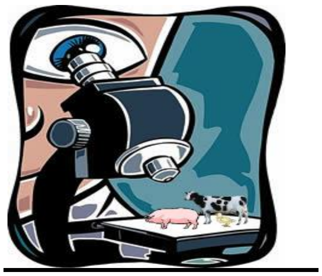


MEAT MARKETS UNDER A MICROSCOPE

A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

March 25, 2017

I suppose I should begin by acknowledging that the blanket embargo against Brazilian beef by its major export customers appears to be winding down to a ban on meat from 21 plants directly linked to the federal police investigation …. or so I read today, anyway. According to Reuters, China was the first to scale back the embargo, followed by Egypt and Chile. But—*but*—the same story stated that

"…. sources familiar with the investigation said there was a large amount of unpublished evidence pointing to widespread fraud and not just isolated abuses in the meat industry…."

And so, maybe the book is not closed just yet. I must admit that I tend to dismiss this sort of development prematurely, and to do so in this instance could be a big mistake.

So let's look at some simple facts (at least I *think* these are facts) and talk about some hypothetical possibilities.

Brazilian Beef Exports (in thousand tons):

	2015	2016
Hong Kong	165.5	181.4
China	97.5	165.6
Egypt	178.0	164.9
Russia	169.4	131.0
Iran	97.4	95.0
Chile	54.2	70.0
Italy	29.1	5.8
Netherlands	15.8	17.5
Venezuela	93.7	22.7
Saudi Arabia	-	28.7
Singapore	15.1	15.4
Philippines	11.3	20.0
Vietnam	11.0	6.6
Other	140.1	152.5
Total	1,078.0	1,077.0

Unless you've been in a coma for the last several years, you already know that Brazil is the world's largest exporter of beef. The table at left shows who the major buyers have been recently. And so an embargo against Brazilian beef naturally could prompt some major trade shifts.

Each of the top eight customers on the last week instituted partial or blanket bans on Brazilian meat (including chicken and pork; since beef is the market at greatest risk, I am focusing on this category). Where does U.S. export business stand most to gain, should the complete bans be reinstated? Well, I guess that Russia is out of the question, at least in the near term, since Russian imports of U.S. meat were banned four and a half years ago, in retaliation for economic sanctions imposed because of military aggression in Ukraine. Mainland China is also presumably out of the question, because China maintains it exclusion of U.S. beef initiated in late 2003 in response to the discovery of Bovine Spongiform Encephalopathy in an American herd. [Earlier this year China said that it would resume imports of U.S. beef, but did not indicate how soon this would happen.]

Otherwise, we're looking at "fair game". The U.S. has been a major and steady supplier to Hong Kong (averaging 24 million pounds per month in 2016); and in the past, Egypt (averaging ten million pounds per month in 2011-2012); and Vietnam (averaging ten million pounds per month from 2009 through 2012). Korea has also banned shipments of beef from Brazil, but Korea has not been a significant beef customer to Brazil up to this point.

OK, so how much additional export demand would U.S. packers stand to gain? Well, we have to consider that Australia, New Zealand, Canada, Uruguay, and the EU would all share in the "Spoils". If we focus on the markets in Hong Kong, Egypt, and Vietnam, and arbitrarily factor in a one-half share of this additional business, then we're talking about—and this is Kindergarten-level analysis—an incremental business of 90,000 tons at an annual rate to Hong Kong, and 80,000 tons to Egypt; adding the influence of smaller markets, we might be talking about an increment of 200,000 tons per annum, or 17,000 tons per month, or an average of 37 million pounds per month. In the past 12 months, total U.S. beef exports have averaged 216 million pounds per month, and so this would represent a 17% increase in total U.S. beef exports. No small deal.

If I simply factor in a 17% increase in U.S. beef exports in the calculation of net domestic beef supplies, it raises the forecast of average cutout value by about $2 per cwt. In reality, the price impact would be greater, due to the "shock factor"—this would be a development that was not anticipated, which is always more impactful than one which is anticipated and prepared for, such as the high rate of beef production this spring and summer.

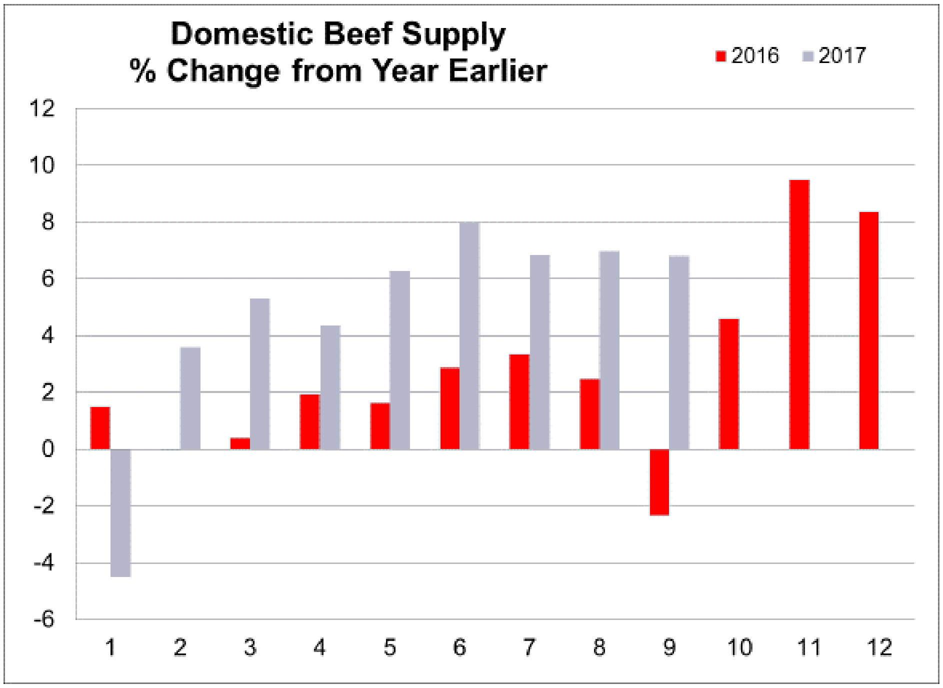
Also to be considered is the reduction in the supply of beef to the U.S. from Australia and New Zealand (perhaps Canada as well) as these supplies are redirected to the countries currently supplied by Brazil (Russia excluded).

Let's not get ahead of ourselves, though. What I'm doing is to estimate the extreme scenario, which is the total suspension of imports of beef from Brazil for months on end. Although it does not seem likely at the moment, no one really knows. Of course, the Brazilian government and trade associations will do everything they can to downplay the scandal, but it is the customer's perception that counts the most. And on that subject, I suspect that whatever official stance is taken by the U.S. will be followed by other countries. Not that we Americans necessarily set the standard for the rest of the world, but I'm just sayin'….. and on *that* subject, the potential reduction of U.S. imports of Brazilian beef is not a potential market-mover. They amounted to a considerable 18 million pounds per month in November and December, but only eight million pounds in January.

As long as I'm talking about exports and net domestic beef supplies, I should show you what I'm thinking in terms of both metrics in the absence of any change brought about by this Brazilian meat inspection scandal. The table below lists my humble expectations of U.S. beef exports, and the graph on the next page shows my forecast of net domestic beef supplies.

U.S. Beef Exports in Million Pounds

	Q2	% Change	Q3	% Change
Japan	216	+20%	204	+16%
Korea	118	+17%	122	-3%
Hong Kong/Taiwan/Vietnam	104	+22%	116	+10%
Mexico	101	-1%	104	-3%
Canada	90	+4%	78	+9%
Total	707	+14%	701	+6%



I should point out that these projections incorporate a 9% year-over-year increase in beef production in the second quarter and an 8% increase in the third. They also include the assumption that beef imports will be down 2% in the spring and unchanged in the summer. You might wrinkle your brow at these import projections, considering the rather sharp decline in the amount of product coming in from Australia (it is running about 40% below a year ago); however, this is being offset by fairly hefty increases in imports from Mexico, Uruguay, and Nicaragua.

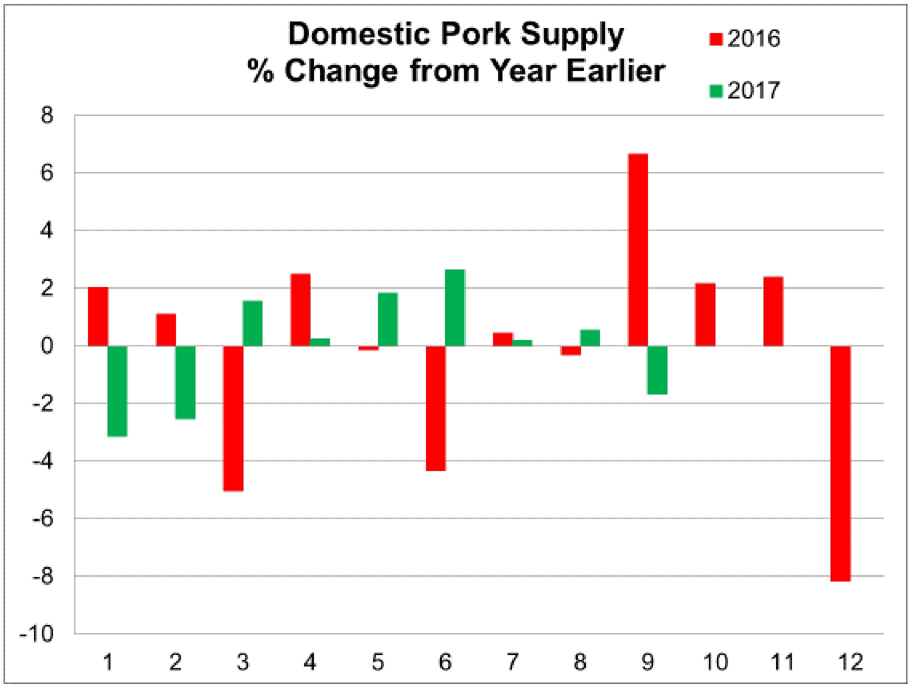
This is probably a good time to show the equivalent pictures in the pork market:

U.S. Pork Exports in Million Pounds

	Q2	% Change	Q3	% Change
Mexico	450	+26%	450	+13%
Japan	323	+6%	300	-1%
Canada	132	+1%	141	+1%
China/Hong Kong/Taiwan	148	-38%	130	-8%
Korea	119	+20%	66	+1%
Australia	51	-5%	44	0%
Total	1410	+7%	1309	+6%

One footnote: As crazy as it may seem, I am not willing to abandon my theory that some quantity of U.S. pork is being either shipped through Mexico to another destination (Russia?), or is being purchased by Mexico to offset exports of Mexican pork to some clandestine location. If February shipments of U.S. pork to Mexico (to be published in about two weeks) are once again very large, then it will cast doubt on the notion that they are ballooning temporarily in preparation for a “Trump Trade War”.

It has become quite clear that the frantic, eight-week rally in pork belly prices during January and February has had a major impact on wholesale bacon demand. Squelching demand through higher prices is always a faster process than building demand through lower prices, and this will prove to be no exception. The belly market has pulled back 56¢ per pound since February 15, but the only thing this has stimulated, as best I can tell, is some replenishment of frozen inventories. There was a net drawdown of four million pounds during January and a net accumulation of only two million in February, but now that prices have come down to $1.30 per pound, there should be a more substantial buildup between now and June 1. My guess is that the growth in freezer stocks will amount to eleven million pounds here in March; 13 million in April; and nine million in May—all of which are above normal, but not wildly so. I doubt that



the lower prices that we are witnessing right now will do much, if anything, to spark demand before summertime. I am being told that prices will have to get down to $1.10-$1.15 in order to generate a significant amount of interest among buyers, which makes sense to me. This is, in fact, the nearest discernible support level on the chart. And I might as well set myself up to look like a fool: It seems reasonable to think that the seasonally adjusted pork belly demand index will retreat to approximately where it stood in November/December; if that is to be the case, then prices will average near $1.40 in July and August, developing major resistance around $1.50.

Meat Markets Under a Microscope is published weekly by Procurement Strategies Inc., 1460 Oxford Road, Des Plaines IL 60018. For subscription information, please contact Kevin Bost at (847) 296-4992 or visit our website at www.procurementstrategiesinc.com.