APRIL 2018

Rural Price Index

Falling crop production in South Australia

Construction of the Index

The BankSA Rural Price Index informs the state's farmers and farm industries how prices are faring for South Australia's farm products. The index aggregates price movements across 17 products which make up more than 80% of South Australia's farm output.

There are three groups of products – grains (such as wheat and barley), livestock and related products (dominated by sheep, wool and beef), and horticulture (dominated by grapes).

The index shows prices in Australian dollars (thereby reflecting the prices received by South Australian farmers), as well as in terms of the prices paid by foreign buyers (that is, prices in foreign currency).

A weaker backdrop, but not all is grim

The bigger they come, the harder they fall – which is to say that last year's bumper wheat crop is unlikely to be matched any time soon. Add in a stubbornly high Australian dollar, and South Australia's farmers – while still in good shape – are facing some extra challenges.

The business backdrop for the state's farmers has weakened of late. After a record 2016-17 season, total winter crop production in South Australia fell by some 38% in 2017-18 due to less favourable weather conditions.

Yet it could have been worse: while weaker than the bumper crop of 2016-17, this forecast has lifted from the earlier outlook published late last year by the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES). And as mentioned, bear in mind that 2016-17 was a massive year for local agriculture – its gross value added to the state's economy rose by close to 30%. In fact, agriculture actually accounted for two thirds of the state's economy growth last year. The state's GSP rose just over 2.2% in 2016-17, and if agriculture were to be subtracted, GSP growth falls to around 0.8%.

At the same time, beef and veal prices have eased amid fierce competition from Japan and the United States, while world grain prices are also down – though the news on prices has been more solid for the likes of wool, lamb, dairy and wine.

The Australian dollar's strength remains, but is expected to ease

As usual, Australia's currency has been on the move – the Australian dollar rose from a low of 72 US cents in late 2016 to a recent peak above 81 US cents in early 2018. This upswing, which ended a five-year run where the currency gradually dropped in value, was a result of a stronger world economy, and a resultant increase in demand for Australian mining and agricultural commodities.

The Australian dollar has also risen steadily against the currencies of the likes of China, Japan and Indonesia, leaving the Trade Weighted Index value of the Australian dollar at its highest level in three years. That currency shift has made our exports (particularly of bulk commodities such as wheat) less competitive on global markets.

The Australian dollar also appreciated against currencies of other major wine producers such as Chile, South Africa and New Zealand for extended periods through 2017. However, Australian wines continue to carry a premium in export markets – which is good news for South Australia's large wine sector.

"The business backdrop for the state's farmers has weakened of late."

Looking ahead, two things are happening that raise the prospect of a gradual easing of the Australian dollar. Interest rates in Australia are now more or less on par with the US, providing less incentive for global markets to move (or keep) money in Australia. At the same time,

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Index base : January 2000 = 100	Level	January 2018 % change since Aug 2017	Jan 2017	Jan 2016
AUSTRALIAN DOLLAR INDEX				
Grains	171.8	+2.5%	+2.5%	-11.7%
Livestock and Livestock Product	230.9	-0.0%	+1.1%	+5.5%
Livestock Only	*235.6*	*-0.2%*	*+1.2%*	*+6.5%*
Horticulture	141.2	+14.8%	-11.2%	+25.4%
TOTAL ($A Based)	**192.8**	**+2.6%**	**-0.4%**	**+1.6%**
SDR INDEX				
Grains	201.4	+0.9%	+1.8%	-5.2%
Livestock and Livestock Product	270.8	-1.6%	+0.5%	+13.2%
Horticulture	165.5	+13.0%	-11.7%	+34.6%
TOTAL (SDR Based)	**226.1**	**+1.0%**	**-1.0%**	**+9.0%**
TOTAL (TWI Based)	**225.9**	**+1.6%**	**-0.4%**	**+8.4%**

CHART R1
BANKSA RURAL PRICE INDEX – JANUARY 2000 = 100

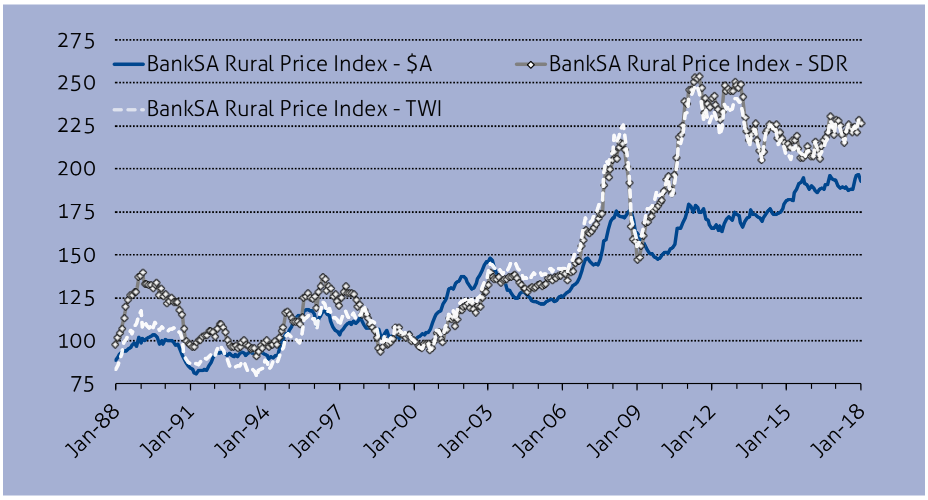
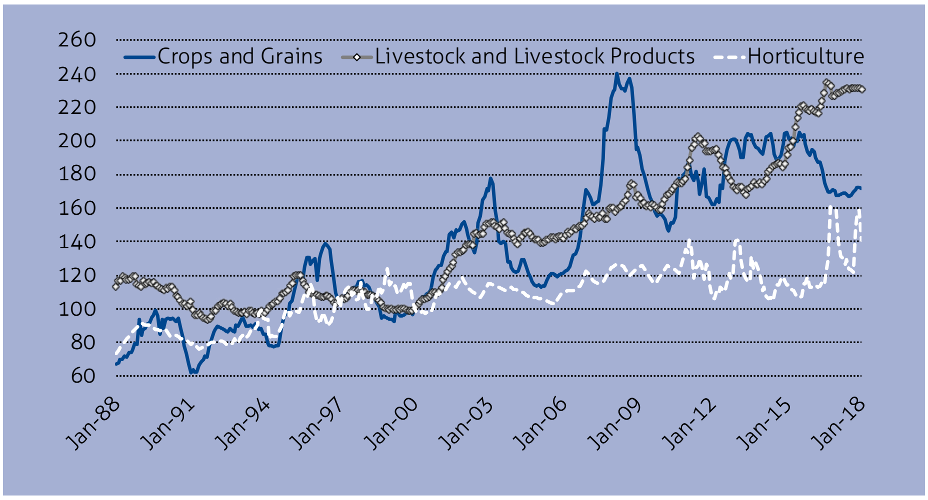


CHART R2
COMPONENTS OF THE BANKSA RURAL PRICE INDEX



the momentum in Chinese politics is now less geared towards stimulatory policies. That combination may generate less demand for Australian commodities, and therefore lead to a lower Australian dollar over time.

Chart R1 compares what local farmers receive (the blue line) and what foreign buyers pay (the other two lines). The wider the gap, the less competitive South Australia's farm products are on the world stage as foreigners have to pay more foreign currency for our products. After easing over the first half of the decade, the gap between these two measures has blown out again – somewhat limiting the competitiveness of South Australia's farm exports.

Rural Price Index varies across major categories

The performance of the three key commodity groups within the broader South Australian farm sector is shown in Chart R2. Recently, the RPI has varied across the major sectors:

- crops and grains have begun to pick up slightly, beginning to unwind the sharp fall seen since 2015;
- livestock and livestock products have been more stable, maintaining historically high prices, while
- horticulture prices have been volatile.

But prices are only half of the story. The amount of produce to which those prices apply makes up the other half. Total winter crop production in South Australia dropped this year, albeit from very high yields of the year before.

The state's major crops – wheat, barley, canola and oats – all saw production fall substantially. The falls were partly magnified due to last year's records, but less favourable weather conditions were also a factor. The worst hit was barley, with strong winds and hail damage in late 2017 leading to a production fall of around 40%. Output was also lower across the state's smaller winter crops such as field peas, lentils and lupins.

But it was a mixed bag – the rains were below average in the cropping regions in the north of the state, but above average in the southern regions.

The livestock and livestock products commodity group remains the biggest contributor to South Australia's farm incomes – with the top six commodities adding a record $2.5 billion to the state's economy across 2015-16. And it held that spot despite weaker beef prices in the first part of the year.

Looking ahead, most livestock products are expected to see lifts in volumes and solid results for prices. That may be less true for beef and veal however, where additional production increases in Japan and the United States may lift global supplies enough to drive down prices.

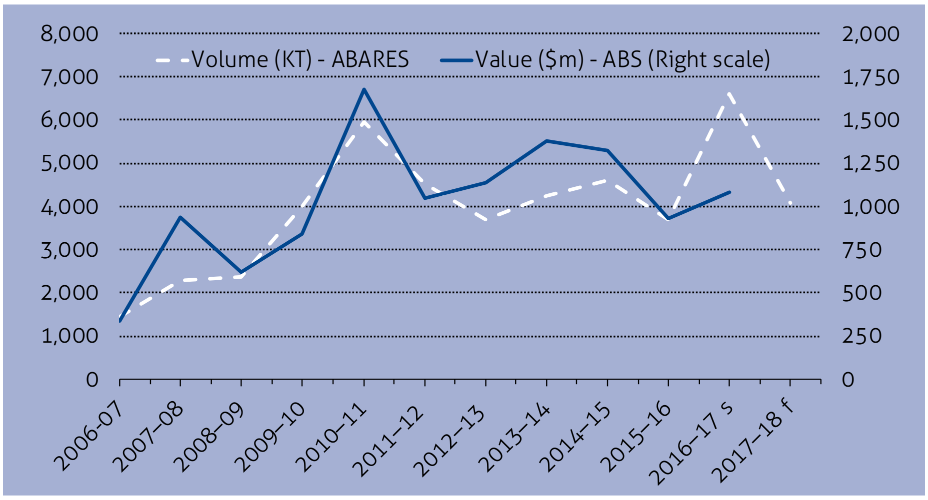
South Australia's horticulture sector has continued to recover from its fall in late 2016, which was caused by spring storms and flooding that battered parts of the state. However, movements in the horticulture index have been volatile. The prices of major crops affected by storms in late 2016 – such as onions and tomatoes – have since moderated.

Wine grapes remain the largest horticulture crop in South Australia. The outlook for grape production is good and, with Australian wines continuing to carry a premium in export markets, there is promising news on prices.

Wheat production takes a turn

Wheat is the most important commodity in South Australia – it has given the largest dollar return to the state every year since 2006-07 (when drought conditions saw wheat outperformed by wine grapes). And in good years it can account for more than a quarter of the state's agricultural income.

CHART R3
WHEAT OUTPUT, SOUTH AUSTRALIA



Note: s ABARES estimate, f ABARES forecast.

Source: ABARES Australian crop report, February 2018, ABS publications 7503.0 and 7501.0.

However, wheat production in South Australia (and across Australia) fell significantly in 2017-18 due to less favourable weather conditions (see Chart R3).

Then again, perspective is everything: this year's fall (to a wheat output of 4.1 million tonnes in 2017-18) follows the bumper 2016-17 winter crop. And those declines are not restricted to South Australia, with Australia's 2017-18 wheat crop the smallest in around a decade.

With that in mind, the state's wheat production is expected to remain close to the average over the past 10 years.

The outlook for prices is another plus. As Chart R3 shows, the bumper 2016-17 crop boosted output levels far more than it boosted payments to farmers. That was because strong global supply saw prices slide sharply.

However, prices for wheat picked up in late 2017 in both Australian and international markets. And, looking ahead, the world wheat indicator price is forecast to average $US218 per tonne in 2017-18. That might not be back at its previous highs, but it would be a higher average than seen across 2016-17.

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