GRAIN INSIGHTS NOTE

July 2020

GRAIN INDUSTRY REMAIN HIGHLY COMPETITIVE

Every grain producer knows the resilience that comes with working in this sector, whether through the long hours of sowing, harvesting and carting the crop, or having to be prepared for the success of high prices and a good crop, or at the mercy of the weather and global forces way beyond your control.

In the period of Covid-19, all industries – grain, other agri sectors, and beyond – have been tested in ways like never before.

Through the second half of 2020 and into 2021, the grains industry will face a number of new challenges. The task for the industry will be to evaluate how Covid-19 has impacted it so far this year, domestically and globally, as well as how these factors are likely to influence it going forward.

Importantly, the industry needs to prepare and strategize for the confluence of major global factors set to continue impacting the sector.

The grain production sector is by its nature a resilient industry. In comparison with other globally traded agri commodities, grains is arguably the most competitive sector, with the top 12 exporters making up 80 percent of world trade. With this mix of exporters, major import markets have the ability to switch suppliers reasonably easily. As a result, the Australian grain industry has become accustomed to remaining continually focussed on maintaining relationships, while keeping aware of new markets. In addition, in a bid to continually meet the evolving demands of global consumers and feed markets, the Australian grains industry must continue to develop new innovations, both in terms of the grains themselves, as well as the supply chain processes.

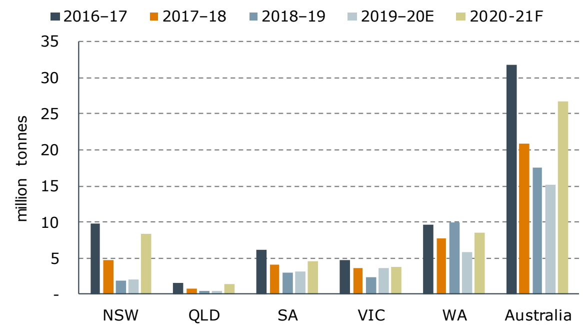
Arguably, the biggest driver facing the grains industry right now is too much of what should be a positive development for grain farmers around the world – the relatively good growing season for all of the major grain producing countries. As a result, the outlook is for a record global crop overall, with a number of grain producing countries forecasting record production level. While some of the major producers and exporters are forecast to see slight falls from last year, most notably from Europe, the forecast combination of high grain production and stocks points to minimal signs of strong price rises in the months to come.

INDUSTRY NEEDS TO PREPARE AND STRATEGIZE FOR THE CONFLUENCE OF MAJOR GLOBAL FACTORS SET TO CONTINUE IMPACTING THE SECTOR

AUSTRALIA FORECASTING A RECORD HARVEST

For Australia, the industry is cautiously optimistic that 2020/21 will see the best wheat crop in five years. While forecasts will vary, the current projection is that Australia could see a wheat harvest of 26 million tonnes in 2020/21, which would be up 71 percent on last year's drought-hit low of 15.2 million tonnes.

Australia Wheat production by state



Source: ABARES

This forecast remains a cautious one, as while most grain-growing regions of Australia experienced a good start to the season, a number of them saw little or no rain throughout June this year. With four or five months to go until the harvest starts, these regions will need to see a return of good moisture to see their crops reach their potential.

On the back of the production outlook, grain exports are also forecast to see a major turnaround from last year, predicted to jump 90 percent to 17.5 million tonnes. This would see wheat exports accounting for around 67 percent of Australia's total production, a figure which is in line with the average proportion of the last ten years.

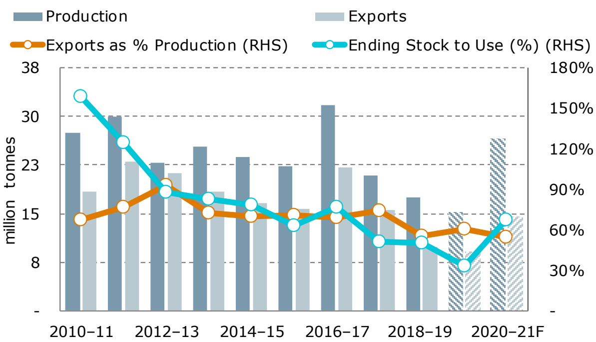
On its own, a strong recovery in production is definitely good news for the sector. That said, swings of these proportions in both production and exports also come with impacts which need to be factors in to industry planning.

To put it in proportion, a 42 percent increase in national wheat production would be the second largest increase in 24 years. For exports, not only would a 90 percent rise on the previous year also be the second largest in almost a quarter of a century, it would also be the fourth largest year-on-year rise in at least the last 50 years.

At a farm level, where a lot of growers would have seen their wheat production levels fall for around six of the past seven years, a rise of this volume will require a number of important strategic operational decisions. Many growers will need to evaluate what proportion of grain they may store on their farms, rather than sending to grain receival sites, and how to ensure they have adequate storage facilities should this eventuate, whether in silos, bunkers or other options.

Operationally, with prices for cattle and sheep continuing to remain at strong levels, a number of grain producers will also be evaluating the balance of stock versus crop acreage in their mixed farming operations. As part of this, amongst a number of other considerations, they will be balancing in the level of feed grain they will store on-farm, and how this will tie in with their own budgeting forecasts on possibly either buying feed or selling grain.

Australia Wheat Production & Exports



Source: ABARES

For grain traders and receival site operators, the build up to this year's harvest will similarly need to focus on ensuring that logistical capabilities and storage capacity are prepared for the scale of crop which could eventuate. In the record wheat crop of 2016/17, some industry stakeholders were caught unprepared by the scale of the crop, leading to some logistical challenges along the supply chain.

In comparison, the forecast year-on-year crop increase in 2020/21 will be greater than that year, in both volume and percentage increase.

In terms of the Australian wheat stocks-to-use ratio, an indicator of the end stocks compared to the total usage, and one which is regarded as having reasonable impact on price, current forecasts have Australian wheat as heading for 20 percent, which is consistent with the average figure for the past decade. On this outlook, Australian wheat prices would seem unlikely to be headed for strong upward pressure.

Similarly, the forecast percentage rise in wheat export volumes is also the fourth highest in the last 50 years. To put it in perspective, the major rise in Australia wheat exports in 2016/17, which presented some challenges to the Australian wheat export supply chain at the time, was 40 percent on the previous year, while the current forecast for the 2020/21 export rise is up 90 percent on the previous year.

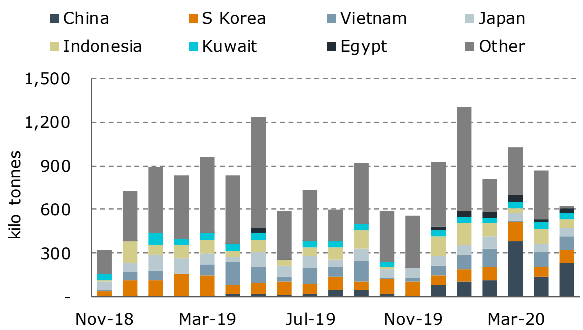
To this end, it will be important for the industry to ensure that any potential issues such as port access and capacity or possible Covid-19-related bureaucratic issues at the receiver end are planned for in advance. In addition, for companies utilising containerised grain, any issues arising out of the reduced availability of containers due to Covid-19 related shipping interruptions will also need to be factored into planning.

AUSTRALIA FORECASTING A RECORD HARVEST

On a very positive side for exports, the outlook for increased wheat exports to Indonesia has been enhanced by the Free Trade Agreement between the two countries announced in May this year. Under the agreement, which officially came into force on July 5, Indonesia has granted duty-free exports of up to 500,000 tonnes of feed grains – a category which includes wheat, sorghum and barley.

With last year's Australian drought hit crop offering limited supply, Indonesia largely sourced its feed grain needs from the Black Sea Region, as well as from Argentina. However, with the strong forecast for the coming harvest, Australian producers will be in a far greater position to capitalise on this opportunity. Going forward, the quota is scheduled to grow at five percent per annum, further increasing the market opportunity.

Australia Wheat exports by country



Source: Trademap

The new trade conditions are a clear indication of Indonesia's ongoing challenge not just for food security, but to ensure the smooth functioning of its complex food supply chain, and the important role that Australia will need to play in this scenario. With a population of around 270 million, and third highest population density of the world's ten most populated countries (141 people per sq. km, compared to Australia's 3 people per sq. km), Indonesia is challenged in its ability to grow feed for its beef and dairy cattle herds. In addition, limited cold supply chains mean that the country will continue to rely largely on live animals for its meat needs –

rather than meat imports – and the feed requirements which these animals bring.

GLOBAL WHEAT OUTLOOK

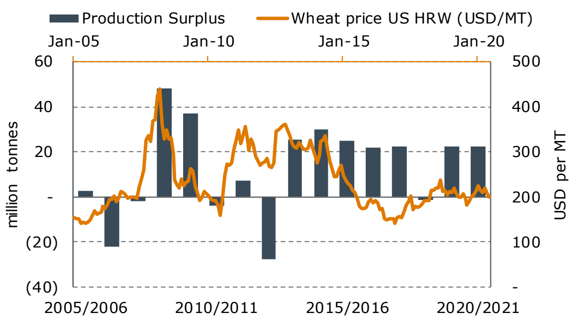
In terms of the current global outlook, the world continues to be on track for the biggest wheat crop ever, despite recent weather concerns in some of the major production regions. The global wheat crop is currently forecast to be up around five million tonnes on last year's figure, rising to just under 770 million tonnes.

While this would be a relatively small percentage increase, of around 0.7 percent, it comes against a backdrop of a forecast fall in global exports, largely due to countries with good wheat crops requiring fewer imports. As a result, the world's stocks-to-use ratio is currently forecast to hit 34 percent, the highest figure since 1968/69. Again, this is a further indicator of limited grain price rise potential.

For the big wheat producers, Canada and India are both forecast to grow their largest ever wheat crop, while Russia, China and Pakistan are forecast to grow their second largest crops.

Apart from the weather, the forces of geopolitics are likely to continue to impact the industry, though to what degree remains a matter of uncertainty. The effects of China's tariff hikes on Australian barley remain to be seen, including in terms of the time frame for the tariffs.

World Wheat Production Surplus & Price



Source: USDA, Worldbank

It has been noted that one beneficiary of the tariffs has been Canada, which has picked up some of Australia's China barley market share. This is at the same time as China's restrictions on Canada's canola exports have provided opportunities for Australian producers. As a result, some Canadian barley exporters are treating their new export opportunities with some degree of caution.

APART FROM THE WEATHER, THE IMPACTS OF GEOPOLITICS ARE LIKELY TO CONTINUE TO IMPACT THE INDUSTRY, THOUGH TO WHAT DEGREE REMAINS A MATTER OF UNCERTAINTY

One other driver to watch closely over the months until November will be the US election. The US rural vote is one both parties will fight hard to win, and the US government will work hard during this time to boost agricultural exports to boost its vote. Despite the apparent diplomatic tensions between China and the US, China recently imported substantial volumes of US corn, and is on track fulfil a commitment made at the start of 2020 to buy a record level of US agri exports, as a trade sweetener.

While the US agri exports may not directly challenge Australia's grain exports, they have the potential to shift the wider grain complex, particularly for feed, making the quest to find new markets, as well as growing existing ones, all the more important.

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