

Global wool outlook: Can China sustain global demand?

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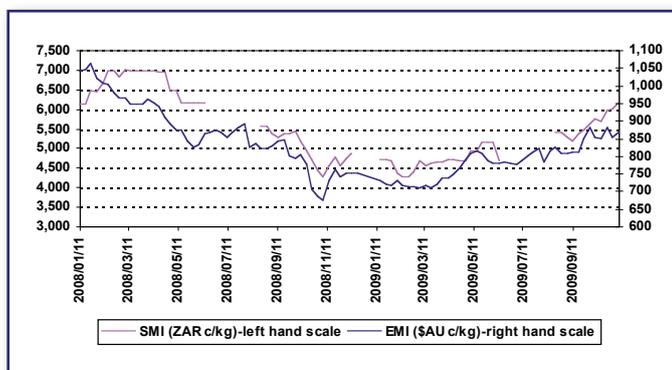


"In the short to medium term Chinese domestic demand will be the principal driver of global demand for wool... However, in the medium to long term, increase in wool prices will increasingly be supported by the pick up in demand in major importing countries as the global recession eases up."

The global economic downturn severely affected the demand for wool. The demand for raw wool is derived from the demand for apparel. With demand for apparel in major importing and consumer economies such as the US, the EU and Japan declining, demand for wool declined as well. Retail sales of apparel in these markets have been affected by increasing unemployment rates and declining consumer incomes as a result of the global recession. According to Wool Economic Focus with the exception of China and the UK, apparel sales declined in major consuming countries y/y in October 2009. Apparel sales are down 5.6% in the US, 10.2% in Japan, and 4% in Germany; while in the UK it increased by a modest 0.8%¹.

The decline in the eastern market indicator (EMI) price reflected these trends. The EMI reached a two and a half year low in November 2009 (see Figure 1)². As illustrated in Figure 1, the South African Market Indicator (SMI) generally followed the same trend. This largely reflected the outlook in the global economy and more specifically consumer spending in industrialised countries such as the US, EU and Japan. Nonetheless, wool prices have shown some signs of recovery in the second half of 2009 (see Figure 1).

Figure 1: Weekly EMI and SMI, January 2008–October 2009



Source: Own calculations from AWEX data

Despite the substantial signs that the economic downturn has come to an end, there is still some uncertainty on whether the demand for wool apparel will recover as well. The demand for wool clothing is depended on higher consumer incomes as economic conditions improve. However, in major wool importing economies such as the US, Japan and the EU, unemployment levels are high and still rising. Hence the prospects of demand in these markets are still gloomy. Retail spending and consumer spending in these countries will remain subdued throughout 2009 and into 2010.

What are the prospects for wool demand given this gloomy picture in major importing countries? China is increasingly becoming a major importer of wool. Recent South African wool export data reflects the increasingly Chinese influence on global wool demand. From July 2008 to June 2009 China accounted for 46.7% of SA's total exports by value. While demand for China's apparel exports has fallen in line with the global recession, domestic demand has grown rapidly. Domestic demand in China is largely driven by the US\$585

billion fiscal package which has stimulated consumer spending. ABARE (the Australian Government's Research Agency) reports that apparel retail sales in China grew by more than 21% in 2008, with the y/y growth in November and December (the two months following the global financial crisis) still at 21% and 19% respectively³. Retail growth rate in China is expected to average about 14% in 2009; while 7 percentage points lower than 2008, this growth rate is still significant. In the short to medium term Chinese domestic demand will be the principal driver of global demand for wool.

What are the prospects for wool supply? Production of apparel wool is estimated to have declined by 10% in all major countries between 2008 and 2009. Predictions indicate that production will further decline by 5% in 2010. The decline in wool output is influenced by a shift to other enterprises, the use of sheep for meat production rather than wool as meat becomes more profitable and in some countries poor seasonal conditions have contributed to lower wool output. The decline in wool supply is expected to improve the outlook of wool prices. However, supply alone will not be sufficient to improve prices; global demand conditions will have to improve as well.

How competitive is wool in relation to other fibres in the global downturn? The global economic downturn has affected both the price of wool and the prices of those fibres which compete with wool; namely cotton and polyester. However, wool remains competitive during the economic downturn. Since January 2008, the price ratios of wool to cotton and wool to polyester have generally been on the decline. For example, between July and May 2009, the average wool to cotton price ratio was approximately 25% lower y/y at 4.2: 1. Similarly, between July 2008 and April 2009, the wool to polyester ratio averaged 3.1:1, 15% lower than the 2000 to 2008 average ratio of 3.6:1⁴. In other words, in relative terms, the price of wool has fallen more than both fibres and hence wool has become increasingly more competitive in 2008/09. These trends are expected to be the same for 2009/10. That being the case, the demand for wool can be expected to be higher relative to cotton and polyester in the short to medium term.

What are the prospects for global prices in the next 12 months? Prices have already risen significantly despite lower retail demand in major importing countries. The EMI has risen by almost 9% in A\$ terms and by 20% in US\$ terms this year⁵. However, it should be noted that global demand conditions still remain very difficult except for domestic retail demand stemming from China. The rise in prices has been supported by low current and future supply prospects stemming from supply side bottlenecks already discussed. However, in the medium to long term, increase in wool prices will increasingly be supported by the pick up in demand in major importing countries as the global recession eases up.

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1 Wool Economic Focus, October 2009. Also available online at <http://wool.landmark.com.au>

2 ABARE (2009). Australian commodities, June Quarter, vol 16 no 2.

3 Ibid, pg 317

4 ABARE, Op.cit., pg 319.

5 Wool Economic Focus, op. cit.