

Industry projections 2019

Australian sheep

MLA's Market Intelligence – globalindustryinsights@mla.com.au

KEY POINTS

- Flock to contract further until rainfall deficiencies ease
- Lamb slaughter to fall due to reduced flock and poor lambing rates
- Mutton production to drop from recent highs
- Strong demand, led by China, to support prices



KEY 2019 NUMBERS

- ➔ **Lamb slaughter:**
21.2 million head
- ➔ **Lamb production:**
475,000 tonnes cwt
- ➔ **Lamb exports:**
247,000 tonnes swt
- ➔ **Sheep slaughter:**
8.0 million head

* Graphic illustrates year-on-year change

Summary

The poor conditions that marred 2018 will have a significant impact on sheepmeat supply in 2019, with lamb slaughter forecast to be its lowest since 2012. Dry conditions, which have led to substantial drops in marking rates and the extensive culling of ewes and ewe lambs, underpins the forecast for a 7% decline in lamb slaughter in 2019, at 21.2 million head.

In the year ahead, many producers will be hoping for some consistent rainfall to help alleviate the pressures associated with high feed costs. Unfortunately, the current Bureau of Meteorology (BOM) three-month outlook does not point to a considerable turnaround in seasonal conditions. Considering the substantial moisture deficiencies apparent in many regions, particularly NSW, any improvement in conditions would require consistent 'above-average' rainfall over the coming months. As a result, sheep slaughter is forecast to remain near long-term averages at 8 million head, but back from the large numbers processed in 2018.

Both sheep and lamb carcase weights were impacted by the tough conditions and high cost of feed in 2018. This is expected to continue in 2019 with feedstocks depleted and feed demand to remain high until conditions improve. A fall in slaughter and carcase weights drives the 7% forecast decline in lamb production for 2019 to 475,000 tonnes carcase weight (cwt). Mutton production will likely see a steeper drop of 16% to 188,000 tonnes cwt.

The national flock is estimated to have declined by over 4 million head, or 6.1%, by mid-2018 and is forecast to experience a further decline of 3.7% to mid-2019 as many producers are forced to continue destocking as they wait for a turnaround in the weather. Longer term, high prices across both sheepmeat and wool provide a strong incentive for producers to rebuild their heavily depleted breeding flocks once conditions allow.

Fortunately, robust international demand and a low Australian dollar will continue to support Australian exports and, in turn, domestic saleyard prices. Records were broken in 2018 as markets around the world competed strongly for Australia's high quality sheepmeat. The expectation for supply, and consequently exports, to decline in both Australia and New Zealand will likely see global competition for sheepmeat intensify in 2019. The conditions that drove strong prices for well-finished stock last year look likely to remain in place in 2019, particularly whilst conditions remain dry.

Assumptions

For the purpose of these projections, average to below-average rainfall has been assumed for the first four months of 2019 for Australia's sheep producing regions, based on the Bureau of Meteorology (BOM) three-month outlook. A return to more average conditions have been factored in out to 2022. With the exception of WA, SA and western Victoria, the BOM has given most regions an equal likelihood of receiving either 'above average' or 'below average' rainfall. Above average temperatures are predicted to continue. This outlook follows an extremely challenging 2018 and appears to provide little relief to the widespread rainfall deficiencies across Australia.

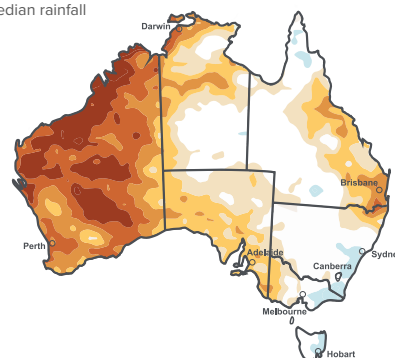
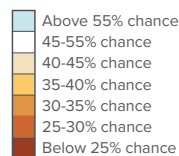
The Australian dollar eased in 2018 against all major currencies, including the US dollar (-13%), Japanese yen (-11%), Korean won (-9%), Chinese renminbi (-5%), euro (-5%) and New Zealand dollar (-5%). The Australian-US exchange rate moved 10US¢ lower over the course of 2018, opening at 81US¢ before closing the year at 71US¢ and recently dipping below US70¢ for the first time since 2016.

The major banks have largely similar views for the Australian dollar in 2019, with forecasts ranging from 70US¢ to 75US¢. The performance of the Australian dollar, versus other major currencies, will be driven by comparative economic performance and how trade tensions impact the broader global economy.

Fluctuations in the Australian dollar are, as ever, extremely difficult to predict. Hence, current exchange rates are assumed for these projections but any major swings in exchange rates may have a significant influence.

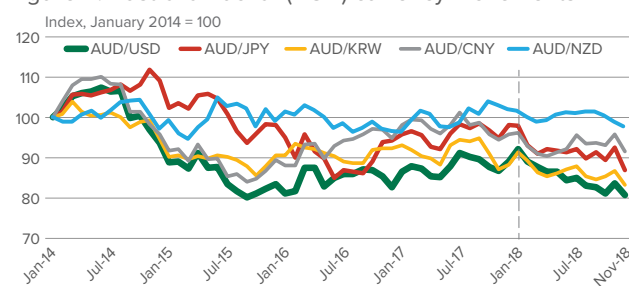
Figure 1: Australian rainfall outlook February to April 2019
Chance of exceeding the median rainfall

Legend



Source: BOM

Figure 2: Australian dollar (AUD) currency movements



Source: Reserve Bank of Australia

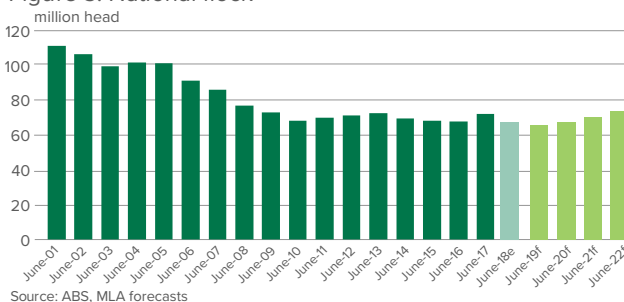
Flock and slaughter

After an increase of 6.8% in 2017, the national sheep flock is estimated to have declined over 6% to around 67.7 million head by June 2018. This decrease was predominantly driven by a 27% year-on-year drought-induced increase in sheep slaughter in 2018 and, to a lesser extent, a 2% increase in lamb slaughter over the same period.

The first six months of 2018 saw unseasonably high lamb slaughter – the first time national slaughter has exceeded 12 million head over the first half of the year – before declining through winter and early-spring as it became more difficult to finish lambs. Sheep slaughter saw inverse trends. As the season deteriorated through the winter of 2018, sheep slaughter spiked as many producers worked hard to reduce stocking rates and feeding costs and processors sought to keep kill floors running.

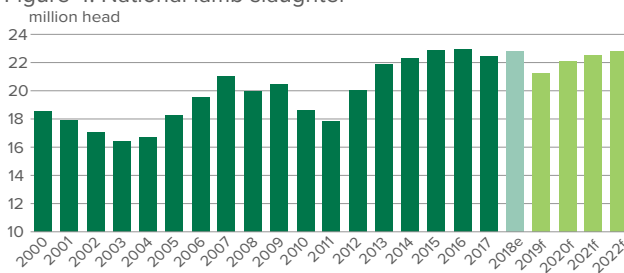
The significantly reduced breeding flock, poor current conditions and negative rainfall outlook, suggest fewer joinings than usual and a continuation of the lower-than-average lambing rates experienced in 2018. As a result, lamb slaughter is forecast to be down 7% in 2019 at 21.2 million head, while sheep slaughter is predicted to be down 16%, at 8.0 million head.

Figure 3: National flock



Source: ABS, MLA forecasts

Figure 4: National lamb slaughter



Source: ABS, MLA forecasts

With slaughter still predicted to be relatively high, and no obvious break in the season imminent, the national flock is expected to decline 3.7% by June 2019 to 65.3 million head. In the event of widespread 'average' or 'above-average' rainfall occurring from autumn, lamb and sheep slaughter would likely be restricted further, as producers look to rebuild flocks to take advantage of the strong prices – pushing the national flock back towards 70 million head.

One factor that has potential to impact the number of lambs slaughtered in 2019 is the changing definition of lamb. The proposed definition will include any young sheep under 12 months of age or which do not have any permanent incisor teeth in wear – in line with New Zealand standards. Under the current definition they become mutton as soon as eruption occurs. This may give producers around an extra 30 days to finish lambs – resulting in more slaughter stock meeting the lamb classification, but likely having little impact on aggregate slaughter numbers.

Figure 5: National sheep slaughter



Carcase weights and production

Improved pasture management, supplementary feeding programs and a shift in the flock composition towards meat and dual-purpose breeds have underpinned long-term growth in carcase weights. However, these factors faced off against deteriorating seasonal conditions during the 2018 winter and spring, leading to a decline in average carcase weights for both sheep and lambs.

The average national lamb carcase weight for 2018 is estimated to have declined to 22.4kg/head from 22.7kg in 2017. Elevated slaughter, particularly in the first six months of the year, helped to offset the decline in carcase weights. As such, lamb production is estimated to have reached 510,000 tonnes cwt in 2018, unchanged on 2017.

As flock downsizing ramped up during winter, sheep carcase weights became more volatile. The national average sheep carcase weight is estimated to have averaged 23.5kg/head in 2018, down 6% on 2017. High turn-off more than compensated for the decline in carcase weights, with production anticipated to have risen 19% to 224,000 tonnes cwt.

In 2019, the big question is how carcase weights will recover, as productivity improvements will once again be pitted against a variable climate. Given the sub-optimal start to the season in many key production regions, the more likely scenario is for the long-term upward trend in carcase weights to remain hindered by seasonal conditions and high feed costs.

Figure 6: Average carcase weights

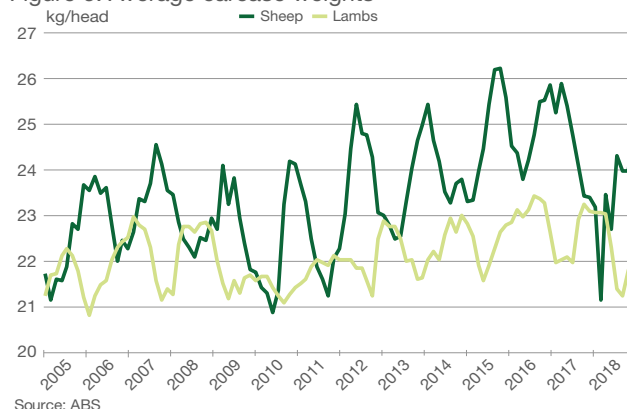
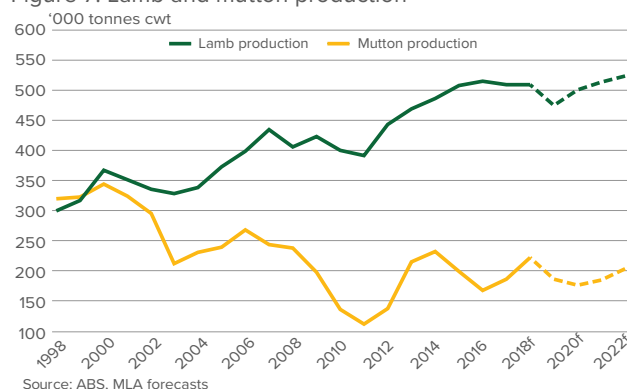


Figure 7: Lamb and mutton production



While the forecast for 2020 onwards is for a continued gradual rise, the average lamb carcase weight is expected to remain around 22.4kg/head in 2019. In terms of volume, lamb production is forecast to fall 7% to 475,000 tonnes cwt, its lowest levels in the last five years.

The national average sheep carcase weight is expected to stabilise in 2019, at 23.6kg/head, with production forecast at 188,000 tonnes cwt, down 16% year-on-year.

Domestic demand

Australia's consumption of lamb came under pressure in 2018, as volatile supply and strong international demand combined to drive domestic prices into record territory. Domestic lamb consumption has remained resilient in recent years, despite the increases in retail prices. However, stagnant wage growth and increased living costs have driven many consumers to become more price sensitive and, subsequently, lamb consumption eased in 2018. However, with per capita lamb consumption around the 7.5kg mark and lamb capturing a 12% share of fresh meat retail sales value last year, Australia remains one of the largest per capita consumers of sheepmeat in the world.

Pricing remains the biggest driver of falling lamb consumption and this was exacerbated in 2018, with the indicative retail price in the first nine months averaging \$15.32/kg and exceeding last year's record highs. This 3% jump in average retail price is quite significant when compared to chicken which rose only 1%, beef being flat and pork easing 1%. This is in-line with longer-term trends, with lamb's relative price to pork increasing significantly in the last 20 years, from a 10% discount in 1998 to a 31% premium in 2018 (year-to-September). Lamb's retail price has increased by more than 50% in the last 15 years, while pork has increased only 31% and chicken just 6%.

The growth in sales of lamb mince (one of the cheapest lamb products) while many other products/cuts declined indicates consumers are seeking cheaper offerings to keep lamb on the plate.

Lamb remains one of Australia's favourite proteins and has a unique role in the national diet. However, further pricing pressure, due to forecast supply constraints and ongoing strong international demand, will likely see Australia's per capita consumption continue to dip in the coming years. Justifying lamb's premium to shoppers will be crucial to keeping lamb in Australian consumers' repertoire.

Figure 8: ABS retail price – Lamb index to pork

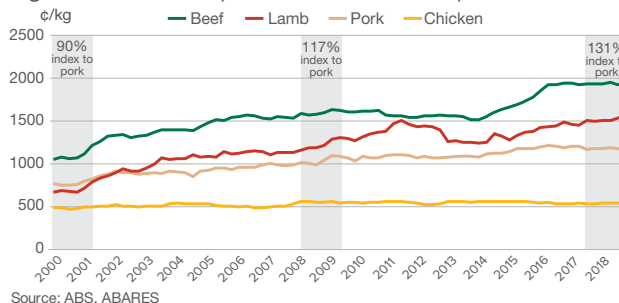
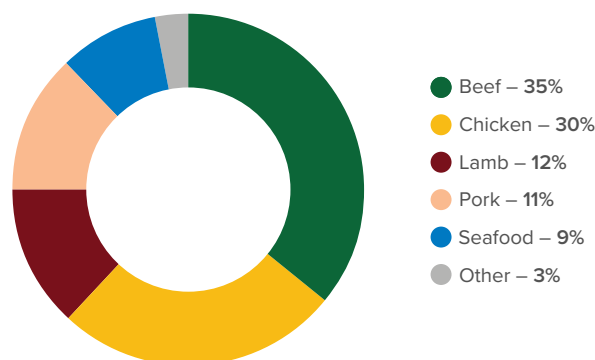


Figure 9: Retail fresh meat value share in Australia – 2018



International markets

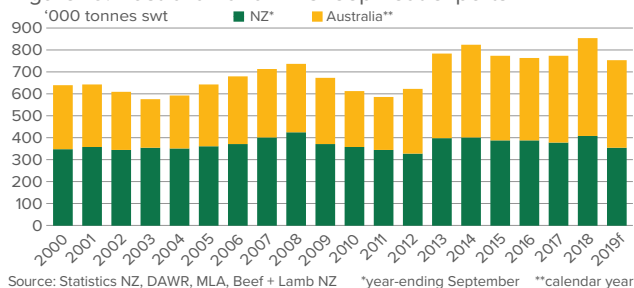
Sheepmeat supply out of Australia and New Zealand – which account for more than 70% of global trade – has been unable to keep pace with strong global demand, led by China in 2018. Global sheepmeat consumption encompasses a broad mix of product types and cuisines but, broadly, it remains a niche, premium component of many diets. Australian sheepmeat exports have benefitted from broad-base strong demand, with shipments to its three largest markets – the US, China and the Middle East – all breaking records in 2018.

Forecasts for the Australian dollar indicate further support for exports, as was the case throughout the second half of 2018, with the major Australian banks predicting the Australian dollar to remain below 75US¢ during 2019.

In 2018, Australian lamb exports increased 7% year-on-year to a record 267,000 tonnes shipped weight (swt), while mutton shipments jumped 23% to 180,000 tonnes swt. Reflecting a reduced flock and limited supply, 2019 lamb exports are forecast to contract 8% to 247,000 tonnes swt, while mutton is projected to fall 16% to 151,000 tonnes swt.

New Zealand sheepmeat exports are anticipated to follow a similar trend as it grapples with its own supply shortages. New Zealand lamb exports for the year-ending-September 2019 are expected to contract (1.7%) for the fourth consecutive year to 284,000 tonnes swt, while mutton is expected to fall 16.9% to 71,000 tonnes swt (Beef + Lamb NZ).

Figure 10: Australian and NZ sheepmeat exports



This simultaneous contraction in the supply base of the two leading exporters will restrict trade and keep pressure on global prices. Fortunately for Australian producers, new entrants – similar in scale to Australia or New Zealand– are not present or competitive enough to steal market share over the coming year.

However, there are still risks facing the global economy, with demand for Australian sheepmeat exposed to the unfolding trade war between the US and China – Australia's two largest export markets. If either economy continues to slow, or a contraction evolves into a broader global recession, consumer purchasing power for premium sheepmeat may decline. While so far avoiding any direct blowback from a protectionist shift in US trade policy, the export-oriented Australian sheep industry remains vulnerable to an escalation of tariffs or other countries following suit and imposing trade barriers.

Figure 11: Lamb exports by destination

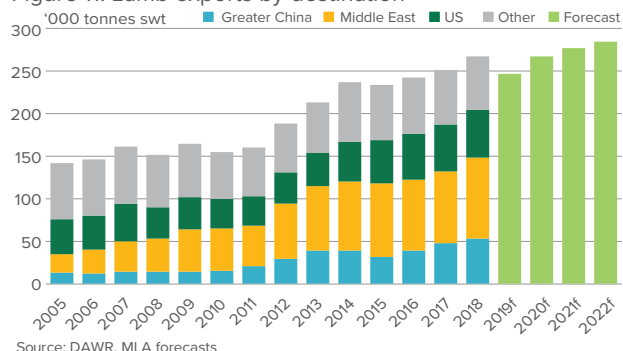
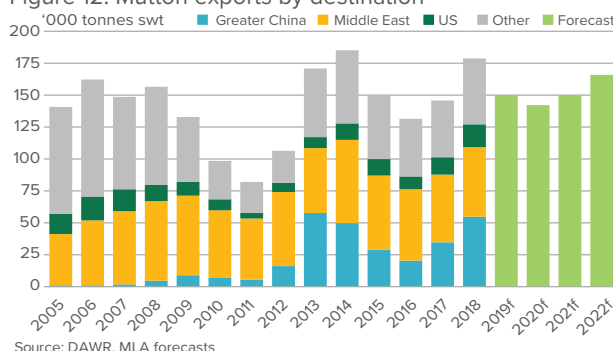


Figure 12: Mutton exports by destination



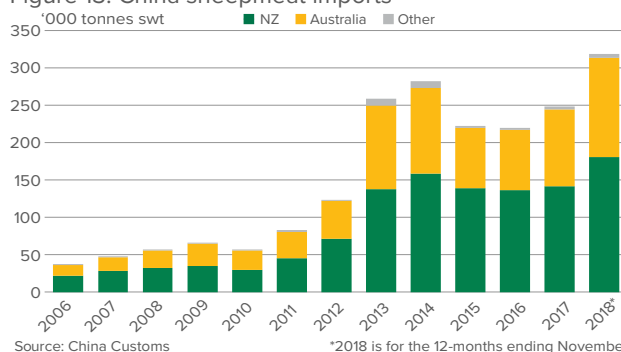
China

China – the world's largest producer, consumer and importer of sheepmeat – was the standout market of 2018, recording a 10% and 57% surge in Australian lamb and mutton trade, respectively. An expanding number of households who can afford and are eager to consume sheepmeat underpins the growth in exports to China, with additional import requirements in 2018 compounded by a cyclical low in domestic supply.

New Zealand also recorded a surge in sheepmeat trade to China where it remains the market leader – in the 12 months ending November 2018, China sheepmeat imports from New Zealand were up 33% year-on-year, at a record 181,000 tonnes swt. While Uruguay and Chile export some sheepmeat to China, they remain minor players with limited growth prospects.

For Australia, China remains an important market for breast and flap, where it is used in a variety of stew, soup and hot pot dishes. Sheepmeat also features in western and high-end foodservice and opportunities exist for growth in retail, but overall sheepmeat still plays a relatively niche role in consumer diets.

Figure 13: China sheepmeat imports



The discovery and spread of African swine fever in China in 2018 will likely lead to some additional requirements for imported meat protein. However, imported pork and chicken will find the greatest support given their dominant role in consumer diets and price point. While expected to remain a major market in 2019, risks for imported sheepmeat demand include a further slowdown in the Chinese economy or an over-reaction by local producers ramping up supply in response to current strong market signals.

US

Despite China's growth in 2018, the US continues to be Australia's largest export lamb market and most valuable sheepmeat market. Lamb consumption in the US remains small and is often concentrated in east and west coast cities and within certain demographic groups. Australia leads New Zealand in the imported lamb market, which has continued to record steady growth as domestic US supply recedes. In addition to a long-term contraction, domestic supply may be particularly tight in the first quarter of 2019 given an 8% year-on-year contraction in Colorado sheep-on-feed in November.

Strong US economic expansion in 2018 supported lamb demand, particularly through the foodservice channel. However, tight Australian lamb supplies in early spring and buying competition from other markets pressured US imported lamb prices higher, particularly Australian lamb racks, limiting retail features over Thanksgiving and the Christmas period. High prices will continue to test growth in the market, at a time of abundant and cheap competing proteins.

Middle East

Total sheepmeat exports to the Middle East grew in 2018 but performance was mixed on a market-by-market basis. The United Arab Emirates remains Australia's largest destination in the region, expanding 3% year-on-year to almost 30,000 tonnes swt in 2018. Exports to Qatar – fuelled by demand from migrant workers constructing the 2022 World Cup infrastructure – surged 45% year-on-year to 25,000 tonnes swt. Meanwhile, shipments to Iran more than doubled to 11,000 tonnes swt, following a contraction in domestic supply and the lifting of sanctions in 2016 (despite the US reimposing sanctions in 2018 and the economy and currency coming under significant pressure).

However, mutton exports to other markets, particularly Saudi Arabia and Bahrain, contracted amid the emergence of China bidding prices higher. The region remains sensitive to the price of oil and regional conflict. However, broader socio-economic trends and limited local supply, due to drought and resources constraints, underpin long-term growth opportunities for imported sheepmeat.

EU and UK

Australia, once again, fully utilised its country specific EU sheepmeat quota (19,186 tonnes carcase weight equivalent) in 2018. However, developments in the market present both opportunities and risks for Australia's sheepmeat access in the short and long-term.

Most pressing, the chaotic Brexit process will likely mean Australia's existing sheepmeat quota will be split 80% and 20% between the UK and remaining EU (based on historical usage) respectively. While access overall will remain unchanged, further quantitative restrictions between both markets could have negative implications for Australian exports. The proposed change reduces Australian exporters ability to respond to customer demand between the EU and UK.

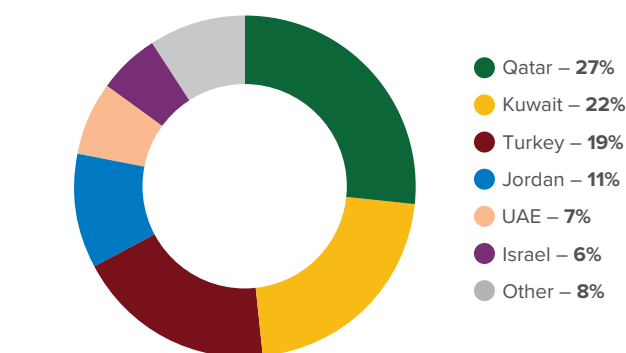
Longer term, however, the Australian Government commenced free trade negotiations with the EU mid-2018 and has signalled a desire to follow suit with the UK following Brexit. Given Australia's disproportionately small quota in comparison to New Zealand, and the regions large wealthy consumer base familiar with sheepmeat, the EU and UK present valuable growth opportunities, given expanded access.

Live exports

The sheep export industry is at a cross roads following a temporary cessation of trade in 2018 and an uncertain regulatory outlook. Sheep exports effectively came to a halt over the July-October period – during which 600,000–800,000 sheep would typically have been exported. Sheep exports finished 2018 at 1.1 million head – the lowest level in over three decades and testing the economies of scale the industry requires to operate. Over 2018's July-October period, there was an uptick in chilled carcase exports to some live export markets – notably Qatar and, to a lesser extent, Kuwait and the United Arab Emirates – however, many export-type sheep remained in WA paddocks.

As it stands, the industry has self-imposed an annual cessation of the sheep trade over the June-August period; however, additional regulation proposed may see this window expanded to the May-October period (a period which typically accounts for half the annual export volume). WA, which accounts for over 80% of national sheep exports, would have its existing slaughter capacity hard pressed to process the full additional volume of sheep currently live exported, if there was a sudden all-out trade closure – either through the industry contracting to an unviable size or through political intervention. If this occurred it may result in some sheep being freighted to the eastern states for processing in the short term, as the WA kill capacity expanded and/or the state flock contracted.

Figure 14: Live exports in 2018



Source: ABS, DAWR, MLA forecasts

Meanwhile, the demand for live sheep across the Middle East will continue, given the preference for freshly slaughtered animals, and replacement sheep will likely be drawn from Sudan, Somalia, India, Romania and Georgia.

The outlook for Australian live sheep exports remains uncertain and hinges on the implementation and timeline of regulations. Assuming the industry can operate at a reduced scale, exports are expected to range from 850,000–1,350,000 head over coming years (dependent on a three or six-month annual trade cessation). Given the outlook is uncertain, MLA will continue to update its forecast throughout 2019 as more information comes to light.

Prices

Lamb prices rose to unprecedented highs in 2018, bolstered by international demand and a supply shortage of finished lambs, particularly during the winter months. The mutton market, while more subdued, found an encouraging level of support despite the substantial increases in supply.

The national saleyard trade lamb indicator averaged 681¢/kg cwt in 2018, which was 28% above the five-year average and 8% up on the year prior. Given the difficulties in achieving weight gains, a supply shortage of finished lambs began to develop during winter. As such, heavy lambs began trading at a premium to trade and restocker categories on a ¢/kg basis in July 2018, and have largely continued to do so since. The conditions that drove strong prices for well-finished stock look likely to remain in 2019, particularly while the outlook remains dry.

Lamb prices understandably stole most of the headlines during 2018; however, mutton may have been the real hero of the season. Prices remained historically strong, despite the drought induced supply influx. The national saleyard mutton indicator averaged 441¢/kg cwt in 2018, which was 33% above the five-year average and only -1% down on the year prior. However, not all sheep indicators performed so well, with the supply of lighter ewes increasing significantly over winter. This led to the category trading at a discount to the major mutton indicator.

Looking beyond the current rainfall deficiencies, a variety of indicators point towards 2019 continuing to be a positive year for sheepmeat prices, with many producers hoping this is the case as lower lamb and sheep sales and record feed costs affect profits. The forecast drop in sheepmeat production in 2019 should underpin prices across both lamb and mutton throughout the year, with further upside potential if improved seasonal conditions spark increased restocker activity.

Furthermore, robust international demand, a decline in New Zealand production and a low Australian dollar will continue to support demand for Australian exports and, in turn, domestic saleyard prices. Record prices were not only seen in Australia in 2018, with New Zealand's prices also reaching new heights, as demand from Asia, particularly China, increased and drove competition for high quality sheepmeat.

Broader global trends point to a bright future for the industry; however, seasonal conditions in Australia will likely have a stronger effect on prices in 2019. Lamb supply, particularly in NSW, seems set to remain volatile and while improvements in management practices place the national flock in a position to recover, nothing can replace timely, consistent rainfall.

Figure 15: Saleyard trade lamb indicator

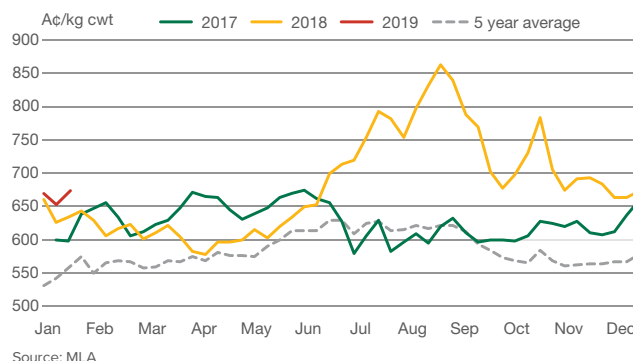


Figure 16: Australian and NZ lamb prices

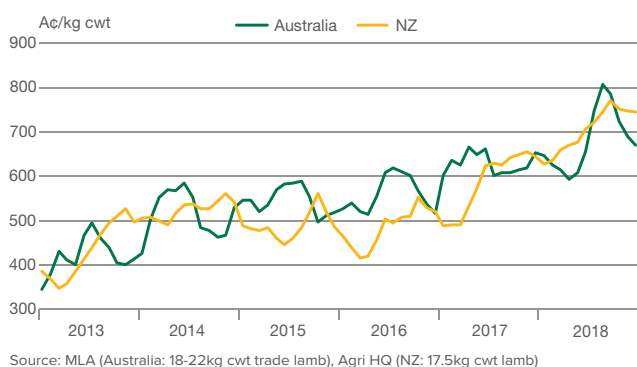
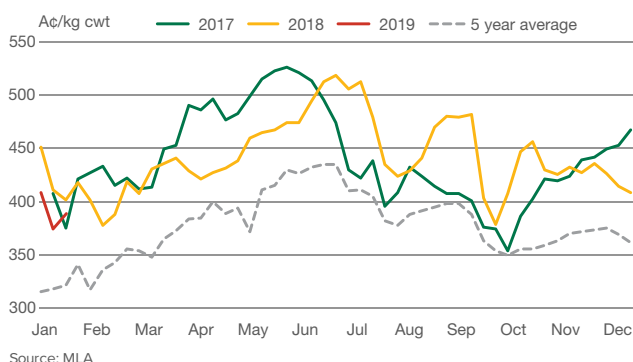


Figure 17: Saleyard mutton indicator



Situation and outlook for the Australian sheep industry

	2014	2015	2016	2017	2018e	2019 ^f	% change 2019 ^f on 2018	2020 ^f	2021 ^f	2022 ^f	% change 2022 ^f on 2018
Sheep and lamb numbers ('000 head)*											
As at 30 June	69,361	68,025	67,543	72,123	67,730	65,260		67,390	70,280	73,820	9%
Percentage change	-4.2%	-1.9%	-0.7%	6.8%	-6.1%	-3.7%		3.3%	4.3%	5.0%	
Slaughtering ('000 head)											
Sheep	10,086	8,487	6,965	7,536	9,550	8,000	-16%	7,200	7,500	8,200	(14%)
Lamb	22,251	22,876	22,956	22,431	22,780	21,200	-7%	22,100	22,500	22,800	0%
Avg carcase weight (kg)											
Sheep	23.2	23.7	24.4	25.0	23.5	23.6	0%	24.8	25.0	25.1	7%
Lamb	21.9	22.2	22.5	22.7	22.4	22.4	0%	22.7	22.9	23.0	3%
Production ('000 tonnes carcase weight)											
Mutton	234	202	170	188	224	188	-16%	179	188	206	(8%)
Lamb	486	509	516	509	510	475	-7%	502	514	524	3%
Sheep exports** ('000 tonnes)											
Mutton shipped weight	186	151	132	147	180	151	-16%	143	151	167	(7%)
carcase weight	223	181	161	179	220	184	-16%	175	184	203	(7%)
Lamb shipped weight	237	234	242	251	267	247	-8%	267	277	285	6%
carcase weight	280	277	290	302	322	296	-8%	320	333	341	6%
Domestic utilisation ('000 tonnes c/c weight)***											
Lamb	207	231	226	207	189	178	-5%	181	181	183	(3%)
kg/head***	8.8	9.7	9.3	8.4	7.5	7.0		7.0	6.9	6.9	

Source: ABS, DAWR, MLA forecasts

f = forecast (in italics)

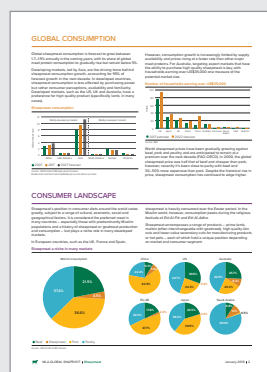
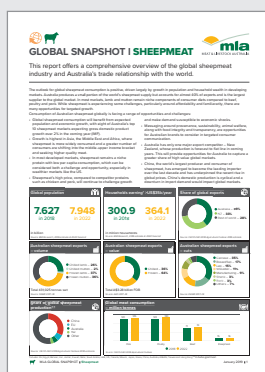
* From 2018 is an MLA estimate based on ABS Data. Please note, the flock estimates are based off the new EVAO cut off used by the ABS. Previously this was \$5,000 EVAO, but was changed upwards to \$40,000 EVAO. For more information, please visit www.abs.gov.au

** 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.

Global sheep snapshot

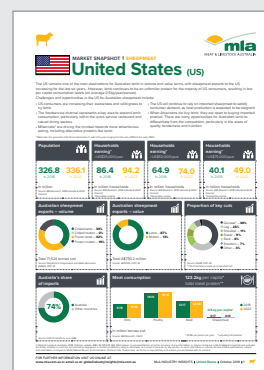
This report offers a comprehensive overview of the global sheep industry and Australia's trade relationship with the world.



To view the Global Sheep snapshot click here

Market snapshots

MLA's market snapshots aim to give a better understanding of Australia's main red meat markets along with insights into what's driving consumer demand.



To view market specific snapshots click here

© Meat & Livestock Australia, 2018. ABN 39 081 678 364. MLA makes no representations as to the accuracy of any information or advice contained in MLA's *Australian sheep industry projections 2018* and excludes all liability, whether in contract, tort (including negligence or breach of statutory duty) or otherwise as a result of reliance by any person on such information or advice. All use of MLA publications, reports and information is subject to MLA's Market Report and Information Terms of Use. Please read our terms of use carefully and ensure you are familiar with its content.

Click here for
MLA's Terms
of Use