Wool prices in historical perspective

From 1991 to 2001 wools prices were supressed due to the hangover from the abandonment of the reserve price scheme (RPS) in 1991. A stockpile of 4.7 million bales had accumulated prior to the cessation of the RPS and had to be disposed of which took to around year 2001 to do so. The seasonal average moved from just 671ac in 1991 to 784ac in 2001 representing a yearly average rise of just 1.45%.

The next 10 years saw prices move just 1% yearly from the 2001 price of 784ac to the 872ac mark in start 2010. Out of the ordinary episodes of global troubles through that period such as the terrible events of 9 11 2001, the stock market crash of 2002, the SARS virus global epidemic 2003 that mainly affected our largest wool processing nation of China, the global war on terror, sub-prime housing collapse of the US from 2007 and the resultant GFC all affected demand and therefore wool prices.

The negatives that faced the wool industry through the period of 1991 to 2009 as outlined caused the production (sheep and wool volumes) losses. Whilst there were some good years for income through that period, at just a raw 1 to 1.5% increase of annual wool value, wool, as well as sheep meat, was simply underperforming against all profit indicators and the CPI which drove landholders to alternative on farm enterprises.

Production and sheep numbers stabilised from 2010 to 2015, but exceptionally good meat prices and widespread economic advice pointing to food over fibre supposedly being a more lucrative future, has led to more growers joining to meat breeds (crossbreds). Sheep numbers have remained somewhat similar, but the percentage mix of the breeds of animals being farmed had altered to represent far more dual purpose or crossbred. Thus, figures were showing lowering volumes of wool produced as the meat sheep cut much less wool per head (around 3.5kgs for a retained crossbred (ewe) compared to around 6kg for a Merino ewe.). As of today though, a significant recovery is seemingly underway, with a surge in wool production of 6% being recorded in the past 12 months.

From 2010 to today there has been a significant upswing in wool prices, resulting in an annualised increase of returns of 4.3% or a compounded 35% increase in wool values over the past 7 years. The gains in themselves are significant, but what is more compelling, is the manner the prices have chartered. Levels have consistently and steadily improved season on season
and is strongly indicative of demand overtaking supply as the key price influencer.

Up until this year, all wool types have been a part of the driving up of the general price indicators, but the past 6 months has seen a divergence in fortunes for the differing wool types with just the Merino breed wool types continuing to appreciate as crossbred wool falls away for the time being.

The hugely variable wool types and descriptions Australia now produces has obviously been a key factor in wool price determination. Unlike the pre RPS closure period which saw Australia produce 20 to 24 micron Merino wool, we now find ourselves in the unique situation of “not really” producing a global supply of any 1 particular type. Everything from 14 to 24 can be found in commercial quantity in the Merino sector with extremely varying amounts of VM, staple strength ranging from 15 to 50nkt and length ranges of 55 to 120mm largely as a number of growers have changed to 6 or 8 month shearing patterns.

The current trading conditions and indeed those of the past few seasons, is very much a demand scenario leading the price charge. Several commentators keep calling it “supply driven price rise” but a true analysis reveals this theory as false. Australia is testing over 3% more wool than the comparable time last year and we have also offered more than 6% more at auction. The truth is our larger supply simply cannot keep up with the surge in demand.

AWEX has recorded a 7.4% increase in first hand wool offered at auction this past season compared to last, and yet a 18% increase in the EMI price over the same period has been achieved. The AWTA has also tested near 5% more weight of wool, affirmation of the real growth of supply year on year. So, it appears that despite this increased supply, there has been an even larger increase in demand as prices continued to strengthen.

Over the past two years, the AWEX Eastern Market Indicator monthly average has risen approximately 480ac/clean kg from 1059ac/kg in February 2015 to around 1540ac/kg today. Year on year comparisons show that the EMI is currently 18% or higher in Australian dollar terms and 21% higher in USD terms, The USD is important in that it is estimated to be the currency that over 65% of wool is traded on. Prices at auction continue to rise. At the end of the first selling week in March 2017 the EMI hit a new record level of 1549ac.
clean/kg. Whilst the price gains up to 1430/1440 record levels in mid January were progressive and hard fought for, the rise from those levels to the current 1540 were swift, and significantly, at the same time when the AUD strengthened against the USD from .74 to nearly .80 today...... so our major customer China who uses USD to buy Aussie wool were hit on 2 fronts, the physical market and the FOREX.

However, the EMI does not show the whole picture and when examined at individual micron levels, some of the gains become even more impressive. The past two years, 17, 19 and 21 micron wools have gradually climbed the price chart together, closely mirroring the movement of each. In a move out of trend, the past 4 to 6 months has seen superfine and fine wool prices break away from the broader types. Within this shift up, a large gap has been created between 17 and 19-micron wool prices as the demand for superfine quality has turned up. The monthly average price of 19-micron wool has lifted 679 ac/kg (56%) over the past two years and currently sits at a monthly average of 1878 ac/kg. The strong demand for these micron types has contributed to the average bale price for 19 micron wool of $2231 (185kg bale).

In the first half of 2017, strong demand out of China and Italy for wool of 18 micron and finer has seen a confident lift in prices for the woolgrower. A large order for finer micron uniforms out of China helped push the prices up, as garment makers continued to source the fabrics for these uniforms to fill their orders. The monthly average price of 17 micron wool types has lifted 871 ac/kg in 24 months. An increase of 67% for the woolgrower leaves the price for these wools currently sitting at 2158 ac/kg, while the average bale will fetch $2538 (185kg). For the best spinners types, reports of averages over $3,000 per bale are now commonplace, with some healthy premiums on contract above these levels available from the leading Italian buyer.

WOOL FORWARDS – DERIVATIVES IN WOOL

All wool price indicators in the Merino sector have registered at the 100th percentile bands in the past 6 months when measured and rated against the previous 5 years.

Compared to the previous 5 years, if you hit the market at the right time with the same wool you have been producing in that period, you have never sold wool at higher levels.
With these historic highs in place, it is recommended wool growers at least familiarize themselves with the forwards options or derivates that are available. This is most suited to wool growers who are inclined to include a percentage of hedging as part of their farm economic management.

No matter what forward product is entered into, the intentions of you, the grower, remains static. A forward product or a hedge is absolutely not about “winning” or “losing” on the trade, it is all about the insurance of a price at a future date that the participating grower would be happy to receive at the time that “insurance” coverage is taken. If you are looking for “a winner”, then the product is most likely not being used for the right reason and would then be set up to largely disappoint.

**WOOL versus OTHERS**

Wool prices have continued to pull away from other fibres used in clothing, demonstrating the superior positioning of wool in the marketplace. Premiums for superfine wool have also finally returned. As the price of Australian wool continues in an upward trend, it has gradually pulled away in value when compared to what others refer to as competitive fibres, but in reality these mostly chemical fibres are just a cheaper alternative to the wool garment and especially the Merino product.

Fibres such as Acrylic, Nylon, Polyester and Cotton are becoming relatively cheaper in comparison to wool. The Eastern Market Indicator has spent much of the past 15 years at roughly 4 times the price of its cotton equivalent. Presently, Wool (blue line in above graphic) is now more than 6 times the price of cotton, twice the price of nylon, 7 times the price of polyester and about 6 times the price of acrylic. The value gap between wool and other fibres is continuing to expand, showing how the world is willing to pay a premium for wool as a superior natural fibre.

While these competitive fibres are not all direct fibre substitutes for wool, these increased price ratios represent the willingness of the end consumer to recognise wool as a preferred fibre. The performance and potential of wool ultimately matter for the processor, the designer and most importantly, to the consumer. This is essential given wool will never compete with these other fibres on price alone.
Wool accounts for less than 1.5% of global fibre consumption, so it becomes evident that wool is not a bulk commodity such as acrylic, nylon, polyester and cotton. As the value of these other commodities remains low or in decline due to oversupply or low soft crude oil prices, the value of wool need not follow suit. The position of wool as a premium fibre, when compared to these other fibres, should allow the price to be set by consumer demand and not impacted by the low price of synthetic and bulk production competitive fibres.

At the luxury end of the market where wool has to be positioned in order for our wool growers to make a decent return on capital. Only rarer and natural fibres such as vicuna, yak cashmere, alpaca and silk ever truly be a competitor with wool for the luxury consumer product market. At present, the luxury market demand for ultra-light weight products on ultrafine merino, cashmere, silk and other similar materials has been grown steadily. The demand of ultrafine wool is increasing rapidly, and the market size is about 3 to 5 million meters of fabrics each year.

Cashmere is the most often revered of fibres, but let’s put that enterprise quickly under the microscope as a true competitor to wool. The world’s annual production of coarse cashmere is estimated at 15 000 to 20 000 tonnes, or 6 500 tonnes of "pure cashmere" after scouring and dehairing. China's output is estimated at 10 000 tonnes, followed by Mongolia (3 000 tonnes). Other, smaller producers include Australia, India, Iran, Pakistan, New Zealand, Turkey, and the USA.,

The average fibre diameter for cashmere can be no more than 19 microns, and top quality fibre is just 14. Like our traditional Australian ultra and super fine wool types, cashmere does possess a natural crimp, allowing it to be spun into fine, lightweight fabrics. Similarly, Cashmere has small air spaces between the fibres, which makes it warm without weight, while thin cuticle cells on the fibre surface make it smooth and lustrous. But here’s the rub, after sorting and scouring, the goat fibres are cleaned of the coarse outer hairs and what remains is the annual yield of underdown of just 150 g per animal. At this rate it requires around 6 to 8 goats to make a sports jacket that could be made from a third to half of an ultra fine Merino 14 micron fleece. That production level and scope of industry is hardly a threat or a true competitor to the wool industry and in fact, may be an assistance to achieving higher price levels for ultra fine wools through cashmere/wool blends.
Confidence amongst the local buying trade here in Australia remains at a high. Most of the exporters were “not caught out too badly” by the strong and relatively quick gains in AUD and the auction price. Most have the odd “bad” contract to deliver, with losses of well over 2 dollars per kg, but those same exporters are recovering from those bad sales quickly by some “buy and sell in volume” trades whereby they buy today and sell next week after the market moves further up. This basically changes volume business from the normal 12c per kg gain to a 30c per kg gain in very short time as long as the market continues upwards.

With both exporters and agents overseas still on the hunt for wool, the short term remains extremely positive. India appears to “have missed the boat” as far as having bought enough, they are short. History has seen this happen to them before and they tend to just sit out the very high prices, rather than follow. They just wait – even for years – which is why they can remain in wool business. They just buy a minimum to keep the factory going whereby their key staff only are gainfully employed to keep them. With different social laws, the labour force can be just marched on and re-hired when work picks up again.

The premium European users are still very short for their mainly worsted or long wools sectors, but they tend to also understand the market and seasons better than the Chinese and in reality would most likely have 3 to 6 months minimum in stock. In saying this though, they normally like to run at 12 months production ahead in their key and regular products in mainly the 17 to 18.5 micron types. China may get small quantity of 17.0-18.5 micron from New Zealand or South America, but Australia is the only country that can supply quantity. So, in reality, Australia has no substantive competitor in 18.5 and finer microns”. Let’s hope that sentiment remains in play.

Overall sentiment in China remains positive, although there are several users indicating Merino wools finer than 19 remains at “too high a level” and those high levels are killing off demand in some sense. The 19.5 to 23 micron brackets remain price sensitive within the current ranges, but comparatively “better priced” compared to the finer merino. Demand can be described as steady and consistent.

Crossbred demand remains poor for all wool broader than 30 micron, but the large volumes of previously held stocks are being depleted due to some clever blending of synthetics back into the wool yarns. Crossbred wool finer than 27 micron is still being blended with much finer Merino (in some cases as fine as
16 micron is blended with 27mic). The technique for this type of blend arose from the “fake fur” or “faux fur” for those European inclined folks! mini boom which this type of rough/smooth raw wool ingredient mix suited. This “fake fur” business though has seemingly waned and failed somewhat, but Chinese traders and top makers have learnt from this use of “wide micron ranges” and many of the better mills in China are saying “exploitation” is now the demand creator for such “inferior” wool tops.

China wool top export to Europe was higher in value past 12 months, but significantly, the volume has decreased year on year.

The upcoming new government uniform for Chinese Rail, Police, Army Traffic/Transport and Schools would be reverting back to 21 and 22.6 micron. Indeed the Army/Police and transport/traffic (which has high numbers required) would also increase synthetic percentage and the 2018 uniform would be 80:20 or even 70:30 wool:synthetic blends (90:10 last year)...Rail and Schools would remain 100% wool, but would move from the 18.5micron of last year to 21micron or even 22.6 micron.

Due to high stock levels and low prices/margins in the crossbred business, a “number” of first & second stage processors have converted their machinery to be able to accept Merino wools. This was a costly change and is a very physical process with the mills machinery. Cards needing rewiring, gauges decreased in combs etc etc so switching back and forth is not so easy or cost efficient. Due to this changeover a newly created “machinery demand” has been created whereby more Merino is required just to keep machines going, hence forming a part of the dearer Merino and cheaper xbd market that has arisen

Throughout China, there is an absolute majority of influential companies all singing from the same hymn book – and that is the need for major activities around Promotion and Education of not just the consumer, but also of the younger generations and in particular school and college aged students. China appears to have quickly developed a social justice responsibility in their day to day textile activities and feel for further growth of all the chain, a push to further promote and educate all things wool.
**FASHION / TRENDS**

**Growing Incomes**

- As economies such as China & Japan grow, income levels are expected to rise- allowing the purchase of premium products and clothing, creating new markets.

- As older residents work longer into life, income increases for those who no longer support children yet continue to work. Becoming an increasing market for premium and quality products.

- US and China are the only countries with over one million households earning over US$300,000 per annum and joint US$440 billion spending on miscellaneous goods and services including luxury goods in 2016.

- India is a home to more than 15 million middle class households, whose discretionary spending amounts to almost US$90 billion, and this number is expected to double in the next five years. (Euromonitor International)

**Product developments**

- The OptimTM fabric was developed at the Wool Development Centre, which was set up in 2013 in China, by both The Woolmark Company and The Nanshan Group. The resultant unique, high-performance fabric is one that is resistant to both wind and water, making it suitable for outdoor wear and sports such as recreational sailing and hiking.

- Spinners are creating performance yarns in 100 per cent wool, or creating wool blends with other performance fibres used in activewear such as elastane or cordura. We’re also seeing the rise of wool wadding, increasing the selection of wool in the outerwear market, along with wool sneakers being used for both function and fashion.

**Conscious Consumer**

- Fastest growing waste problem- $5billion spent a year on fashion

- 60% of all fashion goes to landfill

- Average Australian spends $2000 a year on fashion

Consumers are increasingly calling for ‘eco-friendly’ products so that they can make sustainable choices.
Sustainability: Consumers “expect ecologically unobjectionable fabrics, a conservation-minded use of resources, reduced emission of pollutants, greater social commitment, and fair treatment of employees in production facilities. In many countries, legislators are requiring companies to create more sustainable products, such as by prohibiting certain harmful dyestuffs”- McKinsey & Company

Sportswear

Has undergone transformation within the Asia Pacific, which has been influenced by the developments in the US, the world’s leading sportswear market. The sportswear market is continually influenced by the trends of fashion.

Growing interest in health and wellbeing, combined with the casualization of dress codes and added with the impact of social media has fuelled growth across all categories and markets of sportswear. (Euromonitor International)

• Merino wool has the ability to combine comfort and flexibility with casual elegance, which makes it well-placed to cater for the growing athleisure market.

• Brands- and their customers- need multi-functional apparel that can take them from the gym to a café with a trip to the grocery store in between.

• It’s not just traditional sportswear brands that incorporate wool into their garments, a growing number of fashion brands are following suit. Brands such as Z.Zegna, Hugo Boss and Massimo Dutti are introducing wool into their performance wear offering.

While the US remains the largest market for sportswear, the Asia Pacific region is the fastest growing in the world. Between 2011-2016, sports-inspired apparel and footwear contributed over USD 2 billion in absolute value growth.

In the long term, prospects for wool are positive given the rekindling of interest in wool among key sectors of the retail market, including in the next-to-skin active leisurewear market... Success will depend on whether wool can attract the attention and interest of consumers in the countries where incomes are rising. Consumption of wool tends to increase as per capita income rises... That is where promotion programs such as those run by Australian Wool Innovation/ The Woolmark Company and the Campaign for wool becomes a vital ingredient to the sustainability of the strong wool price.