

Economic trends and opportunities for Australian agriculture

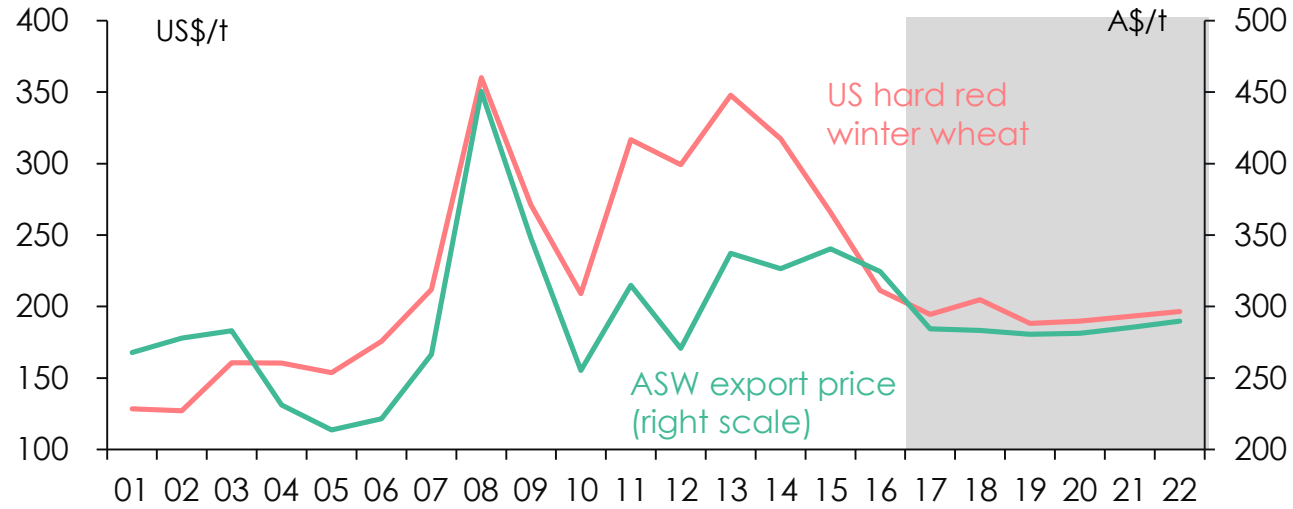
Saul Eslake



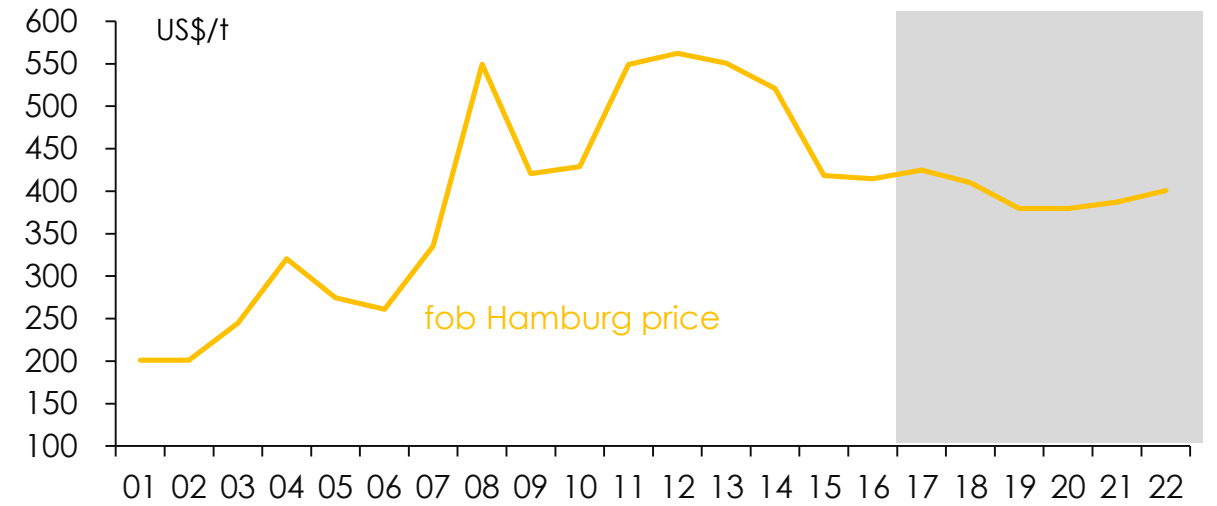
The outlook for commodity prices

Prices of Australia's major agricultural commodity exports expected to remain broadly stable over next few years

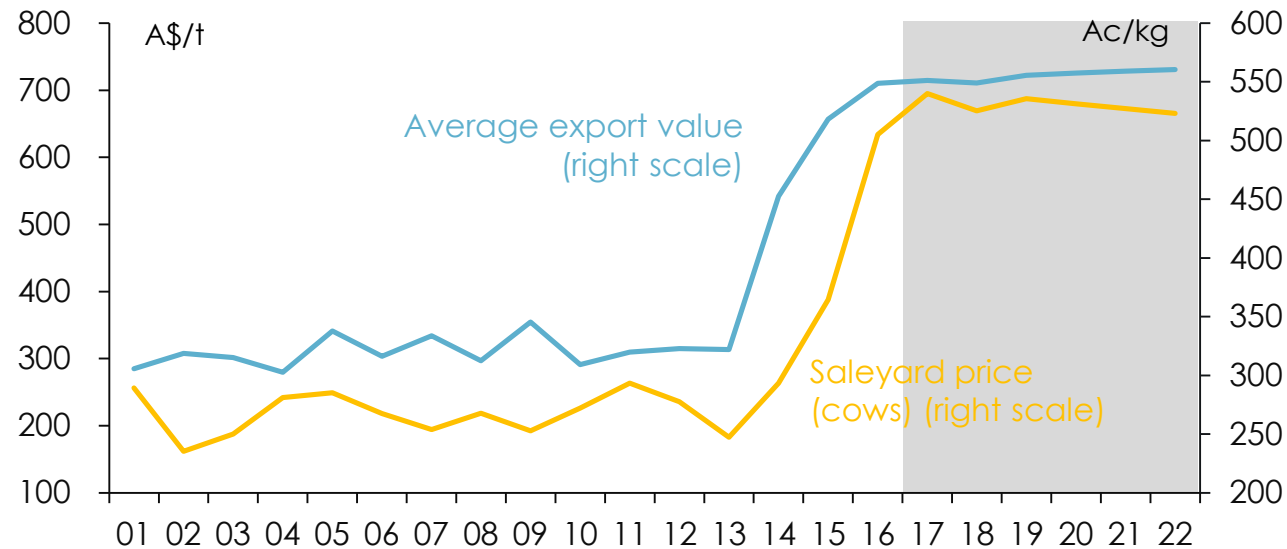
Wheat



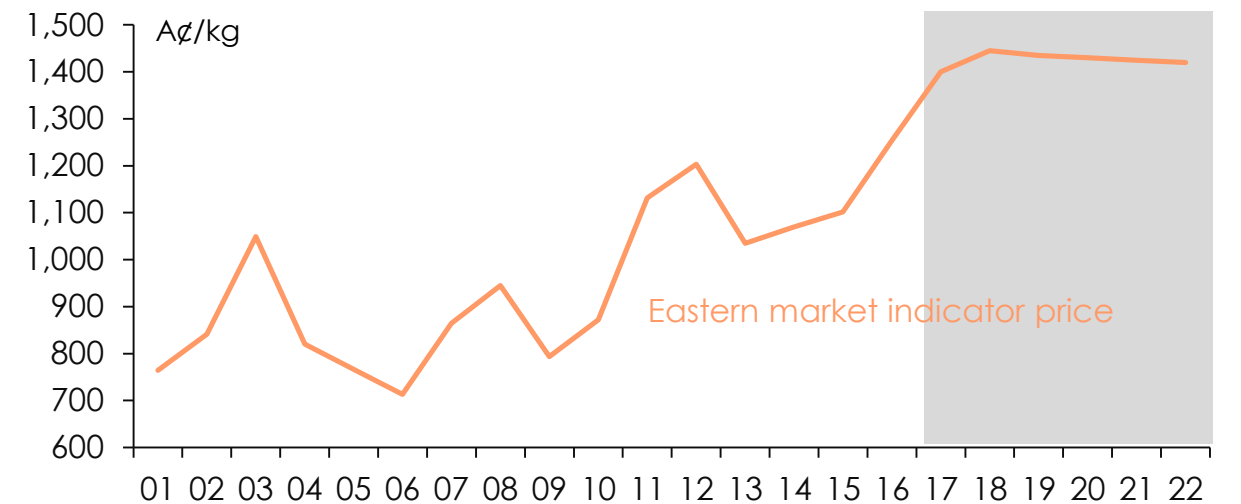
Canola



Beef



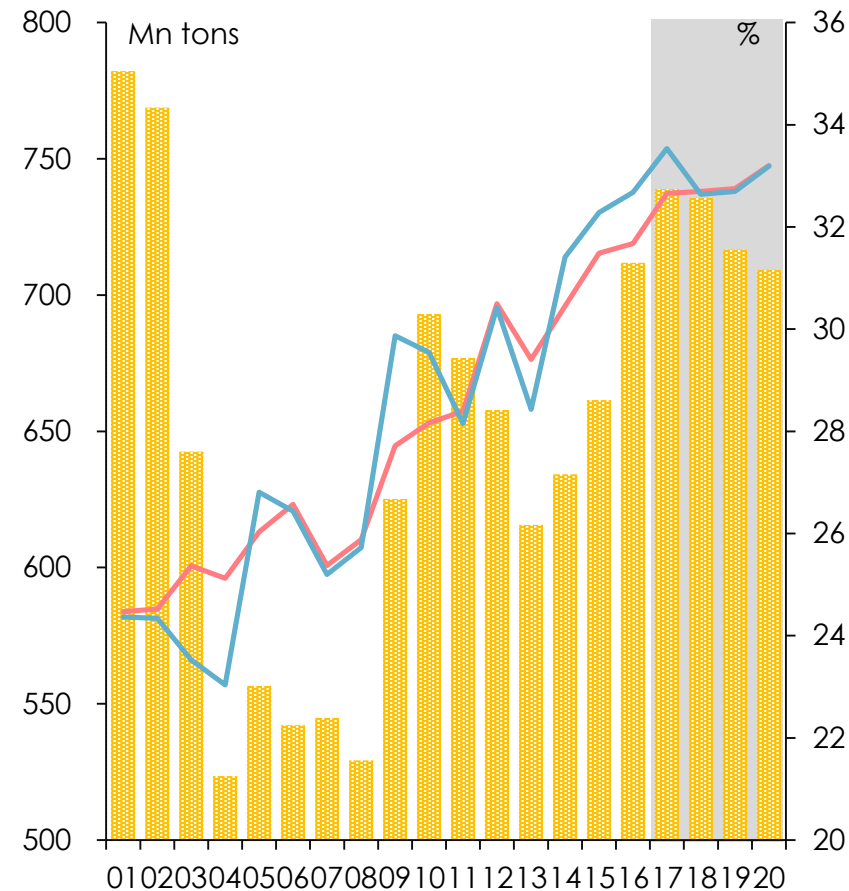
Wool



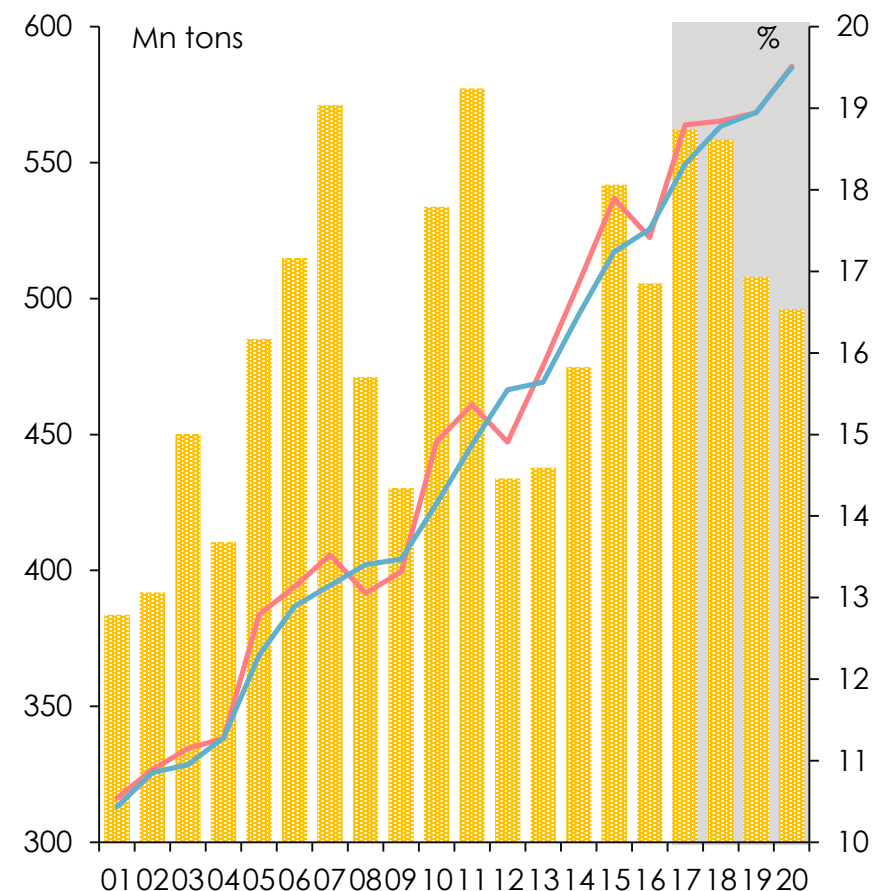
As (almost) always in agricultural commodity markets, prices reflect the interaction of global demand and supply

Global demand, supply and stocks of selected agricultural commodities

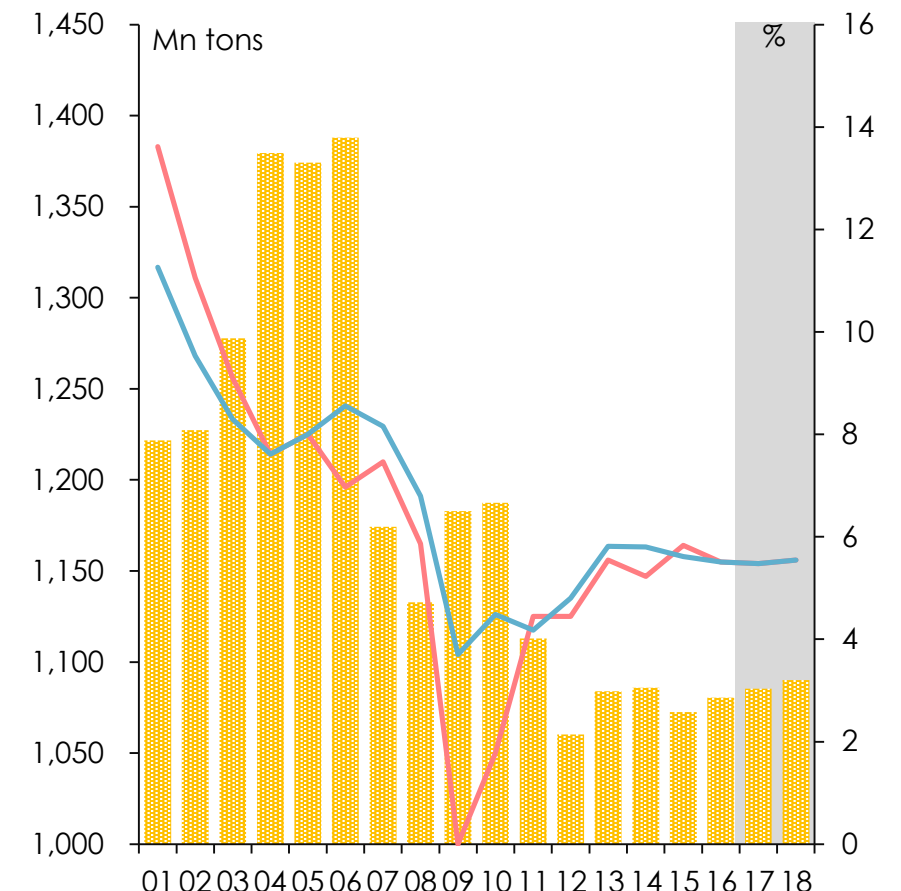
Wheat



Canola



Wool



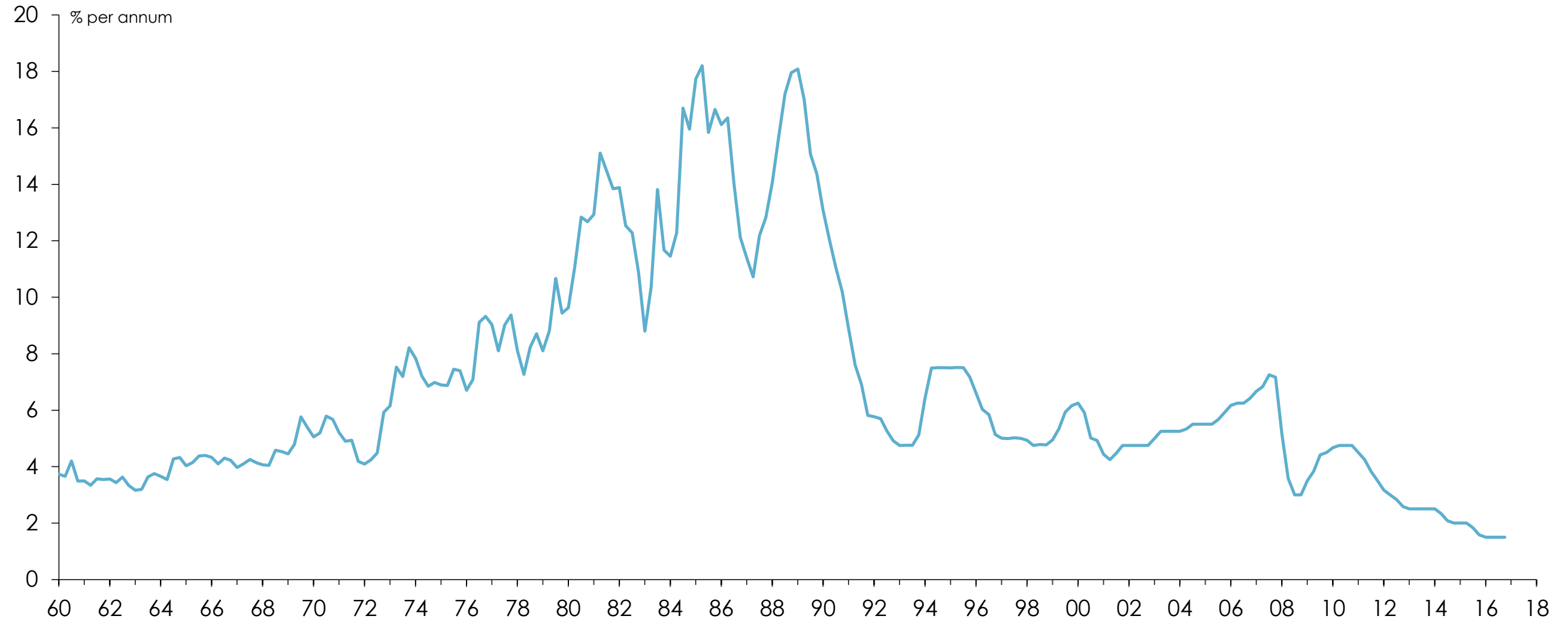
— Production (left scale) — Use (left scale) ■ Stocks (as a % of use) (right scale)

Source: ABARES, Australian Commodities, June 2017.

The outlook for interest rates

The Reserve Bank's official cash rate is the lowest it's ever been

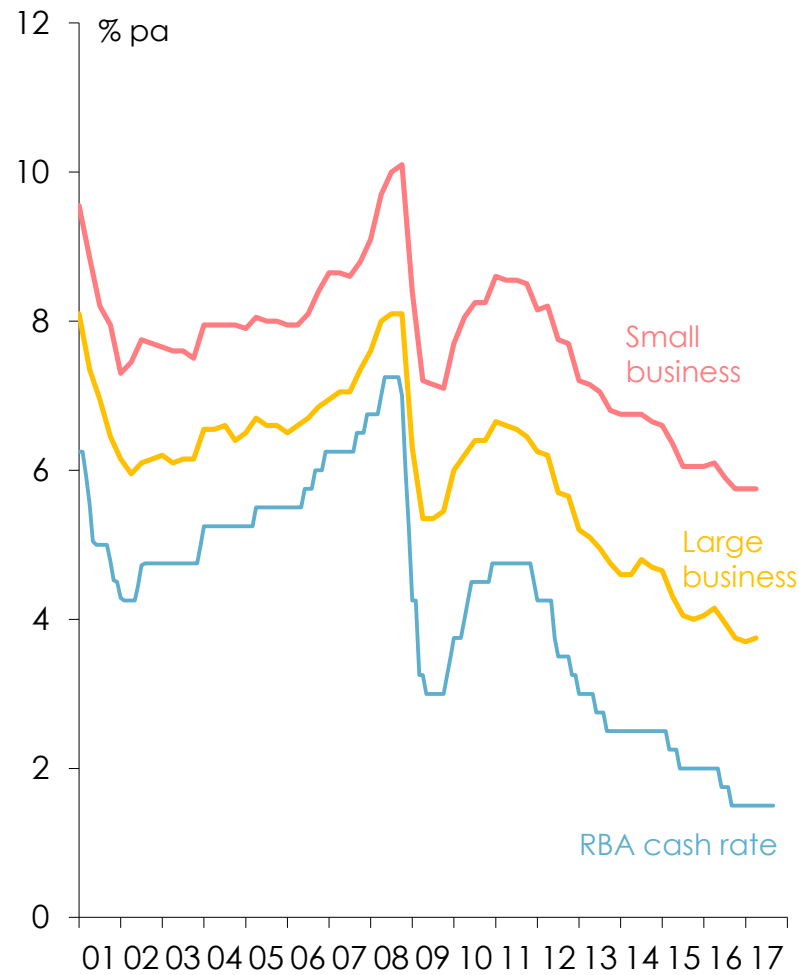
The Reserve Bank's official cash rate



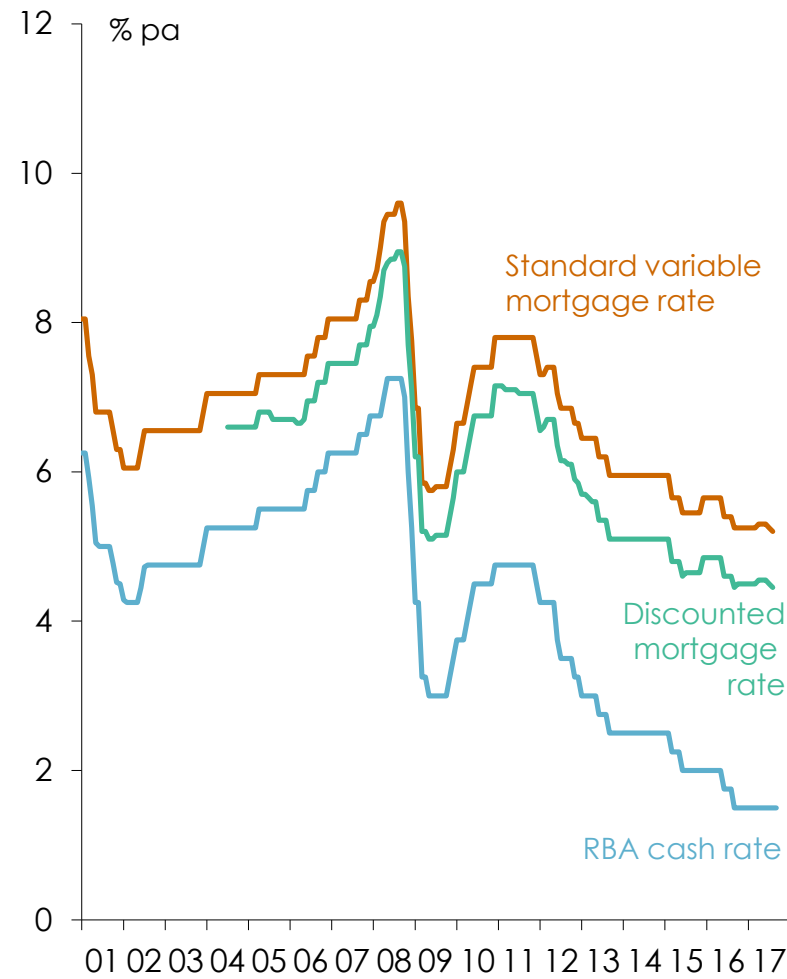
Source: Reserve Bank of Australia.

Interest rates actually paid on business and housing loans are also at record lows - though some rates have been rising on some housing loans

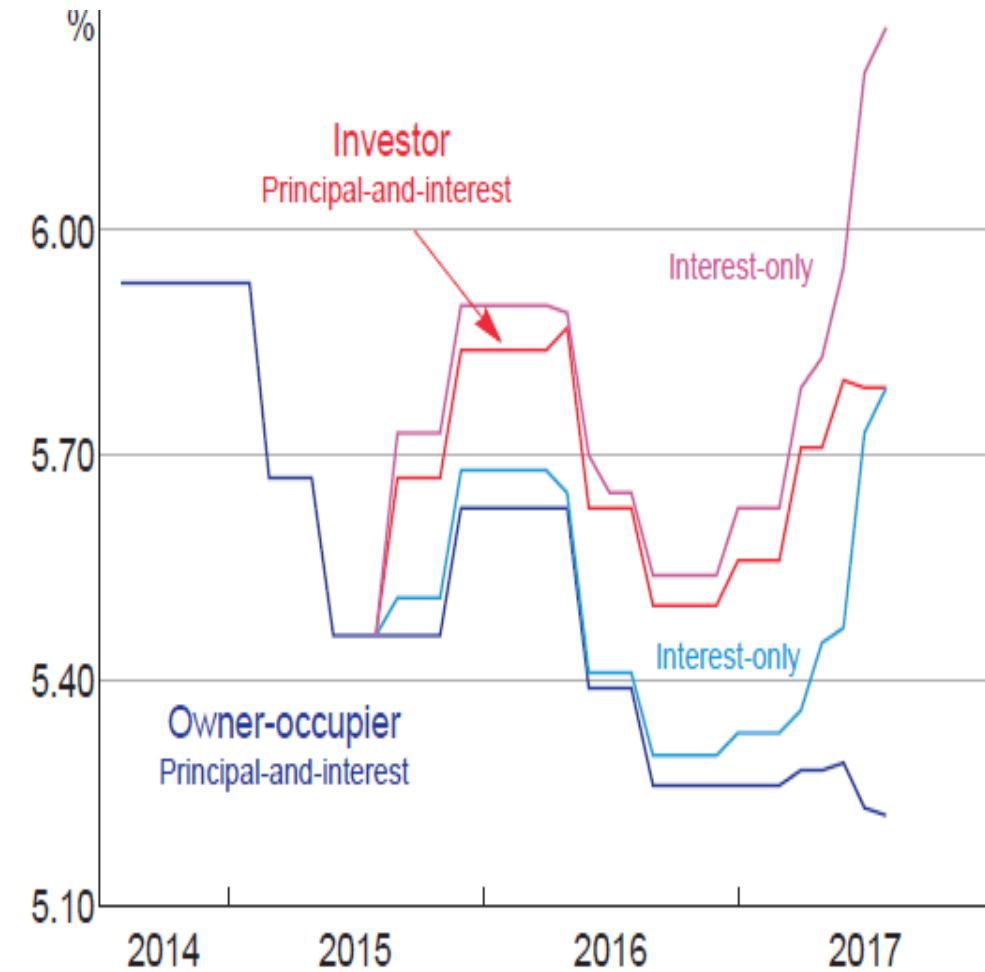
Business loan interest rates



Housing loan interest rates



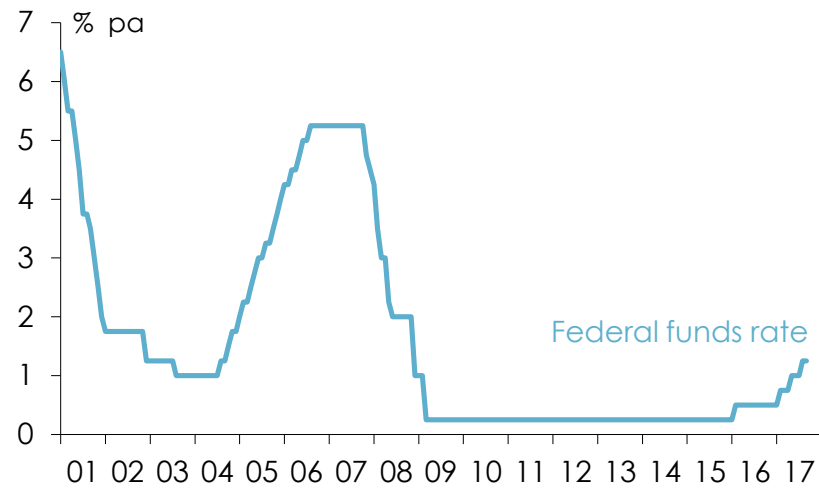
Recent developments in housing loan interest rates



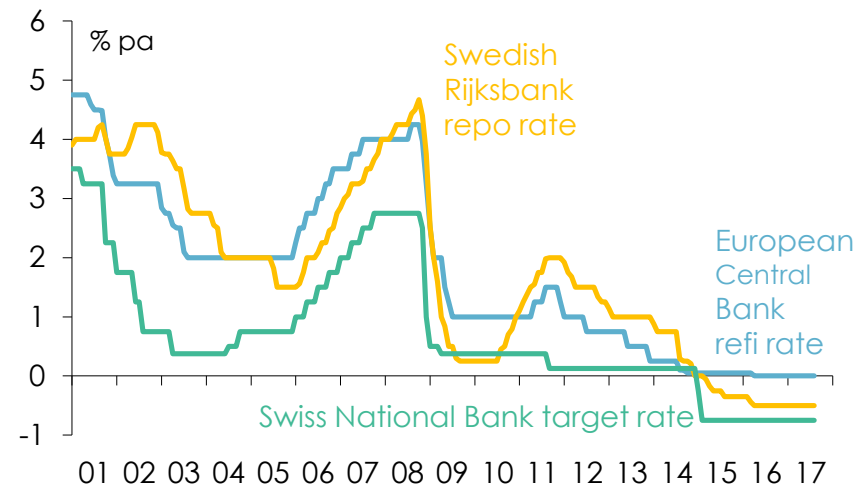
Source: Reserve Bank of Australia.

Interest rates in most major overseas countries fell to even lower levels than Australia after the financial crisis, but some are now starting to rise

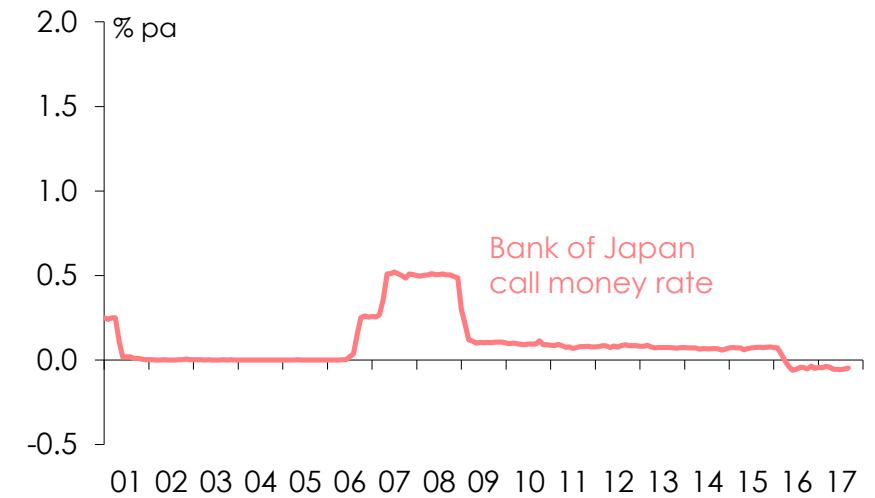
United States



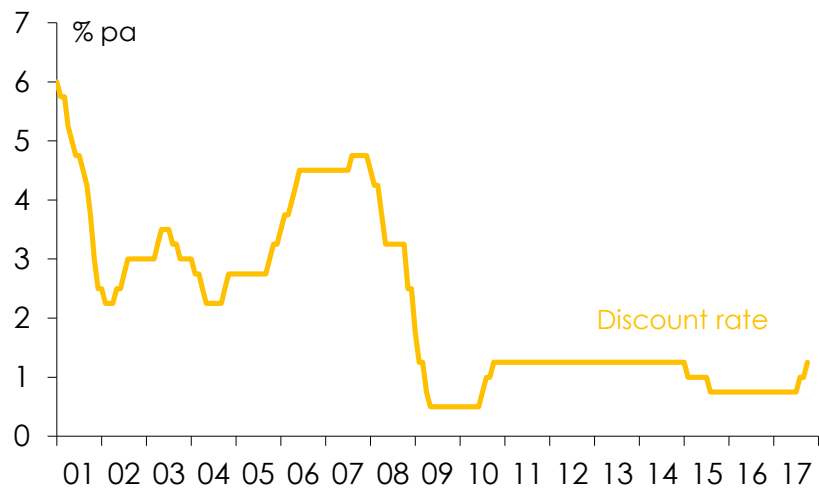
Europe



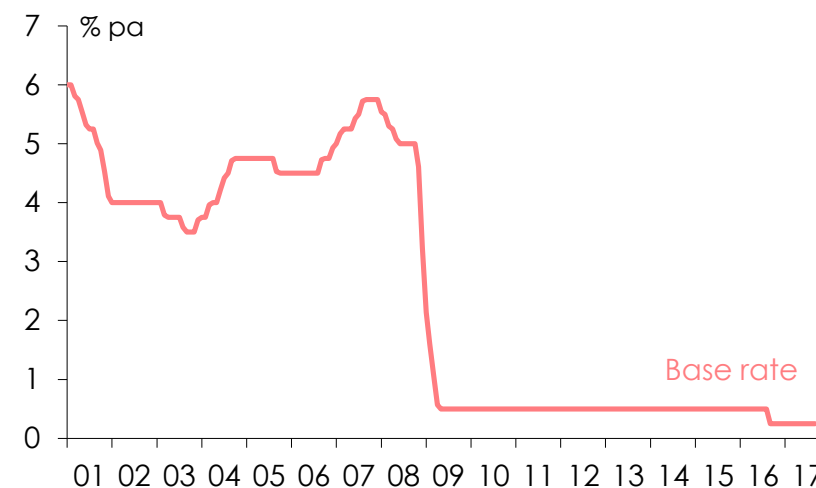
Japan



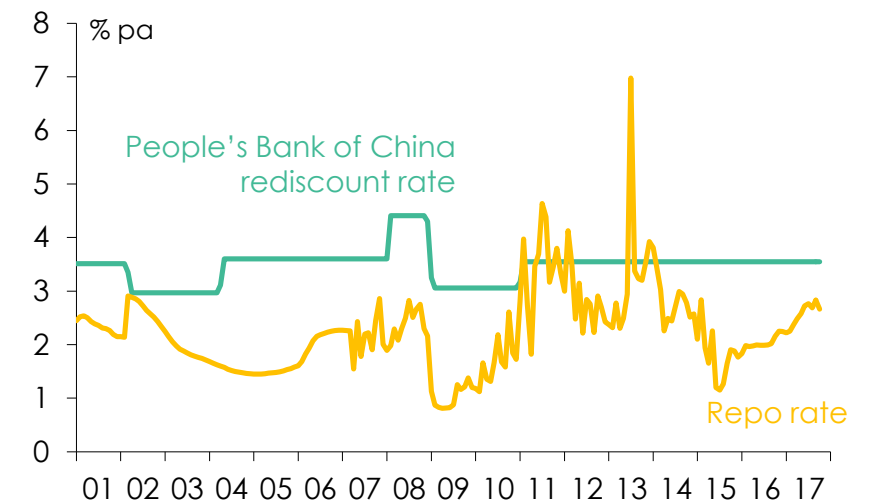
Canada



United Kingdom



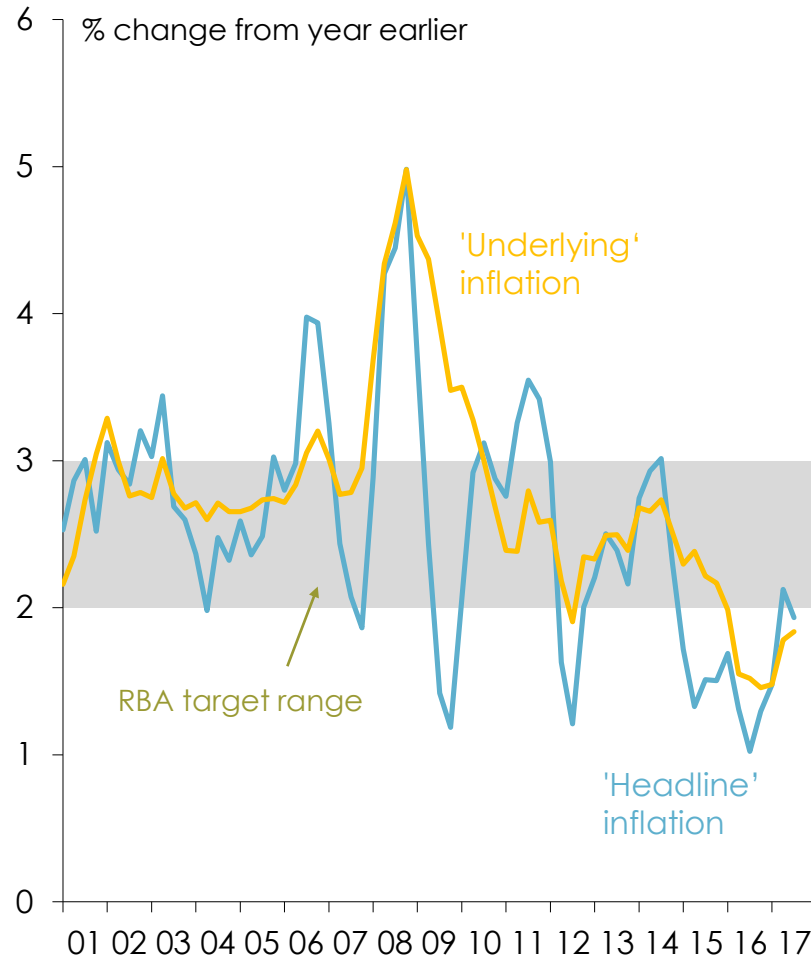
China



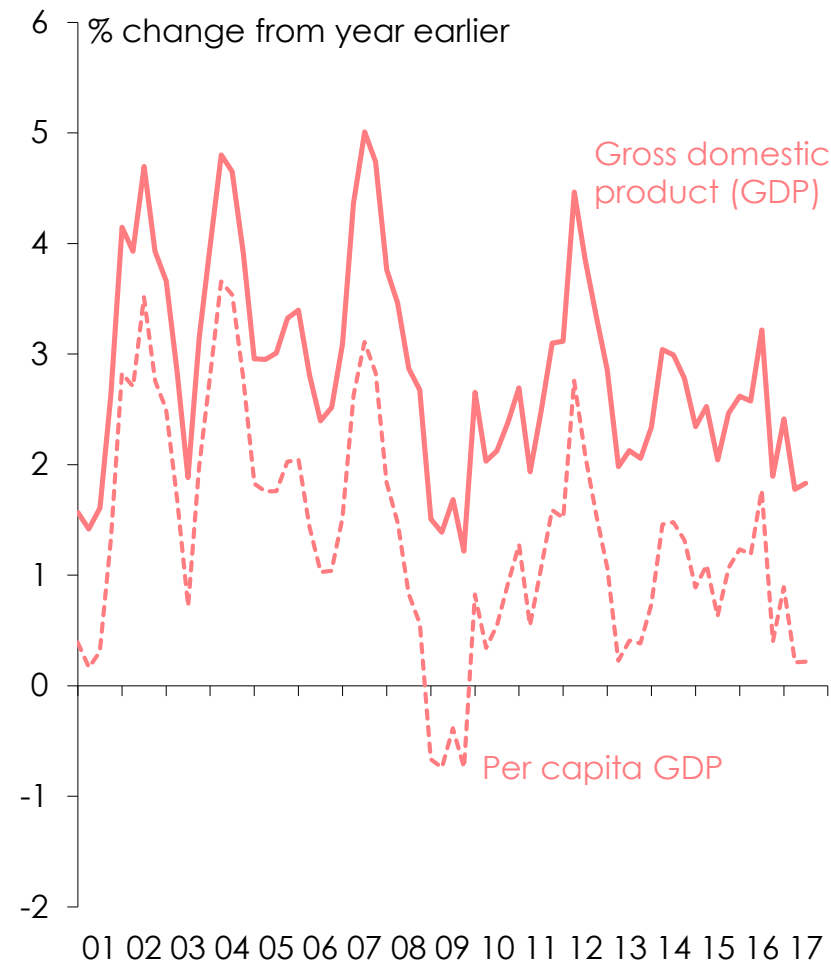
Sources: US Federal Reserve Board; Bank of Canada; European Central Bank; Swedish Riksbank; Swiss National Bank; Bank of England; Bank of Japan; People's Bank of China; Thomson Reuters Datastream.

The RBA wants to see inflation at between 2 and 3%, economic growth at around 3%, unemployment at around 5% and less 'under-employment'

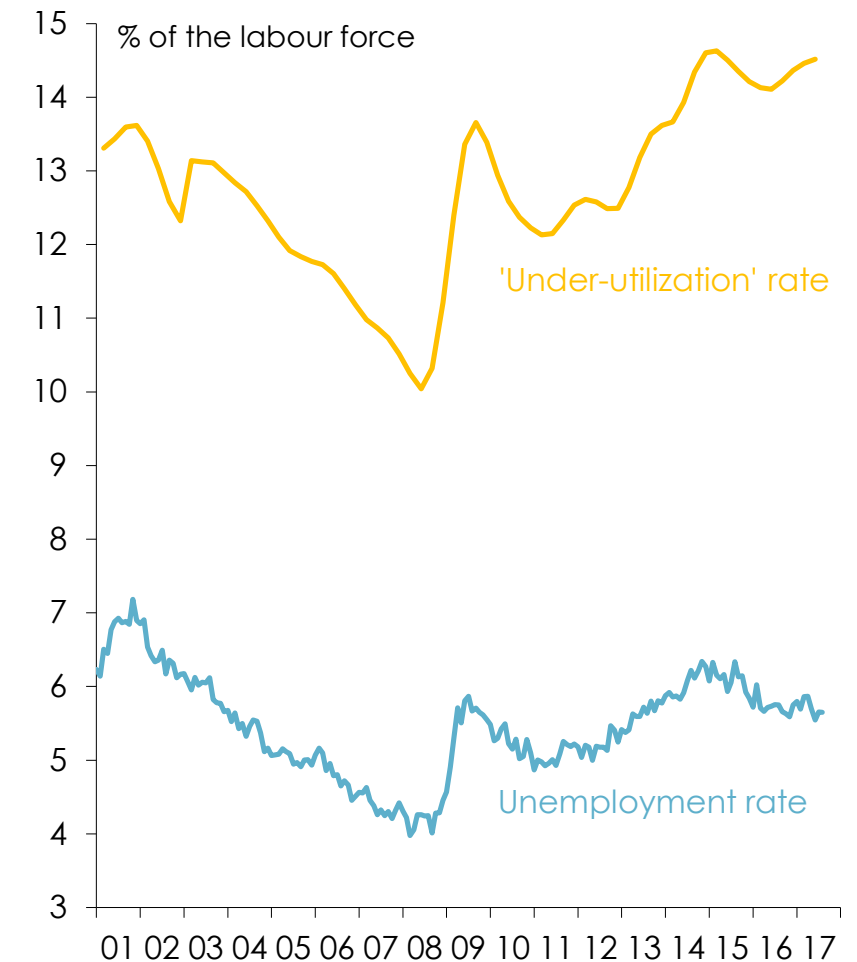
Consumer prices



Economic growth



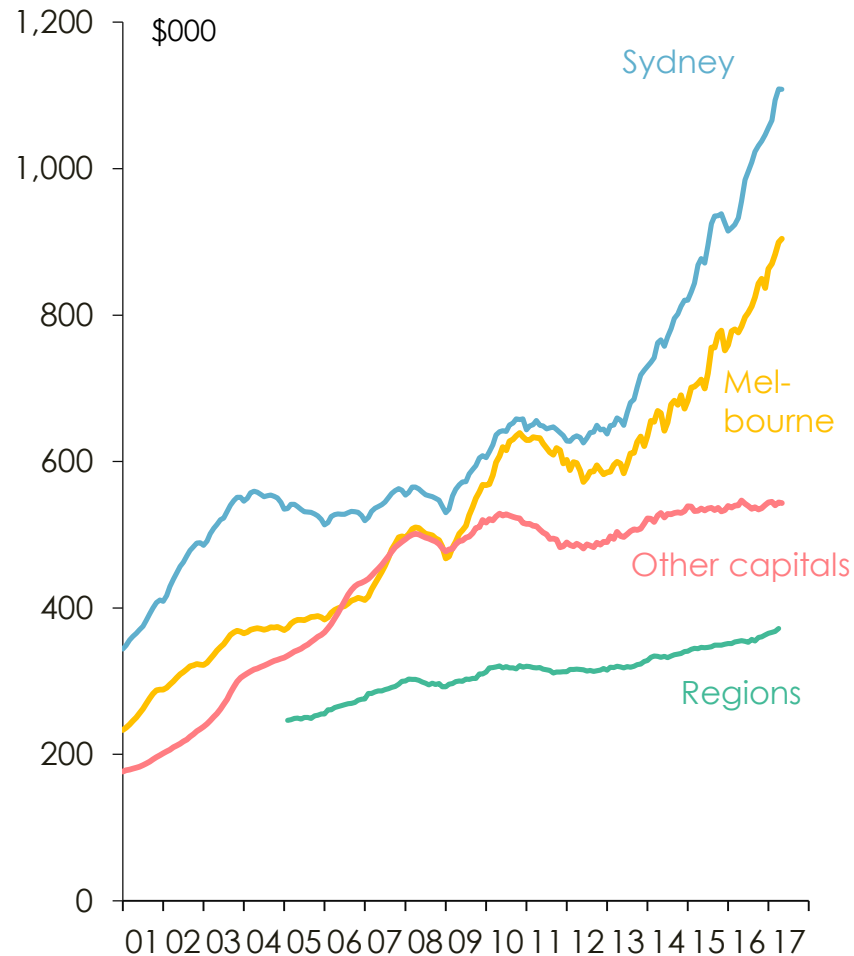
Unemployment and under-employment



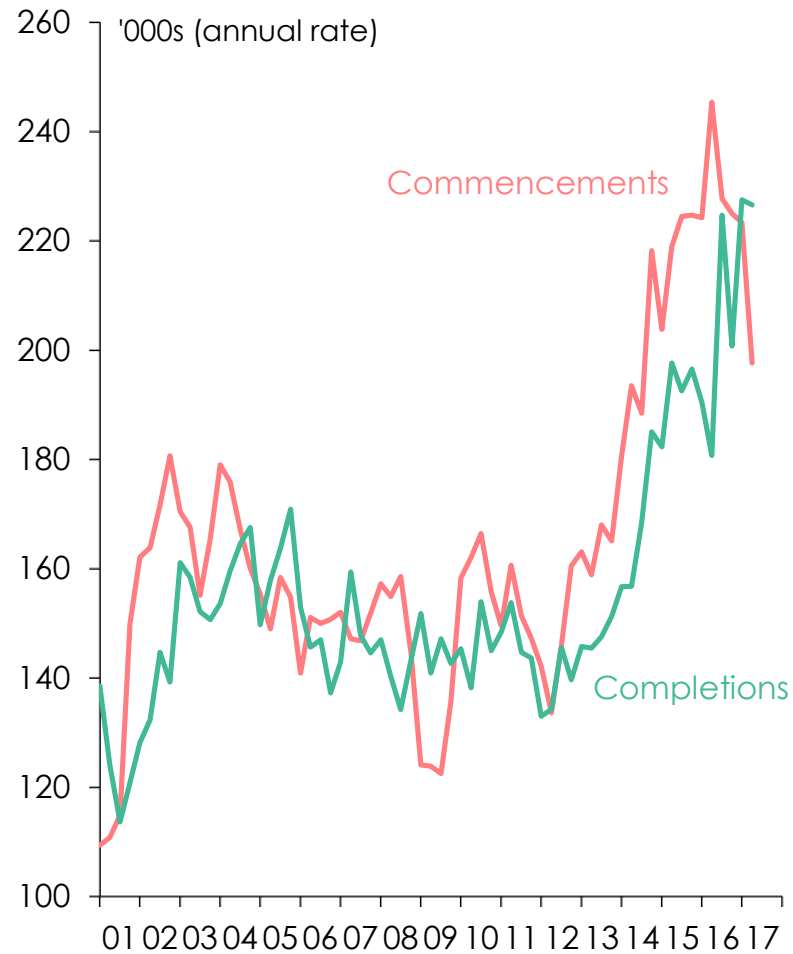
Note: 'underlying' inflation abstracts from the impact of volatile items (typically items such as petrol, or fruit and vegetables) on the CPI. The labour force 'under-utilization' rate includes people employed part-time who are willing and able to work longer hours (and weights them equally with people who are 'unemployed' in the conventional sense). Source: Australian Bureau of Statistics.

Record low interest rates have stimulated a surge in capital city house prices and a boom in dwelling construction, but also record levels of debt

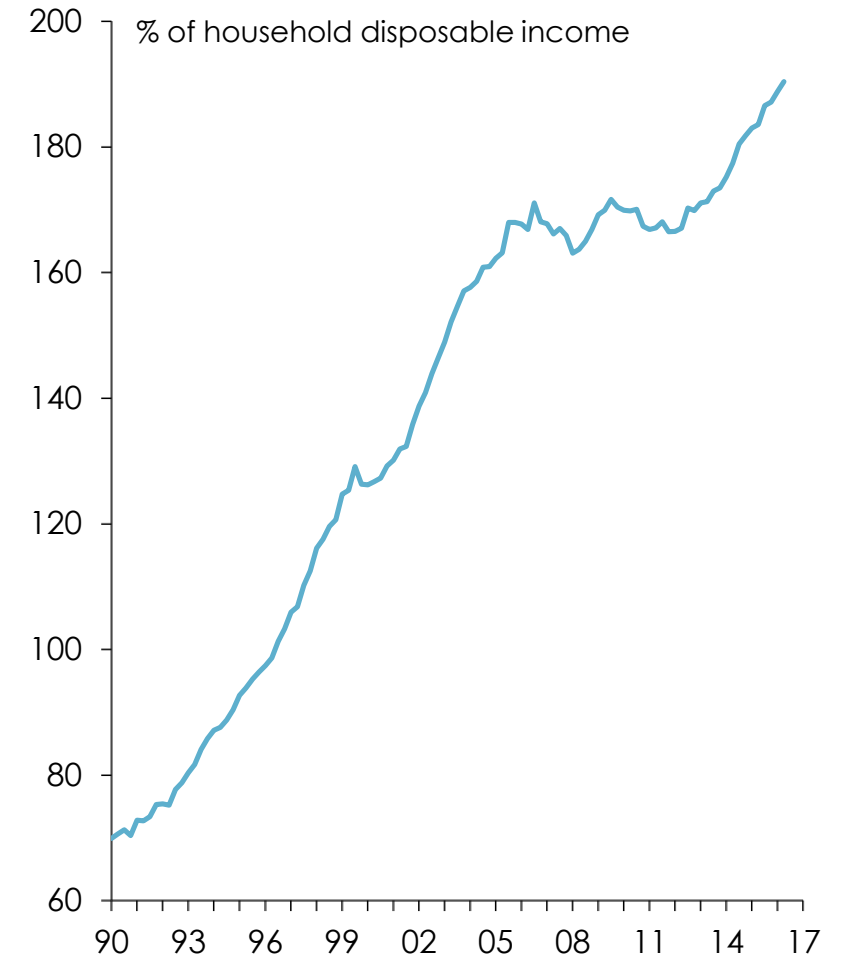
Housing prices – Sydney & Melbourne vs the rest



Housing construction activity



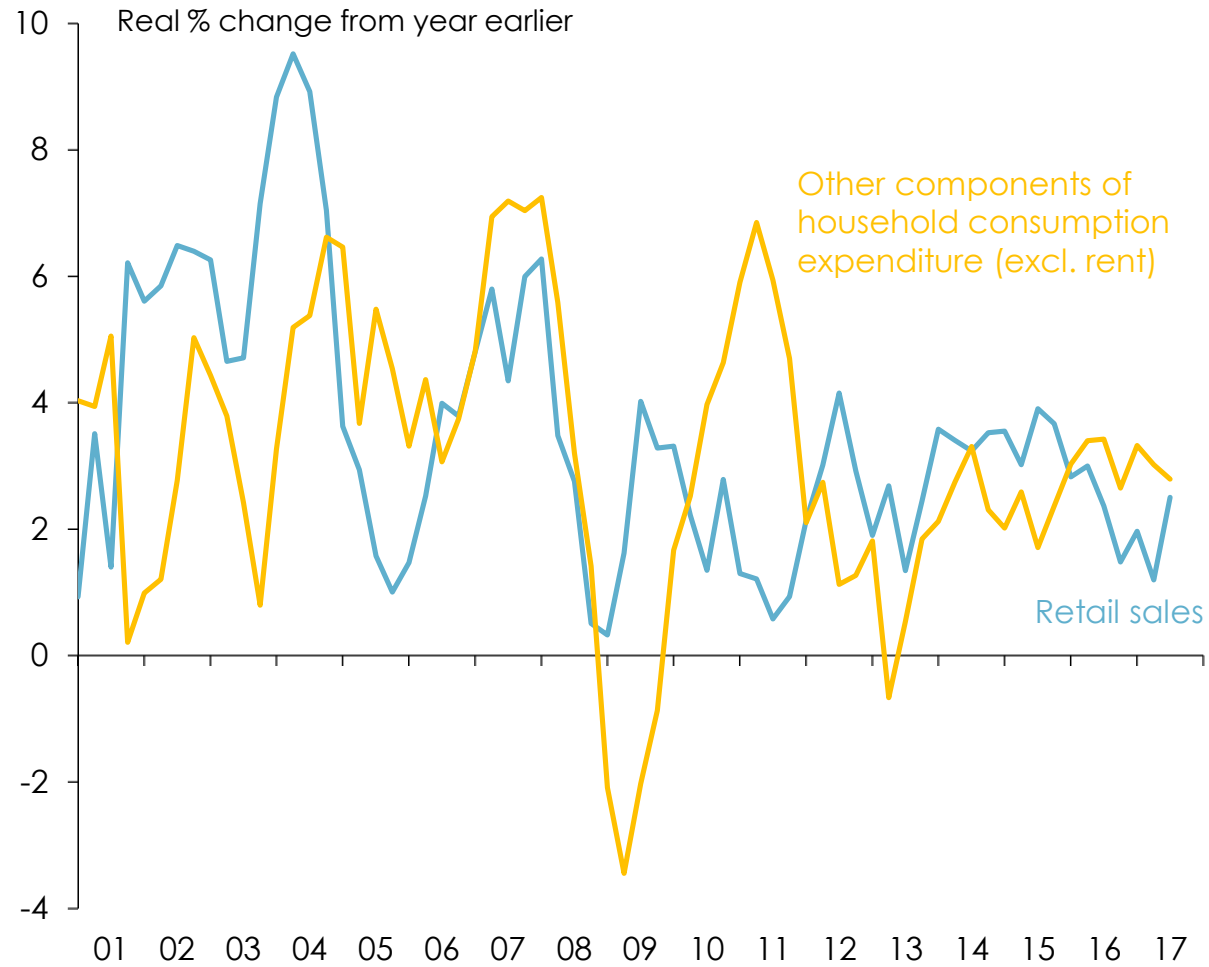
Household debt



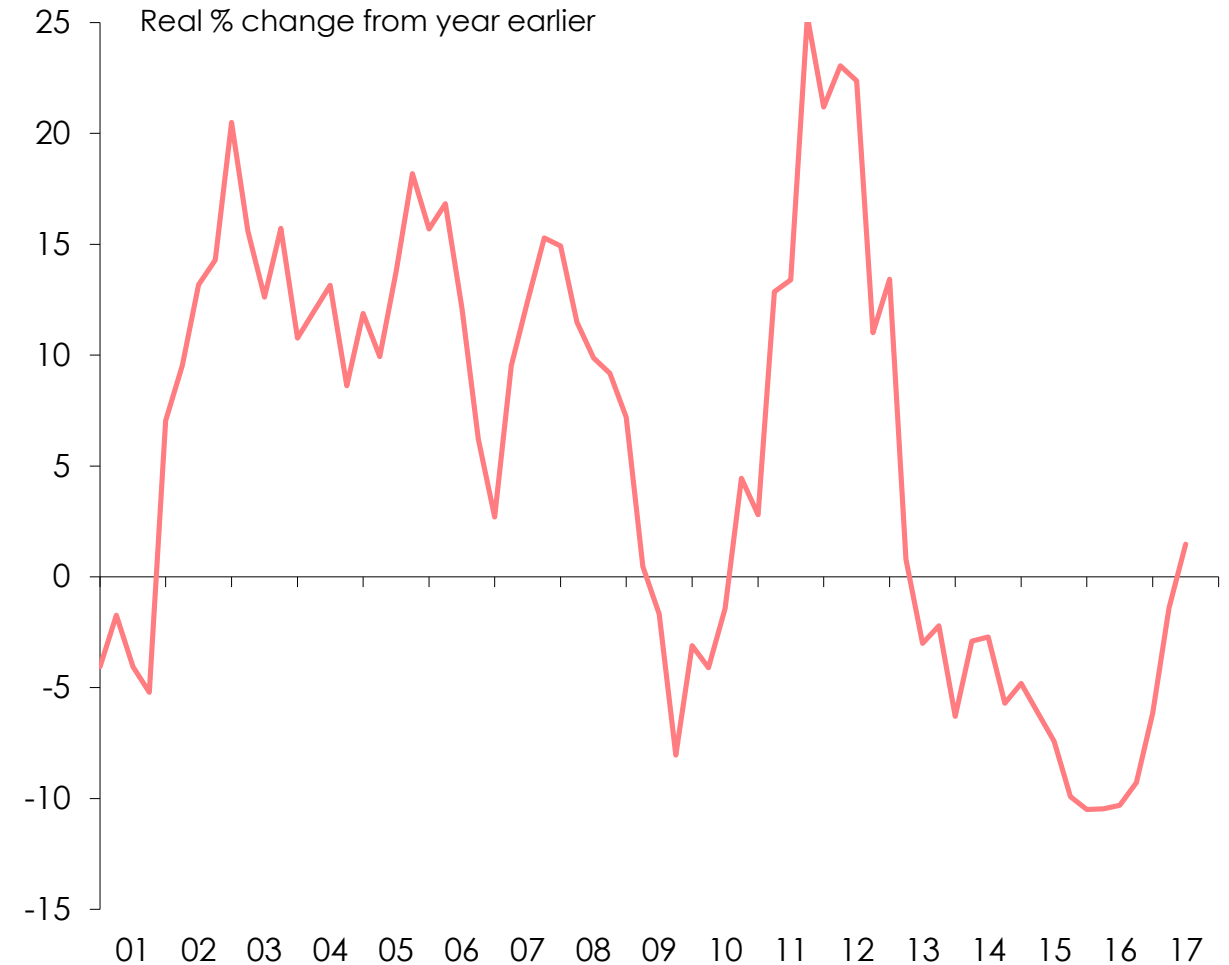
Source: CoreLogic – RP Data; Australian Bureau of Statistics; Reserve Bank of Australia.

But consumer spending and business investment – normally the two largest drivers of economic growth – have remained weak

Household consumption expenditure



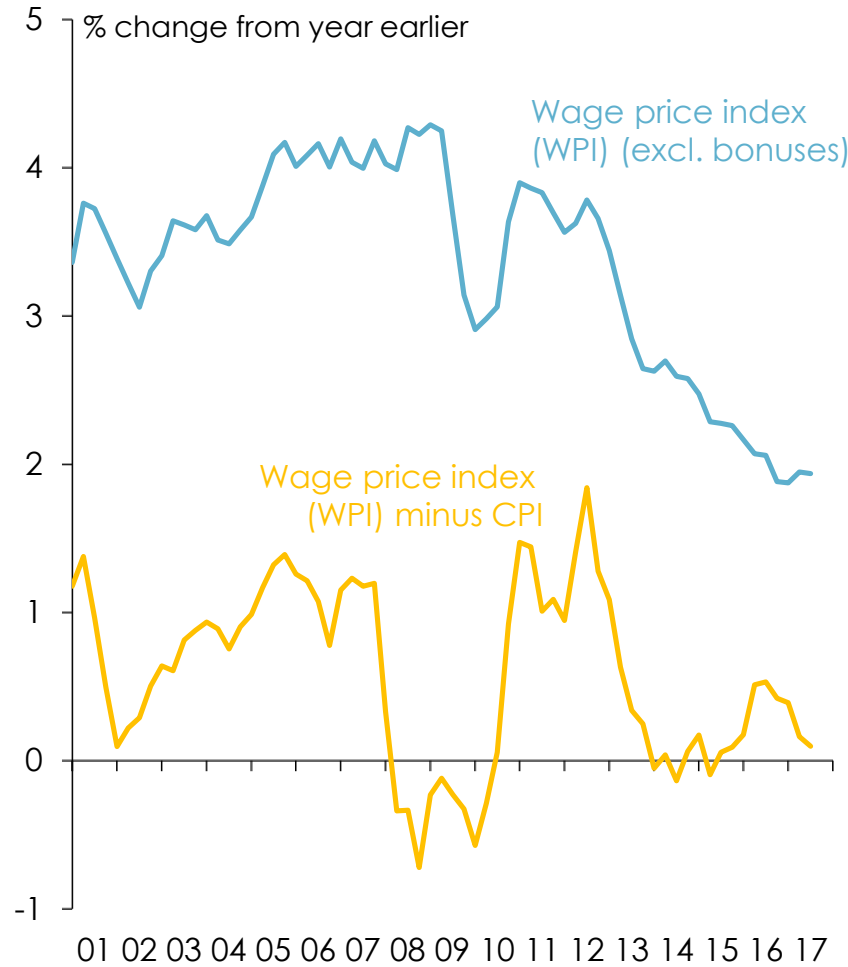
Business investment expenditure



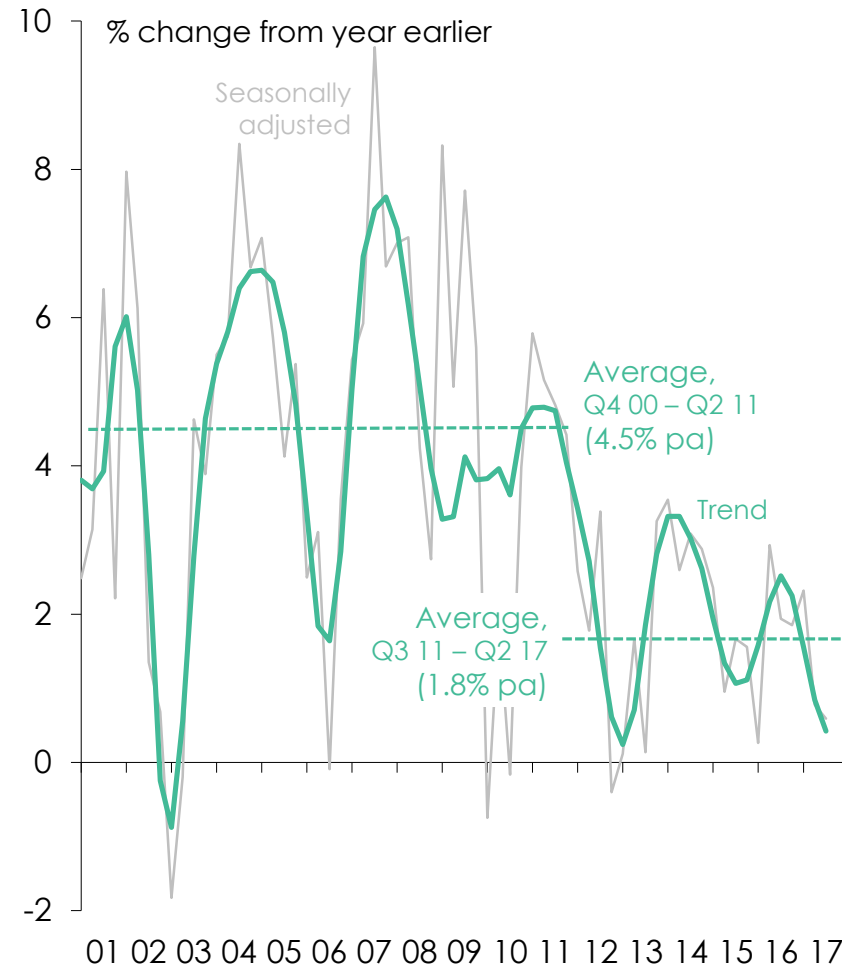
Source: Australian Bureau of Statistics

Sluggish wages growth has meant weak growth in household incomes and depressed levels of consumer confidence

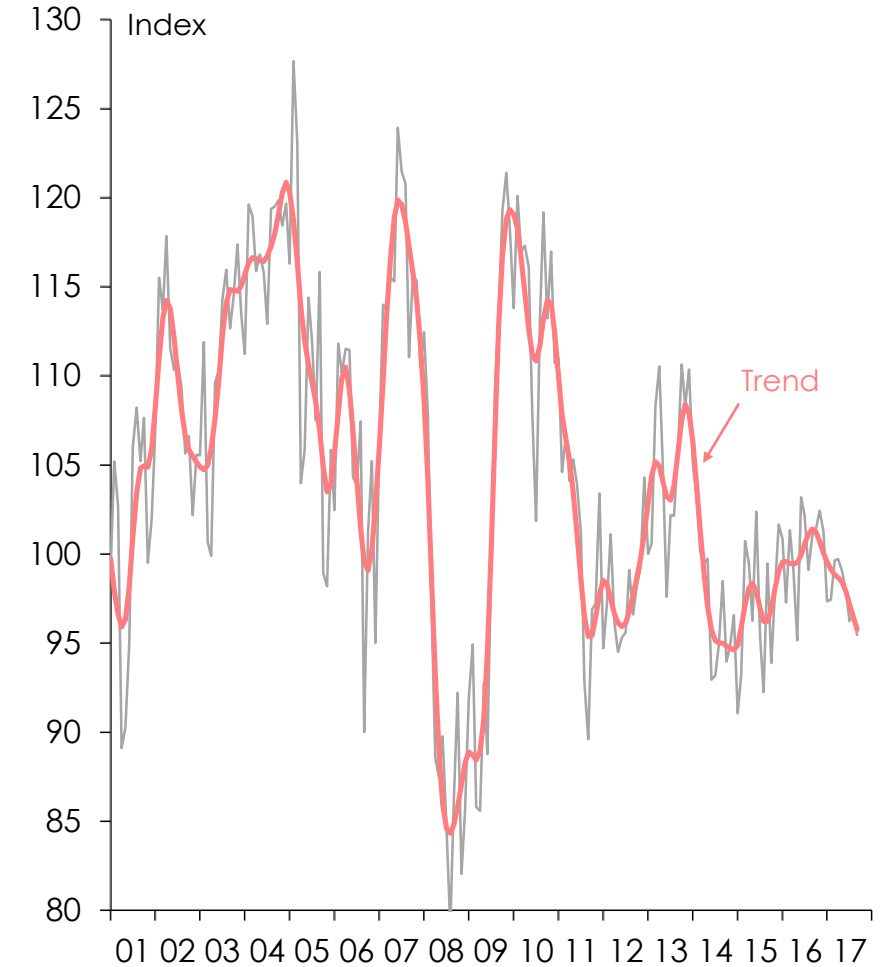
Nominal and real wages



Real household disposable income



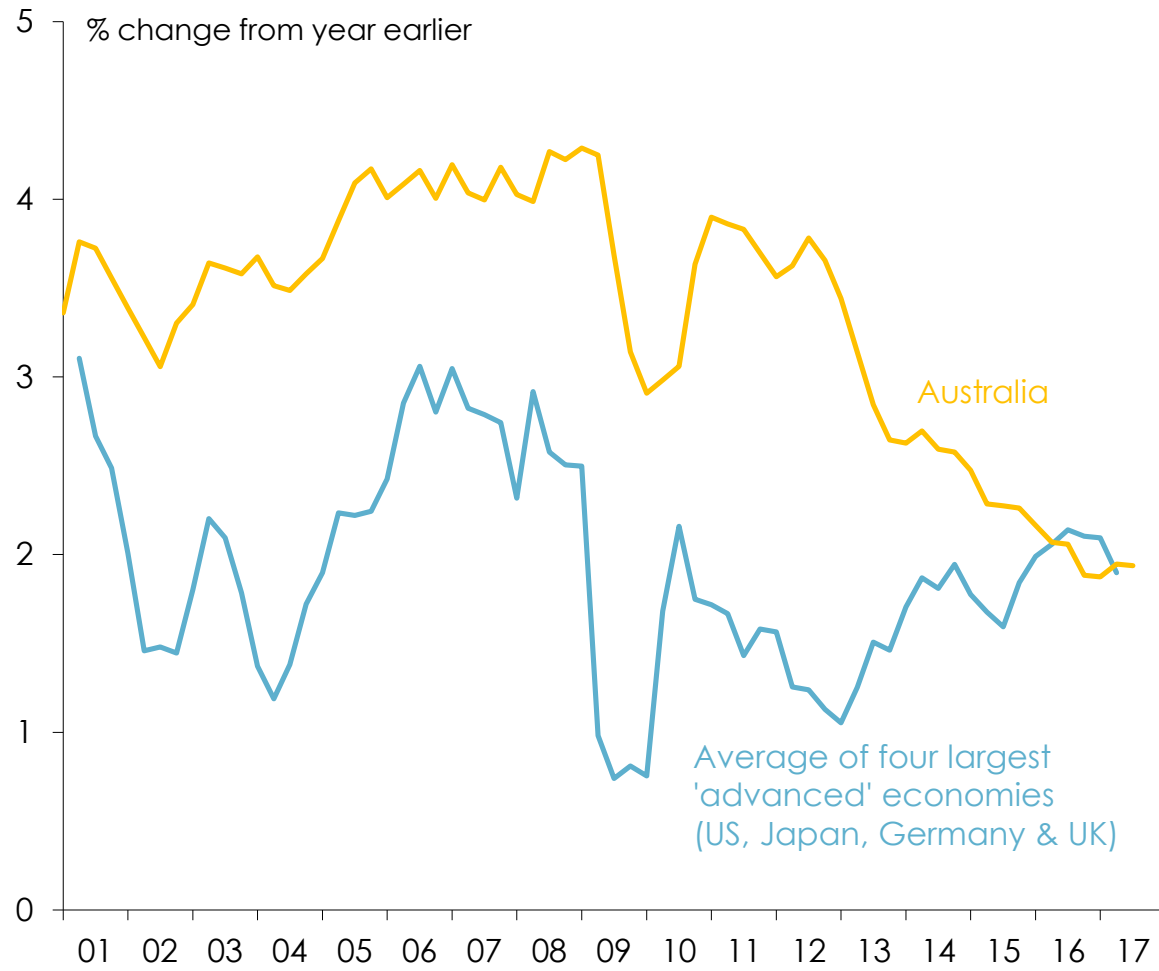
Consumer confidence



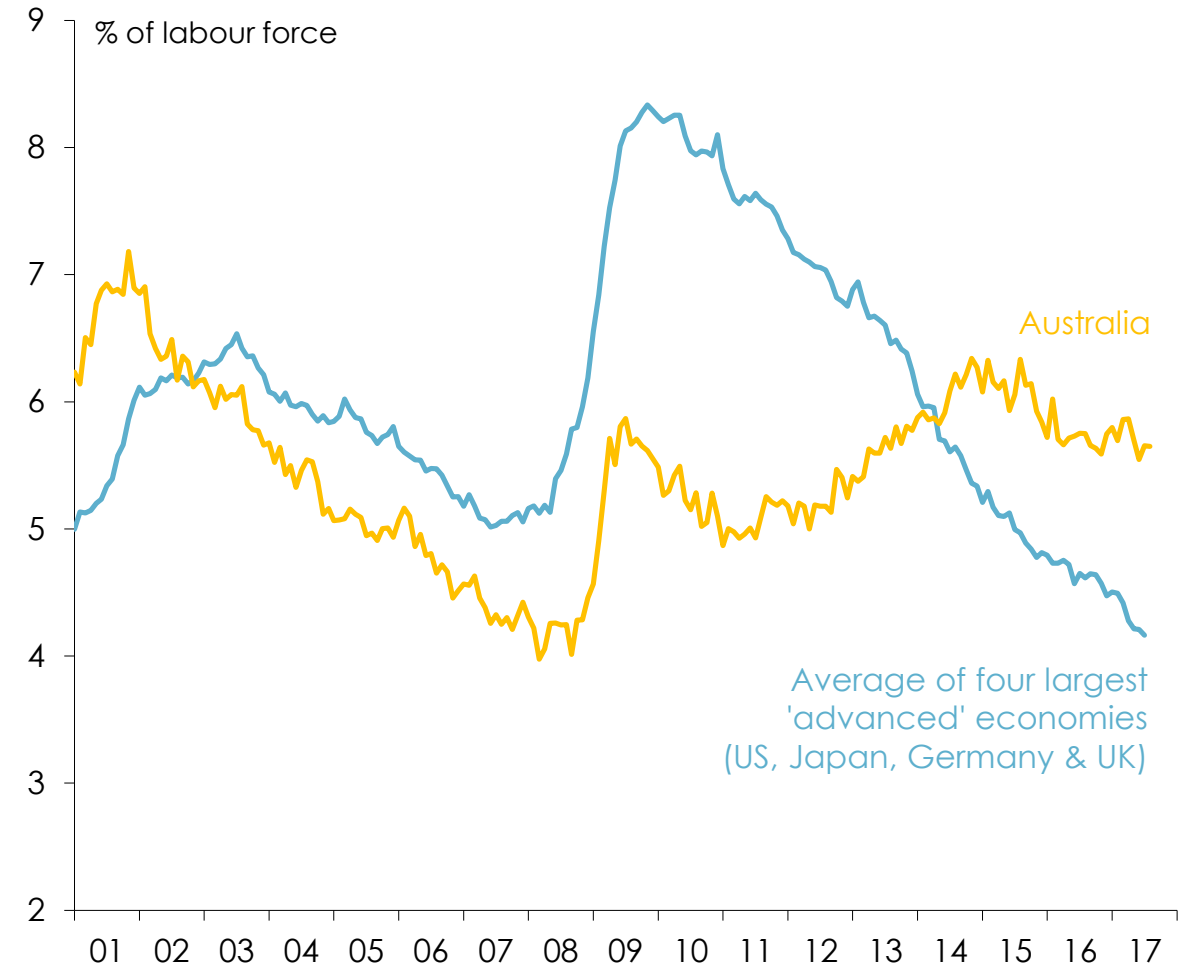
Sources: ABS ; Westpac and Melbourne Institute of Applied Economic & Social Research.

Weak wages growth has been common among 'advanced' economies, especially following periods of high unemployment

Wages growth – Australia vs four largest 'advanced' economies



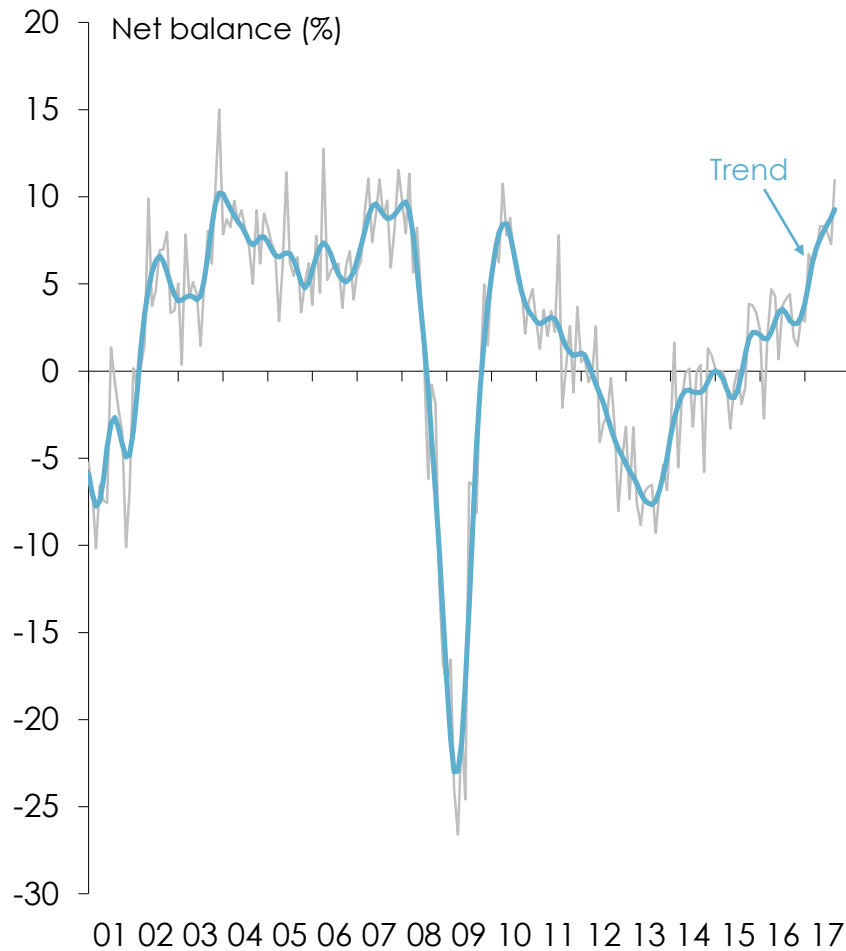
Unemployment – Australia vs four largest 'advanced' economies



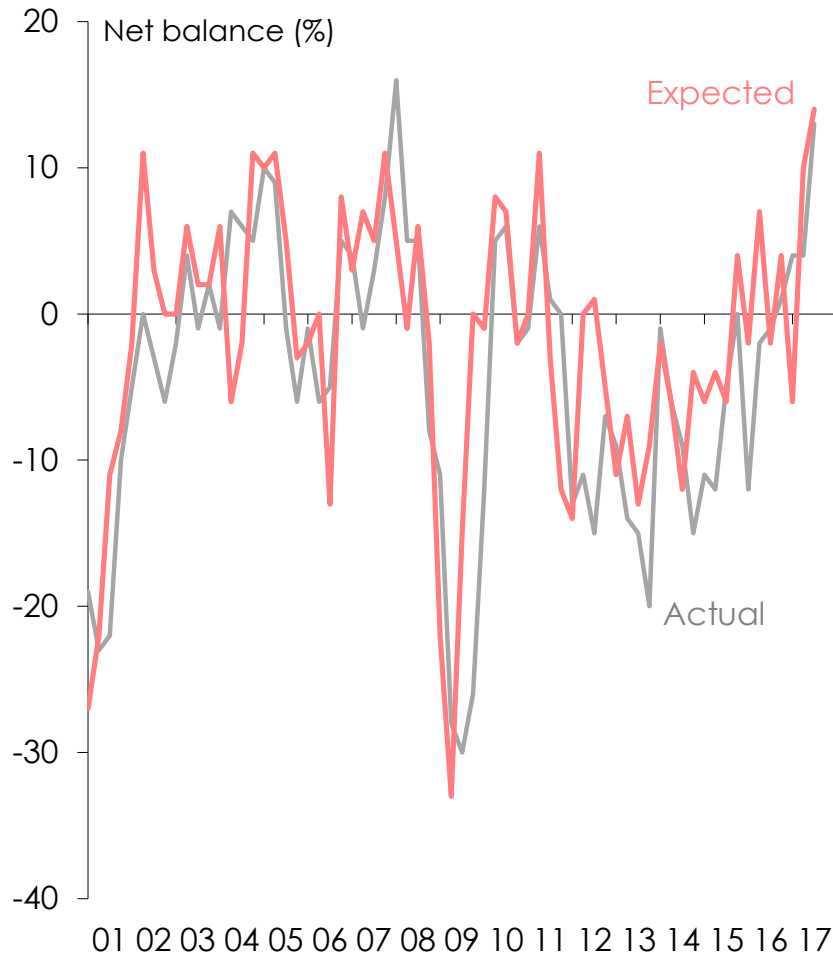
Sources: US Bureau of Labor Statistics; Japan Ministry of Health, Labour & Welfare; Deutsche Bundesbank; UK Office for National Statistics; Australian Bureau of Statistics.

Employment growth seems likely to pick up, which should eventually be reflected in stronger wages growth

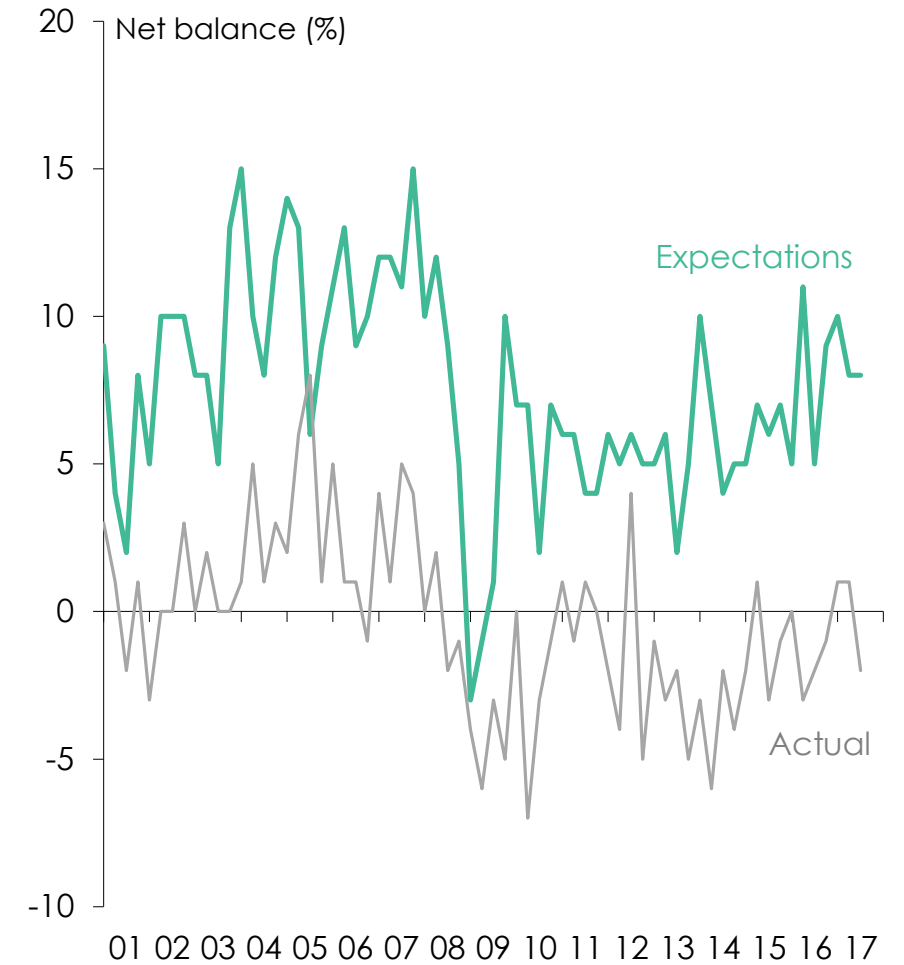
NAB survey of employer hiring intentions



Westpac-ACCI survey – employee numbers



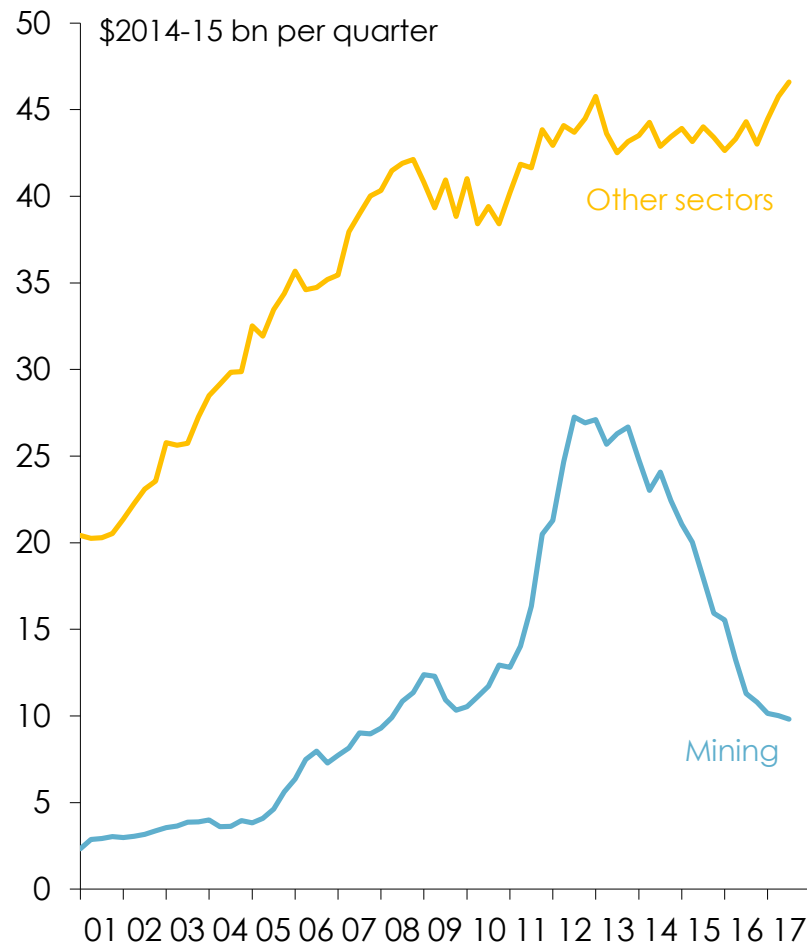
Sensis SME survey – size of workforce



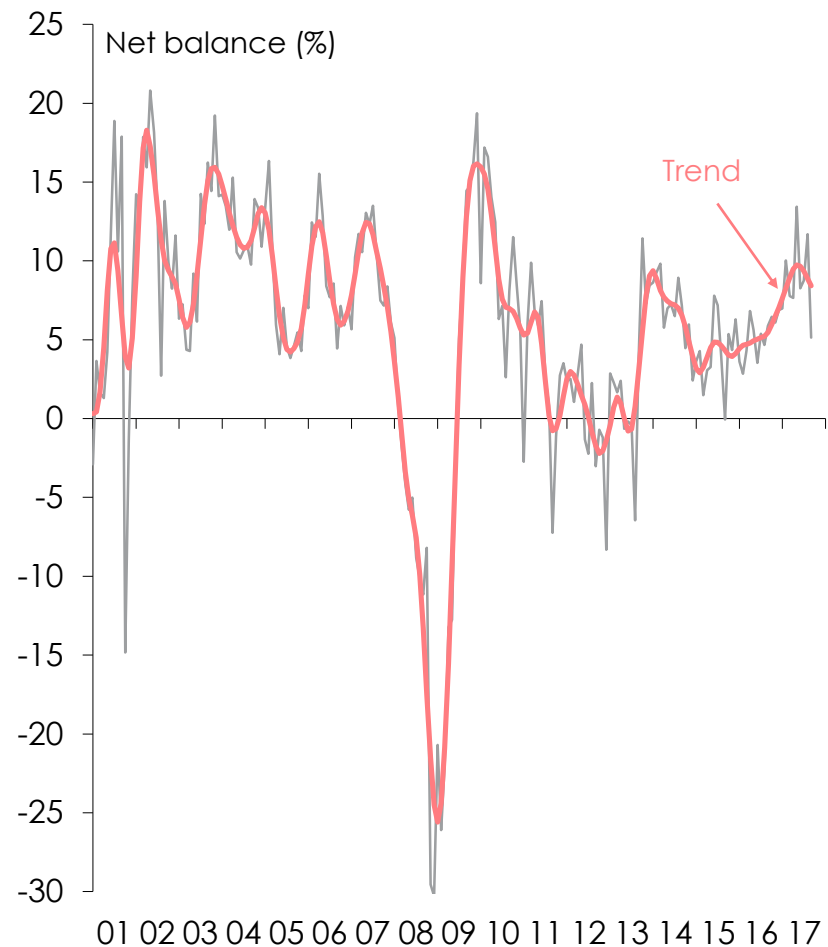
Sources: National Australia Bank; Westpac and Australian Chamber of Commerce & Industry; Sensis.

Similarly it seems likely that business investment will 'bottom out' and start to pick up over the next year

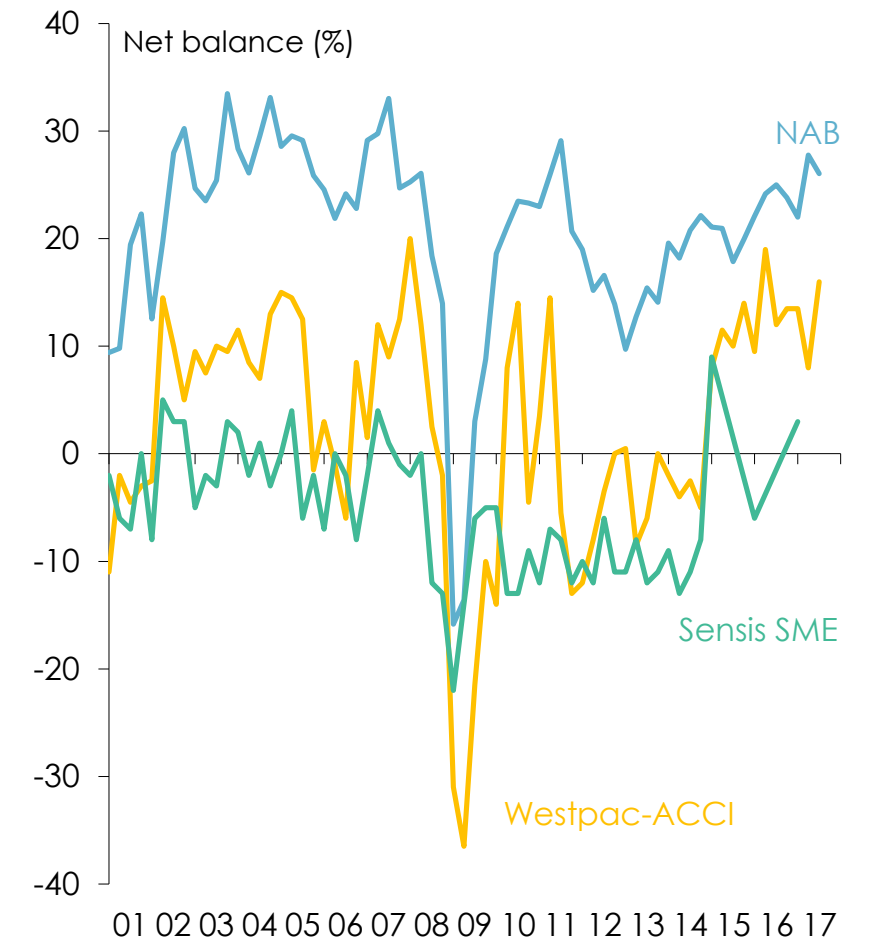
Business investment – mining vs other sectors



Business confidence



Business survey capital expenditure expectations

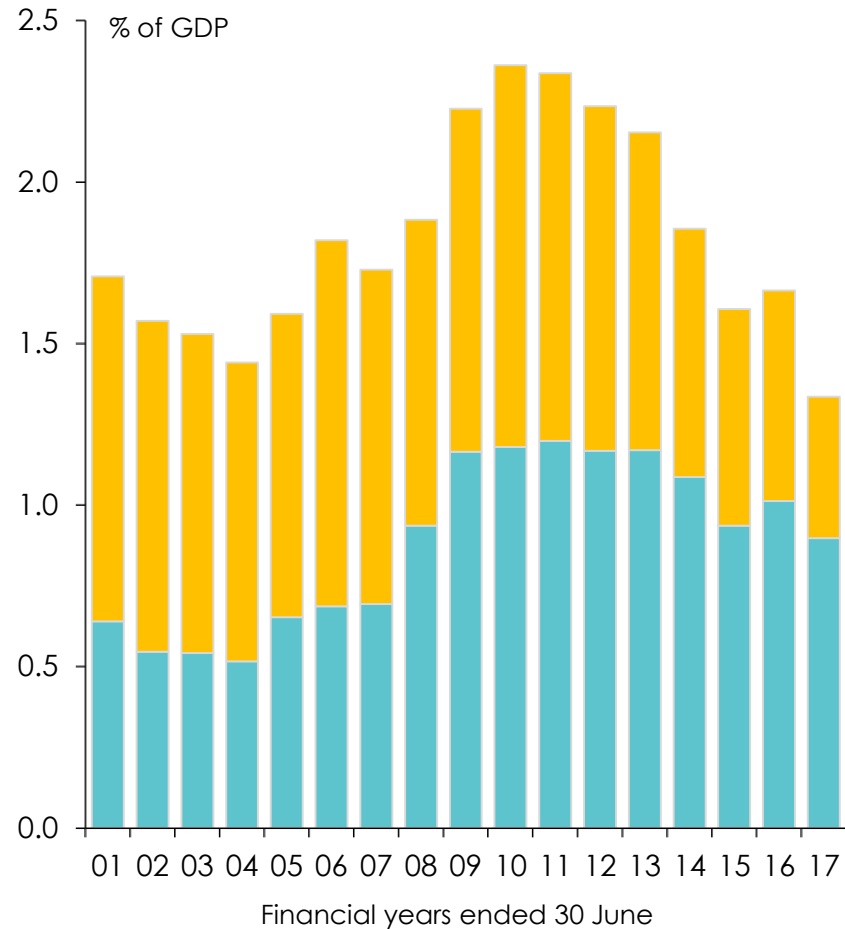


Sources: National Australia Bank; Westpac and Australian Chamber of Commerce & Industry; Sensis.

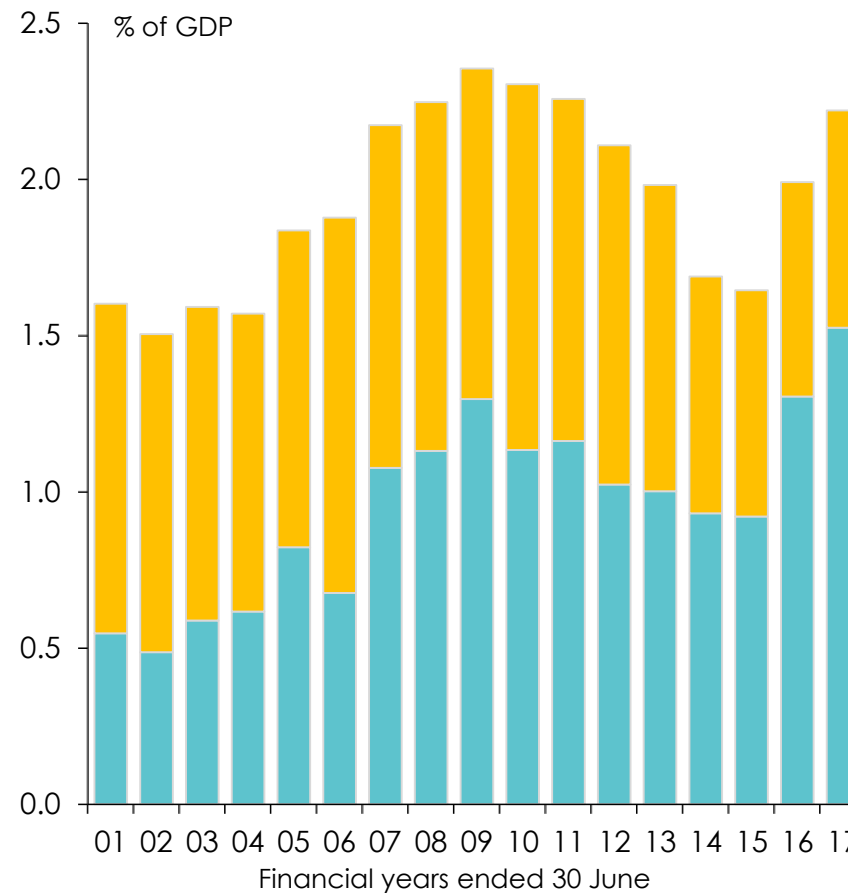
Higher levels of infrastructure investment spending will also provide some impetus to economic growth

Indicators of engineering construction activity for the public sector

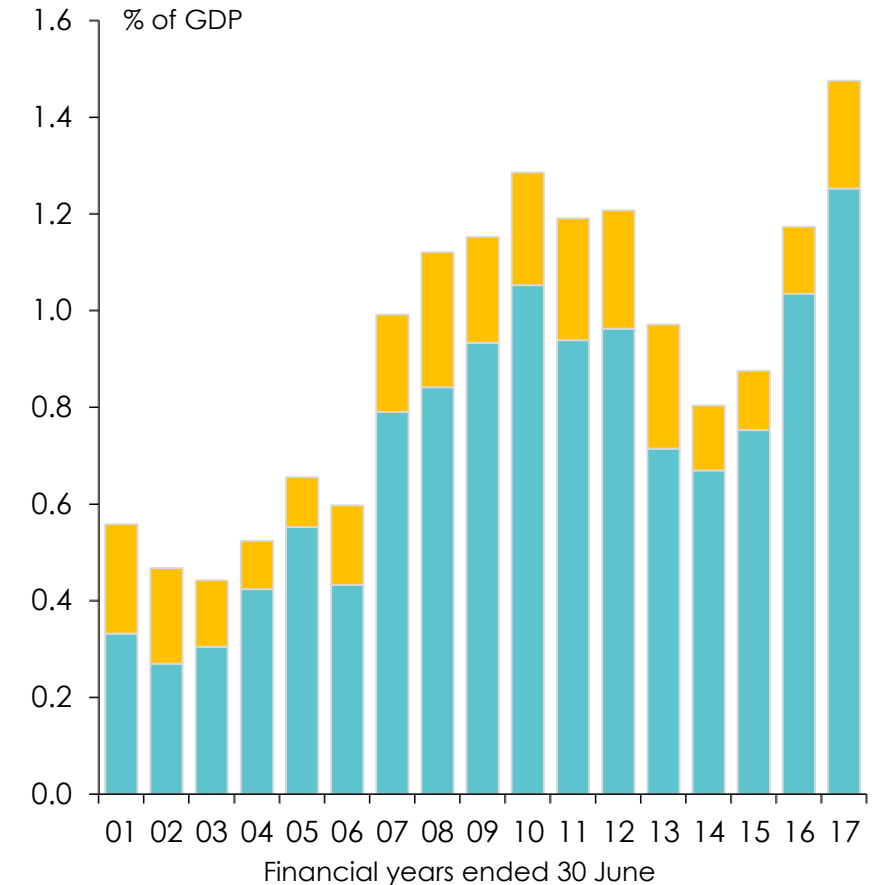
Value of work done



Commencements



Work yet to be done



■ Work by the private sector for the public sector
 ■ Work by the public sector for the public sector

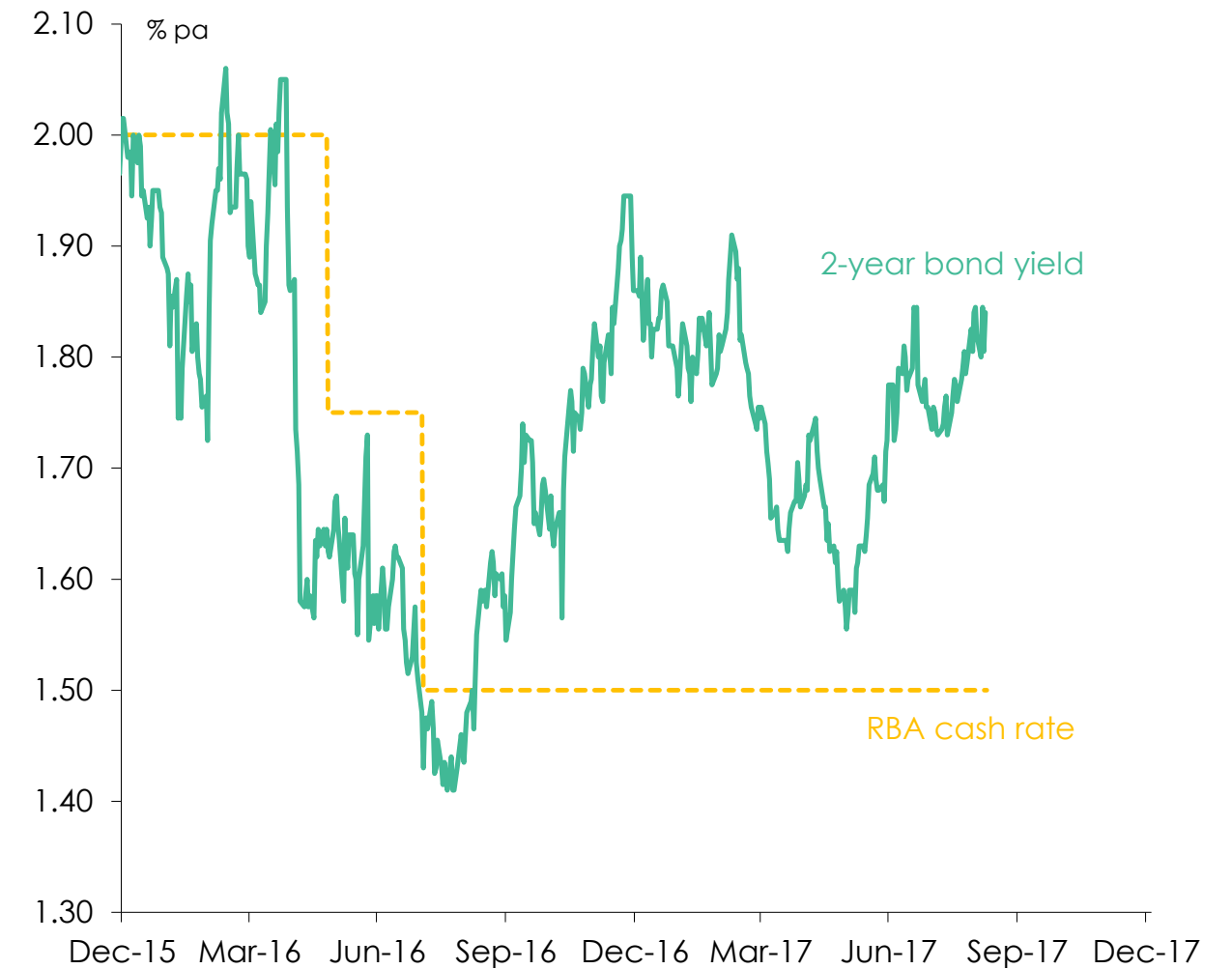
Note: 2016-17 figures for commencements and work yet to be done are for the first three quarters. Source: ABS.

Financial markets are expecting Australian interest rates to go up, although not very much, and not very soon

Overnight index swap (OIS) rates and the Reserve Bank cash rate



2-year Commonwealth bond yields and the Reserve Bank cash rate

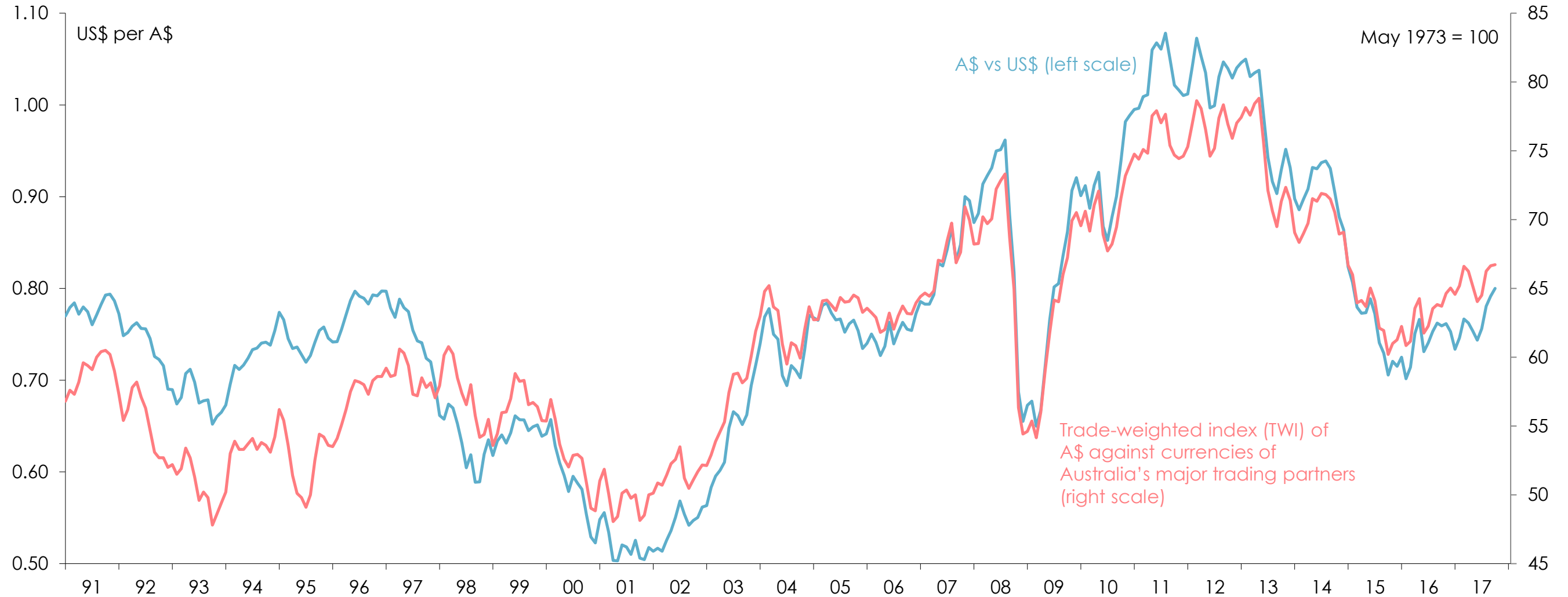


Source: Reserve Bank of Australia; Thomson Reuters Datastream.

The outlook for the Australian dollar

The Australian dollar has been surprisingly strong against the US\$ and other major currencies since mid-2015

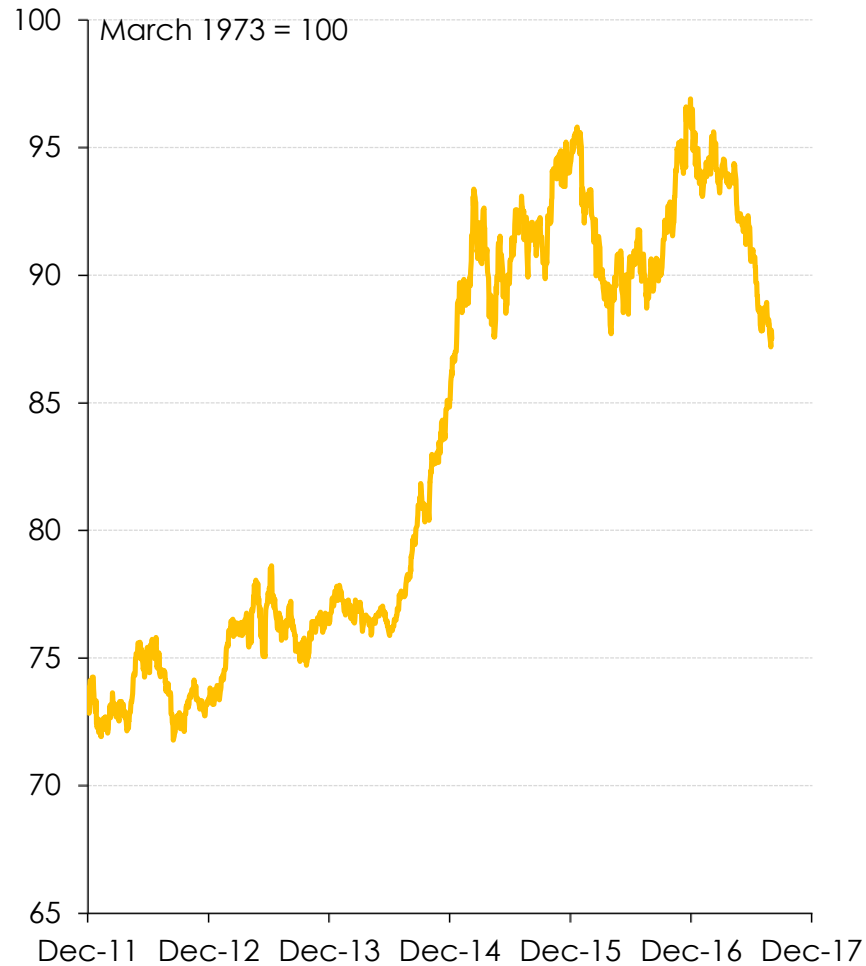
The Australian dollar vs the US dollar and other currencies



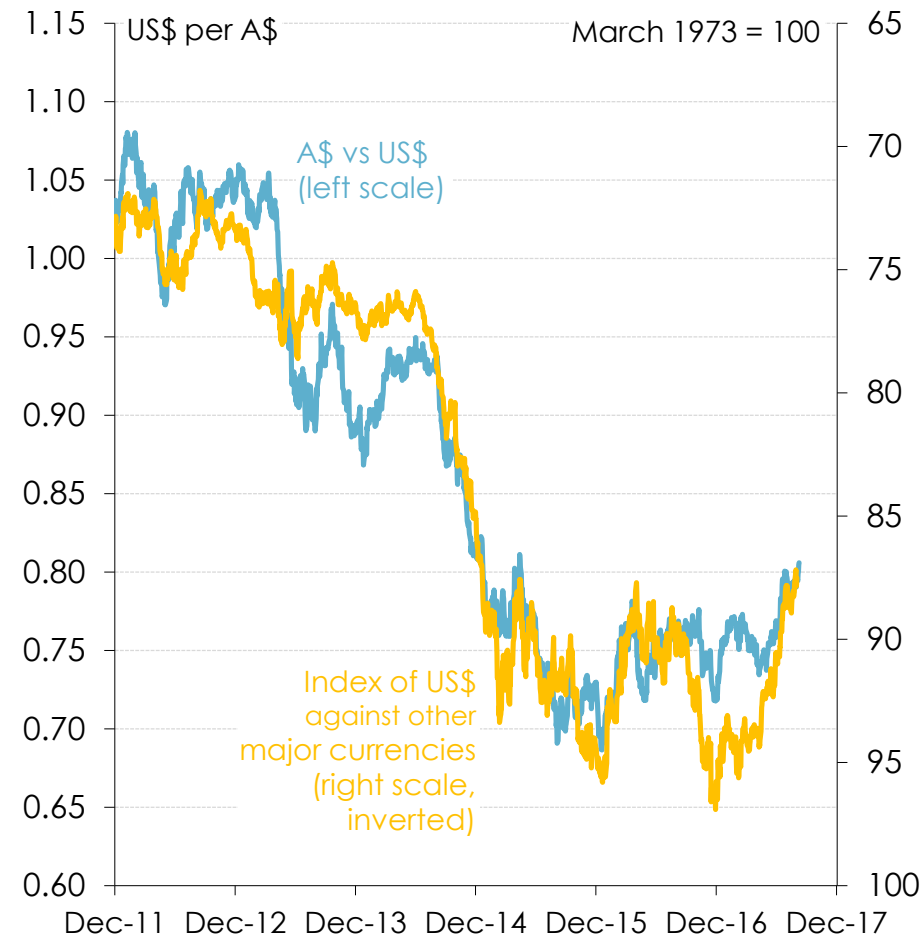
Source: Reserve Bank of Australia.

The unexpected resilience of the A\$ against the US\$ is largely the result of a surprising fall in the US\$... with help from a rebound in iron ore prices

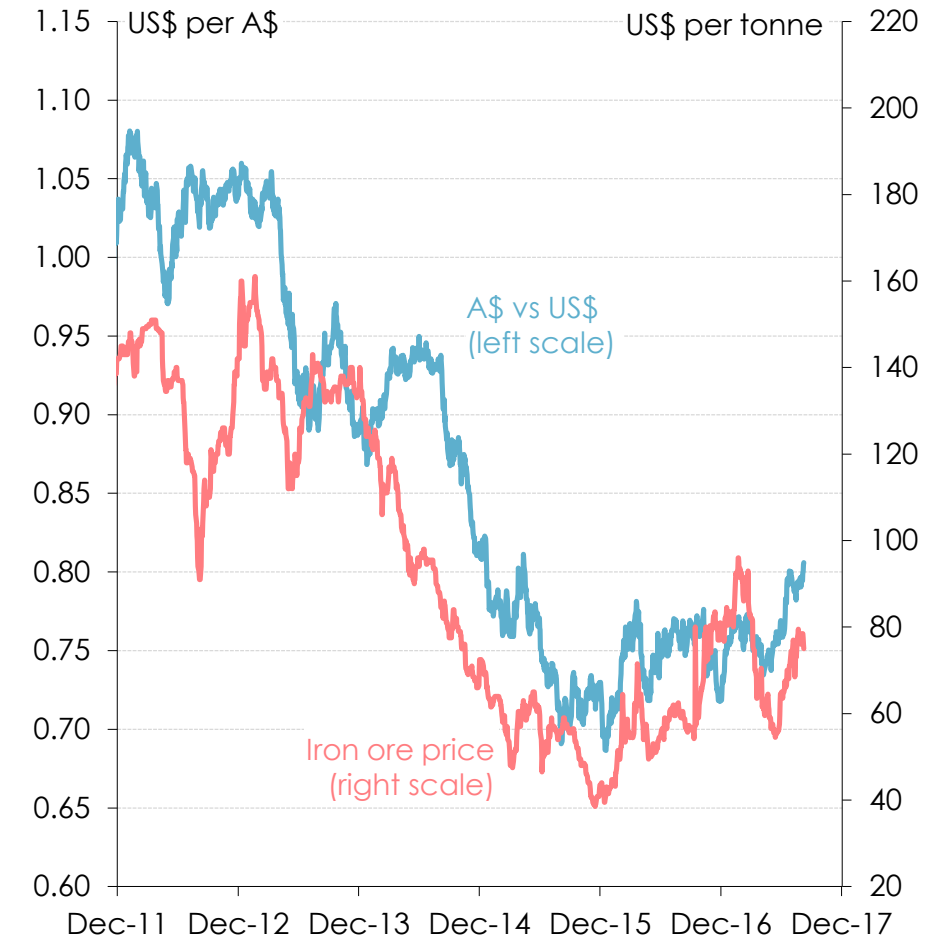
Index of US dollar against other major currencies



A\$ vs US\$ and US\$ vs other major currencies



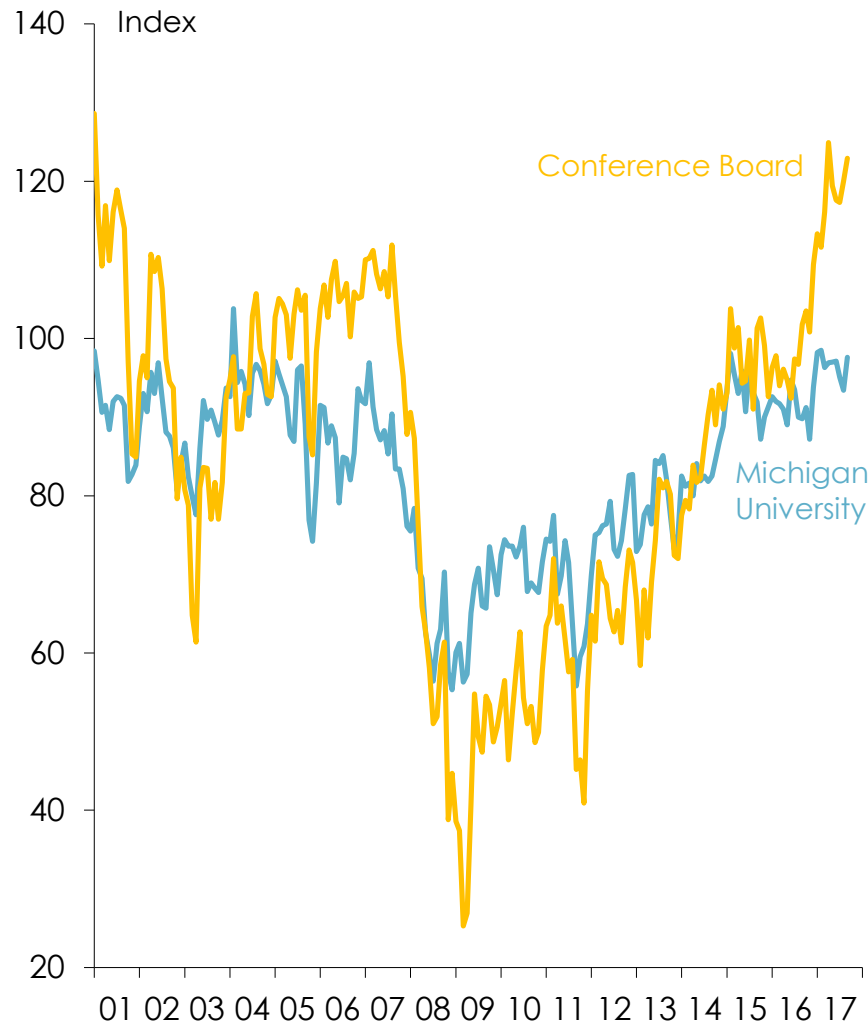
A\$-US\$ and iron ore prices



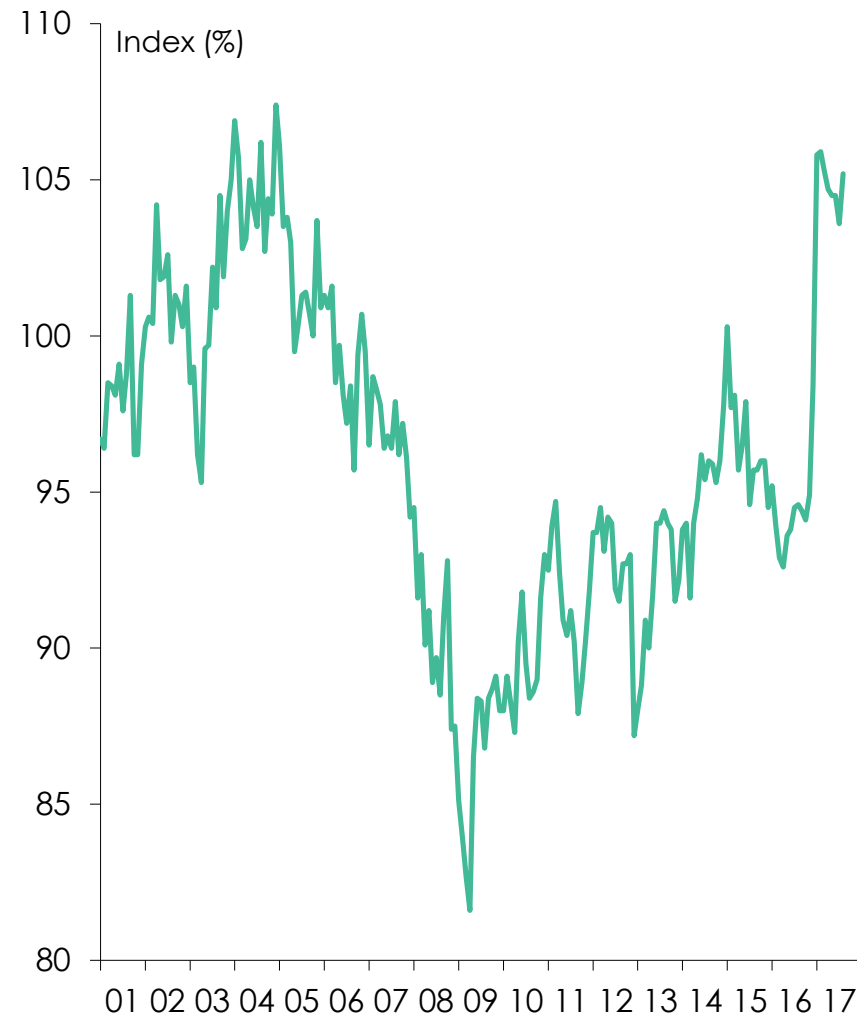
Sources: US Federal Reserve Board; Reserve Bank of Australia; Thomson Reuters Datastream

US consumer and business confidence improved markedly after Donald Trump won the presidential election last November

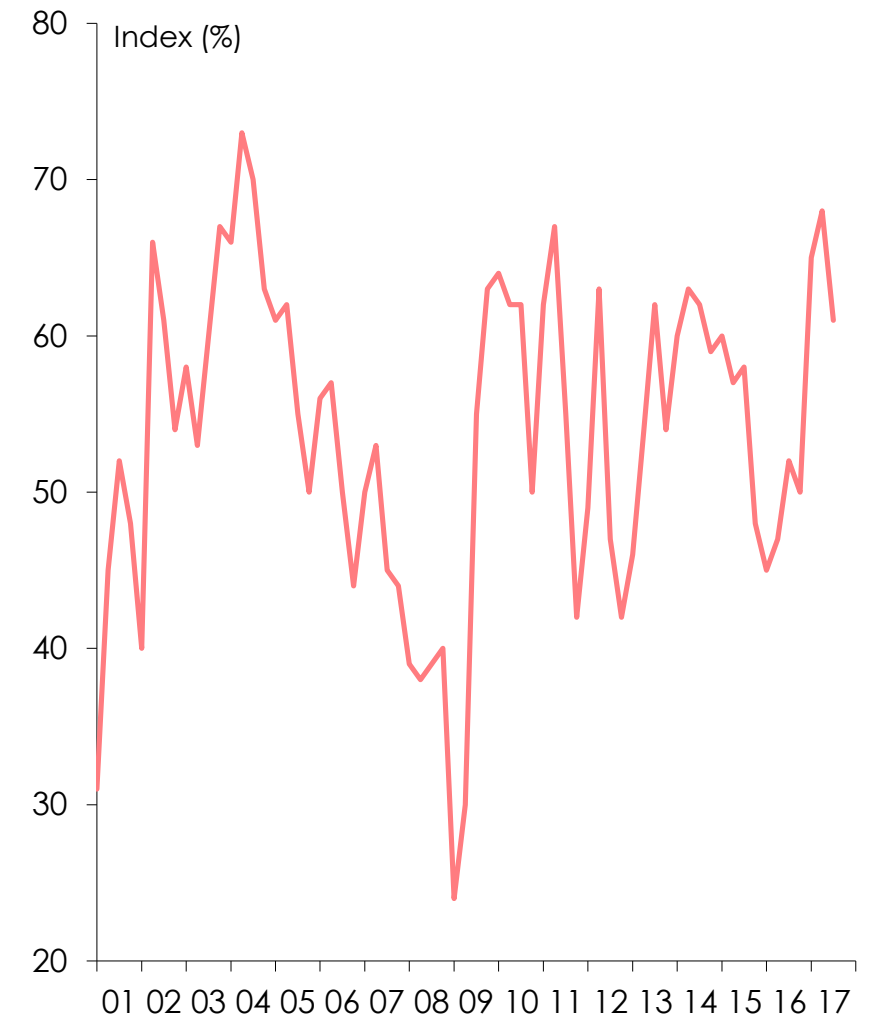
Consumer confidence



Small business optimism



CEO confidence



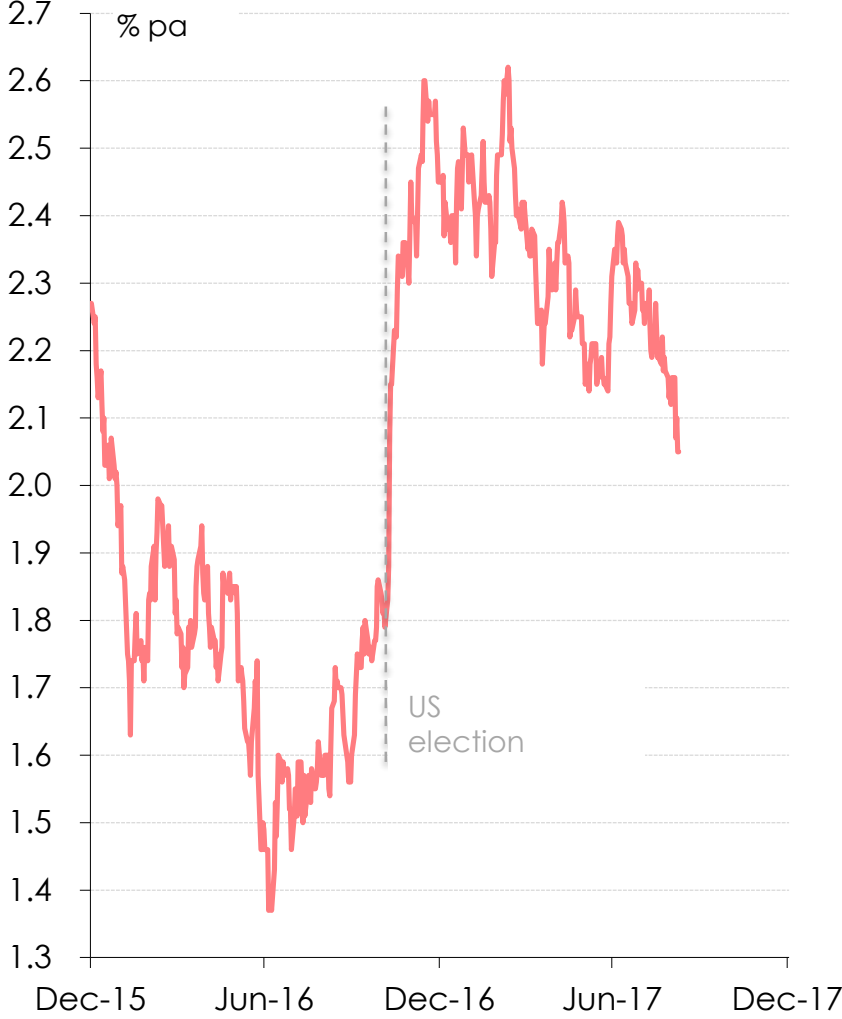
Sources: The Conference Board; University of Michigan Survey Research Center; National Federation of Small Businesses.

The share market remains optimistic about prospects for the US economy under Trump – but other financial markets are now much less convinced

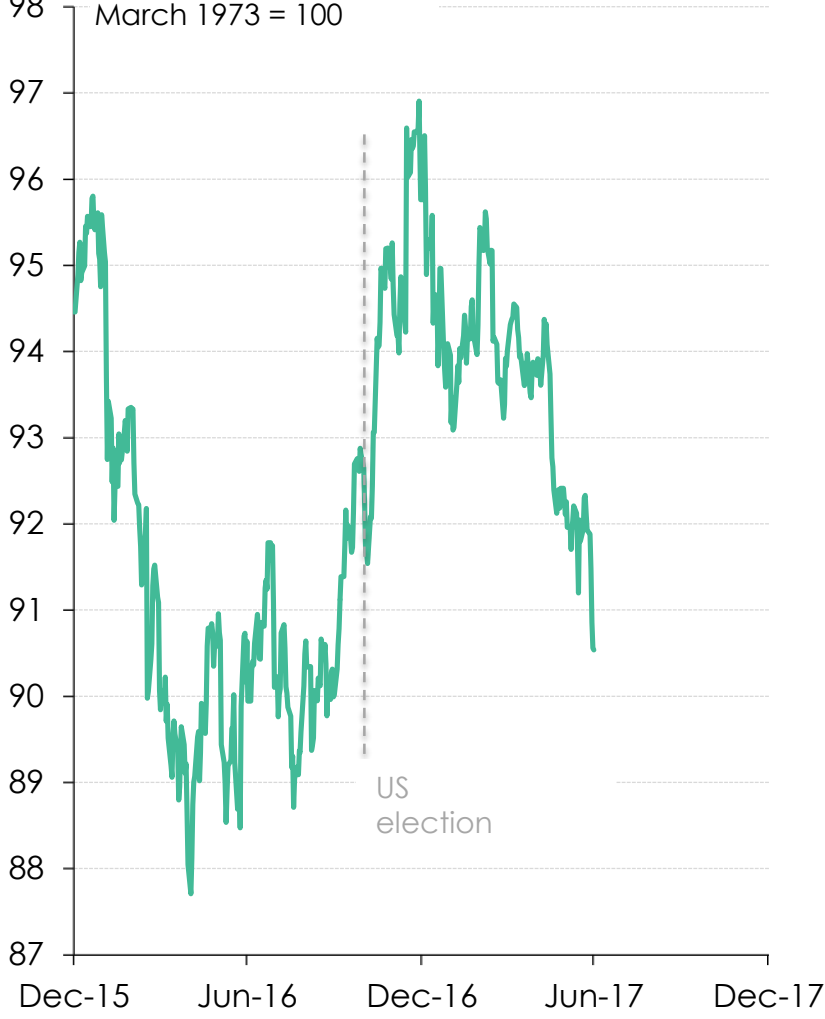
US stockmarket (S&P 500)



US 10-year bond yield



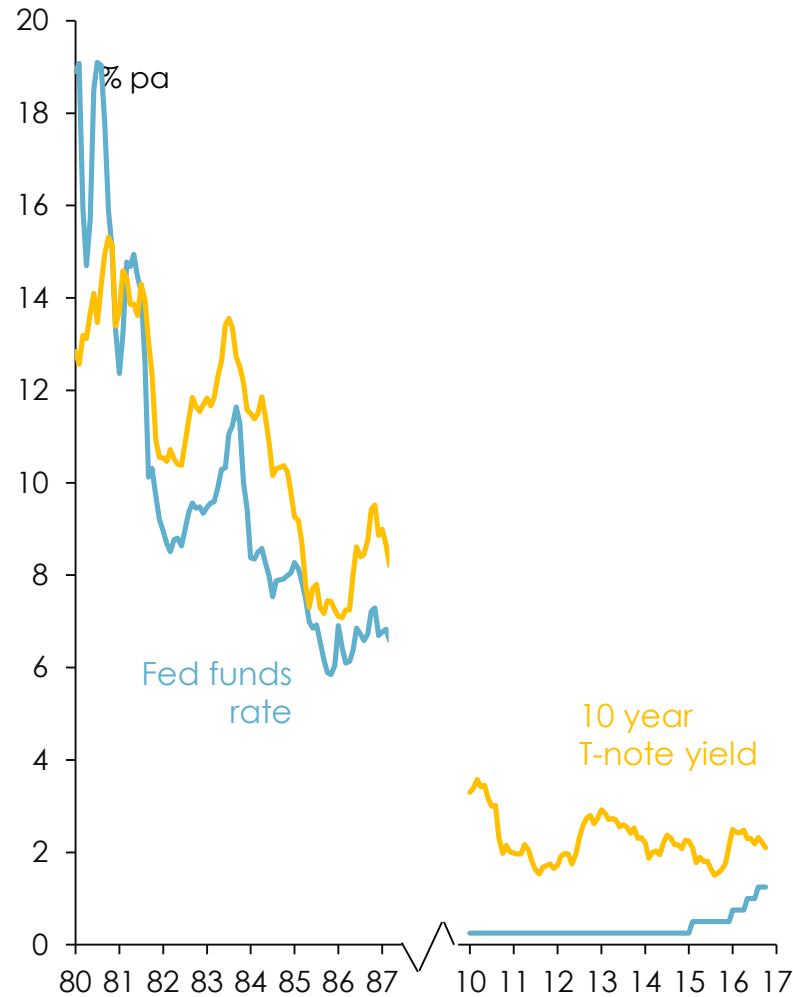
US dollar



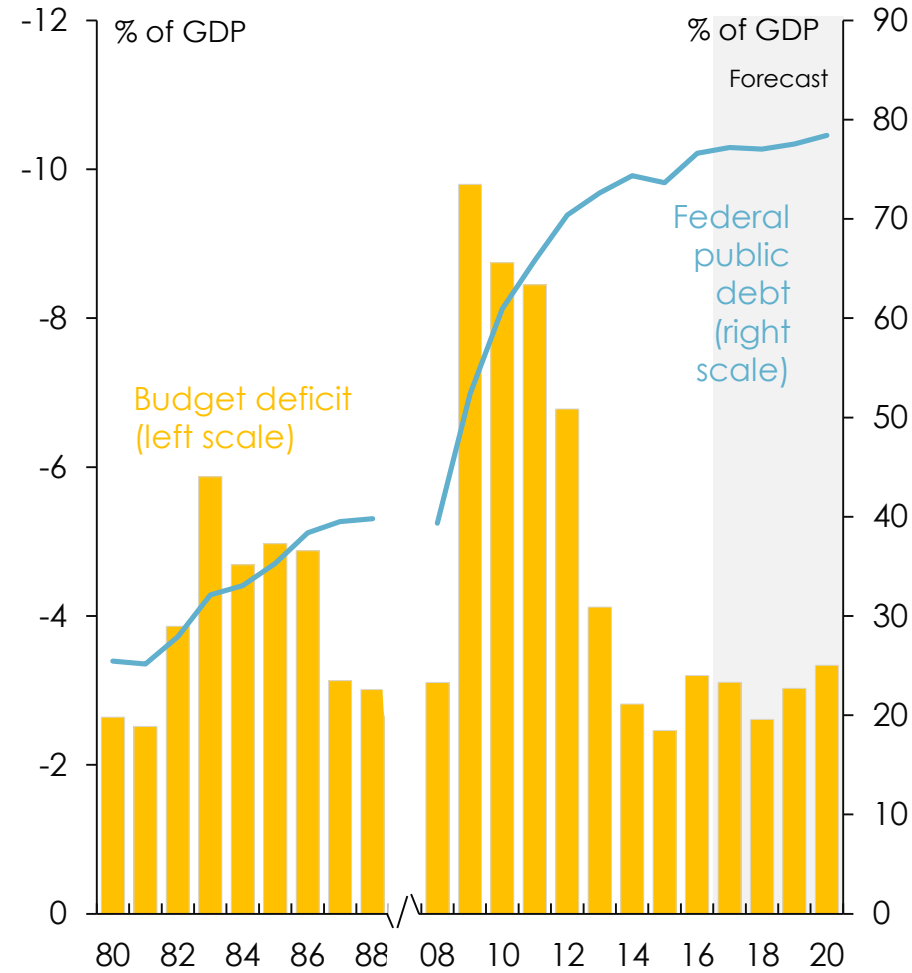
Source: Thomson Reuters Datastream.

Three reasons why Trump's fiscal policies – if they are ever legislated – wouldn't have the same effect as Reagan's

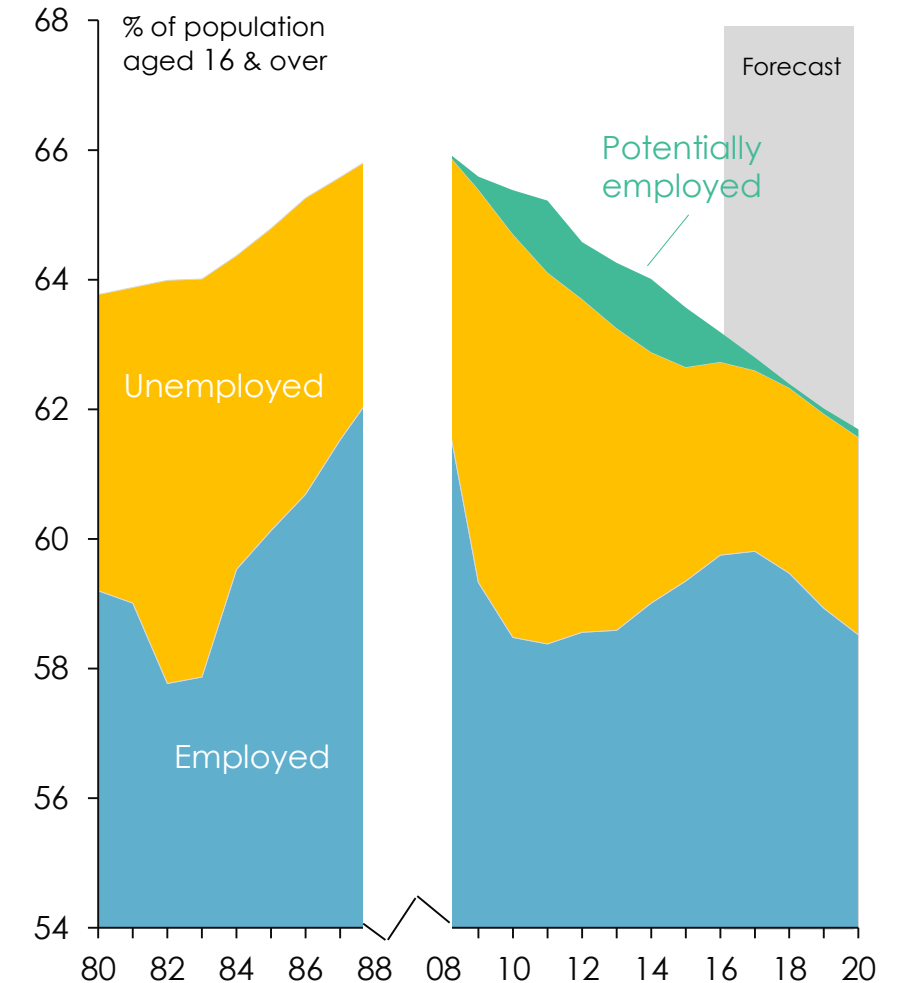
Interest rates



Federal budget and debt



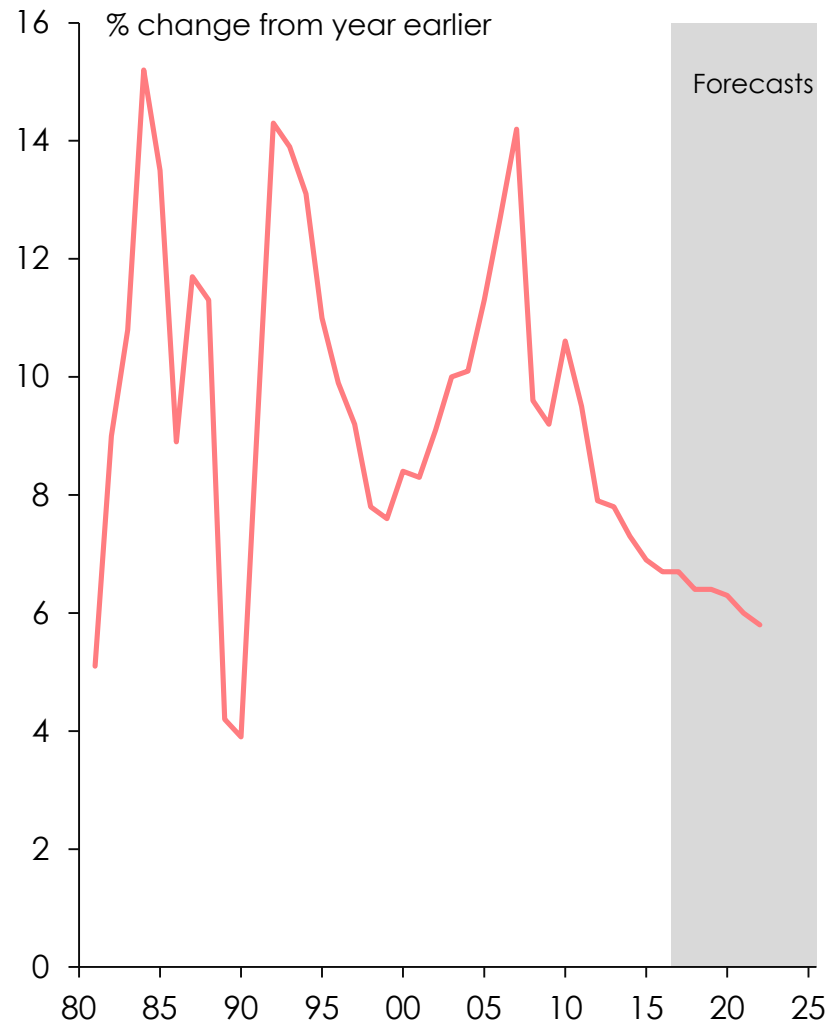
Labour supply



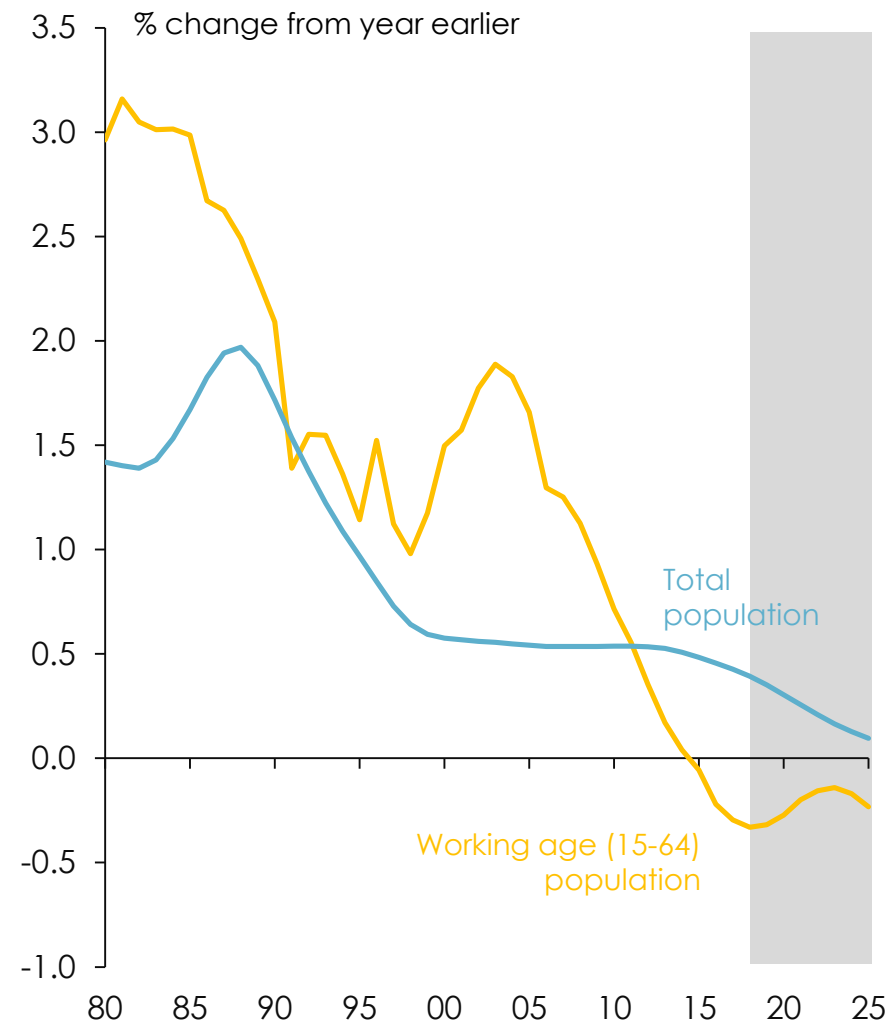
Sources: US Federal Reserve; US Congressional Budget Office.

China's economy is slowing, partly because its workforce has started to shrink – and it also has a potentially massive debt problem

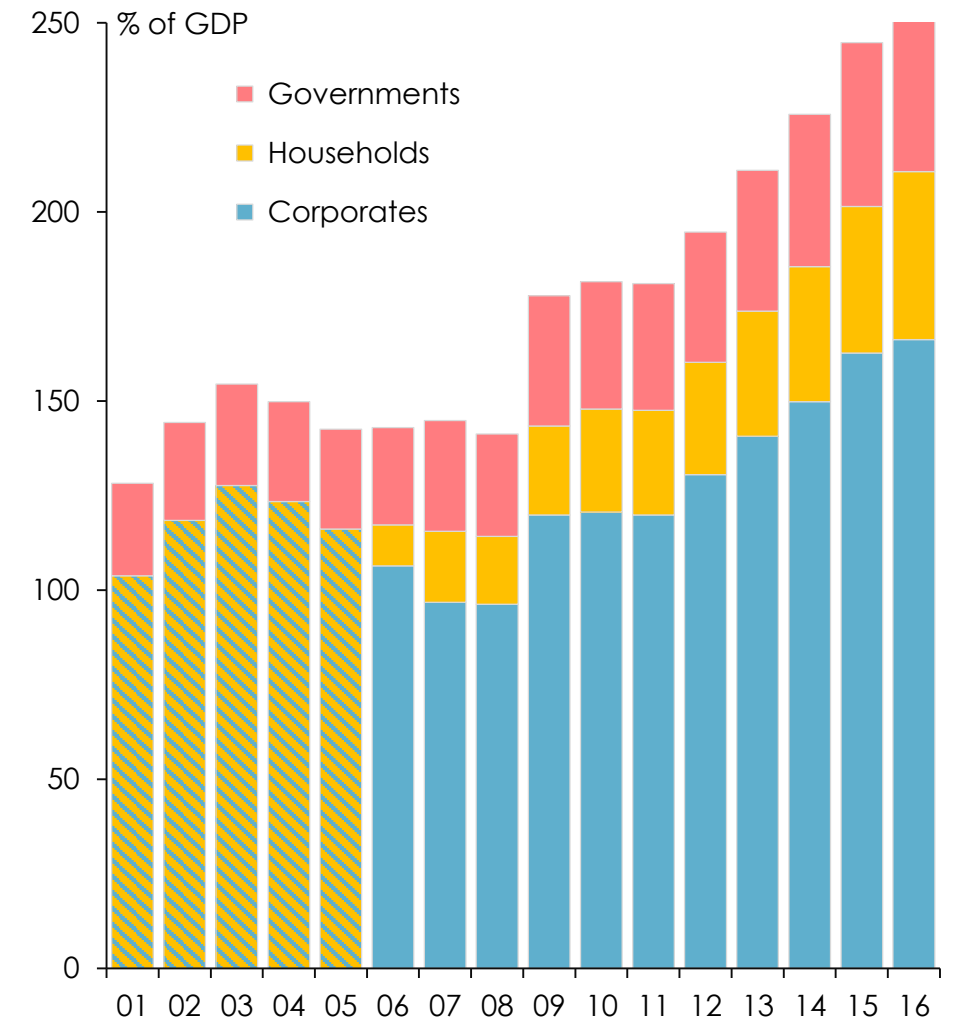
China real GDP growth



Chinese population



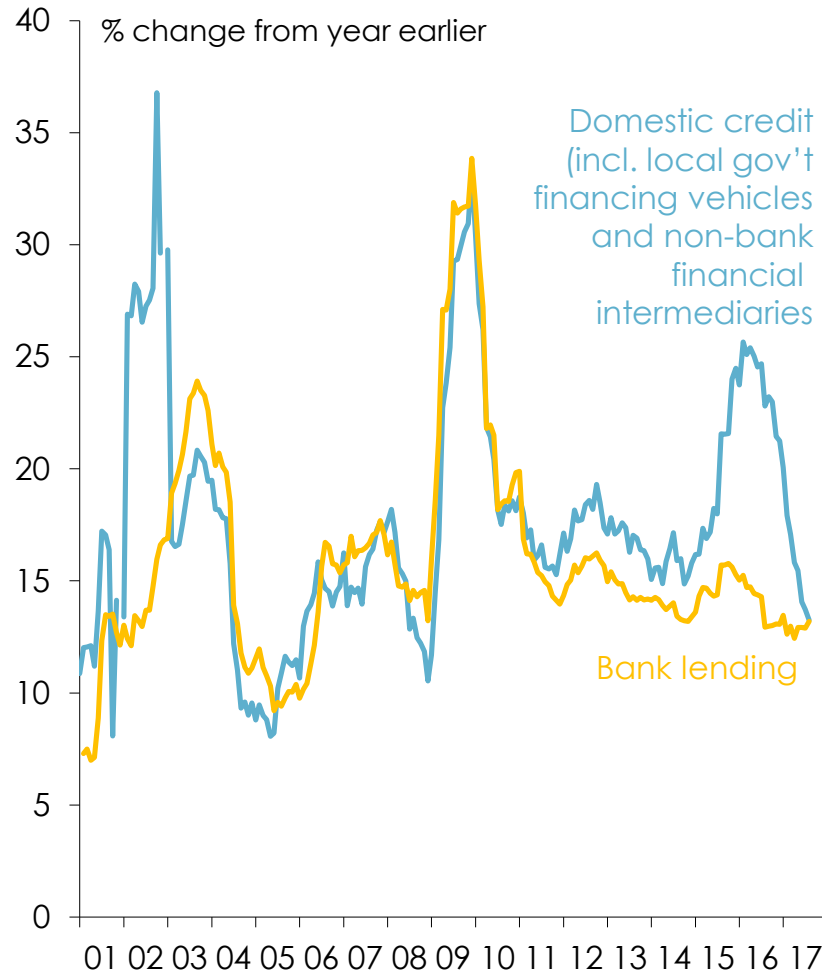
Chinese debt



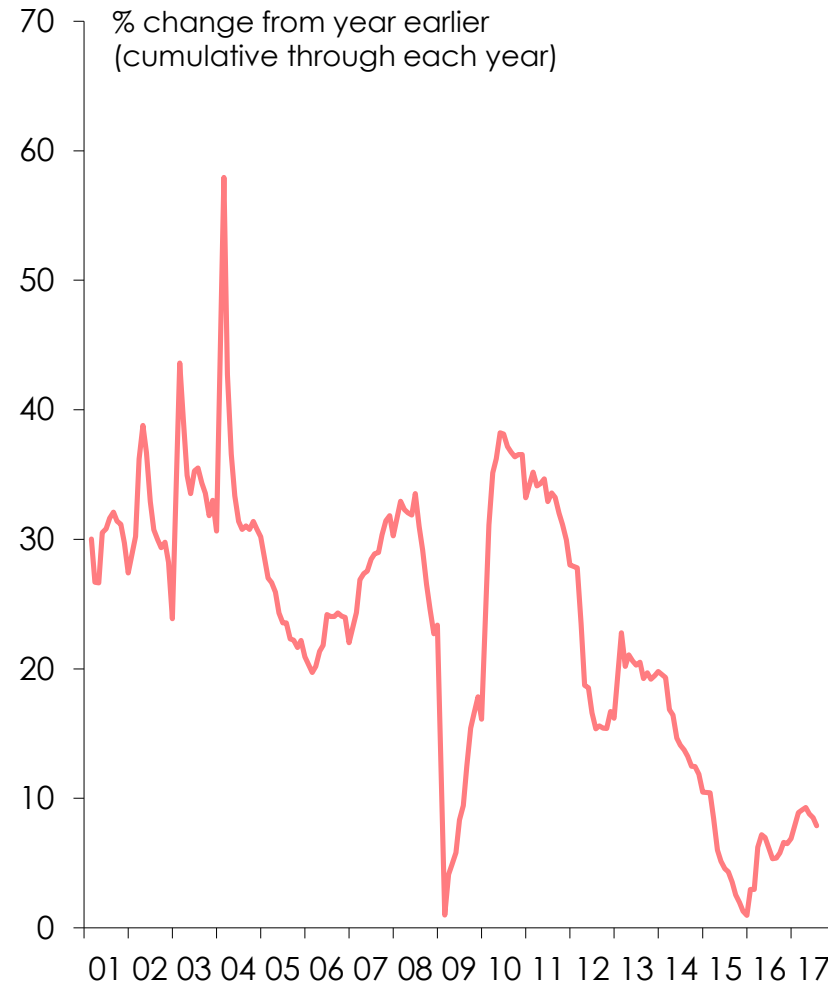
Sources: China National Bureau of Statistics; IMF; UN Economic & Social Affairs Division, Population Branch; Bank for International Settlements

China has been through another debt-driven property investment cycle which appears to have peaked in recent months

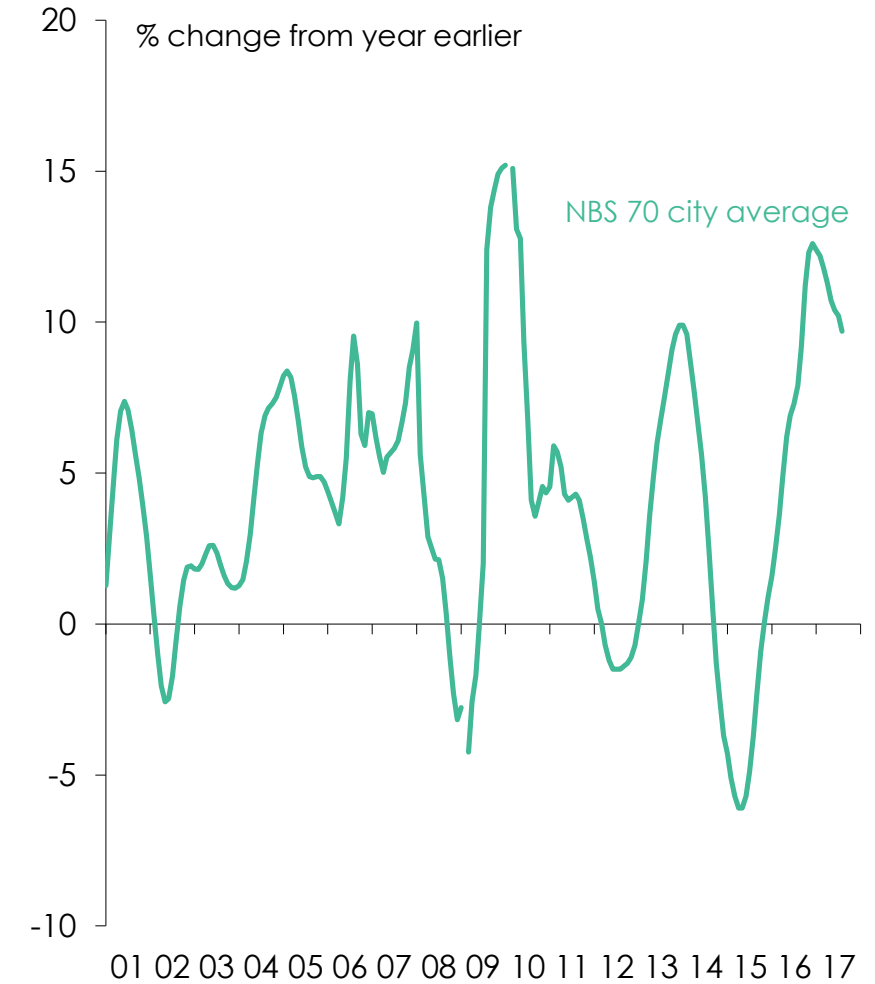
Credit growth



Real estate investment



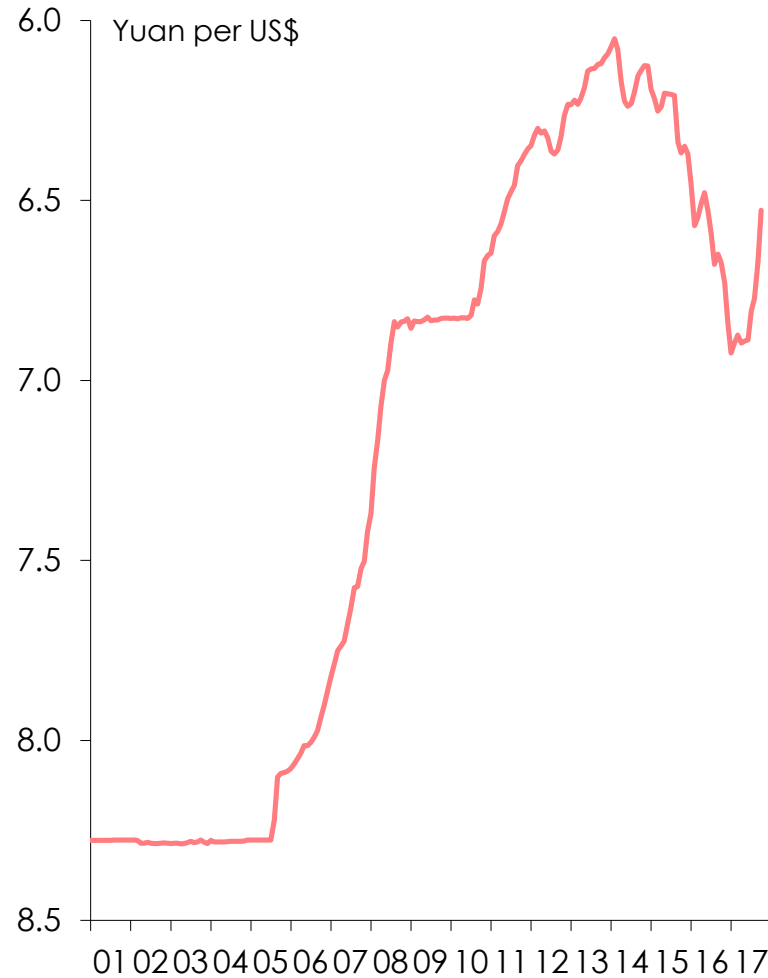
Urban property prices



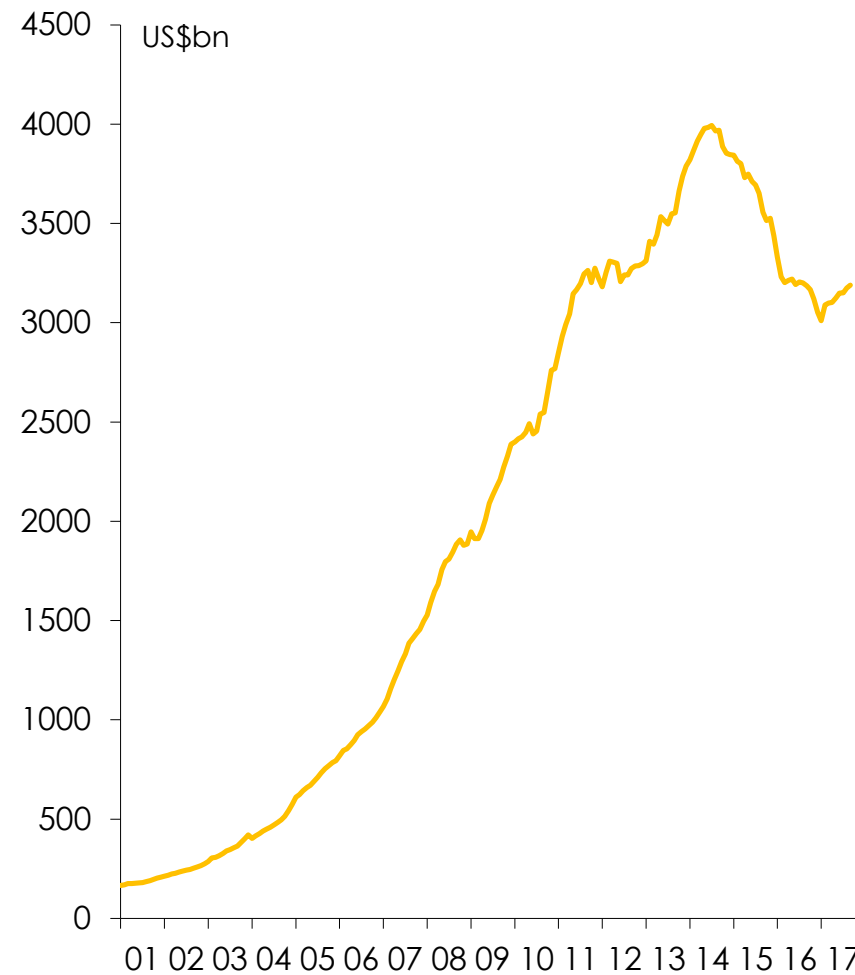
Sources: People's Bank of China; China National Bureau of Statistics.

China has become more concerned about a sharp fall in its own currency – prompting it to impose tighter controls on capital outflows

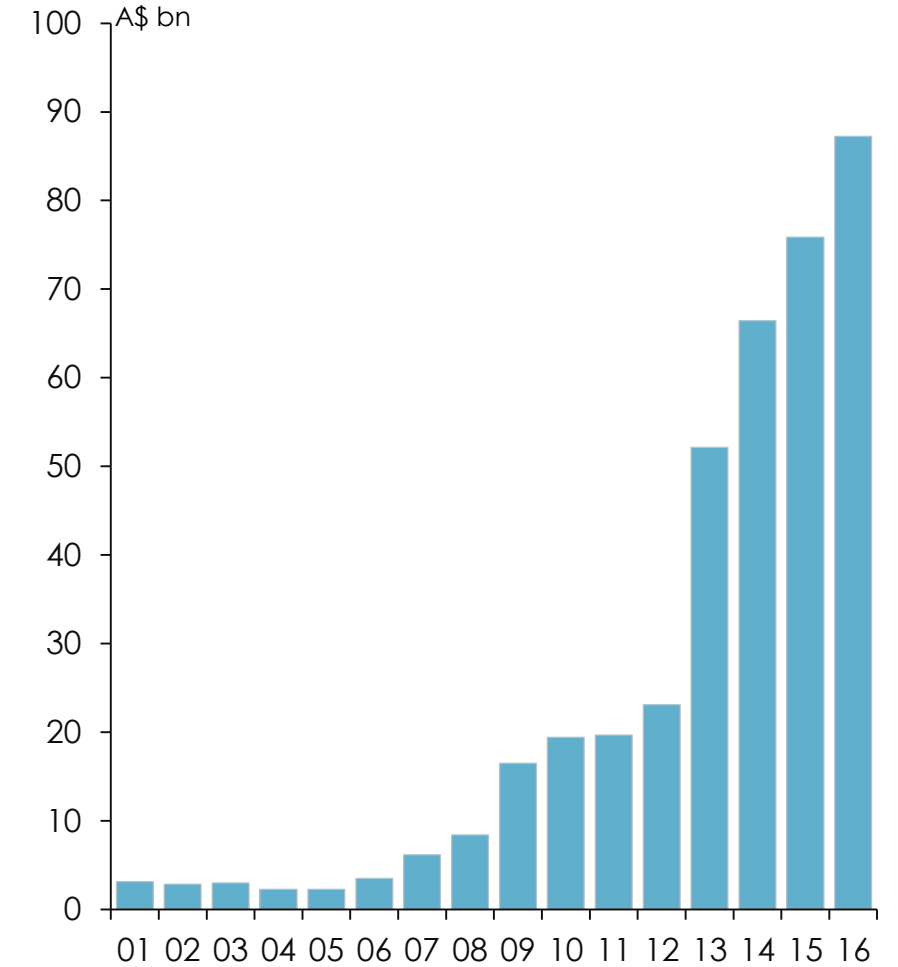
Chinese yuan vs US\$



China's foreign exchange reserves



Chinese foreign investment into Australia

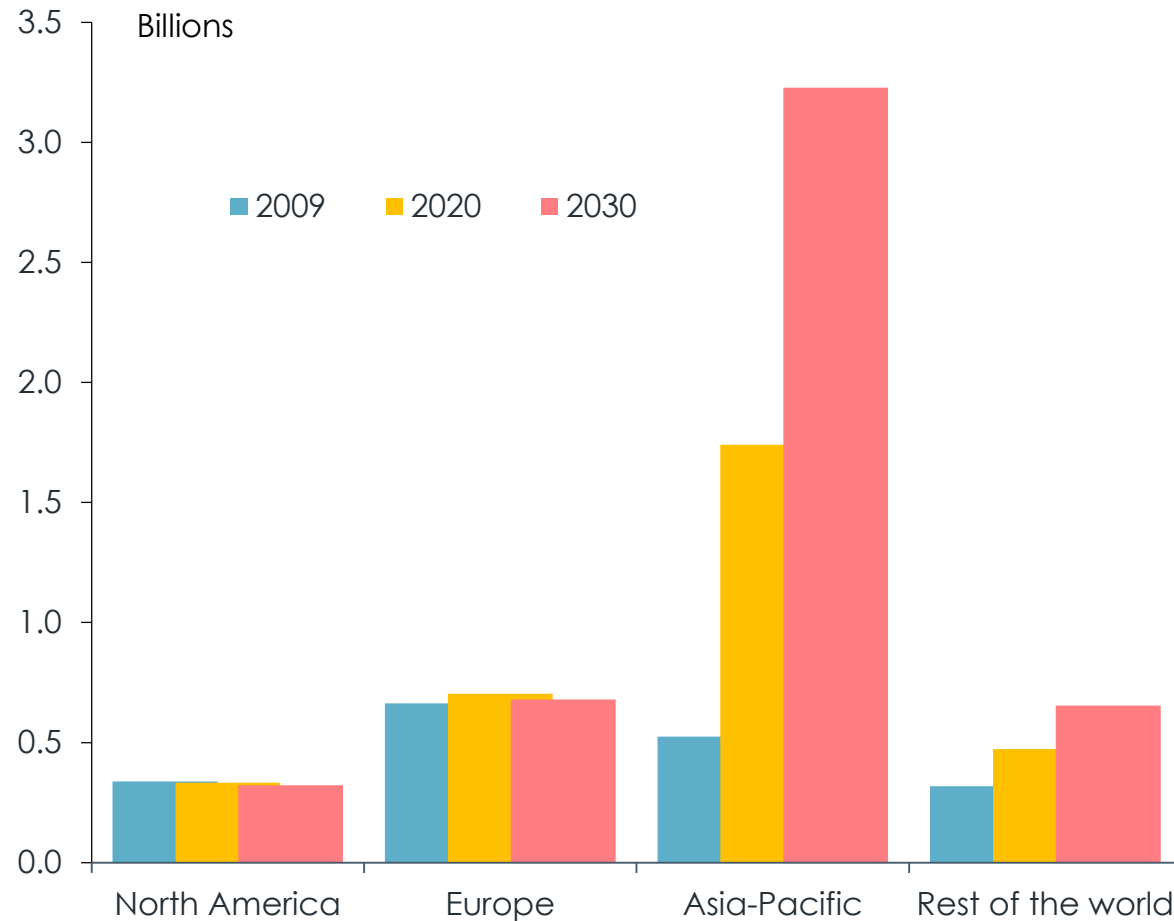


Sources: People's Bank of China; Australian Bureau of Statistics.

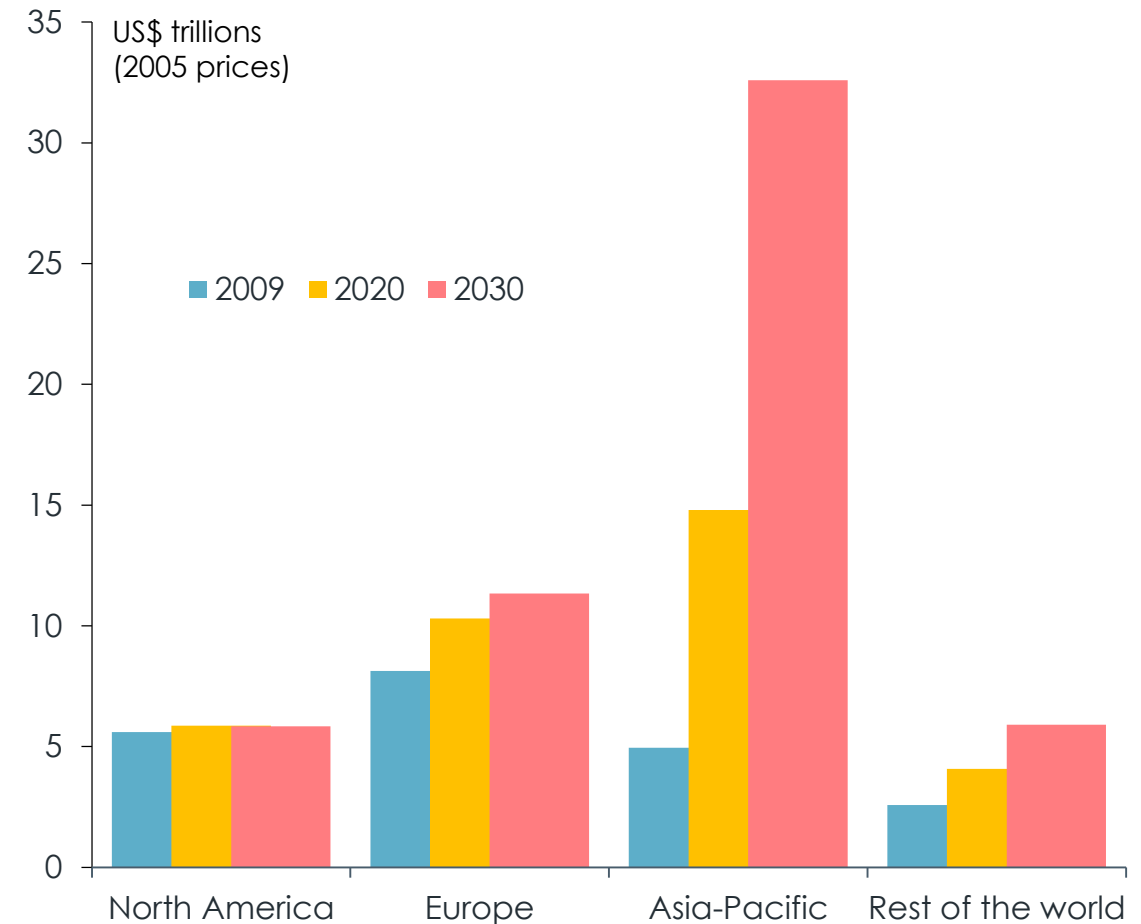
Longer term prospects for Australian agriculture

The numbers and spending power of 'Asian middle classes' will increase dramatically over the next 15 years

Number of 'middle class' consumers



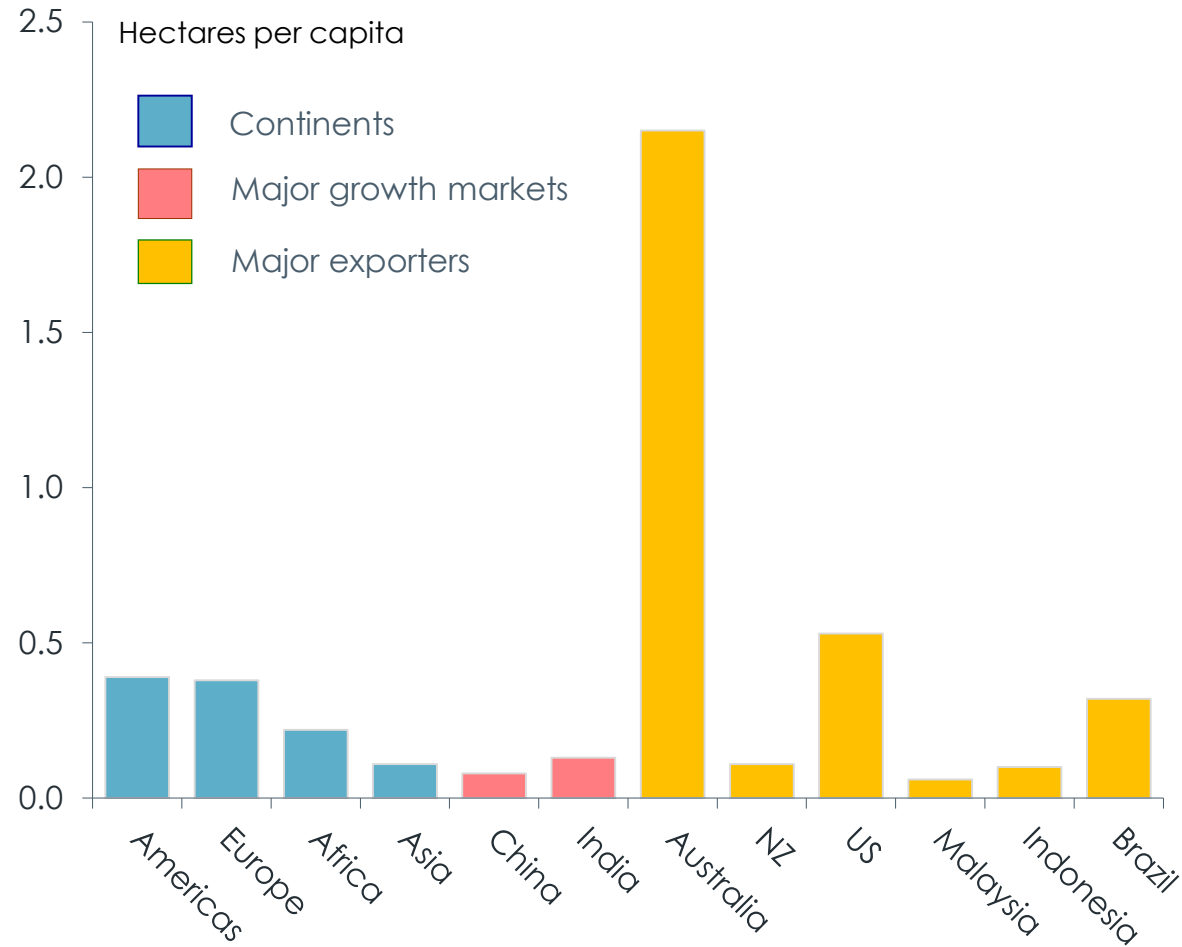
'Middle class' consumer spending



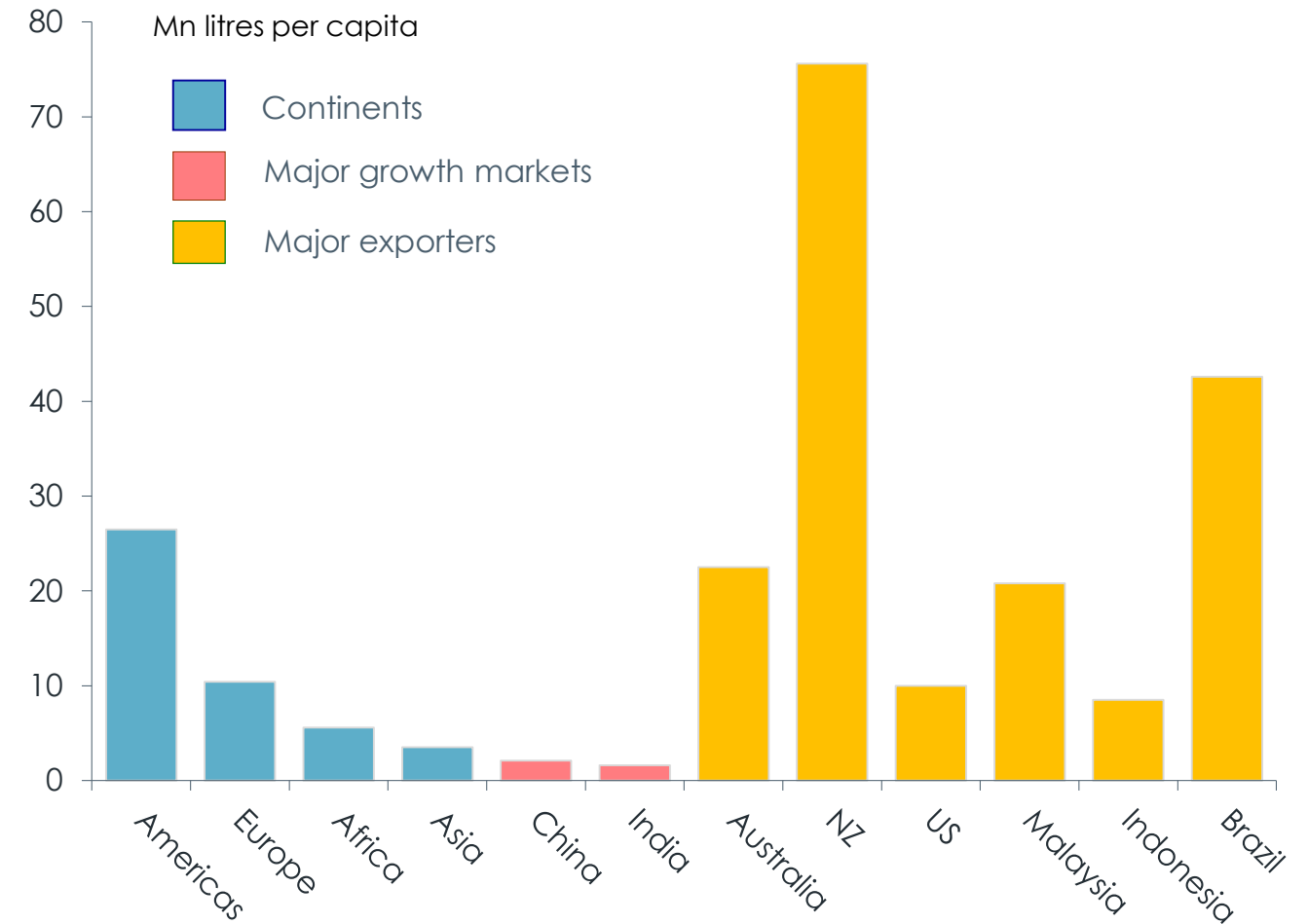
Note: 'Middle class' is defined as people with daily spending of between US\$10 and US\$100, in 2005 prices converted at purchasing power parity exchange rates.
Source: Homi Kharas and Geoffrey Gertz, "The New Global Middle Class: A Cross-Over from West to East", Wolfensohn Centre for Development, The Brookings Institution, Washington DC, 2010.

But Asia's potential to lift agricultural production is limited by constraints on both land and water ...

Arable land



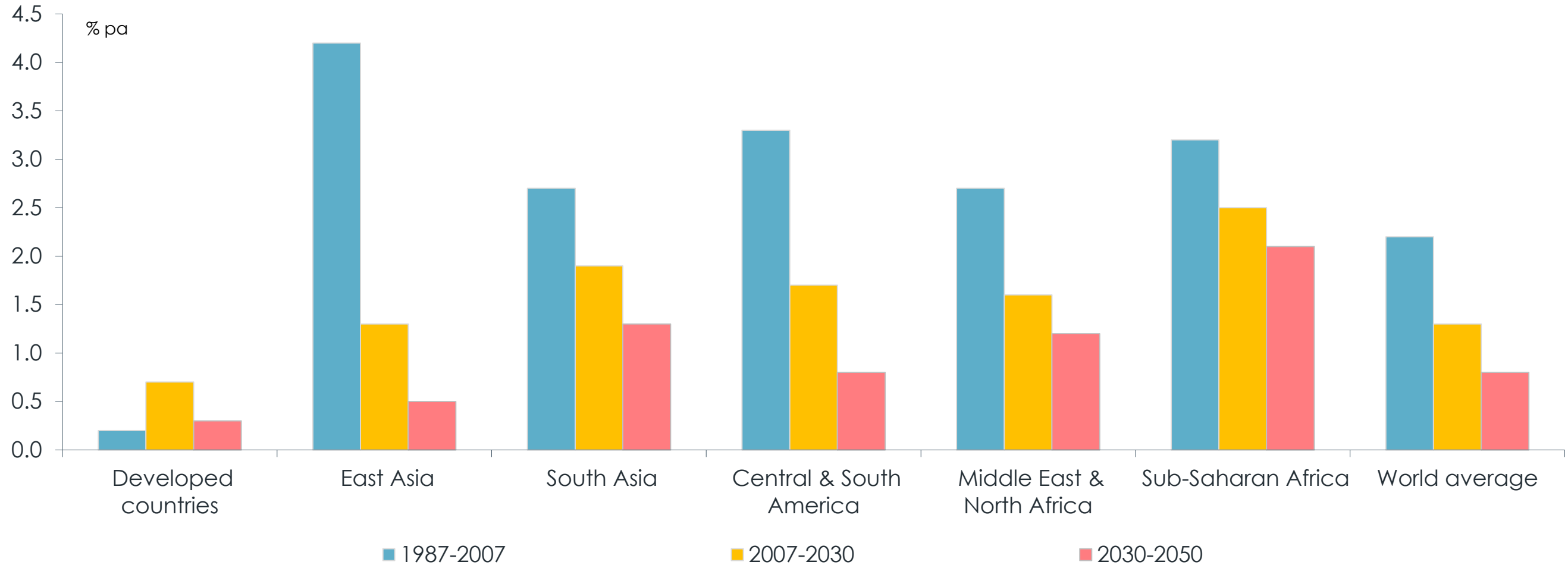
Renewable water supply



Source: ANZ & Port Jackson Partners, Greener Pastures: The Global Soft Commodity Opportunity for Australia and New Zealand, October 2012.

... so the growth rate of agricultural production is likely to slow – especially in Asia

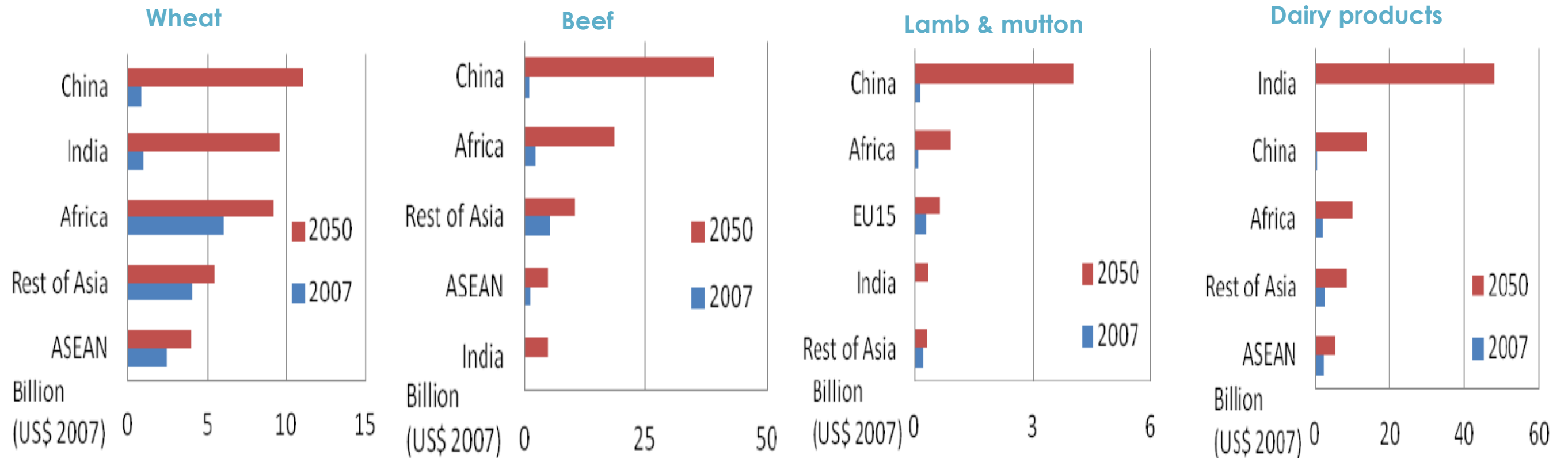
Growth rates of agricultural production



Source: Nikos Alexandratos & Jelle Bruinsma, *World Agriculture Towards 2030/2050: The 2012 Revision*, ESA Working Paper No 12-03, Food and Agriculture Organization (June 2012).

... and Asian countries (in particular) will need to import a lot more food products

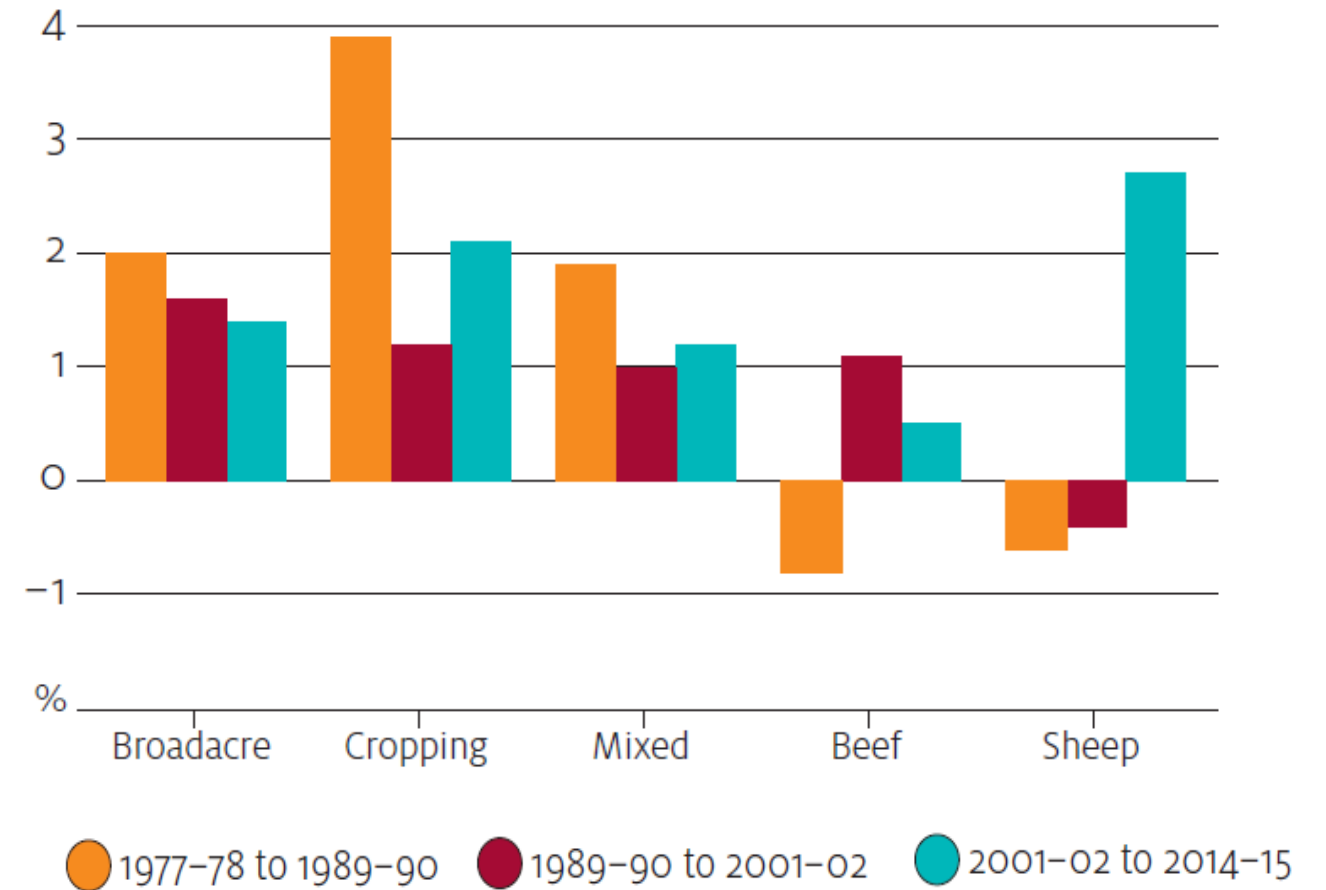
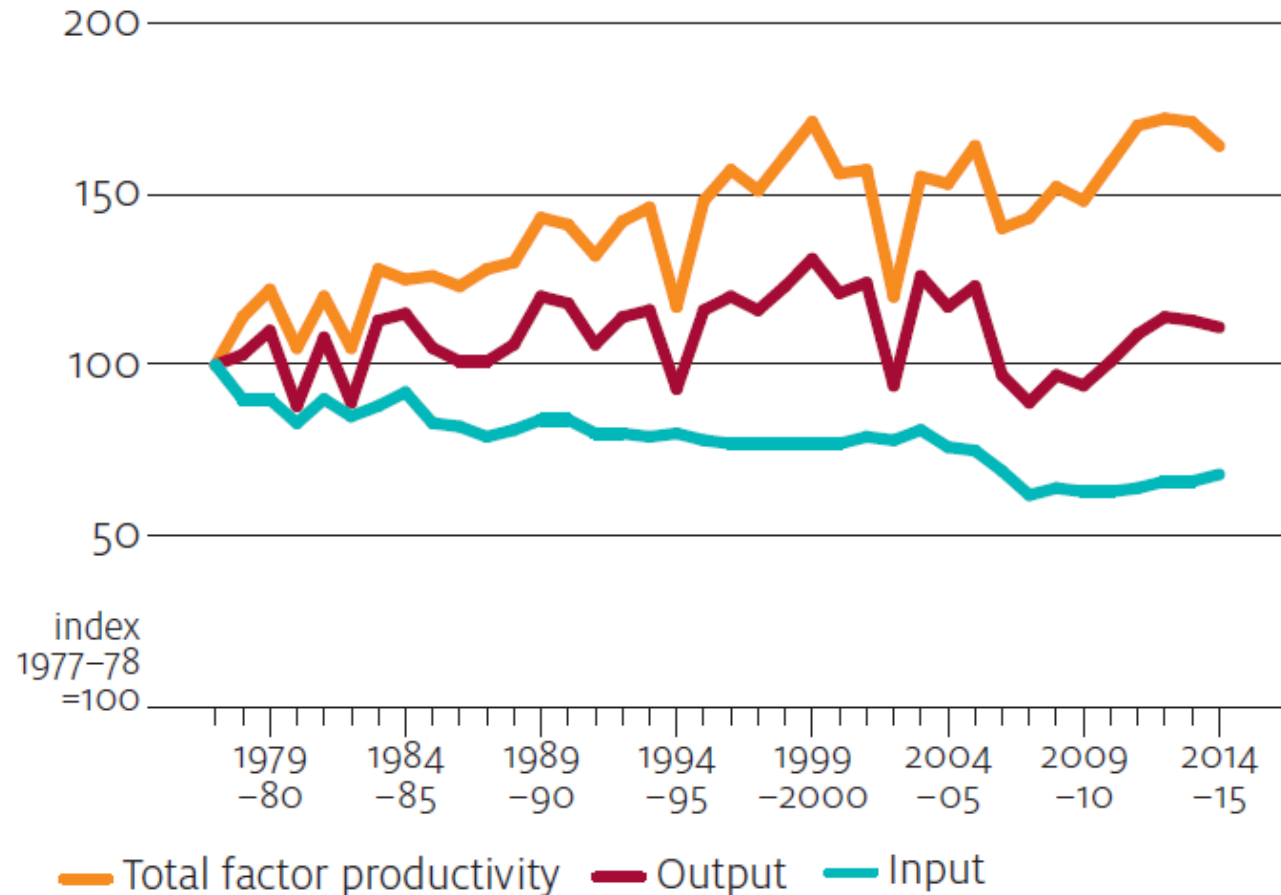
Sources of global food import demand



Source: Verity Linehan, Sally Thorpe, Neil Andrews, Yeon Kim & Farah Beaini, *Food Demand to 2050: Opportunities for Australian Agriculture*, Paper presented to 42nd ABARES Outlook Conference, 6-7 March 2012; Australian Government, *Australia in the Asian Century White Paper*, October 2012.

But to capitalize on that opportunity, Australian agriculture will need to improve its productivity ...

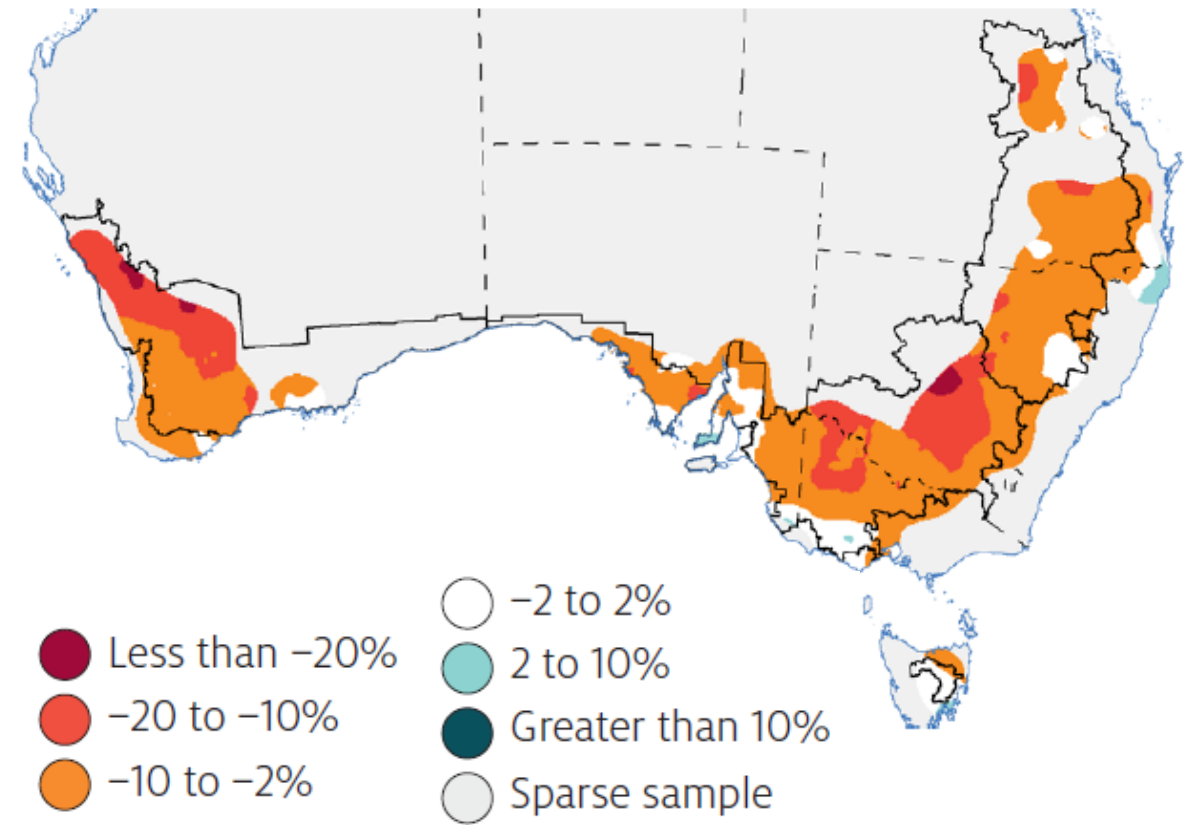
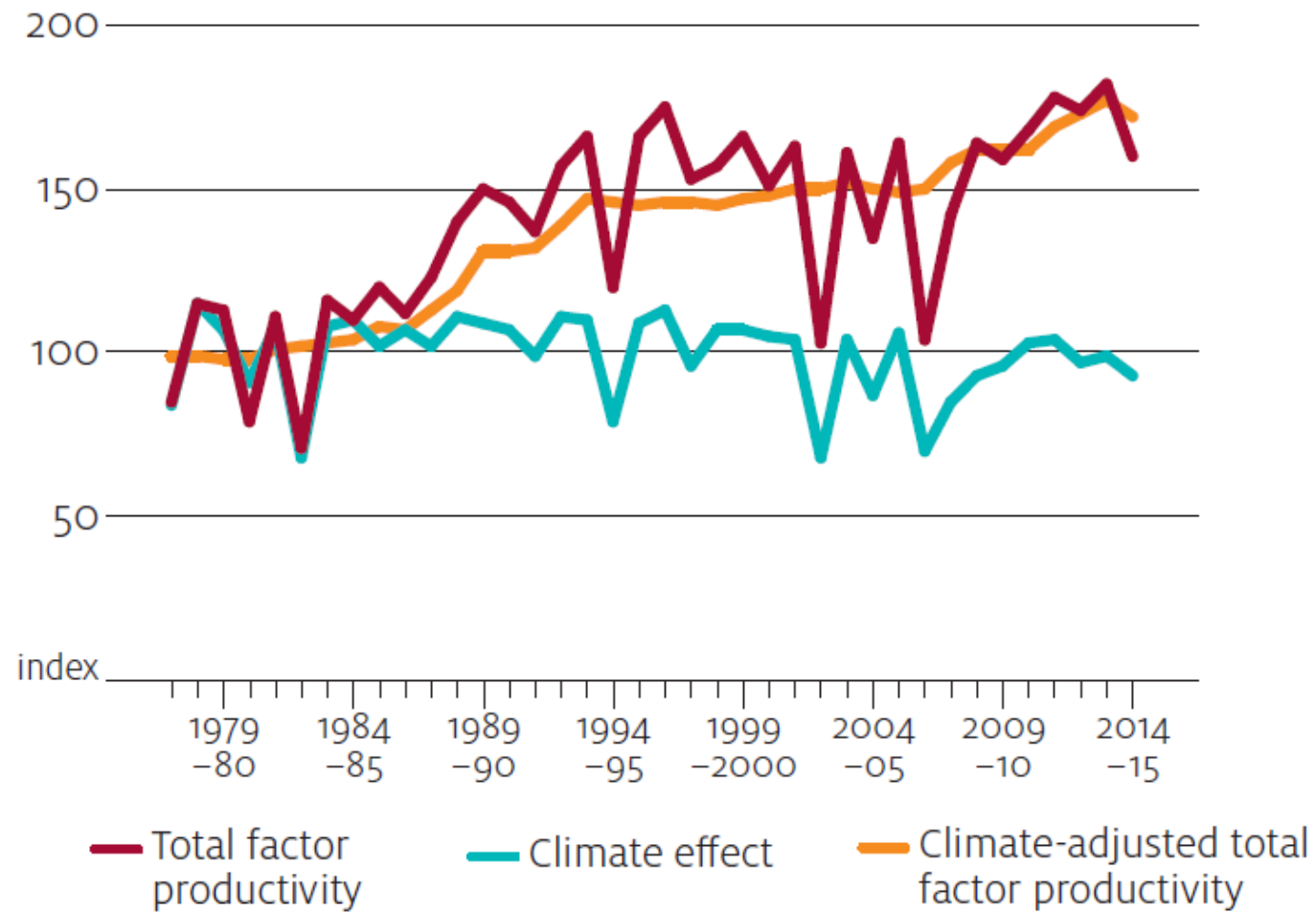
Total factor productivity in Australian broadacre agriculture, 1977-78 to 2014-15



Note: Total (or multi-) factor productivity is the ratio of total production to a measure of inputs (land, labour, capital, and materials & services) used in the production process. Source: Charley Xia, Shiji Zhao and Haydn Valle, 'Productivity in Australia's broadacre and dairy industries', in *Agricultural Commodities*, ABARES, March 2017.

... including by adapting to climate change ...

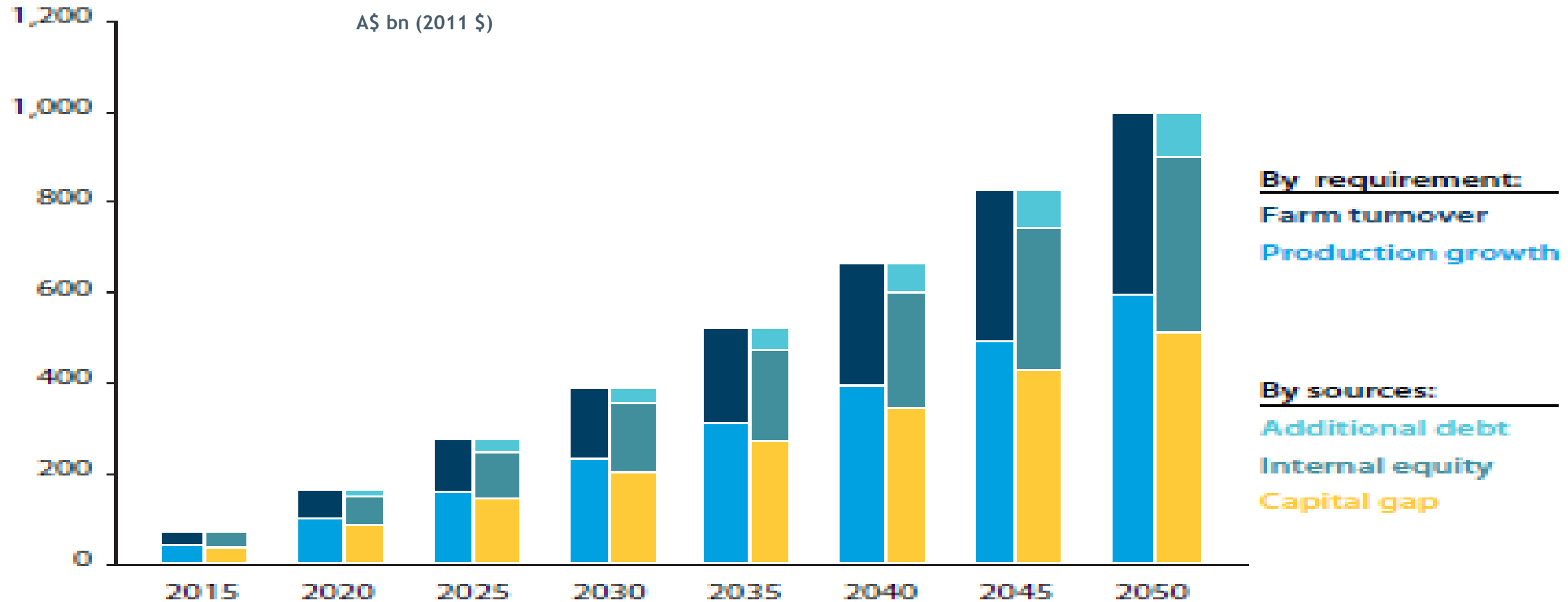
Impact of climate change on productivity levels in cropping



Source: Neal Hughes, Kenton Lawson and Haydn Valle, *Farm performance and climate: climate-adjusted productivity on broadacre cropping farms*, ABARES, May 2017

... and attract new capital investment, (inevitably) including from foreign sources

Cumulative capital required by the Australian agricultural sector



Source: ANZ & Port Jackson Partners, *Greener Pastures: The Global Soft Commodity Opportunity for Australia and New Zealand*, October 2012.

Summing up ...

Key elements of the economic outlook for Australian agriculture

- ❑ **Major agricultural commodity prices to remain around current levels**
 - subject to the usual risks around major weather events, natural disasters and big shifts in trade policies
- ❑ **Australian interest rates will start moving up next year – but in a gradual, limited way**
 - the RBA does not want to cut rates any further (unless there is a major adverse economic shock) for fear of further stoking metropolitan property prices and household debt
 - but nor does it want to start raising them until it is much more confident that inflation is back within its 2-3% target range, and unemployment is closer to 5%
 - the timing of any changes in the RBA's interest rates won't be dictated by movements in overseas rates
 - interest rates will not rise by very much over the next few years
- ❑ **The A\$'s fortunes will be dictated largely by events overseas, particularly the US and China**
 - if the US\$ continues to weaken, then the A\$ will stay uncomfortably high (for exporters)
 - but if by some chance Trump does get his act together, and the US economy strengthens, the A\$ will fall back to the low US70s
 - a 'hard landing' in China would almost certainly send the A\$ into the US60's
- ❑ **Medium term economic developments in Asia provide opportunities for Australian agriculture**
 - but Australian agriculture will face a lot more competition than Australian mining
 - Australian agriculture will need to improve productivity and attract more investment capital

Thank you!

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