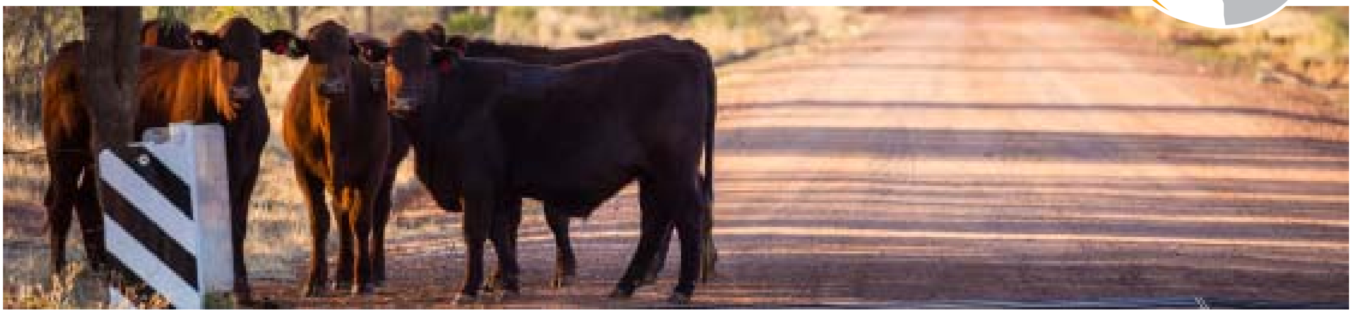
Australian cattle

Industry projections 2016
July Update



KEY POINTS

- Tight supplies confirmed
- Early indication of herd rebuild
- Restockers to underpin cattle market
- Australian cattle prices approach US

KEY 2016 NUMBERS

Slaughter	Production	Beef Exports	Live exports
7.4 (million head)	2.17 (million tonnes cwt)	1.03 (million tonnes swt)	1.1 (million head)

* Graphic illustrates year-on-year change

MLA's Market Information – Ben Thomas
bthomas@mla.com.au

Introduction

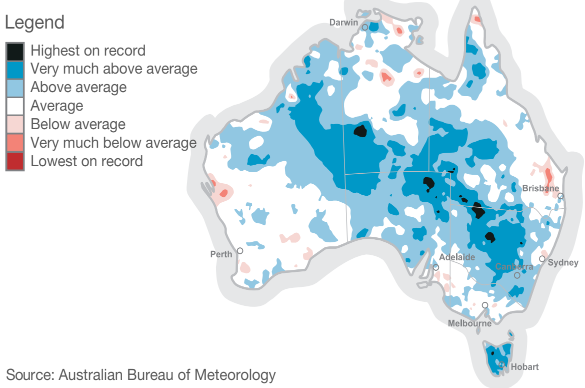
Halfway through 2016, the Australian cattle industry finds itself in the middle of conflicting forces. On the one hand, recent widespread rainfall has reinforced the expectation of tighter cattle availability over the coming 12 months, sparking fierce restocker competition that has led to a sudden surge in cattle prices. On the other hand, global beef prices have softened further from their record highs in 2015. This mid-year cattle market update aims to shed light on the cocktail of uncertainty.

Weather outlook

A late autumn break, which continued through June, brought widespread rain to most key producing regions, boosting producer sentiment and the cattle market alike.

For the April to June period, large parts of central and south east Australia received 'above average' rain, while falls across the Top End, eastern Queensland, Victoria, south east SA and southern WA were mostly 'average' and with only some pockets recording 'below average' rainfall (Bureau of Meteorology – BOM). Over this three-month period, there were only a few areas with a 'serious' to 'severe' rainfall deficiency, which were in south east Queensland and the Cape York Peninsula, the Top End and along the mid-coast of WA.

Figure 1 Australian rainfall - 1 April to 30 June 2016



Source: Australian Bureau of Meteorology

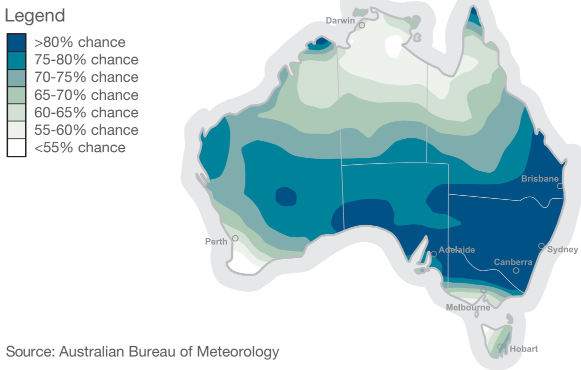
Weather outlook continued...

According to BOM, El Niño-Southern Oscillation (ENSO) indicators in the tropical Pacific Ocean are in a neutral state – meaning neither an El Niño nor La Niña weather pattern is currently in action. Recent observations and climate models suggest, however, that La Niña may develop over the coming months.

The outlook for July to September is for a wetter than average period for most of the country. Across much of northern Australia, the chance of an early onset of rainfall following the dry season is higher than average. If the three month outlook comes to fruition, it is likely to sustain the current strong cattle market through restocking demand and consequent limited availability.

Figure 2 Australian rainfall outlook: 1 July to 30 Sept

Chance of exceeding the median rainfall



Source: Australian Bureau of Meteorology

Slaughter, production and herd

There have been only been subtle changes to the April cattle slaughter and beef production projections.

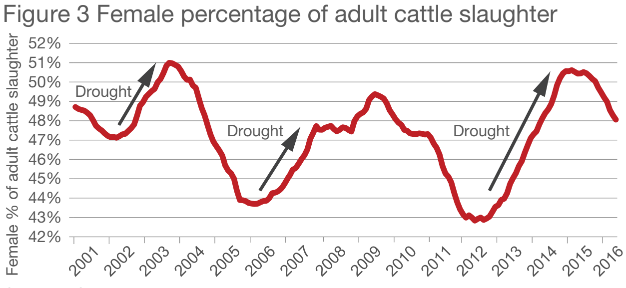
Slaughter cattle availability for the remainder of the year is expected to tighten slightly more than predicted in January, with the 2016 forecast revised down to 7.4 million head, a fall of 18% from 2015 (7.6 million head was predicted in January). The lower proportion of female cattle slaughter indicates the commencement of national herd rebuilding. The latest data indicates that the rolling 12 month average female proportion of the adult kill was only 48.6%, down from the peak in of 50.6% during 2015. Female slaughter, as a proportion of the national kill, is likely to continue drifting down to below 44% as full rebuilding takes place.

As projected in January, a significant lift in average carcase weights has occurred this year - largely on the back of a higher proportion of cattle on feed, lower stocking rates when a widespread break occurred, and a higher proportion of male cattle being slaughtered. Considering the average weights are already up 3% year-on-year, a small upward revision to 2016 average adult cattle carcase weights is included in the July projections, exceeding the record set in 2012, at 288kg/head.

Beef and veal production is now expected to be 2.17 million tonnes cwt, down 15% from 2015, with the decline in slaughter only partly offset by heavier carcases. Production is anticipated to ease further in 2017 to the lowest volume since 2003, at 2.06 million tonnes cwt, before building up from there over the remainder of the projection period.

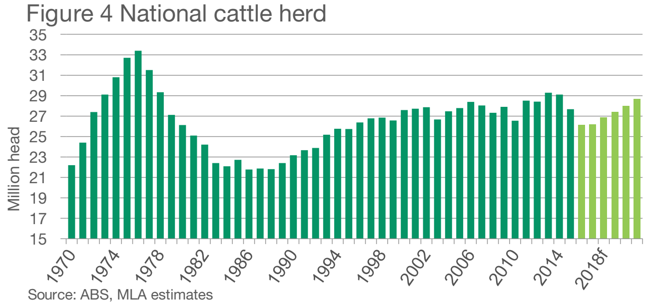
Interestingly, better seasonal conditions should see improved branding rates and fewer on-farm losses, which combined with the expectation of lower slaughter numbers than initially anticipated, should go a long way to assisting the herd recovery. The Australian cattle herd is forecast to edge slightly higher by 30 June 2017, to 26.2 million head.

Figure 3 Female percentage of adult cattle slaughter



Source: ABS

Figure 4 National cattle herd



Source: ABS, MLA estimates

Prices and buyer breakdown

The Eastern Young Cattle Indicator (EYCI) has continued its record breaking run, averaging 618¢/kg cwt in June, up 123¢/kg cwt or 25% from year-ago levels – on the back of 'above average' to 'very much above average' rainfall across large swathes of Queensland, NSW and central Australia in late May and June.

In particular, the recent rain-fuelled confidence amongst restockers led the price charge. Of the EYCI-eligible cattle in recent weeks, restockers purchased 39% of them and paid, on average, 675¢/kg cwt (or a 16¢/kg cwt premium to the EYCI). In comparison, feedlots purchased 41% of the total and paid 661¢/kg cwt (2¢/kg cwt premium), while processors purchased 20% and paid 624¢/kg cwt (35¢/kg cwt discount).

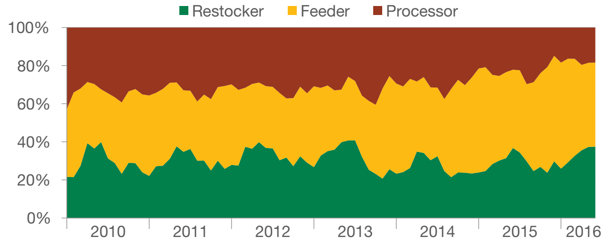
Prices and buyer breakdown continued...

It should be noted that many EYCI-eligible cattle were, and still are, in store condition and not suitable for slaughter, and processors source the majority of cattle direct from producers and feedlots (processor purchases of EYCI-eligible cattle in the last week of June were just shy of 3,000 head, while the eastern states slaughter was almost 127,000 head).

Interestingly, 2010 and 2011 was the last time the eastern states of Australia had 'above average' rainfall for an extended period. In those years, restockers paid a 10-20¢/kg cwt premium to the EYCI and purchased 25-40% of eligible cattle. That scenario appears to have returned this year.

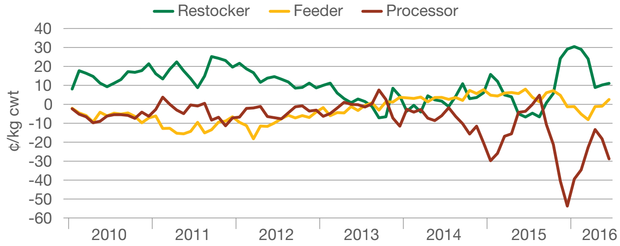
Furthermore, feedlot buyers make up the largest component of EYCI cattle purchases and rarely depart from 10¢/kg cwt of the average. The need to manage a margin on each purchase, and over a fixed time horizon (mostly less than 100 days prior to realising a profit), explains the less volatile prices over time, relative to other buyers. Conversely, restocker purchases are much more volatile, reflecting changes in seasonal conditions to a greater extent but also the buyer's ability to spread the cost of cattle over a longer time frame and weight gain.

Figure 5 EYCI buyer composition



Source: : MLA. Data are monthly aggregations

Figure 6 Buyer premium (discount) to EYCI



Source: : MLA. Data are monthly aggregations

With a favourable seasonal outlook, it is likely restockers will continue to pay the strongest premium relative to the EYCI. However feedlots will more than likely continue to be competitive (given strong fed cattle prices and low feed costs) and purchase significant numbers of suitable cattle for the remainder of 2016.

Australian cattle prices in a global context

The world cattle market remains in two different leagues. These are closely aligned with North American grainfed production and the grassfed systems used across most of the rest of the world.

On the one hand, Canadian and US indicative prices are significantly higher than their global counterparts, despite having softened from their highs in mid-2015 and production expectations for the remainder of the year suggest that the weakening market will continue.

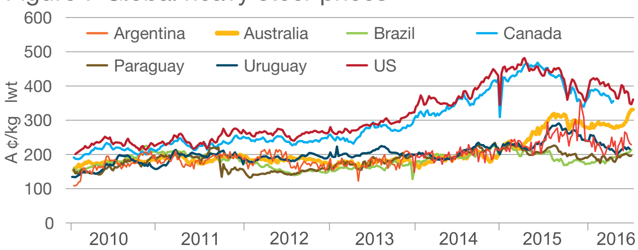
At the same time, in A¢/kg lwt terms, the South American markets are strengthening on the back of improved market access for Brazil and Argentina and contracting supplies in Uruguay and Paraguay. While all of these markets have generally improved in recent months, they continue to lag those elsewhere in the world, largely as a result of weaker currencies.

Australia's indicative pricing currently sits between the two regions. The Australian heavy steer indicator averaged 312¢/kg lwt during June, buoyed considerably by the rain induced tight cattle situation, and is likely to remain high for at least the winter months.

It is unlikely average Australian finished cattle prices will overtake the US and become the dearest cattle market amongst the major exporters, largely as a result of the greater trade exposure and significantly fewer grainfed cattle. But the very narrow gap may in fact continue to tighten, based on the diverging production situations in the respective markets, while weak currencies will keep South American cattle prices below Australian prices for the foreseeable future.

While coming very close to US cattle prices may be deemed as a milestone for Australian producers, it could also be an indication that a ceiling has been reached.

Figure 7 Global heavy steer prices*



Source: IPCVA (Argentina, Paraguay); MLA (Australia); Esalq/Cepea (Brazil); INAC (Uruguay); USDA (US), Canfax (Canada)

* Indicative heavy steers including grassfed and grainfed categories

Imported 90CL prices

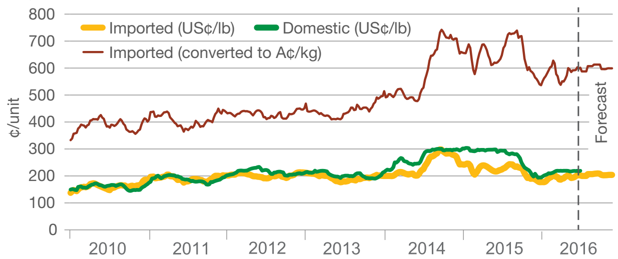
One of the key price indicators for the Australian cattle and beef industry is imported 90CL (chemical lean) cow beef in the US. This is due mainly to the sheer size of the 90CL manufacturing beef trade from Australia to the US. In 2015, the US was Australia's largest export market for beef (415,951 tonnes shipped weight), and manufacturing beef was the largest category – accounting for 66% of the total. This was more than the total volume of beef sent to any other country except Japan.

Over time, the imported 90CL indicator has tended to follow the US domestic 90CL prices relatively closely, but through 2014 and 2015 there were some clear divergences as a result of supply changes and currency movements. Through the first half of 2016, the relationship has been much closer to normal, with domestic 90CL beef generally commanding a premium over imported. Prices for both domestic and imported are also back at a level much closer to the average from 2011 to 2014, in US$ terms.

The positive aspect of this market is that while in US$ terms prices are close to the longer term average, the depreciation of the A$ relative to the US$ over the last two years means that returns to Australia exporters remain well above past averages, currently around 600A¢/kg CIF. While this is down from the record highs above 700A¢/kg CIF in 2014 and 2015, prices at this level could be expected to go a long way to helping support the Australian cattle market.

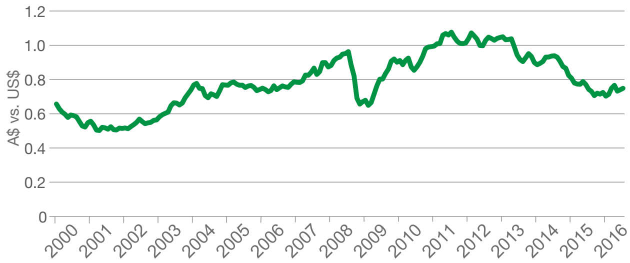
The Steiner Consulting Group forecasts a customs cleared value for the imported 90CL indicator, which indicates a price quite similar to the present level through to the end of 2016. Currency movements will affect returns to exporters, but at 75US¢, the A$ value could remain close to 600A¢/kg CIF through the remainder of the year (NB: Current CME futures prices for the exchange rate have the A$ at US$0.746 in September and US$0.744 in December).

Figure 8 US 90CL prices



Source: MLA, CME

Figure 9 A$ vs. US$



Source: XE.com

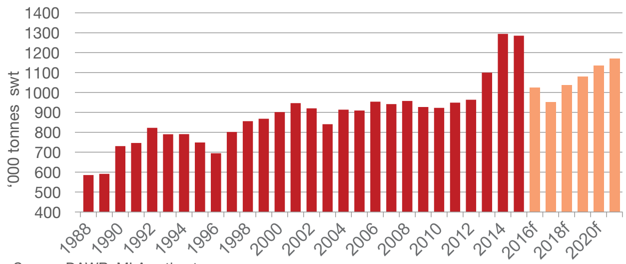
Exports and the domestic market

Australian beef and veal exports for the year to June have receded with production, and are down 18% year-on-year, at 528,599 tonnes swt. Encouragingly, the chilled (higher valued component) was down to a lesser extent than the frozen volumes, with the chilled volume at 144,947 tonnes swt, down 9% year-on-year.

The projected volume for 2016 remains just above 1 million tonnes swt, down 20% from the back-to-back record years, but still be the fourth highest volume on record. Looking beyond 2016, shipments will more than likely contract with production again in 2017, before slowly gaining momentum from there and reaching 1.17 million tonnes swt in 2021.

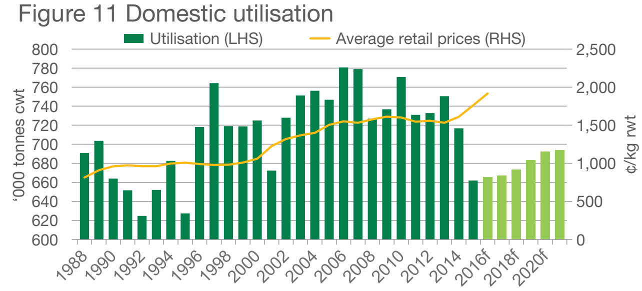
Of the primary markets for the year-to-date, the US has been slower compared to the same time last year, especially for frozen grassfed beef. Japan has also been challenged by competition with the US, although grainfed export volumes remain at reasonable levels. In Korea, shipments have held up extremely well, as the third KAFTA tariff cut is assisting the competitiveness of Australian product compared to the more expensive domestically produced Hanwoo beef.

Figure 10 Beef and veal exports



Source: DAWR, MLA estimates

Figure 11 Domestic utilisation



Source: ABS, MLA estimates

Exports and the domestic market continued...

China continues to demand a historically high proportion of Australian product, with industry suggesting the northern hemisphere summer should continue to drive imports. Competition in China is growing though and latest Global Trade Atlas data suggests May export volumes from Brazil to China were 20,286 tonnes swt, compared to Australia's 8,433 tonnes swt during the same month. The Brazilian volume has now totalled 168,900 tonnes swt since re-entry in June 2015, compared to Australia's128,083 tonnes swt over that same period.

On the domestic market front, despite strong export demand combined with contracted beef availability, domestic utilisation is forecast to hold steady with last year. The large year-on-year decline in per capita consumption from 2014 to 2015 is not expected to be repeated in 2016 and 2017 but is still expected to move gradually lower over the forecast period. This is encouraging considering the domestic situation has been challenged by rising retail beef prices, which for the March quarter (latest data) were the highest on record in nominal terms, at $19.16/kg rwt.

Live export market

Australian live cattle exports for the year-to-June (latest data) are at 630,547 head, down12% year-on-year causing the forecast for 2016 to be revised to 1.1 million head (from 1 million head forecast in April). The revised estimate remains significantly below (17%) the number exported in 2015, but will still be the third highest on record.

Live cattle exporters, along with processors, are anticipating that the number of cattle available will become particularly tight as the year progresses, especially as the northern attention turns from liquidation to herd rebuild.

Indonesia remains the largest market for the year-to-June, with 313,529 head exported, down 14% year-on-year. Numbers to Vietnam are also historically high, at 125,178 head, while shipments to all other major markets were up 19% year-on-year at 141,769 head.

During June, the Darwin live feeder steer indicator was 325¢/kg lwt, up 28% year-on-year, while steers delivered to Townsville were 285¢/kg, up 30%.

Conclusion – Australian cattle market

The Australian cattle market is likely to remain supported for the remainder of 2016 as a result of the positive rainfall outlook, expectations of abundant feed availability during spring, strong restocker competition and no indications of a sudden strengthening of the A$. Producers need to be mindful, however, of the price adjustment that will eventually occur as a result of the lowering export prices, and eventual recovery in beef production in Australia. It is unclear exactly when this will happen, and to what extent prices will go down in the next cycle, but it is something that producers should be wary of while making longer term cattle investment decisions with restocking prices at such high levels.

Situation and outlook for the Australian cattle industry

	2011	2012	2013	2014	2015	2016[f]	% change	2017[f]	2018[f]	2019[f]	2020[f]	2021[f]	% change 2021[f] on 2015
Cattle numbers ('000 head)*	**28,506**	**28,418**	**29,291**	**29,100**	***27,413***	***26,142***		***26,191***	***26,878***	***27,403***	***27,977***	***28,654***	*5%*
percentage change	0.4%	-0.3%	3.1%	-0.7%	*-6.4%*	*-4.6%*		*0.2%*	*2.6%*	*2.0%*	*2.1%*	*2.4%*	
Slaughterings ('000 head)													
cattle	7,261	7,352	8,344	9,226	*9,007*	*7,400*	*-18%*	*7,000*	*7,400*	*7,600*	*7,850*	*8,000*	*-11%*
calves	682	625	690	688	*655*	*630*	*-4%*	*625*	*640*	*680*	*700*	*710*	*8%*
total	7,943	7,977	9,034	9,914	*9,662*	*8,030*	*-17%*	*7,625*	*8,040*	*8,280*	*8,550*	*8,710*	*-10%*
Avg carcase weight (kg)													
cattle	287.3	287.5	278.0	276.8	*279.0*	*288.0*	*3%*	*289.0*	*291.0*	*293.0*	*295.0*	*296.0*	*6%*
calves	62.7	62.2	58.5	60.1	*56.0*	*60.0*	*7%*	*60.0*	*60.0*	*60.0*	*60.0*	*60.0*	*7%*
Production ('000 tonnes carcase weight)													
beef	2,086	2,114	2,320	2,554	*2,513*	*2,131*	*-15%*	*2,023*	*2,153*	*2,227*	*2,316*	*2,368*	*-6%*
veal	42.8	38.9	40.4	41.4	*32.9*	*37.8*	*15%*	*37.5*	*38.4*	*40.8*	*42.0*	*42.6*	*29%*
total beef and veal	2,129	2,153	2,360	2,595	*2,546*	*2,169*	*-15%*	*2,061*	*2,192*	*2,268*	*2,358*	*2,411*	*-5%*
Cattle exports ('000 head)	695	619	850	1,292	*1,332*	*1100*	*-17%*	*925*	*950*	*1000*	*1100*	*1200*	*-10%*
Beef exports ('000 tonnes)**													
total, carcase weight	1,398	1,419	1,611	1,881	*1,889*	*1,507*	*-20%*	*1,397*	*1,521*	*1,588*	*1,668*	*1,719*	*-9%*
total, shipped weight	949.2	963.8	1,099.8	1,294	*1,285*	*1,025*	*-20%*	*950*	*1,035*	*1,080*	*1,135*	*1,170*	*-9%*
Domestic utilisation ('000 tonnes c/c weight)***													
imports	7.7	5.7	3.6	4.4	*3.0*	*3.5*	*17%*	*3.5*	*3.5*	*3.5*	*3.5*	*3.5*	*17%*
total, carcase weight	720	720	736	702	*646*	*649*	*0%*	*651*	*660*	*667*	*676*	*677*	*5%*
kg/head****	32.1	31.6	31.8	29.9	*27.1*	*26.8*	*-1%*	*26.5*	*26.4*	*26.4*	*26.3*	*26.0*	*-4%*

Source: ABS, DAWR, MLA forecasts

f = forecast (in italics)

* As at 30 June, 2016 is an MLA estimate
** excl. canned/misc, shipped weight
*** Beef and veal production plus imports, less exports of beef and veal and canned/processed beef, carcase weight
**** kg/head consumption calculated from total carcase weight divided by Australian population

Australian beef and veal exports ('000 tonnes swt)

	2011	2012	2013	2014	2015	% change	2015 Jan-Jun	2016 Jan-Jun	% change
To:									
Japan	342.2	308.5	288.8	293.8	285.2	-3%	141.8	125.0	-12%
US	167.8	224.1	212.7	397.9	416.0	5%	227.2	145.6	-36%
Korea	146.4	126.0	144.4	150.9	166.6	10%	78.8	85.4	8%
China	7.8	32.9	154.8	124.6	148.2	19%	68.3	47.6	-30%
Canada	10.1	15.7	17.9	32.9	42.6	29%	23	12.2	-47%
Taiwan	36.7	38.3	35.7	36.4	30.4	-16%	14.2	14.6	3%
Indonesia	39.6	27.1	39.4	53.1	39.1	-26%	17.9	33.2	85%
Philippines	21.0	25.7	27.0	34.4	25.4	-26%	9.8	14.0	43%
Singapore	9.7	14.1	10.6	10.1	8.8	-13%	4.2	3.9	-7%
Malaysia	14.4	15.5	15.9	13.1	12.3	-6%	6.2	4.9	-21%
Thailand	2.5	2.8	4.3	5.4	5.9	9%	2.6	2.1	-19%
Hong Kong	8.9	6.3	5.1	14.7	6.7	-55%	3.3	2.1	-36%
EU	12.8	14.9	19.8	24.6	23.4	-5%	11.4	12.0	5%
Middle East	32.1	31.4	61.0	59.8	53.4	-11%	26.8	17.0	-37%
*Other	97.2	80.4	62.1	35.2	21.0	-40%	11.2	9.0	-20%
Total	**949.2**	**963.8**	**1,099.5**	**1,287.0**	**1,285.0**	**0%**	**646.7**	**528.6**	**-18%**

Source: DAWR
* Main countries in other = PNG, South Africa, Central and South America, Russia