's a case of so near yet so far for some Australian grains producers as weather events across the country have seen some uncertainty descend over what was forecast to be another stellar year for wheat and grains producers.

RAIN DELAYS HIT THE HARVEST ACROSS MUCH OF THE EASTERN SEABOARD AND WHILE GOOD TONNAGE IS FLOWING INTO RECEIVAL CENTRES, THERE ARE CONCERNS OVER THE QUALITY OF THE RAIN IMPACTED HARVEST.

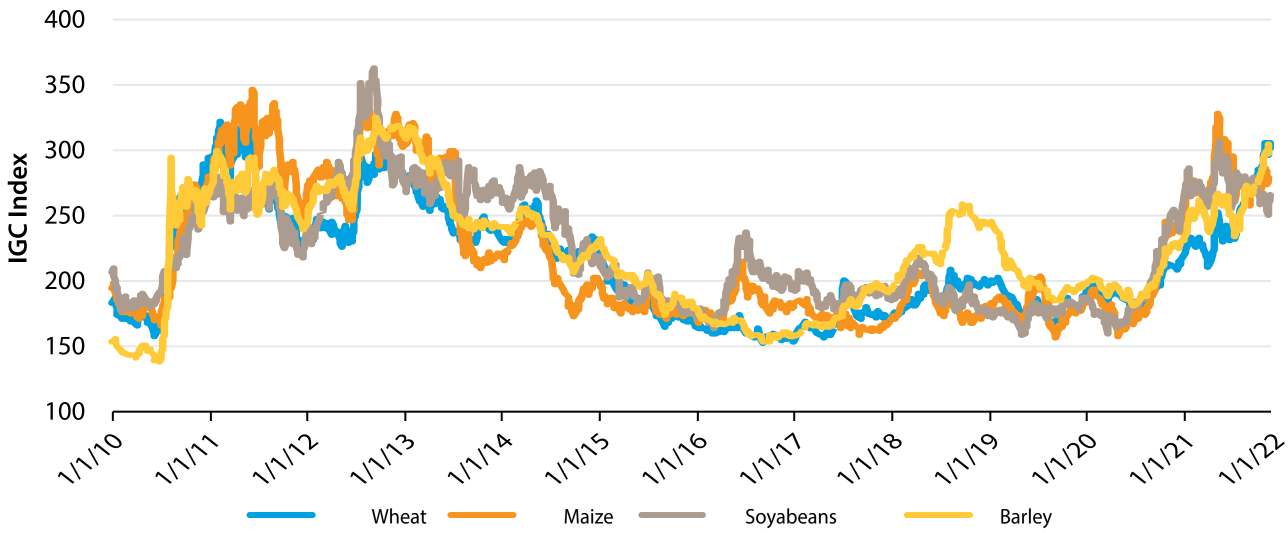
On a global stage, Russia is the story of the month, as the Government confirms its intention to lower export volumes in early 2022 as food inflation continues unabated.

GLOBAL GRAINS MARKET CONTINUES UPWARDS CLIMB

Global wheat prices continue to climb steadily higher, with the International Grains Council wheat sub-index reaching levels not seen since 2011. This rise in the global wheat price continues to be driven by concerns over supply – as has been the case for much of the year. The latest United States Department of Agriculture global grains outlook has seen the Russian wheat harvest forecast to come in around 13 per cent down on last year's crop. This result is actually a slight revision up from last month's report and now an almost final harvest figure. Despite this, global production was forecast down slightly on the back of cuts to forecasts in the European Union and United Kingdom. On the whole, however, total global supply is still forecast to be at a record level in 2021/22.

Global consumption has also been forecast down slightly, as feed wheat becomes relatively more expensive than other feed grains. Global wheat trade has been forecast upwards, however much of this upwards revision in trade has been reliant on exports from Russia.

GLOBAL GRAINS PRICES CONTINUE TO RISE



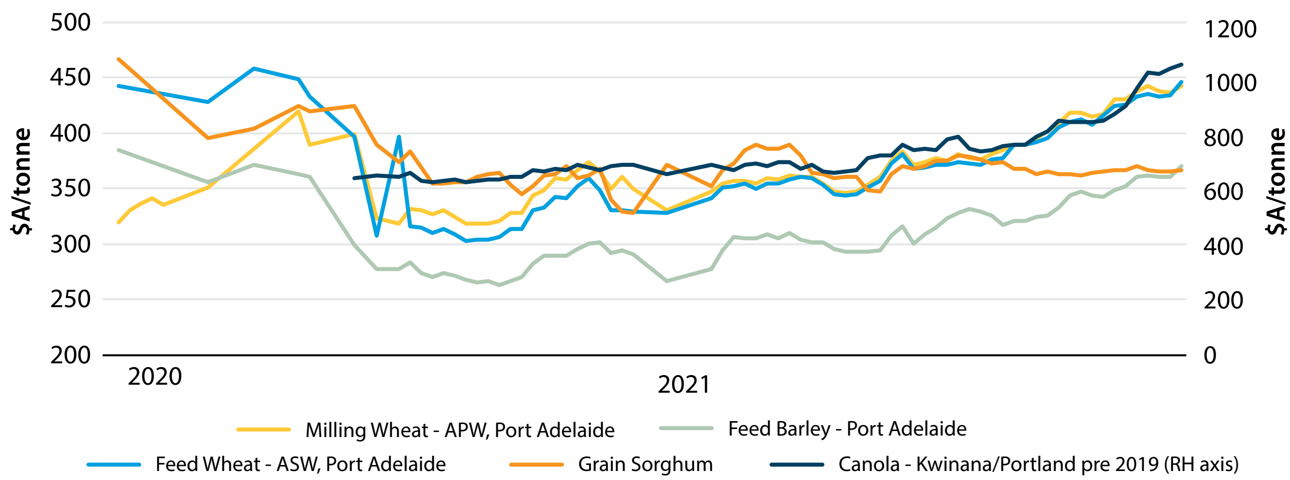
Source: IGC, ANZ

The announcement from the Russian Government in early November that they intend to limit Russian wheat exports in an effort to address domestic food inflation, saw wheat prices climb even higher. While details on the export restrictions are scarce – the quota will rely heavily on the final Russian harvest figure and pace of exports for the remainder of the year and early 2022. The new quota is expected to be announced in January 2022 and commence in mid-February.

RAIN EVENTS RAISE RISK TO QUALITY

Australian grains prices continue to perform strongly in comparison to the previous season grains, however as rain events have raised concerns over the quality of the new season's harvest, prices have eased slightly for feed wheat. A lack of high quality milling wheat in the Australian market has seen the spread between feed wheat and milling wheat jump from $5/tonne to over $50/tonne in a short period of time.

CANOLA INDICATOR PRICES BREAK $A1,000/TONNE



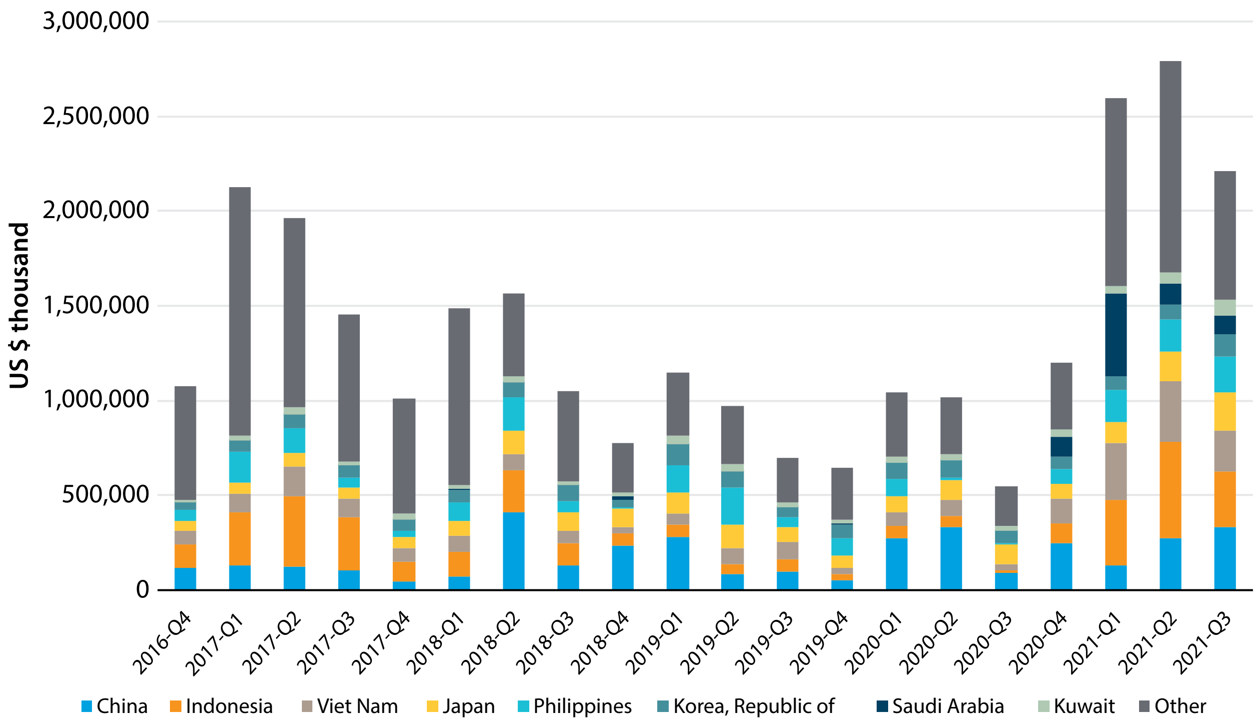
Source: ABARES, ANZ

It hasn't been all smooth sailing for the Australian harvest, however, with rain events throughout the eastern states delaying harvest and resulting in some downgrades in crop quality. Rainfalls of between 50 and 150 millimetres were seen across Queensland, New South Wales and South Australian farming regions where harvest is either underway, or getting close. Rain events appear to have led to both a boost in tonnage but also a downgrade in overall quality. However with feed wheat prices remaining relatively strong, the exceptionally strong season and tonnage has meant that farmers in rain impacted areas remain in a relatively strong position. And while many farmers scrambled to bring in the harvest, a lack of labour particularly in border areas, put a significant restriction on the amount that could be bought in before the rain hit. Canola plantings have been more heavily impacted as they neared harvest with rain and hail damage in parts of Western Australia, South Australia and the eastern states.

WITH LA NIÑA COFIRMED AND MORE RAIN ON ITS WAY, ALL EYES WILL BE ON THE SKY.

On the export market front, Australian wheat exports continue to perform well, particularly into South-East Asia as freight rates climb and competition from Russia wanes. And despite trade restrictions on some Australian exports to China, Chinese continue to ramp up purchases of Australian wheat.

AUSTRALIAN CEREAL EXPORTS REBOUND



Source: TradeMap, ANZ

Australian cereal exports continue to rebound strongly out of Covid, with growing demand from China despite trade tensions. While China usually sources wheat and other grains from the United States and Canada, the recent drought in northern America as well as expensive oil and freight rates have seen Chinese and other Asian demand for Australian grain grow strongly.

SHEEP INSIGHTS

OVERVIEW

+ The global demand for sheep meat looks likely to remain strong
+ Despite losing ground to NZ, US demand for lamb stays high
+ High ewe prices show industry confidence

- The spring flush has seen a fall in lamb prices
- High saleyard prices and a high AUD has impacted lamb exports to the US
- The softening in prices for medium to lower quality ewes may disappoint some sellers

Apart from those in the middle of shearing, the good November rains were welcomed by most sheep producers. Coming on the edge of summer, the boost to feed growth will have many farmers looking over the next few months even more optimistically than they already were.

Producers will already be crunching the numbers – potentially less supplementary feed needed later in summer, better condition for sheep heading to the saleyards over the coming months. Perhaps most notably, it may also spur many producers into having the confidence to hold their stock back from the markets for longer than originally planned, in the hope that prices will reverse their downward trend over the past month and start to rise again.

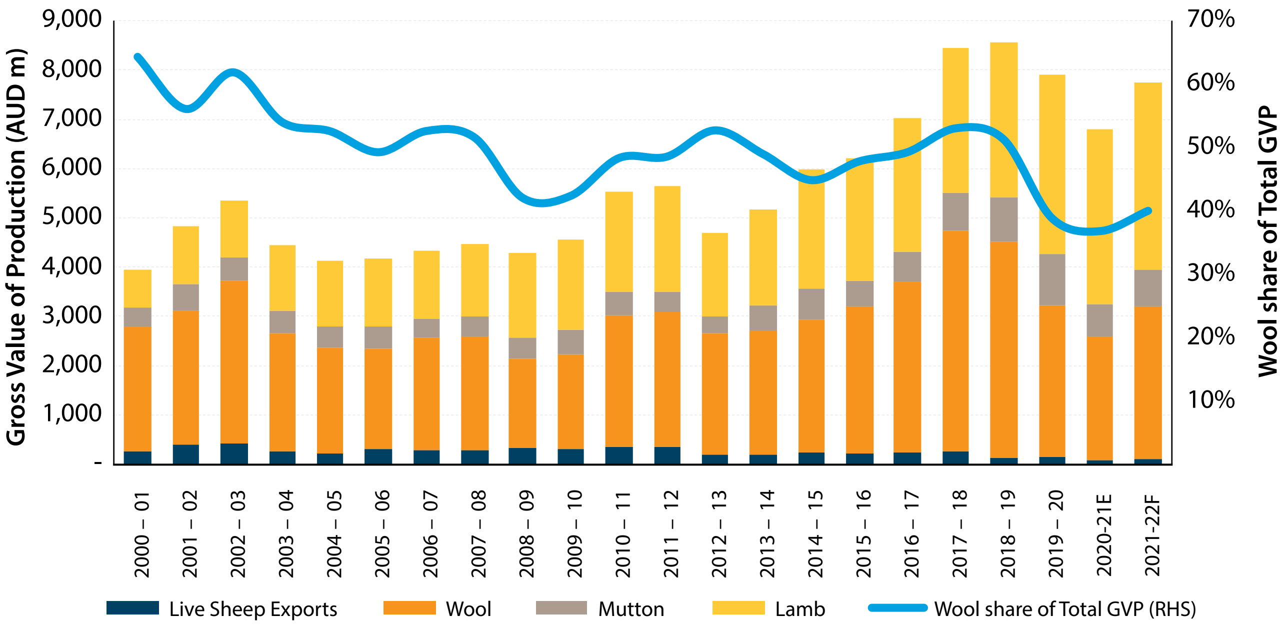
In particular, lamb producers will also be looking to make the most of the new feed to add extra condition, and increase their saleyard returns. The risk with this strategy is that if many in the industry follow the same path, a surge in quality lambs closer to Christmas could dampen prices, as buyers are faced with ample supply.

The good spring rain also had the impact of bringing restockers back to sheep markets, many of whom may have been lessening their buying activity on the expectation of feed drying out more quickly heading into summer. With current forecasts of the rain continuing at least into December, it appears likely that enough producers may take the opportunity to keep rebuilding their flocks, to put further upward pressure on prices.

Across sheep prices, it is notable that while the industry benchmark Eastern States Trade Lamb Indicator (ESTLI) price is down, other sheep prices have remained at or around record levels. The ESTLI's decline was not unexpected – more than almost any other livestock category, lamb prices are likely to fall at this time of year as a surge of Spring lambs hit the market. This year however, heading into summer and 2022, the potential for a quick price recovery is strong, on the back of the consumer demand for lamb, likely to flow from a combination of the lifting of restrictions on restaurants and social gatherings, and the onset of the summer BBQ season.

Away from lamb prices, it has been the recent prices paid for ewes which has been not only startling but has provided a terrific indication of the confidence in the industry by some of the most experienced operators. The fact that young top end ewes are now exceeding $500 per head at a number of saleyards would have been inconceivable even a year ago.

THE PRODUCTION VALUE OF AUSTRALIA'S SHEEP INDUSTRY CONTINUES TO GROW STRONGLY



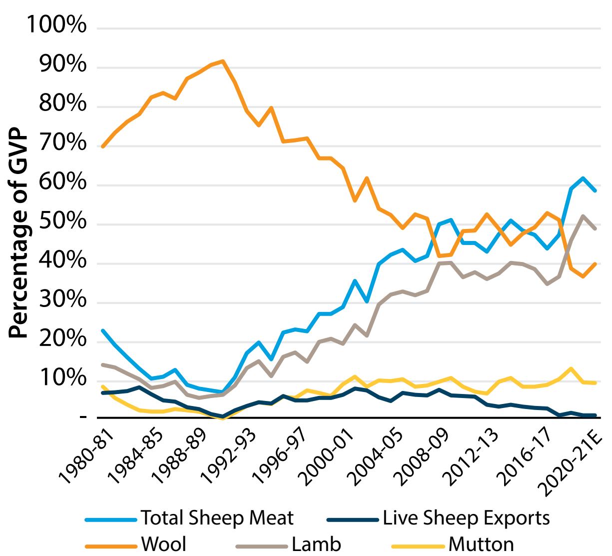
Source: ABARES, ANZ

Clearly, the sheep producers who are paying these prices have calculated that the returns in the industry going forward, both from meat and wool, will justify these investments.

Importantly, it is also clear that the high prices being paid for ewes are not uniform across all categories, and that for the middle and lower ends of the market, there has recently been a softening in price. While this could be interpreted as parts of the market returning to prices closer to the long term average, it could also indicate the growing gap between some of the larger players in the sheep industry and many of the traditionally sized farms.

Looking into the coming months, lamb exporters will be hoping for a recovery from the decline in export volumes over the past few months. In particular, exports to the US have been down almost 10 per cent on the previous year. In contrast, New Zealand lamb exports to the US have almost doubled in recent months. Looking at the different variables behind this, one major difference between the lamb from both countries is cost. Combining the high saleyard price of Australian sheep with the recent unexpected strong rise in the value of the Australian Dollar to the US dollar, the current price of Australian lamb is well above that of its NZ competitors to the American importer.

LAMB OVERTAKES WOOL AS PERCENTAGE OF SHEEP INDUSTRY GROSS VALUE OF PRODUCTION



Source: ABARES, ANZ

On one hand, the change in export volumes is a reminder that to a degree, lamb remains a premium product, rather than a staple one, so will be more vulnerable to change. That said, the fact that demand for NZ lamb has remained strong is a reassuring sign of ongoing demand, albeit impacted by price. Interestingly, mutton exports have remained strong over the same period, potentially due to a lack of competition from NZ.

WOOL INSIGHTS

OVERVIEW

+ Wool prices continue to strengthen when supply tightens
+ The reduction of wool as a share of overall sheep production value makes oversupply less likely
+ Finer wool continues to enjoy price premiums

- Record volumes of some wool types could dampen prices
- Coarser wool prices continue to stay low
- Fine wool prices have fallen in late 2021

As the Australian wool market heads toward the end of the year, it has continued to see the same level of volatility to which its participants have become quite accustomed to over the years.

More than perhaps any other major Australian agri commodity market, the wool selling system continues to find itself in a "chicken and egg" situation. That is, supply continues to impact price, which reverses shortly after. As the market is seeing right now, when wool supply is tight, prices are pushed upwards. As a result, more woolgrowers enter the market to capitalise on these high prices, and the increased supply sees prices fall again. And by and large, the cycle continues.

DIVERGENCE IN PRICES ACROSS THE MICRON RANGE DRIVEN BY PREMIUMS FOR FINER WOOLS

One factor of the wool market which has increasingly stood out over 2021 has been the divergence in prices across the micron range. For example, it is notable that over the past 18 months prices for fine wool had risen so quickly that 18.5 micron was 40 per cent higher than 20-micron wool by mid-October, although the margin had shrunk by mid-November.

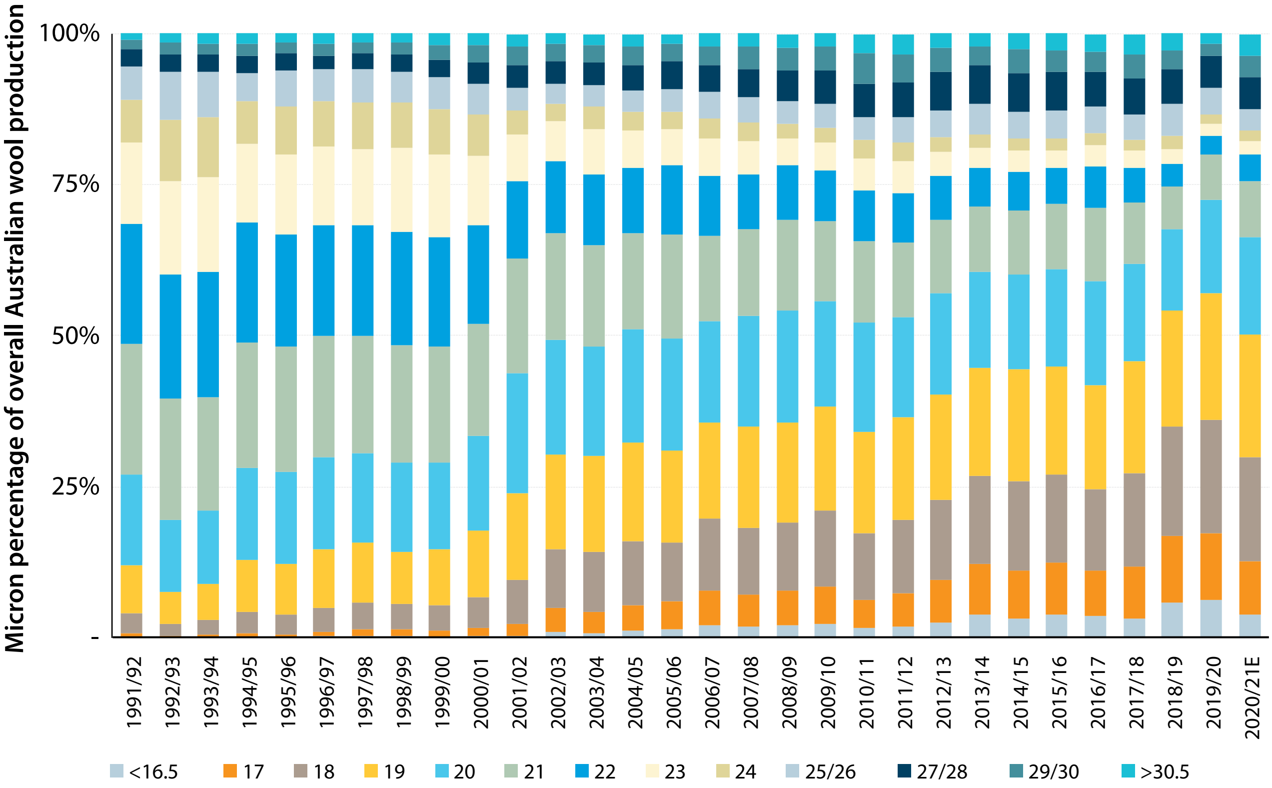
Looking ahead over coming months, the specific levels of demand from different wool-users will continue to have a major impact on price. For example, if fine wool demand declines markedly, the market could find itself in a position where medium micron wool exceeds it in price. This could also potentially occur if the market sees a strong growth in the supply of fine wool, a scenario which would be frustrating for producers who had worked hard to achieve this particular micron range.

Given that the period from July to October in 2021 saw record volumes of fine wool hit the market, it is likely that this could continue to grow in its share of overall wool production, dampening the potential for strong price rises for some time.

At the other end of the micron scale, crossbred wool prices are still struggling. Once again, supply is the issue. In particular, the market is seeing large volumes of wool over 26.5 microns, while volumes over 30.5 micron are at decade highs.

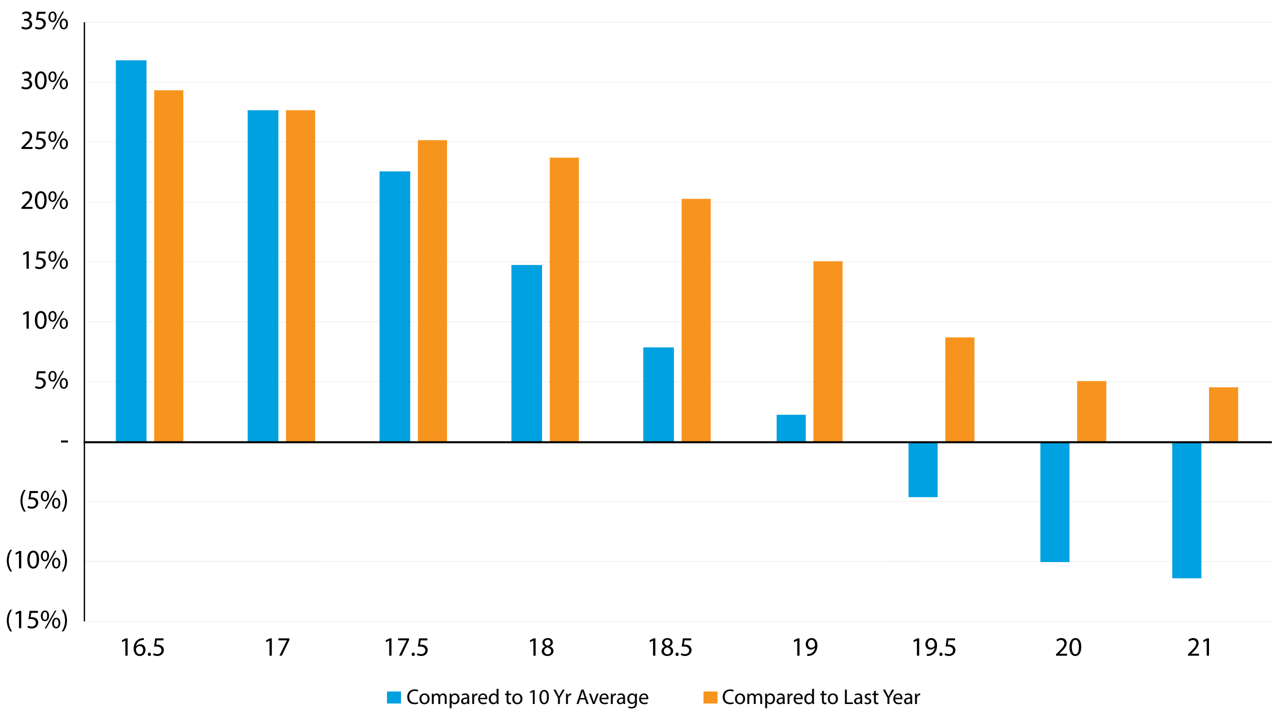
Looking ahead, the strong trends in demand for sheep meat could be one factor which will provide some balance to the market. If lamb demand continues at the current rate, as well as export demand for mutton, then the market is unlikely to see an oversupply of wool any time soon.

AUSTRALIAN WOOL PRODUCTION REFLECTS INCREASING DEMAND FOR FINER MICRON WOOL



Source: Australian Wool Innovation, ANZ

AUSTRALIAN WOOL PRICE COMPARISON BY MICRON



Source: Australian Wool Exchange, ANZ

DAIRY INSIGHTS

OVERVIEW

+ A strong increase in global prices is supporting increased returns to the farmgate across many of the nation's dairy farmers
+ Good rain across spring in the dairy producing areas should support a strong growing season as weather turns warmer
+ Strong demand from China for dairy imports is supporting global demand and prices

- Domestic production is currently down, year-on-year, as a result of the cold, wet spring
- An expected return to stronger production in both Australia and New Zealand as the weather warms up is likely to keep further price rises in check
- Competition for alternative uses for dairy farm land continues to impact supply

Australian dairy producers are approaching Christmas with a sense of renewed optimism – increasing global prices and local price stepups, a good grass and feed growing season and a strong demand for Australian milk production are all putting the spring in a dairy farmer's step.

Poor growth in global production has provided a boost to global prices, while increased demand for butter and cheese has meant that global prices have been on the rise since late August. Despite this strong position, some are arguing that prices are likely to fade in the new year, as production returns to normal and processors try to regain some margin.

GLOBAL PRICES CLIMBING INTO CHRISTMAS

After a relatively subdued period in mid 2021, global dairy prices have been on a run since August with the Global Dairy Trade (GDT) auctions posting another increase of 1.9 per cent in the most recent auction. This brings the average dairy product price up to $US4,287/MT – bringing the GDT index up to almost on par with March 2021, which was itself a price not seen since 2014. Increases in prices came across the board, with the strongest gains being made in butter (3.5 per cent), cheese (2.2 per cent), whole milk powder (1.9 per cent) and skim milk powder (1.4 per cent). The auction saw the largest tonnage sold for the year, with strong buyer participation.

Strong global prices and steady increases have been replicated in the European Union and United States, as poor production flows through. Globally, European production has been weather impacted, while China's domestic production and US production were constrained by high feed costs and limited feed availability. Production in New Zealand and the Australian southern states has also been impacted by a cold, wet spring. Throughout the middle of the year, production was particularly strong in the EU and US which, in part, explained the slight mid-year slump in global prices.

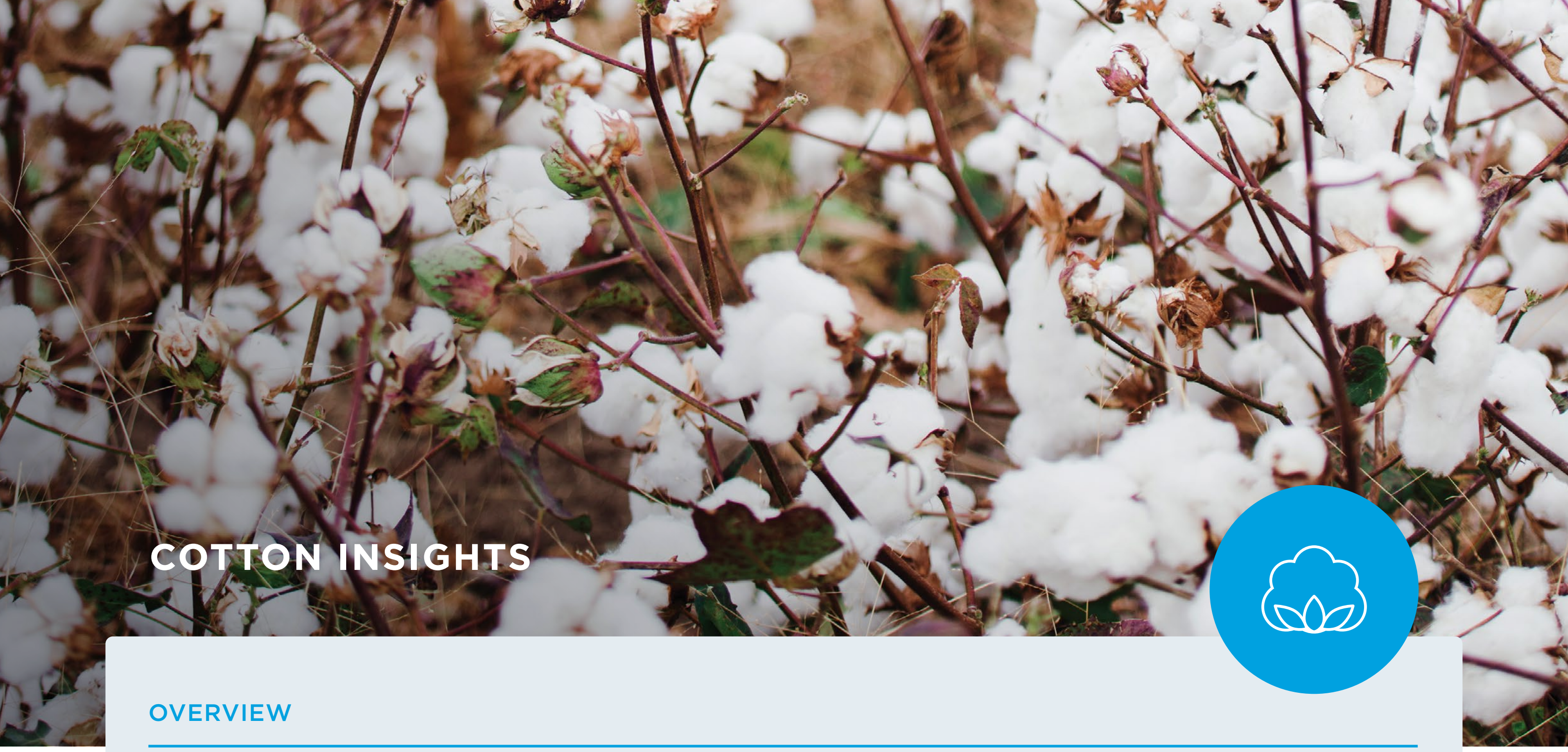
In the medium to longer-term, global production is likely to remain relatively stable presuming normal seasons meaning that global prices are also expected to remain relatively flat. In support of this trend, there have been increases in farm gate prices from many corners of the globe, including Ireland, Australia and with the expectation of further farmgate prices in New Zealand.

CHINESE IMPORT DEMAND DRIVING THE MARKET

China's demand for dairy imports continues to drive global prices and demand – having taken a significant amount of the increased global production through the middle of the year as increased imports. While imports to China cooled slightly in the third quarter of 2021, as imports appeared to outpace consumption for the first half of the year, exports to China remain up 27 per cent on this time last year. Chinese demand is being driven by a number of factors, including the domestic promotion of the health benefits of dairy, as well as the strong rebound of the Chinese economy following Covid. While Australian exports to China fell 28 per cent in the third quarter of 2021, that shift was mirrored across most major export markets except Indonesia and are reflective of a drop off in local production.

DOMESTIC PRODUCTION DOWN DUE TO COLD, WET SPRING

Australian milk production is down over 3 per cent year-to-date to September. This is primarily due to low dairy herd numbers, as well as a cold, wet spring to date which has constrained pasture growth. Unsurprisingly, the greatest drops in production have been in Tasmania (8.8 per cent) and Victoria (4.4 per cent), however year-to-date, production is also down in all other States except New South Wales. The wet early spring however does bode well for a good late spring with good soil moisture setting up strong growth once the warmer weather arrives.



COTTON INSIGHTS

OVERVIEW

+ Consumer demand increasing as key economies lift restrictions
+ Cotton prices reach highest level in 10 years
+ Wet seasonal conditions continue for the Murray Darling Basin allowing increased cotton planting

- Increases in cost of doing business due to labour and freight shortages
- Exporters struggling to find freight capacity restricting supply
- Chinese restrictions on Australian cotton imports forcing producers to seek alternate markets

Good seasonal conditions appear ready to settle in for another wet season as the Bureau of Meteorolgy confirms another La Niña. This, along with improved global economic conditions brings good news for Australian cotton farmers particularly in the Murray Darling Basin (MDB).

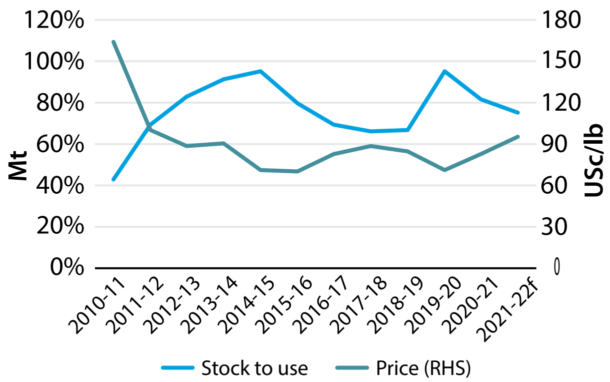
The global economic recovery is expected to continue throughout 2021–22, with major economies reaching targeted vaccination rates however, the announcement of a new Covid variant, OMICRON has put somewhat of a dampener on expectations.

While demand is still expected to recover, increased costs of doing business due to labour shortages and supply chain delays has limited the movement of freight around the world, further limiting supply. And by way of a reminder to buyers that cotton is an agricultural commodity, drought has also impacted supply from some key producers, including the US.

The supply constraints along with increased demand is expected to see cotton prices increase 14 per cent in 2021-22 to an average US95 cents per pound, the highest level in 10 years.

Global production is expected to increase by 5% on 2020–21 levels but will not be enough to offset increased demand with the global stocks-to-use ratio expected to decrease to 75%, the lowest since 2018–19.

COTTON PRICE RISING AS STOCK TO USE DROPS



Source: ABARES, ANZ

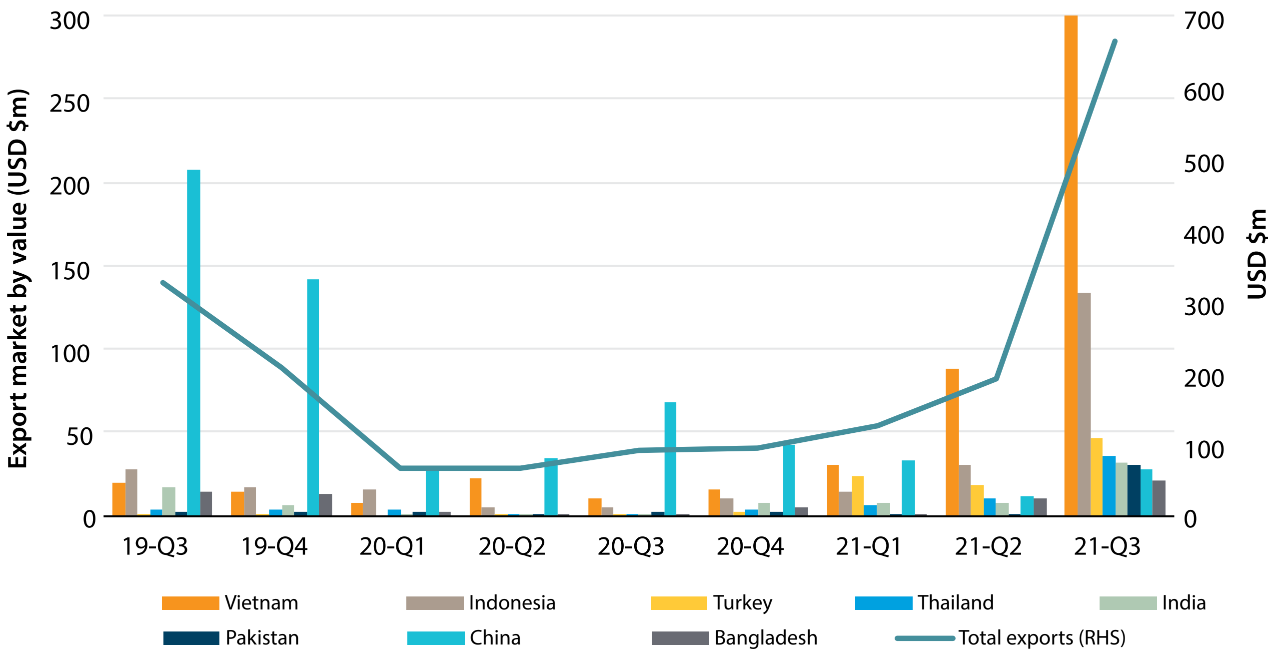
The Australian cotton crop is expected to reach 1,044 kt (4.6 million bales) in 2021–22, a 72 per cent increase on 2020–21. The wet conditions across the MDB have lead to increased planting of irrigated cotton for the upcoming season.

With significant rainfall events set to continue this year, New South Wales cotton farmers have supported a proposed government initiative to relinquish approximately one third of their floodplain harvesting allocations in a bid to improve river flows and ecosystems downstream.

Cotton Australia calculates that floodplain harvesting for irrigation in NSW accounts for just three per cent of water during a flood event, however, the support for the program reflects farmers commitment to positive environmental outcomes.

While the MDB accounts for around 91 per cent of Australia's total cotton farms and cotton area (ABS 2016) the unpredictable nature of cropping in the region has led to some cotton farmers venturing north to seek out more secure rainfall in central and north Australia. While it's still early days, a new cotton gin at Tarwoo Station, outside Katherine in the Northern Territory, is on track to become operational within the coming months.

AUSTRALIAN COTTON EXPORTERS FINDING NEW MARKETS IN 2021



Source: TradeMap, ANZ

Following reports of the Chinese government discouraging importers from buying Australian cotton in October 2020, Australian exports to China have declined steadily. With China being the largest processor of raw cotton, the dislocation has been a challenge for the Australian cotton industry. However, as cotton exports from the United States picked up demand from China, Australian cotton has been able to find alternative processing countries vacated by the United States.

In the first three quarters of 2021 Australian cotton exports have increased to Vietnam, India and Turkey. While Australian cotton exports to non-Chinese markets are expected to increase further, shipping costs continue to be a problem with challenges for exporters finding shipping capacity.

WINE INSIGHTS

OVERVIEW

+ The opening up of restaurants and pubs after Covid restrictions will boost wine consumption
+ Australian wine exports are seeing strong growth in markets, including the UK and Hong Kong
+ The boost in domestic tourism could increase sales at wineries

- The high Chinese tariffs and extended trade ban may not see Australian wines enter that market for at least five years
- The reduction in exports may lead to a domestic oversupply
- The impact on the supply chain could see wine companies reassess grape contracts

For the Australian wine industry, the combination of the lifting of Covid restrictions, combined with the onset of the festive season and the summer holidays couldn't have come at a better time. While Australians have certainly consumed wine at home during the various lockdowns, the reopening of pubs and restaurants, as well as the resumption of social gatherings, will provide a welcome stimulus to the sector.

THE AUSTRALIAN WINE SECTOR HAS FACED A UNIQUE ARRAY OF CHALLENGES OVER THE PAST YEAR, AND THE RELAXATION OF RESTRICTIONS WILL MAKE THINGS EASIER.

Undoubtedly the most high-profile challenge to the Australia wine industry over the past year has been the impact of China's wine tariffs of up to 220 per cent. While the tariffs were first introduced in November 2020, China confirmed in March 2021 that they would apply for five years. Since that time, Australia had sought to have the matter examined in the World Trade Organisation (WTO). While the first request for examination was blocked by China in September 2021, the WTO agreed in November that the matter would be looked at.

The impact of the tariffs has continued to be stark. In the six months to June 2021, Australia exported $13 million worth of wine to China, compared to around $490 million over the same period in the previous year. Notably, away from China, exports actually increased by 12 per cent over that period to $1.96 billion. This included strong growth in exports to the UK, Singapore, South Korea, Malaysia, Taiwan and Thailand, while most notably exports to Hong Kong rose by 111 per cent to $187 million, making it the fourth largest market for Australian wines.

Overall, an indicator of the quality of wines now not being shipped to China came from recent Wine Australia figures showing that in the 12 months to September 2021, while the overall volume of wine exports was down 17 per cent to 638 million litres, the value of exports fell by 24 per cent to $2.27 billion.

Adding to that was the results of an ABARES report in July 2021, which calculated that the Chinese tariffs would mean Australian wine production in 2025 would be $480 million below what it would have been, as a result of reduced production and expected lower average prices.

RECORD HARVEST FOR AUSTRALIAN WINE

Domestically, a major impact of these tariffs on the Australian market may yet to be seen. For a start, 2021 saw Australia produce a record harvest of 2.03 million tonnes. While this would normally have been a positive outcome for the industry, in a year when so much wine has not been able to be exported, it may well lead to an oversupply for at least a year ahead. In addition, of the record 2021 vintage, around 57 per cent was red grapes, which has led to the largest red wine production in 10 years. Given that around 95 per cent Chinese imports of Australian wine had been red, this could further create the potential for oversupply.

This could cause further repercussions along the wine supply chain. For example, the high stocks could mean that wine companies reassess their grape contracts in the coming year. At a retail level, there may well be strong discounting to move stock, not only from wine companies, but by larger retailers and supermarkets, looking to take advantage of cheaper wine to boost their own labels.

More broadly, as well as the short-term changes from the Covid-related shutdowns and disruptions, the Australian wine consumption market continues to evolve, as does consumer behaviour. Overall, it would appear that the number of wine drinkers in the Australian population is actually falling. Between 2010 and 2020, the number of weekly wine drinkers in Australia fell from 8.5 million to 7 million. As a percentage of the total population, the decline is even more stark, falling from 50 per cent of the population to 38 per cent. Interestingly, the number of people drinking alcohol of any kind regularly has continued to decline, with the percentage of the population consuming beer falling even faster than wine. In line with a number of trends across the food and beverage landscape, many consumers are moving towards what they perceive as healthier diets, with many seeing reduced alcohol consumption as part of this.

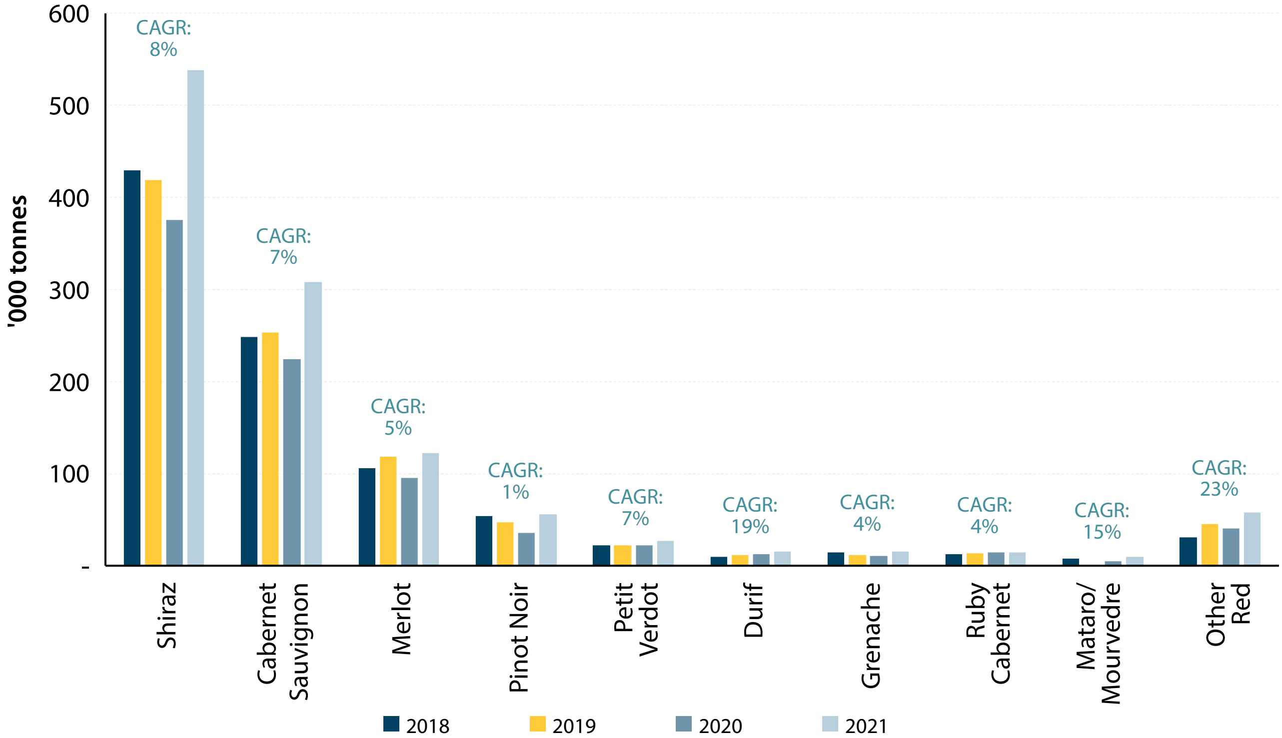
The impacts of Covid have played out across the wine sector in different ways. In terms of retail sales, Australian Bureau of Statistics (ABS) data of all liquor retailers shows that sales surged at the start of the Covid disruptions in early 2020, and by May 2020 were up 40 per cent on what they had been at the start of the year. Interestingly, after liquor store sales trended downwards over the following 12 months, they climbed again in the third quarter of 2021. This may well reflect consumer fatigue with the ongoing effects of lockdowns, particularly in Melbourne and Sydney.

In terms of wine varieties in Australia, while some names have seen recent strong growth, the traditional ones still dominate. For red wines, Shiraz and Cabernet Sauvignon still dominate the crush. Both have seen strong growth rates over the past four years, which is likely to have been driven by long term planning for expected Chinese imports.

For white wines, Chardonnay remains by far the largest varietal in the crush, around four times the size of the two next largest names, Sauvignon Blanc and Pinot Gris/Grigio. Of the white varieties, the most spectacular growth has been by Prosecco, with a compound annual growth rate of 31 per cent over the past four years.

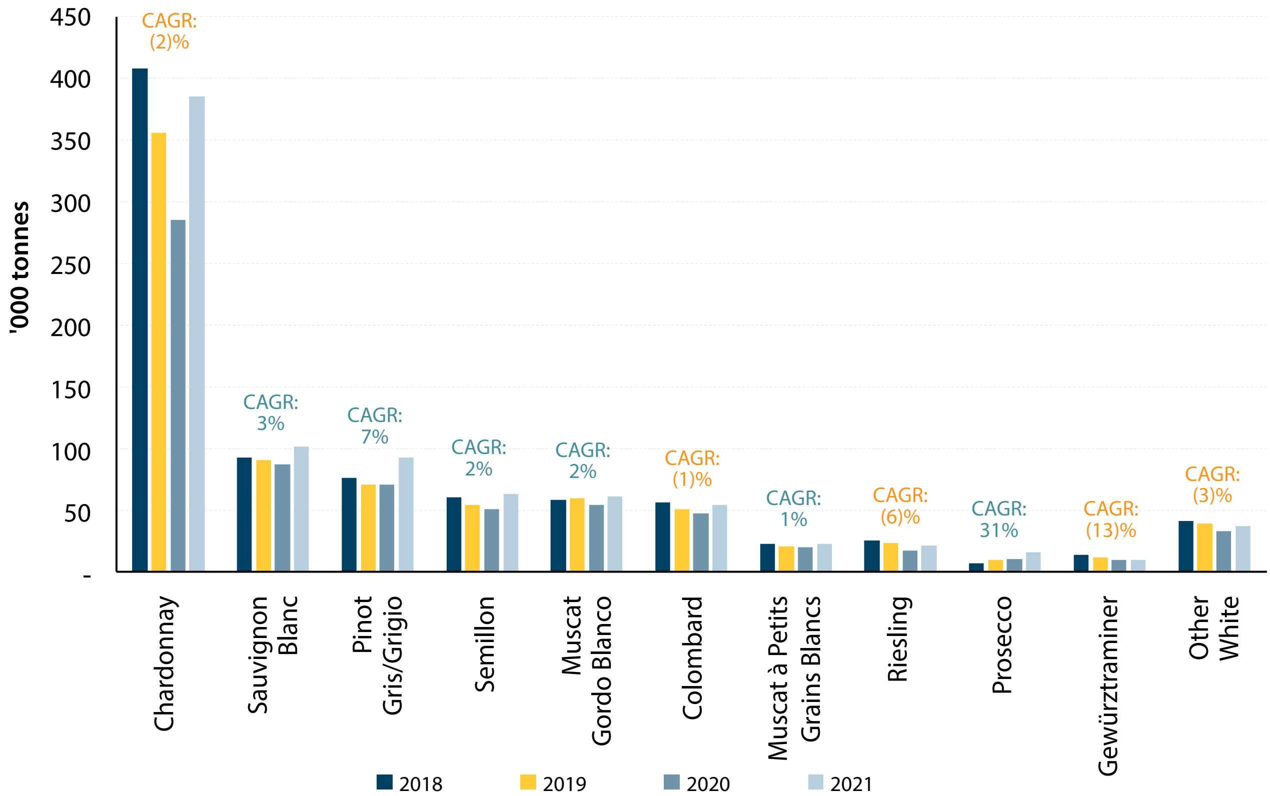
Planning ahead, the Australian wine industry will continue to look for ways to balance the fall-out of the Chinese wine tariffs, while maximising on the opportunities in the domestic market. One major opportunity could well come as a result of the expected boom in domestic tourism, as many Australians continue to focus on holidaying at home, rather than heading overseas again. As part of this, many wineries and wine growing regions across the country will look to attract tourists to experience not just good wines, but fine food and accommodation, as well as retaining the loyalty of these customers when they return home.

TOP RED WINE VARIETIES IN AUSTRALIA BY TONNAGE



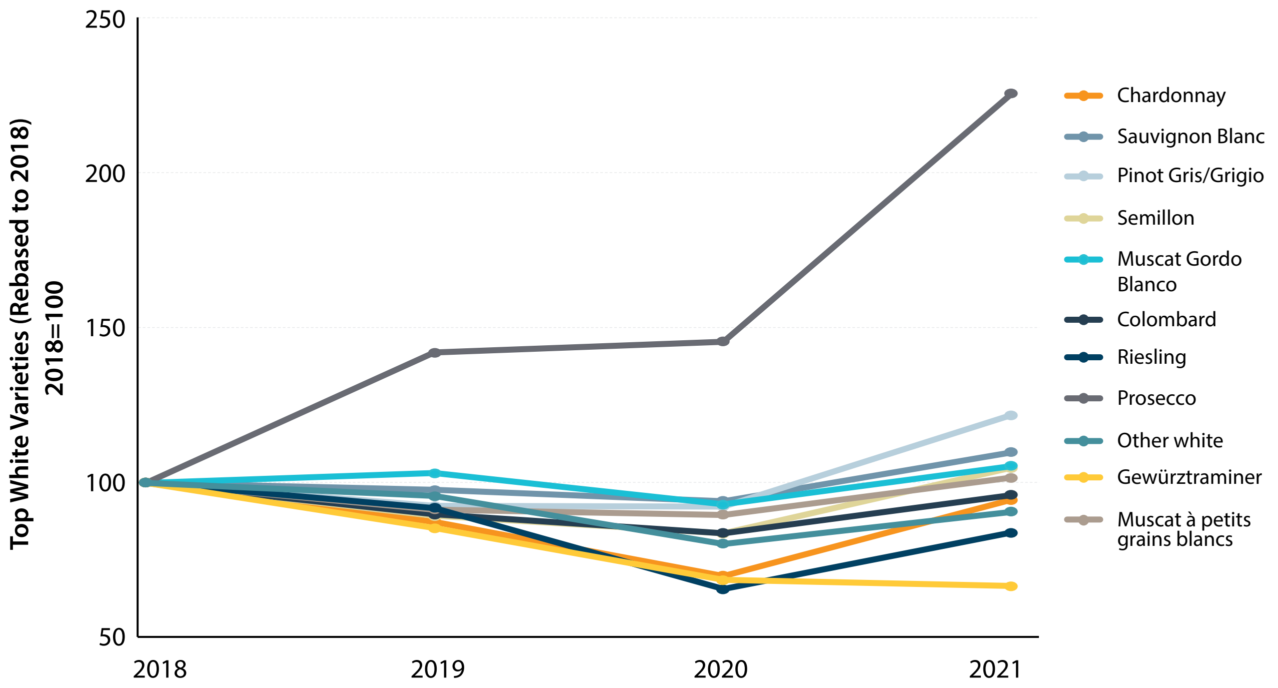
Sources: National Vintage Report - 2021, 2020, 2019, 2018, ANZ

TOP WHITE WINE VARIETIES IN AUSTRALIA BY TONNAGE



Sources: National Vintage Report - 2021, 2020, 2019, 2018, ANZ

AUSTRALIAN WHITE WINE VARIETIES COMPARATIVE TONNAGE GROWTH 2018 - 2021



Sources: National Vintage Report - 2021, 2020, 2019, 2018, ANZ

HORTICULTURE INSIGHTS

ARE INCREASING FOOD PRICES THE NEW NORM?

+ A strong production season, particularly in Northern Australia, has seen abundant supply across a number of crops
+ New access protocols for Australian citrus to the United States is likely to help support exports
+ Retail food prices have shown strong elasticity for increases stemming from increasing labour costs – particularly for vegetable prices

- Labour shortages continue to plague many horticulture producers, narrowing the profit margins for labour-intensive crops
- A relatively mild winter is expected to lead to an increase in fruit fly, particularly in northern Victoria
- Rain and storm events have significantly damaged crops across horticulture producing areas

Its been a bumpy two years for the horticulture industry, as one of the limited number of agriculture industries to face real hurdles as a result of global COVID lockdowns. In northern Australia, favourable growing conditions throughout winter and spring have set the scene for a strong season, while rains across southern Australia also bode for generally good production. However very strong seasons for some fruits, particularly strawberries and avocados, have seen supermarket shelf prices fall. While labour shortage issues look set to persist for the time being, many growers are asking whether higher retail prices can cover the increased costs?

The Australian horticulture industry has faced more challenges than most agricultural sectors over the past two years. The seasonal worker shortage has been the topic of most attention, as the Federal Government's agricultural visa scheme has sought to provide a greater inflow of workers. Global freight shortages, and in particular refrigerated, both sea and air-based have also impacted the ability of Australian producers to export a range of fruit products, as well as increasing the cost of many cheaper fruit and vegetable products imported into Australia.

Seasonally, 2021/22 is shaping up to be a strong year for production in a range of commodities. Recent rain and hail events have impacted some production areas, particularly in South Australia and the Lachlan Valley in New South Wales , although the full impact is not yet certain. At the same time, a mild winter is expected to lead to increase fruit fly numbers in Victoria and while the State Government has allocated funding towards management, fruit fly is still expected to impact production.

FRUIT

With **mango** production ramping up in northern Australia, total forecast production is expected to be up on last year's results, despite production in Darwin coming in under forecast. A forecast increase in Australian **table grape** production driven by good season and increased interest in the industry, will see production hit 210,000Mt. **Avocado** production has surged in both Australia and New Zealand, with many producers now stating that they are selling produce for under production value. A combination of factors including lockdowns and the decline of 'avo toast' consumption, ongoing inability to export to China and shipping shortages across the supply chain have combined with a production increase of 65 per cent in the year following years of drought, increased imports from New Zealand and massive domestic plantings. **Citrus** growers looking to expand their export markets in the face of a decline in exports to China have been cheered by the decision of the United States to allow exports for more areas of Australia to export to the US.

NUTS

Almond and **macadamia** producers are expecting a strong season as a lack of almond supply from California had boosted prices – however recent rains in California is likely to see prices return to normal in the new year. As the second largest global almond producer, Australian almond production and new plantings continues to grow at pace, however South Australian production areas were hit hard by recent rain and hail events which will impact production.

VEGETABLES

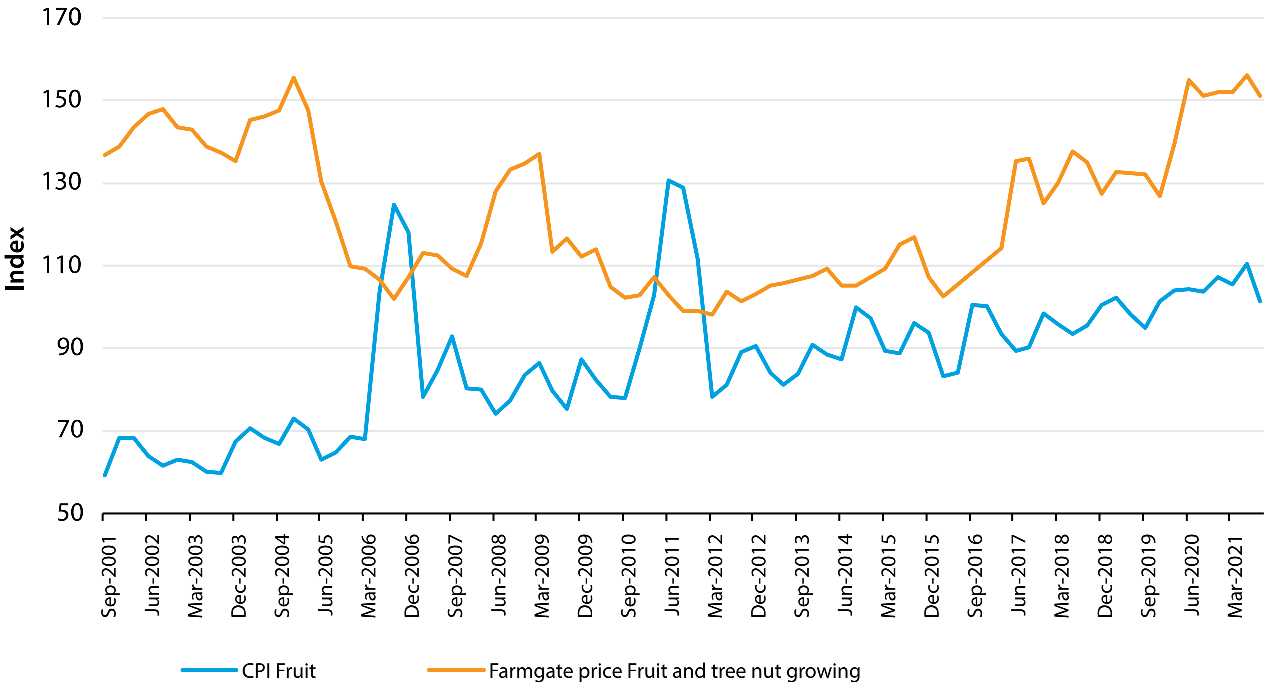
Vegetable producers around Adelaide, the Barossa Valley and Adelaide Hills regions were impacted by recent storms. Lettuce, tomato, cucumber, and zucchini crops were hard hit by rain, hail and strong wind with some growers reporting up to 70 per cent of their crops suffering damage. High labour costs are also pushing the price of many vegetables such as **broccoli** and **tomatoes** which have seen their prices spike to levels usually seen in drought years. **Onion** and **potato** producers are experiencing export difficulties due to shipping shortages, as well as a fall in demand from restaurant closures during lockdown, while Tasmanian potato growers have reported the worst planting season in a number of decades as wet weather and rising fertiliser prices restrict plantings.

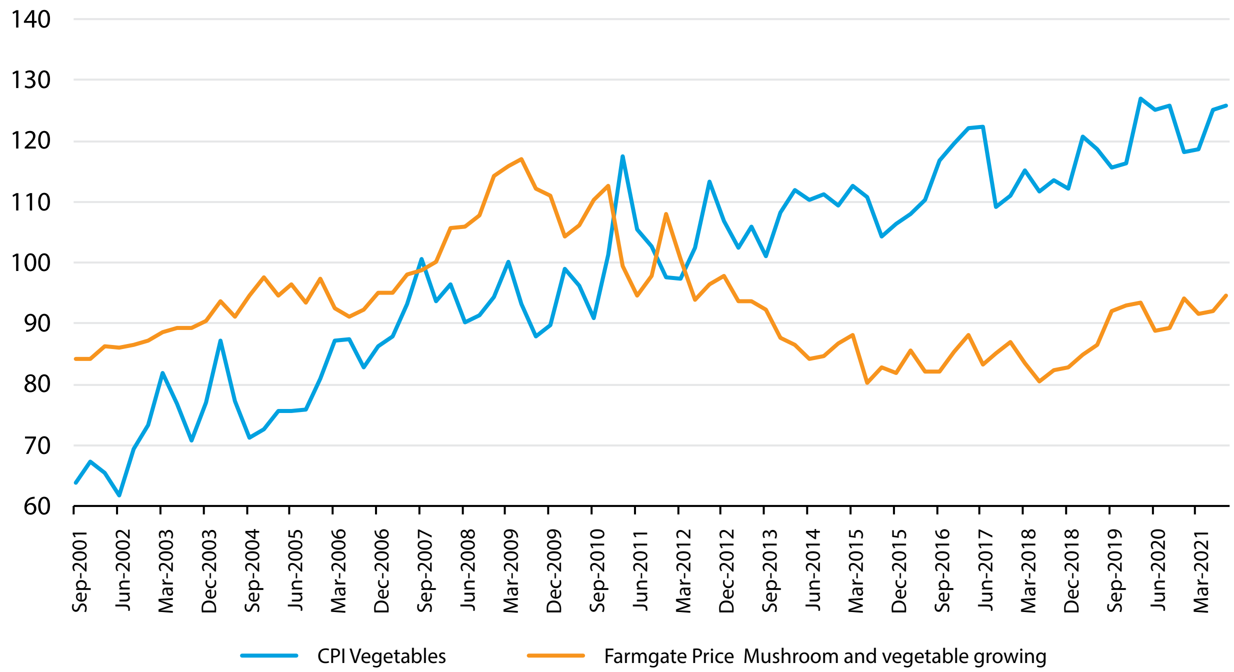
RETAIL FRUIT AND VEGETABLE PRICES

Increasing fruit and vegetable prices has been seen throughout the COVID period, with both sectors reflecting an increase in labour costs associated with labour shortages. Indeed, since just prior to COVID's advent in 2020, retail vegetable prices have increased by over 8 per cent – while fruit prices have actually fallen slightly, despite some quarter to quarter volatility. In comparison the prices of fruit as an input to manufacturing has risen by almost 20 per cent in the same period, and vegetable prices have risen only 2 per cent. While manufacturing input prices are not a direct indicator of farmgate prices, and will also reflect a lack of cheaper imports, it does provide a rough guide to what prices farmers are receiving.

Labour shortages and abundant harvests for some crops has seen some producer's profit margins eroded. As a result, some producers are complaining that constraints on retail prices have pushed producer's profit margin to unsustainable levels. While supermarket prices obviously fluctuate from week to week, it appears that large increases in retail vegetable prices have not been reflected in returns to the farmgate. Concerns over the drop in avocado prices, combined with the number of new trees being planted has also raised the possibility of over supply issues.

FRUIT AND VEGETABLE PRICES: RETAIL VERSUS FARMGATE PRICE





Source: ABS, ANZ

AUSTRALIAN ECONOMIC INSIGHTS

2022 will build on the promising post-Delta recovery

HOUSEHOLDS RESPONDED STRONGLY TO THE REOPENING

Within only a few weeks of the reopening of retail across Sydney and Melbourne, national ANZ-observed spending had returned to pre-Delta levels. Spending in Victoria on non-food retailing outperformed once retail reopened, and NSW spending across shopping and dining normalised almost immediately. This signals that locked-down residents were not shy about returning to at least their pre-Delta level of discretionary purchases. Travel and entertainment spending is still lagging the recovery nationally, but all other broad categories are similar to pre-Delta levels of spending. Consumer confidence about the future of the economy has also come most of the way back from its Delta lockdown lull.

ECONOMY TO BOUNCE BACK QUICKLY AFTER THE DELTA DIP

We expect GDP to improve in Q4 after a Q3 dip due to lockdowns. Business confidence has already bounced from its Delta lows and capital expenditure plans are stronger than previous years. Household balance sheets have been resilient over the course of 2021, and high COVID lockdown savings should translate into stronger consumption growth next year. Over the course of 2022 we expect GDP to expand by around 4.8% y/y.

TRADE TO REVERT FROM RECORD LEVELS NEXT YEAR

The strength in commodity prices through 2021 has helped push Australia's trade balance to record levels. However, declining commodity prices expected over the next year will see the trade surplus narrow to a still-strong position in 2022 and 2023 in our view. The risks to this outlook are tilted to the downside.

WAGE GROWTH STILL MODEST, BUT LIKELY TO ACCELERATE NEXT YEAR

The wage price index (WPI) rose 0.6% q/q in Q3, bringing annual growth to 2.2%. It's still too early to see wage prints in Australia as strong as those in New Zealand, let alone the US. Overall, businesses aren't yet responding to labour constraints by lifting wages faster than pre-pandemic rates. A Melbourne Institute survey shows Australian households continue to report weak actual wages growth and we haven't yet seen a 'Great Resignation' here to put upward pressure on wages. We still think next year is when wages growth will really accelerate, reaching 3% y/y by H2 2022, triggering the RBA to hike rates from H1 2023.

BORROWING COSTS ARE RISING

While we think the RBA is unlikely to raise the cash rate until 2023, borrowing costs will still rise over the course of next year. We expect the RBA to end their quantitative easing program by May next year, which will reduce the flow of liquidity into financial markets, and make it less cheap to lend money. Funding costs for two-year and three-year fixed loans have already started to rise, and any household or business that locked in a rate last year for a loan is unlikely to get a similar rate when those fixed rates roll over from next year. This will lower borrowing capacity and increase servicing costs for some households and businesses.

HOUSING PRICES TO SLOW IN 2022 AND FALL IN 2023

The 20%-plus gains in house prices over the past year won't, in our view, be repeated in 2022. Affordability constraints are biting, new listings have lifted strongly, and macroprudential tightening and higher fixed mortgage rates are set to constrain lending over the coming year. While a return to immigration in 2022 will be a plus, these negatives are likely to more than offset that positive. We expect average capital city housing prices to rise just over 6% in 2022, and to decline around 4% in 2023. Rate hikes from the RBA would contribute to the downward force on the housing market.

RECENT DATA HIGHLIGHT SURPRISING ECONOMIC RESILIENCE DESPITE THE LOCKDOWNS.

Consumer confidence fell in the early weeks of the current lockdown, but is picking up as prospects for reopening become more certain. Business conditions have already lifted from the lows in July and are above their long-run average, even in locked-down NSW and Victoria. Moreover, ANZ Job Ads has declined by less than 7% over the past three months, compared with a 64% decline in the first shutdown last year. All this suggests businesses and households are confident about the outlook and are likely to resume spending once mobility restrictions lift.

TRADE HAS ALSO BEEN RESILIENT

Australia's trade balance surged to a new record high in August, surprising us and the market as exports rose sharply. A very strong lift in coal and LNG exports more than offset a sharp decline in iron ore exports. The recent strength in rural exports continued in August, with exports up 11% m/m. This reflected rises across the board, in particular from cereal grains (up 17% m/m) and wool and sheepskins (up 59% m/m). We now expect the AUD to average 0.75 USD over 2022, which should continue to support our export competitiveness.

FISCAL SUPPORT IS HELPING ECONOMIC GROWTH AND INVESTMENT

The federal government's temporary full-expensing scheme is helping support strong growth in machinery/equipment investment, while there is a large pipeline of major projects construction on both the private and public side. There is a strong chance of further fiscal stimulus in coming months to cement the rebound.

EMPLOYMENT AND ECONOMIC ACTIVITY ARE LIKELY TO REBOUND

With NSW and Victoria's roadmaps for reopening in mind, we expect spending to rebound solidly in Q4. The unemployment rate is likely to rise, from 4.6% in Q3 to 5.2% in Q4 (quarterly averages), as people recommence active searches for work. From there, we think unemployment will drop to 4.3% by the end of 2022.

When we broaden the outlook to total economic activity, we expect 1.4% y/y growth through 2021. We then see growth rebounding strongly to 4.8% y/y over 2022, as the economy reopens and movement restrictions become less frequent and intense.

THE EMPLOYMENT REBOUND WILL ULTIMATELY HELP WAGES GROWTH, BUT INFLATION IS STILL A WHILE AWAY

The rebound will likely see a swift return to the pre-lockdown situation where businesses were having substantial difficulty finding enough suitable labour. Underemployment should fall back to its pre-lockdown mark and hopefully further in 2022. This will ultimately help lift wages growth and inflation.

But it'll be a slow road. With annual wages growth not expected to get to 3% until late 2023, we expect underlying inflation to reach only a little above 2% by end-2023. Given this and the RBA's caution on moving the cash rate, monetary policy is set to remain stimulatory for some time, and we expect the cash rate to sit at 0.1% until 2024. Bond purchases are set to continue until August 2022.

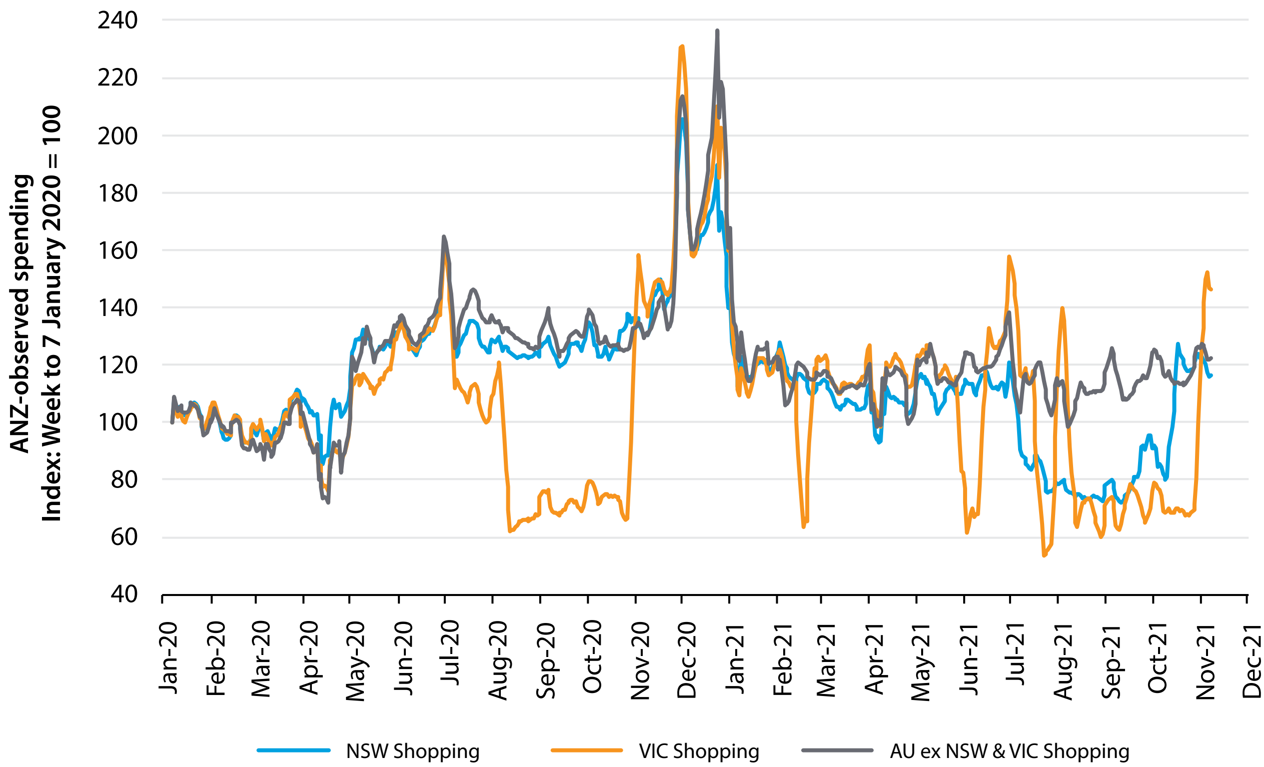
THE RISKS TO THE OUTLOOK ARE CONSIDERABLE

What could make things worse than we expect? In short: more COVID. The possibility of a more virulent strain that prompts further shutdowns would hit our GDP and employment growth forecasts.

What could make things rebound more than we expect? Spending could outpace our expectation, reflecting pent up demand and improving confidence, and the risk that inflationary pressures emerge earlier than we are currently forecasting.

WORKERS ARE DIFFICULT TO FIND AND WAGES ARE LIKELY TO ACCELERATE IN 2022

NSW AND VIC DISCRETIONARY SPENDING BOUNCED BACK AFTER LOCKDOWNS



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