The Australian Grains Industry Conference

Factors Influencing the Australian and Asian Economies – Opportunities for Australian Agribusiness

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Summary conclusions

- Real global economic growth will remain moderate over next few years at ~4%
- US recovery will continue with European prospects now more positive
- China remains critical to the outlook globally and especially for Australia. Risks are that growth will be slower than planned despite policy actions to maintain momentum.
- Medium term trends in support of commodity markets (including agriculture) are intact and positive
- ASEAN markets increasing in importance but will be impacted by China
- Australian prospects still 'flattish' with no clear signs/impetus of recovery to trend growth evident to date

Implications

- Business and investors need to separate the cyclical from structural shifts
- Volatility will remain part of the landscape
- M&A, consolidation will continue. Investment $ are available
- Certainty of returns continue to be prized over promise of growth
- $A decline and recent FTA's have created opportunities for businesses focussed on the right sectors and geographies

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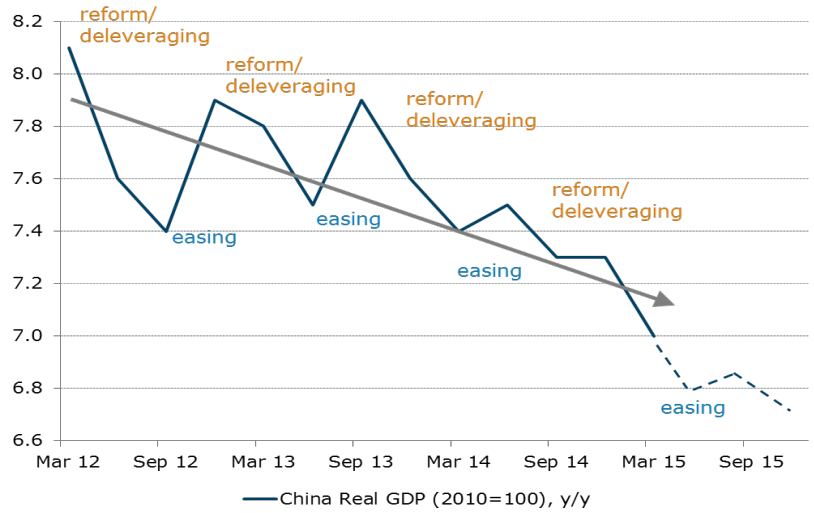
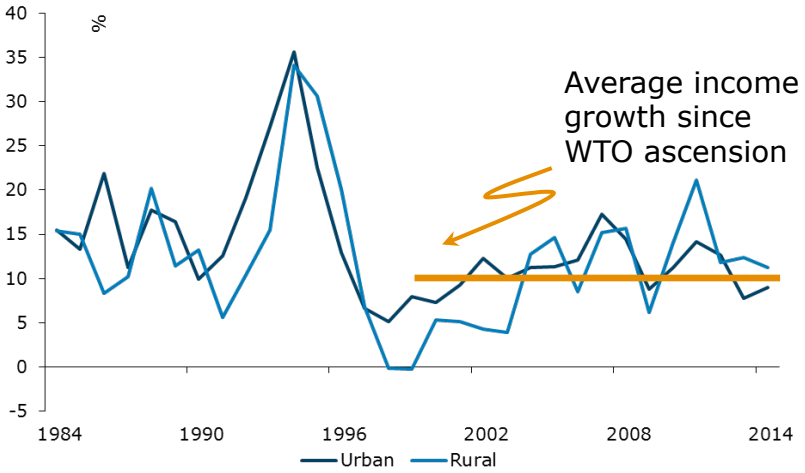
Chinese policy dynamics are now aggressively easing

China GDP Easing



China Household Income Growth



Source: CEIC, ANZ

- China's policy action can increasingly be seen to be moving into an aggressive easing cycle to manage the ongoing slowdown, not counter it.
- The PBoC has cut interest and relaxed deposit rates three times and cut the RRR twice in the past twelve months.
- These measures do appear to be finding their way into the economy as of Q2 official numbers, but these were boosted by stronger equity markets – more recent equity market correction will be felt in Q3
- Recent economic data remain mixed; trends suggest GDP likely to underperform the 7% annual target this year

What should we look for when monitoring China's prospects

- In 2014, the added GDP in China was the equivalent of the 18th largest economy in the world – size does matter
- Over the next year some recovery in property sector is expected to underpin growth – it tracks closely to GDP and has outperformed as an asset class. Urbanisation will continue to support longer term stability in this important market
- Fixed asset growth (investment in manufacturing and infrastructure) remains critical to achieving GDP targets and is currently weaker than expected (11.4% ytd vs 15% target). Further policy easing will signal this important sector needs more stimulus
- Debt levels are high in local government/ in listed companies but low at the central government/ consumers. Deleveraging is needed to de-risk growth and is underway
- Stock market volatility is less significant to growth and confidence than in other major economies. Banking sector provides most finance and is strongly capitalised
- Consumer spending will continue to rise, including demand for food; as well as the volume of demand, there is an increasing focus on quality/brand/source
- Medium term, rising minimum wage levels, urbanisation and extensive structural reforms will boost consumption and focus on quality – critical to business decisions
- Agri production expanding .. but water availability /cost and land use are constraints

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China's ongoing structural reforms will boost consumption

- A nationwide health insurance system has been set up, covering more than 96% of the 1.34bn population.
- A minimum pension established for rural retirees
- The ongoing land lease title reform will transfer the de facto land ownership to rural farmers, creating a wealth effect that will boost rural consumption.
- A unified pension system is due and it will not only enhance China's social security system but also have far-reaching implications for China's capital markets.
- Further reforms in China's education and health care sectors will help reduce precautionary savings and unleash their consumption potential.
- The government is addressing the issue of rising property prices re-introducing public housing program
- The overarching theme of rebuilding China's social safety net, together with an accelerating urbanisation process focused on people's welfare, will become a centrepiece in the overall development strategy in the remainder of this decade.

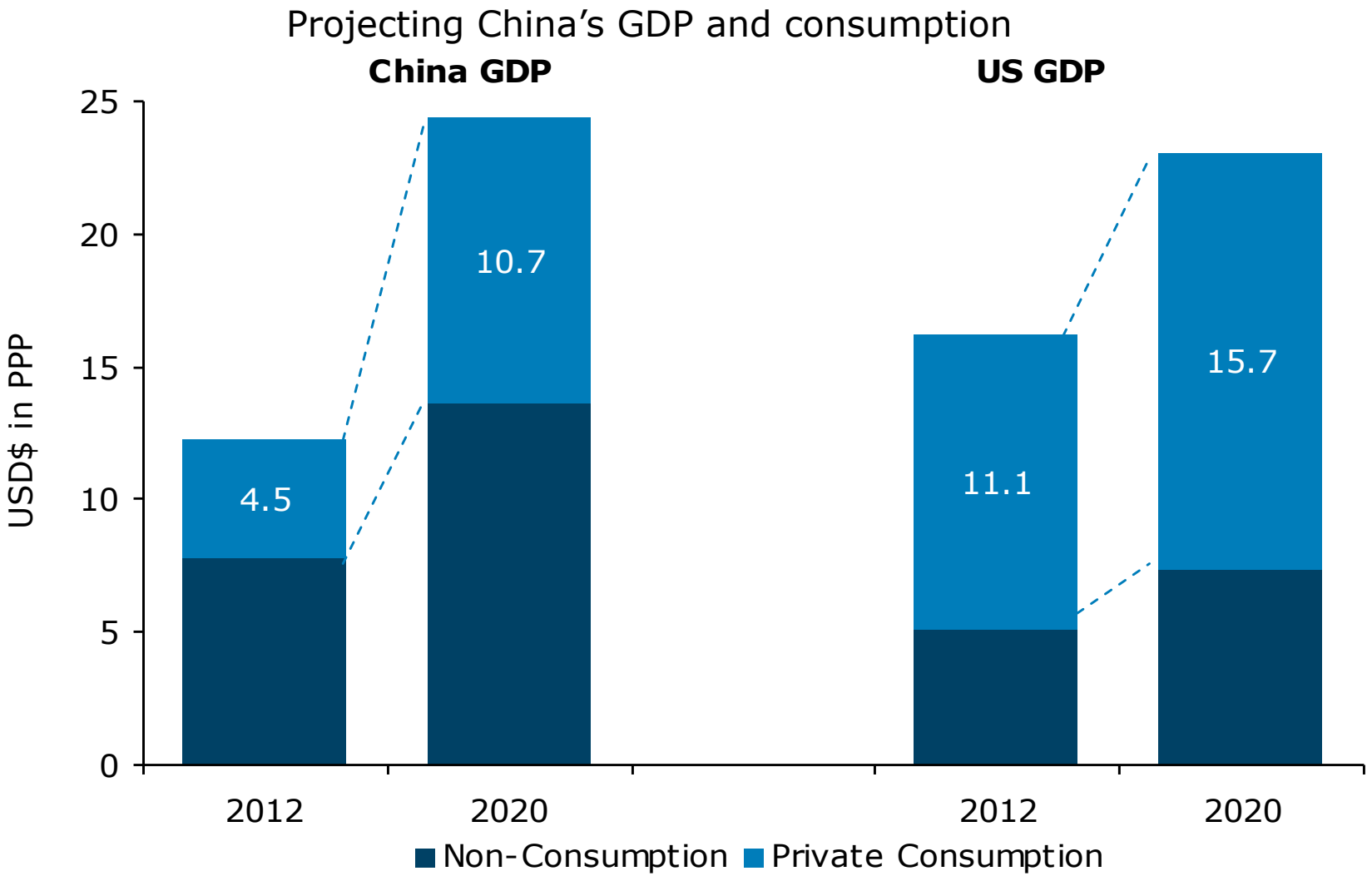
Reduce precautionary saving

Improve earnings and spending power

Create new consumption drivers

Nurture the rise of middle class

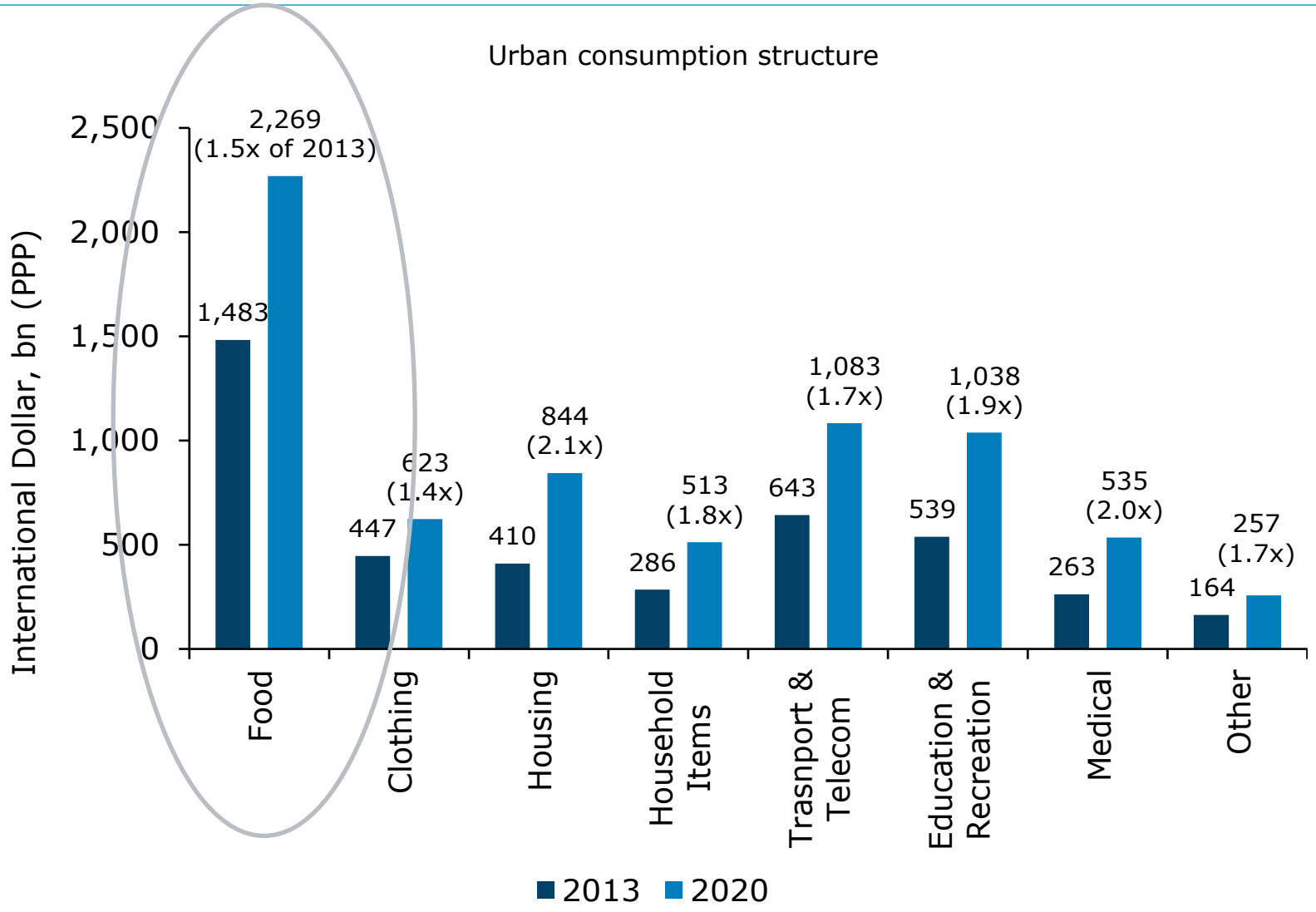
By 2020, China's private consumption will represent 44% of its GDP and 70% of the size of the US consumer market



Note: China's GDP is assumed to grow at an average real rate of 6.7% and the price level is assumed to grow by 3.5% a year. For the US, the respective assumptions are 3.0% and 2.5%. In nominal terms, the values of GDP of China and the US will be USD18trn and USD24trn respectively by 2020, keeping the exchange rate unchanged.

Source: IMF, ANZ Research

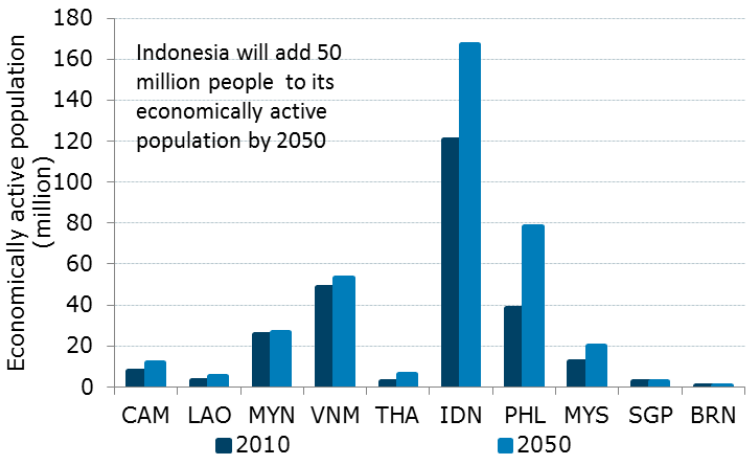
Auto industry, telco, real estate, education, recreation, medical sectors will benefit from China's emerging middle class.



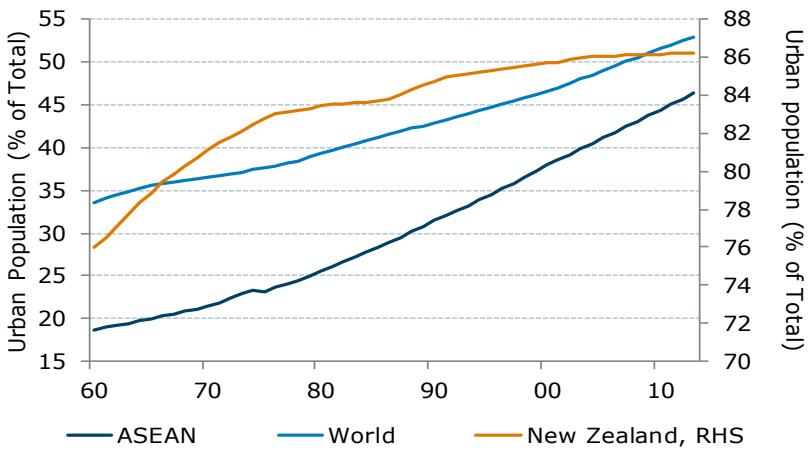
Source: CEIC, ANZ Research

Activity will relocate out of China and drive income formation and consumption elsewhere in Asia

Economically Active Population



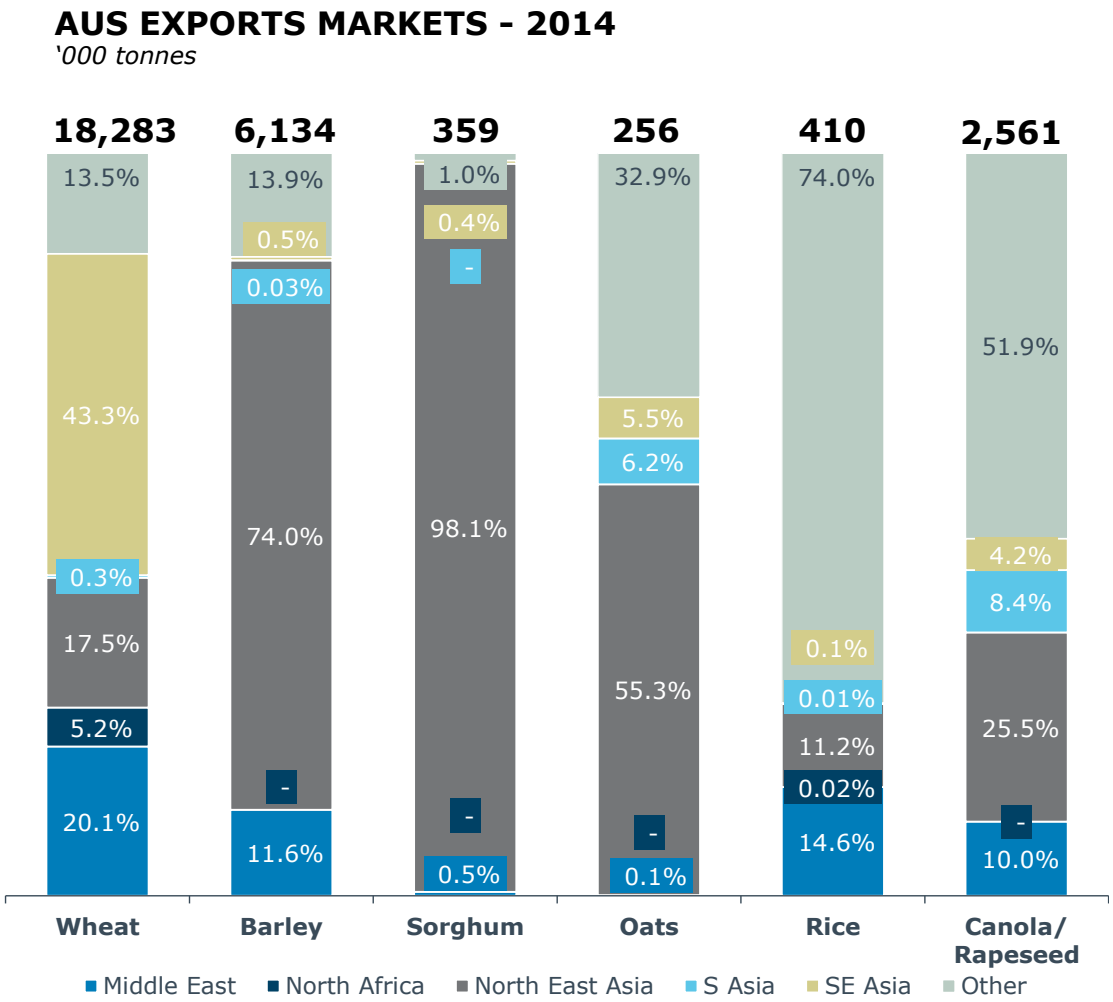
Urban Population – ASEAN vs Aust/NZ



- Rising Chinese wages seeing "Factory Asia" drifting south into the ASEAN
- India and Indonesia moving to large, young working-age populations
- ASEAN and India transitioning from uncertain agricultural income to more certain manufacturing income, boosting demand for goods, especially protein
- As increased Asian manufacturing strains inefficient electricity grids, alternative energies and bio-fuels become more important
- Current low hard/energy commodity prices offers opportunity to invest in soft commodity development at lower cost… cheaper energy to clear fields, cheaper fertilisers, etc.

NE Asia & SE Asia account for nearly two thirds of the trade…

- North East Asia, home to the Australia's major trade partner - China dominates the export markets. NE Asia accounts for ~32% of the exports of the six key commodities
- It is closely followed by SE Asian countries, which represent ~29% of the six key commodities' exports
- Middle East region is at a distant third, at 17% of these exports, with wheat, barley and rice being the major import items



Source: Data sourced from UN Comtrade and it represents calendar year
HS Codes considered for data include Wheat – 1001, Barley - 1003, Sorghum - 1007 , Oats - 1004 , Rice - 1006 , Canola - 1205

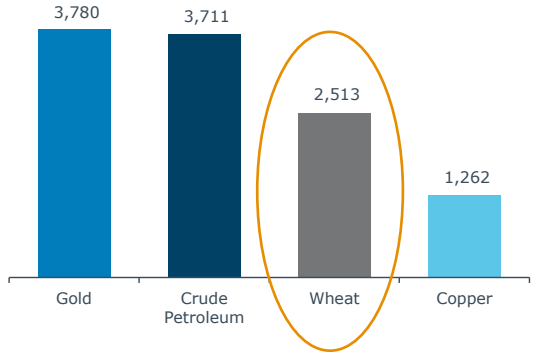
Australian grain also well positioned for ASEAN growth

FTAs will boost Australia's position as main supplier

- ASEAN economic and income growth will directly benefit from China's transformation and will support export demand of our closest neighbours
- Maintaining market shares as demand grows; better linking supply chains and investments

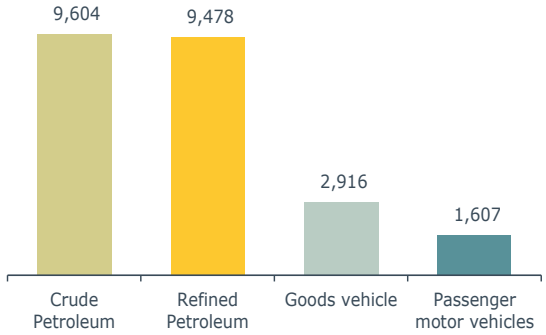
AUS EXPORT TO ASEAN 2014

(AUD m)

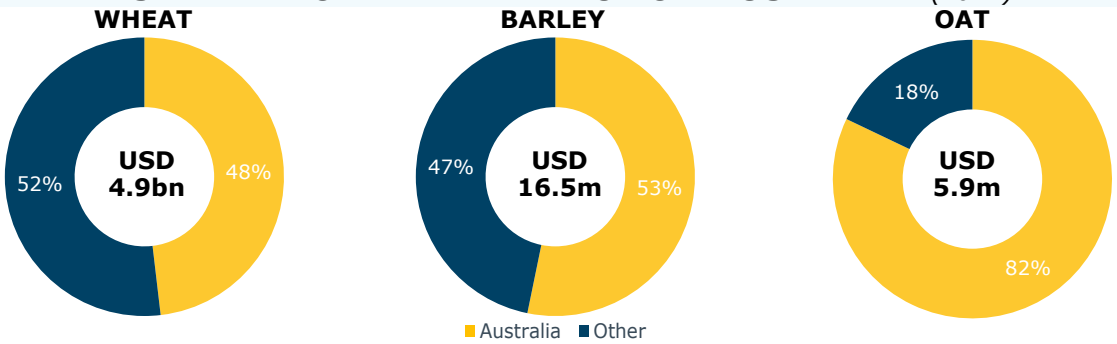


AUS IMPORT FROM ASEAN 2014

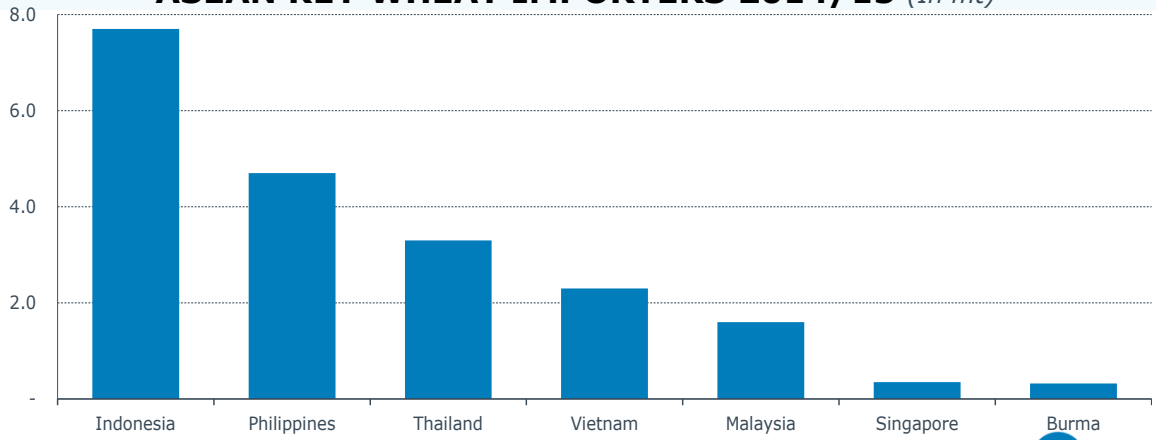
(AUD m)



ASEAN IMPORT DEPENDENCE ON AUSTRALIA *(2014)*



ASEAN KEY WHEAT IMPORTERS 2014/15 *(In mt)*



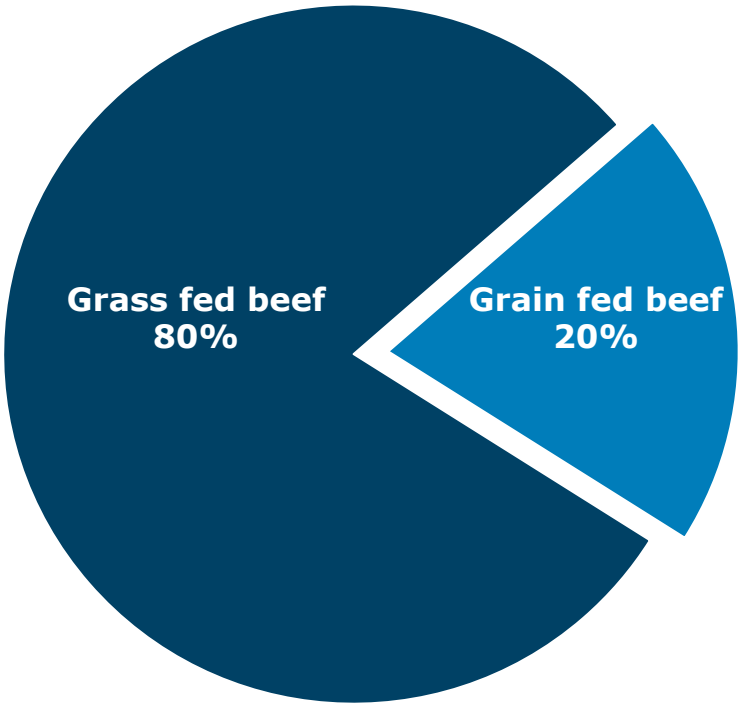
Source: ABARES, Trade Map & ANZ Analysis

Protein demand will inevitably see cattle numbers rise

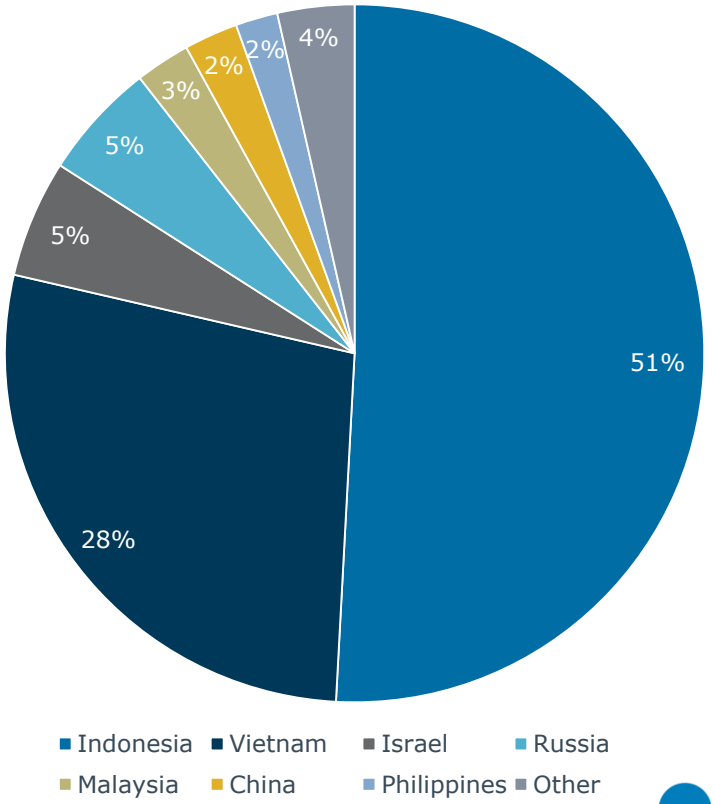
Beef and dairy demand will boost feed requirements

- Live cattle demand will trend upwards, despite individual market hiccups
- Already leading to growth in feedlots, as well as DD by new market entrants
- In addition, new dairy structures increasingly examining barn operation potential
- Feed requirements for both dairy and beef will grow as share of grain production

Australia Beef Exports – YTD March 2015
(In Shipped weight tonnes)



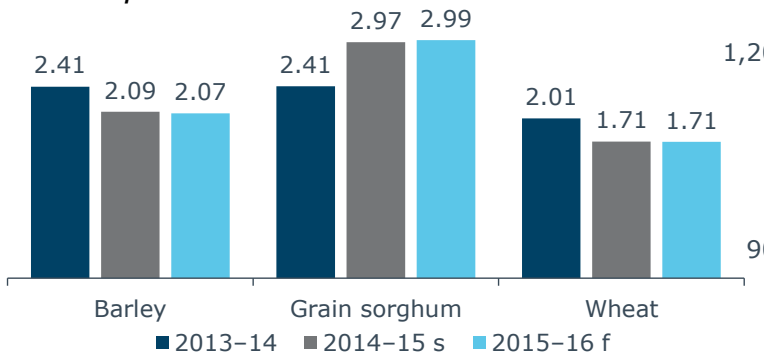
Live Cattle Exports – YTD March 2015



Source: Australian Feedlot Association & ANZ Analysis

Increasing cattle in the feedlots put more pressure on feed supplies…

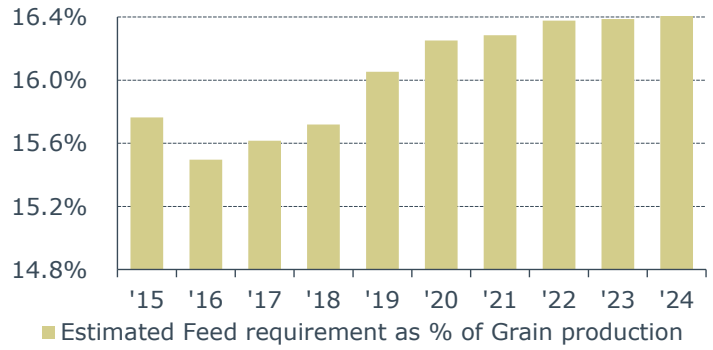
AVG. FARM YIELD IN AUSTRALIA
tonnes per hectare



Source: ABARES

FEED REQUIREMENT – MEAT[1] INDUSTRY
as a % of Grain production

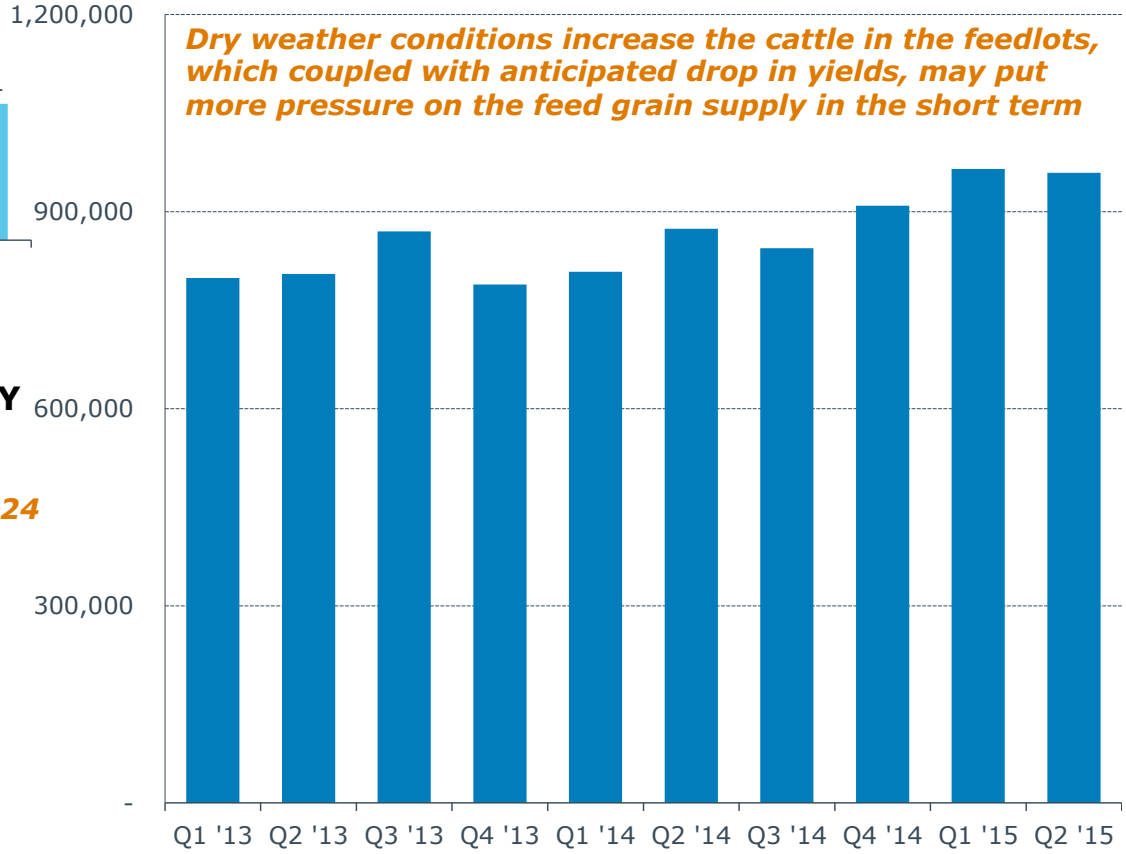
CAGR of feed requirement is estimated to be double that of grain production during 2015-24



Note 1: Include Beef & Veal, Mutton, Lamb and Pork
Source: OECD – FAO, JCS, ABS

AUS FEEDLOTS CATTLE

Dry weather conditions increase the cattle in the feedlots, which coupled with anticipated drop in yields, may put more pressure on the feed grain supply in the short term



Source: Australia Lot Feeders Association

Australia's growth likely to remain below capacity

- Growth in Australia is below long term trend and there is no sign of material recovery in consumer or investment spending yet
- The switch in activity from mining to non-mining sectors is happening, assisted by the lower $A, construction activity (housing) and services. Infrastructure activity has not matched the rhetoric
- Export volumes are still supporting the economy, as is foreign investment. FTA's will assist/drive opportunities
- A lower $A and domestic interest rates (outside housing) still seems likely (with the currency direction assisted by eventual Fed tightening)
- The triggers for a faster economy seem elusive at present. Needed structural reforms (productivity, tax, IR, etc) still seem distant and piecemeal. Household income growth has slowed in response to weaker wage growth and a rise in unemployment. Both will tend to prolong the period of cautious savings (repaying debt) and investment
- Businesses need to manage cash flows in an environment of more limited top line growth. M&A is being used to supplement weaker organic sales. Lower $A has increased the likelihood (made more affordable) of foreign acquisitions in desirable sectors

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