

Wool market outlook

August 2020

Key Points

- Strong Au\$, large offering & CV-19 cause market to slump on open
- Stocks held in stores are growing with even proportional representation across microns
- Selling strategies will need more thought in coming years
- Wool has performed well compared to competitive fibres

Sales opened after the winter recess to one of the largest weekly falls recorded. Continued uncertainty as a result of COVID-19, a stronger Au\$ and a large offering combined to see the market buckle.

Prices

While we were cautiously optimistic to the finish of sales before the three-week winter recess, the resumption of sales delivered a blow to any hopes that we had found the bottom. The wool industry is the most impacted of the major agricultural commodities, with “red ink” across all indicators at wool sales on the opening week.


The key negative drivers were a large increase in the offering which led to the high pass-in rate, the Au\$ had rallied and uncertainty caused by the global pandemic.

Supply & Grower Stocks

This topic has not been on the radar at all in recent years, with grower stocks calculated to be negligible in July 2018 following a strong market move that encouraged growers to liquidate any stock on hand.

Since then there has been a steady growth in bales stored by growers, spread evenly across micron categories as a proportion of supply. The major negative issue is that the growing stocks of grower held wool have the potential to delay any price improvement when the economy & demand improves. We are able to say that up until the CV-19 crisis, the demand was comfortable with 2.0 million bales of supply. The recent good prices reduced stocks, and the drought reduced fresh wool supply in season 2019-20 to under 2.0 million bales.

Table 1. The week in wool

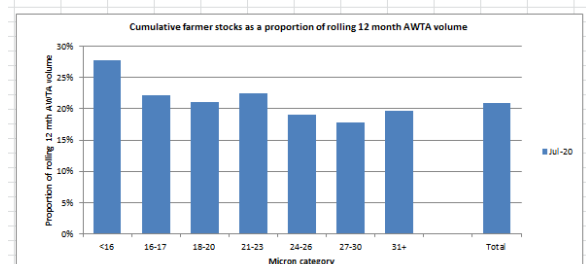
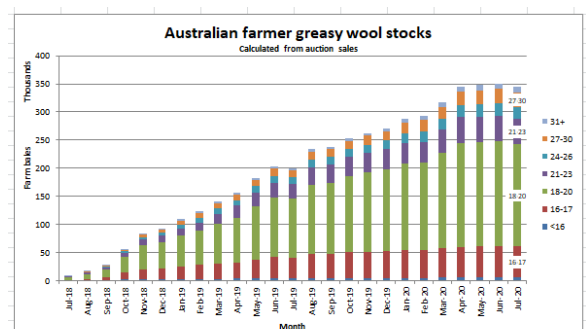
|  | Current | Last week (10/07) | % Change WOW | Last year | % Change YOY |
|--|---------|-------------------|--------------|-----------|--------------|
| AUD/USD | 0.719 | 0.694 | 3.6% | 0.677 | 6.1% |
| EMI AU¢ | 1,006 | 1,134 | -11% | 1,676 | -40% |
| EMI US¢ | 723 | 787 | -8% | 1,135 | -36% |
| WMI AU¢ | 1,055 | 1,202 | -12% | 1,760 | -40% |
| WMI US¢ | 758 | 834 | -9% | 1,192 | -36% |
| Bales Sold | 29,911 | 33,080 | -10% | 29,641 | 1% |
| Pass-in rate % | 30.1 | 6.2 | 385% | 28.6 | 5% |

Source: AWEX, Mecardo

Largest wool price weekly falls since 1989

| Rank | Date | Average Merino Micron | Weekly change C | % |
|------|------------|-----------------------|-----------------|------|
| 1 | 1/03/1991 | 536 | -275 | -34% |
| 2 | 8/06/1990 | 799 | -186 | -19% |
| 3 | 3/04/2020 | 1515 | -172 | -10% |
| 4 | 7/08/2020 | 1165 | -149 | -11% |
| 5 | 20/03/2020 | 1660 | -132 | -7% |
| 6 | 16/08/2019 | 1869 | -129 | -6% |
| 7 | 4/10/2019 | 1774 | -119 | -6% |
| 8 | 2/05/2003 | 1080 | -115 | -10% |
| 9 | 30/08/2019 | 1709 | -102 | -6% |
| 10 | 16/05/2003 | 951 | -101 | -10% |

Source: AWEX, ICS



Fresh shorn supply is unlikely to increase significantly with the reduced flock, so the increase above the comfortable 2.0 million bale level can only come from retained grower stocks. At the recent clearance rate of 20 – 30,000 bales per week stocks will increase to an available supply of 2.5 million bales in the next year. We don't expect a lift in demand, so this stock will weigh on any market recovery. Longer term however, the market will recover, and with low sheep numbers and a growing population with the expectation of economic recovery prices will improve.

Selling Strategies.

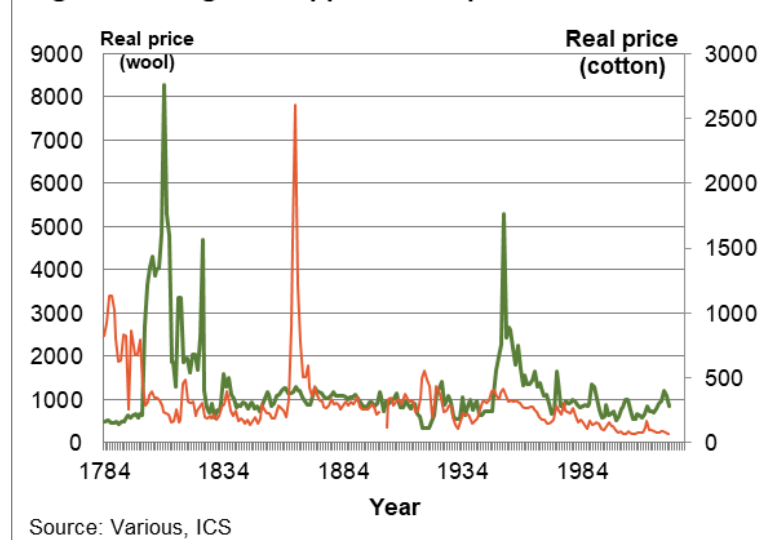
After a period of rising prices making the decision to sell wool easier over the past 3 – 4 years, the selling strategy (and the risk management strategy) needs to be carefully thought out by growers and brokers in the next couple of years. A good model when things are uncertain is to sell a third forward (you can choose your timing on any rally), and sell another third at auction when the clip is tested (use deciles for individual lots to identify which lots to sell). If these two sales provide enough cash to meet requirements, and the outlook for

the market is OK to good, (and you are comfortable with the risk), then the final third of the clip can be held for a period.

This is not the time to be overly bullish about prices, we learnt recently that tightening supply does not automatically mean prices will remain in an upward trajectory.

Key to any decisions will be producers assessing the relative value of cash, versus the risk/reward of possible future price increases.

Figure 2. Long term apparel fibre price series



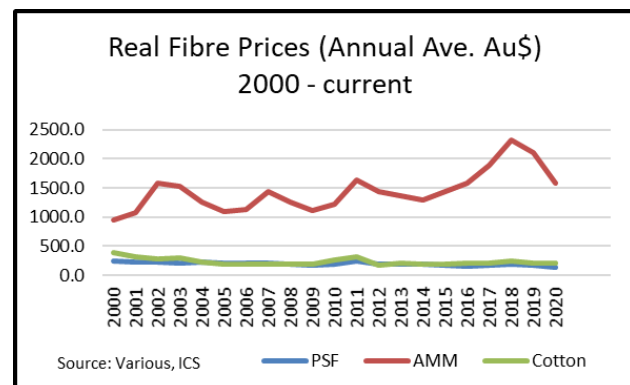
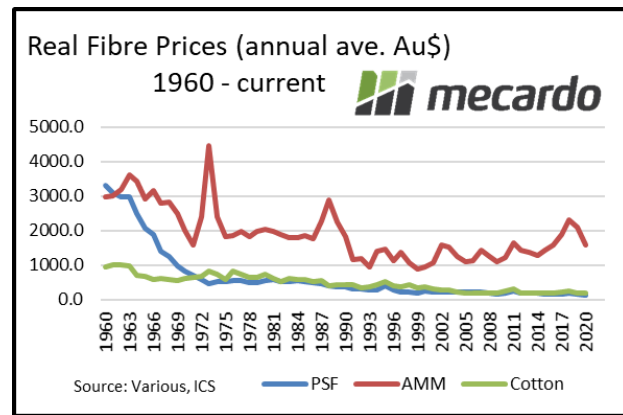
Apparel fibre market

The wool industry operates in a competitive environment, with synthetics and cotton the dominant products in the apparel fibre market.

If we look at the past 20 years, annual production has halved while the global population and clothing sales have continued to grow, demonstrating that the world is not dependant on wool. As a niche product, wool fills a small space and unfortunately the market will move to the more available or cheaper product should wool producers continue to decrease the merino flock.

Wool has performed well over recent times; however, it competes with other cheaper fibres for markets.

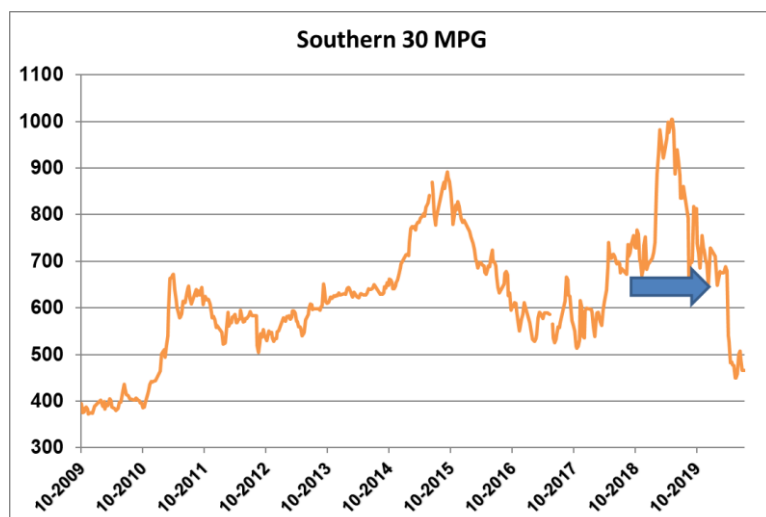
Synthetics are an interesting study, in the 1960s polyester was starting up. After the initial investment cost was recovered, PSF prices dropped in real value by 75% during the decade, putting pressure on existing apparel fibre prices.



Following are a sample of the questions from webinar participants.

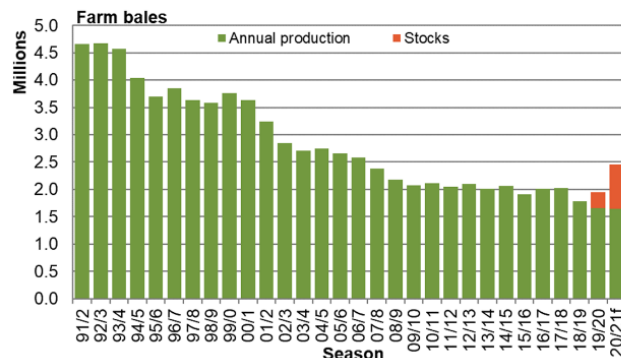
With the lamb market being so good, and more mating to a fat lamb sire, what is this going to do to the cross-breed wool market?

The prospects for cross-bred wool are not good in the short to medium term, pre-CV-19 we had already seen a significant decline in the price, with the past 3 months terrible. There is also a lot of difficulty selling “poorly prepared” lots; this is to be expected when demand is weak and it will take a significant improvement in demand for these types to find favour again.



Common question asked by many is " The merits of holding wool over until hopefully the market improves "?

The major negative issue is that the growing stocks of grower held wool will delay any price improvement when the economy & demand improves. We are able to say that up until the CV-19 crisis, the demand was comfortable with 2.0 million bales of supply. The recent good prices reduced stocks, and the drought reduced fresh wool supply. This is unlikely to increase significantly with the reduced flock, so the increase above the comfortable 2.0 million bale level can only come from retained grower stocks. At the recent clearance rate of 20 – 30,000 bales per week stocks will increase to an available supply of 2.5 million bales in the next year. We don't expect a lift in demand, so this stock will weigh on any market recovery. Longer term however, the market will recover, and with low sheep numbers and a growing population with the expectation of economic recovery prices will improve.



Do you believe China's wool industry cannot afford to let the wool price decrease further as farmers will move away from merino?

The wool industry operates in a competitive environment, with synthetics and cotton the dominant products in the apparel fibre market. If we look at the past 20 years, annual production has halved while the global population and clothing sales have continued to grow, demonstrating that the world is not dependant on wool. As a niche product, wool fills a small space and unfortunately the market will move to the more available or cheaper product should wool producers continue to decrease the merino flock. The ratio of wool price to cotton currently sits at a multiple of 6.9. this ratio has increased as wool volume has declined, with the "new" normal ratio of wool priced at 8 to 9 times the price of cotton considered comfortable.

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