



INFOCUS
MAY
2018

**HIGH
STEAKS**

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The Australian cattle industry has emerged from the boom times of 2014–15 and is now looking at a more subdued, but nonetheless strong year in 2018.

While prices have eased in recent months, and the autumn break has failed to materialise across much of south-eastern Australia, the industry has also undergone other changes in that time.

A rise in global export market competition remains one of the key concerns for many producers, particularly as the US regains access to China, rebuilds its herd and anticipates a boom in grain-finished cattle in coming months as the US Department of Agriculture (USDA) notes a 1 million head increase in cattle on feed since March 2017. At the same time, the Australian industry has undergone a systemic shift towards grainfed finishing for export markets – particularly Asia – which is expected to be a permanent shift, while the global and Australian grain price stage a moderate recovery and the domestic crop remains strongly dependent on seasonal rains to restore soil moisture and deliver an average crop.

As a flip-side to the grain-finished market, Australian live export numbers have taken a tumble in the past year, down 12 per cent year-on-year to March, particularly to the key market of Indonesia. Interestingly however, underlying this is a decline in feeder cattle exports, but the emerging growth of slaughter cattle exports to markets such as Vietnam and China.

The global trade and competition picture continues to be uncertain as tensions between the US and China simmer under the surface – but with a clear indication from China that should the US and the Trump administration administer further tariff increases, then US beef exports to China are firmly in the firing line.

The impact of trade tensions obviously goes much further than merely increasing the cost of competitors' produce. It has the potential to lead to the depreciation of the Australian dollar on one hand, but, in the longer term, reduced global growth and demand on the other.

The Australian domestic herd rebuild continues with the preliminary estimates from the Australian Bureau of Statistics (ABS) of the herd at June 2017 showing a beef herd of 23.3 million – up 5 per cent on 2016, and showing a strong focus for producers on herd rebuilding.



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WHAT IN THE WORLD OF GLOBAL TRADE?

The emerging instability in global trade and what it means for Australian beef.

The Australian beef industry is highly export-focused, with around 70 per cent of Australian production exported. This booming export market, particularly into Asia but also the US, has supported historic prices over the last three years.

Australian producers have benefited significantly from long-term growth in demand from Asia – particularly Japan, South Korea and China – however, dynamics in beef trade have changed in recent years with the rise in competition for the Asia market from the US, Brazil and Uruguay. More topical in today's environment is – how will increased tensions between some of the world largest economies impact Australia's heavily trade-exposed beef industry? And how will the US's reported entrance into the Trans-Pacific Partnership fray affect the concessions won for Australian beef producers?

The recent stoush between the US and China may have calmed, but only the most optimistic would believe that it has been resolved. While President Xi made a number of concessions in response to the first volley of tariffs between the two nations, namely by committing to lower tariffs on US car imports, there is no guarantee if or when this commitment might be implemented. And clearly, US beef is the next in China's firing line. The first round of tariff increases involved the US-implemented, new tariffs on imports of steel and aluminium. In response, China reciprocated with tariffs on US steel and aluminium, as well as a range of agricultural products, including pork, fresh fruit, wine and nuts.

In response, the Trump administration proposed tariffs on 1,300 Chinese goods, including products used for robotics, information technology, communication technology and aerospace. China responded with proposed tariffs on US soybeans, beef, cotton and corn.

While commitments from China's President Xi Jinping to allow foreign companies greater access to China's financial and manufacturing sectors, as well as signalling lower tariffs on cars, have put the so-called 'trade war' on hold, it is by no means resolved. And China's sights are firmly set on Trump's constituency in rural America, including US beef producers. With the US only re-establishing its foothold in the Chinese market since June 2017, the prospect of increased tariffs, whether they come to fruition or not, are likely to have a chilling effect on the re-emerging trade links.

Whether this helps Australian beef or not, is yet to be seen. Brazil and Uruguay are also exporting heavily into China, and Australia's market share has dropped away in recent years as Australian beef increased in price due to lack of supply. With US beef sitting as a direct competitor to Australian beef on price and quality, a 'trade wars' chilling effect on US exports may benefit Australian producers.

Also of interest for Australian beef producers is the finalisation of the new Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) – without the US as a signatory. The new TPP has been hailed by Trade Minister, Steve Ciobo, as delivering a 'substantial advantage' to Australian producers over US beef, particularly in relation to the Japanese market where the tariff on frozen and chilled beef will drop from 27.2 per cent and 29.9 per cent respectively to 9 per cent over 15 years. With the improved access to the Japanese market, many producers are eyeing the 'Jap Ox' market, or grass-finished steers bound for the Japanese and South Korea markets.

The next question comes off the announcement from President Trump that the US will reconsider joining the CPTPP if the outcomes are 'substantially better' for the US. This move was likely to be prompted by US agricultural lobbies, including the National Cattlemen's Beef Association which has expressed concern that Australian beef will now be at an advantage over US beef in the Japanese and South Korea markets. However President Trump has since changed gears, stating that he prefers the option of renegotiating or altering the US's existing bilateral trade agreements with Japan and South Korea – options which are bound to take considerable time to come to fruition. Regardless, the US is in a difficult position in which to renegotiate existing bilateral agreements or achieve entry into the CPTPP, and can only enter the CPTPP with the Agreement of Current Parties, including Australia. Minister Ciobo has indicated he sees considerable benefit to the US joining the Agreement – but whether these benefits are enough to give up Australian beef producers' new-found advantages over the highly comparable US market, is yet to be seen.

EXPORTS & COMPETITION

With export market demand an important driver of domestic prices for Australian producers, it is worthwhile revisiting the major trends and statistics of Australia's beef export markets.

Australia holds just 2.5 per cent of the world's beef cattle herd and accounts for 3.5 per cent of global beef production, yet is a major export market contributor, being responsible for 15 per cent of global beef shipments in 2017. 54 per cent of Australia's exported beef is produced in Queensland, and 18 per cent and 15 per cent in New South Wales and Victoria respectively. With such large market concentration in the one state of Queensland, the impacts of changes to the Queensland herd, weather, and export orders, are felt by all.

Australian trade volumes and import market shares to the countries of Japan, US, South Korea and China, will continue to be of significant importance to the beef industry. Making up our four top export markets, and accounting for over 75 per cent of total export volume in 2017, these markets have been major contributors to the price trends experienced by Australian producers over recent years.

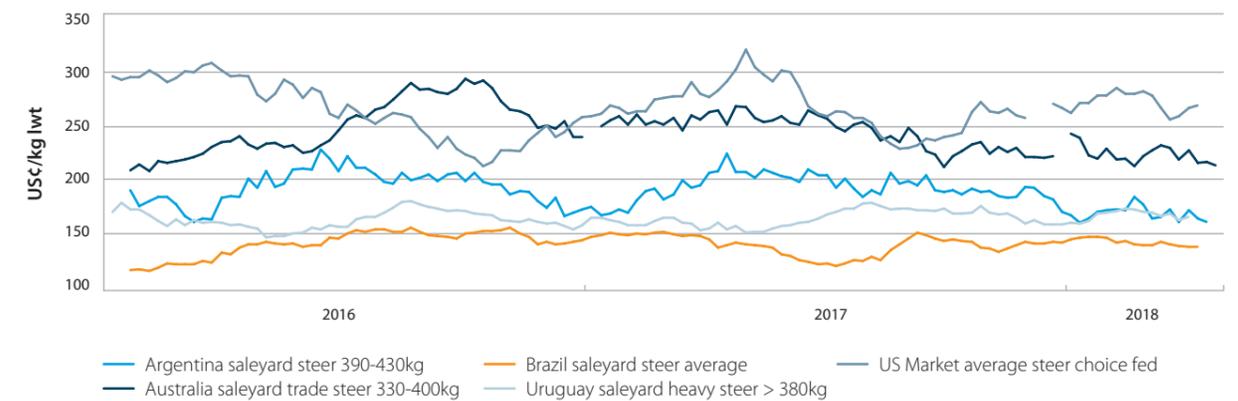
For Japan, our number one market by export volume and value, there is a growing preference for grainfed beef, with particular cuts such as silverside and striploin gaining in share of total exports in 2017. Exports to Japan from Australia have grown gradually over the past five years, to around 290,000 tonnes shipped weight (swt) in 2017. With Japanese consumers placing high importance on knowing the origin of their food, Australia's excellent brand reputation and image in the country will need to continue hold strong against increasing import quantities from the US, which is becoming more competitive in price.

As the US domestic herd grows, US beef prices are forecast to slightly reduce, encouraging further competition for Australian product. Historically, in US dollar terms, Australian beef has enjoyed a price advantage over US product in Japan. In 2012-13, Australian beef was US\$1.28 cents per kilogram (c/kg) cheaper than US beef, reducing to just US\$0.43c/kg by 2016-17. If trends continue towards a cheaper US product, and without an associated easing of Australian prices, Australian market share may come under increased pressure.

An increase in US production will also impact Australian exports to the US itself, as local production edges closer to meeting total consumption and demand, while also increasing the volume of US beef available to export markets. The latest combined OECD-FAO (Organisation for Economic Co-operation and Development and Food and Agriculture Organisation of the United Nations) agricultural outlook data is forecasting that US production will fall short of US consumption by around 543,000 tonnes carcass weight (cwt) out to 2023. This is considerably less than the shortfall the country experienced in 2015 when local production lagged consumption by some 987,000 tonnes cwt. What is important to note however is that the US does not only import Australian beef to simply meet a local production shortfall. Australian beef has a place as a high quality, safe, and ethically produced meat, with attractive alternatives to locally produced and grain finished beef, such as Australian grassfed beef. Chilled Australian grassfed beef contributed to 25 per cent of total exports to the US in 2017, and is growing in popularity as sectors of the population seek to understand more about the food they are eating and the way in which it is produced.

South Korea, Australia's number three beef export market, was down 3 per cent in 2017 export volumes on the five year average from 2012-16, with a more significant 17.5 per cent reduction from 2016 figures. Like the Japanese market, Australia is facing increasing competition from US beef in South Korea, where the US has both tariff and volume advantages over Australian beef. Australian beef in South Korea was on average US\$1.08c/kg cheaper throughout 2016-17, back from over US\$2.00 \$/kg in 2014-15. Australian beef is mostly imported as a frozen product, and trends are toward an increasing preference for grainfed, with frozen grainfed exports from Australia increasing from 12 per cent of total exports to 19 per cent over the past five years. This trend is expected to continue due to product consistency amongst the beef cuts preferred by the South Korean consumer, namely chuck, blade, brisket and ribs.

GLOBAL STEER PRICES



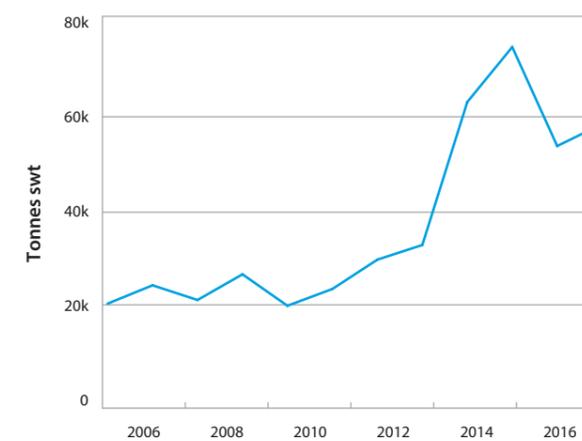
Source: MLA, ANZ

Other competitors in the market include Canada and Uruguay, with Brazil notably having no market access to South Korea. Uruguay, which exports nearly three quarters of its total beef production every year, is a competitor to watch, as production growth has averaged 2 to 3 per cent over the last four years, and now enjoys a Foot and Mouth Disease Free status and a fully functional cattle traceability system which was implemented in 2007.

UP UNTIL 2017, AUSTRALIA ENJOYED BEING THE ONLY COUNTRY WITH MARKET ACCESS FOR CHILLED BEEF INTO CHINA

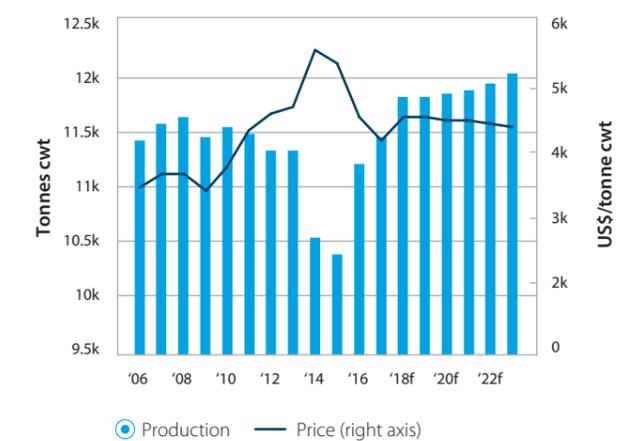
In China, the beef market is very competitive and is expected to become more so as more countries are granted access. Imported product from Australia, Uruguay, Brazil, New Zealand and Argentina make up the major share of beef brought into the country, with Brazil holding the largest increase in market share since 2015. Up until 2017, Australia enjoyed being the only country with market access for chilled beef into China, however the US and New Zealand now also hold arrangements for chilled product. In terms of domestic production, the Chinese beef cattle herd of approximately 53 million head is forecast to increase steadily in both total numbers and quantity of beef produced, with over 8 million tonnes (cwt) of forecast beef production by 2020, according to OECD-FAO figures. Overall, for Australia, a high quality, safe and consistent product will continue to be a market differentiator in China, as cheaper alternative products will increase in availability.

AUSTRALIAN CHILLED GRASSFED BEEF EXPORTS TO US



Source: MLA, DAWR

US BEEF PRICE AND PRODUCTION



Source: OECD-FAO, ANZ

A CLOSER LOOK AT AUSTRALIAN CATTLE PRICES

As the EYCI dips below 500 Ac/kg cwt, opportunities and trends are emerging across different categories of cattle.

As the Eastern Young Cattle Indicator (EYCI) dips below 500 Australian cents per kilogram (Ac/kg) for the first time since 2015, pressures and opportunities are being revealed in different cattle classes, and across different States.

Dry weather across much of Australia has caused the EYCI to decline since February, however the trend for the first quarter of the year has followed the 2016 and 2017 trends of a drop-off in prices prior to the autumn break, followed by a recovery towards the middle of the year. What is different this year, however, has been the closing of the gap between trade and feeder steers and medium and heavy steers. Throughout 2017 the EYCI was being strongly driven by demand for restocker and feeder cattle, while medium and heavy steer prices stayed relatively flat, as many speculated that the Australian cattle industry was undergoing a fundamental change towards grain-finished cattle. The preference for restocker and feeder cattle over medium and heavy steers was also likely to be due to concern over growing global competition for Australia's key export market, the higher than anticipated Australian dollar and a generally declining EYCI across the year.

So does the convergence of feeder/restocker prices with medium and heavy steers mean that the grain-finishing market in Northern Australia is losing steam? In short – no. While the number of cattle on feed in Queensland and, to a lesser extent, New South Wales has declined slightly from record highs, as a result of increasing feed grain prices, on a state-by-state basis, the convergence between heavy and feeder steers has been felt across Victoria, New South Wales and Queensland – although with a slightly greater trend downwards in Queensland.

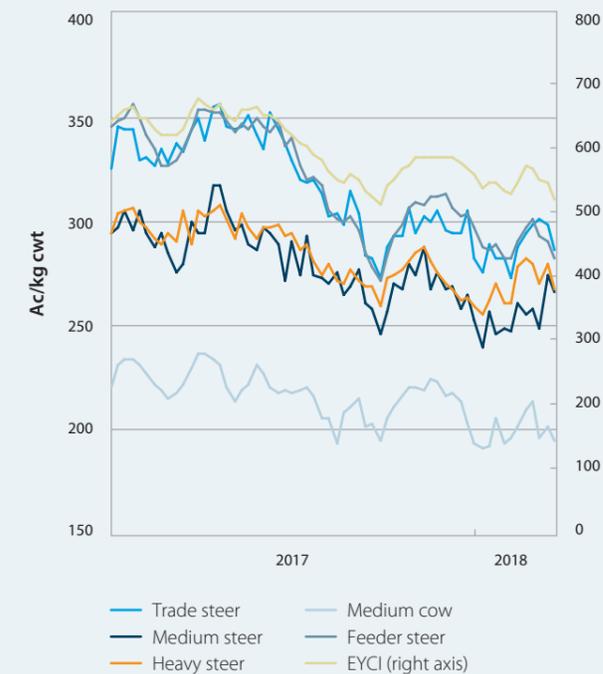
This reducing margin between feeder and heavy steers presents a clear opportunity for those producers expecting the season – and prices – to improve for heavy and grainfed steers into the future.

Performance across other cattle categories is also mixed across states. Restocking activity has, predictably, taken an upturn in Queensland in recent weeks following mid-March rains, but fallen away in New South Wales and Victoria; trade steer prices are performing well in New South Wales but remain relatively weak in South Australia. Across Victoria, New South Wales and Queensland, feeder steer prices moved together for much of the first half of 2017, before breaking in September for New South Wales, and Queensland prices to increase while Victorian prices remained stable. That break also appears to be coming back with prices across the states returning to almost on par in recent weeks.

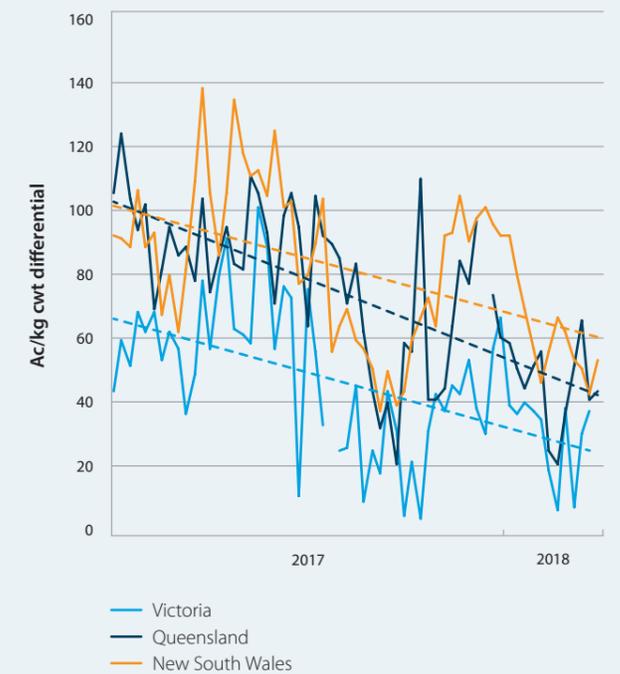
Paddock feeders and finished cattle have shown a similar trend to saleyard prices, having suffered a downturn in recent weeks, with domestic feeder steers and heifers suffering the most marked downturns. Interestingly, longfed and midfed feeder steers for the export market have maintained relatively stable prices since late 2017, albeit lower than the 2016–17 highs. As many of the midfed and longfed grassfed steers are prepared for the Japanese and South Korean market – what has previously been called the 'JapOx indicator' – this may indicate very early signs of interest stemming from confidence in those markets. The grassfed market into Asia remains a comparative advantage for Australia over the US and the US's grain-fed exports.

In contrast to saleyard prices, over-the-hook prices have shown a strong improvement since the beginning of the year, which will ease pressure for lotfeeders going forward. The strong jump in Queensland prices came as a result of the significant rainfall in March, which hindered access to cattle and supply or many processors – and which has since levelled off. The over-the-hook prices will ease the concerns of many lotfeeders who, earlier in the year, were faced with relatively stronger saleyard prices, weaker over-the-hook prices and increasing grain prices putting pressure on margins. Queensland 100-day grainfed steers have also returned to trading at a strong premium over Victoria and New South Wales, after spending much of 2017 trading either on par or slightly below.

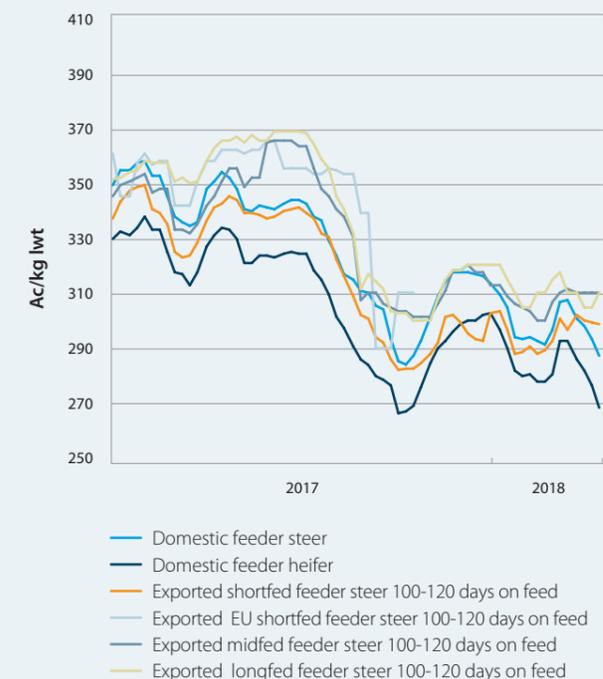
EASTERN STATES SALEYARD CATTLE PRICES



FEEDER STEER V HEAVY STEER PRICES



AUSTRALIAN GRASSFED FEEDER STEER PRICES



OVER-THE-HOOK PRICES BY STATE

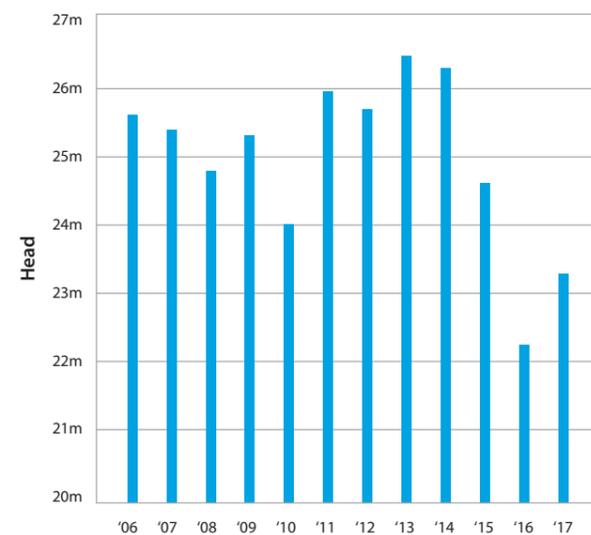


REBUILDING THE HERD - DOMESTIC & GLOBAL

As the Australian herd numbers rebuilt strongly throughout 2016–17, those efforts are currently being slowed by dry conditions.

When discussing the current state and outlook for Australian beef, the need to increase the Australian breeding herd is a common and reoccurring theme. For the three consecutive years from 2013 through to 2016, the national cattle herd declined, reaching a low of just over 22 million head of total cattle and 11.5 million head of breeding cows in 2016. The sell down was most prominent in our largest beef producing state of Queensland, which holds approximately 45 per cent of the Australian breeding cow herd, reducing breeding cow numbers from close to 6.5 million head to just over 5 million head over the same period. Our second-largest beef-producing state, New South Wales, experienced a more gradual downturn in breeders, whilst other states mostly followed suit, albeit with a lesser impact on the overall Australian figures.

AUSTRALIAN TOTAL BEEF CATTLE HERD



Source: ABS, ANZ

While current prices remain high when compared to historical levels, they eased off gradually throughout 2017, and female slaughter levels have stabilised at an average 46 per cent for the past 12 months, according to the latest ABS data. Herd rebuilding has commenced in parts of the southern states, and while Queensland producers were fortunate to experience widespread rains in February and March this year, insufficient follow-on rains may slow the herd-rebuild process and put pressure on prices, which had already failed to rally for any considerable period of time post the rain events.

In general, assuming a return to average seasonal conditions, Meat and Livestock Australia (MLA) is forecasting a steady Australian herd rebuild over the coming years and a stabilising of female slaughter rates to around 45 per cent, and is expecting the national herd to reach its pre-drought peak of over 29 million head by around 2020. Whilst dry seasonal conditions continue to play out in the north, and now also in parts of southern states, poor pasture growth is predicted going into the Australian winter, which will likely slow herd rebuilding efforts, suggesting this target may not be achievable in such a short term.

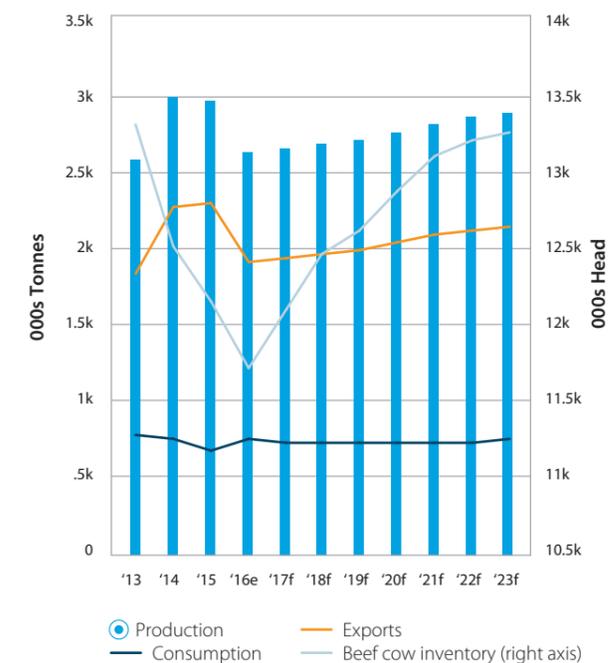
MLA IS FORECASTING A STEADY AUSTRALIAN HERD REBUILD

From a production perspective, a variety of market sources are predicting steady increases in Australian beef production in the near term, driven by the aforementioned herd rebuilding forecast, suggesting more cattle will be available for slaughter. A key question, however, may be should our herd build go back to the levels anticipated, and production forecasts play out as predicted, will Australian producers be met with a beef price that is on par with expectations set by the favourable pricing period of 2013-2017?

In an increasingly competitive global market for beef, the herds, trends and outlooks for beef production of our major competitor countries are vital considerations for the Australian industry. The US beef herd, totalling some 94 million head and including a current figure of approximately 31 million breeding cows, according to recent USDA and OECD data, has been on the rise since 2014, which marked the end of a five year decline in cow numbers across the country. As the US herd recovers, US beef production, domestic consumption and exports are all on the rise, and as such place further competition on prices and market share into Australia's prized export markets of Japan and South Korea. Australian imports into the US may also come under pressure in terms of both volume and price as US domestic production rises and is able to further meet its growing domestic demand.

In Brazil, there is also a herd-building process underway, however, in contrast to Australia and the US, who are recovering from previous herd reductions, our largest South American competitor has seen a steady and measured increase in its cattle herd and boasts the second-largest herd in the world behind India. With major challenges of meat quality, restricted market access, and poor local economic and political conditions not to be dismissed, the sheer size of the herd and production and export potential mean that even small gains in international market access and trade volumes for Brazilian beef will still have implications for the Australian industry. The OECD is forecasting that domestic beef consumption in Brazil will rise only modestly through to 2023, whilst its production forecasts are much more bullish. The result would be more beef available to export markets, at competitive prices, into some of the shared Australian and Brazilian markets, most notably China.

AUSTRALIAN BEEF PRODUCTION

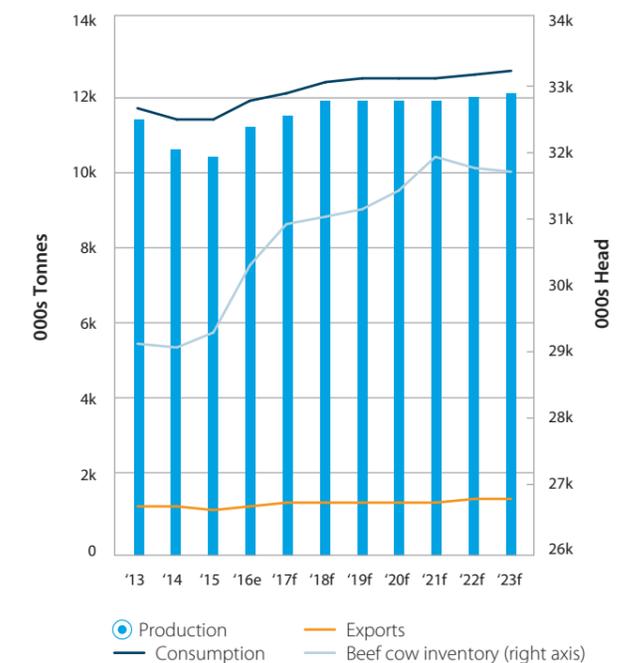


Source: OECD-FAO, ANZ

At over 300 million head, the Indian beef and water buffalo meat industry cannot go unmentioned. The herd, over 10 times that of Australia's in size, contributes to 19 per cent of the world's total beef shipments, with India's major markets being Vietnam, Malaysia, Egypt, Iraq and, since mid-2016, Indonesia. Accessing the Indonesian beef market with carabeef (Buffalo) was a major step forward for India's industry, and leads to queries as to which other South East Asian countries may seek cheaper protein alternatives for growing populations. The timing of the market access was particularly important for Australia as it coincided with peak Australian beef prices in 2016. In what could also be seen as a strategic move by the Indian government, MLA reports that almost all export meat is processed at state-of-the-art and large-scale, government-approved abattoirs, as opposed to local domestic market abattoirs that have poor hygiene standards and often lack cold storage.

It is anticipated that both the US and Brazil will have increased amounts of beef available for export at increasingly competitive prices. How Australia positions itself to retain its competitiveness and export market share – be that in quantity, value or both – will be important in determining the price of Australian beef going forward. For Australian beef destined for Japan, South Korea and the US in particular, food provenance, ethical production and finishing systems, and meat eating quality and consistency will need to continue to be major areas of focus for producers as international competition ramps up.

UNITED STATES BEEF PRODUCTION



Source: OECD-FAO, ANZ

LIVE EXPORTS & THE FEEDLOT SECTOR

Australia's live export industry has gone through a number of challenges in recent years, with the disruption of Australian trade, followed by the emergence of Indian water buffalo into Indonesian markets, being the key factors at play. We may, however, be starting to see the path towards the end of these challenges, as exports to Indonesia start to pick up pace. In the year to March 2018, Australia exported 508,224 head to Indonesia, down 12 per cent on the year to March 2017, but above 2015 levels. However, strength in the market not only stemmed from stability in exports to Indonesia, but the emergence of other markets around Asia – not only for feeder cattle which are the staple export to Indonesia, but for slaughter cattle. In the year to March 2018, live slaughter cattle exports increased 14 per cent to 1,097,706 head, with the markets of Vietnam and Malaysia emerging as key. However, it must be noted that exports to Vietnam were coming off a low figure in 2017 after a series of supply chain issues and high Australian cattle prices.

WHILE LIVE EXPORT NUMBERS DECLINED THROUGH 2017, EARLY 2018 HAS SHOWN SIGNS OF RECOVERY

While overall, year-to-March export numbers were down 12 per cent, there were strong signs that any downturn had turned around as the January to March figures were 21 per cent higher than in 2017, with slaughter cattle exports increasing 83 per cent.

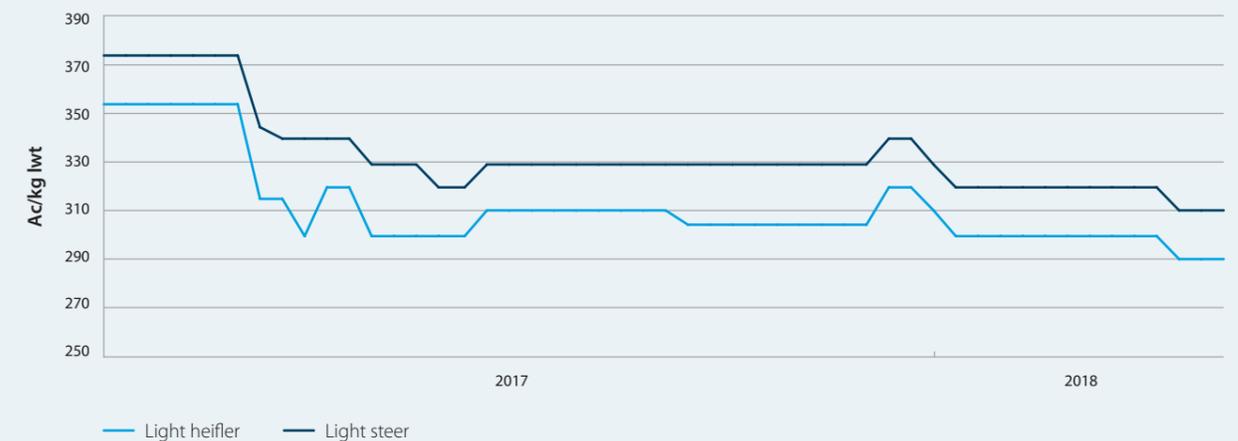
The importance of the live export market to the Australian cattle industry cannot be underestimated. According to the global Agri Benchmark Network Study, which surveys a range of production systems across Australia and the world, live export cow/calf production systems are Australia's most profitable beef production systems. In this respect, Australia's comparative advantage in cattle production currently lies in cow/calf production rather than the pasture or grain finishing systems, making live exports one of Australia's core industries in Northern Australia.

The number of cattle on feed in Australia has been in decline since mid-2017, after it peaked at almost 1,090,000 head. According to the Australian Lot Feeders' Association (ALFA) and MLA survey from the December quarter 2017, the number of cattle on feed decreased 51,572 head, or 5 per cent from the previous quarter. The reduction in the number of cattle on feed came from a reduction in utilisation of existing capacity, which fell from 80 per cent to 75 per cent. The overall capacity of feedlots actually increased slightly in the December quarter from 1,278,184 head to 1,293,623 head.

Much of that decline has primarily been due to increasing feed grain prices, declining over-the-hook prices and steady or improving saleyard cattle prices. As discussed above, the discrepancy between over-the-hook and saleyard prices seems to have disappeared over the past few weeks, however the appreciating feed grain price is likely to persist for the foreseeable future.

In export markets, lot feeders are seeing significant signs of strength – particularly in those markets in Asia with a preference for the softer texture of grainfed beef. Japan continues to be a strong export market for both grassfed and grainfed, with Australian exports to Japan being split almost 50/50 between the two. According to the MLA, figures from the Department of Agriculture and Water Resources (DAWR) show that for the December 2017 quarter, Australian grainfed beef exports were up 11 per cent from December 2016. In that same quarter, grainfed exports hit a record level in 2017, with exports to Japan increasing 7 per cent year-on-year, making up almost half of Australia's grainfed export market, and exports to China up 13 per cent, although from a low base. On the other hand, Australia's other key market of South Korea suffered a drop of 4 per cent as a result of competition from the US tariff reductions delivered through the South Korea-US Free Trade Agreement.

LIVE EXPORT PRICES TO INDONESIA EX. DARWIN



Source: MLA, ANZ

LOT FEEDERS ARE SEEING NEW SIGNS OF GROWTH IN NEW EXPORT MARKETS

NUMBER OF CATTLE ON FEED BY STATE



Source: MLA, ANZ

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