Industry projections 2019

Australian sheep – June update

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KEY POINTS

- National flock to fall as the drought continues to bite
- Fewer expected lambs to limit winter and spring supply
- China and US demand underpin robust saleyard prices

KEY 2019 NUMBERS

Lamb slaughter: 21.2 million head

Lamb production: 477,000 tonnes cwt

Lamb exports: 254,000 tonnes swt

Sheep slaughter: 8.5 million head

* Graphic illustrates year-on-year change

Summary

Strong prices aside, 2019 has continued to be another extremely challenging year for the nation's sheep producers. Drought conditions have persisted in all key sheep production regions, with many producers now running significantly reduced flocks.

The dry conditions have led to sheep slaughter remaining elevated so far in 2019. However, there has been an easing trend through autumn and a slow-down is expected in the second half of the year as producers look to maintain their core breeding flocks. Overall, annual sheep slaughter has been revised slightly upwards and is now expected to fall 11% year-on-year, to 8.5 million head.

A reduced breeding flock and generally poor lambing rates, combined with a poor weather outlook for winter, is expected to disrupt lamb supply in the coming months. For the first quarter of 2019, lamb slaughter remained close to year-ago levels. However, supply is expected to tighten for the remainder of the year and, without a turnaround in conditions, producers will face similar challenges to last year in getting lambs to finished weights. Forecast national lamb slaughter has remained unchanged and is expected to decline 7% on 2018, to 21.2 million head.

The aforementioned seasonal challenges will drive a contraction in the national sheep flock, which is expected to fall to 65.8 million head by June 2019, down 6.8% year-on-year and an 8.7% fall since 2017.

Focusing on demand, the outlook remains positive for the industry. Both lamb and mutton prices have reached record highs in the last 12 months despite the drought that has gripped the nation. This has been underpinned by strong demand for Australia's sheepmeat exports, which continue to push new highs, bolstered by a declining Australian dollar and limited competition. The growth in demand from China and the US in particular, has translated into strong domestic farm gate prices, with the national mutton indicator breaking through 600¢/kg carcase weight (cwt) in May for the first time and lamb prices now on par with the record highs of August 2018.

Seasonal

Throughout 2019, rainfall has been insufficient in all key sheep production regions, compounding the effects of an extended two-year period of rainfall deficiencies. A small number of weather events have brought some decent falls, albeit not the consistent rain required to ease current deficits.

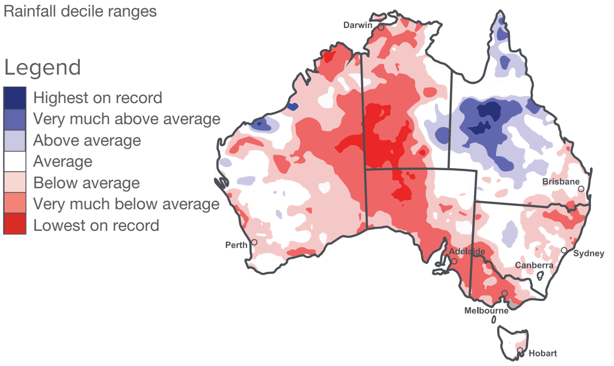
On the whole, NSW remains the worst affected with 99% of the state still drought-declared and many producers relying solely on supplementary feeding programs to maintain flocks. As the window for a decent autumn break has all but closed, some areas will likely have to wait until spring to see any major pasture recovery.

Elsewhere, very few regions across SA, WA and Victoria have been immune to the poor conditions. Forming a crucial component of Australian sheepmeat production, the absence of winter rain in these states may lead to a disruption in spring lamb supply – similar to what was experienced in 2018.

Turning to the Bureau of Meteorology's climate outlook for June to August, a drier-than-average winter is expected for all key regions Australia-wide.

Figure 1: Australian rainfall – February to April 2019

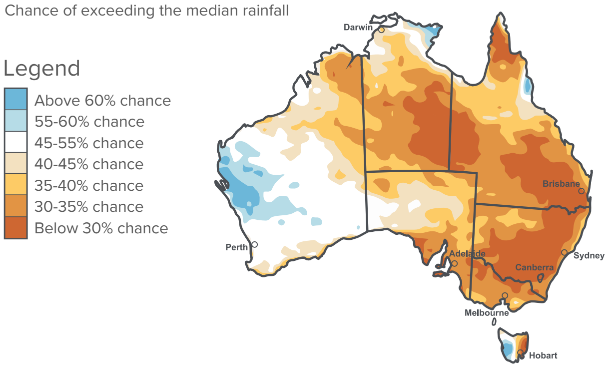
Rainfall decile ranges



Source: BOM

Figure 2: Australian rainfall outlook – June to August 2019

Chance of exceeding the median rainfall



Source: BOM

Flock and slaughter

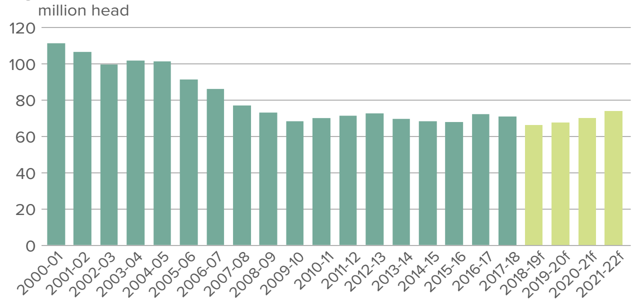
Heightened sheep slaughter, lower-than-expected lambing rates and an unfavourable weather outlook is expected to see the national flock fall to 65.8 million head by June 2019, a decline of 6.8% year-on-year. The fall represents the largest year-on-year decline since 2008, when the Australian sheep industry was still undergoing a transition away from a Merino-based flock.

Despite the expectation for tightening supplies, first quarter lamb slaughter was up 1% year-on-year. The consistent lamb supply so far in 2019 is partially due to the highly irregular season, which has seen lambs that would typically reach slaughter weights last October to December hitting the market later than usual. In addition, faced with a lack of pasture, some producers were forced to offload more lambs earlier than initially planned.

Reported lambing rates have been generally disappointing, with some exceptions from producers who have been heavily supplementary feeding. There has also been large variability and broadly lower than average reported scanning rates. However, some producers have achieved improved results, having opted to re-join following poor initial scanning results.

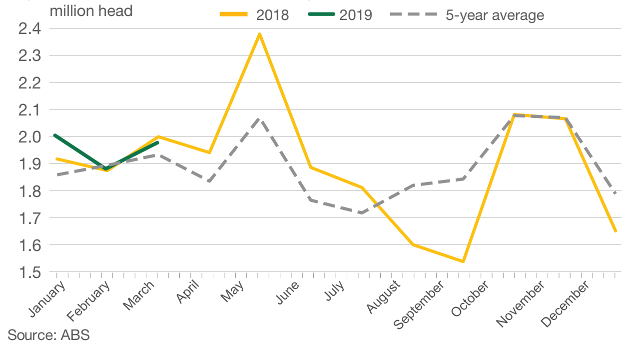
Considering the poor scanning rates, significant culling of breeding ewes and uncertainties regarding seasonal conditions moving forward, an already unpredictable season is likely to persist for the remainder of the year.

Figure 3: National flock



Source: ABS, MLA forecasts

Figure 4: National lamb slaughter



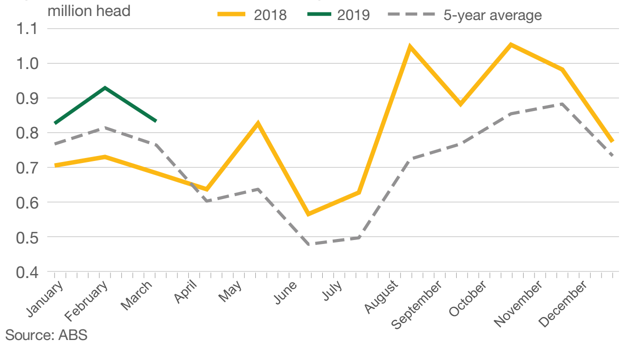
Source: ABS

The aforementioned challenges will almost certainly see a reduction in lamb slaughter during winter to spring, while seasonal conditions will play a huge role in the timing of future supply. Overall forecast annual lamb slaughter remains unchanged from the January projections, at 21.2 million head, down 7% on 2018.

In the first quarter of 2019, national sheep slaughter was up 22% on 2018 levels, to 2.6 million head. Projected annual sheep slaughter has been revised upward, to 8.5 million head, back 11% on 2018. Sheep slaughter is expected to slow towards the back end of 2019 and into 2020, as producers look to consolidate their flocks following a period of heavy destocking. As always, sheep slaughter remains highly-related to the weather, hence a faster improvement in conditions will likely see an even more significant slow-down in breeding ewe slaughter.

Under the assumption of average conditions from spring 2019 and the incentive provided by high lamb and wool prices, sheep supply is projected to decline substantially in 2020 as producers commence flock rebuilding. Subsequently, a significant recovery in the flock is expected from 2020 to 2023. Lamb slaughter and production are also projected to recover from 2020.

Figure 5: National sheep slaughter



Source: ABS

Carcase weights and production

Average carcase weights have, in the long-term, followed a consistent upwards trend, due to improvements in genetics and production systems, as well as a continued transition away from Merino lambs towards first and second-crosses. However, with no significant change in the season, average carcase weights for sheep and lambs have remained fairly stable in 2019, following a modest decline in 2018.

Expected lamb carcase weights for 2019 remain unchanged from 2018 levels, at 22.5kg cwt. High prices for finished lambs are encouraging producers and feedlots to supplementary feed lambs to maintain weights, despite poor pasture availability and high grain prices.

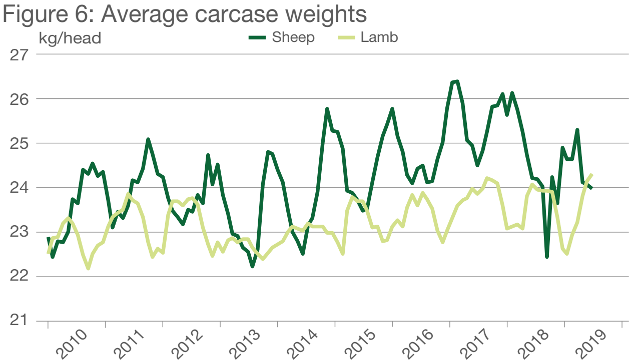
Average sheep carcase weights have been revised down, as drought conditions continue across large parts of the country. 2018 sheep carcase weights were just below the five-year average (23.7kg cwt) and are expected to decrease to 23.4kg cwt in 2019.

Total sheepmeat production is expected to be lower in 2019, as slaughter levels ease in the second half of the year. Lamb production is expected to be 477,000 tonnes cwt, down 7% year-on-year, and mutton production is now forecast to be 12% lower than 2018, at 199,000 tonnes cwt.

Average carcase weights are not expected to deviate outside the seasonal norm for the rest of the year. The usual decrease through the winter could potentially be more pronounced as the southern wet season (April to November) has yet to come to fruition. However, very strong prices will continue to provide encouragement to grain feed both sheep and lambs to heavier weights.

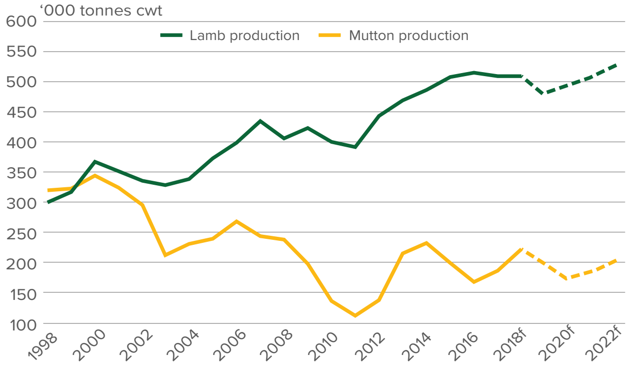
The amendment to the definition of lamb, expected to come into effect on 1 July 2019, will be a factor that could encourage further increases in average carcase weights in the future. The new definition, allowing lambs to have permanent incisor teeth erupted but not in wear, will give producers an estimated 30 extra days to finish lambs. This would provide producers with greater confidence to extend feeding and finish lambs to heavier weights.

Figure 6: Average carcase weights



Source: ABS

Figure 7: Lamb and mutton production



Source: ABS, MLA forecasts

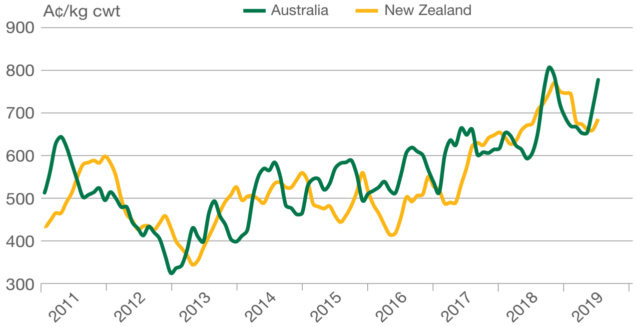
International markets

Amid the current drought-induced elevation in sheepmeat production, strong global demand has acted as the counterbalance supporting Australian lamb and mutton prices. Sheepmeat exports have grown year-on-year across most markets during the first four months of 2019, with the US and China the standout performers. Despite sheepmeat exports from New Zealand also recording a strong start to the year, global markets have proved willing buyers and soaked up surplus supply without lowering prices.

In fact, combined, Australia and New Zealand exported unprecedented first quarter lamb volumes in 2019 with prices recording the strongest start to the year on record. Currently exports simply cannot keep pace with global demand, a divergence that will become particularly acute as seasonal lamb supplies begin to dry up in Australia and New Zealand over winter.

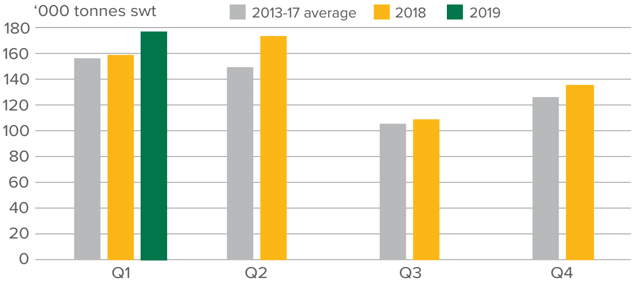
Despite an elevated start to the year, exports are forecast to contract throughout the remainder of the year as the handbrake is applied to supply. Lamb exports are forecast to finish the year 6% below 2018 levels, at 254,000 tonnes shipped weight (swt), and mutton to contract 9%, to 160,000 tonnes swt.

Figure 8: Australia and NZ lamb prices



Source: MLA (18-22kg cwt trade lamb), NZ AgriFax (17.5kg cwt lamb). Prices up to April 2019.

Figure 9: Australian and NZ total lamb exports

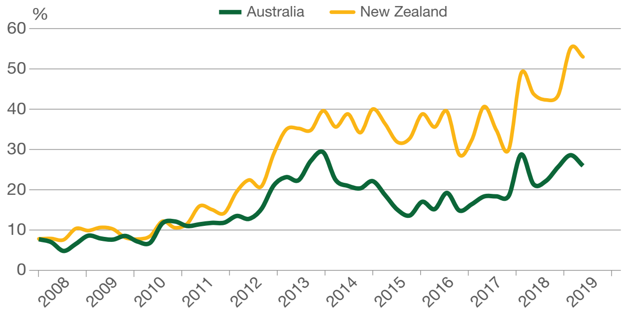


Source: Statistics NZ, DAWR

China

The most significant transformation in export dynamics in recent years has come from China, purchasing record volumes of imported product in 2018 and continuing to ramp up sheepmeat imports in 2019. For New Zealand, China now represents half of total sheepmeat exports; for Australia, it is closer to a quarter. While both countries have greatly benefitted from China, the market remains sensitive to fluctuations in its domestic flock (which accounts for 95% of consumption) and risk of the the ongoing trade war slowing down economic growth. However, with domestic production increasingly unable to satisfy appetites from an expanding class of affluent consumers, Chinese demand does not appear to be slowing, even as sheepmeat retail prices reach record highs. Sheepmeat imports may find further support from the impending pork deficit later this year and in 2020 in the wake of African Swine Fever, but availability and price point suggest poultry, seafood and imported pork may record the greatest shift.

Figure 10: Share of sheepmeat exports destined for China



Source: DAWR (Australia); Statistics NZ (NZ)

During the first four months of 2019, Australian lamb exports to China increased 22% year-on-year, to 21,000 tonnes swt, while mutton shipments surged 99%, to 22,000 tonnes swt.

United States

After years of contraction, per capita US sheepmeat consumption has been edging higher since 2013, underpinned by growing familiarity and willingness to try lamb amongst millennials, increased incidence on US menus and a post-GFC economic recovery.

Australian lamb exports during the first four months of 2019 jumped 27% year-on-year, to 23,000 tonnes swt, spurred on by limited supply coming off Colorado feedlots. New Zealand also recorded strong growth, with lamb shipments up 46% year-on-year during the first quarter, at almost 8,000 tonnes swt. Encouragingly, the increased sheepmeat trade appears to be flowing through to consumers, with US sheepmeat in cold storage declining in February and March after opening the year at burdensome levels.

While the US lamb market has been a strong performer in 2019, if the unresolved trade-war eventually impacts the economy, lamb demand could suffer due to it being a relatively high-priced niche product and geared towards foodservice.

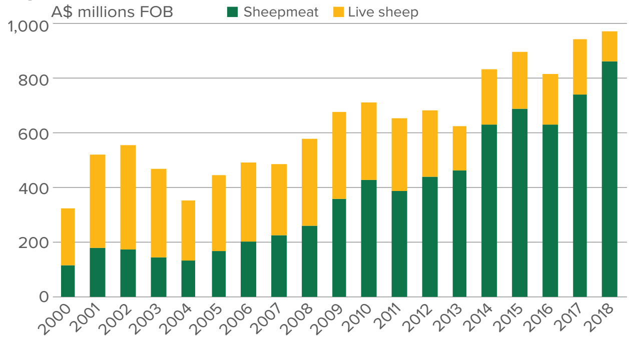
Middle East

Sheepmeat exports to the Middle East have tracked close to 2018 levels so far this year, though volumes have varied between markets and generally expanded for lamb and withdrawn for mutton.

Australian lamb exports to the United Arab Emirates, Australia's largest and highest value sheepmeat market in the region, expanded 13% year-on-year so far in 2019, with increased shipments of high value chilled cuts. Australian chilled lamb carcase exports to Iran have also increased significantly year-on-year, driven by a lack of domestic supply and rising prices in the country. However there has been a drop in exports to some of the more price-sensitive markets including Saudi Arabia, Qatar, Oman and Jordan.

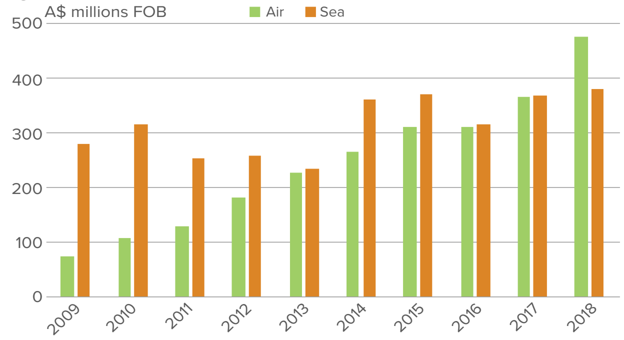
Australian sheepmeat – from imported primals, carcases or live animals – remains a major source of protein across the Middle East. However, to supply fresh sheepmeat into the market and meet strict shelf life requirements, and to offset the reduced sheep export volumes, there has been a significant shift to air-freight product. More recently, after opening up to imports in 2017, Iran accounted for half the growth in chilled air-freight trade to the region in last year. In fact, air-freight exports exceeded sea-freight product for the first time in 2018 on a volume and value basis.

Figure 11: Export value to MENA



Source: IHS Markit

Figure 12: Sheepmeat exports to MENA-10



Source: IHS Markit

Live exports

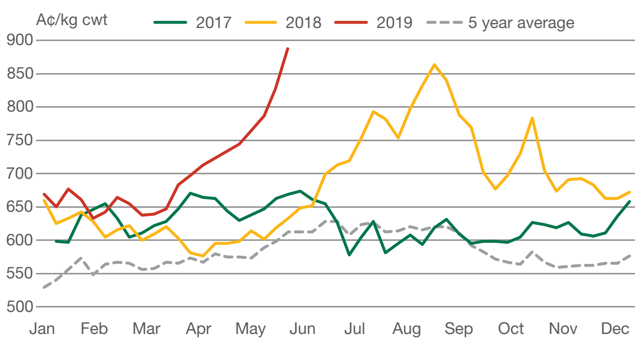
The outlook for the Middle East live sheep trade remains challenging. Despite tracking close to 2018 levels during the first four months of 2019, the trade to the Middle East will cease over the Northern Hemisphere summer period (June–August) and changes to stocking density could reduce the shipping capacity by 20% or more during operating months. Broader political and community considerations add further uncertainty to the long-term future of the trade.

Assuming, the trade can operate within the proposed timing and stocking density regulatory changes, MLA is forecasting 2019 exports to finish close to 1.1 million head – about half the 2013-2017 five year average.

Prices

Sheep and lamb prices have accelerated in 2019 – as was anticipated – albeit the timing and extent of the lift has been unseasonal. It is highly unusual to have record or near-record lamb and sheep prices while in the midst of a severe drought. Elevated sheep and lamb slaughter for the year-to-date has not been enough to curb prices, which have responded to a combination of outside factors, especially high global demand and a lower Australian dollar.

Figure 13: National saleyard trade lamb indicator



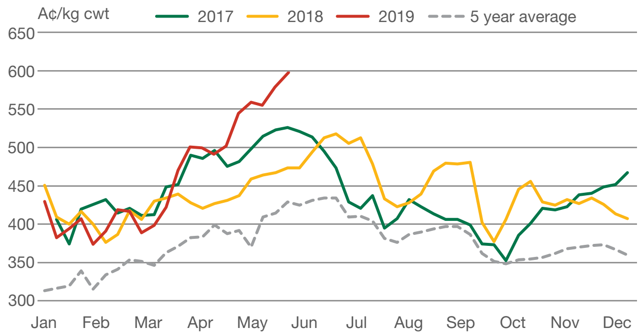
Source: MLA

The national saleyard trade lamb indicator opened the year at 657¢/kg and has since advanced to 888¢/kg, 40% above year-ago levels. Since March, the indicator has diverged from year-ago levels, but is following a similar trajectory to the price rise apparent from April through September in 2018. A similar margin of increase has already brought the indicator in line with the record prices witnessed last year. The prospect of limited lamb supply through winter – as was the case in 2018 – combined with robust international demand, tightening New Zealand supplies and a low Australian dollar will continue to support Australian lamb exports and, in turn, domestic saleyard prices. Additionally, any significant improvement in pasture conditions would provide further upside potential as many producers are eager to rebuild on the back of strong prices signals from both wool and sheepmeat.

Mutton prices have also rallied, largely driven by export demand, as close to 95% of all mutton produced is destined for overseas markets. The national saleyard mutton indicator, at the start of January was 421¢/kg cwt, 12% back on the year prior. However, on 28 May the indicator tipped 600¢/kg cwt, continuing to set new records as the season progresses.

The forecast drop in sheepmeat production in 2019 should keep lamb and mutton prices historically high throughout the year, with additional upside possible if improved seasonal conditions spark restocker activity.

Figure 14: National saleyard mutton indicator



Source: MLA

Situation and outlook for the Australian sheep industry

		2014	2015	2016	2017	2018	*2019f*	*% change 2019f on 2018*	*2020f*	*2021f*	*2022f*	*% change 2022f on 2018*
Sheep and lamb numbers ('000 head)*												
As at 30 June		69,361	68,025	67,543	72,125	70,607	*65,840*		*67,100*	*70,000*	*73,570*	*4%*
Percentage change		-4.2%	-1.9%	-0.7%	6.8%	-2.1%	*-6.8%*		*1.9%*	*4.3%*	*5.1%*	
Slaughterings ('000 head)												
Sheep		10,086	8,487	6,965	7,536	9,521	*8,500*	*-11%*	*7,000*	*7,200*	*7,800*	*(18%)*
Lamb		22,251	22,876	22,956	22,431	22,725	*21,200*	*-7%*	*21,750*	*22,200*	*22,850*	*1%*
Avg carcase weight (kg)												
Sheep		23.2	23.7	24.4	24.8	23.7	*23.4*	*-1%*	*24.8*	*25.0*	*25.1*	*6%*
Lamb		21.9	22.2	22.5	22.7	22.5	*22.5*	*0%*	*22.8*	*22.9*	*23.0*	*2%*
Production ('000 tonnes carcase weight)												
Mutton		234	202	170	187	225	*199*	*-12%*	*174*	*180*	*196*	*(13%)*
Lamb		486	509	516	509	511	*477*	*-7%*	*495*	*507*	*526*	*3%*
Sheep exports ('000 tonnes)**												
Mutton	shipped weight	186	151	132	147	176	*160*	*-9%*	*139*	*145*	*158*	*(10%)*
	carcase weight	223	181	161	179	215	*195*	*-9%*	*170*	*177*	*193*	*(10%)*
Lamb	shipped weight	237	234	242	251	270	*254*	*-6%*	*267*	*279*	*294*	*9%*
	carcase weight	280	277	290	302	324	*304*	*-6%*	*321*	*335*	*353*	*9%*
Domestic utilisation ('000 tonnes c/c weight)***												
Lamb		207	231	226	207	187	*173*	*-8%*	*174*	*173*	*172*	*(8%)*
kg/head***		8.8	9.7	9.3	8.4	7.5	*6.8*		*6.8*	*6.6*	*6.5*	

Source: ABS, DAWR, MLA forecasts

f = forecast (in italics)

* From 2019 is an MLA estimate based on ABS Data. Please note, the flock estimates are based off the new EVAO cut off used by the ABS. Previously this was $5,000 EVAO, but was changed upwards to $40,000 EVAO. For more information, please visit www.abs.gov.au

** excl. canned/misc, shipped weight

*** Domestic meat consumption is measured by removing the portion of exports (DAWR data) from total production (ABS data) and assuming the difference is consumed (or at least disappears) domestically. Imports are also added to domestic consumption when present. Per capita consumption is calculated by dividing domestic consumption by ABS population data. Please note that domestic per capita consumption is entirely a supply statistic and does not take account of waste or non-food uses of livestock meat products.

^ Much uncertainty remains on the outlook for live exports and future forecasts will reflect developing trading, regulatory and social licence impacts upon the live export industry's ability to operate.