ANZ Research

NZ Forecast Update: Farmgate sheep & beef prices

19 January 2021

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Contact

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Farmgate returns to soften further

Key points

- International market returns have stabilised but farmgate prices expected to soften further.
- Labour shortages and a lack of refrigerated containers may limit processing capacity.
- The strong NZD continues to erode farmgate returns.

Market and logistical risks in play

Farmgate prices for lamb and beef are expected to soften further as we head into the peak processing months. Winter returns were lower than normal, but aligned with our previous expectations, as lockdowns limited demand for dining out opportunities.

China remains a bright spot as its economy is recovering quicker than other parts of the world. Further lockdowns remain the key risk for demand for high-end meat cuts that are typically consumed at restaurants.

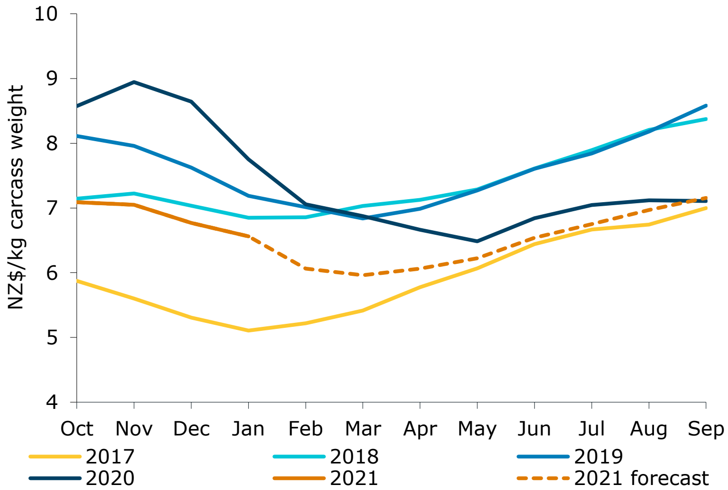
International prices for NZ beef and lamb have generally stabilised but the strong NZD is taking the edge off farmgate prices.

A lack of cool store capacity and disruption to shipping could cause processing delays later in the season.

Further downside for lamb

Schedule prices for lambs are trending down as is normally the case at this time of the season. Prices commenced 2021 slightly higher than we previously anticipated but further downwards pressure on prices is inevitable. Market prices do not justify current returns so as processing volumes lift we expect schedule prices will retreat relatively quickly. We anticipate schedule prices will drop below $6.00/kg CW by February.

Figure 1. Farmgate lamb schedule price trend and forecast

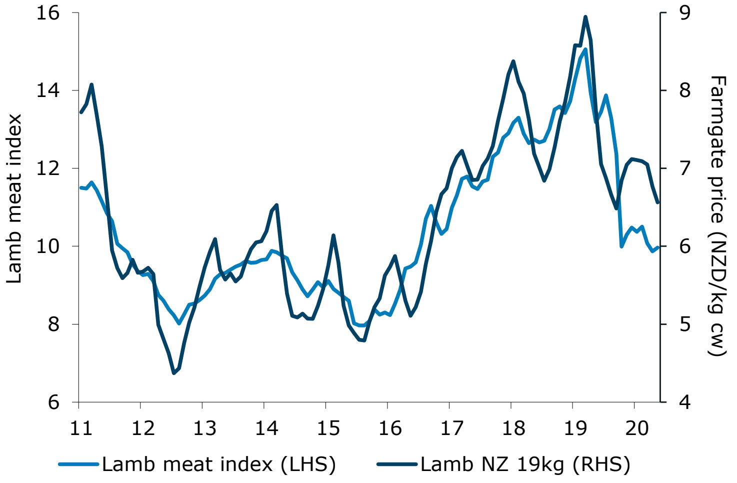


Source: AgriHQ, ANZ Research

Lambs destined for slaughter are currently returning $6.50/kg CW in the North Island and $6.40/kg CW in the South Island. As more lambs become available and procurement pressure subsides these prices are expected to taper off. At present there is plenty of feed available so we are seeing lambs being held onto a little longer. Whether this trend continues will depend on the feed situation, but regardless lambs are expected to be delivered to processors at considerably heavier weights than last season when drought played havoc with the feed situation.

Lamb returns have eased considerably in the past month. This has primarily been due to the strength of the NZ dollar. The price of some cuts have actually firmed when considered in their local currencies.

Figure 2. Farmgate lamb prices vs overseas market prices (NZD)

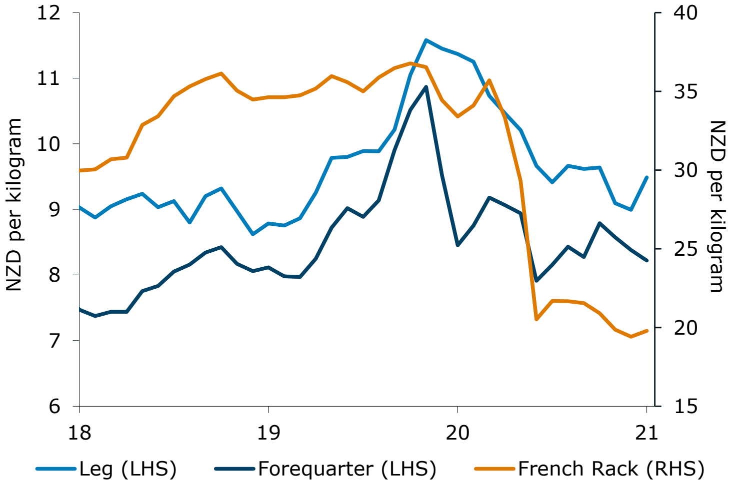


Source: AgriHQ, ANZ Research

International prices for lamb cuts have stabilised somewhat in the past few months following the sharp slide in pricing in the first half of 2020 as demand slumped during the first round of COVID-19 lockdowns.

French rack remains a tough item to sell and there are some instances of this product being discounted in the local market. Prices of leg cuts continued to decline in H2 2020 as uncertainty surrounding the Brexit negotiations reduced demand from UK and European buyers. Meanwhile demand for the cheaper forequarters firmed a little allowing for prices to rebound somewhat.

Figure 3. Market prices for selected lamb cuts (NZD)



Source: AgriHQ

Brexit deal delivers more certainty

The price of lamb legs being sold into the UK & EU markets has firmed slightly following the conclusion of Brexit negotiations. Brexit created considerable uncertainty for lamb traders as it threatened to disrupt the flow of UK lamb into the EU. The negotiations resulted in tariff free access for UK lamb.

NZ exporters will have less flexibility on sales into the UK and the EU due to the original EU quota now being split between the two regions. That said the total volume of NZ lamb that has been exported to the EU (including the UK) in recent years hasn't even reached half of the pre-Brexit export quota. This quota has subsequently been split between the EU and the UK meaning there is now 114,184 tonne quota available for each region.

The increase in demand for NZ lamb in recent years from other markets, such as the US and China, mean exporters are less reliant on the traditional UK and European market. So the reduction in the quota is not a major constraint - as long as demand from other markets is maintained. These quotas are then allocated to individual meat exporting companies based on historic sales volumes. Quota is tradeable between companies.

NZ is working towards trade agreements with both the EU and the UK which could result in more favourable conditions but these negotiations may take years and it is unlikely the EU will provide any concessions on agricultural goods. At present there is no tariff on lamb entering the UK/EU in-quota but if the quota volume is exceeded then a general tariff rate of approximately 50% of the value of the lamb is applied. It is not a flat rate – it consists of a fee per kilo and a percentage of the value. The tariffs differ a little between the UK and EU and also between cuts. But the rates are significant enough to effectively prevent any sales outside the quota system.

Global demand subdued

Overall, global demand for lamb products is relatively subdued. Prices for cuts like forequarters and legs are holding near their five-year average level when considered in NZD terms, but well below the prices attained more recently. Meanwhile French racks are trading at a significant discount (approximately 35% down) on the five-year average. There has been some recent strength in the price of flaps which are mainly sold to China. China's economy is recovering which paints a positive story but supply of pork and beef are also increasing which curbs demand for lamb.

In general, demand for export lamb is not keeping up with supply and stocks are building locally. Access to refrigerated containers is also challenging which makes exporting product in a timely manner more challenging. With container availability scarce and throughput starting to seasonally lift we could start to see pressure building on storage capacity. If this happens then processors may need to slow processing which could result in a sharper fall in schedule prices.

Store stock sales limited

The quantity of store lambs changing hands this season has been less than normal. Good pasture growth and relatively low stocking rates has allowed some breeding operations to finish a larger quantity of lambs than normal. Despite the reduced quantity the price of lambs trading through the yards or from the paddock is considerably softer than last season. This is not surprising given the lower schedule prices and the high levels of uncertainty in future pricing. At present, lambs are generally priced at $2.85 - $3.15/kg LW with slightly stronger prices in the North Island and lighter lambs returning more on a per kg basis.

Crops and pastures are generally in good condition so it is not surprising that the early sales for this year have been better supported than those in December. An air of caution from buyers remains with last seasons' drought still front of mind, and uncertainty surrounding future returns.

Ewes have been well sought after at the early ewe fairs as flocks rebuild following last season's drought.

Processing on track for now

Early season lamb processing is tracking at a very similar rate to the past couple of seasons in both islands. Processing volumes eased through the Xmas break as most companies took advantage of the natural slow-down in throughput that was occurring due to good pasture growth conditions which allowed plants to close their doors without causing huge disruptions to suppliers.

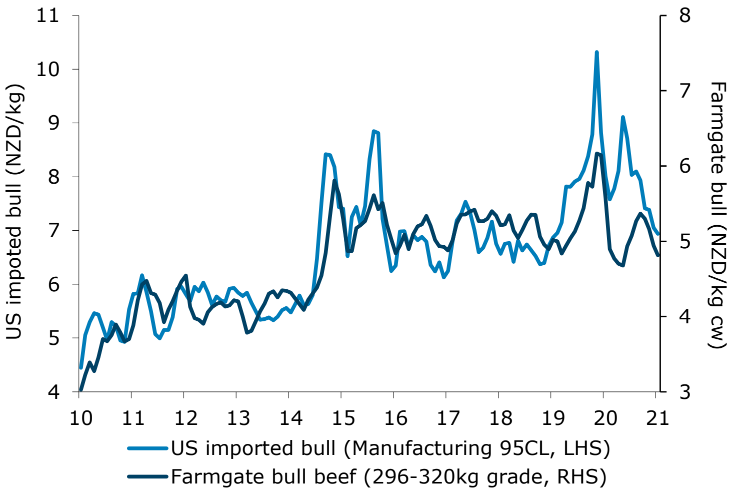
Processing plants are now operating at or near capacity and it has been relatively easy to get space for lambs. But some processing plants are struggling to keep running at full capacity due to a shortage of workers. The reduction in the number of overseas workers entering NZ for seasonal roles means a number of meat industry workers have moved to other industries such as fruit picking and rural contracting. This could curb capacity through the peak processing months if additional labour is not able to be sourced.

Beef markets ease while schedules firm

Manufacturing beef prices are currently holding at respectable levels in our international markets. However, our strong currency means returns are lower than normal in NZD terms.

Farmgate returns for bull beef have now realigned with export returns, but both series are currently trending down (see Figure 4.)

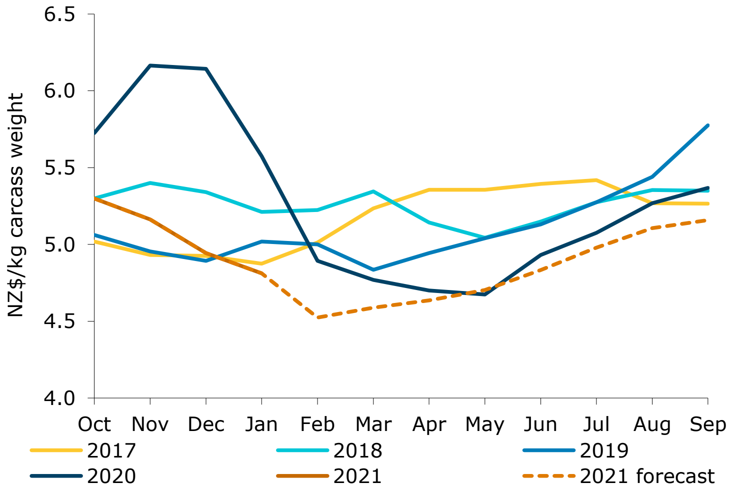
Figure 4. Farmgate bull beef price vs overseas market price



Source: AgriHQ, ANZ Research

Schedule prices for bull and steer are expected to trend down to about $4.50/kg CW. They are already near this level in the South Island but are about 30c higher in the North Island.

Figure 5. Farmgate bull beef price trend and forecast



Source: AgriHQ, ANZ Research

The farmgate price only lifted a little during the low supply months, peaking at about $5.40/kg CW in the late winter/early spring. The smaller lift than normal was expected due to the weak global economic conditions. Since this time schedule prices have dropped about $0.60/kg CW. Prices are now 6-11% lower than normal for this time of the season and the lowest level recorded for January since 2015.

From here we expect to see prices soften a little further, perhaps dropping another 20 – 30c/kg CW before gradually firming again. Exactly how low prices move will depend on where international markets head from here and how quickly the NZD appreciates. Some stability in international prices is anticipated but the NZD will continue to put downward pressure on farmgate returns.

International market demand steady

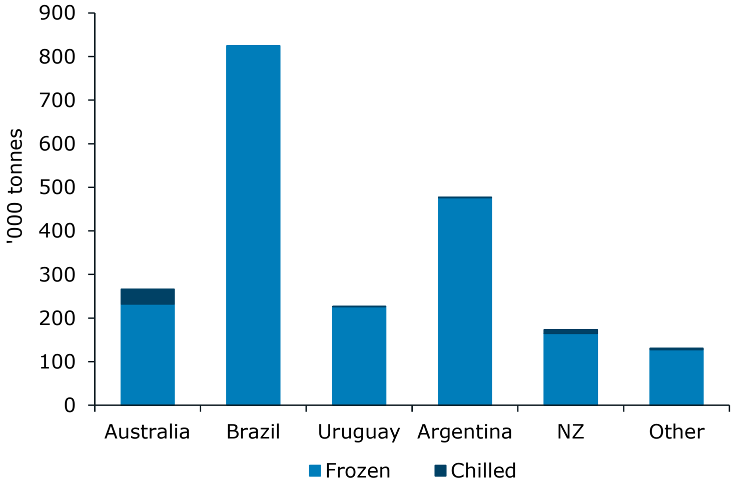
China and the United States continue to be the major markets for our beef exports but we are no longer seeing the price wars that were in play in late 2019 which pushed beef prices to record levels. In the two months to November, 40% of the beef exported from NZ went to China while 25% was destined for the US, when measured in volume terms. Other significant markets for our beef include Japan, Taiwan and Korea.

The price of US imported bull and cow meat has been relatively stable for the past couple of months but the softer USD means the returns in NZD terms have eroded about 8% over that time.

China is now importing more beef from South America (see Figure 6). In the 12 months to November 2020, 73% of the beef imported by China was supplied by Brazil, Argentina and Uruguay. Australia supplied 13% and NZ supplied just 8%.

The currencies of Brazil and Argentina have weakened over the past year making it cheaper to import from these regions. China has also been buying larger quantities of grain from South America as trade tensions with the US and Australia remain in place.

Figure 6. China beef imports by source – 12 months to Nov 2020

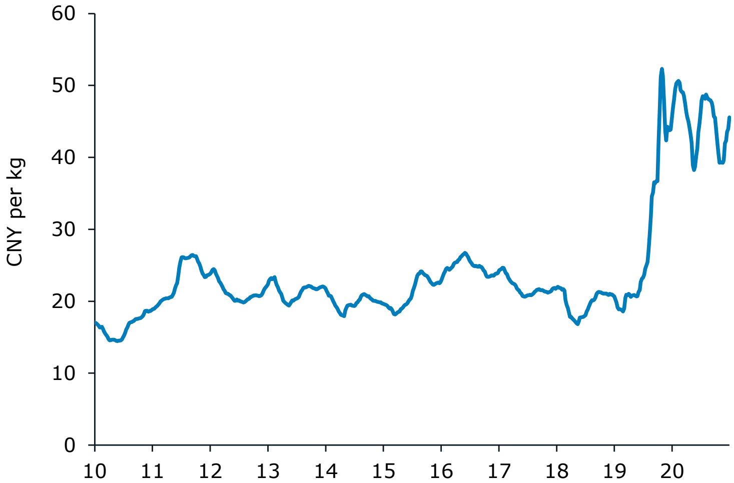


Source: MLA

New Zealand will only ever be a relatively small supplier of beef to China so it is imperative that strong relationships are maintained with Chinese importers. This also provides an opportunity to supply more niche products into this market and increase returns that way.

China's own pork industry is gradually recovering but pork prices remain elevated (see Figure 7.).

Figure 7: China fresh pork wholesale price



Source: MOFCOM, Bloomberg

The US market for beef is expected to remain relatively tight in the coming months. Slaughter volumes are forecast to ease as strong milk prices in the US result in cows being kept in dairy herds longer than usual.

Grain prices in the US are trending up as forecast volumes have been revised downward for major feed crops such as corn and soybeans. As grain prices rise the cost of finishing stock in feedlots will increase. We are likely to see either a decrease in the volume of stock being finished, or livestock finishes demanding higher prices for produce. Either option will be somewhat supportive to the price of imported beef.

Imported beef from Australia his currently in tight supply which is also supportive of prices. This should stem further falls in the price of imported beef.

However, the relatively low value of the USD means the sale of beef to this market is not as lucrative as it previously was. A modest lift in in-market prices could still result in lower farmgate prices due to the strength of the NZD.

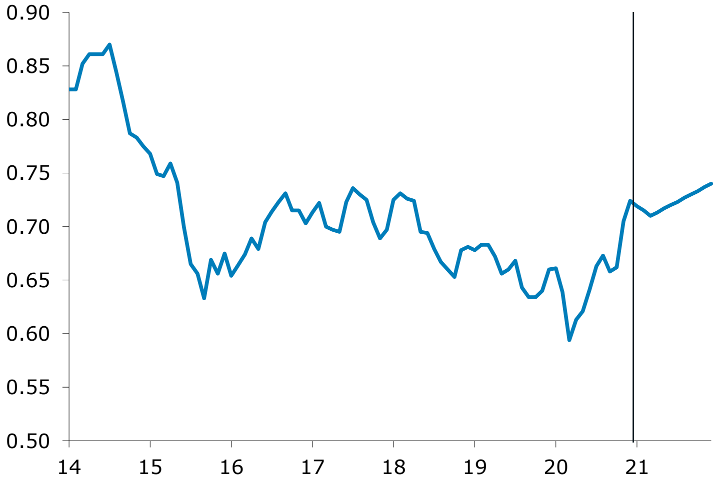
Firmer NZ dollar hinders returns

The NZ dollar has strengthened in recent months. Although the NZD has softened a little this year it is still well above USD0.70. The relative strength of the NZ economy is part of the story but this is little consolation to our farmers.

In fact we expect the NZ dollar could go even higher – heading to USD0.74 by the end of the year. The recent lift in our currency is mainly driven by global trends pushing down the value of the US dollar.

International prices are eroded by our strong currency meaning there is less to pass-through to farmgate prices. Australian farmers face the same issue as the AUD has also strengthened against the USD, but the currencies of some South American exporting regions have weakened which is helping returns to farmers in Brazil and Argentina.

Figure 8. NZD/USD



Source: RBNZ, ANZ Research

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