DECEMBER 2017

Rural Price Index

Record winter crop 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).

Output is set to fall from record highs

The business backdrop for the state's farmers softened a little of late. Farm output this financial year is likely to be weighed down by a drier than average winter and lower export prices across a number of commodities. A higher Australian dollar is also eating into the competitiveness of Australian producers.

All up, output is set to fall from the record highs seen in 2016-17, and incomes will be under a bit more pressure.

Australian dollar continues to strengthen

A higher Australian dollar is bad news for domestic producers as it makes them less competitive in global export markets. While the Australian dollar is still well below the highs seen three years ago (around 95 US cents) and the peaks above parity with the US dollar in 2012, it has been picking up recently.

> **"A higher Australian dollar is bad news for domestic producers as it makes them less competitive in global export markets."**

After reaching a low of around 72 US cents in late 2016, the Australian dollar has since risen to trade in a range of 75 to 80 US cents. This is the result of strong growth momentum in Asian economies (particularly China) and uncertainty about the pace of US interest rate increases.

And although we don't send much produce to the United States, the Australian dollar has also appreciated against the currencies of major farm export markets, such as the Indonesian rupiah (9%), Chinese yuan (4%) and Japanese yen (3%). If sustained, this could hurt Australian farm incomes. This stronger currency is likely to have a particularly big impact on exporters of lower value bulk commodities such as wheat.

The Australian dollar has also gained ground against a number of other 'new world' wine producers such as Chile, South Africa and New Zealand. That puts South Australia's large wine sector at a disadvantage and could place downward pressure on international demand in favour of lower priced alternatives.

Chart R1 shows the difference between what local farmers receive (the blue line) and what foreign buyers pay (the grey line). The bigger the gap, the bigger the problem for South Australia's competitiveness.

The fact that the Australian dollar fell by more than global food prices from 2013 to 2015 provided a net benefit to South Australian farmers. Since then, the gap between the two measures has been widening. In recent months, this has been largely due to a higher Australian dollar and lower prices for many farm commodities.

Rural Price Index drops for all major categories

The performance of the three key commodity groups within the broader South Australian

BankSA Rural Price Index

Index base : January 2000 = 100	Level	August 2017 % change since Feb 2017	Aug 2016	Feb 2016
AUSTRALIAN DOLLAR INDEX				
Grains	166.4	-2.6%	-3.7%	-14.1%
Livestock and Livestock Product	222.7	-2.7%	-5.2%	+2.4%
Livestock Only	*224.8*	*-3.7%*	*-7.1%*	*+2.4%*
Horticulture	122.9	-11.7%	+1.7%	+8.6%
TOTAL ($A Based)	**183.7**	**-3.9%**	**-3.8%**	**-2.8%**
SDR INDEX				
Grains	198.2	-3.2%	+0.3%	-6.7%
Livestock and Livestock Product	265.2	-3.3%	-1.3%	+11.2%
Horticulture	146.4	-12.2%	+5.9%	+18.0%
TOTAL (SDR Based)	**218.8**	**-4.5%**	**+0.1%**	**+5.6%**
TOTAL (TWI Based)	**217.4**	**-4.4%**	**+0.9%**	**+4.9%**

CHART R1
BANKSA RURAL PRICE INDEX – JANUARY 2000 = 100

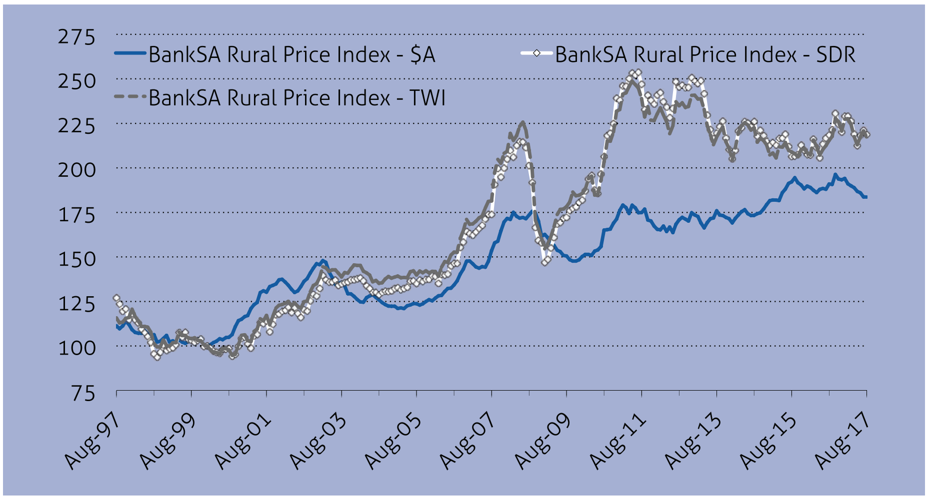
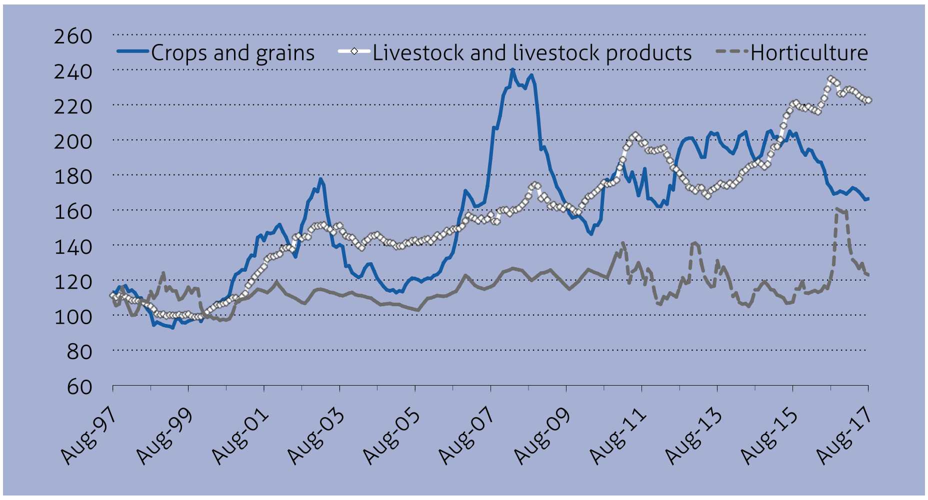


CHART R2
COMPONENTS OF THE BANKSA RURAL PRICE INDEX



farm sector is shown in Chart R2. Over recent months, the Rural Price Index has fallen across all major sectors – including crops and grains, livestock and livestock products, and horticulture.

Equally important is the amount of produce to which those prices apply. Winter crop production in South Australia reached a record high in 2016-17, following a season of strong rainfall. Total production of the state's four major crops – wheat, barley, canola and oats – increased by more than three-quarters over the year, while yields were also higher across smaller winter crops such as chickpeas, field peas, lentils and lupins.

But of the three commodity groups listed in Chart R2, the crops and grains sector is affected more directly by short-term changes in weather conditions. Conditions for crop development were less favourable during autumn and winter in South Australia. Rainfall was below average in the major producing regions of Eyre Peninsula, Yorke Peninsula and the lower north.

The more challenging planting conditions are driving an expected fall in winter crop production. The Federal Government's official farm forecaster, ABARES, expects a 43% drop in crop production in South Australia over 2017-18 (compared to a 39% decrease across Australia).

In addition to the fall in production, prices for both wheat and barley have continued to moderate from their 2015 peaks. As these two commodities account for more than a third of the state's farm production, the combination of lower volumes and prices is bad news for overall incomes.

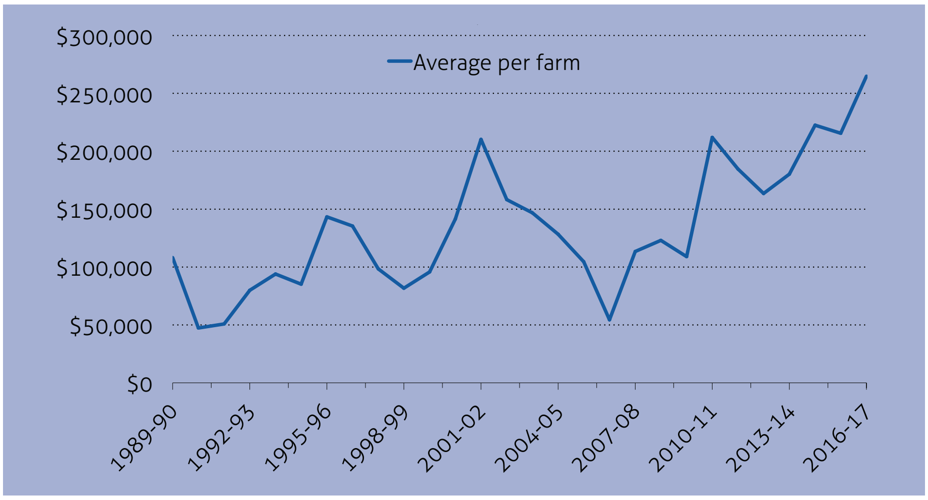
The livestock and livestock products commodity group remains the biggest contributor to South Australia's farm incomes. The livestock and livestock products RPI grew by almost 40% from a low in mid-2013 to a peak in mid-2016. Since then it has fallen by 5%. And while production has continued to lift across most commodities, prices for beef, sheep and pigs have moderated over recent months.

South Australia's horticulture sector has continued to recover from spring storms

that battered parts of the state. The South Australian Department of Primary Industries estimated that there are around 300 growers who were impacted by the floods in late 2016, accounting for a third of the state's greenhouse industry. The price of major crops affected – such as potatoes, onions and tomatoes – has since moderated. As a result, the horticulture index has fallen by more than a fifth from its recent flood-affected peak in October 2016.

Wine grapes are the largest horticulture crop in South Australia. And although prices have remained relatively flat, the sector was boosted by the announcement of the State Government's $1.8 million Wine Industry Development Scheme. The program involves grants to wineries to improve their cellar door experience as well as to promote regional wine tourism.

CHART R3
FARM CASH INCOME, LAMB PRODUCERS



Source: ABARES Australian Agricultural and Grazing Industries Survey.

Good times for South Australian lamb producers

The average cash income of Australian lamb-producing farms rose to a 20-year high in 2016-17. According to the Agricultural and Grazing Industries Survey, the cash income generated by an average farm was $265,000 in 2016-17, up by almost a quarter on the previous year (see Chart R3). This follows improved seasonal conditions in many lamb-producing regions and higher prices for lamb.

This looks set to continue, with ABARES projecting that the saleyard price of lamb will increase by 6% in 2017-18. Those higher prices reflect the rebuilding of existing flocks and firm demand for lamb in Australia's key export markets.

This stronger backdrop is a positive for South Australia's relatively large sheep meat and wool sector, which together accounts for almost a fifth of all farm production in this state. In fact, the average South Australian lamb-producing farm was estimated to have recorded a cash income of $358,000 in 2016-17, around a third higher than the Australian average. Profits are also higher, with the average South Australian farm estimated to have earned a profit of around $180,000 in 2016-17, above the $140,000 profit seen across Australia.

As conditions improve, the good news is set to flow through to exports. ABARES is forecasting that lamb exports are set to increase over 2017-18 as demand from Asian importers increases and supply from competing exporters such as New Zealand decreases. Wool exports are also set to increase, largely driven by a stronger appetite for woollen apparel in China.

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