

Industry projections 2018

Australian sheep – September update

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KEY POINTS

- Dry drives spike in sheep slaughter and drop in carcase weights
- Lamb prices reach record highs as strong demand meets tightening supply
- Three-month weather outlook offers little reprieve from the dry



KEY 2018 NUMBERS



Lamb slaughter:
22.9 million head



Lamb production:
511,000 tonnes cwt



Lamb exports:
257,000 tonnes swt



Sheep slaughter:
9.3 million head

* Graphic illustrates year-on-year change

Summary

It has been a year of extremes so far for the Australian sheep market, with lamb prices soaring into uncharted territory in recent months, although certainly not without its challenges. Widespread rainfall deficiencies in south-east Australia, particularly drought-stricken NSW, have led to elevated sheep slaughter levels for the most part of the year and placed downward pressure on carcase weights. This has led to a significant upward revision of 2018 sheep slaughter forecast to 9.3 million head.

The dry conditions drove increased lamb slaughter for the first half of the year, however this has fallen in recent months due to the delay in new season lambs entering the market. Annual lamb slaughter is now projected to be 22.9 million head for 2018, up 2% on 2017.

Meanwhile, strong global demand for Australian sheepmeat, combined with the softer Australian dollar and constrained domestic supplies out of New Zealand, have supported record export volumes and values.

Seasonal

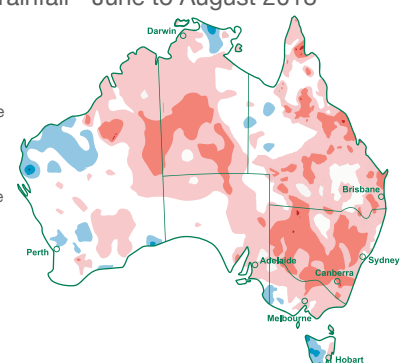
After a very dry first half of the year, poor winter rainfall resulted in worsening conditions across most production regions in eastern Australia.

Some areas, particularly in NSW, are facing an unprecedented stretch of well below-average rainfall. In August, the NSW Department of Primary Industries declared 100% of the state to be in drought. Elsewhere across the nation, some areas in southern Victoria, southern SA, Tasmania and south-western WA received closer-to-average winter rainfall.

Figure 1: Australian rainfall - June to August 2018

Rainfall decile ranges

Legend



Source: BOM

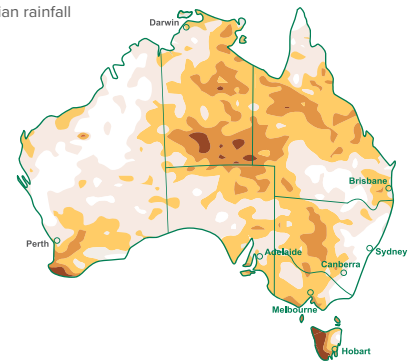
According to the Bureau of Meteorology's latest three-month weather outlook, spring will likely see a continuation of drier-than-average conditions in the majority of key sheep production regions west of the Great Dividing Range. The flow-on effect for producers in these regions is a potential intensification of existing poor conditions.

Figure 2: Australian rainfall outlook Oct to Dec 2018

Chance of exceeding the median rainfall

Legend

- Above 45% chance
- 40-45% chance
- 35-40% chance
- 30-35% chance
- Below 30% chance



Source: BOM

Slaughter

After tracking near even with last year through the first quarter, lamb slaughter spiked in the second quarter of 2018 as dry conditions worsened and producers looked to destock. This peaked in June with the highest month of lamb slaughter on record. Over the year-to-July, lamb slaughter was 9% higher than last year at 13.8 million head. New South Wales, Victoria and WA have seen the biggest year-on-year increases, up 11%, 19% and 11% respectively.

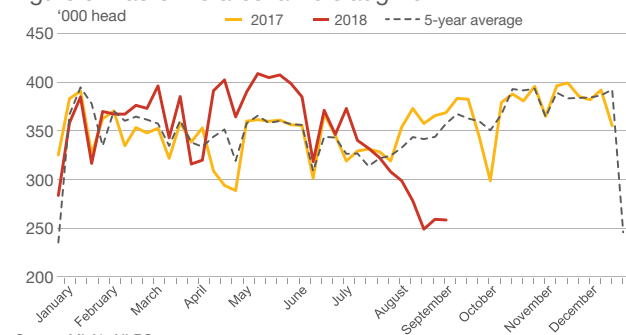
Lamb slaughter numbers declined rapidly through August, with heavy and slaughter-ready categories particularly hard to come by. With the delayed seasonal influx of new season lambs from the end of winter into spring, combined with a poor spring rainfall outlook, lamb slaughter is projected to finish at 22.9 million head for 2018, up 2% on 2017.

Sheep slaughter has continued to track well above last year's levels and, at 4.8 million head, was up 27% year-on-year for the January to July period (ABS). New South Wales, Victoria and WA sheep kills increased by 33%, 28% and 27% respectively, in comparison to year-to-July totals in 2017. The May to July period recorded especially high levels of sheep slaughter, up 41% from last year and 25% above the five-year average.

Looking at eastern states slaughter as highlighted in Figures 3 and 4, sheep slaughter has trended in the opposite direction to lamb as processors look to maintain throughput and producers destock. With the recent surge in sheep slaughter, 2018 is projected to finish at 9.3 million head, up 23% on 2017 levels.

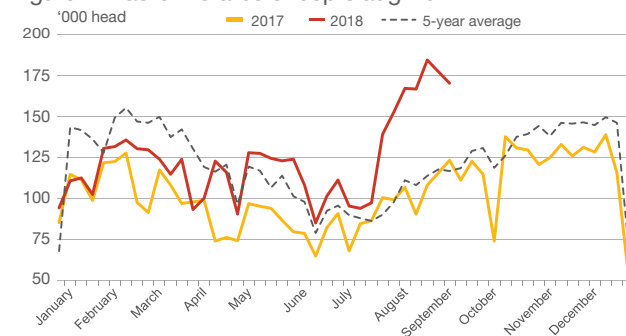
Strong lamb and mutton prices have been a motivating factor to maintain or build flock numbers. However, the lack of winter rain across much of Australia, particularly NSW and northern Victoria, has put a lot of pressure on producers to destock or supplementary feed. As a result, it is estimated that the national flock will decrease 5.5% to around 68 million head.

Figure 3: Eastern states lamb slaughter



Source: MLA's NLRS

Figure 4: Eastern states sheep slaughter



Source: MLA's NLRS

Carcase weights and production

Lamb

For the first quarter of the year, lamb carcase weights tracked very closely to year-ago levels, but the national average slipped lower year-on-year as the dry autumn and winter progressed. In July, the national average lamb carcase weight fell to 22.3kg – 1kg lighter than the same time last year. For the first seven months of the year, lamb carcase weights remained above the five-year average – although it is unlikely this will be the case for much longer.

Heading into spring, it is typical for carcase weights to ease as greater numbers of new season lambs come onto the market. However, the decline this year is expected to be more pronounced than usual. With no indication of improved seasonal conditions in the near future, reports suggest there will be greater numbers of lighter weight, unfinished new season lambs coming onto the market this year, as many producers in drought-stricken NSW and northern Victoria face challenging feed conditions.

For 2018, the national average lamb carcase weight is forecast to be 2% lower than last year at 22.3kg.

In terms of production, lighter carcase weights are expected to offset the year-on-year rise in slaughter in 2018. Total lamb production forecast for the year is 511,000 tonnes carcase weight (cwt) – very similar to year-ago levels.

Sheep

Sheep carcase weights have also suffered with the poor season this year, although to a greater extent than lamb, and have been more volatile through autumn and winter. Given the high price of feed and strong lamb market, it appears producers have been prioritising weight gains in lambs over this period. Sheep carcasses have been considerably lighter than last year and have dipped below the five-year average in recent months.

For the January to July period, the national sheep carcase weight averaged 23kg – 6% lower than the same period last year. It is expected that sheep carcase weights are going to remain well-below last year's levels for the remainder of 2018 and average 23kg for the calendar year, meaning they will be 8% lower year-on-year.

Higher sheep slaughter, only partly offset by lighter carcasses, has lifted forecast mutton production to 213,000 tonnes cwt for 2018 – an increase of 13% from 2017.

Figure 5: Lamb carcase weights

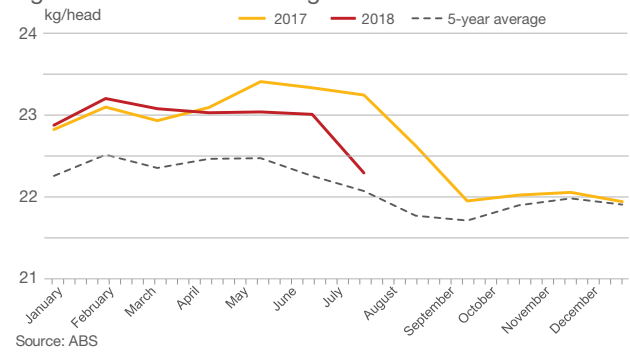
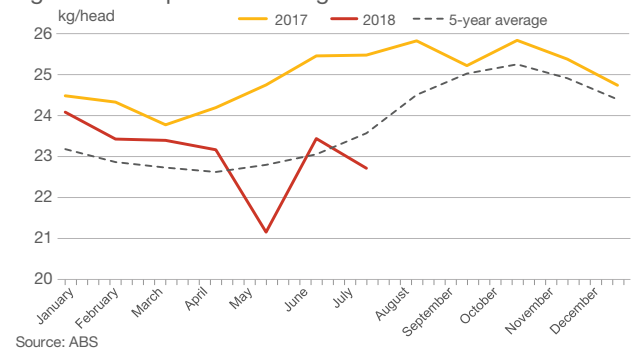


Figure 6: Sheep carcase weights

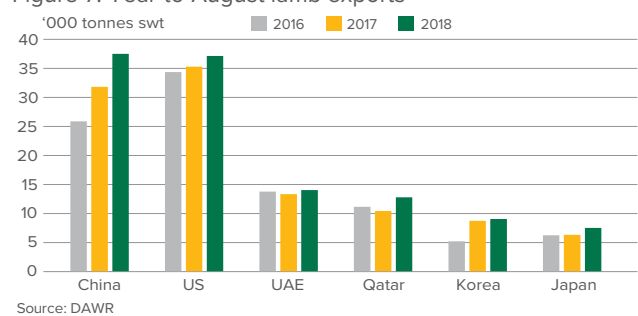


International markets

Global demand for sheepmeat has been strong in 2018, underpinned by a resilient global economy, a softer Australian dollar and constrained domestic supplies in key markets. Lamb exports between January and August increased 12% to a record 183,000 tonnes shipped weight (swt), while mutton shipments surged 25%, to 105,000 tonnes swt. Furthermore, the unit value of Australian lamb exports for the year-to-July reached new record highs at A\$8.00/kg, and was mirrored in mutton, which climbed to A\$5.88/kg for the same period. These factors saw the value of Australian sheepmeat exports hit new heights in 2016–17, at A\$3.29 billion, up 24% year-on-year.

China has accelerated its imports of Australian sheepmeat over the last 12 months, increasing 44% for the year-to-August and overtaking the US as Australia's largest lamb market by volume. While the local Chinese production and import demand is cyclical, there has been a long-term divergence between how much the country can produce and what it would like to consume. China is the world's largest producer, consumer and importer of sheepmeat, so when the country is short on supply, the impact is felt in Australia and New Zealand.

Figure 7: Year-to-August lamb exports



Demand has been strong in Australia's traditional markets – such as the US, EU, Malaysia and UAE – as well as a suite of emerging markets. Korea has grown in the last four years to become Australia's fourth largest lamb export market, predominantly driven by lamb skewers and Japanese-style barbecue (*Genghis Khan*) in the foodservice sector. Meanwhile, Iran has emerged as a significant market following the initial loosening of sanctions in 2015 – over the last eight months it has grown to 8,500 tonnes swt, up from just over 1,000 tonnes swt the same period last year. However, the trade is volatile and will hinge on the country's future relationship with the US and Iran's response to the reinstatement of sanctions.

To date, the sheepmeat trade has avoided any direct spill over from the developing US-China trade war (China did apply tariffs to imports of US sheepmeat but the trade was very minor). In fact, the official launch of Australia-European Union Free Trade Agreement (A-EU FTA) negotiations in mid-year and conclusion of Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA) negotiations in August signal future improved access to a mature and an emerging sheepmeat market, respectively.

In addition to strong demand, constrained lamb supply out of New Zealand – Australia's only major competitor in the global sheepmeat trade – has kept pressure on prices in both supplier countries. Pushed out in the fight for acres against dairy and beef cattle production, the New Zealand sheep flock was back 0.8% year-on-year midway through 2018 at 27.3 million head. Production has stagnated over the last decade, as productivity gains have been offset by the decline in the breeding flock, and export growth has come at the cost of domestic consumption. In the first seven months of 2017, New Zealand sheepmeat exports were up 1% year-on-year, at 276,000 tonnes swt. New Zealand sheepmeat exports have continually become concentrated on China, with the one market now accounting for 43% of exports and growing at the expense of traditional markets.

Figure 8: Year-to-August mutton exports

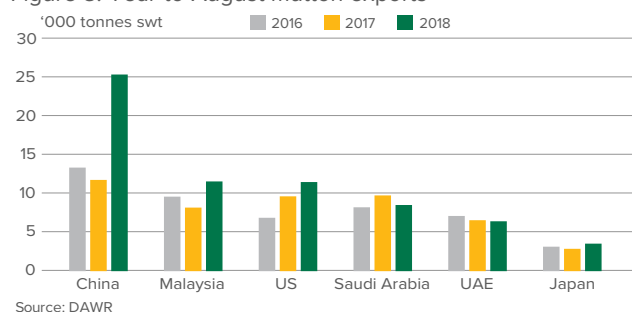
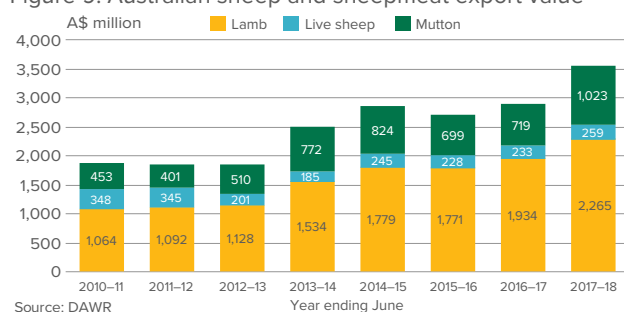


Figure 9: Australian sheep and sheepmeat export value



Live exports

Sea-freight sheep exports ground to a halt, with no shipments to the Middle East for three months. The trade faces a suite of challenges – most immediately, increased regulation to shipping during the northern hemisphere summer and the license suspension of a major exporter – but shipments are expected to resume in the last quarter of 2018. Shipments tracked close to year-ago levels during the first half of the year (at 784,000 head, back 5% year-on-year) but, with no trade over the last three months, the year will finish at its lowest level in decades.

Sheep exports have increasingly become WA-centric, where they still account for about one third of sheep and lamb turn-off. However, a widespread influx of additional sheep on the market in WA is yet to become apparent, with producers able to hold stock thanks to reasonable pasture conditions. Sheep and lamb slaughter has increased but in line with last year.

WA has maintained a relatively stable sheep flock in recent years. Paired with decent winter rainfall in key sheep regions and solid sheep enterprise profitability, the supply base of stock would likely be sufficient to maintain a live sheep trade near two million head. However, an array of issues will test this upper limit in coming years and the peak demand period, the Eid festival of sacrifice, will continue to fall within the northern hemisphere summer and will remain an ongoing challenge for industry to navigate.

Looking ahead, sheep exports are forecast to finish 2018 at 1.15 million head. However, much uncertainty remains and future forecasts will reflect developing trade, regulatory and social license impacts upon the live export industry's ability to operate.

Prices

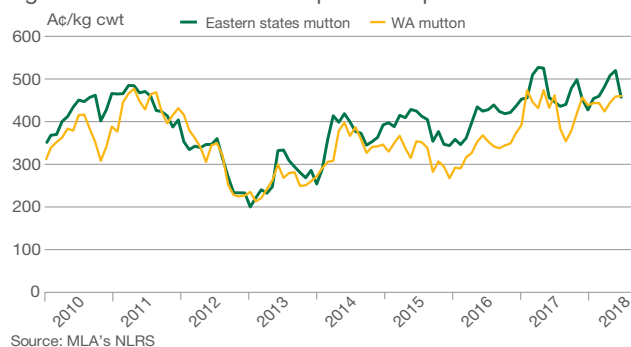
Lamb prices

Australian lamb prices have been rising strongly since April, breaking records as they smashed through the 700¢ and 800¢/kg cwt marks for the first time. Poor seasonal conditions and high feed costs have led to a waning supply of finished lambs as the year progressed. This, combined with strong international demand, has resulted in fierce competition for a diminishing supply and driven up prices across the board. The national heavy lamb indicator has performed particularly well, briefly rising above 900¢/kg cwt. Trade and heavy weights have been trading at a premium to the lighter weight categories, with fewer finished lambs available given the poor season and cost of feeding.

Lamb prices in WA have been good by historical measures so far in 2018 and, after trading at a premium to the east earlier in the year, have lagged behind the recent records being achieved in the rest of the country. WA lamb supplies have followed a more typical pattern, with more normal winter rainfall in comparison to the failed season in the east. In contrast, the mutton east-west price spread is far closer with both sides of the country averaging near parity in recently (see Figure 10).

More recently, the delay in new season lambs has further exacerbated the tight supply, resulting in increased prices across the country as producers struggle to achieve usual weight gains to get new season lambs market ready. The timing and quality of the new season lamb crop will have a large impact on prices for the rest of 2018.

Figure 10: East-West mutton price comparison



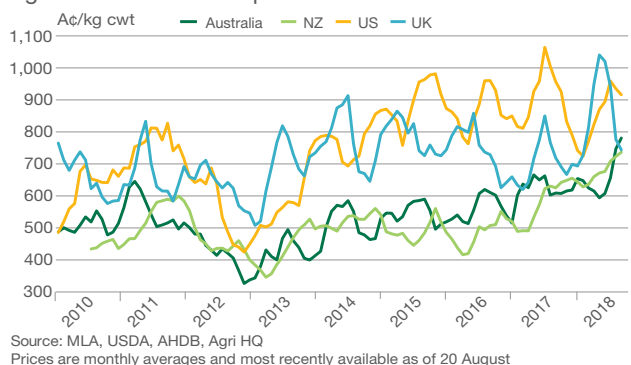
Mutton prices

While the lamb market has been hitting highs not seen before, growth in sheep saleyard prices has been much more subdued. Despite the considerable supply increase, the national mutton indicator has remained surprisingly strong so far in 2018, averaging 437¢/kg cwt in August, up 5% year-on-year and 26% above the five-year monthly average. However, not all sheep indicators have performed so well, with the supply of lighter ewes increasing significantly over winter and trading at a growing discount to the major mutton indicator. Overall, mutton pricing has been quite resilient considering the magnitude of the increase in supply and, consequently, there appears to be some strong upside potential once seasonal conditions improve and supply tightens.

Global lamb prices

Placing Australia's record lamb prices in the global context (see Figure 11) highlights that lamb prices in most major exporting and consuming countries have rallied in 2018. Australia, NZ and the UK have all seen records tumble in the last 12 months, with Australian lamb prices not too far off from their typical spread to other global players, on a currency-adjusted basis, indicating the potential sustainability of strong prices. Additionally, these historically high Australian trade lamb prices, once adjusted to US currency, are yet to surpass the peak reached in 2011, when the Australian dollar was buying above US\$1.05.

Figure 11: Global lamb prices



Outlook

While Australia's pricing isn't out of kilter with other major sheepmeat markets, its growing price premium to beef, pork and poultry means there is an emerging risk consumers will push back on price. As always, prices never move in just one direction and for sheepmeat this will hinge on consumers' appetite to continue paying higher prices. There are also broader risks that could act as brakes, such as cyclical Chinese production and import demand or a slowdown in the global economy. However, the limited global pool of high quality sheepmeat, and need for Australia to rebuild flocks once the current drought breaks, should continue to underpin prices in the next few years.

Situation and outlook for the Australian sheep industry

	2013	2014	2015	2016	2017	2018 ^f	% change 2018 on 2017	2019 ^f	2020 ^f	2021 ^f	2022 ^f	% change 2022 ^f on 2017
Sheep and lamb numbers ('000 head)*												
As at 30 June	72,394	69,361	68,025	67,543	72,123	68,100		68,100	69,600	71,400	73,300	2%
Percentage change		-4.2%	-1.9%	-0.7%	6.8%	-5.5%		0.0%	2.2%	2.5%	2.7%	
Slaughterings ('000 head)												
Sheep	9,615	10,086	8,487	6,965	7,536	9,300	23%	6,750	7,400	7,700	8,200	9%
Lamb	21,886	22,251	22,876	22,956	22,431	22,900	2%	22,250	22,500	22,800	23,200	3%
Avg carcase weight (kg)												
Sheep	22.4	23.2	23.7	24.4	25.0	23.0	-8%	24.7	24.9	25.0	25.1	0%
Lamb	21.5	21.9	22.2	22.5	22.7	22.3	-2%	22.8	23.0	23.1	23.2	2%
Production ('000 tonnes carcase weight)												
Mutton	217	234	202	170	188	213	13%	167	184	193	206	9%
Lamb	470	486	509	516	509	511	0%	507	516	527	538	6%
Sheep exports ('000 head)												
	1,973	2,298	1,960	1,870	1,874	1,150	-39%	1,350 [^]	1,350 [^]	1,350 [^]	1,350 [^]	(28%)
Sheep exports** ('000 tonnes)												
Mutton												
shipped weight	172	186	151	132	147	171	17%	133	148	155	167	14%
carcase weight	206	223	181	161	179	209	17%	163	181	190	203	14%
Lamb												
shipped weight	214	237	234	242	251	257	3%	253	256	262	269	7%
carcase weight	250	280	277	290	302	310	3%	303	308	315	323	7%
Domestic utilisation ('000 tonnes c/c weight)***												
Lamb	220	207	231	226	207	201	-3%	204	209	212	215	4%
kg/head***	9.5	8.8	9.7	9.3	8.4	8.0	-5%	8.0	8.1	8.1	8.1	

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.

[^] 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.

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