Royal Bank of Scotland

Agricultural Services

Sheep Industry Outlook
October 2015

The strong end to the sheep marketing year, which normally happens in May/June, was obvious by its absence in 2014/15 season. Prices followed the five year average through the first quarter of 2015, but then fell away in April and May. Apart from a brief flurry towards the end of June, old season prices remained flat to the end of the marketing year. The new season did not bring better news, as prices fell sharply through July. This was partly a result of an increased number of lambs coming to market but also influenced by lower demand as adverse exchange rate movements made exports more difficult.

In May and June, the number of lambs slaughtered was 3-4% higher than a year earlier – a result of a combination of a bigger lamb crop and an increased 'carry-over' of lambs from 2014. Forecasts for the crop year suggest the number of lambs for slaughter will be up on last year, which itself was up 5-6% on the previous year.

Market prices have been around 10% lower in the first half of 2015 compared to the same period in 2014. Prices peaked in April, close to 450p/kgDwt., but that's 100p/kgDwt (or £20/lamb) lower than last year. Prices dropped to 430p/kgDwt by June before plunging to around 325p/kgDwt in July.(Eblex)

There was a modest increase in the size of the UK breeding flock in December 2014 (3%) (Defra), taking it to just short of 15 million. The increase in the total UK breeding flock was driven by an 11% increase in Wales. England and Scotland recorded an increase of only1.6% in flock size.

This year's lamb crop could be the largest in a decade and more than 10% above the low point of five years ago. Fewer ewe lambs are also expected to be retained for breeding this year, which could add further to the supply of lambs for slaughter. Current estimates suggest that all this will result in up to 900,000 additional lambs coming to market in 2015/16. This follows an increase of 650,000 lambs in 2014/15.

The increase in this year's domestic lamb crop follows a better lambing season. Better conditions last autumn increased conception rates. This combined with the increase in the UK breeding flock and higher carcass weights, will push total domestic meat production higher this year. At the halfway point production was nearly 6% ahead of 2014 (Eblex). Looking behind these trends, the numbers slaughtered have been consistently higher each month this year, with the exception of April, as more lambs were carried over from 2014.

Despite the fall in lamb values, there appears to be a reluctance to cull adult sheep from the flock. In the first half of 2015 the number of adult sheep slaughtered was down 17% on the previous year, reaching their lowest level since 1988. (apart from the 2001, when trade was interrupted by FMD). Cull ewe prices have fallen back from previous highs and have been trading around £60/head – which is very similar to a year ago.

The UK remains the third largest exporter of sheep-meat, behind New Zealand and Australia. The export market remains a key driver for prices, with the bulk of 'standard' grade lamb exports going to France The price for lighter lambs generally improves at times when there are festivals in countries where smaller carcasses are preferred.

For those producers who export their lambs, prices are also influenced by the sterling/euro exchange rate. When sterling is strong, the price paid to UK producers for export lamb is usually lower than if sterling is weak. In the first part of 2015 the strength of sterling against the euro had a negative effect on export margins. The current volatility in euro sterling exchange rates and the impact this could have on the value of lambs in future, are potential concerns for farmers who rely on the export trade.

While the equivalent price of lamb in France is still 15% above that of the UK, the differential is narrower than previous years. Demand in France is currently subdued and likely to remain that way for the rest of the year. A further hurdle for UK exporters is the price of Irish lamb which is currently around 300p/kgDwt. Irish lamb is a direct competitor in the French market. At that price, the supply of Irish lamb is likely to provide strong competition for UK exporters. The Chinese market now accounts for 27% of global sheep-meat trade – taking over from France as the world's largest importer back in 2012. Free Trade Agreements between Australia and New Zealand and China are likely to improve access to Chinese markets for these countries.

The story on imports this year is mixed. Increased shipments of mutton and lamb in the first quarter of 2015 were offset by lower volumes in the second quarter. Drought conditions in New Zealand encouraged earlier shipments into their export markets.

Although the rate of growth in demand from China has eased, it is still likely to attract a higher proportion of lambs from both Australia and New Zealand in the future. Around 90% of Chinese imports of sheep-meat came from these two countries in 2014.

UK exports, on the other hand, were substantially lower for the first five months of the year. This was partly influenced by problems affecting trade with Hong Kong, and large reductions in trade with other EU states (although there are some conflicting reports about the actual volumes being exported). What is clear is that the price being received in the export markets is well down – being influenced by adverse exchange rates. The UK remains the largest exporter of sheep-meat in the EU.

Across the EU, there is likely to be some variation in production. In Spain, which is the second largest producer in the EU, there was a drop in the breeding flock of 6% last year, continuing the long term trend. Their flock has declined by almost a third since 2006 (Eurostat). As a result, lamb production in Spain is down around 4% this year so far. Ireland is showing a 2% decline in breeding sheep numbers, which will also reduce their lamb production for this year. Production in France is expected to be relatively stable.

In the past few years, the consumption of lamb appears to have come under more pressure than other meats, as consumers react to rising prices. Ironically, although better weather can improve lamb performance, it tends to slow consumer demand even further. The extent to which lamb price falls will depend on how demand responds to increased supplies, both in the domestic and export markets. But with consumer confidence still relatively low, it will not be easy to stimulate additional demand for sheep-meat.

Although consumption in the UK has been falling for several years, the decline in the number of breeding ewes in our main European markets has, until now, been keeping the market in balance. That will be tested this year, with the increase in domestic supply likely to put pressure on prices for the remainder of the season. Underlying costs appear to be increasing at a slower rate, but financial margins are still likely to be tighter this year.

The market for wool has shown a modest recovery, but prices are still well short of recent peaks. In 2009 prices were around 60p/kg. These rose to 100 p/kg in 2010, then 145p/kg in 2011, before peaking at around 170p/kg in early 2012. Market prices fell dramatically later that year, to115p/kg. They have since recovered to around 120-130p/kg. There is, however, a wide range of prices depending on the colour, fineness etc. with prices ranging from 50-150p/kg. This seasonal fluctuation in price can be put down to a number of factors. The level of world stocks, sheep numbers, the relative cost of synthetic fibres and the level of demand have all had an impact. As the major purchaser, Chinese buying habits also play a significant part.

Despite this year's difficult market conditions, the longer term outlook, for sheep producers able to meet the market specifications, while continuing to control costs, is still reasonably good. For those in the harder hill and upland areas, where productivity tends to be lower, conditions remain challenging.

This has been confirmed by recent results on farm profitability, which have shown an increasing differential between the most and least efficient producers. This is partly driven by technical factors such as lambing age, but is also significantly affected by production costs and the proportion of lambs which achieve premium market specifications.

The prime consideration for all producers is to focus on what the consumer is looking for, as this is the key route to better prices. This is a recurring theme and producers must pay attention to the carcase quality particularly as lambs move to heavier weights. In many instances, finishing at a lighter weight, with better confirmation will give improved net returns.

It is also important to recognise that the market outlets for lamb are changing. Today, less than 20% of lamb is sold through traditional independent butchers.

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