

SUMMARY – SHEEP MEAT INDUSTRY

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AUTHOR

Paul Deane
Economist

+61 3 9273 6295

Paul.Deane@anz.com

AUSTRALIAN SUPPLY: IS THE DYKE ABOUT TO BURST

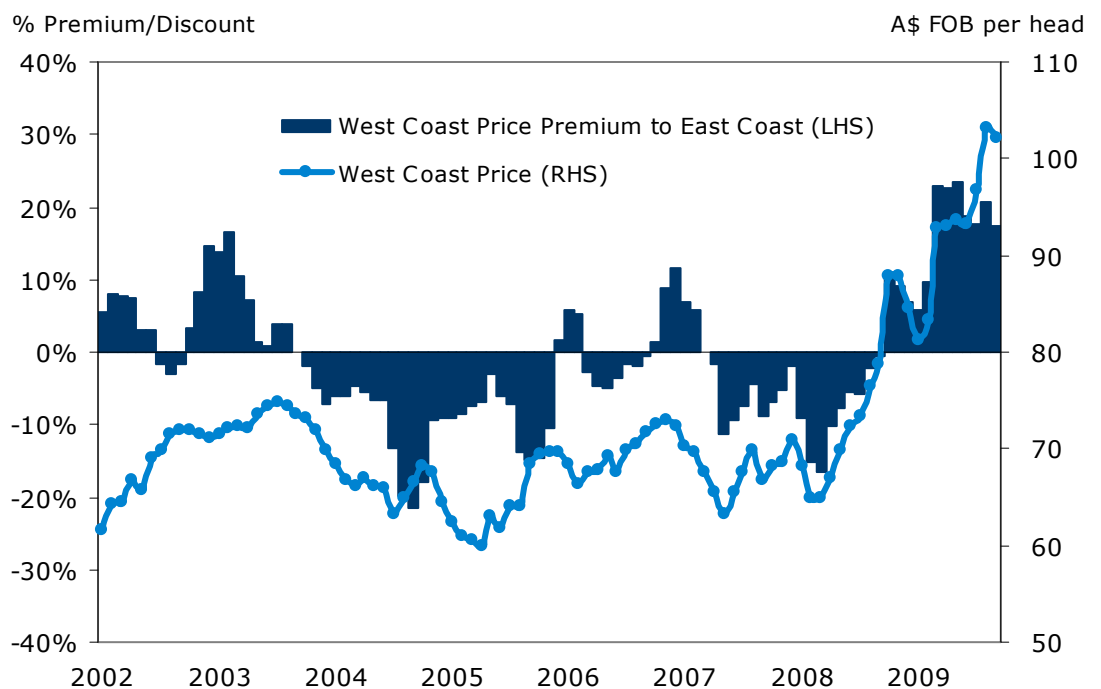
- Large deficits in the Australian flock have now occurred for the last three seasons – how much longer can this go on?
- The current level of lamb production is sustainable, but our forecast for adult sheep slaughterings/live exports is for a 15-20% decline in the current season.
- Our forecast is for the Australian sheep flock to fall to 68 million head by July 2010, a 4 million head or 6% decline year-on-year.

ABS NUMBERS: FACT OR FICTION

- The methodology for ABS sheep numbers is simple – a survey of Australian farmers every year. However, not all years are created equal!
- It is likely that official figures are significantly underestimating the number of lambs marked/produced over the last three seasons. We estimate around 1.5 million more lambs are marked per annum than ABS figures.

FIGURE 1. THE 'WEST COAST SQUEEZE' ...WA LIVE SHEEP EXPORT PRICES

A shortage of surplus adult sheep in WA has pushed the WA live sheep export price above \$100 per head and consistently above prices on the east coast.



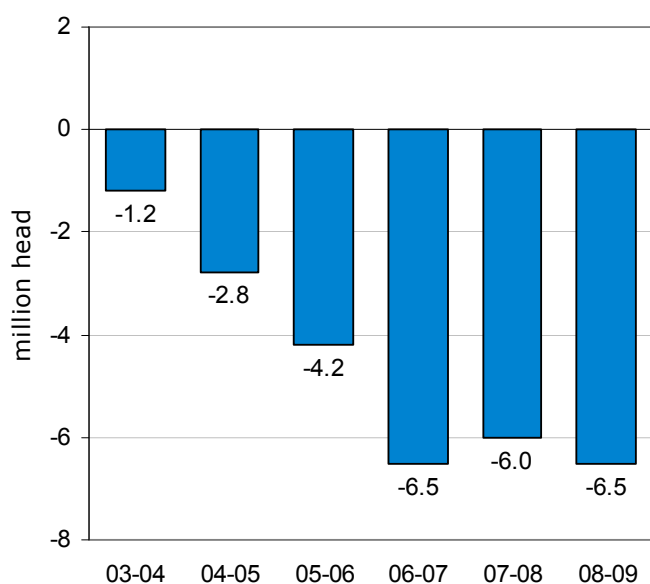
Sheep Meat Industry

In both price and production terms, the Australian sheep and lamb meat industry performed admirably in 2008-09 despite the global economic downturn. Australian lamb slaughterings reached 20.8 million head in 2008/09, just 1% shy of the 2007/08 record high. Live sheep exports maintained similar levels to the previous year, while the season average price for Australian lamb/sheep meat hit an all time high.

BUT AT WHAT COST...

In the 2008-09 season in Australia, around 40 million head of sheep and lambs were removed through slaughtering, live exports and deaths from the flock. At the same time, based on our estimates, only 33.5 million lambs were marked, a deficit of 6.5 million head. These large deficits in the Australian flock have now occurred for the last three seasons (Figure 2) – so how much longer can this go on?

Figure 2. Annual Australian Sheep Flock Deficit



The first point is that despite some calls to the contrary, the current level of lamb production is sustainable assuming the number of breeding ewes does not continue to fall. That is, enough replacement ewe lambs are being produced to sustain the breeding ewe proportion of the flock and still meet existing lamb slaughtering levels.

What is not sustainable are existing levels of adult sheep slaughterings and live sheep exports. One

way the deficit has been met in recent years is the liquidation of the wether (male) portion of the flock (and to a lesser extent adult ewes), but this cannot go on indefinitely (i.e. 'stocks' can only go to zero).

IS THE DYKE ABOUT TO BURST?

Are we already seeing the first cracks appearing as to the sustainability of the existing supply to the Australian sheep meat industry?

Mutton and live sheep export prices have jumped sharply since early 2009, with FOB live sheep export prices hitting A\$100 per head in recent months on the west coast. The extent of the supply squeeze for the WA sheep boat trade is even more apparent when you consider WA sheep prices are now trading consistently above sheep sourced from the east coast. Normally it is the reverse (Figure 1).

Strong lamb prices and record high sheep prices are a strong signal to producers as to the rising value of the ewe portion of the flock. This is likely to reduce adult ewe sheep supply for slaughter and/or the live sheep trade.

In our estimates, the number of adult breeding ewes has declined by around 2.5 million head per annum over the last two seasons. So for Australian breeding ewe numbers to stabilise, a combination of slaughterings and live sheep exports have to at some stage decline by this much. We expect this change to occur in the current season.

For the 2009-10, our forecasts are for a 15%-20% decline in the number of sheep slaughter or exported live compared with 2008-09. Lamb slaughterings are expected to fall modestly but still maintain near record levels. Even with this pull-back in flock outgoings, we still anticipate the Australian sheep flock will decline by a further 4 million head in 2009-10 to 68 million by July 2010.

LATEST ABS NUMBERS – FACT OR FICTION?

The release of ABS preliminary sheep industry figures for 2008-09 this month warrants a closer look at the numbers.

In a nutshell, the latest ABS estimate puts the Australian sheep flock at 71.5 million head of sheep and lambs on 30th June 2009. This is a 19.5 million head or 21% decline compared with 30th June 2006

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(Table 1). Or put another way, the Australian sheep flock has been falling at an average rate of nearly 7 million head per year for the last 3 years.

Table 1. ABS Australian Sheep & Lamb Numbers

Million head	30 th June 2006	30 th June 2009	Change
West Coast	22.1	15.5	-6.6
East Coast	68.9	56.0	-13.0
Australia	91.0	71.5	-19.5

As background, it is worth explaining how ABS sheep number estimates are derived. The methodology is simple – every year a survey of Australian farmers is conducted. However, not all ABS years are created equal! In terms of reliability, the most robust sheep numbers ABS produce are for the ‘census’ years (once every 5 years) – with the two most recent for the 2000-01 and 2005-06 seasons. For the 2006 census year, around 155,000 agricultural businesses were included at a response rate of 91% i.e. the sample size included approximately 140,000 farm businesses.

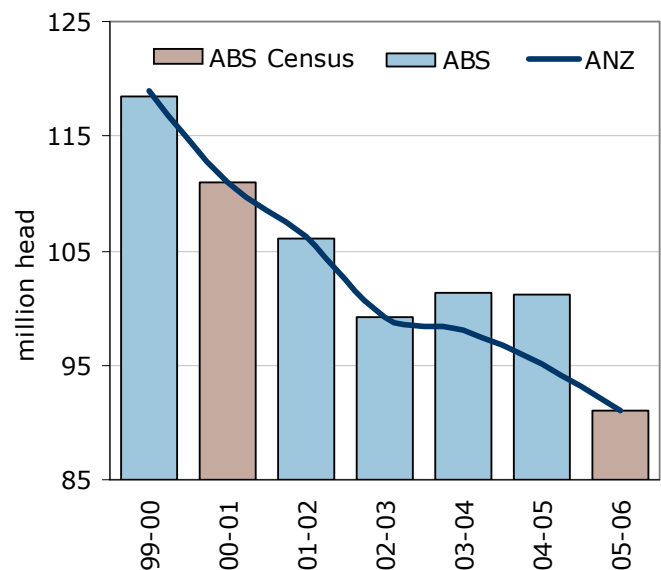
In between census years, ABS sheep number estimates (including lambs marked/produced) are calculated from a survey of a smaller subset of the Australian farm sector. For the 2008-09 survey, the sample was approximately 38,000 agricultural businesses with a response rate of 79%.

Historically ABS have had problems estimating sheep numbers in between census periods. Take the period between 2000-01 and 2005-06 for example. ABS sheep numbers were kept flat for the 2003-04 and 2004-05 season but then after the census in 2006 numbers were dramatically revised lower (by 10 million head in one season). A more plausible scenario was a decline throughout this period rather than in just one season (Figure 3).

Is this the case again that a problem exists with the latest release on sheep numbers?

One way to check the data is to look at the change in the flock (regardless of the starting point) over a longer period. If we take the three seasons since the 2005/06 season (census year), net outgoings from the Australian flock (ABS lambs marked minus ABS slaughterings/live exports and a 4% death rate) implies a deficit of 23 million head (Table 2).

Figure 3. Australian Sheep Numbers (closing)



This is 3.5 million head more than the change in ABS closing numbers from June 2006 to June 2009 (Table 1) and indicates a problem exists with the ABS data. A breakdown of the data by west and east coast is more alarming, given the 5 million head discrepancy on the east coast between Table 1 and 2.

Weighing up the robustness of the various components when calculating changes to the flock (slaughterings, opening numbers, lambs marked etc), along with record high lamb turn-off over the last two seasons, points to ABS underestimating the number of lambs marked/produced over the last three seasons (primarily on the east coast). Based on our estimates, around 1.5 million additional lambs are being marked per annum than official figures.

Table 2. Supply/Demand Balance: 06-07 to 08-09

Million head	30 th June 2006	Supply and Demand Balance	Implied 30 th June 2009
West Coast	22	-5	17
East Coast	69	-18	51
Australia	91	-23	68

Notes: Supply/Demand Balance = Incoming minus Outgoings
Incoming: ABS lambs marked (07-08 mid point was taken)
Outgoings: ABS sheep and lamb slaughterings + ABS live sheep exports + 4.5% death rate

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AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11 005 357 522

100 Queen Street, Melbourne, Victoria, 3000, Australia

Telephone +61 2 9226 4647 Fax +61 3 9273 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited

ABN 11 005 357 522

40 Bank Street, Canary Wharf, London, E14 5EJ, United Kingdom

Telephone +44 20 3229 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of FINRA [www.finra.org] and SEC)

6th Floor 1177 Avenue of the Americas

New York, NY 10036, United States of America

Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND by:

ANZ National Bank Limited

Level 7, 1-9 Victoria Street, Wellington, New Zealand

Telephone +64 4 802 2000

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Sources: ABS, ANZ Economics and Markets Research

