

Macro  
Australian Economics

## Downunder digest

### Australia's prospects in agriculture

- ▶ **Australia is a big player in global markets for a range of agricultural commodities, including wheat, beef and wool**
- ▶ **Demand for agricultural commodities is set to continue to rise, as Asia's middle classes expand rapidly in coming years**
- ▶ **While Australian agricultural production is not large enough to have the same impact on growth as mining, it should be a medium-term support for Australia's export growth**

### Good prospects: but dining will not be as big as mining

Hard commodities are far and away the largest share of Australia's exports. The bulk commodities, plus base metals and energy products account for 57% of Australia's exports (11% of GDP). Iron ore alone accounts for 21% of total exports (4% of GDP).

However, Australia's small population and large land mass also make it a large global exporter of agricultural products. Even though these products only account for 12% of total exports, Australia is the world's largest exporter of wool, the third largest exporter of beef, cotton and sugar, and the fourth largest exporter of wheat.

Australia's large presence in these global agricultural export markets has prompted suggestions that Australia could become the 'food bowl' for Asia or that Australia's recent 'mining boom' could be followed by a 'dining boom' (or even a 'wining boom', given Australia's wine industry). However, while Australia has good prospects in agricultural production, we believe it is not a large enough sector to compete with mining in terms of its prominence in the local economy any time soon: agricultural output only accounts for 2% of production, while mining is around 10% of production (Charts 1 and 2).

Nonetheless, despite its diminutive economic size, there are likely to be opportunities in Australian agriculture, as Asia's middle class incomes rise, diets change and demand for food increases. In particular, historical patterns show that as per capita income rises, demand for meat and dairy rises rapidly as people's diets shift to consuming more protein. Feedstock – such as coarse grains – is also needed to feed animals to meet this demand.

Along the way Australia also faces challenges, including environmental limits to significant expansion and the need for further consolidation of the industry to benefit from economies of scale and thus lift agricultural productivity growth. Willingness to allow significant foreign investment in the sector is also a prominent local political issue, despite the relatively modest amount of foreign investment in the sector at this stage.

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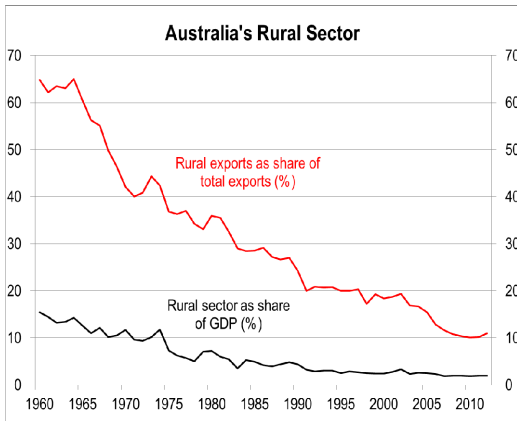
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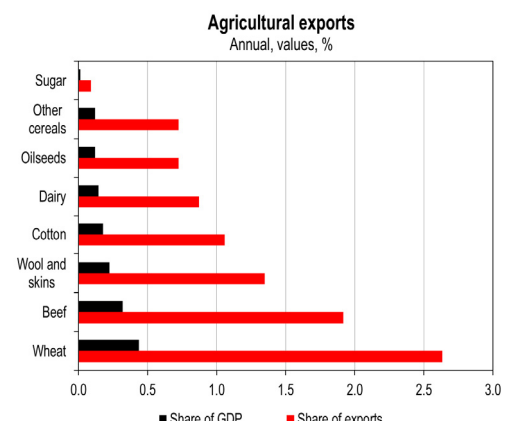
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1. Rural sector has been a falling share of exports



Source: ABS

2. Wheat, beef, wool and cotton dominate rural exports



Source: ABS, Department of Foreign Affairs and Trade

## Agricultural commodity exports shifting to Asia

Australia's rural exports account for around 12% of total exports. This is a much smaller story than hard commodities and energy exports (57% of exports). However, compared to other advanced economies, Australia's rural sector size stands out, and with a small population and large land mass it is a big player in global exports of rural commodities. Australia's agricultural exports are also pivoting towards Asia and, given the ongoing expansion of Asia's middle class incomes, these markets are expected to continue to provide support for Australian rural exports. For details on Australia's broader trade story see:

[Downunder digest: Australian trade set to support growth](#), 28 August 2013.

Australia's biggest rural export is wheat, at 2.3% of total exports (Table 3). Australia is the world's fourth largest global exporter of wheat, behind Canada, the US and the EU, but ahead of Russia. Australia accounts for 12% of globally traded wheat and its major export markets are Indonesia, Korea and China (Chart 4).

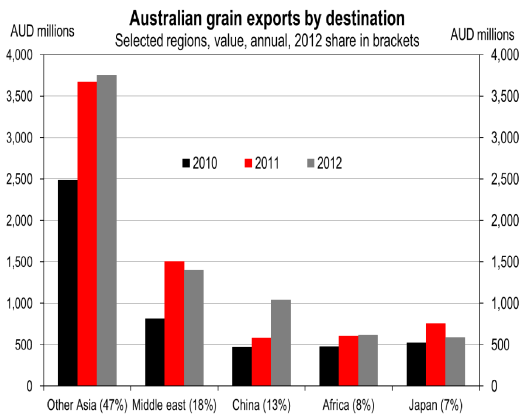
Australia's second largest rural export is beef and veal (at 1.6% of total exports) and, importantly, there has recently been a very large shift in the main destinations for its beef exports. While Japan remains the largest importer of Australian meat, these imports have fallen by 17% over the past three years (Chart 5). Instead, Australia's exports to China have ramped up, rising by 190% over the same period. Part of the reason for the ramp-up in China's imports of Australian beef has been a ban on Chinese imports from Brazil, due to detection of bovine spongiform encephalopathy in that country. However, the pick-up in China's beef imports also reflects rising demand for higher quality food from the growing middle class.

### 3. Australia's rural commodity exports

	Export values (2012/13, AUDbn)	Share of Australia's export values (%)	Growth y-o-y (%)	Global export rank*	Major export markets (Share of total in brackets)
Wheat	6.8	2.3	+6.2	4 (12%)	Indonesia (18%), Korea (10%), China (8%)
Beef and veal	4.9	1.6	+8.9	3 (17%)	Japan (34%), US (22%), Korea (13%)
Wool and Skins	2.9	1.0	-8.3	1 (63%)	China (75%), India (6%), Italy (4%)
Cotton	2.7	0.9	-1.6	3 (11%)	China (60%), Indonesia (10%), Thailand (7%)
Dairy	2.2	0.7	-2.7	4 (7%)	Japan (23%), Singapore (9%), China (7%)
Coarse grains**	2.1	0.7	-8.2	7 (4%)	Saudi (27%), China (26%), Japan (19%)
Oilseeds***	2.0	0.7	+56.0	7 (2.5%)	Netherlands (43%), Belgium (28%)
Sugar	1.4	0.5	-9.8	3 (6%)	Korea (35%), Indon. (28%), Japan (14%)
Other rural	11.2	3.7	NA	NA	NA
Total Rural	36.2	12.0	+4.3	NA	NA
Beverages (incl. wine)	2.1	0.7	-1.3	-	-

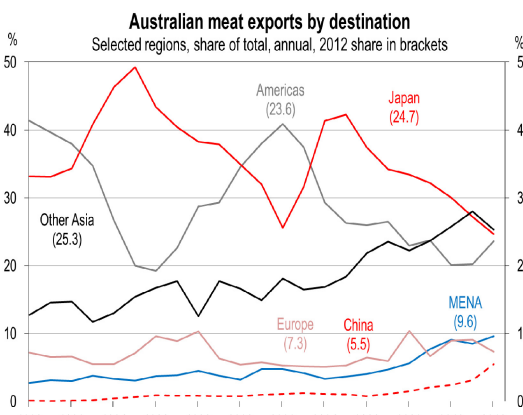
Source: ABS; ABARES, USDA, DFAT, Dairy Australia \*Brackets show % of global exports \*\*Barley, corn, sorghum, oats and maize, barley only for major export markets \*\*\*Canola, soybeans and sunflower seeds

**4. Asia is the key market for Australian grain exports**



Source: Department of Foreign Affairs and Trade

**5. Falling beef exports Japan offset by rise to China and US**



Source: Department of Foreign Affairs and Trade

The direction of wool exports (Australia’s third largest rural export) has also shifted substantially in recent years, reflecting changes in the location of wool processing facilities to lower labour cost centres. Over the past decade, the share of Australian wool exports heading to Europe has fallen from around one-third to less than 10%, while there has been a strong pick-up in demand from China. Asia is also Australia’s largest export market for cotton, with China the key export destination. This largely reflects the location of major cotton mills, with cotton processing centred in the Asia region.

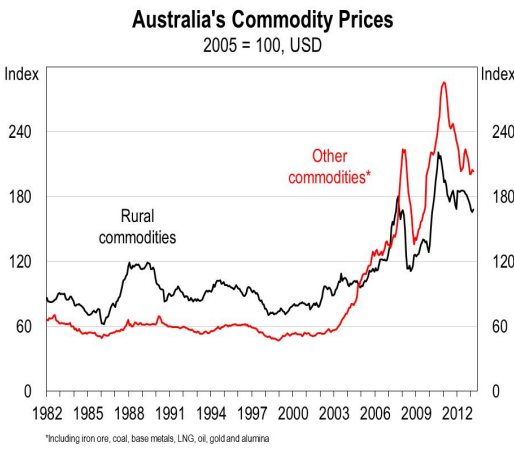
Australia is also a major player in global dairy markets – accounting for 7% of global trade – and is the world’s fourth largest exporter. As with a range of soft commodities, emerging market demand, particularly from Asia, has been a key driver of demand for dairy in recent years. Demand from China has been particularly strong, with import volume growth having averaged +30% over the past decade in the country. For further detail on the outlook for the dairy sector, see: [New Zealand Digest: Global dairy price surge to boost incomes](#), 4 October 2013. While wine is not strictly speaking an agricultural product – it is a manufactured good – it accounts for around 0.7% of Australia’s total exports, so is fairly small.

**Strong growth in emerging market demand likely to continue**

Agricultural commodity prices have increased solidly over the past decade, albeit not as much as metals and energy prices (Charts 6 and 7). Looking at a broad index of Australia’s rural exports, prices reached a peak of 150% above their 1990’s average in 2011 in USD terms. While prices have since eased from these high levels, they remain 94% above this 1990’s benchmark. Rising emerging market demand has been the key driver of commodity prices over the past decade, particularly from China. Looking at China specifically, annual growth in import values of wool has averaged +8% over the last decade, with +28% average annual growth for meat products and +22% growth for cotton.

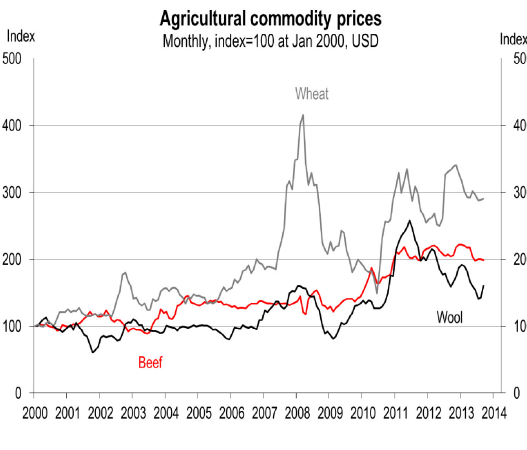
Rising emerging market incomes have been a key driver of this rise in soft commodity demand. As an economy’s income grows, demand for soft commodities, particularly protein consumption, tends to rise – as newly middle income consumers shift their food preferences. Per capita consumption of beef in China has increased strongly in recent years, as the economy has developed. Looking forward, this trend looks

**6. Rural prices have not risen as much as hard commodities**



Source: RBA

**7. Wheat prices have risen more, due to drought conditions**



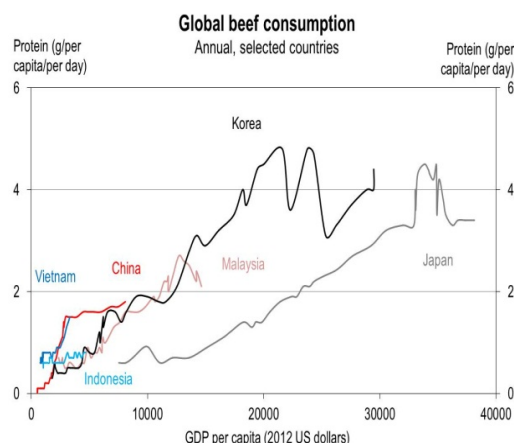
Source: Bloomberg; IMF

set to continue (Chart 8). If China follows the consumption path of Korea, per capita consumption of beef would almost double between 2009 and 2018 – assuming the IMF’s current GDP projections.

The story for grains is more nuanced. Generally, per capita grain consumption rises rapidly in the early stages of a country’s development (Chart 9). As such, China looks to have reached a peak in terms of per capita wheat consumption. However, total economy-wide demand for grains tends to have a more drawn out path. In particular, grains tend to be used in the production of dairy and beef as a feed input. Therefore, while direct per capita consumption of grains levels out early in a country’s development profile, total use is more drawn out as demand for protein consumption increases. In China, per capita consumption of cereals peaked in 1984, but total domestic use per capita (including as feedstock) continued to rise, peaking in 1996 – and after drifting modestly lower, has begun to rise again since 2004.

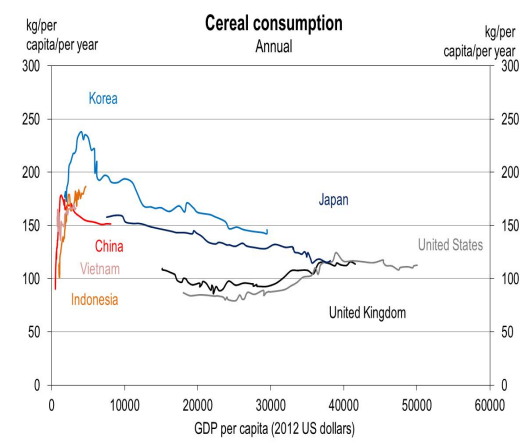
Another potential medium-term support for agricultural demand for Australia’s products is the progression of free trade talks. Currently, Australia is conducting free trade talks with a range of countries, including Korea, Japan and China through both bilateral and regional free trade agreement (FTA) negotiations.

**8. Per capita beef consumptions rises as a country develops**



Source: FAO, Conference Board

**9. Consumption of cereal products peaks early**



Source: FAO, Conference Board

Australia currently has the second most unregulated agricultural market in the developed world (according to the OECD), while countries like Japan and Korea provide substantial support for agricultural producers. Any move towards free trade with these countries could provide a significant drop in costs and boost to demand for Australian agricultural products. However, the freeing up of agricultural markets is often the sticking point in trade negotiations, and the removal of agricultural tariffs and subsidies tends to be the most delayed aspect when FTAs are reached.

## Productivity growth has been strong, but challenges remain

As a starting point, Australia's level of agricultural productivity lags behind the rest of the OECD, largely because of geography and geology. Agricultural output per square kilometre of agricultural land is currently 11% of the OECD average. A large part of this story is that Australia's soil has a low nutrient content, resulting from the geological stability of the country for the past 60 million years. Water is also scarce. The industry also faces a number of environmental challenges that could hold back production growth. In particular, the adverse impacts of climate change and rising water scarcity in Australia are developments that could hamper agricultural production in coming years.

However, while Australia's level of productivity lags behind other countries, productivity growth has generally outperformed. Since the 1980's, annual growth in rural output per worker in Australia has averaged +3.3%, compared to +2.4% for the OECD as a whole. Total hours worked has actually fallen steadily through the last few decades, while total annual production growth has averaged +3.4% since the mid-1970's.

There are a number of factors that have driven this strong productivity performance. Farm productivity got a big boost from the reform and removal of agricultural subsidies and tariffs in the 1980's and 1990's, which enhanced competition and improved price signals to the industry. Consolidation has also gone some way to improving productivity in the industry, with larger farms generally more productive. The development and adoption of new technologies across equipment and bio-technology has likely also given productivity a boost.

Greater consolidation of the industry could help support further benefits from economies of scale. The Productivity Commission notes that in 2005 around one-fifth of broad-acre farms produced around two-thirds of all agricultural output, suggesting there could be significant gains available from greater consolidation of the industry. Foreign investment in the sector could help to facilitate consolidation. While foreign investment has been a contentious local political issue, foreign ownership is at this stage, fairly limited. Australian Bureau of Statistics estimates for 2010 suggested that 89% of Australian agricultural land was locally owned, having fallen from 94% in 1984.

Continued development and adoption of new technologies and further rationalisation in the industry could see stronger productivity and output growth in coming years.

## Bottom line

While agricultural products are a small part of Australia's export basket, Australia is a large global exporter of wool, beef, cotton, sugar and wheat, and these exports are increasingly going to Asia.

Agricultural prices have increased solidly in the past decade, due to strong demand from emerging Asia, and we expect this demand to continue to rise, particularly for beef and dairy products.

Further consolidation of farms and adoption of technology – potentially assisted by foreign investment – could help to lift output and productivity growth in the industry.

HSBC's forecasts for Australia and New Zealand

	Year-average			Year-ended						
	2012	2013	2014	Q213	Q313e	Q413e	Q114e	Q214e	Q314e	Q414e
%*										
<b>AUSTRALIA</b>										
<b>GDP</b>	3.7	2.5	2.8	2.6	2.4	2.5	2.7	2.9	2.9	2.9
Consumption	3.2	2.1	2.7	1.8	2.2	2.4	2.4	2.7	2.9	2.9
Govt consumption	3.2	1.2	2.2	0.3	1.5	2.4	2.3	2.1	2.2	2.2
Investment	10.2	-5.9	0.2	-2.2	-2.2	-1.7	0.9	2.2	2.5	2.0
- Dwelling	-3.8	3.9	8.8	4.0	4.2	4.3	6.6	10.1	10.2	8.2
- Business	16.5	-2.7	-2.1	-1.3	-5.4	-5.9	-2.8	-1.9	-1.9	-1.9
- Public**	-1.5	-1.8	10.4	-10.8	5.1	10.5	10.1	10.4	11.5	9.8
Final domestic demand	4.8	1.1	2.4	0.6	1.0	1.4	2.1	2.4	2.5	2.4
Domestic demand	4.7	0.7	2.4	0.5	0.5	1.3	2.3	2.4	2.5	2.4
Exports	5.8	6.6	6.9	6.4	7.6	5.7	6.4	7.2	6.9	7.1
Imports	6.2	-0.9	5.4	-1.8	0.1	1.4	5.3	5.5	5.4	5.4
GDP (% quarter sa)	--	--	--	0.6	0.6	0.7	0.7	0.8	0.7	0.7
<b>CPI***</b>	1.8	2.3	2.7	2.4	2.2	2.2	2.4	2.8	2.4	3.0
Trimmed mean***	2.2	2.3	2.7	2.3	2.3	2.3	2.5	2.7	2.8	2.8
Unemployment rate	5.2	5.7	5.6	5.6	5.7	5.8	5.8	5.7	5.5	5.3
Labour price index	3.6	3.1	3.4	2.9	3.0	3.1	3.2	3.4	3.5	3.5
Current A/C (%GDP)	-3.7	-2.3	-2.4	-2.4	-2.2	-2.4	-2.1	-2.4	-2.4	-2.5
Terms of trade	-10.4	-1.7	-3.8	-4.8	1.2	3.0	-2.0	-3.7	-4.9	-4.6
Budget balance (%GDP)	-2.9	-1.3	-1.9	--	--	--	--	--	--	--
Capital city house prices	-0.7	5.8	9.1	5.1	7.6	7.0	8.5	8.7	9.0	10.1
Private sector credit	3.8	3.7	6.6	3.1	3.9	4.8	6.0	6.8	6.8	6.8
USD/AUD (end period)	1.04	0.90	0.86	0.92	0.94	0.90	0.89	0.88	0.87	0.86
90 day bank bill rate	3.19	2.80	3.30	3.05	2.80	2.80	2.80	2.80	3.05	3.30
<b>Cash rate (end period)</b>	3.00	2.50	3.00	2.75	2.50	2.50	2.50	2.50	2.75	3.00
%*										
<b>NEW ZEALAND</b>										
<b>GDP</b>	2.7	3.0	3.1	2.5	3.5	3.2	3.4	3.7	3.0	2.2
Consumption	2.4	3.7	3.2	3.8	4.5	3.9	4.0	3.1	2.9	2.5
Govt consumption	0.5	0.2	1.1	-0.3	-0.2	1.2	1.6	1.2	1.0	0.6
Investment	6.4	8.7	9.3	6.2	11.2	11.7	11.6	9.6	8.6	7.4
Final domestic demand	2.9	4.2	4.2	3.6	5.1	5.1	5.3	4.3	3.9	3.3
Domestic demand	3.1	4.2	4.2	3.8	4.8	6.0	5.2	4.2	3.9	3.3
Exports	2.6	0.8	4.1	-0.1	-1.4	0.0	-0.9	6.6	5.9	5.2
Imports	2.2	4.2	7.6	5.0	4.3	6.9	6.9	7.8	8.0	7.8
GDP (% quarter sa)	--	--	--	0.2	1.2	1.3	0.6	0.5	0.6	0.6
CPI	1.1	1.4	2.4	0.7	1.4	2.5	2.5	2.9	2.3	1.9
Unemployment rate	6.9	6.0	5.4	6.4	6.0	5.5	5.4	5.4	5.4	5.4
Labour price index	1.9	2.0	2.3	1.7	2.2	2.5	2.6	2.7	2.1	1.7
Current A/C (%GDP)	-4.7	-3.4	-4.7	-4.0	-3.1	-3.0	-3.7	-4.4	-5.2	-5.6
<b>Cash rate (end period)</b>	2.50	2.50	3.50	2.50	2.50	2.50	2.75	3.25	3.25	3.50

Source: ABS, RBA, HSBC forecasts; \*unless otherwise specified; \*\*adjusted for asset sales; \*\*\*includes the effect of the carbon tax from Q312

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