



IN FOCUS: WOOL



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KEY POINTS

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After an all-time high around two years ago, the wool price has faced a very tough run. The benchmark Eastern Market Indicator (EMI) has lost around 46% of its value (on a monthly average basis) since September 2018. While there was clearly a correction in the market last year, this year has brought further steep losses as the coronavirus pandemic evaporated industrial production and consumer demand.

Australia exports around 75-80% of its wool to China. Chinese buying activity – already falling before the virus hit – has been further dented by the pandemic. While Chinese industrial production has largely recovered, Chinese consumers remain cautious and forthcoming export demand is uncertain.

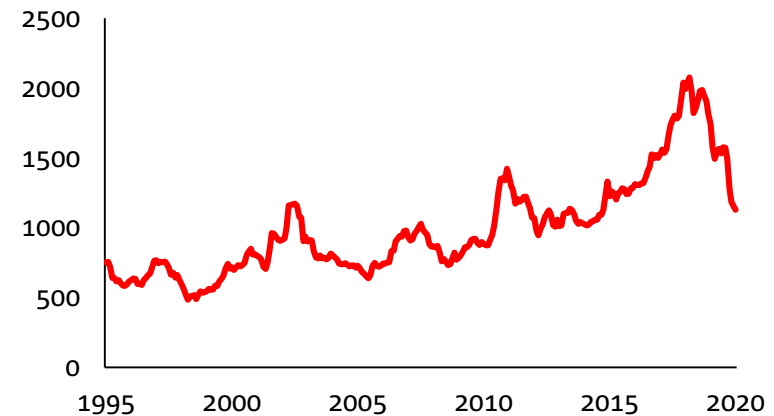
Clothing sales across a number of major economies crashed spectacularly in the first wave of the pandemic, but has recovered somewhat faster than many expected. Whether this continues remains to be seen, especially given the hit to incomes across many economies. This will limit the ability of consumers to make discretionary purchases. We must also consider the possibility of a structural move away from traditional wool-heavy office attire if working from home becomes entrenched.

The Australian dollar has recovered from its sharp falls at the beginning of the year and is now trading above 72 US cents. Our forecasts point to a weak USD seeing an AUD at 80 cents by mid-2022. We also expect the AUD appreciate against the Yuan, albeit more gradually.

Where does this leave wool prices? In our view it leaves limited upside this year. The return since the return from recess EMI has fallen to only a smidge above \$10/kg, although last week saw stabilisation on a nearly 30% week on week drop in the wool offering. While a poor price will likely lead to domestic stockpiling, it is hard to see a pick-up in demand fundamentals and a higher AUD will be a drag. We see EMI around \$10/kg this year and \$12 next year.

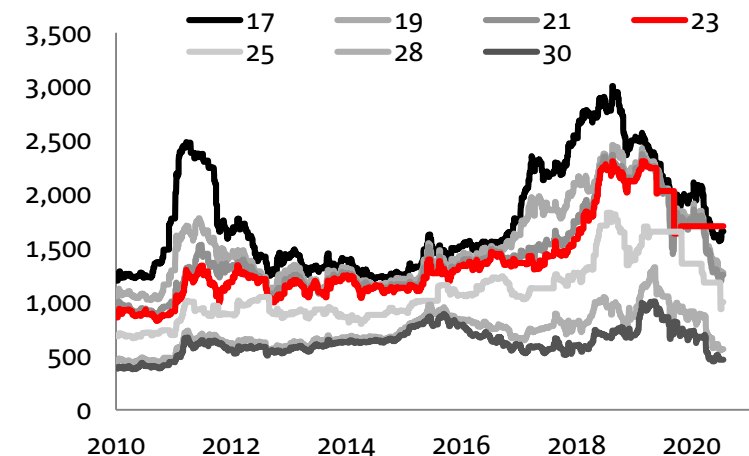
EASTERN MARKET INDICATOR

AUc/kg, monthly



PRICES BY MICRON

Southern region, AUc/kg



Source: AWI, Bloomberg

WOOL INDUSTRY LONG TERM TRENDS

Consumer moves away from wool and unsustainable support culminated in the collapse of the wool reserve price scheme in 1991, leading to a structurally lower wool clip in Australia. The stockpile took a decade to sell down and by the mid-2000s China was the sole remaining large buyer of Australian wool.

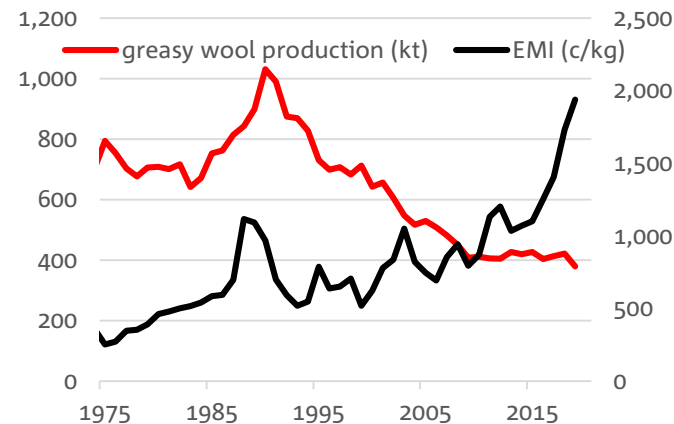
Australian wool production has fallen 63% since 1989-90. While wool production in other major exporters has also fallen, Chinese domestic production has continued to increase. Australia produced nearly 30% of the world's wool at the beginning of the 21st century, but now produces around 20% - roughly comparable to Chinese domestic production.

There has also been a move away from mixed farming in the sheep-wheat belt towards cropping only enterprises, with fencing, sheds and management expertise gone. Many remaining sheep producers have transitioned to crossbreeds for fat lamb production. With lamb prices so strong, the incentive to focus on meat rather than wool is considerable.

These long term factors, combined with drought conditions in eastern Australia, meant that the huge rally in wool prices that began around four years ago was not matched by higher production.

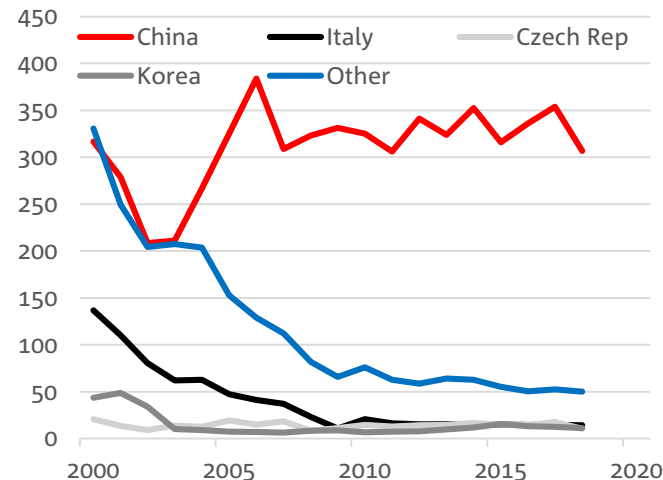
AUSTRALIAN WOOL CLIP

KT (LHS) and EMI price (RHS)



DESTINATION FOR AUSTRALIAN EXPORTS

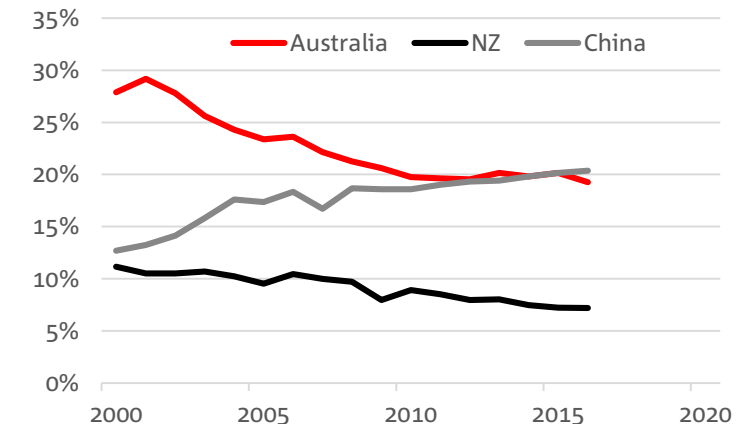
KT



Source: ABARES

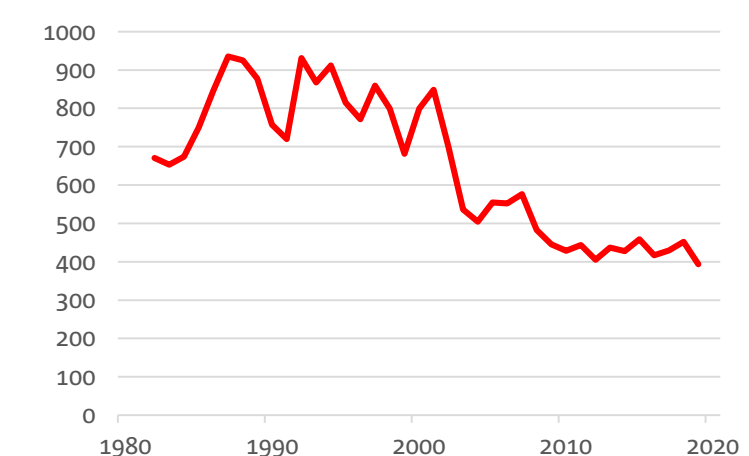
SHARE OF WORLD PRODUCTION

Selected countries, % share



AUSTRALIAN WOOL EXPORTS

KT



CHINESE BUYING ACTIVITY

Australian wool is almost completely dependent on China, for the last decade around 80% of our wool exports (by volume) have gone to China.

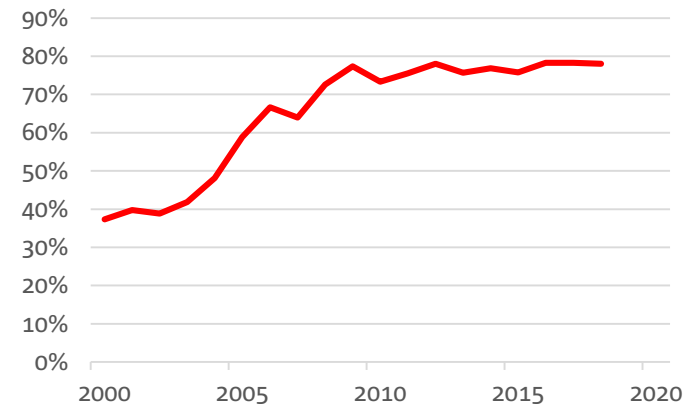
Chinese wool imports have been very subdued of late. Monthly customs data shows a drop off in late 2018, a brief resurgence in mid-2019 following the usual lunar new year slump, and low imports since August, noting a data issue in January-February this year.

Chinese wool imports were down 43% on a year-on-year basis in June 2020. Cotton imports were down 25% year-on-year over the period. With alternative fibre prices subdued (cotton lower was lower but has gained somewhat in USD terms recently, and a collapse in demand has seen oil prices fall substantially), wool will likely remain under pressure.

Australian wool prices have traditionally been quite sensitive to the exchange rate. Indeed the post-2016 rally was accompanied by a lower AUD. However recent movements have been more detached. In any case, our forecasts point to an appreciating AUD, both against the USD and CNY.

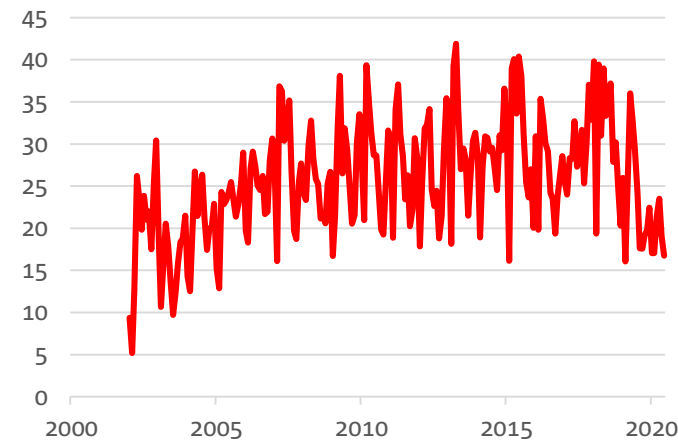
WOOL EXPORTS – CHINA SHARE

Australia, export share by value



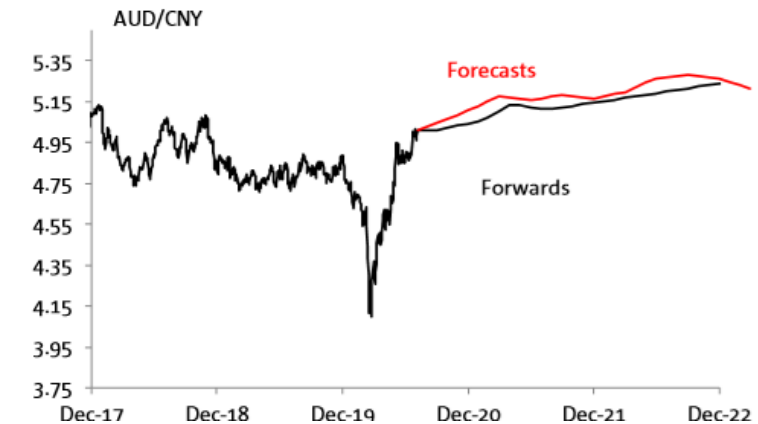
WOOL IMPORTS – CHINA

'000 tonnes, monthly



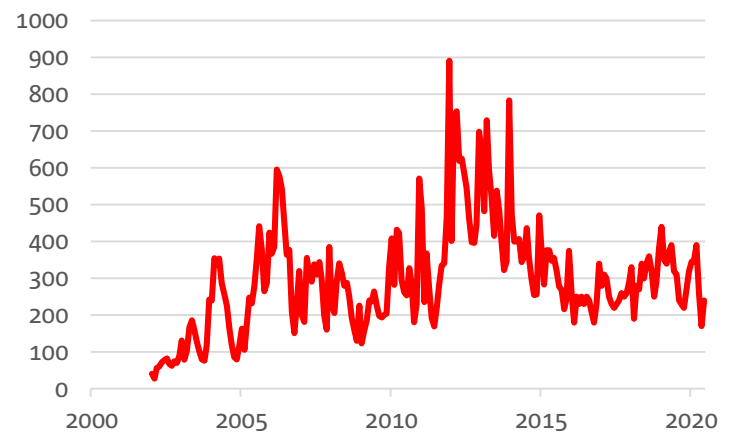
EXCHANGE RATE

AUD-CNY including NAB forecasts



COTTON AND YARN IMPORTS – CHINA

'000 tonnes, monthly



Source: Bloomberg, Datastream, Dxdata, ABARES and NAB Group Economics

WILL CLOTHING DEMAND RECOVER?

Clothing sales across a number of major economies crashed spectacularly in the first wave of the pandemic, but has recovered somewhat faster than many expected.

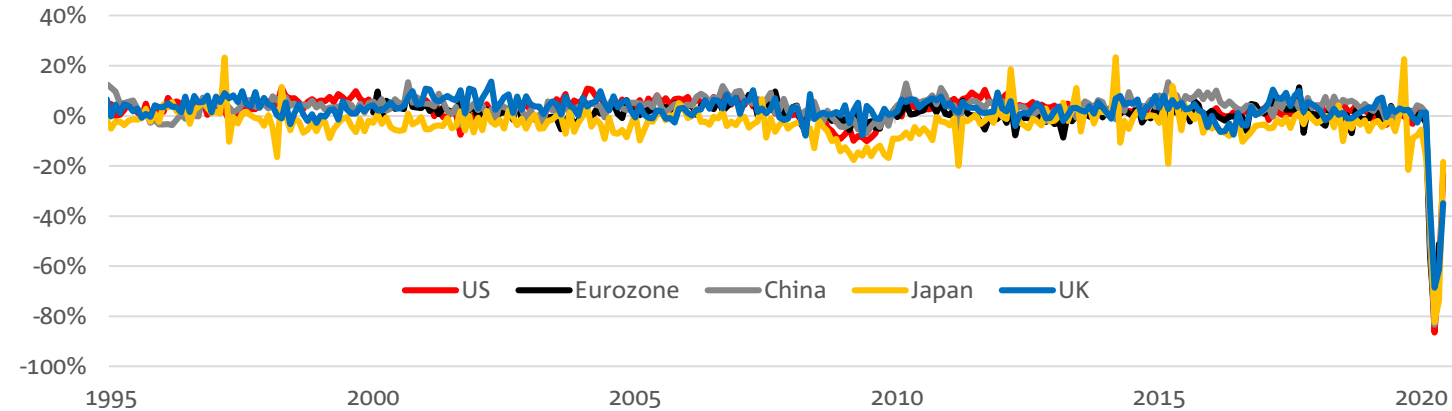
It remains to be seen whether the partial recovery in clothing can be sustained, especially given the hit to incomes across many economies.

The global economy is facing its sharpest downturn in decades, with many countries facing the toughest conditions since the great depression. While a v shaped recovery is possible, it is increasingly difficult to sustain as the pandemic rolls on. This will limit the ability of consumers to make discretionary purchases.

In addition, with office workers largely continuing to work from home, along with the prospect this will continue post-virus, we have to consider the possibility that there will be a structural move away from traditional wool-heavy office attire. While it is not our place to comment on current fashion, let alone that of the future, the move away from the suit and tie could spell trouble for wool.

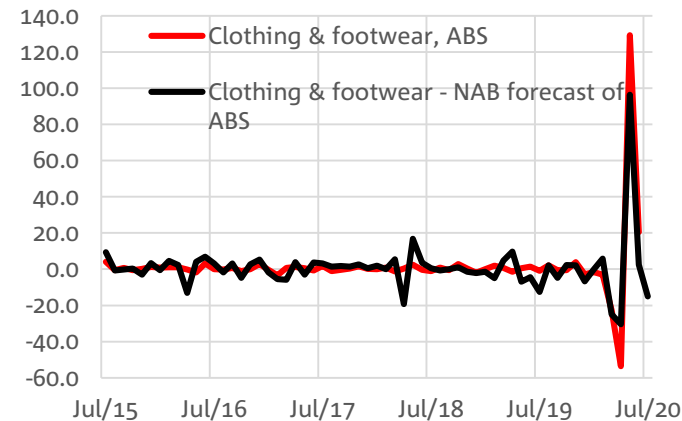
CLOTHING SALES GROWTH – SELECTED COUNTRIES

Year on year



CLOTHING AND FOOTWEAR - AUSTRALIA

ABS retail sales m/m and NAB forecast



NAB KEY AUSTRALIAN FORECASTS

As of 12 August 2020

	2019	2020-F	2021-F	2022-F
Domestic Demand (a)	1.3	-4.8	-0.5	3.6
Real GDP (annual average)	1.8	-3.8	0.8	2.9
Real GDP (year-ended to Dec)	2.2	-5.7	3.1	2.8
Terms of Trade (a)	5.1	0.1	2.2	1.3
Employment (a)	2.4	-3.7	0.4	3.1
Unemployment Rate (b)	5.2	9.2	7.6	6.6
Headline CPI (b)	1.8	0.5	1.4	1.7
Core CPI (b)	1.4	1.1	1.1	1.4
RBA Cash Rate (b)	0.75	0.25	0.25	0.25
\$A/US cents (b)	0.70	0.74	0.78	0.80

(a) annual average growth, (b) end-period, (c) through the year inflation

Source: ABS, Datastream, Dxdata and NAB Group Economics

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