Industry projections 2019

Australian sheep – September update

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

KEY POINTS

- International demand underpins record saleyard prices
- Lamb slaughter reflects reduced ewe numbers and generally poor marking rates
- Southern supply pivotal to price movements for the remainder of 2019

KEY 2019 NUMBERS

Lamb slaughter:
21.6 million head

Lamb production:
495,000 tonnes cwt

Lamb exports:
268,000 tonnes swt

Sheep slaughter:
8.5 million head

* Graphic illustrates year-on-year change

Summary

Lamb and mutton prices surged to record levels this winter as lower domestic supply met with robust international demand. Producers with livestock to sell were buoyed by the elevated prices as processors competed extensively to secure product and satisfy export demand. However, the majority of Australian sheep producers are still managing heavily depleted breeding flocks and heightened feed costs as severe drought conditions continue.

Water shortages have reached a critical point for large parts of the east coast, with regional towns in northern NSW now under water restrictions as councils seek to ration limited water supplies. Producers in these regions face an increasingly difficult and expensive burden in sourcing water for livestock, with many opting to further destock and not join their ewes on hand.

The extent of elevated breeding ewe turn-off at the beginning of the year eased during the winter months, as producers looked to spring and post-weaning before assessing feed availability. The annual sheep slaughter forecast has remained unchanged on the previous projections at 8.5 million head.

The southern wet season has been mixed so far, with parts of SA and south-west Victoria having an above-average season – in stark contrast to the challenging conditions experienced in northern Victoria and the majority of NSW. The significant variability has presented challenges in ascertaining how national lambing rates have performed however, the overwhelming consensus is for fewer lambs to enter the market for the remainder of 2019.

Lamb slaughter reached the lowest level since January 2012 in June and remained subdued in July. However, National Livestock Reporting Service (NLRS) reported numbers indicate new season lambs are starting to appear in reasonable numbers. As a result, forecast national lamb slaughter has been revised slightly higher on the previous projections and is now expected to decline 5% on 2018, to 21.6 million head.

Demand for Australian sheepmeat, from China and the US in particular, has been exceptionally strong so far in 2019, supported by a depreciating Australian dollar. This strong international demand has helped underpin record lamb and mutton prices and provides the platform for many producers to begin rebuilding their flocks when conditions improve.

Seasonal

Rainfall deficiencies worsened in many regions over winter, with Australia recording its fifth driest January to August period on record. Higher than average daytime temperatures also depleted soil moisture and stock water reserves. The Bureau of Meteorology (BOM) has likened the ongoing drought to both the Millennium and Federation droughts, as some major catchment storage levels have now fallen below levels seen during these periods.

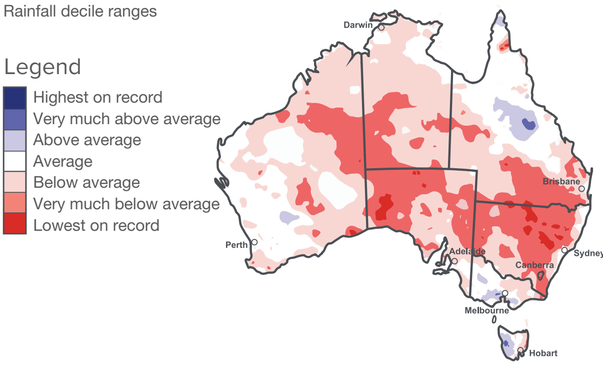
NSW remains the worst affected state, with below-average winter rainfall compounding already serious water deficiencies. Many regional towns face the prospect of 'Day Zero', a complete exhaustion of water reserves, in the next 3-18 months if conditions do not significantly improve.

The southern wet season (commencing April) in Victoria has been patchy, with average-to-above-average rainfall in the South West, Wimmera and Central districts. However, scattered rainfall across key production regions, combined with a hotter than usual winter, offered little to no reprieve for many producers and stifled the prospects for significant improvement through spring.

Looking ahead, the climate outlook for October to December forecasts another drier than average three months, with all key production regions given a less than 35% chance of exceeding median rainfall. Additionally, daytime temperatures across the country are expected to be warmer than average for the remainder of 2019.

Figure 1: Australian rainfall – June to August 2019

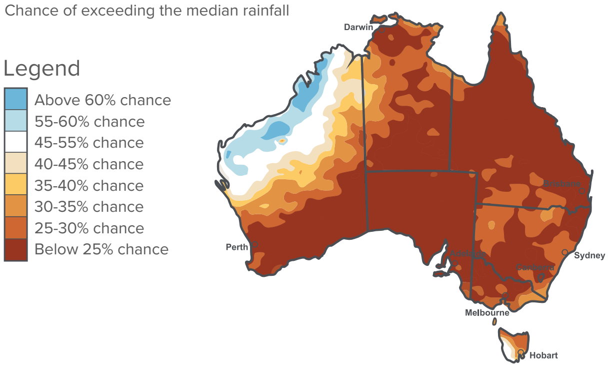
Rainfall decile ranges



Source: BOM

Figure 2: Australian rainfall outlook – Oct to Dec 2019

Chance of exceeding the median rainfall



Source: BOM

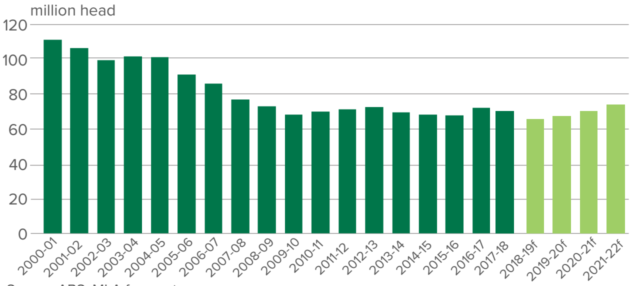
Flock and slaughter

The national sheep flock was hit hard in 2019 on the back of difficult conditions in many key sheep producing areas. At 66 million head, the flock estimation represents a decline of 6.5% year-on-year, driven by the high sheep slaughter and poor joining and lambing rates.

The supply of lambs for processing has been a major talking point throughout 2019, with the market balancing generally lower marking rates, high prices encouraging sales, the rebuild of depleted flocks in some areas and sustained destocking in many others. Lamb slaughter for the year-to-July is down 6.9% year-on-year, with the majority of this decline occurring in June and July, during which 740,000 less lambs were processed.

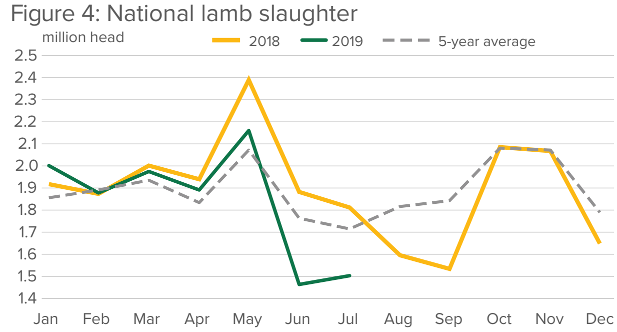
As the supply of 2018 season lambs diminished, the aforementioned decrease was not unexpected, as high numbers entered the market in late 2018 and early 2019. However, the size and timing of new season lambs entering the market this spring is uncertain, given the drought impact on lambs on the ground and feed availability. The National Livestock Reporting Service slaughter data shows an increase of new season lambs entering processors slightly earlier in 2019 than last year, leading to a small upwards revision in expected lamb slaughter to 21.6 million head, negating some of the reduced throughput during the winter months.

Figure 3: National flock



Source: ABS, MLA forecasts

Figure 4: National lamb slaughter



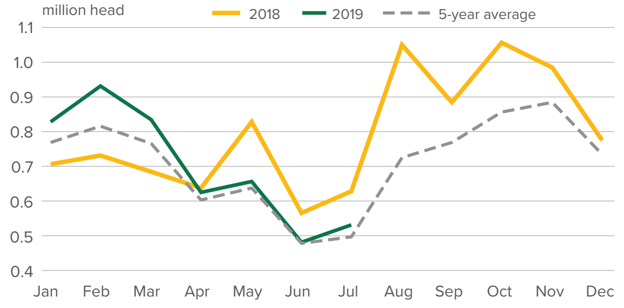
Source: ABS

The mixed season has resulted in large variations in reported lambing rates across key production regions. Some southern regions had a reasonable autumn and winter season and experienced average lambing rates; however, the consensus has largely been for lower than average lambing rates. As a result, the supply of lambs could fluctuate more than normal over the remainder of this year.

Similar to lambs, sheep slaughter contracted during the winter months. After a strong start to 2019, combined June and July sheep slaughter was back 15% from the same period in 2018. Sheep slaughter for year-to-July was still 2.2% above year-ago levels but is anticipated to track lower until the end of the year. Forecast 2019 sheep slaughter has remained unchanged at 8.5 million head.

Typically, the supply of sheep to processors is more heavily driven by seasonal conditions rather than the size of the pool available. If conditions worsen in key production areas of NSW and Victoria, destocking could accelerate quickly.

Figure 5: National sheep slaughter



Source: ABS

A high likelihood of below-average rainfall across the majority of the country, combined with strong prices for both mutton and lamb, is expected to see the national flock under pressure for the rest of 2019. However, with a return to more average conditions in 2020 and the high returns currently available in the industry, it is expected to provide strong platform to rebuild the national flock.

Carcase weights and production

The impact of deteriorating feed and stock water pressures shouldn't be understated; however, average lamb carcase weights have progressed in 2019, supported by the price of finished lambs. Producers with lambs on hand but limited feed have increasingly refined their production systems to reflect the difficult conditions, with greater focus on supplementary feeding and lot feeding lambs. Expected lamb carcase weights for 2019 are now projected at 22.9kg, up 2% year-on-year.

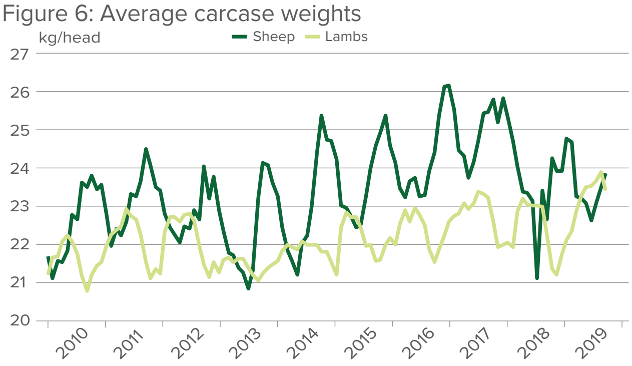
Average sheep carcase weights continue to reflect the impact of the prolonged drought, with many entering processors with low condition scores. Sheep carcase weights are forecast to remain stable on last year at 23.7kg, but back on the five-year average.

In 2019, lamb production is forecast to decline 3% year-on-year to 495,000 tonnes carcase weight (cwt). The decline in production is due to the considerable drop in lamb slaughter, but will be partially offset by increasing carcase weights.

Mutton production is expected to contract sharply during 2019 after a surge in drought-driven sheep slaughter in 2018. Production is forecast to fall 11%, or 24,000 tonnes cwt year-on-year, to 201,000 tonnes cwt.

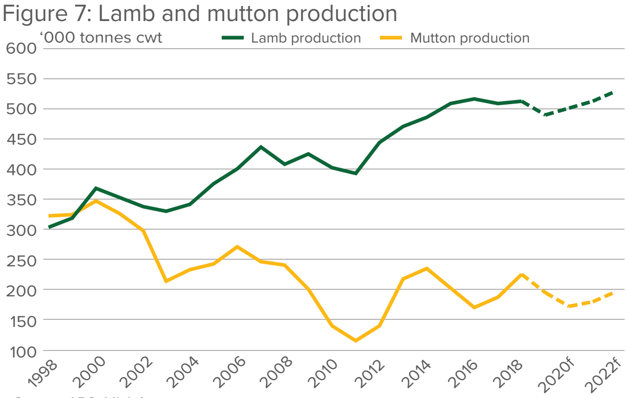
Looking forward, lamb production is expected to steadily recover over the next few years to 531,000 tonnes cwt in 2022, based on a long-term trend in lamb productivity gains and the assumption of a growing flock on the back of a return to average seasonal conditions.

Figure 6: Average carcase weights



Source: ABS

Figure 7: Lamb and mutton production



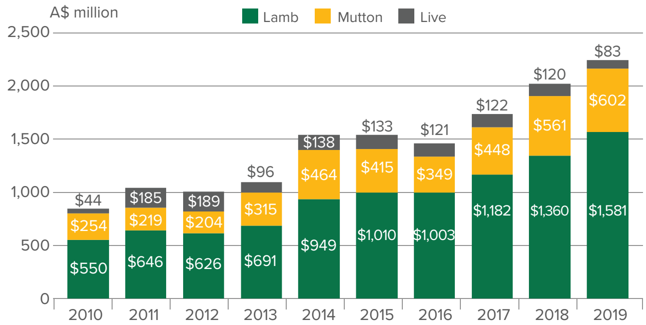
Source: ABS, MLA forecasts

International markets

Global demand for sheepmeat through 2019 has been strong, underpinned by a growing population of affluent consumers in emerging markets. China and the US, in particular, have been performing well for Australian sheepmeat exports; however, ongoing trade tensions between the two present a risk to economic growth and future demand.

On the back of elevated supply at the start of the year export volumes have expanded, allowing the sheep industry to take advantage of excellent global demand. For the 2019 year-to-August, Australian sheepmeat exports grew 2% year-on-year, reaching 187,000 tonnes shipped weight (swt). However, export volumes will likely follow both lamb and mutton slaughter and slow over the final months of the year relative to 2018. As such, 2019 lamb and mutton exports are expected to finish the year at 268,000 tonnes swt and 162,000 tonnes swt respectively, back 1% and 8% year-on-year.

Figure 8: Australian sheep and sheepmeat export value: January-July



Source: IHS Markit

Sheepmeat export values broke many new records for the first seven months of the year, reflecting the strength of demand from international markets and an Australian dollar trading near a 10-year low. Lamb exports reached $1.6 billion, 16% ahead on last year, and mutton exports reached $602 million, 17% up on last year. The average export unit value also hit new highs across lamb and mutton with lamb at A$8.90/kg, up 11% on this time last year and mutton, increasing 4% on last year to A$6.13/kg.

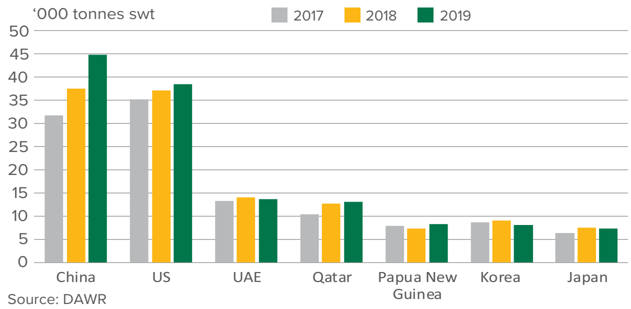
China

China's emergence as a major meat buyer has been critical to supporting global prices at a time of record meat (beef, poultry, pork) production and trade. Since 2015, the portion of households in China earning over US$35,000/year has grown from 1.8% to 3.3%, representing an additional 7.1 million households. While still a minority, this fast growing consumer class is underpinning demand growth for premium red meat and allowed consumers to explore the range of traditionally more expensive lamb cuts.

The rapidly emerging pork shortage from African Swine Fever (ASF) has also been key in supporting demand for lower-priced mutton with China now accounting for close to 40% of Australian shipments. With the pork shortfall in China estimated at 10-20 million tonnes, imports of all meats have been trending upwards throughout the year but are a drop in the ocean compared to the overall protein gap left by ASF.

The pork shortage is expected to become more prevalent in the second half of 2019, and the wholesale price of pork in China recently surpassed the previous 2016 high of ¥30/kg (now approaching ¥40/kg). Given the premium status and relatively small volume of Australian lamb, it is unable to fill the protein shortfall created by ASF. This market will continue to be underpinned by growing preference among affluent consumer segments for Australian sheepmeat.

Figure 9: Top lamb export markets: January-August

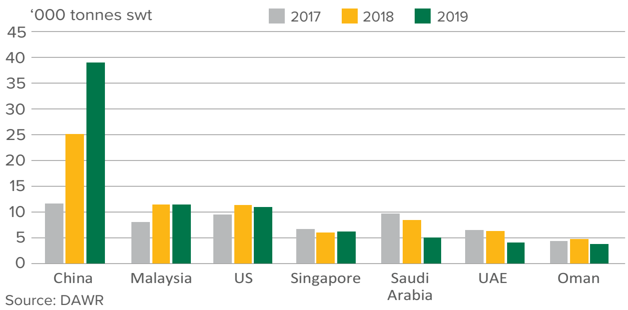


Source: DAWR

United States

While the US trails China from a volume perspective, it remains Australia's most valuable lamb market, taking a large portion of leg and loin cuts and representing 28% of total export value for the year-to-July (China trails in second place with 19%). On a volume basis, lamb exports to the US continue to grow and have expanded 4% so far in 2019. At the same time, however, mutton exports to the market have declined 4% so far in 2019 in light of strong competition from China.

Figure 10: Top mutton export markets: January-August



Source: DAWR

The average export unit value of lamb to the US underpinned the markets value growth, averaging A$13.08/kg in the first seven months of 2019, up from A$11.24/kg a year ago. However, in US dollars, the unit price has been relatively steady, fluctuating between US$7.50/kg and US$8.50/kg over the past three years, helping keep Australian lamb affordable to US consumers.

However, relative to competing proteins, lamb in the US is priced at a significant premium and is sensitive to consumer purchasing power and foodservice traffic. While US consumer demand remains strong, the impact the trade war will have on the economy and US spending will be key areas to watch.

Middle East

Exports to Middle Eastern markets have slowed in 2019, feeling the pinch from lower oil exports and slower economic growth, as well as higher competing bids from China, particularly for mutton. Mutton exports to the United Arab Emirates (back 35% year-on-year), Bahrain (back 16%), Saudi Arabia (back 40%) and Oman (back 19%) have all experienced negative growth as global pressures mount. Saudi Arabia has also been affected, particularly by foreign labour laws pushing migrant labourers – large consumers of mutton – out of the country.

Trade to Iran has also come to a virtual halt since June due to the government's removal of foreign currency exchange rate subsidies for meat importers in May, and in turn a reaction to the consequences of re-imposed US sanctions. In 2018 Iran was Australia's eleventh largest market on a volume basis, taking 11,000 tonnes shipped weight of lamb.

The live export ban was extended through to late September. While some Middle Eastern markets have been able to take increased volumes of air-freight lamb carcases, notably Qatar, the live shortfall from Australia is expected to have been replaced with sheep out of Africa and Eastern Europe. With the extended trade suspension and reduced stocking densities during operating months, live sheep exports in 2019 are forecast to decline to 1 million head.

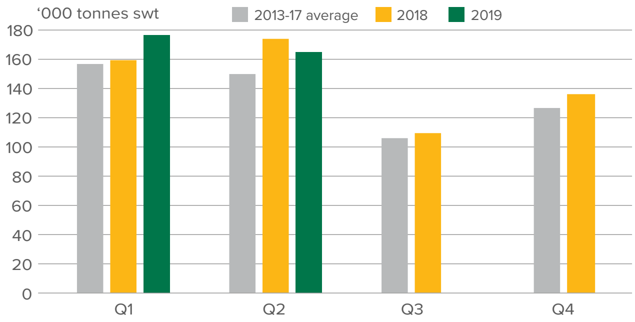
New Zealand supply

Lamb supply coming from New Zealand was tight through the winter, with slaughter figures down 6.7% as of late July and season-to-date exports down 18% on 2018. New Zealand exports to the US have dropped by 25%, while China has continued to increase purchases, accounting for 42% of July exports.

Slaughter should pick back up after the winter seasonal low; however, the 2018-19 lamb crop was 6% down on the previous year, due to reduced breeding ewe numbers. As producers look to retain more hoggets to replenish stocks this year, lamb slaughter may remain historically tight.

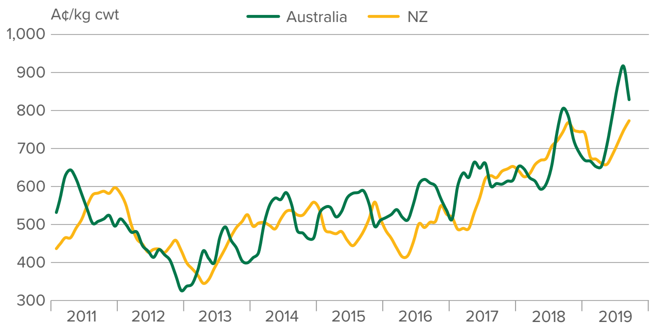
Risk factors can be expected for the remainder of the year, with the ongoing trade war, leading to a possible recession in US and dampening China import demand.

Figure 11: Combined Australian and NZ lamb exports



Source: DAWR, IHS Markit

Figure 12: Australian and NZ lamb prices



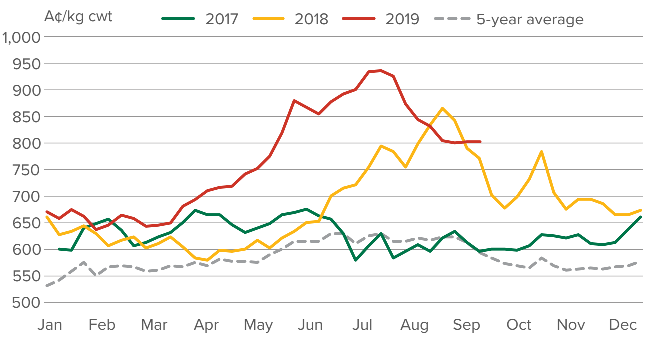
Source: MLA (18-22kg cwt trade lamb), NZ AgriFax (17.5kg cwt lamb).

Prices

Amid severe drought, domestic sheep and lamb indicators have surged to new highs in 2019. Demand from overseas markets has outweighed domestic availability and more than offset the negative price pressure usually associated with a prolonged dry period.

Prices across all categories reached record levels during winter. The national saleyard trade lamb indicator powered through 900¢/kg at the beginning of July and ultimately reached a peak of 950¢/kg, 9% above the high achieved in September 2018. Saleyard prices were propelled by processor competition, as they were required to compete extensively to secure stock across all categories, particularly livestock suitable for the export market.

Figure 13: National saleyard trade lamb indicator



Source: MLA

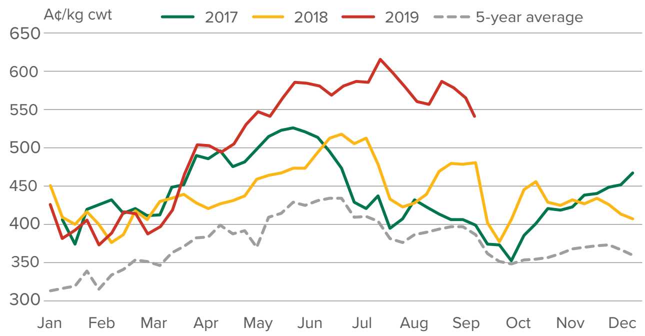
Heavier weight categories were undersupplied due to fewer old lambs available through winter. The national saleyard heavy lamb indicator rose to 998¢/kg in mid-July, 9% higher than the peak achieved in 2018.

The initial run of early season lambs, and several processors reducing production for maintenance, have seen domestic saleyard prices ease since the start of August. However, limited New Zealand offerings will restrict overseas availability and a softer Australian dollar will continue to support Australian lamb exports and, in turn, domestic saleyard prices. Forward contracts released by processors for September to November also suggest an element of price support until the end of the year. The timing and size of the Victorian lamb crop, which usually drives east coast supply from October onwards, will also have a big impact on prices.

The national saleyard mutton indicator reached a record 614¢/kg in mid-July, 18% above the high achieved the year prior. With the market being driven almost entirely by the strength of export markets – approximately 95% of mutton produced is exported – robust demand from overseas markets has had a major influence on record price levels.

Once conditions improve, strong prices for both sheep and lambs are likely to see many producers begin to rebuild their flocks after a long period of destocking. Increased restocker activity, will apply further competitive pressure to processors looking to fulfil export demand.

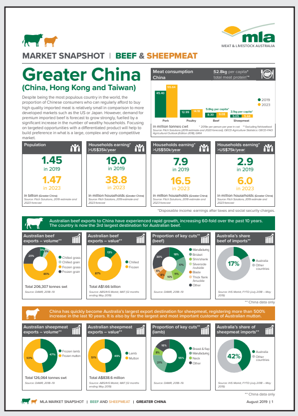
Figure 14: National saleyard mutton indicator

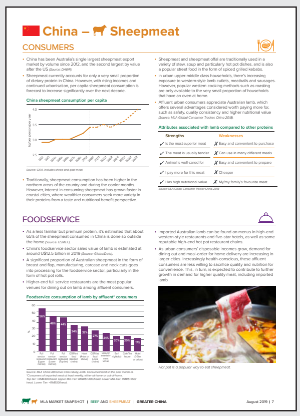


Source: MLA

Market snapshots

MLA's market snapshots aim to give producers a better understanding of what's driving demand in the main markets where Australian red meat is consumed. These will enable producers to be more informed when having discussions with their supply chain partners and – armed with a better understanding of where their product is going – make more informed business decisions about their own production and on-farm investments.





To view market specific snapshots click here

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	*66,000*		*66,750*	*69,800*	*73,700*	*4%*
Percentage change	-4.2%	-1.9%	-0.7%	6.8%	-2.1%	*-6.5%*		*1.2%*	*4.6%*	*5.5%*	
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	*21,600*	*-5%*	*21,800*	*22,200*	*22,900*	*1%*
Avg carcase weight (kg)											
Sheep	23.2	23.7	24.4	24.8	23.7	*23.7*	*0%*	*24.5*	*24.9*	*25.1*	*6%*
Lamb	21.9	22.2	22.5	22.7	22.5	*22.9*	*2%*	*23.0*	*23.1*	*23.2*	*3%*
Production ('000 tonnes carcase weight)											
Mutton	234	202	170	187	225	*201*	*-11%*	*172*	*179*	*196*	*-13%*
Lamb	486	509	516	509	511	*495*	*-3%*	*501*	*513*	*531*	*4%*
Sheep exports ('000 tonnes)**											
Mutton shipped weight	186	151	132	147	176	*162*	*-8%*	*138*	*144*	*158*	*-10%*
Mutton carcase weight	223	181	161	179	215	*197*	*-8%*	*168*	*176*	*193*	*-10%*
Lamb shipped weight	237	234	242	251	270	*268*	*-1%*	*274*	*284*	*298*	*11%*
Lamb carcase weight	280	277	290	302	324	*322*	*-1%*	*329*	*340*	*358*	*11%*
Domestic utilisation ('000 tonnes c/c weight)***											
Lamb	207	231	226	207	187	*173*	*-8%*	*173*	*173*	*172*	*-8%*
kg/head***	8.8	9.7	9.3	8.4	7.5	*6.8*		*6.7*	*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.