Australian sheep and lamb prices – where do we really stand?

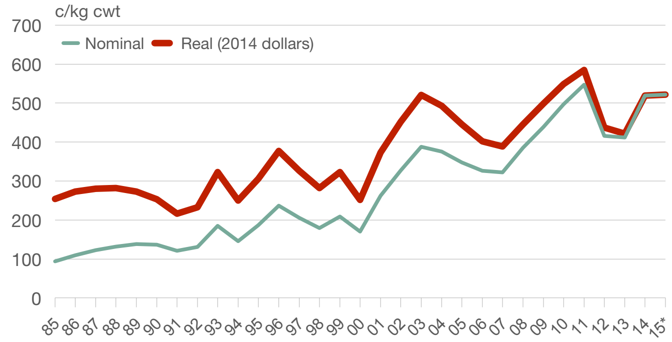
AUSTRALIAN SHEEP PRICES

Australian sheep and lamb prices, in nominal terms, have increased dramatically in the last three decades. Adjusting these prices to real terms, however, removes the effects of inflation and provides a more meaningful look into how prices are really tracking.

For the first quarter of 2015, real trade lamb saleyard prices are double where they were three decades ago, averaging 522¢/kg cwt (Figure 1), while real mutton prices have improved close to three-fold (Figure 2).

To record significant real price rises over the space of three decades is relatively rare amongst agricultural commodities. Normally, productivity growth outstrips demand growth, causing prices to fall in real terms. That this has not occurred in the sheepmeat industry, despite significant productivity growth over the last decade, indicates the underlying strength in demand. Sheepmeat is the only major Australian agricultural commodity to register a positive long term growth in real prices.

Figure 1: Average national trade lamb prices

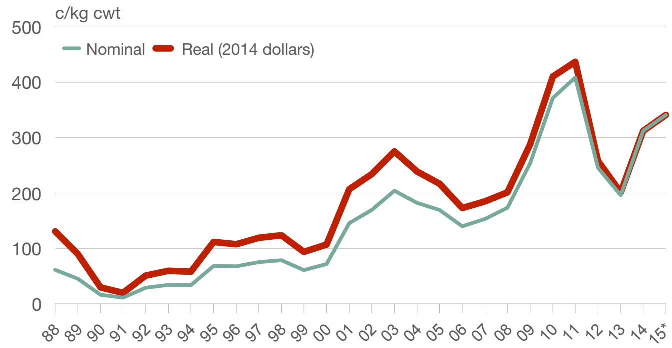


Lamb before January 1996, 16–18kg cwt, score 3; from January 1996, lamb, 18–20kg cwt, score 3; from July 2003, trade lamb, 18–22kg cwt, score 2–4

* Year to date

Source: ABARES, MLA's NLRS

Figure 2: Average national mutton prices



Ewes and wethers, 18–24kg cwt, score 2–3.

* Year to date

Source: ABARES, MLA's NLRS

This report outlines a brief history of lamb and mutton prices from 1985 to the present and examines the key factors that influenced the industry over that time.

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A TIMELINE OF PEAKS AND TROUGHS

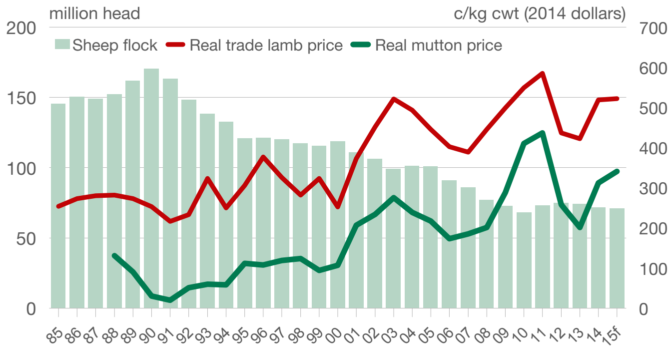
The 1980s were a decade of optimism and high profitability in the Australian sheep (wool) industry, driven by rising global wool demand and underpinned by guaranteed minimum producer wool prices. The lamb industry, on the other hand, was in decline. Lamb was largely a by-product of wool, with slow production growth, falling per capita consumption and a poor quality and health image, both domestically and overseas.

In 1987 the Australian government assigned responsibility for setting the reserve price for wool to the Australian Wool Corporation (AWC). The wool price climbed throughout the late 1980s, as did the reserve price. When the demand for wool collapsed the AWC had to heavily intervene in the market to support the reserve price. By the late 1980s the AWC was purchasing 60-70% of all wool offerings, with stocks building to unsustainable levels. As growers scrambled to capitalise on the exceptionally high returns and the national sheep flock increased, a flock reduction scheme was enacted in an attempt to correct supply and demand imbalances.

The 1990s were a turbulent decade, commencing with the wool price crash, the end of guaranteed wool prices, farm losses and sheep flock liquidation. During this period the specialist meat lamb industry was born.

In 1990 the national sheep flock peaked at 173 million head (Figure 3). In that same year, the Australian government announced the suspension of the Wool Reserve Price Scheme, causing the wool indicator to fall 40% overnight. As a by-product of wool, real mutton prices hit a low point, averaging just 20¢/kg cwt in 2014 dollars during 1991. Lamb prices also suffered, although to a lesser degree. Despite the onset of an El Niño event in 1992, prices began to slowly recover as the industry entered a period of restructure, moving away from wool and toward slaughter lamb production.

Figure 3: Australian sheep flock



Source: ABS, ABARES, MLA's NLRS f = forecast

In the 1980s and early 1990s around 85% of all lamb produced in Australia was sold domestically. The remaining 15% of production was exported, largely to the Middle East, Papua New Guinea and Europe. Research conducted in late 1980s, however, identified the United States as a prospective export market. In response to this research, significant R&D and marketing investments were directed towards servicing US market – the R&D to encourage production of large, lean lambs and the marketing to attract US customers to Australian product. This period represented the initial and highest marketing expenditure phase of the US Fresh Australian Range Lamb (FARL) program[1].

This development of a specialist lamb industry saw prices move gradually higher across the 1990s. Lamb prices first spiked in 1993, assisted by tighter supplies following rapid stock liquidation, a low Australian dollar and a 17% decline in NZ lamb production, causing Australian exports to lift 35% year-on-year. They then peaked again in 1996, at 377¢/kg cwt (2014 dollars).

As the development of a specialist lamb industry gathered momentum, the quality and health image of Australian lamb was raised not only on the international market, but also at home. The stronger demand for lamb, coupled with food safety scares in other proteins, halted the steady decline in Australian sheep meat consumption that had been occurring since the 1970s.

Harsh seasonal conditions in 1997 resulted in high turnoff and poorer stock condition, which saw prices ease from their 1996 peak. The subsequent collapse of the Russian rouble in 1998 left the skins market in crisis and placed further downward pressure on real sheep and lamb prices.

[1] CIE, *An evaluation of domestic and US lamb marketing*, prepared for MLA, December 2008.

The 2000s were a decade of rapidly rising (but volatile) lamb and mutton prices, driven by stronger domestic and export demand, punctuated by periods of severe drought and ending with the aftermath of the Global Financial Crisis.

The new millennium commenced with higher turnoff placing downward pressure on prices. A sharp but brief recovery occurred in 2001-02 (due to intense export demand and a low A$), before a downturn in seasonal conditions resulted in seven consecutive years of drought, including two of the worst ever recorded in 2002-03 and 2006-07. Real prices entered a prolonged period of decline, with real trade lamb prices falling 25% and mutton 33% from 2003-07.

It is worth noting that the price declines of the millennium drought were softened to an extent by the rapidly rising domestic and export demand for lamb. Demand was fuelled by the higher quality product from meat breeds, successful industry marketing initiatives, the rising health image of red meat and growing demand in the US. Coupled with the effects of a drought depleted Australian flock and tighter global supplies, the industry turned a corner in 2008. Prices went from strength-to-strength and weathered some significant economic set-backs, including the onset of the Global Financial Crisis and a high A$ through 2009-10. Sharp rises in the A$ were passed through into higher sheepmeat prices to consumers without impacting overall demand, reflecting the tight global demand/supply balance and Australia's now firmly established role in the international market.

2010-2014 was a period of climatic extremes (but with a backdrop of rising overseas demand and global prices), leading to supply and price volatility.

A La Niña event in 2010-11 saw the millennium drought come to an end as rainfall records were broken. After a decade of poor seasonal conditions, the sheep flock hit its lowest point in 2010 at 68.1 million head, reducing the availability of sheep and livestock for slaughter at a time when export demand was surging and global supplies were tight. The resulting competition between processors (meeting export demands) and restockers (rebuilding intentions) created the perfect scenario for prices to hit record highs in March 2011, with trade lambs averaging 585¢/kg cwt and mutton 437¢/kg cwt (2014 dollars). These unprecedented (and largely unforseen) highs were short lived, however, and prices contracted sharply through 2012 as the season – and thus industry sentiment – began to erode.

With the dry times continuing through 2013-14, slaughter and export volumes broke record after record as many producers had no option but to de-stock. Global demand, driven by the increasing middle class in developing markets (mainly China, which entered as a major player on the international market), was strong enough to absorb the higher production, seeing average real lamb and mutton prices rise to 519¢/kg cwt and 312¢/kg cwt, respectively, in 2014.

CURRENT INDUSTRY DRIVERS: GROWING INTERNATIONAL DEMAND AND CONSUMPTION

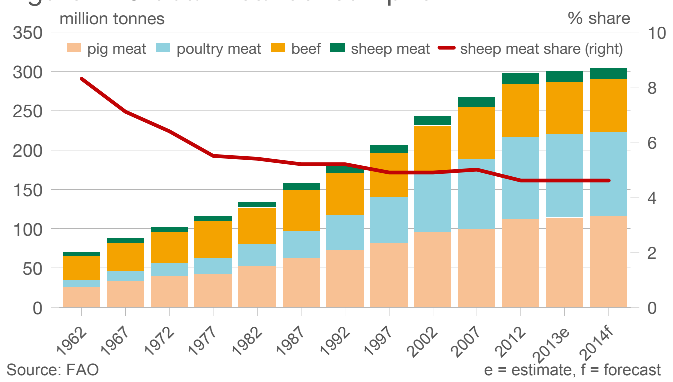
Australian sheepmeat production has increased dramatically over the past few decades, to a record 486,565 tonnes cwt in 2014, despite the declining national flock. The lift in production has been assisted by developments in genetics, pasture and on farm management, leading to higher carcase weights and lean meat yields. However, domestic consumption has been declining in response to higher prices and changing consumer preferences, as cheaper proteins (poultry and pork) continue to encroach on sheepmeat's market share.

This decline in domestic consumption, combined with the strength of international demand for Australian sheepmeat, has seen the industry become increasingly export focused. In 2013-14 57% of all lamb and 96% of all mutton produced was exported (ABS). Australia is now the world's largest sheepmeat exporter and, combined with New Zealand, accounts for almost 85% of global exports (FAO). As a result, the Australian sheep industry is now more heavily exposed to trends in international markets than ever before.

While sheepmeat makes up only a small and declining share of global meat consumption (and remains a niche product in all developed countries except Australia and New Zealand), global consumption of sheepmeat has more than doubled since 1962 (Figure 4), largely due to a rapid increase in demand from China (Figure 5).

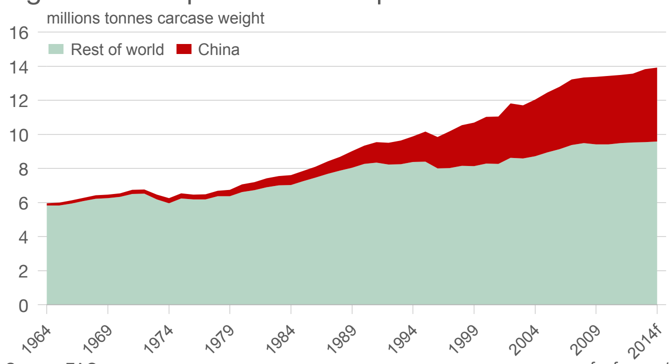
This global growth in sheepmeat consumption, which has occurred over a long period of time, has recently been met with a decline in New Zealand sheepmeat production, reducing the global exportable sheepmeat surplus. New Zealand sheepmeat production has dropped about 15-20% over the last decade as enterprises have moved away from sheep and into dairy. The "bottom line" result is that growth in sheepmeat supply has failed to keep pace with growth in demand, causing sheepmeat prices to rise. Sheepmeat prices have risen by more than any other protein, both in real and nominal terms. In fact, lamb is the only major agricultural commodity to register positive growth in real prices over the past 30 years (Figure 6).

Figure 4: Global meat consumption



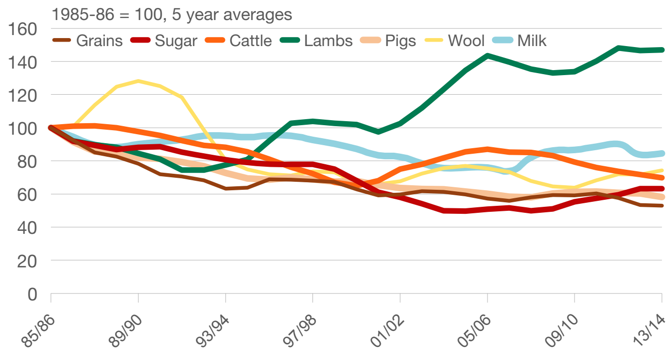
Source: FAO e = estimate, f = forecast

Figure 5: Sheepmeat consumption



Source: FAO f = forecast

Figure 6: Real commodity prices



Source: ABARES

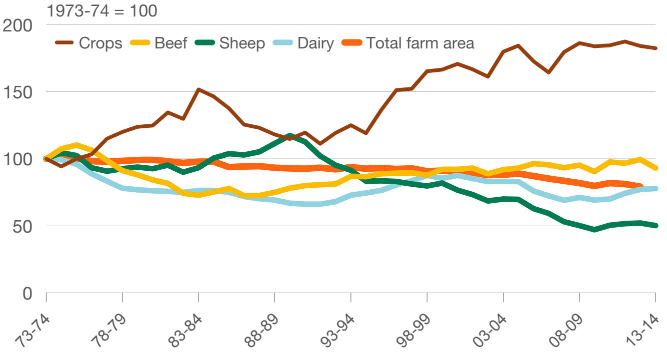
INDUSTRY CONSTRAINTS: SUPPLY LIMITATIONS, RISING COSTS AND CLIMATE VARIABILITY

Although real lamb and mutton prices have risen in the long term, the cost of inputs has also increased. Furthermore, it needs to be recognised that sheepmeat production competes with grain production for scarce land resources. In 19 of the past 20 years, data from ABARES agricultural commodity surveys shows that cropping enterprises have recorded the highest average rate of return among broadacre industries[2]. Consequently, the area of farm land used for cropping has almost doubled since the early 1970s, while the national sheep flock has halved (Figure 7).

Furthermore, total factor productivity (TFP) growth[3] has tended to fluctuate with the industry moving through periods of re-stocking and de-stocking (Figure 8). Over a long period of time the Australian sheep industry has not achieved the same productivity growth as the other agricultural commodities. ABARES estimates that from 1977-78 to 2012-13 productivity in the Australian sheep industry improved at an average rate of 0.2% per year (whereas beef averaged 1.3% and cropping 1.5% productivity growth over the same period)[4]. However, more recently (between 2000-01 and 2012-13), productivity growth in the sheep industry has outpaced that of any other Australian broadacre industry, growing by an average of 2.3% a year.[5]

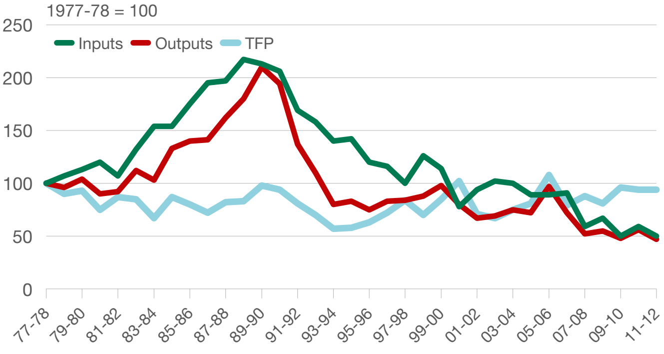
Although increasing competition for land and the cyclical nature of productivity remain significant constraints for the industry (and thus prices), the profitability outlook remains bright. While yearly slaughter lamb farm cash incomes have fluctuated in line with prices, input costs and productivity, Figure 9, shows that the long-run trend has been a steady increase (ABARES). In fact, over the last 20 years, cash incomes for slaughter lamb farms have more than doubled in real terms (2013-14 dollars), with a similar trend evident in slaughter lamb farm business profit.

Figure 7: Changes in farm land use and livestock



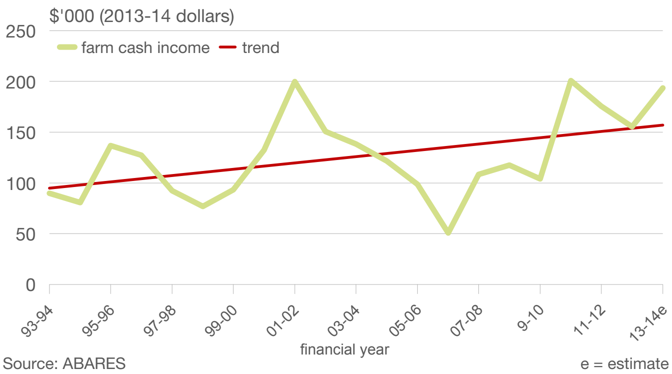
Source: ABARES

Figure 8: Productivity in the sheep industry



Source: ABARES

Figure 9: Australian slaughter lamb farm income



Source: ABARES

e = estimate

[2] ABARES, *Agricultural Commodities*, March quarter 2015

[3] TFP growth measures the growth in the ratio of total market outputs to total market inputs

[4] Therese Thompson and Peter Martin, *Australian beef: Financial performance of beef cattle producing farms, 201112 to 201314,* Australian Bureau of Agricultural and Resource Economics and Sciences, Research report 14.7, August 2014

[5] ABARES, *Agricultural Commodities*, March quarter 2015

KEY POINTS:

- Since its peak in 1990, the Australian sheep flock has gone through a 20-year contraction, with the wool crash of the early 1990s prompting significant structural change within the industry.
- The 1991 wool crash saw trade lamb prices dip to 216¢/kg cwt (in 2014 dollars) and mutton prices fall to just 20¢/kg cwt in 1991.
- Prices have since generally tracked on an upward trajectory, except in years heavily influenced by drought.
- The birth of the specialised meat sheep industry in Australia assisted a recovery in prices after the wool crash, generating increased global demand for higher quality lamb.
- The national sheep flock is forecast to contract 0.9% to 71 million head in 2015, before the rebuilding phase commences (provided a return to average seasonal conditions).
- Beyond the influence of rainfall, supply going forward also depends on returns relative to other commodities, such as wheat and wool.

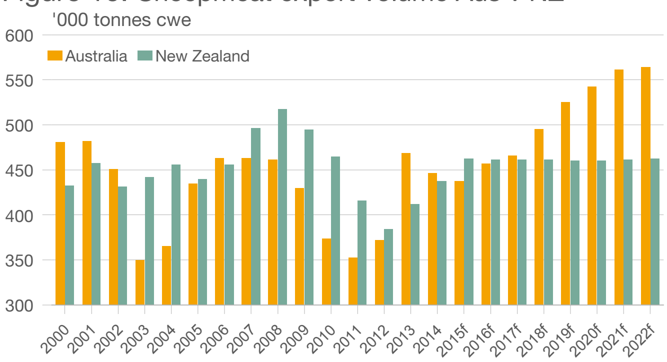
POSITIVE FUNDAMENTALS GOING FORWARD

All the factors that created the 2010-11 lamb and mutton price records are again present in 2015, including a low flock and strong export demand from the Middle East, US and Asia.

In fact, three further positive factors are present, which should provide greater stability in the market than was the case in 2011. These include a much lower exchange rate, liberalisation of the Australian sheepmeat trade to China (including co-products of the sheep industry) following the China-Australia FTA, and an expected reduction in the New Zealand flock and sheepmeat exports (Figure 10).

The main drag or risks to prices, as always, lie in the possibility of drought and unexpected trade disruptions.

Figure 10: Sheepmeat export volume Aus v NZ



Source: FAO-OECD f = forecast

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