MEAT MARKETS UNDER A MICROSCOPE

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

August 9, 2018

These days, I am more vigilant of changes in foreign trade flows than usual, because I am trying to gauge both present and future impacts of the “tariff wars” that have broken out and do not seem to be subsiding. I *have* to try, because I’m betting my money on the outcome. And I’m hearing all sorts of conflicting stories, in most of which I have to place some credence because I automatically assume that the people who are telling them know something that I don’t (usually a safe assumption). The most objective evidence is to be found in the actual volumes counted by U.S. Customs and Border Protection. And so I am showing my revised projections, now that trade statistics for the month of June have been published—after the first tranches of Mexican and Chinese tariffs were put in place.

As always, I invite you to point out any numbers that seem to be out of line:

U.S. Beef Exports (million pounds) & Change from Year Earlier

	Q3 ‘18	% Chg	Q4 ‘18	% Chg	Q1 ‘19	% Chg	Q2 ‘19	% Chg
Japan	238	+1.9	203	+6.6	218	+10.5	237	+2.5
Korea	175	+39.1	176	+30.2	151	+11.2	171	+3.6
China/HK/Taiwan	118	-0.4	161	-9.4	119	-15.0	118	-4.7
Mexico	115	+1.9	115	+3.3	101	+2.8	111	-2.9
Canada	78	-0.7	81	+1.9	74	+4.2	78	-4.5
Total	812	+8.8	829	+6.0	750	+2.7	804	+0.6

U.S. Beef Imports (million pounds) & Change from Year Earlier

	Q3 ‘18	% Chg	Q4 ‘18	% Chg	Q1 ‘19	% Chg	Q2 ‘19	% Chg
Canada	220	+4.1	198	+5.9	184	+4.9	202	+0.3
Australia	191	-9.2	173	-1.9	147	+4.0	176	+0.4
New Zealand	139	+1.3	75	-3.4	172	-1.0	192	-3.0
Mexico	136	-8.6	124	-6.6	123	+0.1	129	+2.6
Nicaragua	33	+0.4	39	+8.8	38	-6.0	35	+3.8
Uruguay	32	-15.2	27	+19.1	25	+6.9	34	+16.3
Brazil	24	-9.8	25	-10.7	29	-10.3	32	-1.2
Total	784	-3.7	670	+0.3	727	+0.7	809	+0.4

I expect the year-over-year increases in beef exports to continue through the first half of 2019. Why should I not? As best I can tell, there is but one direct threat to this outlook, and that comes from Hong Kong. At first glance, China’s tariff on U.S. beef appears harmless, since the amount of beef shipped directly to Mainland China had been averaging less than two million pounds per month. However, one of the stories that is being passed around the Sewing Circle is that while Hong Kong is not applying any punitive tariffs, China may be cracking down on the "Gray Trade"—products that more or less pass through Hong Kong into China without additional border processing. U.S. beef shipments into Hong Kong *have* been quite significant, averaging almost 30 million pounds per month. Maybe it's just coincidence, but I notice that these shipments fell to a two-year low in June. Hmmm….

Otherwise, beef business with Japan and Korea—the two largest customers—is healthy as of the latest checkup. Meanwhile, Mexican purchases of U.S. beef were up 9% in the first half of the year and up 10% in June.

I am anticipating little change in total U.S. beef imports. Imports from Canada, the number one source of foreign beef in America, after reaching a low point in 2013, have been trending upward for the last five years. Without knowing the exact reason for the uptrend, I have to assume that it will remain intact over the next twelve months. If imports from Australia follow a typical seasonal path in the second half, they will fall short of a year earlier (in the first half of 2018 they were up 3%). What has turned out to be a serious drought in Australia should pump up production in that country, but Australia's export business with China is more lucrative and therefore preferred over the U.S. market, and any slowdown in U.S.-to-China/Hong Kong shipments will present an opportunity to Australian exporters. Mexico, which has risen to the number four spot among foreign beef suppliers to the U.S., has seen its business pull back noticeably so far in 2018. The year-over-year declines have been pretty consistent over the past six months, and I am merely guessing that similar declines will prevail through the balance of the year.

U.S. Pork Exports (million pounds) & Change from Year Earlier

	Q3 '18	% Chg	Q4 '18	% Chg	Q1 '19	% Chg	Q2 '19	% Chg
Mexico	397	-6.2	460	-7.0	440	-3.7	435	-9.4
Japan	281	+0.6	325	+1.5	320	+1.9	306	+2.2
Canada	138	-1.8	138	+0.4	125	+0.1	130	+4.3
Korea	124	+62.0	198	+24.6	230	+9.2	205	+5.2
Colombia	77	+75.6	87	+30.9	75	+15.6	75	+7.9
China/HK/Taiwan	45	-53.2	55	-62.1	60	-57.4	80	-35.1
Australia	42	+3.4	56	-5.8	63	+1.7	52	+2.8
Total	1236	+0.5	1479	-4.2	1454	-4.1	1442	-5.0

If the Mexican and Chinese tariffs on U.S. pork remain in place, then I have to think that total U.S. pork exports will drop below a year earlier this fall and remain down in the first half of 2019. Now, my intuition is that the Mexican tariff will be lifted sometime this year. But who am I to know when this will happen? My posture is to wait until it does happen, and then refigure accordingly.

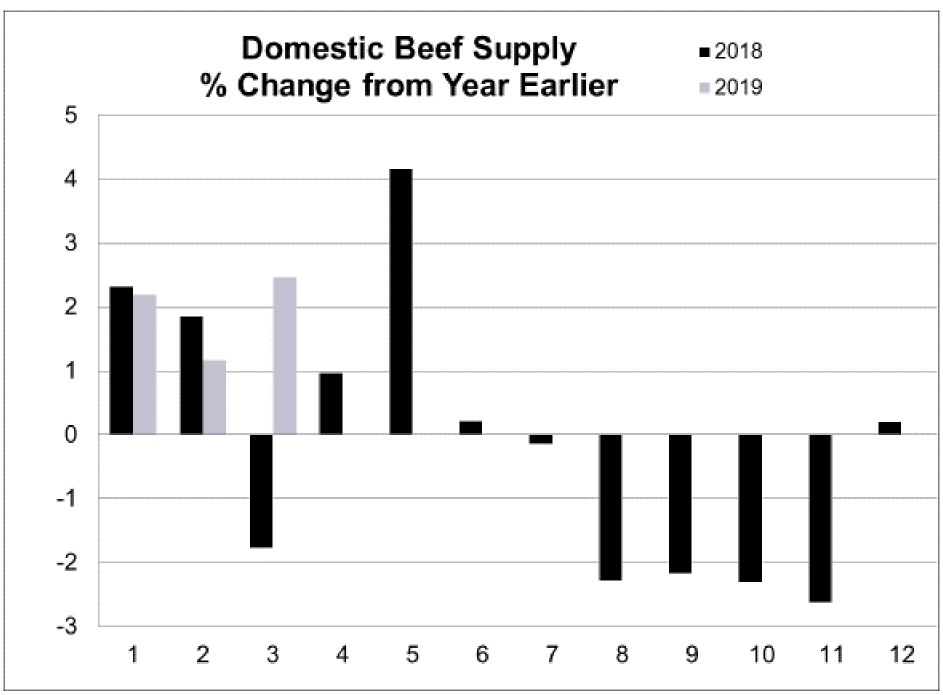
One opinion that makes sense to me in regard to Mexico is that, in the words of one guy who is in a place to know, the U.S.-Mexican pork trade is "too big to fail"; Mexico needs the supply of U.S. pork because Canadian product is the only direct substitute; and the U.S. pork industry obviously needs the Mexican business. Another consideration is that U.S. ham prices are currently quoted at 62¢ per pound vs. 68¢ a year ago; and so, even including the 20% tariff, prices to Mexican buyers are up only about 6¢. My projections assume a relatively mild impact on export volumes down the road. And yet, I notice that U.S. pork exports to Mexico fell 16%

from May to June, compared with a ten-year average *increase* of 2% during the same period….and in June, the tariff was just 10%.

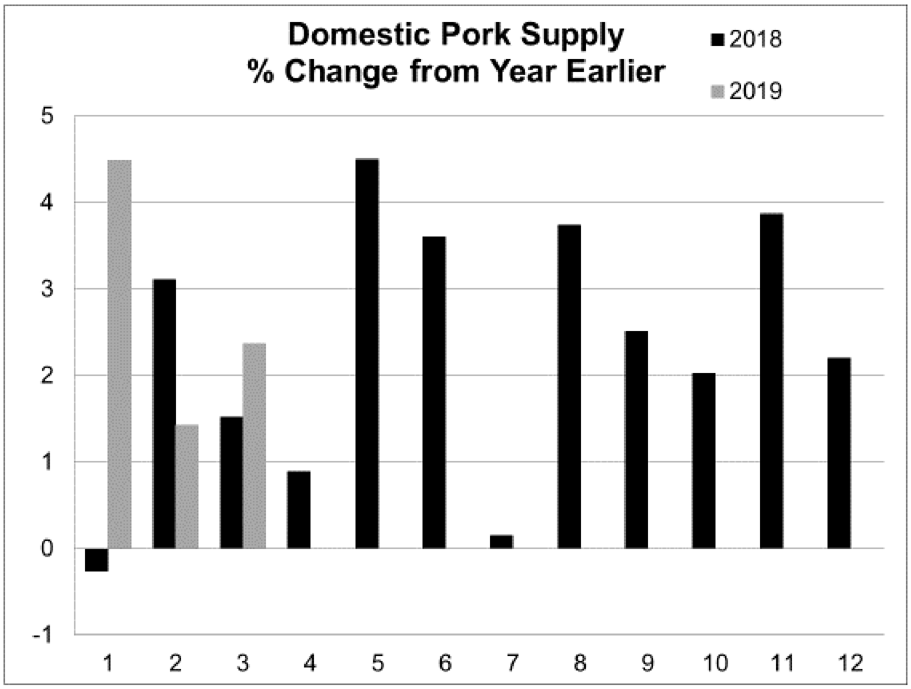
In regard to China, the U.S. pork export business faces more "headwinds" (I know—I hate that word, too) than in Mexico. For one, China is the "front line" of the trade battle, and so the issues are presumably more difficult to resolve. A more deeply-rooted hindrance to the U.S.-China pork business is the expansionary trend in Chinese production. I read that the Chinese pork farming industry is undergoing a transformation similar to that which happened in the U.S. in the 1980's (i.e., consolidation and greatly improved efficiency). Pork exports to China/Hong Kong/Taiwan combined were off 36% from a year ago in June. My projections assume that with a total tariff exceeding 70% (including the existing value-added tax), the direct shipments of pork to China will virtually dry up; that shipments to Taiwan will remain as they have been (2-3 million pounds per month; and that there will be *some* increase in shipments to Hong Kong from the most recent twelve-month average of 9 million pounds per month.

But I have to keep in mind that low U.S. prices should tend to attract demand for U.S. pork in other parts of the world (Colombia is a prime example); and apart from China and Mexico, volumes seem to be growing as one would expect in the midst of down trending prices. My projections take this consideration into account as well.

When we talk about U.S. pork imports, we're talking about Canada. It makes sense to me that shipments from Canada into the U.S. will be reduced to the extent that Canada displaces the U.S. as a supplier to Mexico. Therefore, I am willing to assume that the drop in total pork imports from a very stable 90-95 million pounds per month to 83 million in June was not a "one-off"….and that U.S. pork imports will run 5-10% below a year earlier through the balance of 2018—or until Mexican tariffs on U.S. product are removed, whichever happens first.



So, then, it looks as though per capita domestic beef supplies will be 2.0-2.5% smaller than a year earlier from now through November. That situation should reverse in the first quarter of 2019, with December being the "crossover" period. I shall not go into detail today on the production variables, but my most important supply-side assumption is that steer and heifer kills will average just above 500,000 per week (down 2%) here in August; 488,000 in September (down 3%); 486,000 in October (down 3%); and 480,000 in November (down 4%). These prospects do not seem so odd after seeing last week's total come in at 97.6% of a year ago. Statistically speaking, they are the most objective than I can muster.



Likewise, I am objectively taking USDA's winter and spring pig crop estimates at face value in the pork production projections. I should point out, though, that I am assuming that hog carcass weights will average nearly two pounds lighter than a year earlier from September into this winter, thinking that producers will move hogs aggressively because of the bearish price outlook and barn space considerations. **Even so, per capita domestic pork supplies should be up about 2% through the balance of the year, except for a "spike" in November**. In November 2017, hog slaughter in November was unusually small in relation to the rest of the quarter; I am assuming that this time around, fall hog slaughter will be distributed more normally.

Meat Markets Under a Microscope is published weekly by Procurement Strategies Inc., 99 Gromer Road, Elgin IL 60120. For subscription information, please contact Kevin Bost at (847) 212-7523, or visit our website at www.procurementstrategiesinc.com.