Mutton Industry Trends in Perspective

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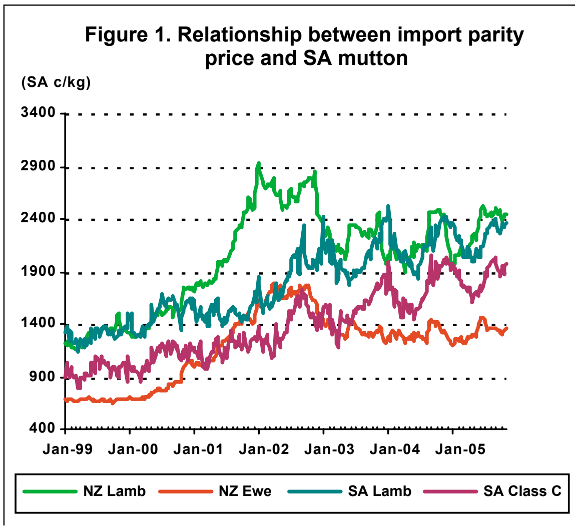
South Africa's Competitiveness on the International Market.

The South African competitiveness on the international market is to a large extent determined by the volatility of the exchange rate and the level of international prices. South Africa is a net importer of mutton and only produces approximately 83% of its domestic consumption. Shortages on the domestic market are therefore supplemented with imports in a bid to maintain market share. South Africa's mutton imports are mainly from Australia and New Zealand with a share of 94% and 5% respectively. Imports are also sourced from Namibia and are mostly live animals. Imports from Namibia increased by 25% during the first 2 months of 2005 compared to the same period last year. Production conditions in these countries will therefore have an impact on the availability of lamb and mutton and therefore on the international price.

Meanwhile, the Australian sheep slaughter rates declined by 15% to 620,000 head during July compared to last year which was the lowest monthly total since August 2003 according to the Australian Bureau of Statistics (ABS). The drop in slaughter rates during July was largely due to the improved seasonal outlook across the eastern states, as many producers withheld stock in order to begin rebuilding flock numbers after the previous droughts of the previous two seasons. In addition, the resumption of the live export trade to Saudi Arabia affected the total number of sheep available for domestic slaughter, particularly in Western Australia. This is expected to push international prices higher due to supply shortages. The impact of this on the domestic market is that prices will be pushed higher.

Import parity prices are directly influenced by the relative changes in the exchange rate as no subsidies are applied from these exporting countries. The Rand has seesawed between R 5.90 and R 6.80 to the US Dollar since the beginning of the year. South Africa's competitiveness on the international market is illustrated in Figure



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- South African Class C mutton continues to trade above the import parity levels of the New Zealand ewes. The international ewe prices have declined slightly and this coupled with a relatively stronger Rand accounts for the drop in the New Zealand ewe import parity price.
- Import parity prices for lamb eased marginally lower by 0.1% in during September 2005 compared to August 2005 largely due to a stronger Rand, and were 1% compared to September 2004. It is therefore not expected that imports of lamb will increase.

Domestic Trends: Production, demand and price trends.

➢ Domestic production trends.

Mutton production in South Africa reached a low in 1995. The main reasons for the decline in mutton production were attributed to the collapse of the wool industry in the late 1980's, the drought in the early nineties, the escalation of stock theft as well as the breakdown of vermin control. In spite of a recovery in meat production since 1995 sheep stock numbers continued to decline through out to 2004 largely due to relatively low wool prices as well as extremely low skin prices. Herd numbers have to a large extend recovered due to an improvement in production conditions coupled with a decline in stock theft that had plagued the industry in the past although there remain pockets of high stock theft in some areas. About 45 251 sheep were stolen in 2004 with a recovery rate of only 30%. In 2003 the amount of sheep stolen stood at 54 935 and the recovery

rate was 26%. Stock theft has therefore declined by almost 18% between 2003 and 2004 hence the return of numbers in traditional sheep producing areas.

However, another trend is developing in which sheep areas are now stocked with game in an effort to take advantage of growing tourism industry. This is particularly prevalent in the sheep production areas of the Eastern Cape where the amount of land dedicated to wildlife ventures has increased steadily with the growth of almost 25% a year. The Eastern Cape is the largest wool-producing province and last season produced 29.4% of total production.

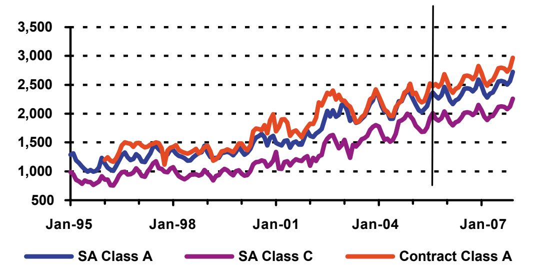
➢ Demand trends.

Demand for mutton has remained relatively good due to a significant improvement in the welfare of the consumer as a result of lower interest rates and the robust growth in the economy recorded at 4.8% in the second quarter of 2005. Prices across all meat categories have been driven by strong demand from a cash-flush consumer stimulated by low interest rates. The PCE (private consumption expenditure) reached record levels in years prompting the warnings from the South African Reserve Bank that rates might be adjusted upwards early in 2006 and that might alter meat consumption patterns in the long term.

➢ Price trends.

The monthly average prices of weaner lambs increased by 5% during September 2005 compared to September 2004 to an average of R 11.84 per kilogram live mass due to tight supplies on markets as a result of herd rebuilding due to improved production conditions in the previously drought stricken areas of the Western Cape. The average producer price of Class A2/A3 lamb increased year on year by 23% from September 2004 to September 2005 and

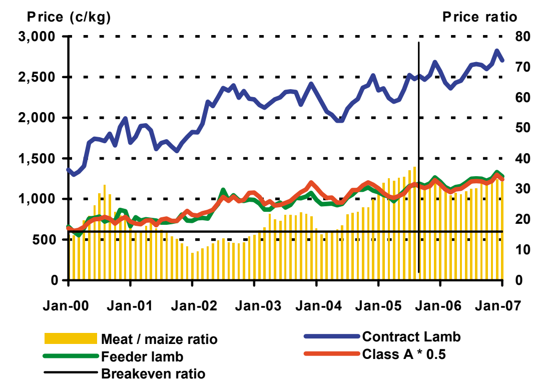
Figure 2. Domestic Muton Prices (c/kg)



are expected to continue to increase as reflected in Figure 2.

Meanwhile, the price of yellow maize which is a major ingredient in feed declined year on year by almost 30% compared to September 2004 thereby lowering the cost of feeding. As a result, the meat-maize price ratio (1kg meat buys 32kg of maize) improved by about

Graph3. Relationship between Mutton & Maize prices



77% in September 2005 compared to September 2004 as reflected in Figure 3 below.

Given the current maize surplus and relatively low world prices it is expected that grain prices will remain under pressure, creating a windfall for more intensive production systems. The profitability of sheep feedlots is therefore expected to continue to improve.

Summary and Outlook.

- The competitiveness of South Africa on the international market will to a large extent be determined by the volatility of the exchange rate and the level of international prices. The exchange rate is forecast to weaken to average around R 6.50 per US dollar by year end and about R 6.80 in 2006. Imports are therefore expected to come under pressure consequently improving the country's competitiveness.
- South Africa is a net importer of mutton and only produces approximately 83% of its domestic consumption. Shortages in the domestic market are therefore supplemented by imports in a bid to retain market share.
- As all mutton that is produced domestically is consumed, an increase in mutton production will normally lead to an increase in market share.
- Given the current maize surplus and low world prices it is expected that grain prices will remain under pressure resulting in a further improvement in the profitability of supplementary feeding on cheaper maize.
- Given the significant growth in the economy, recorded at 4.8% during the second quarter 2005, as well as low interest rates, demand for mutton and meat in general is expected to increase placing upward pressure on domestic prices.
- Domestic mutton prices are expected to move with the normal seasonal price trend which declines during October and increase during the braai-months. It is therefore expected that prices will strengthen due to strong consumer demand during this period.