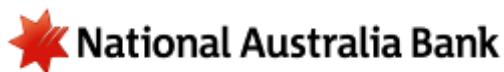


Economic report



Post-farmgate agribusiness survey

Vyanne Lai, NAB Agribusiness Economist

March quarter 2013

Post-farmgate business conditions softened

- **Post-farmgate agribusiness conditions deteriorated in the March quarter to be mildly negative to be more consistent with underlying trends.**
- **Customer demand remains the single most significant constraint to businesses' future profitability.**
- **Despite weaker business conditions, expectations for capex plans surged as businesses seek to take advantage of the current low interest rates.**

Business conditions could not hold on to gains

After a positive result in the December quarter, the March quarter result has relapsed into negative territory, to be more consistent with the negative pattern observed in the three quarters prior to the December quarter. This suggests that perhaps the December quarter result was more of a "blip" in the data due to seasonal factors than an accurate representation of the underlying trend, which appears to be still weak. On balance, more survey respondents reported poor conditions than good. Driving the result were broad-based decreases across the three key components that make up the index: employment, trading and profitability, trading conditions registering the sharpest drop.

Strong protein export demand in the December quarter due to the holiday season and Lunar New Year which followed would have skewed the result in the quarter somewhat. However, it is worth mentioning that the movements in the agribusiness result are in contrast to that of industry overall, which suggests that conditions during the March quarter were relatively more favourable. Agribusiness confidence remains in negative territory following a minor deterioration of 2 points to -9, possibly reflecting weak expectations on export sales, sales margins and adverse sentiment on wheat and farm equipment.

Conditions weaker on demand, government policies and exchange rate concerns

Despite an improvement in financial market sentiments and the emergence of some "green shoots" in the domestic economy, such as recovering retail sales and housing market, sluggish consumer demand continues to weigh on the post farmgate agribusiness industry. According to the survey results, 63% of survey respondents cited sales and orders as a

constraint on output while more than half of respondents cited demand as being the most constraining factor likely to impact on profitability over the next twelve months. Compared to December quarter, a higher proportion of respondents reported less forward orders and export sales which culminated in poorer trading conditions in the March quarter. A higher share of respondents also reported that they had fewer employees and poorer cash flows.

Medium-term expectations are still resilient

Despite poorer current conditions, post-farmgate agribusiness's expectations for business conditions for the next 12 months are decidedly positive still. Similarly, expectations on profitability were also quite solid, with 42% of respondents expecting an improvement in the next twelve months, marginally above the 39% for the broader economy. The lack of demand continues to be the most cited constraint on future profitability; weighing on respondents' minds are also future tax and government policies and exchange rate. Consistent with the current low interest rate environment and soft labour market, respondents view interest rates, wage costs and the availability of suitable labour as relatively minor constraints on future profitability. The overall optimistic outlook has translated into significantly stronger expectations for capex plans in the next 12 months, to their highest level since December quarter 2011.

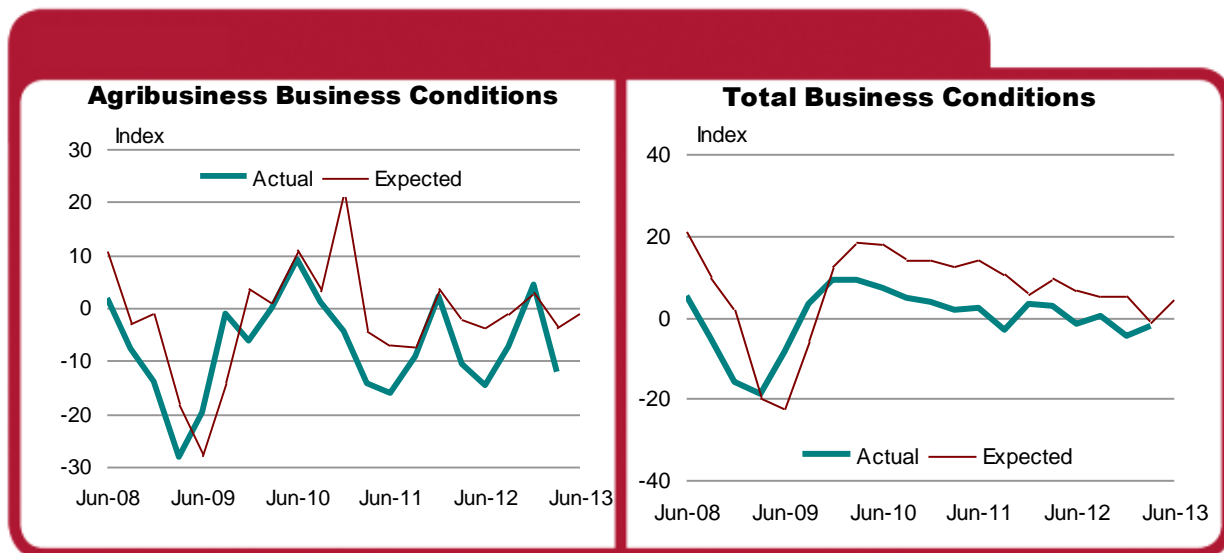
Key Survey Indicators

	Q3	Q4	Q1
Index	2012	2012	2013
Business Conditions	-7	4	-12
Business Confidence (r)	-13	-7	-9
Trading	0	10	-13
Profitability	-14	-3	-18
Employment	-9	6	-5
Expected Conditions - 3 months	3	-4	-1
Expected Conditions - 12 months	16	13	13
Forward Orders	-9	5	-5
Capacity Utilisation (%)	76.7	78.5	79.4
Capex Plans (Next 12 months)	5	6	20

r Corrected from previous issue
Source: NAB Group Economics

Post-farmgate agribusiness conditions slumped from December-quarter high

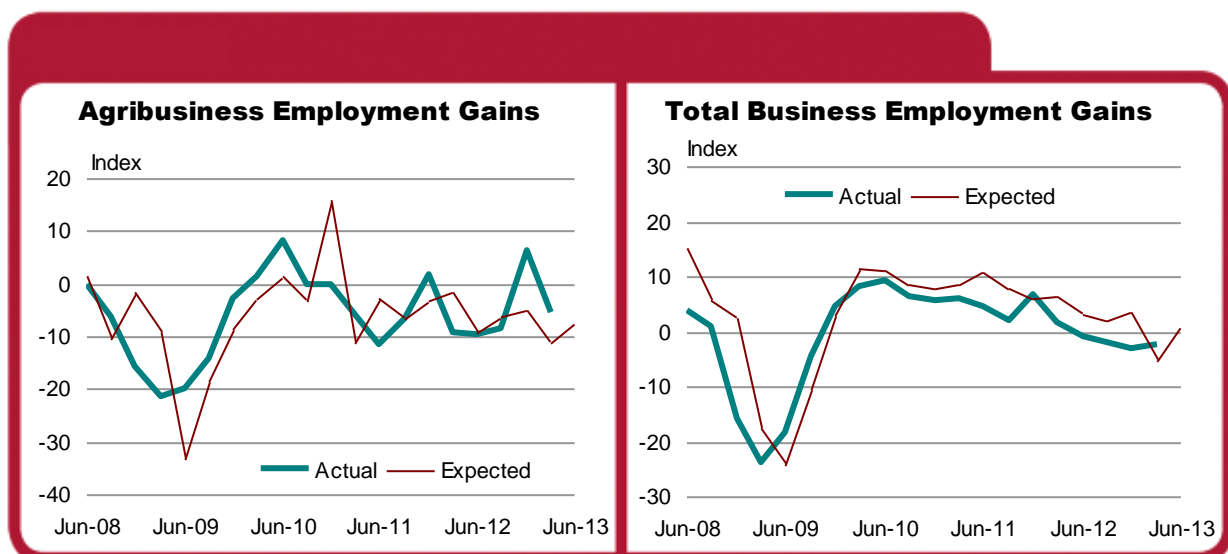
After a strong December quarter, the agribusiness conditions index has more than reversed its gains from last quarter to be back in the negative territory. This means that, on balance, conditions were perceived by survey respondents as poor or very poor. According to the survey, 29% of the respondents have cited poor or very poor conditions, compared to 22% in the December quarter. The softening of the index reflects broad-based deteriorations in profitability, employment and trading conditions. The largest drop was recorded in trading conditions, which decreased by 23 points. That said, the fall is relative to the high base in the December quarter, which tends to be seasonally strong. In contrast, total business conditions have fared better in the March quarter, possibly reflecting improved confidence in global financial markets and tentative recoveries in the retail and housing sector in Australia.



Source: NAB Group Economics

Post-farmgate employment softened

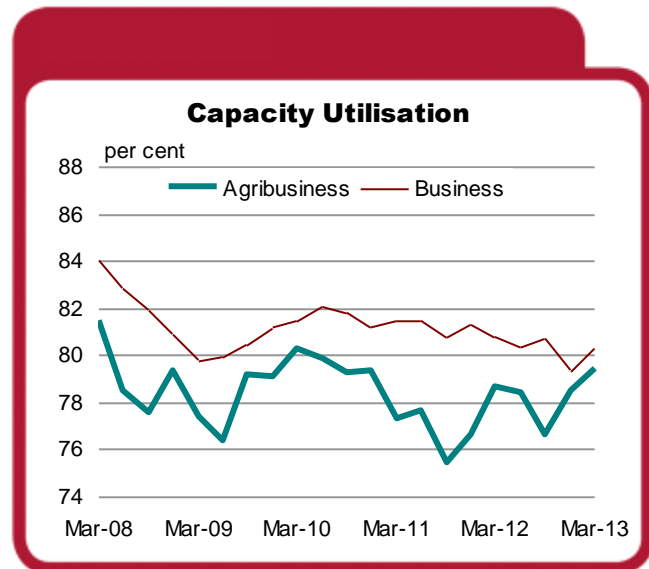
Employment conditions deteriorated in the March quarter, partly offsetting the gain made in December quarter. The survey results showed that on balance, there are more respondents reporting a decrease in hiring in the quarter compared to those which increased their staff numbers. The result is consistent with poorer trading conditions (less forward orders and export sales) which could have influenced businesses' reluctance to hire. In contrast, there was a modest pickup in employment conditions of total businesses as a whole. The three-month employment outlook is also rather cautious, however, with 71% of respondents indicating that they are inclined to keep their employee numbers unchanged.



Source: NAB Group Economics

Capacity utilisation ticked up despite poorer conditions

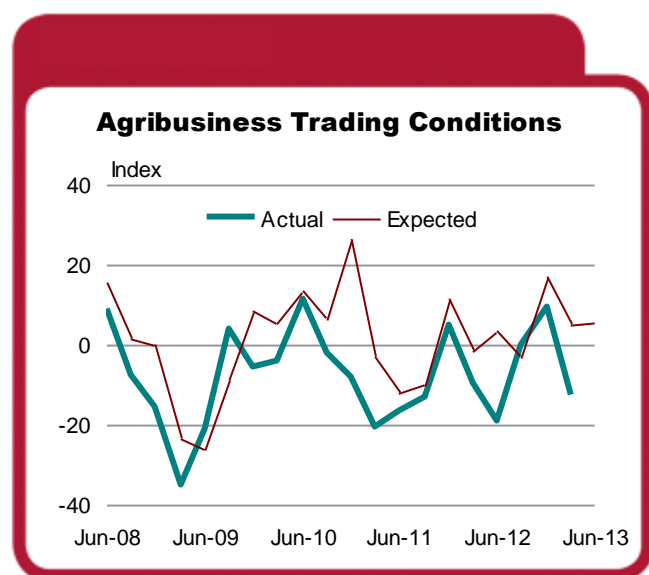
Bucking the trend of most measures of business conditions, capacity utilisation of post-farmgate businesses has ticked up again in the March quarter to 79.4%, which is above its long-term trend. This suggests that businesses might be in a phase of inventory building in response to low stock levels in the quarter. The narrowing of the gap in capacity utilisation between agribusiness and total businesses as a whole suggests that the declining trend in the productivity of post-farmgate businesses could be ending and some businesses could be looking to expand their productive capacity.



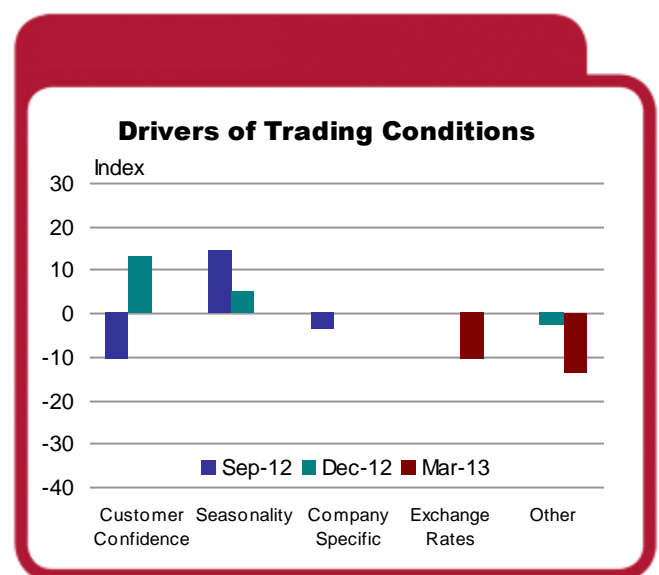
Source: NAB Group Economics

Trading conditions softened on stronger exchange rate and higher input costs

Trading conditions slumped heavily in the March quarter after two consecutive quarters of growth, to be back in negative territory at -13 points from +10 points in the previous quarter. One of the major contributors to the quarter's result was likely to have been the exchange rate, which appreciated over the quarter. Post-farmgate businesses generally faced higher input costs over the quarter as well, as prices of meat (beef, lamb and poultry), dairy, wool and cotton have risen substantially over the quarter, potentially weighing on the margins of businesses such as food processors and woollen mills.

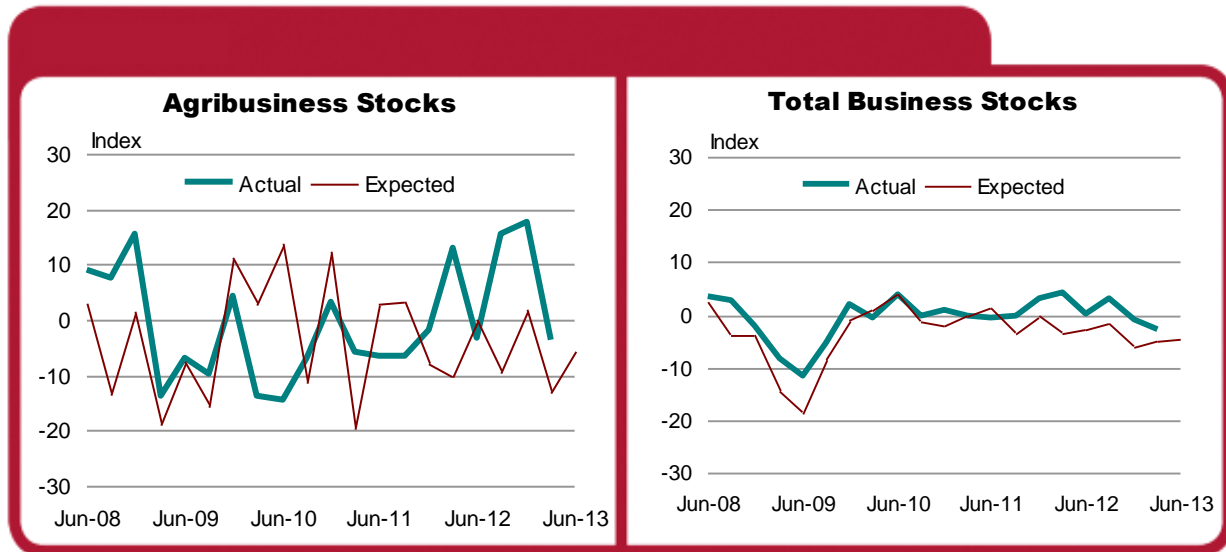


Source: NAB Group Economics



Stocks slipped on destocking cycle and lower forward orders

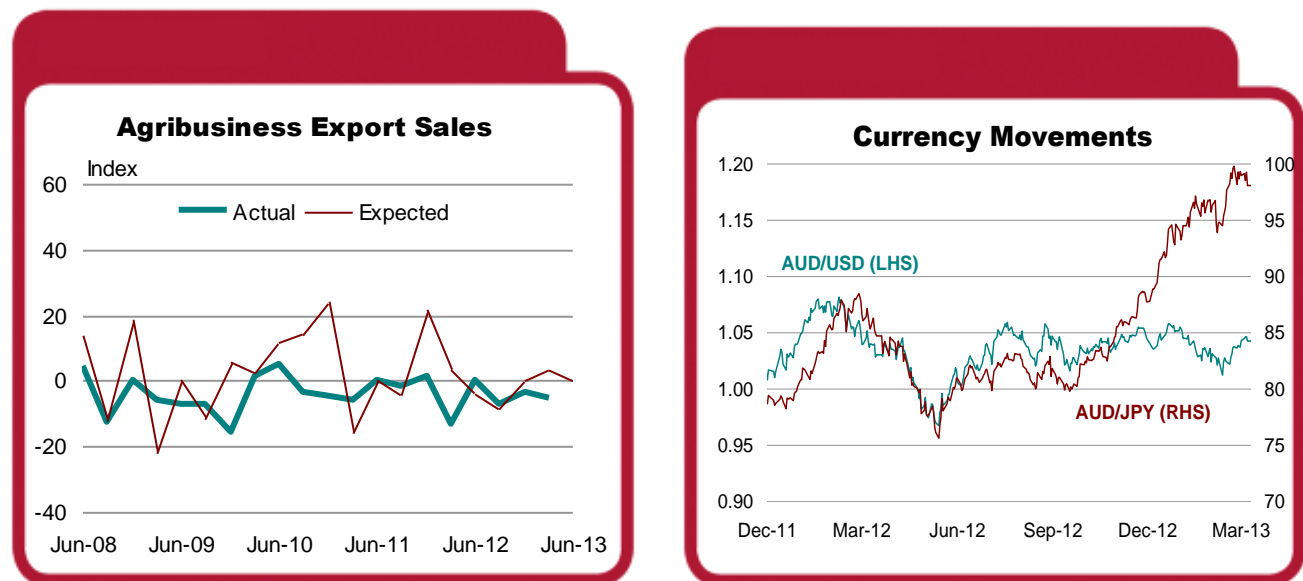
The stock levels index fell sharply in the March quarter, possibly reflecting more businesses opting to run down their inventories built over the second half of last year and lower future orders in the quarter. According to the survey results, 23% of respondents reported a decrease in stock levels during the quarter relative to 18% reporting an increase. The index level is nevertheless higher than the expected level of -13. When asked about future stock levels, respondents expect an improvement in the June quarter with destocking carried out by a smaller share of businesses.



Source: NAB Group Economics

Export sales remained subdued in the March quarter

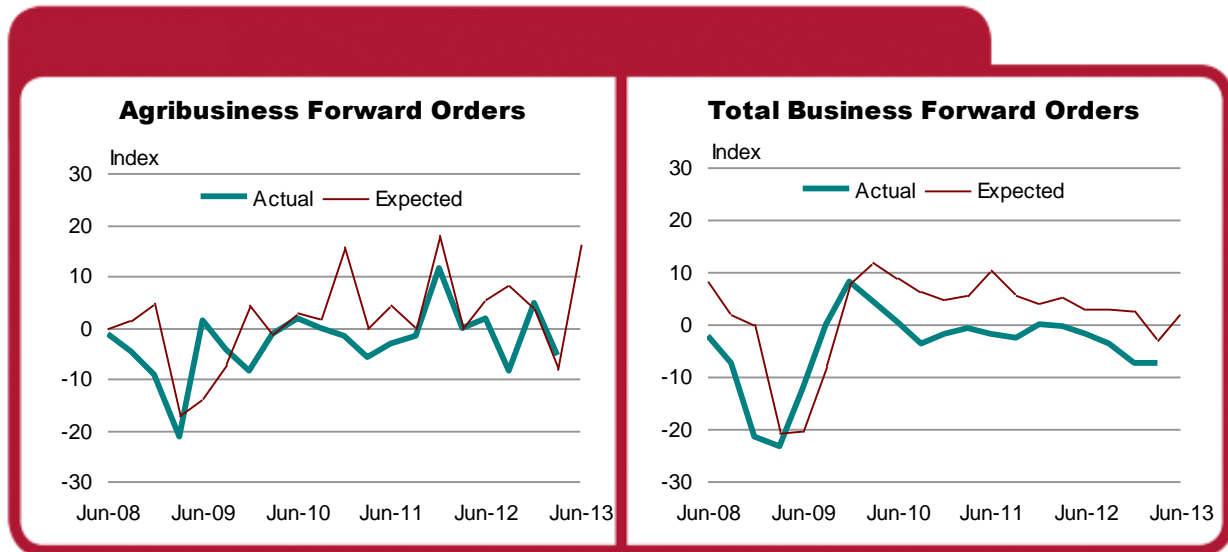
The sustained strength of the exchange rate, further enhanced by an appreciation of the AUD against the USD and JPY over the March quarter, has kept a lid on export sales conditions. The rise of the Australian dollar against the Japanese yen has been especially stark as a result of aggressive monetary easing by the Japanese central bank, to be fluctuating around the 100 yen mark at present. As a result, the export sales index is still mired in negative territory, and has not recorded a positive reading since December quarter 2011. According to the survey results, just 13% of survey respondents reported an increase in export sales in the quarter while 21% reported a decline. When asked about the quarter ahead, expectations by survey respondents were neutral on balance, indicated by the expectations index of 0 in the June quarter.



Source: NAB Group Economics, RBA

Forward orders moderated in the March quarter

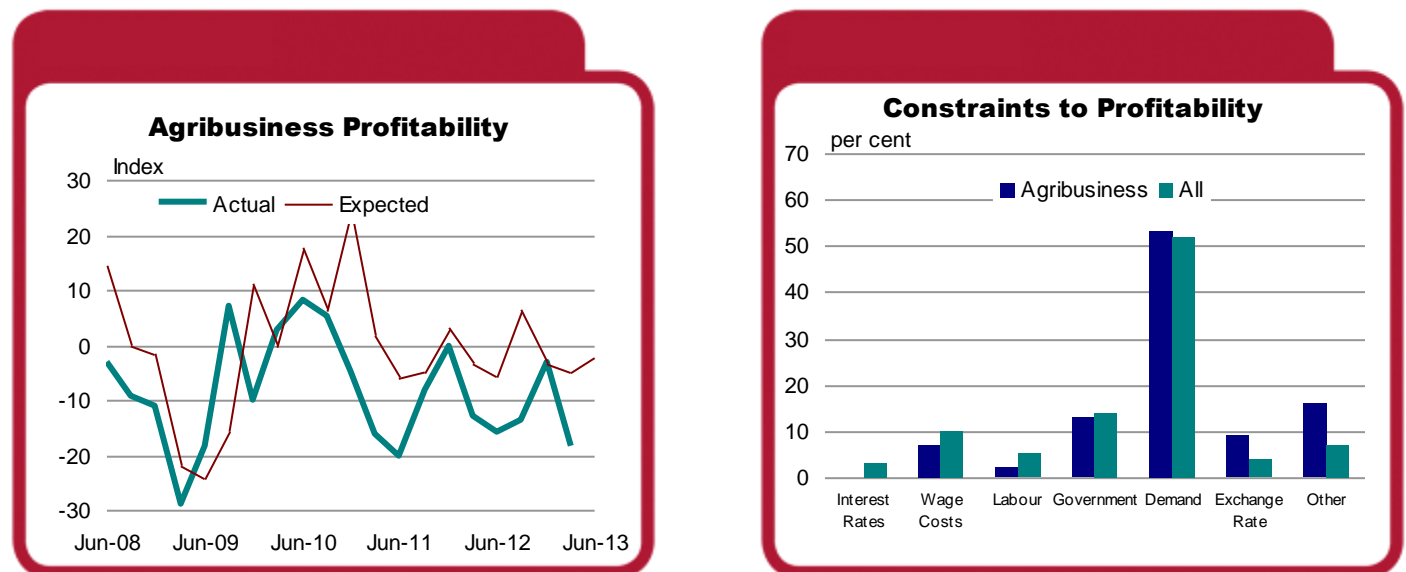
Forward orders from the customers of agribusinesses were down in the quarter, with the index falling by 10 points to -5 points. Some customers could have been deterred by the higher prices observed in a number of agricultural products, such as meat and dairy, in the quarter. According to the survey results, 30% of respondents reported lower forward orders while 22% reported an increase. Survey respondents are significantly more upbeat about the June quarter, with the expectations index at +16 points.



Source: NAB Group Economics

Profitability remains very much subdued

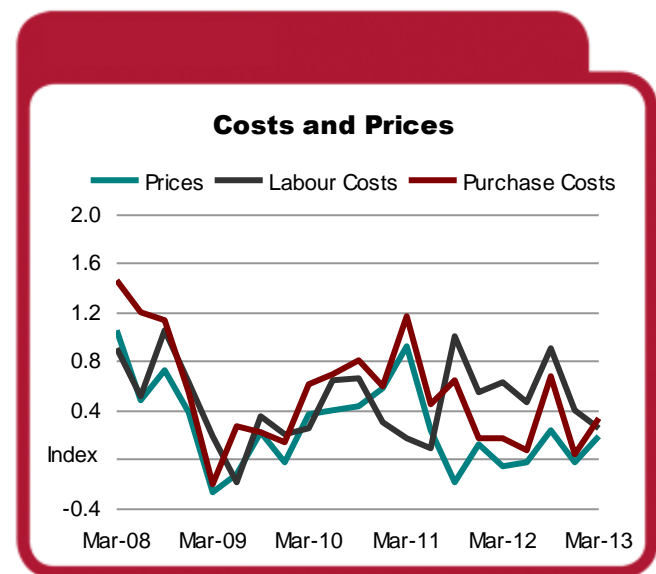
Consistent with the trends across broader businesses, the lack of demand is expected to be the most constraining factor on post-farmgate businesses' profitability over 2013. More than half of respondents reported demand as a major constraint on future profitability, bringing the index down by 15 points to -18. Firms also reported "other", "government and policy" and "exchange rate" factors as relatively constraining. Consistent with historically low borrowing rates as well as the relatively low rate of capacity utilisation in the economy at present, respondents view interest rates and the availability of suitable labour as relatively minor constraints on future profitability. In the March quarter, 40% of respondents reported poor to very poor profitability while 21% reported good to very good profitability. For the quarter ahead, survey respondents were a little more optimistic, with the expectations index at -2 points.



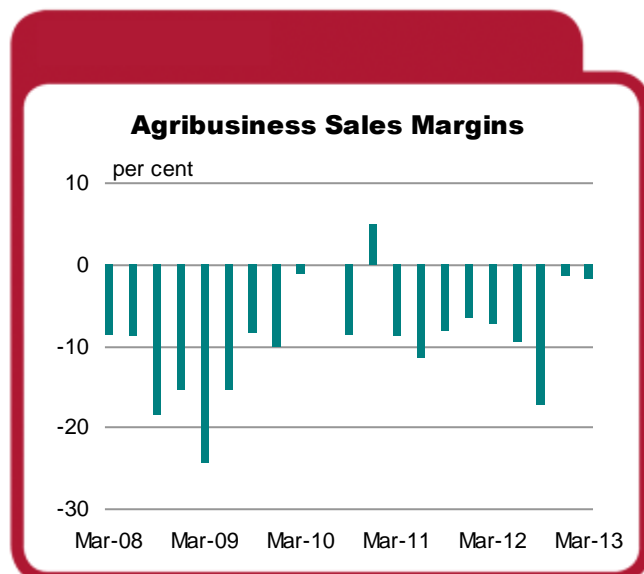
Source: NAB Group Economics

Sales margins conditions unchanged in the March quarter

Sales margins conditions remained unchanged in the March quarter, with the increased share of post-farmgate businesses reporting poorer results balanced by an equal rise in the share of businesses reporting stronger margins. In the quarter, prices of products were higher and labour costs lower; however these are offset by a rise in purchase costs. According to the survey results, 24% of respondents reported an increase in sales margins compared to 26% reporting a fall.

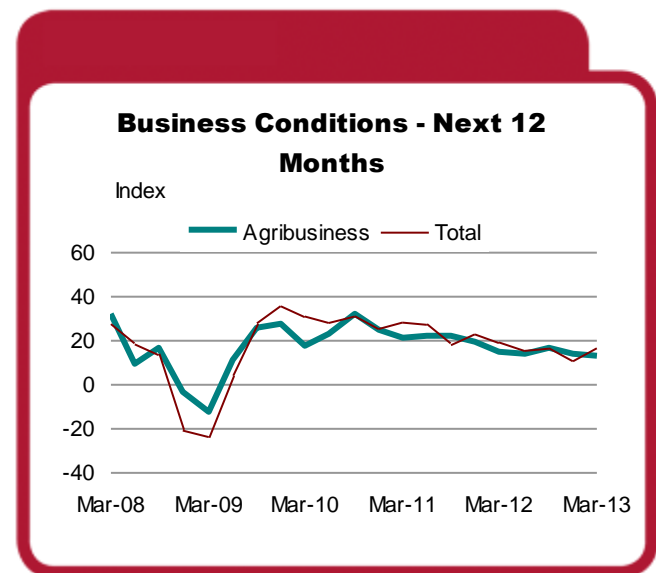


Source: NAB Group Economics

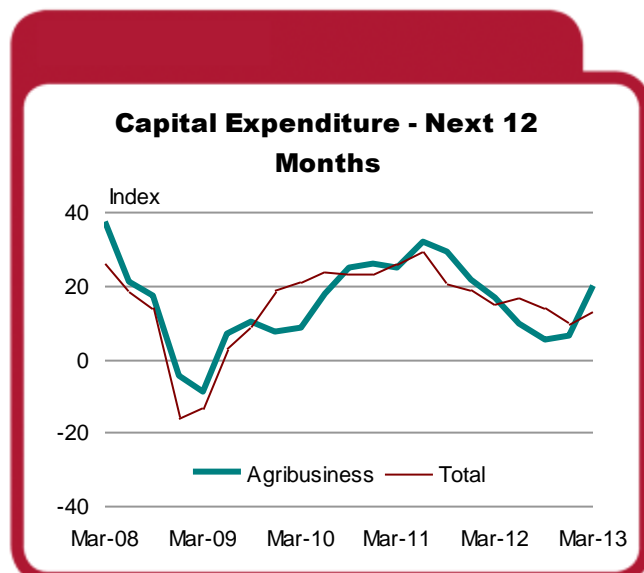


Long-term expectations softened but capex plans improved modestly

Medium-term expectations for business conditions within the post-farmgate agribusiness sector were largely unchanged in the March quarter at +13 points, a level which is very similar to that of total businesses. Despite the fall in long-term expectations index, the index for expected capital expenditure over the next twelve months surged to the highest level in a year. This suggests that some post-farmgate businesses might be taking advantage of the current low-interest environment to obtain credit from banks to upgrade their business facilities.



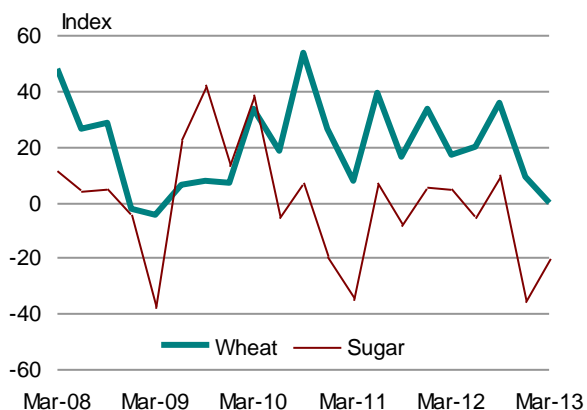
Source: NAB Group Economics



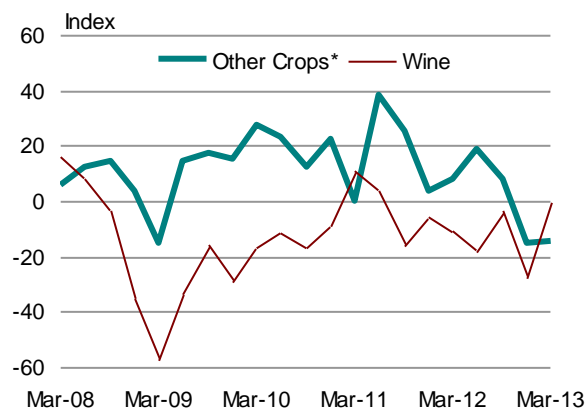
Agribusiness confidence in commodities and other supplies

Post-farmgate agribusiness confidence in crops had improved, on balance, over the March quarter. Of all crops, wine recorded the sharpest uptick in its confidence index, driven by growth of bottled wine exports in the higher price segments to major overseas markets, such as the US. Confidence in sugar was up slightly, but the index is still significantly negative as sugar prices are now at their lowest point since December 2010 due to surplus global production. The wheat confidence index fell sharply in the quarter to the neutral point as prices tumbled due to recovering corn and soybean production which are preferred as animal feed ingredients. The confidence for other crops remained largely unchanged in the March quarter.

Agribusiness Confidence in Crops



Agribusiness Confidence in Crops



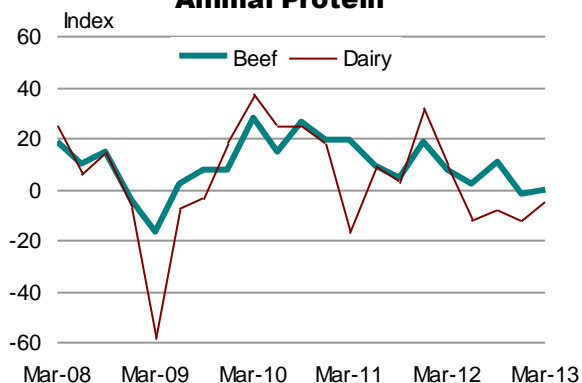
*Includes fruit, vegetables, fodder

Source: NAB Group Economics

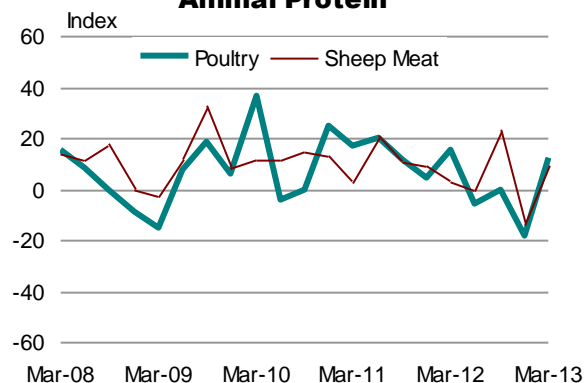
Post-farmgate agribusiness confidence in animal proteins was generally more positive in the March quarter, with poultry being the standout at +13 points, followed closely by sheep meat at +10 points. Dairy also recorded an improvement to be still marginally negative at -4 points. The sentiment for beef improved slightly to be at the neutral point.

Rising costs of feed, which are borne by the poultry meat processors, have been weighing on confidence on businesses for some time now but they are likely to moderate from the coming quarter onwards from falling grains prices. On the other hand, strong demand for lamb exports by China and the Middle East has helped to lift sentiment despite comfortable supply conditions. For dairy, higher purchase costs of milk from farmgate from the lack of supply is still weighing on sentiment, although it is likely that some dairy processors also benefit from the flow-through of higher prices for the processed dairy products.

Agribusiness Confidence in Animal Protein



Agribusiness Confidence in Animal Protein

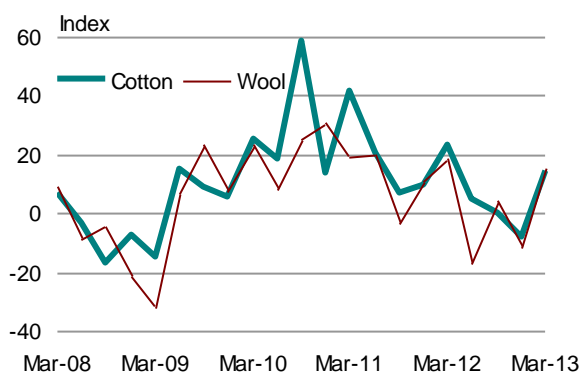


Source: NAB Group Economics

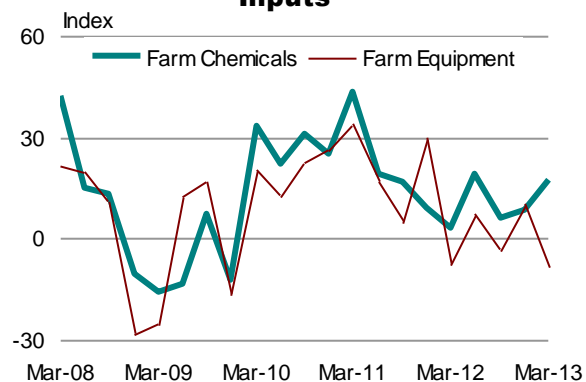
Confidence in fibres was broadly higher in the quarter, with indices for cotton and wool both breaking into positive territory. The index for wool rose by 27 points to +16 while cotton climbed 22 points to +14.

Agribusiness confidence in farm input was mixed in the quarter, with the fall in confidence for farm equipment partly offset by a rise in confidence in chemicals. Confidence in farm equipment has been fluctuating around the neutral mark for the last year, suggesting that the earlier perceived affordability advantage from a high exchange rate has waned somewhat from a prolonged period of AUD strength. Positive sentiment around chemicals is largely based on the currently low levels of fertiliser inputs such as natural gas, urea and Diammonium Phosphate (DAP).

Agribusiness Confidence in Fibres



Agribusiness Confidence in Farm Inputs



Source: NAB Group Economics

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About the Agribusiness Survey:

The agribusiness survey is a cohort of the NAB Quarterly Business Survey which surveys approximately 900 small/medium to large sized Australian companies. The agribusiness sample is approximately 100 small/medium to large sized companies, mainly in the food manufacturing industry but also wholesaling, services, and a small number of firms in other sectors. Gundabluuey Research Pty Ltd mainly conducts the survey over a two-week period in the final month of each quarter. To ensure the highest possible accuracy, respondents to the survey are chosen at random from those firms with 40 or more employees.

Definitions

Business confidence is a measure of respondent's expectations of business conditions in their industry for the upcoming quarter. Business conditions are a simple average of trading, profitability and employment indices, reported by respondents for their company. The trading, profitability and other indices are calculated by taking the difference between the percentage of respondents nominating good or very good, or a rise and those nominating poor or very poor, or a fall. For example, if 25 per cent of respondents state that trading levels are good or very good and 10 per cent state these levels to be poor or very poor, the corresponding index of trading performance would be 15. The Capacity Utilisation Rate measures the degree to which an industry is operating at or below full capacity level. The full capacity rate is defined as the maximum desirable level of output given existing capital equipment. The Capacity Utilisation Rate is calculated as the average of respondents' capacity utilisation for the quarter. The cost and price change indices are the average of respondent's estimates of past and expected cost and price movements.

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