AWI
MARKET INTELLIGENCE
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With the wool market falling significantly in recent weeks, this month we look at the fundamentals behind the drop. We reassess the key drivers in the current market and place the state of the market in context in terms of how far the wool market generally does fall.

The wool market's benchmark Eastern Market Indicator (EMI) has spent the last six months over 1800 c/kg, with a top at 2116 cents and this time last year was at 1578 cents. The last 10 weeks has seen the market fall 11.4% from its very top to where it ends this month but even now the EMI sits some 18% higher than it was this time last year. The price-drop over the last two months was not unexpected but for many in the market, the extent of the drop was larger than expected.

Many in the market have commented on the lacklustre bidding due to a lack of fresh orders from further down the wool processing chain. October is generally a quieter time in the cycle as manufacturers and brands await selling data from retail stores from the new fall/winter selling season before deciding on any new orders. Given the journey from raw wool to retail shelf typically takes at least 3-4 months, much of the wool purchased at the higher rates over the last 6 months is now actually on northern hemisphere shelves awaiting consumers, therefore testing the willingness of consumers to pay a higher price.

But naturally the drought is also having a significant impact on the market too, particularly for Chinese buyers who buy close to 80% of the national clip. While Chinese processors and manufacturers do now purchase significant amounts of superfine wool, the bulk of their bidding is for 19-21 micron wools. These wools are known as "bread and butter" types for Chinese mills and often are used for official uniforms and the like.

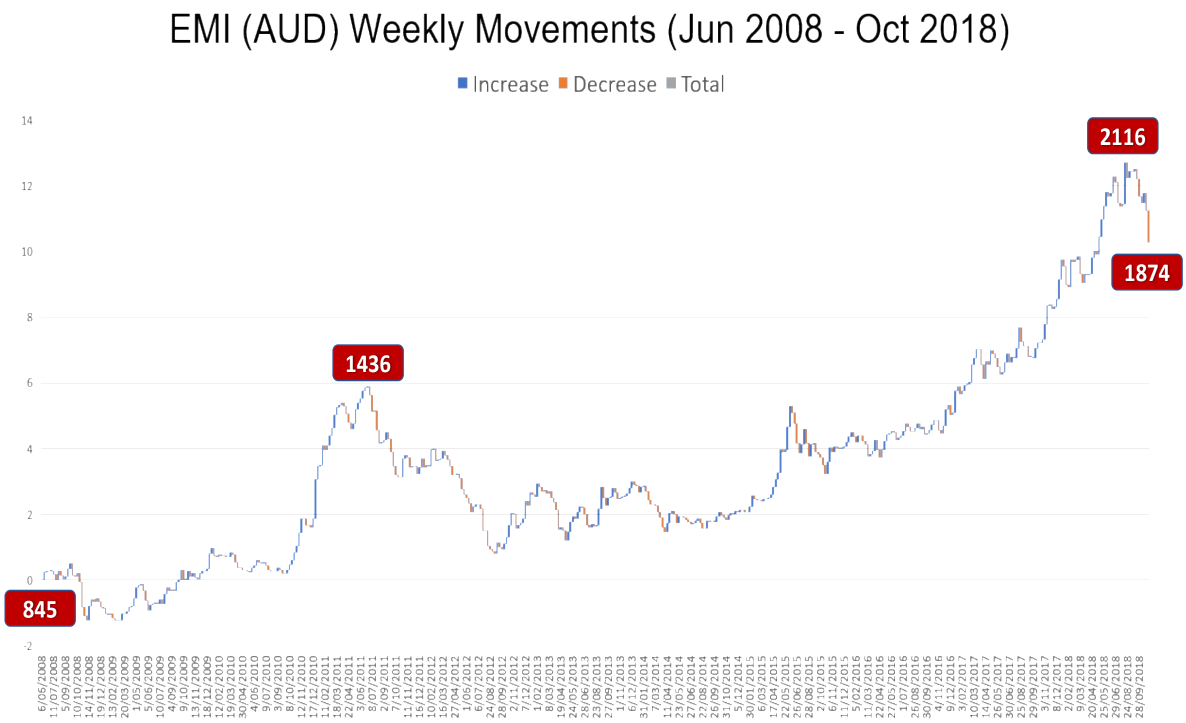
As we know, drought has had a very significant impact across large areas in NSW, SA and Victoria for well over 12 months now. Many growers who would normally expect to produce large, bulky fleeces of 19-21 micron Chinese "bread and butter" wools have been producing fleeces of 16-18 micron and these wools have therefore been falling outside the traditional specifications for many Chinese mills. In fact, there has been a significant lift in production of 16-17 micron wools in the last 12 months, in the order of 70-80%. At the same time, the drop in wool production nationally is expected to be in the order of 10-15% given the offloading of stock.

Combine the change in the production profile of Australian Merino wool due to drought, a traditionally quiet time for buyers, a dropping market and heightened expectations of Australian woolgrowers, and it is not surprising to see pass in rates in recent weeks lift to almost a quarter of the offering.

So we have somewhat of a Mexican standoff existing amongst buyers. A case of who will blink first and re-enter the market and start buying again at the reduced levels. Some have even likened it to a large mob of sheep in a yard with an open gate in one corner; once one sees and moves through the gate, the rest will follow.

But ultimately the demand for garments at retail will determine auction prices. Without demand, there is no price and equally without supply, demand is pointless so the constant debate about supply or demand in the market is somewhat trivial because it is always a function of both.

So how does the 11.4% drop in the EMI in the last 10 weeks (similar drop in US dollars) compare with other falls over the last decade?



The fall from 2116c/kg to 1874 is a sharp fall by any measure.

Looking at the fall in monthly averages alone, the EMI in Australian dollars terms has dropped 5.7% from Sept-Oct 2018. In the past decade, falls of larger than 6% have been seen between the following months:

- Sep-Oct 2008: -6.9% (873 to 813)
- Sep-Oct 2011: -6.3% (1253 to 1174)
- July-Aug 2012: -8.6% (1045 to 955)
- Mar-Apr 2013: -8.1% (1088 to 1000)
- Jun-Jul 2015: -7.3% (1328 to 1231)
- Sept-Oct 2018: -5.66% (2083 to 1965)

So, from a short-term perspective, falls of this magnitude have been seen before but across the last 10 weeks, the drop in prices is quite out of the ordinary and with a series of factors at play, including Chinese business confidence, the drought and the timing in the fashion cycle.

We await the bottom of the market with great interest and, like the sheep in the yards, look forward to the first of the mob heading through the gate and getting demand and price moving in an upward direction again.

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