

IN FOCUS: BEEF AND CATTLE OUTLOOK

DECEMBER 2016

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Photo Mai Thai

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SUMMARY

The Australian cattle industry has enjoyed a stellar two year run of rising prices, and more recently, very good rains across many cattle producing regions. The Eastern Young Cattle Indicator – a key benchmark for the industry – smashed records to reach 725 AUc/kg in August this year, all the more exceptional given that the indicator had not exceeded 428 AUc/kg before 2015. Winter-spring rainfall was well above average for much of Australia (with the exception of the WA wheatbelt and Cape York) and the highest on record in some areas. This drove restocker interest after several dry years in Queensland, Australia's biggest cattle producing state.

The initial phase of this boom was caused squarely by US demand for imported beef in response to domestic US supply constraints following high corn prices and drought in 2011. However, these factors have since dissipated, with US drought conditions much more localised and corn cheap and plentiful. Further, there is likely to be much more competition in the US imported beef market in the coming years as South American producers become more competitive.

With the US market no longer a driving factor, the current phase of the boom has been based on domestic restocker interest as producers look to rebuild herds following elevated slaughter rates in 2013 and 2014. While this has been supported by a wet winter and spring, as the weather dries out the risks to saleyard prices are considerable. This is further compounded by generally less favourable prices in some export markets, although we note that beef prices to Japan and live export prices to Indonesia have remained more favourable.

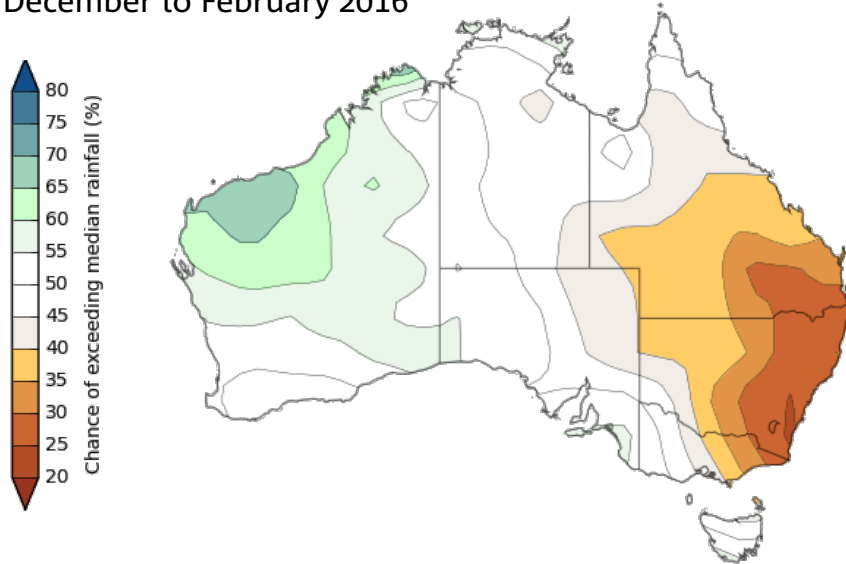
We have already seen some price contraction – the EYCI is now below 640 AUc/kg. But the bigger question is to what extent this decline presages a greater contraction in the new year. It has been our view for some time that the international beef outlook is now much weaker than in 2014 and 2015 and if eastern Australia sees a hot, dry summer (as per the Bureau of Meteorology's latest forecasts) restocker interest could slow rapidly. Our forecasts point to the EYCI falling to 500 AUc/kg in the September quarter 2017. This is an approximately 30% contraction from peak, although remains above the range of prices prior to 2015.





THREE MONTH RAINFALL OUTLOOK

December to February 2016



The Bureau of Meteorology (BoM) three month rainfall outlook for the summer points to hot and dry conditions Australia-wide in December, persisting into January and February in the east while the west may see average to above average rainfall later in the summer.

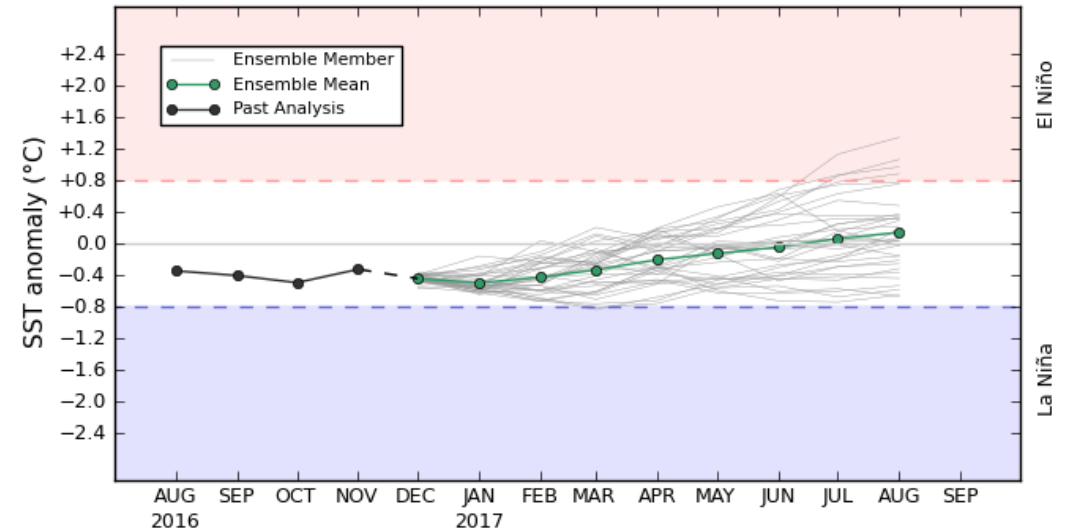
A wet spring across much of south-eastern Australia has seen plentiful pasture growth, which should persist into early summer in some areas where root-zone soil moisture is above average. Queensland, however, looks set to suffer, with soil moisture below average and hot conditions expected.

High fuel loads across much of Victoria, New South Wales, south-east South Australia and Tasmania raises the prospect of a bad fire season.

Source: Bureau of Meteorology

BOM POAMA MODEL LONG-RANGE EL NINO OUTLOOK

Monthly mean NINO 3.4 – 4 December 2016



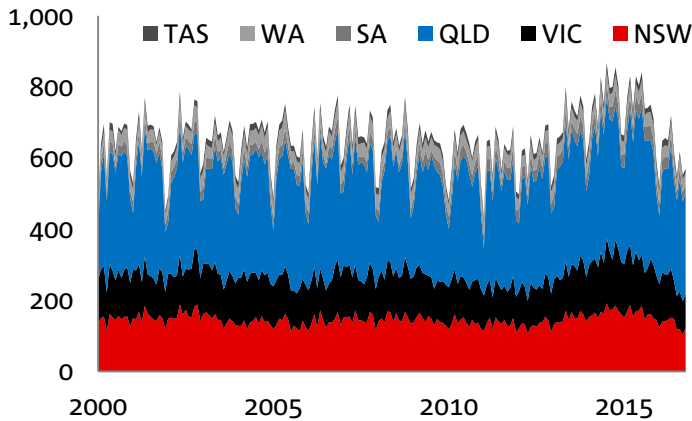
The Bureau of Meteorology's latest outlook now places El Niño-Southern Oscillation (ENSO) in a neutral position after several months of La Niña watch. BoM's POAMA long range model points to neutral conditions in 2017, if anything tending slightly closer to El Niño by mid-2017.

STATE OF THE HERD AND SLAUGHTER RATES



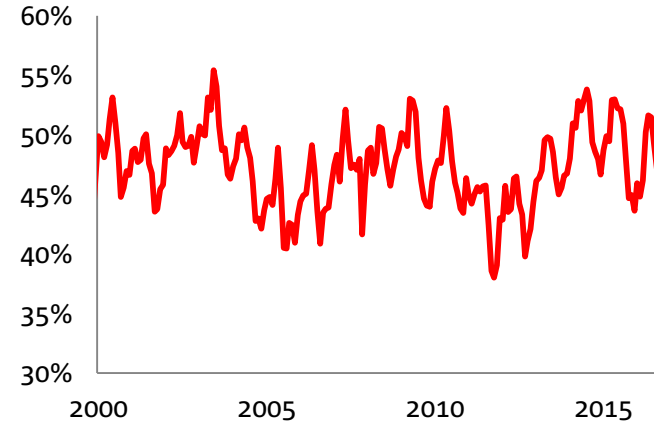
MONTHLY CATTLE SLAUGHTER

Number ('000)



FEMALE SHARE OF TOTAL SLAUGHTER

Per cent

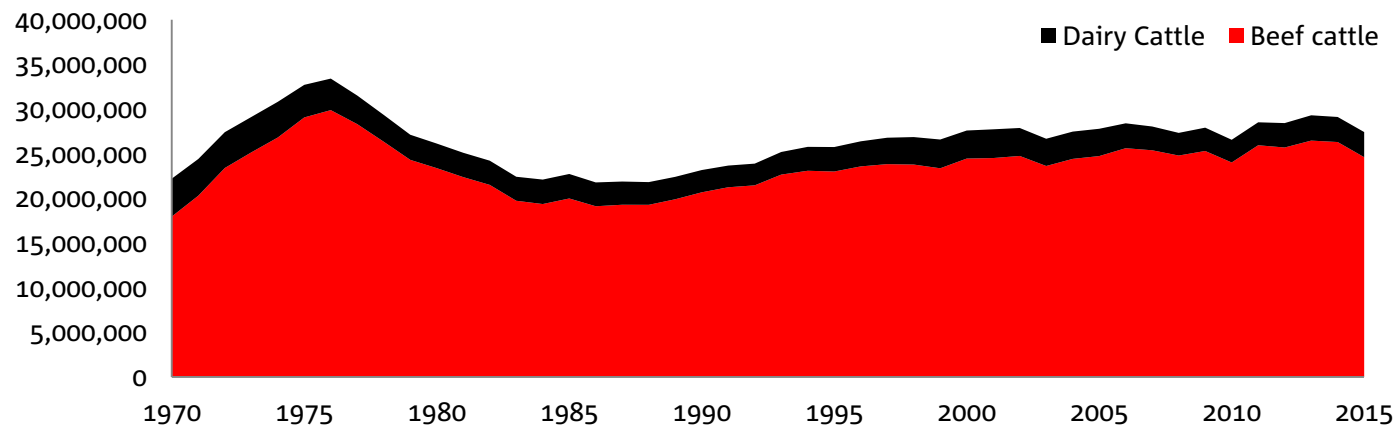


2013 and 2014 saw very elevated rates of slaughter, well exceeding rates seen in the millennium drought. This reflected a combination of very challenging climatic conditions in parts of Queensland and elsewhere, combined with very strong demand from the US, where a drought and high feed prices in 2011 had seen the herd depleted.

The female share of total cattle slaughter peaked at almost 54% in July 2014, higher than the crescendo of the millennium drought in 2009 but not as high as the 55% in June 2003 (during the very severe 2002-03 El Niño). Lower rates of female slaughter recently point to herd rebuilding progressing in earnest.

AUSTRALIAN CATTLE HERD

Head at 30 June



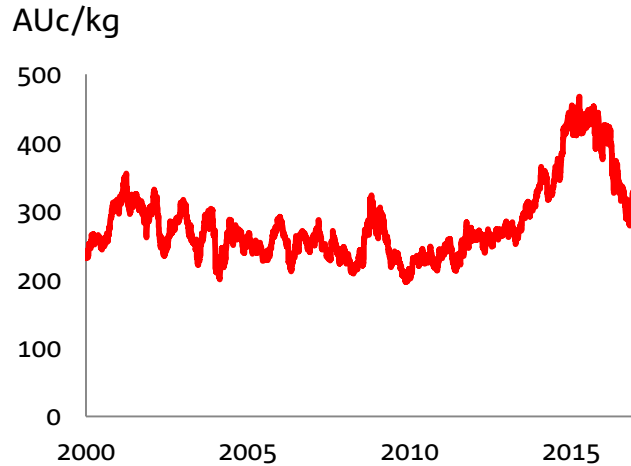
Meat and Livestock Australia's October update to its cattle industry projections places the Australian herd at 26.14 million in 2016, the lowest since the mid-1990s. MLA expects the herd to increase moderately next year. We expect supply available for slaughter to remain constrained over the coming months, although a return to drought conditions could put more supply on the market.

Source: Meat and Livestock Australia, Australian Bureau of Statistics and NAB Group Economics

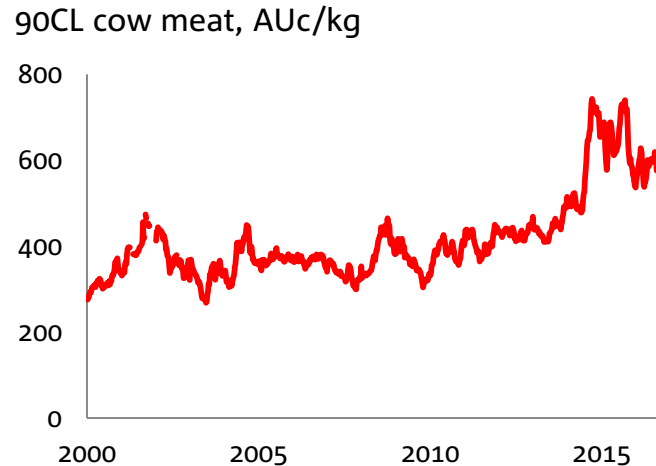
INTERNATIONAL PRICES



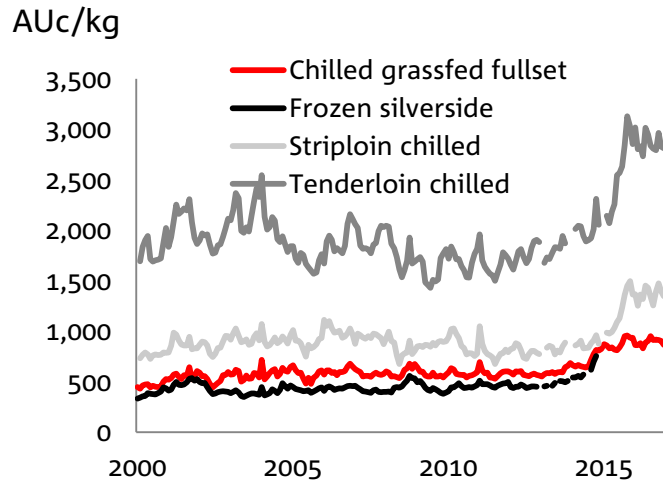
US LIVE CATTLE FUTURES



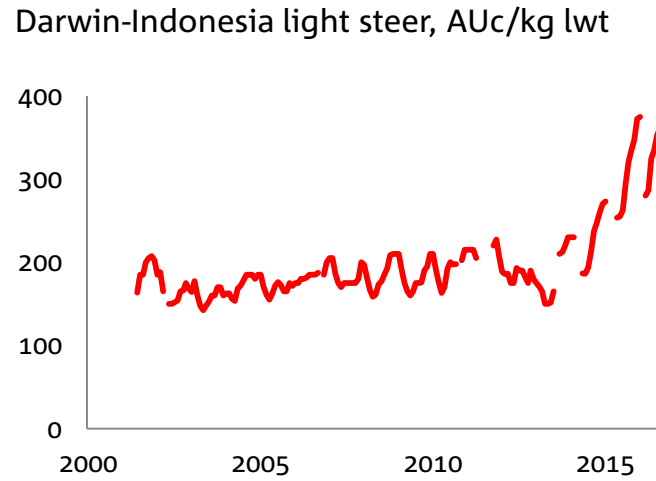
AUSTRALIA-US EXPORT PRICE



AUSTRALIA-JAPAN EXPORT PRICES



LIVE CATTLE EXPORT PRICE



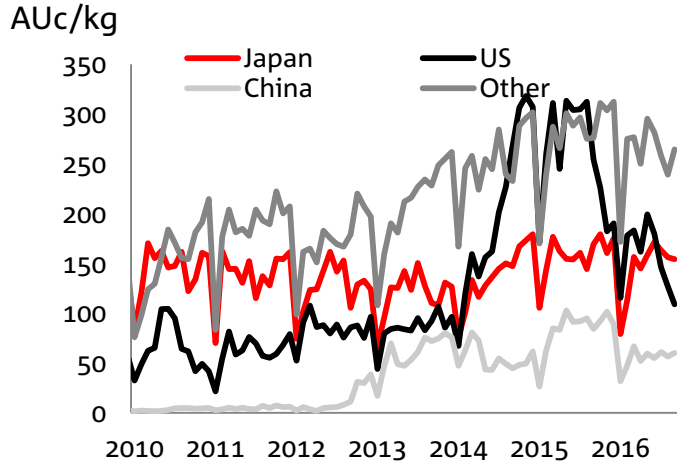
International prices are very mixed. The US live cattle market has given up virtually all the gains from the 2013 to 2015 boom in AUD terms, and while cattle futures on the Chicago Mercantile Exchange has seen some upside recently, overall it paints a very sobering picture. Australian 90CL cow meat export prices to the US remain somewhat higher than the domestic market, although trading has been very light on limited supply. Low feed prices, especially for corn, have improved input costs for US cattle producers and the USDA has increased its US beef production forecasts this month. The USDA expects US domestic beef production to increase 6.1% in 2016 and a further 3.2% 2017.

Australia-Japan export prices remain elevated, particularly for some cuts. Live export prices are also strong. Darwin-Indonesia light steers traded near record in November. The live export market contains some risks, particularly relating to short quota periods and domestic beef production policy in Indonesia. However, diversification into the Vietnamese live export market has mitigated some of the risks of dependence on a limited number of markets.

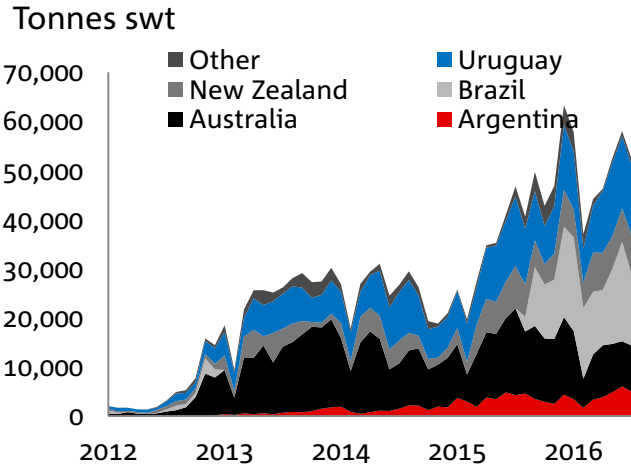
Source: Meat and Livestock Australia, Bloomberg, Australian Bureau of Statistics and NAB Group Economics



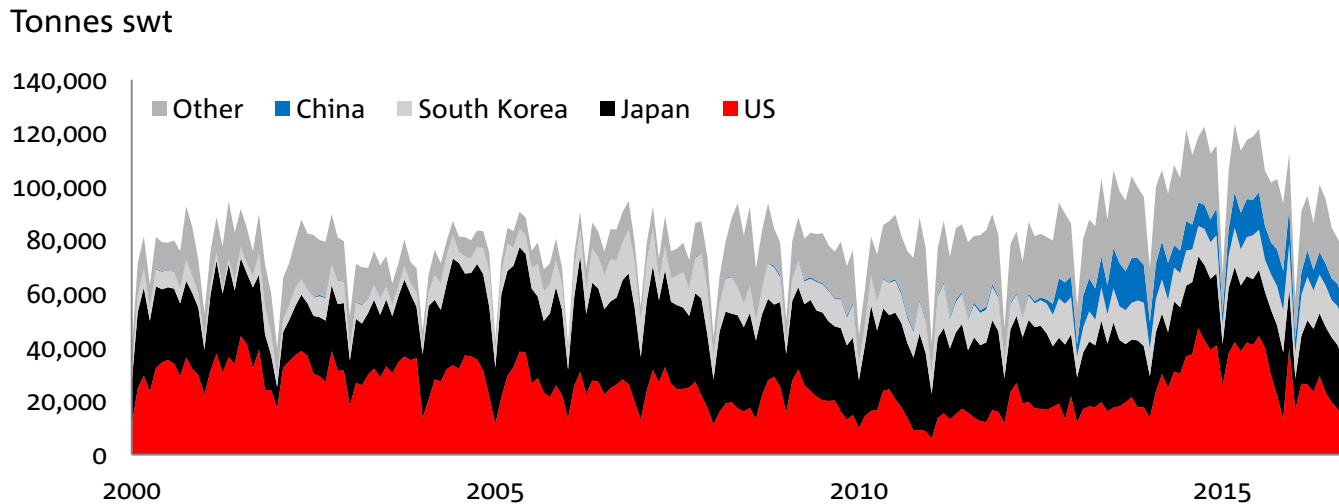
VALUE OF AUSTRALIAN BEEF EXPORTS



CHINA BEEF IMPORTS BY SOURCE



MONTHLY AUSTRALIAN BEEF EXPORTS BY DESTINATION



Source: Meat and Livestock Australia, Australian Bureau of Statistics, Global Trade Atlas and NAB Group Economics

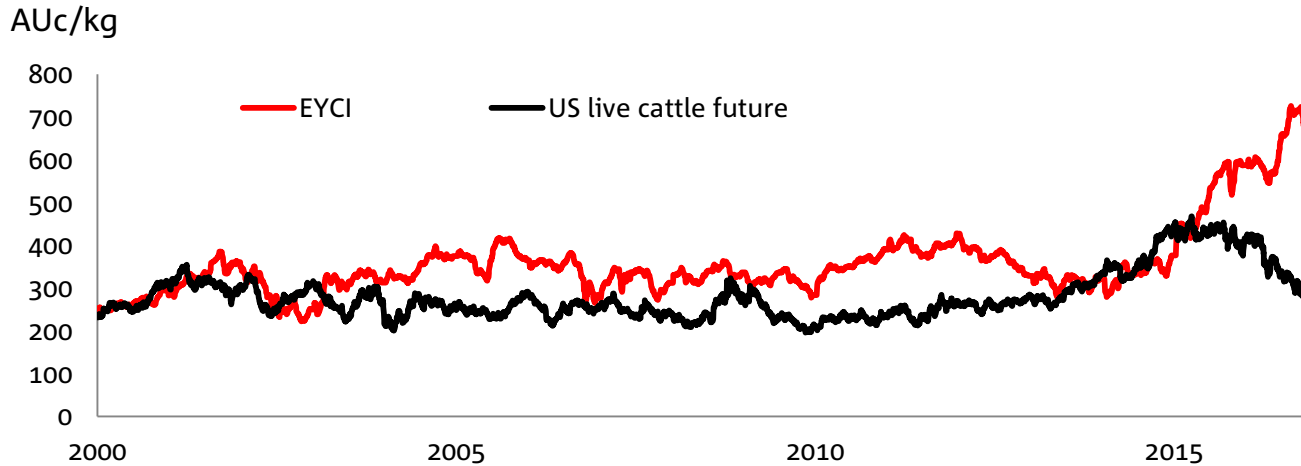
2013, 2014 and the first half of 2015 saw an incredible beef export boom to the US, measured in both price and volume terms. However, as we outlined above, this boom has now faded away amid lower US prices, higher US domestic production and constrained Australian supply. Indeed, Japan has now overtaken the US to once again become Australia's biggest beef export destination. Japan's population is neither growing nor consuming more beef per capita, pointing to low volume growth opportunities in this market. However, Japan is likely to remain a very reliable destination for Australian beef for many years to come.

Less certain is the Chinese market, which looked very favourable when Australia gained broader access in 2013. However a lack of price competitiveness, combined with strong competition from Uruguay and more recently Brazil has seen Australian volumes decline in absolute and relative terms. In 2014, Australia supplied 45% of the imported beef to the Chinese market, while in the first eight months of 2016 this shrunk to just 19%.

DOMESTIC PRICES AND OUTLOOK



EASTERN YOUNG CATTLE INDICATOR AND US CATTLE FUTURES



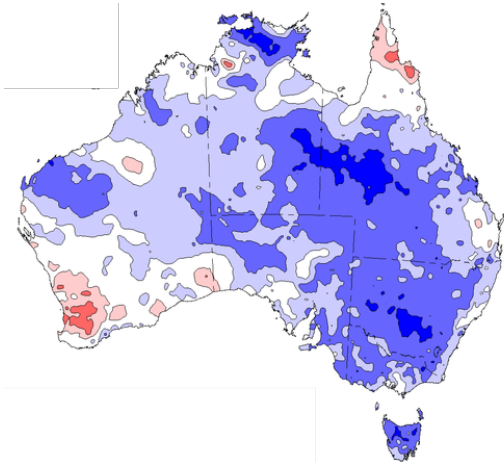
High prices this year have been driven almost exclusively by domestic restocker interest rather than global fundamentals. Should restocker interest slow in response to dryer conditions, it is likely that prices will come under further pressure. While our annual 2016-17 price forecast for beef remains in positive territory compared to 2015-16, there is likely to be more pressure in 2017-18.

the EYCI now in the high-630s, quite a retreat from the peak of almost 726AUC/kg reached in mid-August this year. This movement is in line with a seasonal increase in supply, although expectations of a dry summer and concerns about Australian competitiveness in key export markets is also a factor in the decline.

Our forecasts point to the EYCI falling to 500 AUC/kg in the September quarter 2017. This is an approximately 30% contraction from peak, although remains above the range of prices prior to 2015.

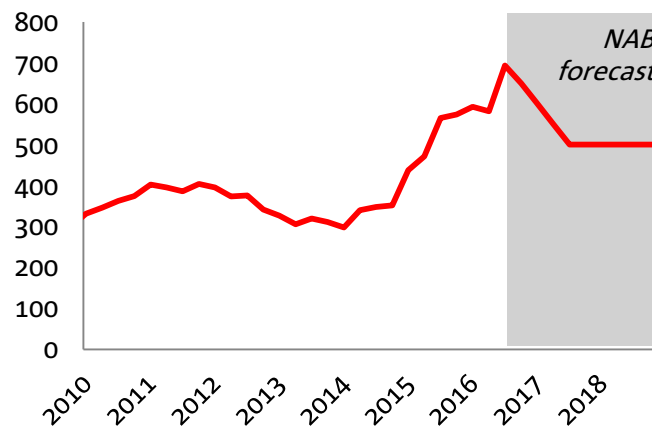
WINTER-SPRING RAINFALL DECILES

1 June to 30 November 2016



NAB EYCI FORECAST

AUC/kg, quarterly



Source: Meat and Livestock Australia, Bloomberg, Australian Bureau of Statistics, Bureau of Meteorology and NAB Group Economics