Agribusiness Outlook 2022 - Australia

Making Hay While the Sun Shines

February 2022

RaboResearch
Food & Agribusiness

Rabobank

Making More Hay While the Sun Still Shines Brightly

Australian agriculture is on track for a fourth consecutive year of increasing gross value of production in 2021/22 after a year of high, in many cases record, commodity prices and production recovery, to record volumes in some instances. This represents a recovery from the 2017-2019 drought and the realisation of a 'once in a blue moon' year for Australian agriculture in 2021.

Very strong agricultural pricing in 2021 came as a result of hardship globally. Drought and adverse weather in key cropping regions, strong stockpiling demand in the face of potential food shortages, and Covid-induced labour shortages in more intensively produced agri products (such as horticulture and dairy) and transport challenges delivered clouds to agriculture sectors in many regions of the world and a silver lining for Australian agriculture.

A second straight year of increasing pricing coincided with favourable to very favourable Australian production conditions again. For those sectors where production has been lower, high pricing still delivered strongly profitable positions. Australian farmers have been able to make hay while the sun shines.

Hay-making opportunities will be less pronounced in 2022.

We start 2022 with the Australian food supply chain under ***unprecedented*** pressure. Supply chain disruption and bottlenecks are being felt across the board, from access to inputs at the farm level through to consumers accessing food on supermarket shelves. The role of global forces and local Covid-spread means impacts will linger at least through Q1 2022.

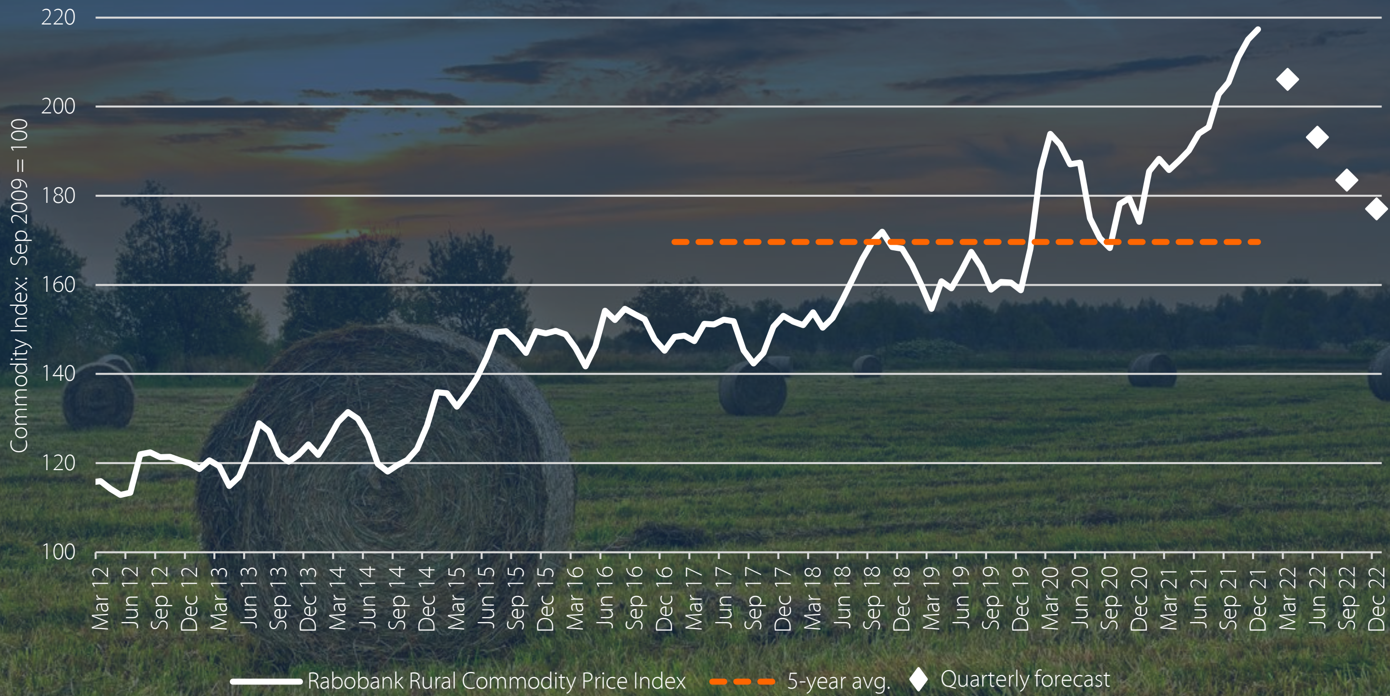
We also expect some of the heat to come out of a range of commodity prices in 2022 as supplies are renewed globally, higher stock levels are realised, and demand tempers. However, we expect prices to fall in calendar year 2022 to levels that are still elevated against, or near to, five-year averages.

The Australian production outlook is mixed but from a high base. Very favourable seasonal conditions in 2021, and in some cases record rainfall, provide a beneficial start to 2022 cropping and pasture prospects due to good soil moisture levels. However, we cannot (yet) expect a repeat of the 2021/22 record grain & oilseed harvest for 2022/23. Still, for livestock, we do expect year-on-year lifts in slaughter numbers for both cattle and sheep in 2022 given the now extended good production conditions in most regions that have enabled some herd and flock rebuilding. Milk production is also likely to lift, but only in 2H 2022, while 2022 cotton production is on track to rise again with an 85% YOY increase.

Movement towards lower pricing over the course of the coming year, mixed year-on-year expectations for production, and supply chain challenges mean we expect a year-on-year decline in farming margins in 2022. Still, we expect another favourable year for Australian agriculture in 2022 to make some more hay.

Still Strong AU Ag Prices, but a Correction From Heights With Lower Global Prices and Good Local Supply

Rabobank Rural Commodity Price Index (Australian dollar based)



Source: Bloomberg, MLA, Rabobank 2022

Note: Index is comprised of local prices for wheat, barley, canola, sorghum, beef, lamb, dairy, wool, sugar, and cotton, expressed in Australian currency and weighted according to their share of the value of production of Australian farmers (using the sum of the value of these products as the denominator).

Ubiquitous Uncertainty in the Face of Rho, Sigma, and Tau

2021 had its challenges, and 2022 will have bumps and headwinds too.

Despite the fact that the world mostly learned to live with Covid and severe and extended lockdowns mostly seem to be a thing of 2020 and 2021, the world is grappling with Omicron surges and the prospect of Rho, Sigma, or Tau delivering the next blow.

On top of this lies the pervasive challenge of inflation, which continues on one of the steepest rises in 30 years, and the ongoing economic burdens of stimulus. We expect global policy tightening designed to moderate demand. However, with the risk of stymying economic recoveries, policymakers will be challenged to find a balance, and that will keep markets guessing.

Still, inflation is not just a demand issue, and supply chain rigidity will be key among the factors that will challenge 2022 markets.

- ***Freight*** – Dry bulk freight rates have fallen considerably from their 11-year highs in 2021, but still remain elevated on several routes. Container rates remain near their recent record highs, and we expect trade execution issues for boxed freight to continue in 2022.
- ***Geopolitics*** – The tight global market for agricultural commodities has shielded Australia from the impact of a changed export relationship with China. As markets unwind, we expect Australia may need to work harder on its diversification into alternative destinations. Meanwhile, we do not exclude the potential for further market fallout from current Ukraine-Russia tensions, which could deliver exaggerated volatility in markets ranging from wheat through to oil and fertiliser.
- ***Farm inputs*** – While some reprieve from high prices is on the horizon, it's more likely in the second half of 2022, meaning a still challenged first half and still elevated prices in the second half.
- ***Labour shortages*** – Labour challenges will persist and spread with Omicron and any subsequent surges. Expanded vaccination and treatment options should reduce labour stress over the year, but labour impacts will be protracted in the supply chains of developing countries where vaccination levels remain low. Locally, the issue will likely taper during 2022, with some foreign labour able to arrive and local workers not as widely impacted by infection or isolation requirements. Upward agricultural sector wage pressure is unlikely to subside.
- ***Vulnerable markets*** – Pandemic risks remain elevated in a number of our export markets. Omicron has yet to surge in some markets where there are low vaccination rates and challenged health systems. In the context of public debt, these markets are vulnerable to downturns that may curtail their import demand.

However, local macro settings remain supportive for Australian agriculture. In particular, we expect the Australian dollar to find only a little strength this year, remaining near its five-year average, and interest rates not to lift until 2H 2022, and then with caution.

Taking Stock and Being Ready for What's Next

Australia's second consecutive year of great pricing and mostly exceptional production conditions in 2021 mean the Australian agriculture industry is well placed to take on the challenges of 2022. More importantly, it means the industry can prepare for the time when the sun is not shining so brightly in its favour, including being ready for…

Margin decline

- The world can produce more than enough food and fibre for its needs. Restocking will occur, global prices will decline, and Australian farm returns will decline.
- Technology and productivity gains elsewhere in the world will continue to be a factor in downward price pressure.
- The Australian farm sector cannot lose sight of the need to be cost competitive and align itself with opportunities to increase efficiency and foster a sustainable production system.

Getting greener

- Commitments to sustainability across countries and supply chains, especially in the wake of COP26, have grown exponentially.
- Decarbonisation and sustainability more broadly will be key features of procurement of agricultural production and operational expectations in the future.
- Moreover, this will mean the need to manage higher energy costs.
- In this Australian federal election year, policy on carbon and sustainability will be front and centre.

Market diversification and new trading relationships

- The tight global markets of 2021 have shielded the Australian agriculture sector from the reduced opportunities to export to China.
- We continue to believe that this will not be a market that readily returns to Australia for supply.
- As global commodity resupply occurs and relative demand eases, we expect Australia to be more vulnerable to lower pricing.
- Diversification and flexibility of farm input supply origin is also a strategy Australia needs to consider.

Drought and climate change

- Drought will return to Australia at some point in the coming years as will other adverse weather events.
- With expectations for these to become more extreme, decisions made in this time of favourable conditions will be instrumental in facing these environmental challenges.

Cheryl Kalisch Gordon
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2022 Commodity Outlooks

Global supply recovery is likely in 2022; therefore, prices are predicted to ease into mid-2022 but remain above the ten-year average.

Prices will remain historically high but lower than 2021 levels. Global supply recovery is anticipated for 2022, but La Niña is already hurting South American crops, which increases the importance of northern hemisphere production volumes.

Canola prices to ease into Q2-Q3 2022 as global oilseed supply constraints improve.
Pulses, especially chickpeas, will continue to feel the impact of container supply chain disruptions.

Prices will contract as supply lifts and producer demand eases, but the market will set a new baseline price, stepping up from the average prices seen prior to 2015.

With increased sheep numbers and good conditions supporting lambing rates, we expect lamb slaughter and production to increase in 2022 but prices to remain strong.

Recovery in suit sales resulting from workers returning to the office will push the Eastern Market Indicator higher in 2022.

Firm pricing across the dairy complex will continue until there is a rebound in the global supply story. The industry is headed for a record-breaking third consecutive season of above-target EBIT.

Tight global stocks mean the market sees ICE #2 trading above USc 90/lb in 2022. Over the course of the year, we expect local prices to fall but remain above AUD 600/bale, even at year's end.

2022 Commodity Outlooks

Sugar

Support from robust energy prices, low opening stocks, and challenges to supply responses are expected to keep ICE #11 between USc 18 and USc 20/lb and between AUD 560 and AUD 580/tonne in local terms.

Food Markets

Unprecedented supply chain disruption and inflationary pressures mark the start of 2022, with disruptions likely to persist.

Farm Inputs

In recent weeks, some of the demand and supply drivers that elevated global urea prices to record levels have begun to ease. We believe this is the beginning of a slow decline in urea prices over the next six months.

Land

While 2022 will likely be another strong year for land markets, we expect that growth will be slightly lower than what we witnessed in 2021.

FX

We forecast the AUD to hold its ground in the low USc 70s range in 2022, with some near-term slippage offset by appreciation as the year progresses.

Oil and Freight

Rabobank expects Brent Crude Oil prices will maintain USD 80-85/bbl for the remainder of 2022. This is likely to bring about higher-than-average diesel prices for local farmers. Bulk freight has tumbled from its 2H 2021 highs, but container freight is expected to stay significantly elevated in 2022.

Early Indicators Point to Less Rainfall in 2022

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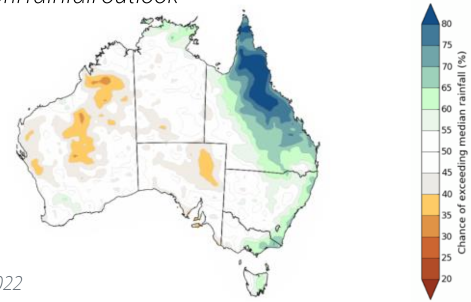
After a very wet conclusion to 2021 on Australia's east coast, the Bureau of Meteorology (BOM) expects the influence of major climate drivers to decline in the coming months.

BOM expects that the El Niño-Southern Oscillation (ENSO) has now peaked. La Niña could, however, remain until early autumn, and this may continue to deliver wetter-than-average conditions to northern and eastern Australia over the coming months. Only one (of seven) international climate models is currently predicting ENSO to exceed La Niña thresholds during March.

BOM expects the Indian Ocean Dipole (IOD) will remain neutral for the foreseeable future and hold little influence on local weather patterns.

Reduced chance of exceeding median rainfall in early 2022

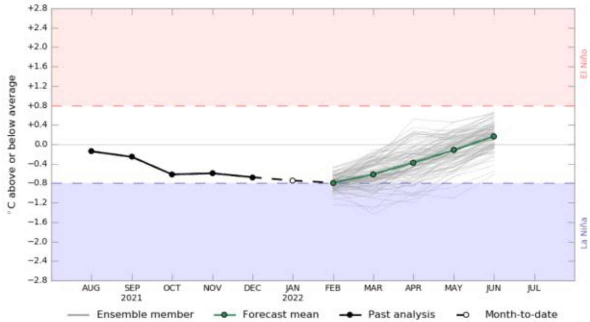
February-April rainfall outlook



Source: BOM 2022

La Niña is likely to have peaked

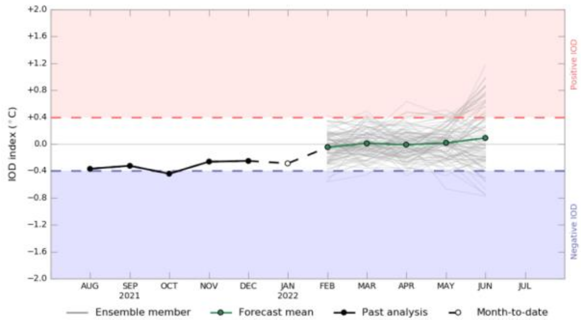
Monthly sea surface temperature anomalies for central Pacific Ocean



Source: BOM 2022

IOD is likely to remain neutral during 1H 2022

Monthly sea surface temperature anomalies for Indian Ocean



Source: BOM 2022

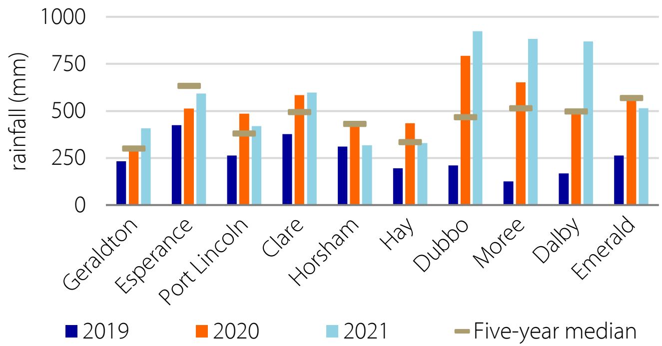
2021 Was One to Remember, Damply

On both sides of the country, 2021 was a strong rainfall year for most, which supported farmers in achieving high yields and cashing in on strong commodity prices.

On the west coast, the grain crop exceeded the largest on record by almost 20%. This was primarily due to high rainfall and the absence of widespread frost. Geraldton recorded over 400mm (vs. 299mm median) for the year, the largest rainfall in the last ten years.

On the east coast, the rainfall numbers were even more impressive. Dubbo received 924mm for the year, surpassing the 916mm recorded in 2016. Moree recorded 883mm for the year, the highest recorded since the Aero weather station opened in 1995. During the November and December harvest window, heavy rainfall caused isolated flooding across NSW, impacting crop quality and quantity.

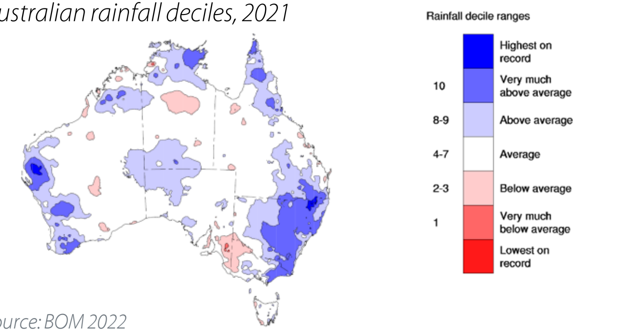
2021 brought remarkable rainfall



Source: BOM 2022

Nearly all regions received average to above-average rainfall in 2021

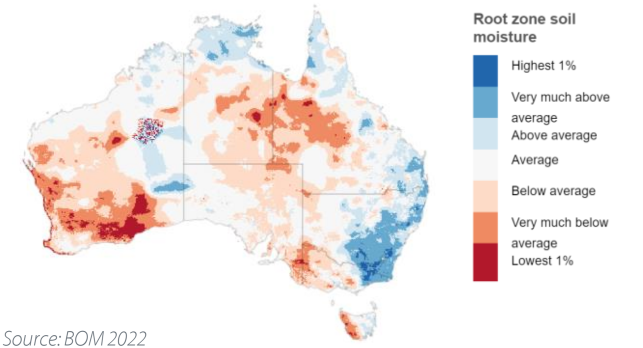
Australian rainfall deciles, 2021



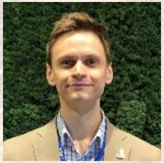
Source: BOM 2022

High soil moisture provides a head start for 2022

Relative soil moisture, January 2022



Source: BOM 2022



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Wheat

Prices to Ease Into Mid-2022

An improvement in northern hemisphere growing conditions should see global prices ease moving into mid-2022 as their harvest begins. However, government export barriers, geopolitical tension and low stock levels will keep prices nearly 40% above the ten-year average. Rabobank forecasts CBOT Wheat to trade between USc 750 and USc 820/bu in 2022, up 11% on the 2021 average. While high prices for another year bode well for farmers, consumers are feeling the pinch, with manufacturers and retailers already hiking prices on grocery shelves.

Assuming the US exits La Niña relatively unscathed by early Q2, global wheat stocks (excl. China) should move closer to the ten-year average by the end of 2022. On the supply side, crop volumes have been impressive in the southern hemisphere, with both Australia and Argentina logging record harvests. In the northern hemisphere, winter plantings are travelling well. However, due to ongoing food price inflation in Russia, export quotas and taxes that restrict shipped volumes are still in place.

An acute shortage of high-protein wheat will remain until at least mid-2022, keeping protein premiums above the ten-year average. Canada's bureau of meteorology is predicting above-normal rainfall over the next thee months after a devastating drought in 2021. Meanwhile, conditions in the EU are already favourable. An average harvest should help alleviate shortages later in 2022; however, low incoming stocks mean that high-protein premiums will remain above average for much of 2022.

Locally, APW prices remain on average up 19% YOY and 57% above the 2016/17 average. Rabobank forecasts APW2 KWI to trade, on average, between AUD 330/tonne and AUD 370/tonne through 2022. Currently, very low basis levels (AUD track price minus CBOT) reflect lingering La Niña in Australia, full soil-moisture profiles and export chain blockages, but if drier conditions return, the current very negative basis could see upside and higher local pricing.

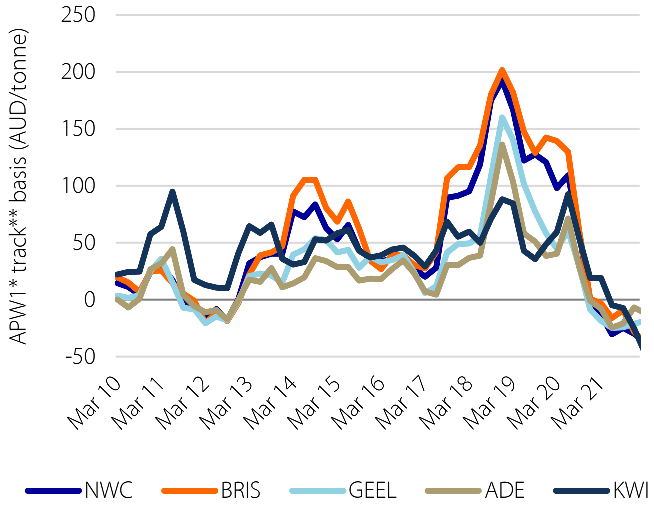
What to watch

- ***Global & domestic supply chain woes to continue in 2022 -*** While dry bulk freight indices fell since late 2021, prices for most AU grain shipping routes have remained up 30-50% YOY. If freight prices decline further, Australia's relative competitiveness in Asia will fall. On the local front, supply chains, particularly on the east coast, continue to struggle with record crop volumes, putting pressure on local prices.
- ***UKR-RUS confrontation -*** if a conflict eventuates between UKR & RUS, the implications on the grains markets will be severe. The two nations together account for 30% of world wheat exports on average and if trade disruptions and sanctions eventuate, we expect that CBOT wheat prices to rise considerably.

Global and Local Prices to Remain at Historically Favourable Levels in 2022

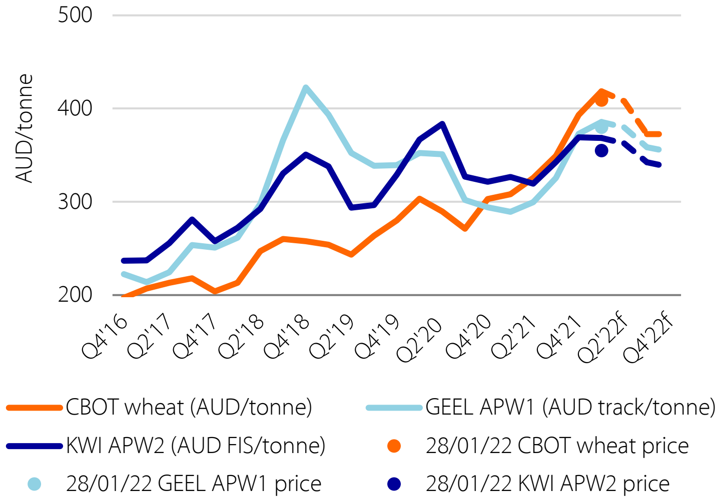
Rabobank

Record harvest sees AU basis at ten-year lows and prone to upside if drier conditions return



*Note: *APW2 used for KWI, **KWI is FIS*
Source: Bloomberg, Rabobank 2022

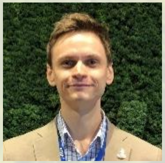
CBOT wheat to stay firm on low global stocks, Russian export taxes, and La Niña risk



Source: Bloomberg, Rabobank 2022 - Quarterly data except for spot price
Forecast date – 01/2022

Prices are expected to remain strong for wheat through 2022. Basis will be determined by whether seasonal conditions in Australia stay favorable or turn drier. Favourable conditions will mean basis remains at current low levels; drier conditions will see basis revert to more positive levels.

Coarse Grains



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Prices high in 2022 but down YOY

Global feed grain prices are expected to remain high, driven by low global stocks, La Niña risk, demand from China's feed sector, and inflated input costs, making corn farmers reluctant sellers. We forecast CBOT Corn to trade in the USc 585 to USc 615/bu range through 2022, 3% higher than the 2021 annual average but below the highs seen in Q2 last year.

Assuming seasonal conditions in key growing regions return to average in 2022, corn stocks (excl. China) should inch towards the ten-year average. The USDA expects Brazil's 2021/22 corn crop to be a record, however La Niña worries are already rife. Brazil's first crop has already been downgraded, but the much bigger second crop will add downward pressure on prices in 2H 2022 if yields stay close to trend. Chinese hog herd growth is expected to see domestic feed demand grow by another 2% to 5% YOY in 2022 (below last year's 12%-15% YOY growth), which means China's strong large import program will continue. In the US, competitively priced soy will battle corn for acres and input prices including fertilizers at elevated levels will impact farmers planting decision.

The lowest world barley stocks since 1983 mean that global prices will remain favourable despite expectations of higher year-on-year new crop supplies. Given China's anti-dumping tariffs, however, Australia will be far more susceptible to price downside than its competitors. If seasonal conditions in Canada improve, conditions remain favourable in the EU, and China still chooses not to accept Australian barley, Australia may be at risk of price downside once midyear harvests come, particularly if corn crops see limited damage from La Niña.

In 2022, we expect Brisbane feed barley to trade between AUD250 to AUD 290/tonne track on average, down on last year but above the ten-year average. Despite plentiful rainfall and pasture, cattle-on-feed numbers remained high through 2021. We expect higher feedlot numbers in 2022, which will ease the negative impact on feed prices of harvest rains that created a large surplus of feed wheat and a large sorghum crop harvest that is underway.

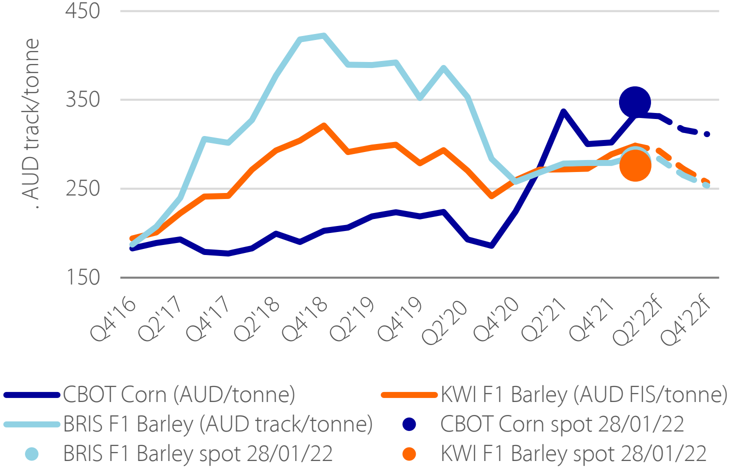
What to watch

- ***Feed vs. malt spread –*** The malt premium in Western Australia rose to AUD 25 KWI FIS in late-January, and is expected to stay positive on the back of poor Canadian malt barley production. A turnaround in the Canadian crop and continued good progress in the EU crop would close the premium, but if the Canadian crop fails to improve from 2021 we may see more support.
- ***The sorghum crop looks very promising -*** In addition to Australia's second-largest barley harvest on record, ABARES forecasts sorghum production will come in at almost 2m tonnes, the highest level in seven years, which will weigh on all local feed grain prices in H1 this year.

Barley Prices to Stay Supported Until at Least Midyear, but Global Resupply Risks Lurk

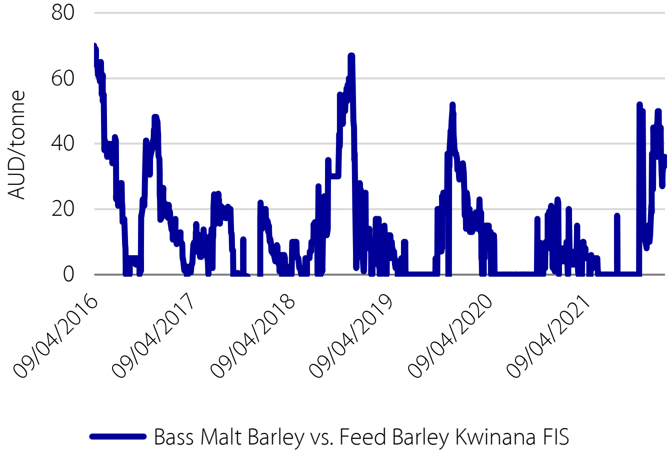
Rabobank

Global shortages to support global and local feed prices, which will ease from midyear



Source: Bloomberg, Rabobank 2022
Forecast date – Jan 2022

Malt premium returns for AU, but whether it remains depends on Canada



Source: Bloomberg, Rabobank 2022

The malt premium over feed barley is likely to remain positive until at least midyear, when new harvest starts coming online in the northern hemisphere, first in Europe and then in Canada around August. Whether Canada can return to average growing conditions or not will be a large determinant for AU malt premiums sticking around.

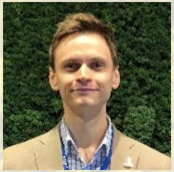
Canola Prices to Ease In Q2/Q3

The golden pricing seen for canola in 2021 is expected to continue in the first half of 2022 but wane as we head into July-September 2022. Rabobank forecasts CBOT Soybeans to trade, on average, between USc 1365 to USc 1410/bu in 2022, up marginally on 2021 and still 36% above the five-year average, with upside potential if South American conditions deteriorate further. This reflects a supportive outlook for the broader edible oilseed complex.

A supply-side response to strong vegetable oil prices means last year's bullish oilseed market should turn bearish moving through mid-2022, including for canola despite its strong long-term outlook (see Global Canola Opportunities in the Sustainable-Fuel Future). Firstly, Brazil started the year with a strong soybean crop, despite recent La Niña dryness. Secondly, Malaysia's flood disruptions in palm regions are easing, labour shortages are expected to improve by mid-year, and production is expected to increase year on year in Q2/Q3. Thirdly, conditions in EU canola-growing regions are favourable, and the forecast for Canadian precipitation looks positive. Fourth, in the US, high nitrogen prices mean farmers will plant more soybeans in April/May in order to lower input needs. Lastly, rumoured record sunflower seed stocks in the Black Sea will need to make their way to market eventually.

For local canola, we see this meaning non-GM canola in Kwinana will likely trade between AUD 690 and AUD 850/tonne FIS and AUD 650 and AUD 790/tonne FIS for GM , marginally down vs. the 2021 average. While down on last year, prices remain above the ten-year average.

The dryness that curtailed Canada's 2021 canola production also slashed its pulse production – the lentil harvest came in 40% below the five-year average and chickpeas almost 60% below. For lentils, this was joined by lower production in Turkey and by India reducing its lentil import tariff to10% to support local lentil prices to levels not seen since 2016. Improved prospects for 2022 production globally and (at this stage) favourable prospects for subcontinent supply means we expect lentil prices to fall away over the course of the year.



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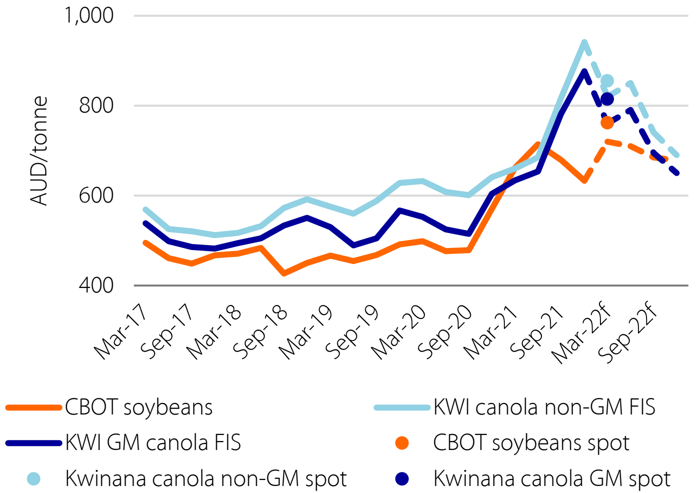
Oilseeds & Pulses

What to watch

- ***Palm oil phase-out in the EU*** – How fast the EU phases out palm oil this year and in the coming years will determine its canola import requirement. If we see more EU countries adopt a faster phase-out, canola prices will rise accordingly. But 2022 will likely also see a recovery of the EU canola crop.
- ***Containers –*** Execution of trade in pulse markets, especially for AU chickpeas, has been hampered by unreliable and high-cost container freight. Freight issues may ease in 2022, but rates are expected to remain historically high. Any easing of pressures is unlikely to unburden local chickpea prices unless challenges arise ahead of the subcontinent region's Rabi harvest in the coming months.

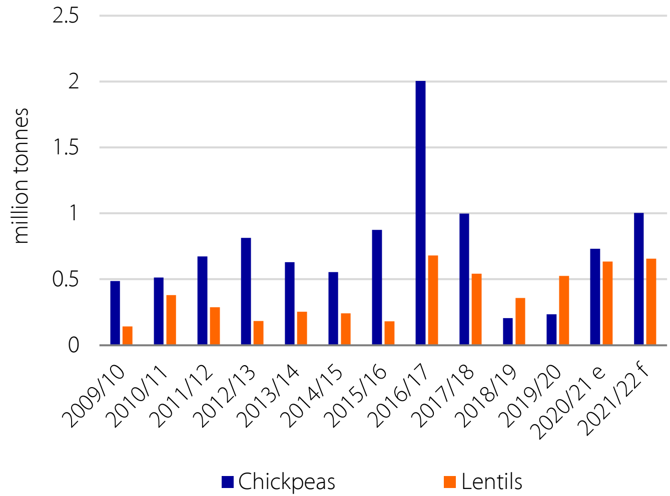
A Veg-Oil-Starved World to Support AU Canola Prices

Historically strong vegetable oil prices have supported Australian canola prices



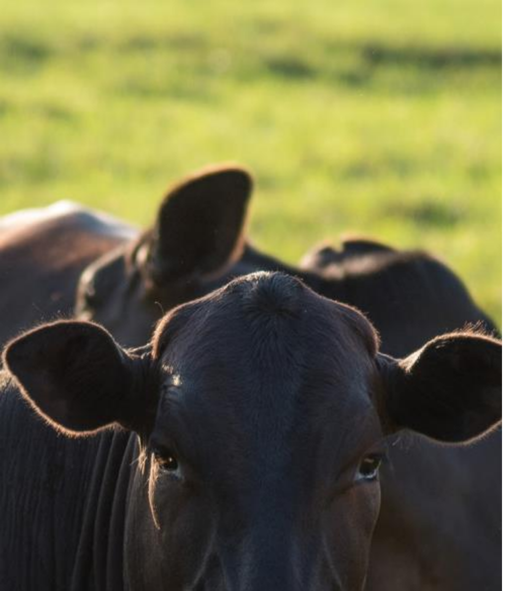
Source: Bloomberg, Rabobank 2022
Forecast date – 28/01/2022, Spot Price – 28/01/2022

AU chickpea production has recovered, but prices to remain subdued due to export freight challenges



Source: ABARES, Rabobank 2022

Despite improved conditions in Europe and more favourable prospects in Canada vs. last year, canola stocks are low, and there is nowhere for consumers to purchase new supplies until mid-2022. Australian harvest pressure should ease, following the first two months of 2022, and allow AU prices to move toward higher, European levels.



Beef Herd on the Mend

After two years of low slaughter numbers, we expect to see a lift in 2022, reflecting an increase in calf production in 2020 and more particularly in 2021 given better seasons and growth in breeding inventory. However, limited cattle numbers and strong demand will continue to drive the market, and with favourable seasonal conditions, we expect prices, while easing, to remain strong.

Slaughter numbers start to pick up. Rabobank modelling suggests a 13% increase in slaughter numbers in 2022. Male slaughter numbers in Q3 2021 showed the first year-on-year increase since Q1 2020 and the biggest rise since Q3 2017. The rise in male slaughter indicates an improvement in breeding numbers and calving numbers through late 2020. Increased availability of cattle will improve productive efficiency in processing facilities and support ongoing strong feedlot numbers.

Although increased cattle numbers will cause cattle prices to ease, favourable seasons, strong consumer demand, and ongoing limited supplies will keep prices strong. Cattle prices continued to defy historical trends through 2021. Monthly EYCI prices only contracted four times in the last 24 months, making it the longest and largest increase in the EYCI history. With favourable rain through parts of Queensland late in 2021, we expect cattle prices will remain firm for the first quarter. But we believe prices will contract as supply lifts and producer demand eases. However, the market will set a new baseline price, stepping up from the average prices prior to 2015.

A lift in production will support an increase in exports. After contracting 15% in 2021, we expect exports to lift in line with the increase in production. Volumes to the US and China will remain subdued given the ongoing strong prices and limited supplies of lean trimmings. But volumes to Japan and South Korea are expected to lift. An easing of cattle prices will support a rise in live export numbers, but ongoing limited supplies mean numbers in 2022 will continue to remain subdued.

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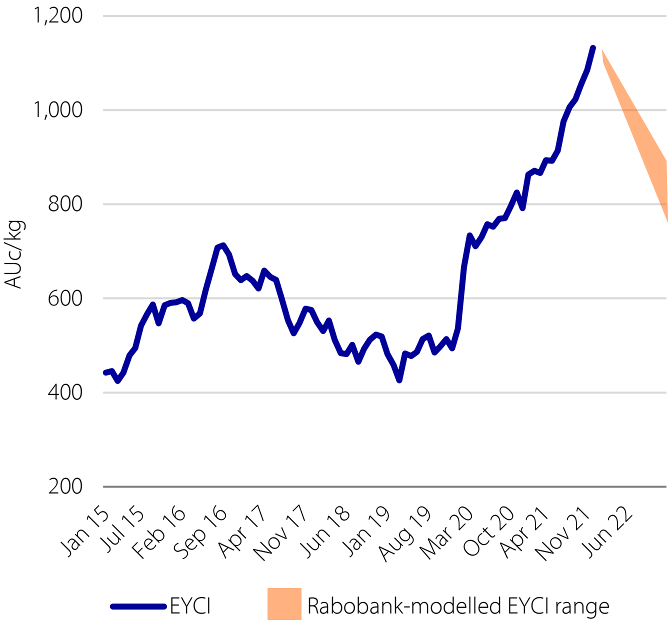
Beef

What to watch

- ***Strength of the US market*** – The US meat market experienced phenomenal demand in 2021, and this flowed through into high import prices and high export prices. US imported lean trimmings finished 2021 32% higher (in USD terms) than 2020. US frozen short plate into Japan in November sold 60% higher than 2020 levels. The strength of this demand has been a windfall, given high Australian cattle prices, and has allowed the market to operate at high levels. While we believe demand in the US will remain strong, any downward movement will create additional margin pressure for Australia and more downward pressure on prices.

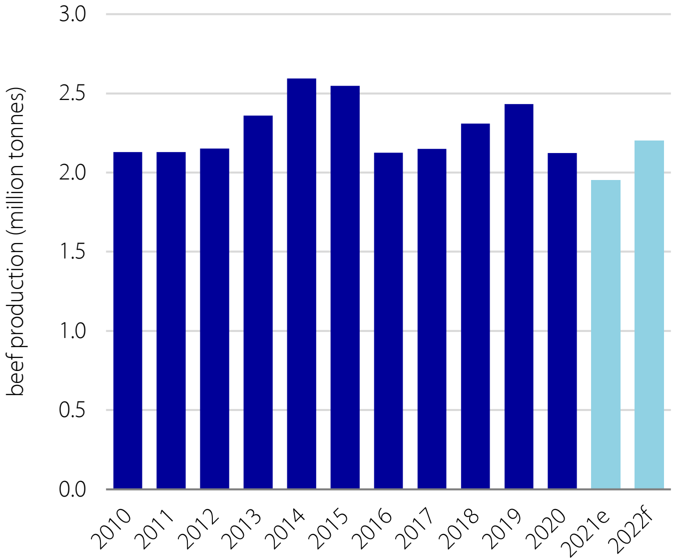
Recovering Volumes of Cattle Lift Production, but Limited Supplies Keep Prices Strong

Eastern Young Cattle Indicator to decline but remain at historical highs



Source: MLA, Rabobank 2022

AU beef production to lift with higher slaughter volumes and heavy carcase weights



Source: ABS, Rabobank 2022

Strong Year Ahead for Lamb

Sheep flock rebuilding continues. With favourable seasons and firm prices, we expect sheep producers will continue to rebuild their flocks in 2022. Sheep slaughter numbers for the first nine months of 2021 were down 36% on the five-year average. Together with solid restocker and merino lamb prices in the latter part of 2021, this suggests producers are looking to hold and grow their flocks – a position reflected in the Rabobank Rural Confidence Survey for Q4 2021, which showed 55% of sheep producer respondents are looking to increase their stock numbers. ***With increased sheep numbers and good seasons supporting lambing rates, we expect lamb slaughter and production to increase in 2022.*** MLA's October projections forecast an 8% increase in lamb production in 2022

We expect ongoing robust consumer demand will offset any downward price pressure exerted by increased supply, keeping lamb and sheep prices strong in 2022. We predict trade lamb prices to average just above AUD 8/kg cwt for the year. With a larger lamb supply, favourable seasons, and ongoing consumer demand, we expect prices to be more consistent across the year with less seasonal variation. Favourable seasons and producer restocking ambitions, together with solid global demand, should also see mutton prices remain firm throughout the year.

Very healthy global demand supplements the strong domestic market to keep lamb prices high. The strength of the US market has been the shining light. The US has increased its share of Australian lamb exports from 21% in 2019 to 27% in 2021, with volumes jumping 16% in 2021. US import prices for chilled lamb were 53% higher at the end of 2021 compared to December 2020. Lamb volumes to China remained steady, and volumes to the Middle East continued to drop, falling 33%.

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Sheepmeat

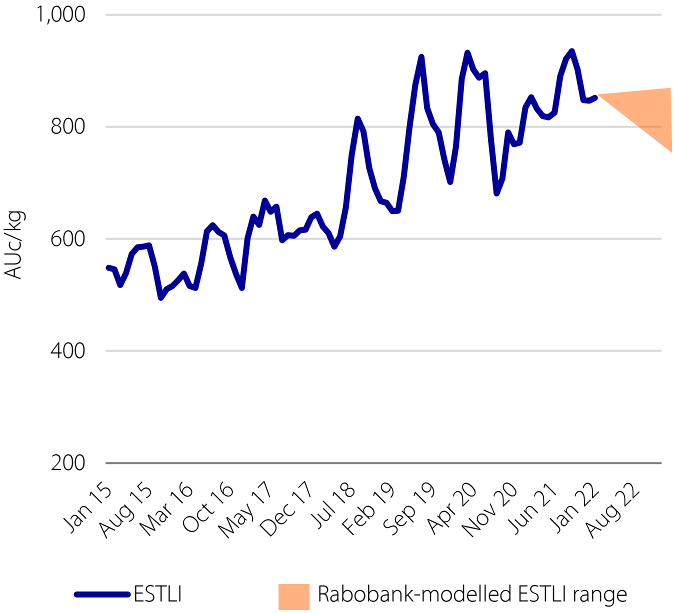
What to watch

- ***Strength of the US market*** – With increased volumes to the US and robust prices, the US market is one of the key drivers of strong Australian lamb prices. Rabobank forecasts that the US economy will remain healthy for the course of 2022. However, it is unknown how consumers will respond to changes in Covid restrictions. Limited travel saw consumers transfer spending to other luxury items, and red meat benefited from this. With the chance to spend in other areas, it is unclear how much red meat spending will suffer. We believe that any change will be relatively gradual as new habits are readjusted.

Prices Remain Strong as Production Climbs

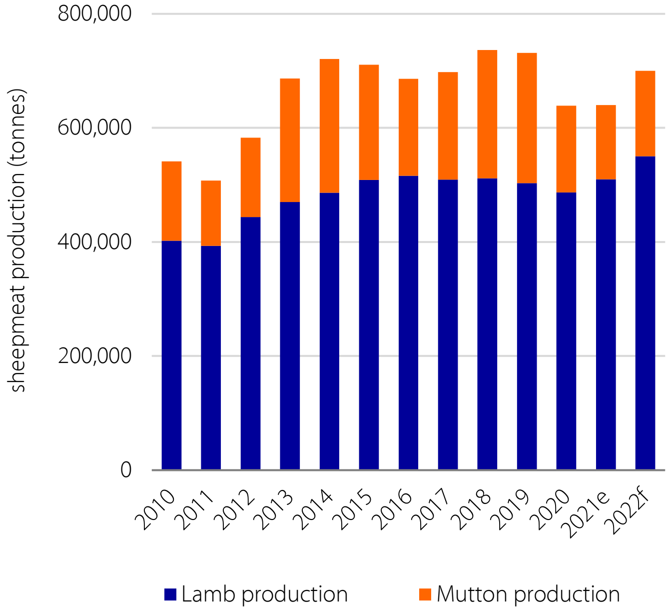
Rabobank

Trade lamb prices to remain strong



Source: MLA, Rabobank 2022

Australian lamb production to rise in 2022



Source: ABS, MLA, Rabobank 2022

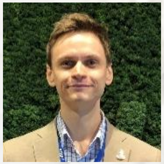
Suit Sale Recovery to Support Wool

Rabobank forecasts demand and prices for fine- and mid-micron wool will pick up as workers return to offices around the world. We project the Eastern Market Indicator will trade, on average, between 1,350c/kg and 1,500/kg in 2022, up 7% on the 2021 average.

While consumer confidence is waning in the world's two largest markets, there are large positive factors that will push wool prices higher. First, US retail apparel sales are continuing to grow, with December data showing an 18% rise vs. pre-pandemic levels. Second, the latest woollen suit important data for October 2021 shows a full recovery to pre-pandemic levels in France and only 26% below pre-pandemic levels in the US. This reflects a return of office workers, and we expect the trend to strengthen through 2022. Even if we see an interest rate-induced slowdown in the world economy this year, we expect the demand for wool from workers returning to offices and buying suits to be the more important variable for wool. On the downside, we saw consumer confidence decline in late 2021 for both the US and China, which is likely to continue this year, especially if economic conditions slow in the post-Covid-stimulus era. China's retail apparel sales, denominated in yuan, have also slowed to a mere 2.6% above pre-pandemic levels in November.

The Australian Wool Production Forecasting Committee estimates 2021/22 wool production at 318m kg greasy, up 8% on 2020/21 levels due to favourable seasonal conditions, with the largest year-on-year gains seen in NSW (+6.7m kg), Western Australia (5.8m kg), and Victoria (5m kg).

The latest ABS export data for Australia shows exports for January to November 2021 reaching 317m kg, up 39% on Covid-disrupted 2020. Australia's export exposure to China remained high at 84% over this period, up from 83% the prior year. In 2022, increased milling activity outside of China may ease our reliance, but not significantly. On the volume front, we expect total exports to rise as production increases and favourable prices prompt farmer selling.



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What to watch

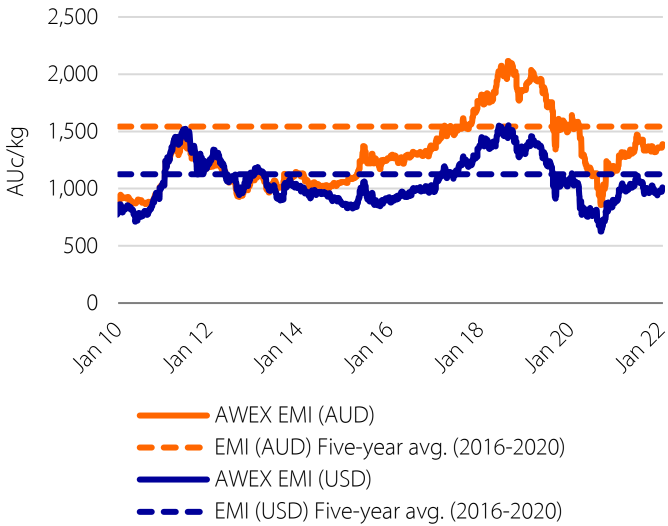
- ***Office casualization in China*** – There has been anecdotal evidence of casualization among Chinese office workers, with more emphasis on business casual and less on suits. Whether this is temporary or permanent will determine the micron type and volume required for the domestic Chinese market in the future.
- ***Container shortages*** – Container shortages continue to be experienced across the commodity spectrum, and the pain is expected to persist over the next six to twelve months. For more information, see Rabobank's November freight report, Out of Stock.

Wool

Wool Prices Lag Cotton, but Improving Suit Import Statistics Point to a Positive Year

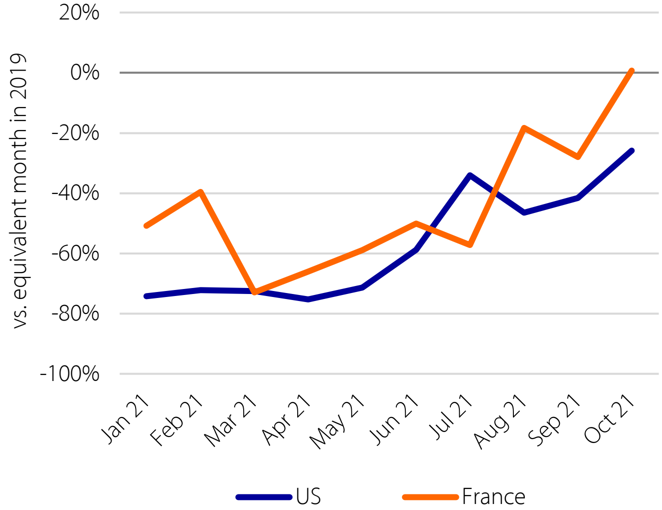
Rabobank

Wool price rise through pandemic and upside for the EMI expected in 2022



Source: Bloomberg, Rabobank 2022

Woolen suit imports rise in the US and EU as workers head back to the office



Source: Trademap, Rabobank 2022

Despite a possible interest rate-induced economic slowdown in 2022, we expect suit sales to continue rising to at least pre-pandemic levels, as office workers (whether vaccinated or not) head back to the office in the EU and US. The recovery in office-wear demand may see suit sales growth rise above general retail apparel in 2022.

On a Strong Footing, With Headwinds

The Australian dairy industry is on a strong footing as it looks to the 2022/23 season. There is widespread profitability, and the industry is headed for a record-breaking third consecutive season of above-target earning before interest and tax (EBIT) margins as the 2021/22 closes out. The early foundations are in place for another good profit in the 2022/23 season. Nevertheless, there are lingering production challenges, and farm margin risk factors lay ahead.

There is potential for upside in current farmgate milk prices across the southern export region as the current season draws to a close. Global market fundamentals remain price supportive for export returns and will continue to do so for the first half of 2022, providing the tailwind for farmgate milk pricing. Any lift in farmgate milk prices would see prices reach new record highs but will be somewhat offset by rising production costs.

Looking ahead, a return to milk growth is still anticipated in 2022/23 amid ongoing profitability. Ongoing consolidation of the farm sector contributed to milk production underperforming in 2021/22. Labour shortages and wetter-than-average conditions through the 2021 season also played a role. Rabobank is forecasting milk production to be down 1.5% in 2021/22. Labour will continue to hold back production growth in 2022/23, but a focus on investing in labour remains a priority for many businesses.

Labour challenges aside, the foundations are in place for a return to growth in the 2022/23 season. Most dairy farm businesses will have a good feed reserve, which will offset climate risks – even with a favourable seasonal outlook and healthy moisture profiles in the lead up to the autumn break. There will also be a plentiful supply of supplementary feed – but with international forces pressuring local prices. Farm businesses will need to budget for higher key inputs costs in the 2022/23 season.

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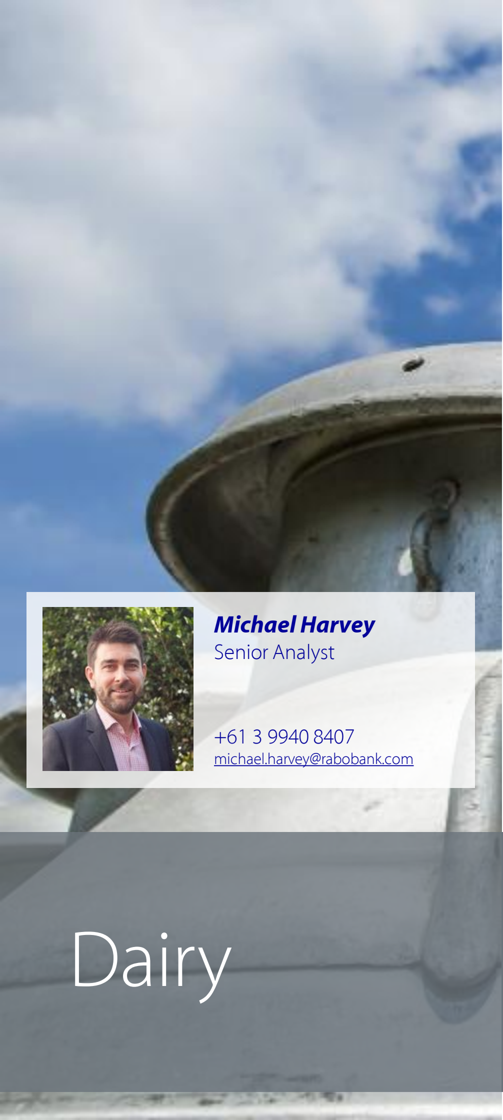
Dairy

What to watch

- ***New season milk prices –*** If last season is any guide, price announcements could come as early as April. Rabobank will forecast a new season price in Q2 2022. Early expectations should be for a buoyant milk price, but a level of caution around another record-high milk price is warranted.



Dairy

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Margin pressure has been building in the post-farmgate sector. The Australian dairy supply chain is facing unprecedented levels of pandemic-led disruption. This has led to a jump in the cost of doing business, as well as production and distribution bottlenecks. Port disruptions have also caused some trade disruption in getting goods out to export markets and led to delays in getting access to imported materials.

Lacklustre milk supply growth, despite good farm profitability, is keeping the heat on dairy companies in terms of recruiting and retaining milk supply. Dairy companies will be eager to see the decline in milk production moderate in 2022 and hoping to see a return to (modest) growth. Challenges persist in the early stages of 2022; however, the industry retains a solid platform to navigate these issues with no major material impact on milk collection and distribution to consumers.

A potential new chapter in Fonterra's Australia business is a key event to watch in 2022.

Commodity prices are teetering at levels not seen since 2014. Global milk supply has been hampered in most major export regions. The combined slowdown in milk supply in the EU and New Zealand has led to an acutely tight supply situation, which has international buyers scrambling for available supply amid shipping delays. Margin erosion and weather-related issues on-farm are the main causes, and a quick turnaround in the supply trend is unlikely. The European seasonal peak in Q2 2022 will be a key item watch.

On the demand side, there are downside risks in 2022, particularly in some key export markets. Broadly speaking, pandemic impacts continue to affect local and offshore food markets and disrupt consumer purchasing behaviour. Looking ahead, consumers will confront food inflation and cost-of-living pressures, which will negatively impact dairy purchases in some emerging markets.

Global market fundamentals show a slowing import demand from China, which Rabobank expects is needed to cool prices in the face of limited supply-side increases in 2022.

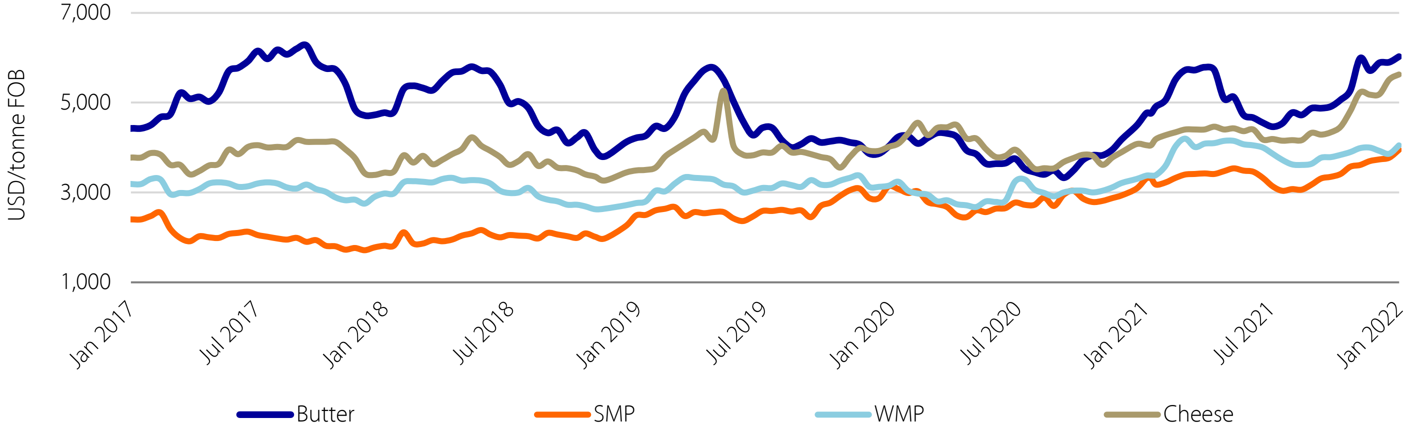
What to watch

- ***China milk prices*** – Local Chinese milk production growth remains high as a wave of farm expansion takes shape. However, this makes the cost of local milk expensive, due to elevated feed costs. This dynamic fosters Chinese buyers' import appetite despite the elevated costs of importing milk in the form of milk powder. If the cost of locally produced milk remains elevated, it will provide support for global benchmarks above long-term averages through 2022.

A Buoyant Outlook With Downside Risk

Rabobank

Global dairy prices (FOB)



Source: USDA, Rabobank 2022

The dairy commodity complex starts 2022 on a very firm footing. All major benchmarks are 20% or more higher than the same time last year. When compared to five-year averages, current spot pricing is even firmer. A very challenging supply profile across the major export regions has been a major contributing factor. A lack of stocks in major exporting regions also adds pressure to markets and has buyers in a delicate procurement position. The demand outlook is complex. Many economies are opening, but new variants and outbreaks mean this is not a linear path. Consumer demand will also be tested by inflationary pressures and less income support. Rabobank does not rule out further upside in the near term. But prices will be tested by the European peak in Q2 2022 and the knock-on impacts on fundamentals from expectations of softer Chinese demand in 2022.

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Sugar

Some Sweetness to Stay

Expectations of ongoing tightness in the sugar balance sheet in 2022 means we expect prices to remain supported over the coming year. The buoyant energy market should support sugar prices via the sugar-ethanol arbitrage in Brazil and, to a lesser extent, India. As for global supply, a second straight deficit in supply in 2021/22 will not be unwound easily in 2022/23.

As 2021/22 closes, global sugar stocks are on track to end down another 6% YOY and 7% below the five-year average. Demand recovery and supply challenges – especially in Brazil, which suffered drought in 2021 – have exacerbated the already tighter balance sheet that opened 2021/22. Sugar prices opened 2022 under pressure from fund selling but remain up 11% YOY.

Due to ongoing below-average rainfall, only a partial production recovery is expected in Brazil's Centre/South in its 2022/23 season. Across all global growing regions, strong competition for planted hectares, due to high prices across agricultural commodities, and more judicious application of high-priced fertiliser will limit supply responses over the next 12 to 18 months.

Meanwhile, the outlook for energy prices is expected to underpin strong biofuel prices. Rabobank's view is that oil prices (Brent) will be robust in 2022, at around USD 80-85/bbl on average, leading us to believe that ***world sugar prices will need to be in the USc 18 to USc 20/lb range (ICE #11) in order to incentivize Brazilian millers to opt for a high sugar mix in 2022/23***.

A protracted milling campaign locally in 2021 has caused frustration to growers amid the otherwise favourable season of average production and good pricing. Local pricing in 2022 is expected to be around 5% to 10% higher than 2021, with the AUD remaining favourable and local supply steady.

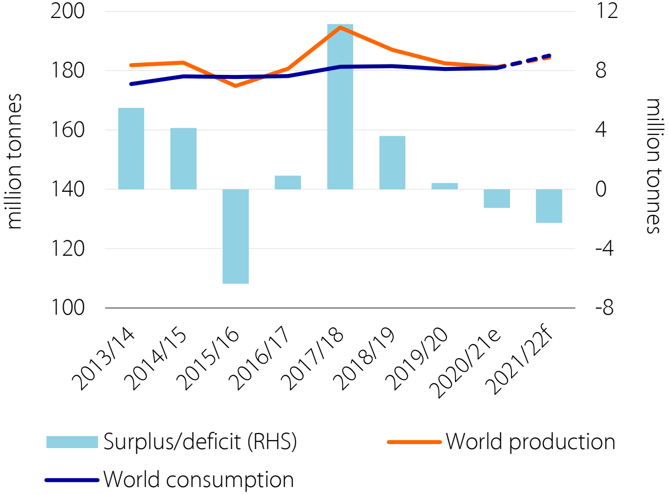
What to watch

- ***Brazilian rainfall*** – The next two months are critical for Brazil's new crop prospects, as season-to-date rainfall is running below average for the second consecutive year.
- ***AUD softness*** – Our outlook forecasts the Australian dollar will remain in the low USc 70s range, helping to keep local sugar prices favourable. This low dollar is, however, going to be a factor that keeps imported farm input products elevated in 2022, and pressure on cane margins.

Deficit Trifecta possible, Still Betting on Brazil

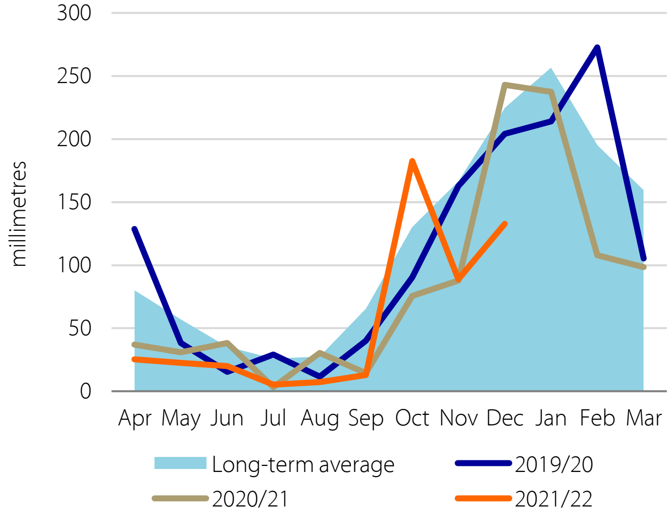
Rabobank

After two global deficits in sugar supply the price outlook is supported, and a third deficit in 2022/23 is not off the table



Source: ISO, LMC, Rabobank 2022

With below-average rainfall in Brazil C/S so far, La Niña dryness is a risk to 2022/23 global supply



Source: Bloomberg, Rabobank 2022

Support from robust energy prices and low opening stocks, as well as challenges to supply responses, are expected to keep ICE #11 between USc 18 to USc 20/lb and between AUD 560 to AUD 580/tonne in Australia.

Cotton

A Valuable Wad of Cotton on Its Way

Australia is on track to register another strong gain in production in 2022. An extra 2.1m bales YOY came in during 2021, and ***this year we see this being surpassed by an extra 2.3m bales YOY – so that 2022 production will likely come in at the highest in a decade.*** Storage across the Murray-Darling Basin currently sits at 91% full, soil moisture is abundant, and strong prices have encouraged more hectares. That said, yields are likely to be down year on year, owing to both a greater proportion of dryland cotton hectares, some flood-related damage, and a return to more average seasonal conditions. The persistence of La Niña and the associated cooler damper conditions during summer growing months is also a downside risk to yields and quality.

ICE #2 Cotton opened 2022 trading up 50% YOY after being in USc +100/lb territory for more than a quarter. Low stocks and a second consecutive deficit year in production are underpinning the market, but high prices are really being sustained by the slow export pace resulting from ongoing ocean freight challenges. The later-than-normal 2021 Brazilian harvest has also not helped, but we expect Brazilian exports to lift in the coming months as ginned supply moves and the container market relaxes somewhat. The forward curve shows the market expects ICE #2 to continue to trade above USc 100/lb until Brazilian supply comes on board in Q3, but still remain above USc 90/lb into 2023, which can be attributed to expectations that stocks will still be rebuilding.

With strong global pricing and a still favourable AU dollar, Australia's favourable production outlook is set to deliver a valuable wad of cotton. We expect ***2022 AU cash prices to trade lower over the course of the year but remain above AUD 700/bale in 1H and above AUD 600/bale in 2H.*** We expect basis to recover in the backend of the 2022 but remain below historical averages given how the market has changed following geopolitical challenges with China.

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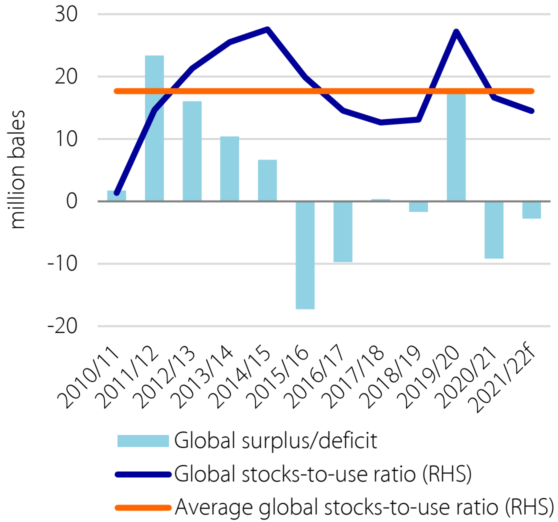
What to watch

- ***Global cotton consumption*** is expected to lift another 3% in the current marketing year, on top of last year's 17% recovery. The market will be sensitive to any Covid-led falls in consumption. However, even steady year-on-year consumption will mean only limited stock rebuilding and, therefore, sustained above-average global pricing.
- ***The US's Uyghur Forced Labour Prevention Act*** – This ban on imports of cotton products from Xinjiang came into force in December 2021. This could see Chinese retaliation, but at this stage, we see the need to keep Chinese spinners at capacity as a priority for China.

Spinners Coming in for More Keeps Stocks Low

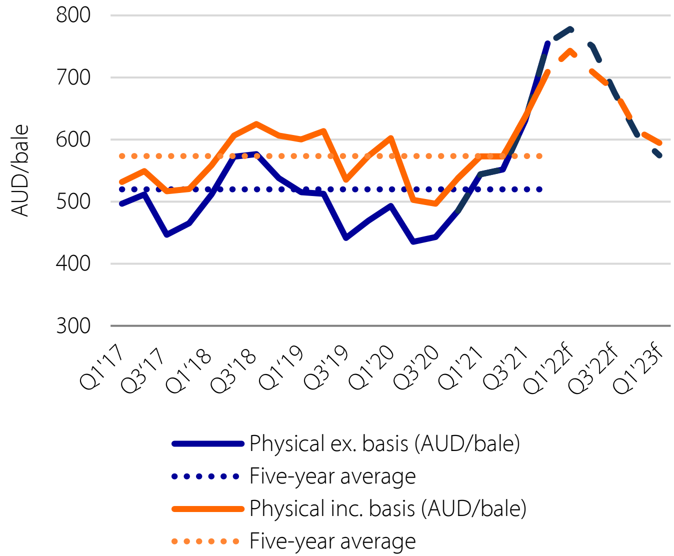
Rabobank

Another year of global cotton supply deficit will keep stocks-to-use below average and global prices high



Source: USDA, Rabobank 2022

AU cotton prices are set to trade above AUD 600/bale throughout 2022



Source: Bloomberg, Rabobank 2022

The strong recovery in cotton production on the cards for Brazil and Australia in 2022 will not be enough to offset another deficit year due to forecast consumption growth of another 3% YOY.

Food Markets

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Highly Dynamic Food Markets in 2022

The global pandemic will continue to impact food markets and supply chains in 2022. The rapid emergence and spread of the Omicron variant is having a profound impact on local and global food markets. While vaccination programs are in full swing in the developed economies, many governments have reinstated containment measures. For food and beverage companies, this is leading to transitory supply chain costs and challenges in keeping product moving through to consumers. Supply chain issues look set to disrupt food markets in the first half of 2022.

Cost-of-living pressures felt by many consumers. Food and beverages companies across all geographies are reporting margin pressure stemming from inflation in all parts of the business, including raw materials and distribution. Inflation is expected to remain high through much of 2022. As a result, companies are acting on retail pricing across a range of consumables. Against a backdrop of this food inflation, consumers are facing additional cost-of-living pressures and reduced income support. The impact on consumer food purchases will vary significantly across geographies and categories; there will need to be a keen eye on potential demand destruction in emerging markets.

A rapid and structural pace of change will continue in consumer behaviors and food innovation. There are some clear pandemic winners, including products catering to consumers who work (and eat more) at home and prefer for snacking and convenience. This, of course, takes place against a backdrop of consumer demand for natural, clean, fresh, and personalised food products. E-commerce in the food system has enjoyed a transformational boost through the acquisition of new consumers.

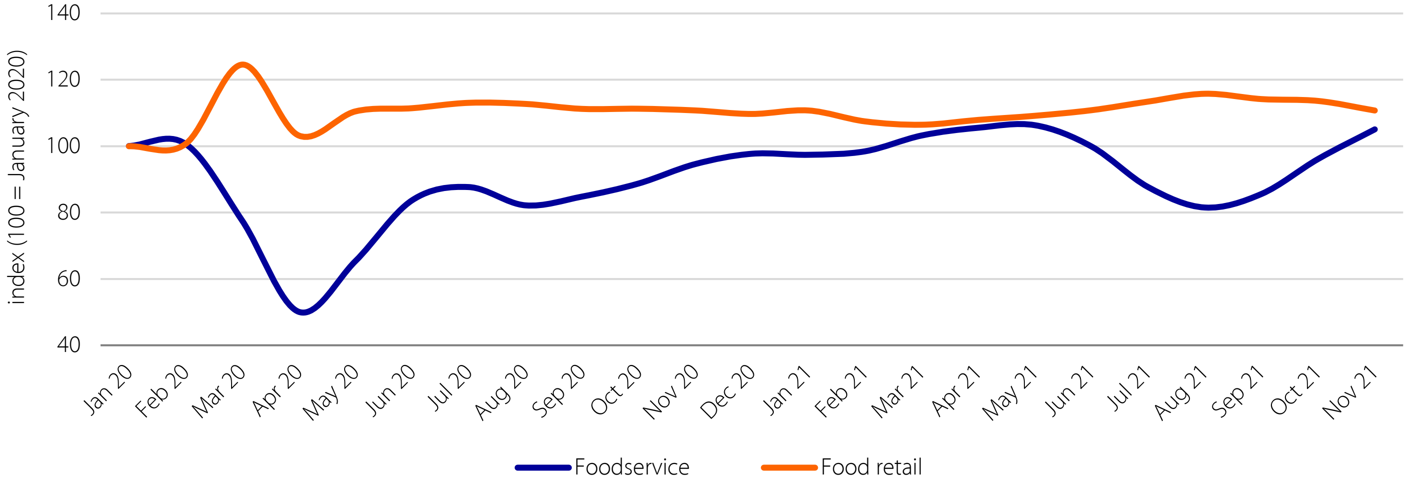
What to watch

- ***China's zero-tolerance Covid policy*** – China continues its strict lockdown policies ahead of the Winter Olympics. There is also growing concern about the state of the economic recovery, which, combined with the policy, is impacting consumer markets in China. There was a slowdown in total Chinese retail sales growth towards the end of 2021. Food retail posted double-digit growth in the most recent data. But when adjusted for inflation, it was a more subdued picture.

Food Market Channel Disruptions Continue

Rabobank

Index of year-on-year turnover in the Australian food market (seasonally adjusted)



Source: ABS, Rabobank 2022

The Delta variant of Covid caused channel disruption in Australia. Given the extended lockdown restrictions and stay-at-home orders across NSW and Victoria, Q3 2021 food markets were hit hard. This led to elevated grocery sales and a subdued foodservice sector. Fast-forward to early 2022, and much of the Australian economy has now opened. However, the impact of the highly virulent Omicron strain will be felt in the local food market again – but with subtle differences. Food companies and retailers need to navigate supply chain vulnerabilities. Meanwhile, consumer movement is voluntarily cautious, leading to reduced foot traffic. Over the course of 2022, the channel distortion should finally return to pre-pandemic norms, but it will clearly not be a linear path to recovery.

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Farm Inputs

Marginal Urea Price Relief in Sight

In recent weeks, some of the demand and supply drivers that elevated global urea prices to record levels have begun to ease. We expect that this is the beginning of a slow decline in urea prices over the next six months.

While this is good news for growers, we expect local urea prices will remain materially higher than 2021 for this season. We also predict freight interruptions will continue to plague deliveries, which may cause some delays.

Prices of European natural gas, a key raw material in urea, have now fallen by 60% from mid-December levels due to increasing supply. There is also some optimism that the Nord Stream 2 pipeline will be approved by regulators, which would further support lower gas prices, but geopolitical tension with Russia could also drive gas price volatility.

Following recent global headlines about urea shortages, some indicators show that the supply balance is improving. The two most recent Indian tenders were oversubscribed by more than double. Some 1.19m tonnes of urea was booked for the most recent December 23 tender, after offerings of 2.75m tonnes. Furthermore, northern hemisphere demand has been very quiet in recent weeks, which has left the market wondering, where will all these extra tonnes go?

Despite our expectation for lower prices over the next six months, we expect local prices will remain well above average. Rabobank expects global prices of corn, soybeans, and wheat will all remain well above average, which is likely to act as a floor in global fertiliser prices, as farmers will continue to aggressively chase yield and protein. It's important to keep in mind that local prices may take as much as three months to reflect global price movements.

In contrast, we expect that phosphate prices will remain at current levels or even increase marginally over the next six months. We expect phosphate supply will remain very tight while China's restriction on export remains. Typically, China exports about 30% of global phosphate trade.

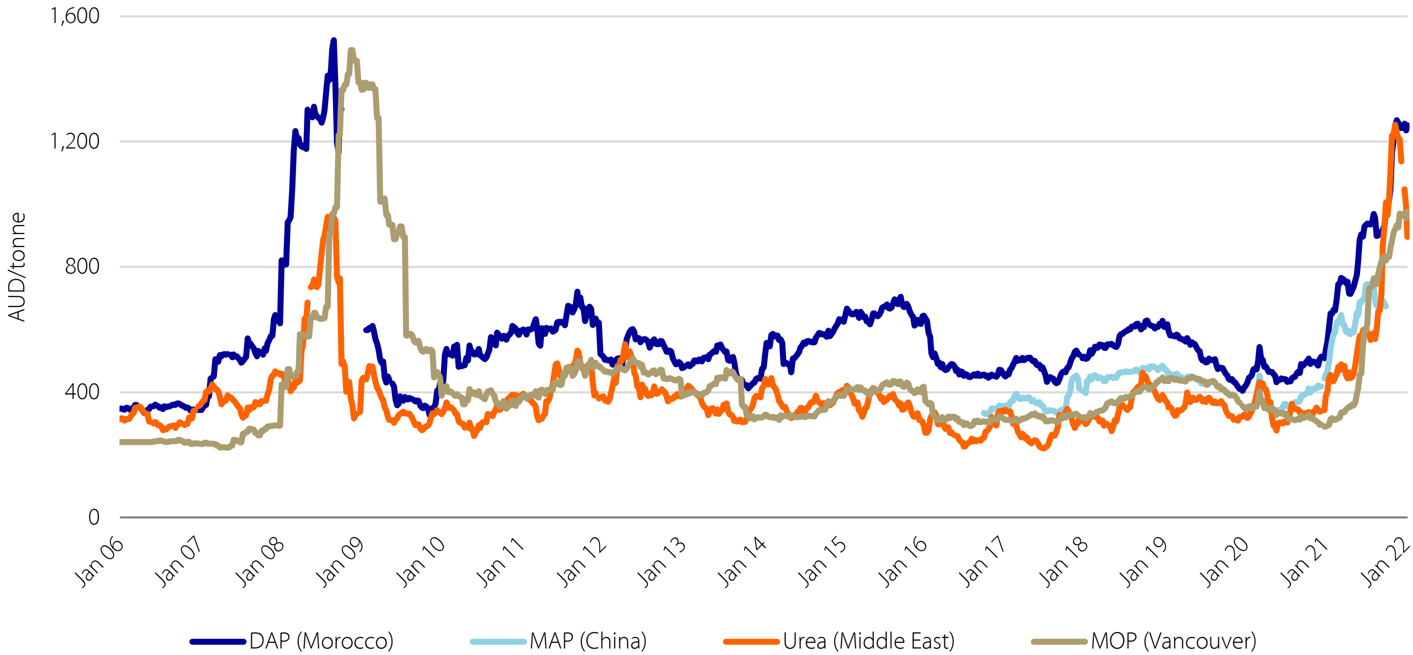
What to Watch

- ***Ukraine and Russian Crisis*** – The threat of conflict, or even further sanctions on Russia and ally Belarus is a major upside risk for fertiliser prices. If Russian gas supplies into Europe reduced, or even cut, this would again send nitrogen prices upward. Furthermore, 23% of global ammonia trade, 14% of urea and 10% of phosphates is exported by Russia. Together with Belarus, both countries make up some 30% of global potash exports. Interruption to supply would again send prices upward from high levels.

Global Urea Prices Have Exceeded 2008 Levels

Rabobank

AUD-adjusted global fertiliser benchmarks have started to slowly retreat from recent highs



Source: CRU, Bloomberg, Rabobank 2022

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Agricultural Land

Another Strong Year Ahead

While we expect that 2022 will be another strong year for land markets, we estimate that growth will be slightly lower than what we witnessed in 2021.

It's hard to see how the macro settings could have been more favourable in 2021. Rainfall was either average or above average in nearly all Australian regions, commodity prices were either at or near record, and interest rates were at a record low.

In fact, commodity prices and production have been so strong, ABARES is expecting that the value of farm production will reach AUD 78bn this year, 15% above last year's record and 25% above the five-year average. Strong revenues have helped bolster farmer purchasing power and confidence. We expect that high demand will continue to be the primary driver of land markets in 2022.

On the flipside, we see two main factors that could begin to slow land price growth in 2022.

First, it's unlikely that seasonal conditions will be as strong as they were in 2021. The Bureau of Metrology is expecting that La Niña will subside during autumn. Poor or even average seasonal conditions would reduce demand from current highs.

Second, there is some speculation among market commentators that the cash rate could rise much earlier than the RBA's initial expectation of 2024. While locally, (underlying) inflation has risen, it remains within the RBA's 2% to 3% target band. The RBA has reiterated that wage growth would need to increase to see a rise in the cash rate. If interest costs were to rise, we expect that this wouldn't initially impact demand heavily given interest is coming off a record low. However, if we see a sustained increase, then this will slow demand.

What to watch

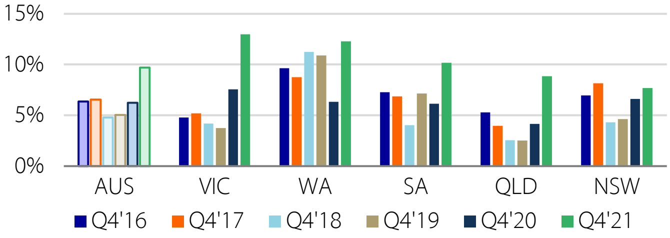
- ***Input Costs*** rose significantly during 2021. We have calculated that crop farmers' expenditure on fertiliser, agrochemicals, and seed will increase by 52% during FY 2022 alone. We expect prices of fertiliser, agrochemicals, and other inputs, such as fuel and parts, will remain high for at least the first half of 2022, placing pressure on margins. If high input costs are coupled with poor revenues, this may significantly impact margins and, in turn, rural confidence and demand for property.

Demand for Farmland Is at a Five-year High

Rabobank

Seasonal conditions have boosted demand

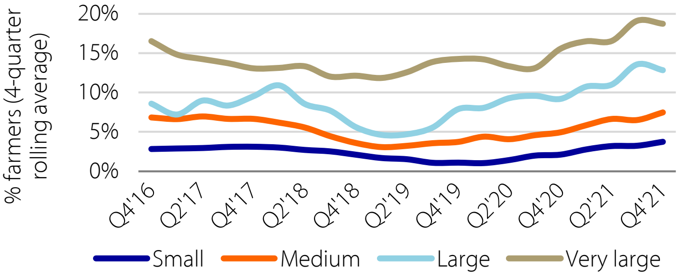
*Percentage of farmers with intentions to buy land within 12 months, by state (12-month rolling average)**



Note: Tasmania has been excluded due to small sample size

Large farmers will continue to drive the market

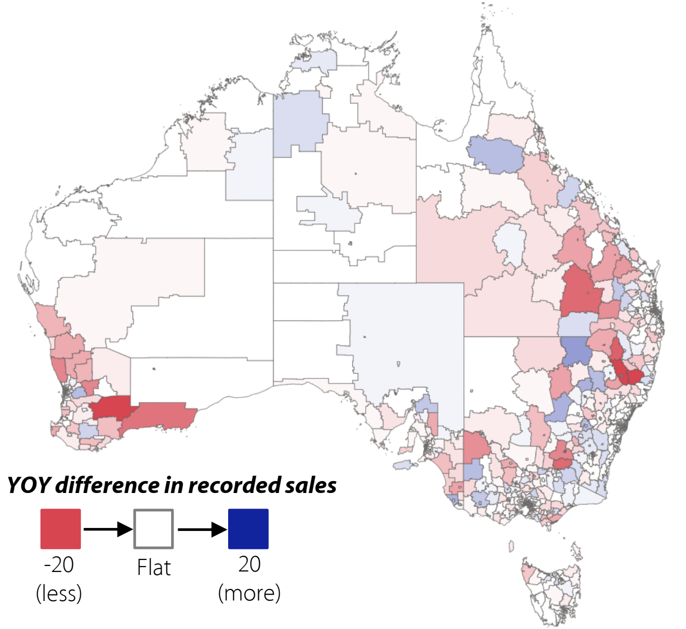
Percentage of farmers with intentions to buy land within 12 months, by three-year average income (12-month rolling average)*



Note: Avg. incomes: Small <AUD 300,000, Medium AUD 300,000<AUD 500,000, Large AUD 500,000<AUD 1,000,000, Very large >AUD 1,000,000
Source: Rabobank Confidence Survey 2022

The number of sales declined across most regions in 2021

*Difference in number of Rabobank-recorded sales between 2020 and 2021**



Note: Properties >40ha, grazing, dairy, arable, and cropping only
Source: DAS, Rabobank 2022

FX

Holding Steadily Lower Through Omicron Adversity

We expect the Australian dollar will be able to take back a little ground from the USD this year, to trade near its five-year average.

Economic headwinds created by Omicron's spread and low wage growth will, on one hand, keep the RBA cautious on monetary policy and lessen pressure on the AUD to lift. On a full year basis, we expect Australian GDP to lift marginally year-on-year to 4% in 2022. However, the impact of skyrocketing Covid cases, isolation requirements, and a dearth of testing capacity in December 2021 and early 2022 will mean GDP moves backward for one to two quarters. This will be not only a result of lower consumption, but also challenges in production, with supply chains stymied by furloughed or sick workers. Notwithstanding this, economy-wide wage growth remains low which, together with uncertain growth prospects in 1H, will maintain the risk of an RBA hike in H2 2022 at the earliest and of the RBA continuing to purchase bonds at a tapered pace towards May. The RBA has flagged late 2023 for its first hike, but latest inflation data supports market expectations that they will not be able to hold that long.

On the other hand, persistently strong commodity prices in 2022 will lend the AUD support. Strong demand, supply chain issues, and sustainability- related energy price pressures are expected to keep resource prices elevated in 2022. For example, Rabobank's view is that oil prices (Brent) will be robust in 2022, trading on average between USD 80/bbl and USD 85/bbl and 30% above the five-year average. A favourable outlook for resources should mean the AUD has a USc 70 floor in 2022.

We forecast the AUD will hold its ground in the low USc 70s range in 2022, with some near-term slippage offset by appreciation toward USc 74 as the year progresses. We expect an average of USc 73 for the calendar year.

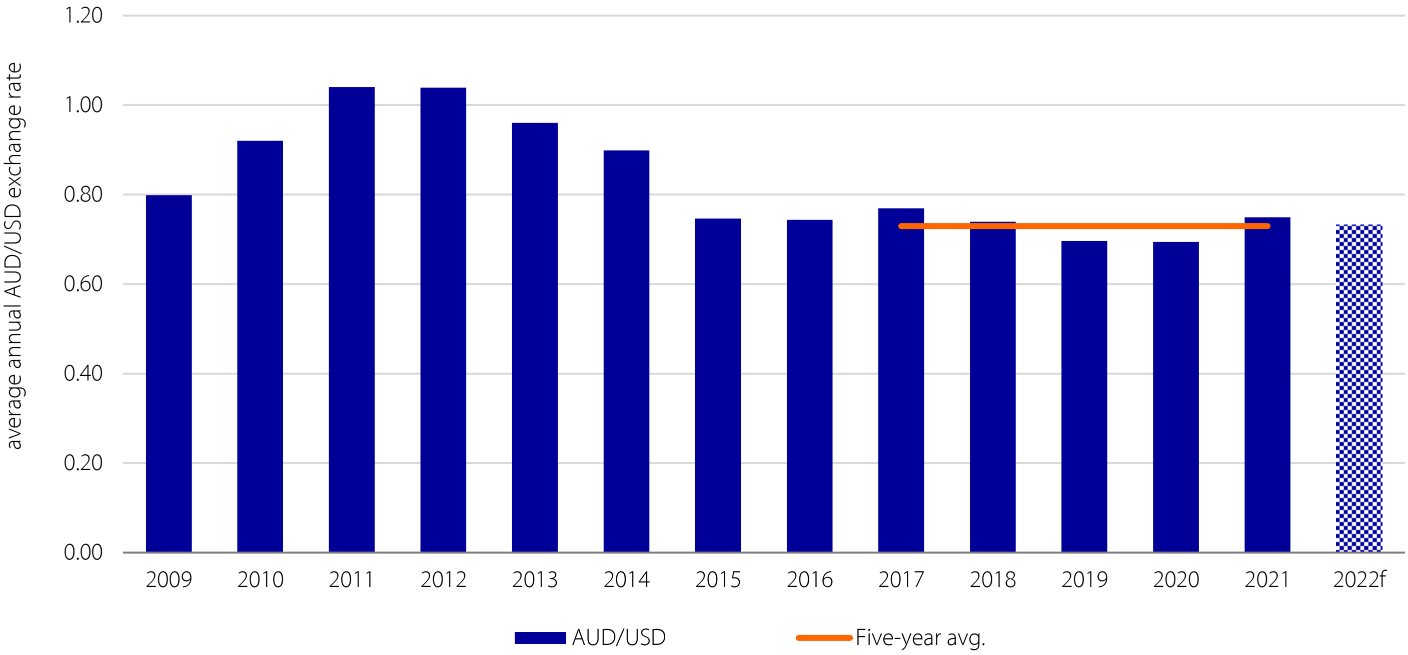
What to watch

- ***China's economy*** – The Chinese economy is increasingly under pressure from its Evergrande real estate crisis. The People's Bank of China initially refused to step in, but it recently eased monetary policy with a small cut to the one-year loan prime rate in December. However, more will need to be done to boost final demand for housing, stave off economy-wide impacts, and lower demand for resources, which would mean potential downside for the AUD.

AUD Holding Near the Five-year Average

Rabobank

Australian currency against the US dollar, 2009-2022f



Source: RBA, Rabobank 2022

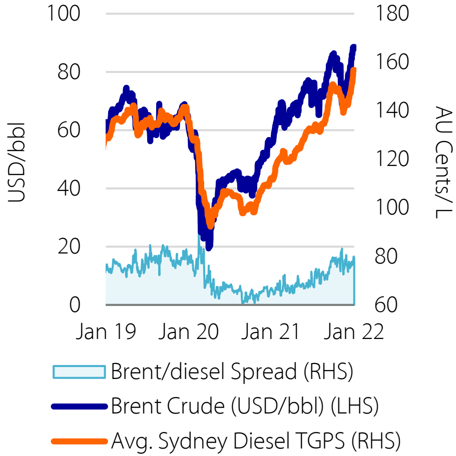
Oil Prices at the Mercy of OPEC+

Rabobank expects Brent Crude Oil average between USD 80/bbl and USD 85/bbl for the remainder of 2022. This is likely to bring about higher-than-average diesel prices.

Global oil markets face geopolitical volatility and are at the mercy of OPEC+, a cartel of the world's biggest oil producers led by Saudi Arabia. With global demand for oil on the rise again as mobility rebounds, OPEC+ is very closely managing production to keep prices supported.

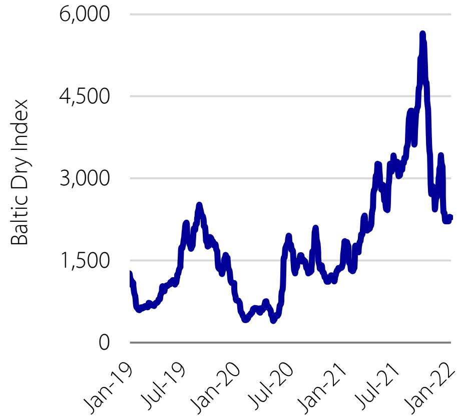
Speculators and institutional investors will continue to play a role in supporting oil prices. In response to high consumer inflation, investors are likely to continue to direct funds towards oil, commodity markets, and commodity index ETFs, not only as an inflation hedge, but also for portfolio diversification. Dry bulk freight rates have tumbled off their 11-year highs and are unlikely to recover quickly while dry containers are expected to continue at high rates in 2022.

Brent Crude Oil and average Sydney Terminal diesel price



Source: AIP, Bloomberg, Rabobank 2022

Baltic Dry Bulk Freight Index



Source: Bloomberg, Rabobank 2022

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