

NAB Commodity Price Outlook March 2007

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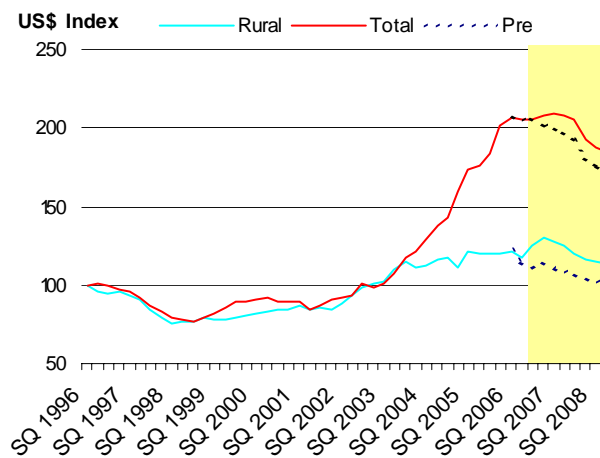
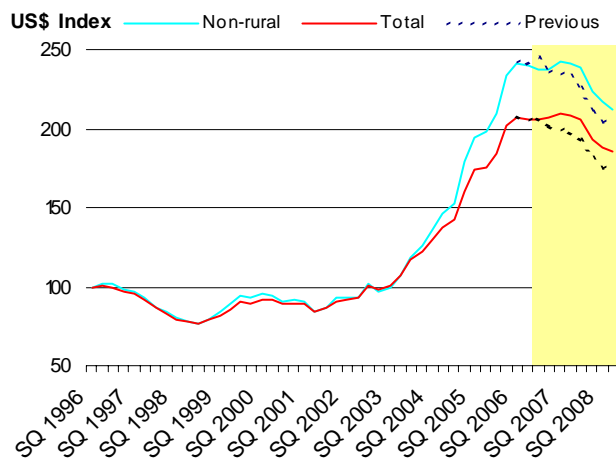
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Summary – commodity boom rolls on, with upgrades across both the farm and resources sectors

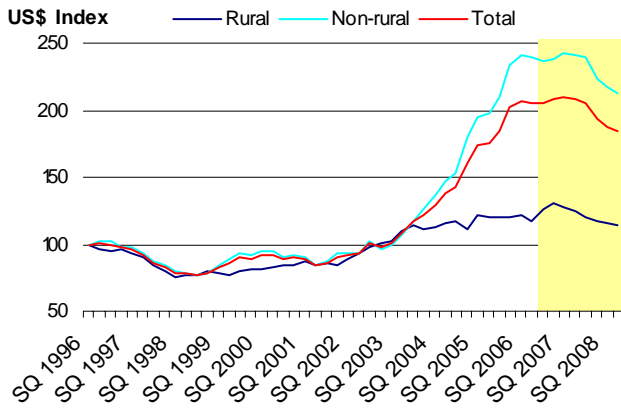
- **NAB upgrades commodity price outlook:** We have raised our forecasts for commodity prices (compared with our outlook in October 2006), reflecting continued strong economic growth as well as the effects of drought on supplies (for rural commodities) and delays to project development (for non-rural commodities).
- **Mixed results across markets in the March quarter:** Despite the underlying strength of fundamentals, prices for non-rural commodities were volatile and trended marginally lower in the first quarter of 2007, as oil and base metal markets suffered from speculative losses.
- However, relative weakness in the resources sector was offset by stronger prices in the agricultural sector, with drought induced supply concerns driving dairy and wool prices higher than previously anticipated.
- **Commodity prices forecast to rise slightly in the second half of 2007:** NAB forecasts higher oil and base metal prices – particularly copper and nickel – to maintain high non-rural prices (stronger for longer). Delays in project development and new supply continue to extend the length of the commodity boom – as producers struggle to meet surging demand.
- While our underlying assumption is for the drought to break in autumn, agricultural commodity prices are expected to remain supported during 2007 by strong global demand and relatively tight supplies of most rural commodities.
- Stronger beef and dairy prices are expected in 2007, with cotton prices also expected to trend higher. While wheat prices are expected to come under downward pressure, prices are expected to remain at historically high levels due to the tightness in global supply.
- **When prices begin to fall in 2008, the falls will be modest:** NAB expects the output of most commodities to increase in 2008, sufficient to place downward pressure on prices. However, with economic growth remaining firm, price declines will be modest – prices will remain historically high in the short term. In addition, upside risk remains, especially in bulk commodities such as iron ore and coal.
- While iron ore prices are forecast to fall in 2008, recent moves by India’s government to withdraw from the export market, as well as the potential for delays to new project developments.
- Similarly, China’s dramatic policy shift in coal markets – drastically reducing export licences – is likely to switch that country from being a net exporter to a net importer, adding potential upside to coal prices.

Commodity prices “stronger for longer”, with modest declines in 2008



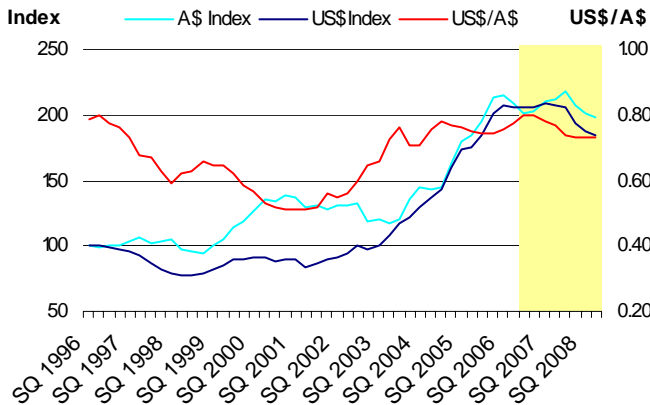
Overview

Global commodity prices to remain high in 2007, before modest falls in 2008...



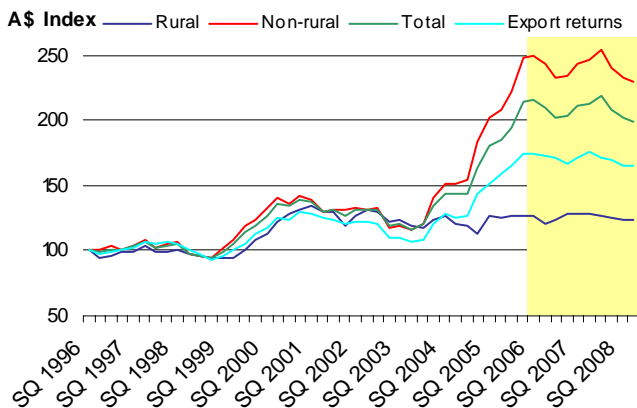
- NAB's commodity price index tracked sideways in the March quarter, as higher rural prices offset negative sentiment in non-rural markets – primarily oil and base metals.
- However, a recovery in these markets will push the index back to peak levels in the third quarter of this year. Assuming the drought breaks in autumn, rural prices are also forecast to rise in the short term, driven by stronger beef and lamb prices.
- Commodity prices are forecast to ease in 2008 on broadly weaker fundamentals – as supply across the rural and resource sectors build – but are expected to remain historically high, given the ongoing strength of demand.

...supporting a stronger Aussie dollar than previously forecast...



- The Australian dollar is now expected to remain stronger for longer, with NAB revising up its AUD/USD forecast. The A\$ is now forecast to average 0.80 during the first half of 2007, before easing slightly to 0.77 by the year end.
- Driving this stronger A\$ outlook is:
 - Continued strength in commodity prices;
 - Reasonable domestic economic growth;
 - Widening interest rate differentials – given US rate cuts
- In 2008, fundamentals point to a gradual easing of the A\$, with the AUD/USD expected to average 0.73 by the end of 2008.

...and stronger commodity unit export returns

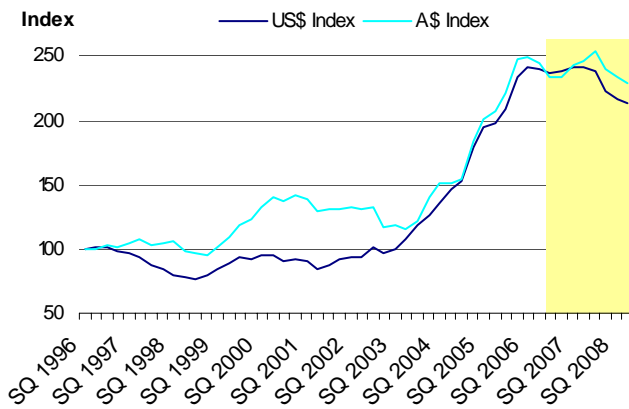


- Australian commodity export returns have risen to record levels, supported primarily by surging prices for iron ore and coal. With A\$ commodity prices remaining high in the short term, commodity returns will trend sideways.
- In stark contrast to the returns for mining, prices for most rural exports and non-commodity goods – primarily manufacturing – are either below or are around historical averages.

Visit [our website](#) for more detail on the outlook for rural and resource commodities.

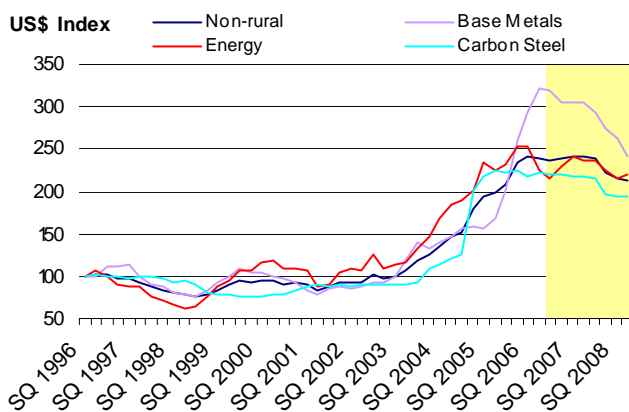
Non-rural commodities

Another strong year in 2007, non-rural prices decline modestly in 2008



- Prices for non-rural commodities remain underpinned by economic development in China (and to a lesser extent India) and the slow production response due to underinvestment in exploration and development as well as infrastructure.
- Prices will remain elevated until supply constraints are unwound sufficiently to meet surging demand.
- Speculation in commodity markets with liquid spot and futures markets – primarily oil and base metals – increases the volatility of price movements, and therefore uncertainty around forecasts.

Base metals to fall the furthest in 2008, but non-rural prices will remain historically high



- The non-rural index eased marginally in the March quarter – led by corrections in base metals and oil markets, as speculators repositioned risk on concerns around the US and Chinese economies.
- Base metal prices are forecast to stabilise – as a rebound in copper offsets falling aluminium prices – while higher oil prices will boost the non-rural price index in the second half of 2007.
- However, weaker conditions for metals in 2008 will lead the declines – albeit modest – in prices for non-rural commodities.

Overview – prices remaining “stronger for longer”, with a supply response leading to modest declines in ‘08

Prices for exchange traded commodities – oil & gas, base metals and gold – corrected sharply at the start of the year, led by copper and oil. Broadly, these declines were driven by concerns economic growth in the United States and China as well as speculative losses in the futures markets. Investors appeared to partially withdraw from commodity markets as they repositioned risk. Non-rural commodity prices have subsequently recovered – and combined with increased contract prices for iron ore and thermal coal – have supported aggregate commodity prices near record levels.

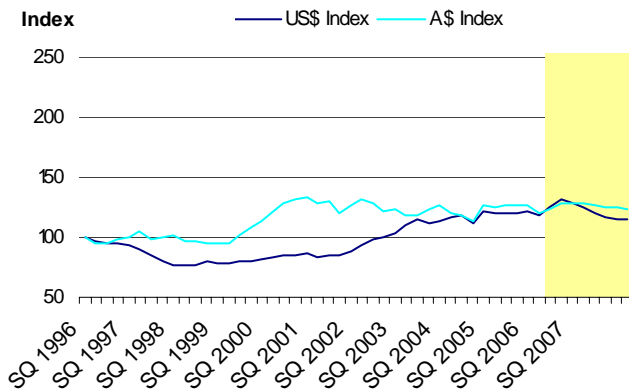
In the short term, the fundamentals of commodity markets remain firm – with demand growth driven by the economic development of China and, to a lesser extent, India. Although China is already either the largest or second largest consumer of most minerals & energy commodities, consumption broadly remains low on a per capita basis – indicating the potential for sustained longer term growth.

Supply pressures in commodity markets should begin to ease in 2007, although constraints will remain in a few key markets. Iron ore, copper, nickel and zinc will be in short supply in 2007, adding upside to prices. Globally, efforts to expand mine production have been impacted by high energy, labour and capital costs. New mining projects have faced repeated delays, as development costs have blown out, while existing facilities, particularly for bulk commodities such as iron ore in Western Australia and coal in New South Wales and Queensland, have been constrained by insufficient infrastructure provision. As a result, commodity prices are forecast to track sideways in 2007, before declining in 2008.

In addition to fundamentals, exchange traded commodity markets have been exposed to increased speculative pressure in recent years. Higher returns in commodity markets than other investment options lured pension and hedge funds to invest. However, recent losses in natural gas, copper and zinc markets may refocus speculative market participants on the risks – not only returns – of commodity investments. As a result, funds may slow, or even withdraw, the flow of investment into these markets. This adds considerable uncertainty to price forecasts.

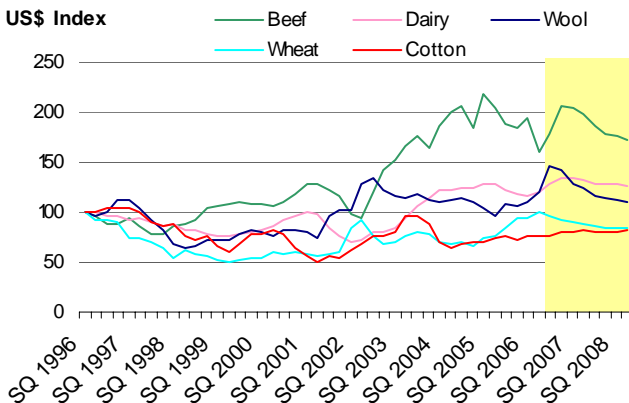
Rural commodities

Prices largely track sideways, although upside pressure remains



- Rural commodity price forecasts have been revised upwards, with drought induced supply concerns driving wool and dairy prices higher than previously forecast.
- While our underlying assumption is for the drought to break in autumn, rural commodity prices are expected to remain supported during 2007 by strong global demand and relatively tight supplies of most rural commodities.
- Prices are forecast to drift lower in 2008, as rural production rebounds from low levels. That said, with a positive demand outlook, rural prices will remain relatively high – particularly for beef, lamb, dairy and coarse grains.

With a favourable price outlook for beef, dairy & wheat



- Strong global demand has helped underpin prices, with demand expected to remain strong over the short to more medium term.
- Rising disposable incomes and changing diets has been positive for beef, lamb and dairy, with prices for these commodities expected to remain high into 2008.
- The expanding biofuel sector is also increasingly influencing the outlook for rural commodities, increasing demand for biofuel feedstocks (such as corn, sugar and rapeseed/canola) and influencing crop planting decisions.

Overview – prices to remain supported during 2007, but drift lower in 2008 as supply concerns dissipate

Beef prices have been adversely impacted by the drought, with producers increasing cattle turn-off in the face of lower pasture and water availability and higher feed costs. While an improvement in seasonal conditions will be the trigger to price recovery, constrained domestic supplies together with firm export demand is expected to support high prices.

Wheat prices are expected to remain at historically high levels in the short term. Increased global production is expected to place downward pressure on prices, however prices will remain supported by tight global stocks.

Cotton prices are forecast to trend higher in 2007/08, as global consumption exceeds production for the third consecutive season. China will continue to dominate the price outlook, as the world's largest producer, consumer and importer of cotton.

Sugar prices have retracted from their peak, as the stronger prices during much of 2006 led to a production response in key sugar producing nations. Consequently the market is in surplus, weighing on the price outlook.

Dairy prices have lifted over recent months, and are forecast to remain high during 2007/08. Supporting prices is limited supply growth in key exporting nations, while consumption continues to rise on the back of increasing disposable incomes and changing diets.

Wool prices have hit ten-year highs (in US\$ terms), with the drought induced drop in domestic production raising supply concerns. While lower supplies are expected to provide support for prices, price competitiveness of wool against substitutes is critical to the price outlook.

Data

NAB Indices of Commodity Prices in USD & A\$ Terms (a)

September Quarter 1996 = 100

Quarter	US\$	Rural	Non-rural	All	Rural	Non-rural	All	Export returns A\$ (b)
	Per A\$		US\$			A\$		
SQ 2001	0.510	87.0	90.2	89.3	133.9	138.9	137.5	127.8
DQ 2001	0.512	84.1	84.1	84.1	129.1	129.0	129.1	124.9
MQ 2002	0.519	85.7	86.8	86.5	129.8	131.4	131.0	123.6
JQ 2002	0.557	84.6	92.7	90.4	119.3	130.6	127.4	120.2
SQ 2002	0.548	88.2	93.0	91.6	126.4	133.2	131.3	121.9
DQ 2002	0.560	93.4	93.6	93.5	131.0	131.2	131.2	122.0
MQ 2003	0.599	98.4	101.6	100.7	129.0	133.2	132.0	120.8
JQ 2003	0.648	100.3	96.9	97.8	121.7	117.5	118.7	110.4
SQ 2003	0.658	102.8	99.6	100.5	122.8	118.9	120.0	109.2
DQ 2003	0.725	109.6	106.8	107.6	118.7	115.7	116.5	107.2
MQ 2004	0.765	114.6	117.8	116.9	117.7	121.0	120.1	108.3
JQ 2004	0.708	110.9	126.1	121.8	123.0	139.8	135.0	120.4
SQ 2004	0.705	113.0	135.9	129.4	125.9	151.5	144.2	127.5
DQ 2004	0.757	115.9	146.3	137.7	120.2	151.8	142.9	125.4
MQ 2005	0.778	117.6	152.3	142.5	118.7	153.8	143.9	125.9
JQ 2005	0.769	110.9	179.2	159.9	113.4	183.2	163.4	144.2
SQ 2005	0.760	122.0	194.5	174.0	126.1	201.0	179.8	151.5
DQ 2005	0.749	119.8	197.7	175.7	125.6	207.3	184.2	158.6
MQ 2006	0.744	120.3	209.4	184.3	126.9	221.0	194.4	164.5
JQ 2006	0.742	120.1	233.9	201.8	127.2	247.7	213.6	174.5
SQ 2006	0.757	121.9	240.6	207.0	126.5	249.7	214.9	174.8
DQ 2006 (p)	0.772	117.9	239.5	205.1	120.0	243.8	208.8	172.8
MQ 2007 (f)	0.800	125.5	237.2	205.6	123.2	232.9	201.9	170.8
JQ 2007 (f)	0.800	130.9	237.8	207.6	128.5	233.5	203.8	166.5
SQ 2007 (f)	0.780	127.8	241.9	209.7	128.7	243.6	211.2	171.8
DQ 2007 (f)	0.770	125.3	240.8	208.2	127.8	245.6	212.4	172.8
MQ 2008 (f)	0.740	119.9	238.9	205.3	127.2	253.6	217.9	184.4
JQ 2008 (f)	0.730	116.6	223.4	193.2	125.5	240.3	207.9	169.8
SQ 2008 (f)	0.730	115.5	216.5	188.0	124.3	233.0	202.3	164.5
DQ 2008 (f)	0.730	114.3	212.6	184.8	123.0	228.7	198.9	161.8
Year ended % change								
June 2006 (a)	-3.5%	8.2%	30.5%	26.1%	12.2%	35.2%	30.7%	21.1%
September 2006 (a)	-0.4%	-0.1%	23.7%	19.0%	0.3%	24.2%	19.5%	15.3%
December 2006 (a)	3.0%	-1.6%	21.1%	16.7%	-4.5%	17.6%	13.3%	8.9%
December 2007 (f)	-0.2%	6.3%	0.6%	1.5%	6.5%	0.8%	1.7%	0.0%
December 2008 (f)	-5.2%	-8.8%	-11.7%	-11.2%	-3.8%	-6.9%	-6.4%	-6.4%
Annual % change								
2006/07 (f)	4.4%	2.9%	14.3%	12.2%	-1.5%	9.4%	7.4%	5.5%
2007/08 (f)	-3.5%	-1.3%	-1.0%	-1.1%	2.2%	2.4%	2.4%	2.0%
2007 (f)	4.5%	6.1%	3.7%	4.1%	1.5%	-0.7%	-0.3%	-0.7%
2008 (f)	-7.0%	-8.5%	-6.9%	-7.2%	-1.6%	0.0%	-0.3%	-0.2%

Price directions – relative to December quarter

Next 3 months	↑	↑	↓	-	↑	↓	↓	↓
Next 12 months	-	↑	-	↑	↑	-	↑	-

(a) See Table 2 on page 4 for details of some selected commodities. More details on key commodities are available in our commodity outlook notes

(b) ABS implicit price deflator for commodity exports

(f) Forecast

Selected Commodity Price Indices in USD Terms

September Quarter 1996 = 100

Quarter	Crude Oil	Met coal	Iron ore	Gold	Base Metals	Beef	Wheat	Cotton	Sugar
Weighting in index	0.15	0.13	0.09	0.08	0.18	0.07	0.06	0.02	0.02
SQ 2002	126.5	84.1	95.6	81.7	84.4	97.1	83.8	62.6	52.3
DQ 2002	126.2	85.8	95.5	84.1	86.9	93.4	91.6	67.7	62.4
MQ 2003	152.0	85.6	95.6	91.5	93.6	119.2	75.9	76.1	70.0
JQ 2003	130.1	84.5	99.7	90.2	92.8	142.0	68.9	76.6	60.4
SQ 2003	135.2	81.6	99.3	94.5	99.8	152.1	69.5	79.8	55.7
DQ 2003	139.3	82.0	104.2	102.0	117.4	167.0	76.2	96.2	53.2
MQ 2004	157.4	83.0	105.0	106.2	139.0	176.8	79.1	96.0	51.5
JQ 2004	171.4	99.4	123.5	102.4	132.1	163.5	78.1	88.3	57.9
SQ 2004	195.9	108.7	123.4	104.5	138.6	185.2	69.9	71.0	68.5
DQ 2004	216.0	117.7	127.9	112.8	146.4	199.4	68.5	63.1	75.7
MQ 2005	222.8	121.2	133.1	111.1	157.3	205.8	69.0	67.9	76.4
JQ 2005	237.3	191.4	212.1	111.2	158.7	183.9	66.4	70.7	74.0
SQ 2005	282.5	217.7	216.7	114.3	156.9	218.4	73.1	69.5	85.5
DQ 2005	268.0	228.8	219.5	126.2	168.2	204.1	76.8	73.4	107.1
MQ 2006	282.6	224.5	219.6	144.0	200.2	188.3	84.2	75.8	145.9
JQ 2006	315.2	212.1	240.1	162.8	259.3	184.2	94.6	71.7	141.0
SQ 2006	315.1	193.6	252.9	161.5	292.6	193.5	93.7	75.4	115.1
DQ 2006 (p)	268.4	199.9	252.9	159.7	320.6	159.5	99.8	75.4	99.9
MQ 2007 (f)	255.9	198.3	252.9	170.3	318.4	177.8	95.4	76.5	90.1
JQ 2007 (f)	274.8	177.4	278.2	168.9	305.5	206.1	92.0	79.1	84.1
SQ 2007 (f)	292.7	174.7	278.2	176.7	306.0	203.7	89.5	80.4	85.8
DQ 2007 (f)	284.9	173.8	278.2	181.9	306.3	198.3	87.9	81.7	90.1
MQ 2008 (f)	286.0	171.2	278.2	194.9	294.2	185.4	86.9	80.4	88.4
JQ 2008 (f)	268.1	156.9	250.4	189.7	274.9	177.7	84.9	79.8	86.7
SQ 2008 (f)	254.7	155.3	250.4	187.1	261.7	175.2	83.9	80.4	81.5
DQ 2008 (f)	263.7	154.9	250.4	181.9	241.3	172.6	83.9	81.1	77.2
Year ended % change									
Jun 2006 (a)	32.9%	10.8%	13.2%	46.4%	63.4%	0.1%	42.6%	1.5%	90.5%
Sep 2006 (a)	11.6%	-11.0%	16.7%	41.3%	86.4%	-11.4%	28.3%	8.5%	34.6%
Dec 2006 (p)	0.1%	-12.6%	15.2%	26.5%	90.6%	-21.8%	29.9%	2.7%	-6.8%
Dec 2007 (f)	6.1%	-13.0%	10.0%	13.9%	-4.5%	24.3%	-11.9%	8.5%	-9.8%
Dec 2008 (f)	-7.5%	-10.9%	-10.0%	0.0%	-21.2%	-13.0%	-4.6%	-0.8%	-14.3%
Annual % change									
2006/07 (f)	-3.0%	-12.9%	15.7%	20.7%	57.7%	-7.3%	15.9%	5.5%	-18.8%
2007/08 (f)	1.6%	-12.0%	4.6%	12.6%	-4.5%	3.8%	-8.3%	5.2%	-9.8%
2007 (f)	-6.2%	-12.7%	12.6%	11.1%	15.2%	8.3%	-2.0%	6.6%	-30.2%
2008 (f)	-3.2%	-11.9%	-5.3%	8.0%	-13.3%	-9.5%	-6.9%	1.2%	-4.7%
Price directions – relative to December quarter									
Next 3 months	↓	-	-	↑	↓	↑	↓	-	↓
Next 12 months	↑	↓	↑	↑	↓	↑	↓	↑	↓
5 year average	188.9	127.7	142.7	106.5	111.3	161.9	74.6	72.1	75.9
Deviation – Dec 06	66.8%	51.7%	77.2%	51.6%	133.0%	19.5%	25.7%	4.5%	51.6%

Appendix

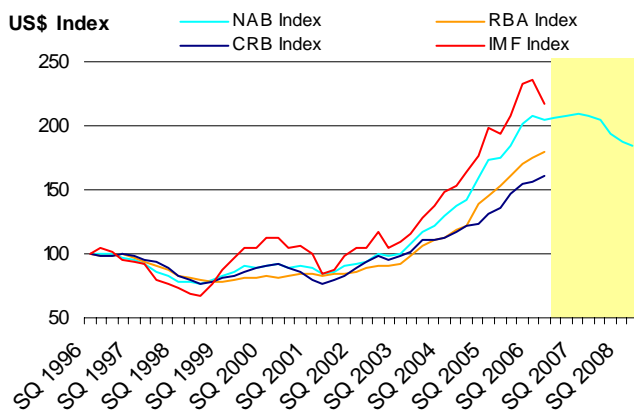
NAB's CPI: Construction & Comparison

Construction

The NAB Commodity Price Index (CPI) is comprised of 19 agricultural, mineral and energy commodities, with sub-indices for base metals, carbon steel, energy and rural commodities. The weights of the Commodity Price Index are based on the average Australian export value for each commodity over the past five years. It is calculated in both USD and A\$ terms using fixed weights outlined as follows:

Commodity	Weight (%)	
	NAB	RBA
Crude Oil	15.1	-
Metallurgical Coal	12.8	14.7
Iron Ore	9.4	9.3
Gold	8.5	9.4
Thermal Coal	8.0	9.7
Beef	6.6	7.9
Wheat	6.2	8.3
Aluminium	6.2	8.1
Nickel	4.4	2.6
Copper	3.8	2.8
Wine	3.7	-
Wool	3.4	4.1
Zinc	2.5	1.5
Cotton	2.1	2.8
Barley	1.9	1.9
Sugar	1.9	2.5
Cheese	1.4	-
Lead	1.2	0.7
Lamb	1.0	-
Alumina	-	7.4
LNG	-	4.8
Canola	-	1.0
Rice	-	0.5

Comparison of indices - USD



Key Sources of Prices

The majority of the non-rural commodity prices are spot basis, with the exception of iron ore and coal. For the latter, ABS average unit export values are used as a proxy since representative spot prices are typically unavailable. All other minerals and energy prices are sourced from Datastream.

Rural commodity prices are similarly either spot or indicator prices, with the exception of wine and sugar. For sugar, the New York No. 11 futures price is used. Wine and lamb prices are ABS average export prices. Other price data is from a range of sources, including Datastream, Bloomberg, USDA, MLA and the Woolmark Company.

As is evident in figure 7, trends in (global) commodity price indices are broadly similar. On occasions, however, different prices, composition and weightings may lead to divergent trends.

A Comparison of major indexes

The NAB and the Reserve Bank of Australia Indexes have a similar composition of commodities. The main difference is that the RBA non-rural index includes alumina but does not include crude oil. As a result, the RBA index does not respond as significantly to the sharp increase in oil prices since 2003. (The RBA index does include LNG – which typically includes oil prices in its contract pricing formulas – however the weighting of LNG is substantially lower than crude oil in the NAB index). The lack of readily available and verifiable data on LNG prices is the reason for its exclusion from the NAB index.

There are also differences in the composition of the RBA and NAB rural indices. NAB includes dairy, lamb and wine prices, but has excluded rice and canola.

The two main international series, the CRB index and IMF index, both have a wider coverage of commodities and differing weightings. Crude oil accounts for around 40 per cent of the IMF index, contributing to the sharp increase in the index since 2003. In contrast, the equal weighting of the CRB index tends to overweight agricultural commodities – relative to the other indices – contributing to the muted increase in aggregates prices compared with the NAB and IMF indices.

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