MEAT MARKETS
UNDER A MICROSCOPE

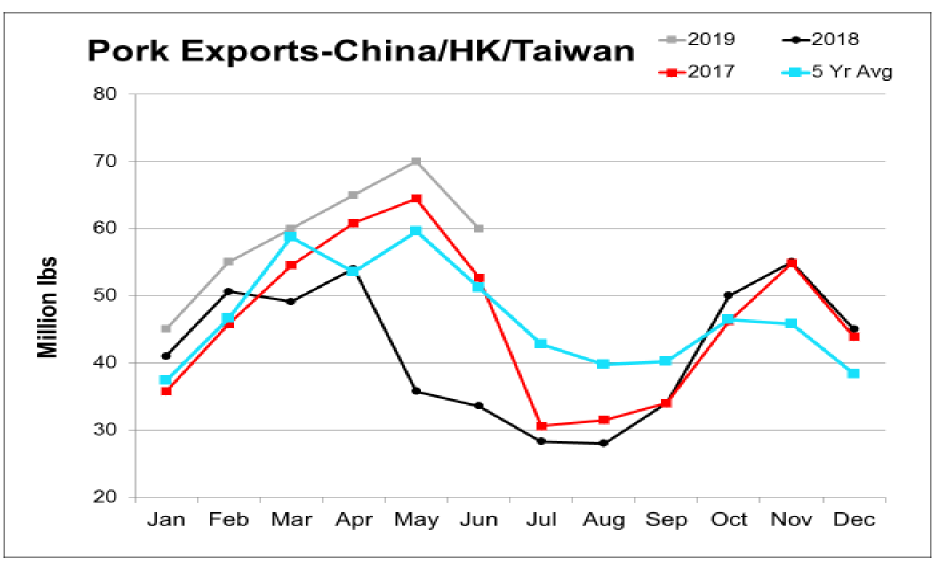
A perspective on the red meat markets by Kevin Bost...sometimes wrong, usually scientific, but always candid

September 11, 2018

In March 1997, a Foot and Mouth disease epidemic broke out in Taiwan, and within four months approximately 40% of the entire pig population was wiped out. During that epidemic, 1,300 farms were affected in March, followed by 3,864 farms in April, 975 farms in May, five farms in June and three in July. Among the 4.66 million pigs found on the infected farms, about 185,000 died from the disease. The remainder, including 1.01 million pigs showing clinical signs of FMD, were destroyed.

The paragraph above was lifted from a paper by Hui-Sung Chang, Chung-Jen Hsia, and Garry Griffith published in the *Australasian Agribusiness Review*. OK, Taiwan's industry was much more concentrated back then than it is in China, and Foot and Mouth Disease is not the same as African Swine Fever; but this is a grim reminder of what *could* happen in China in the months ahead. Why not? Mortality rates due to ASF are higher than those associated with FMD. Also, the FMD outbreak in Taiwan was contained quickly through quarantine and vaccination (I understand that there is no effective, commercially available vaccine against ASF). Arguably, the spread of ASF would be more difficult to control in China.

And so, without going overboard, I think it's prudent to make some allowance for increased U.S. pork exports in the price outlook. This naturally requires a generous amount of guesswork, but there are some historical precedents with which to work.



My rather conservative approach is summarized in the picture to the left. It is worth noting, first of all, that actual shipments of U.S. pork to the conglomerate of mainland China, Hong Kong, and Taiwan did not decline beyond the seasonal norm in July, in spite of the second tranche of

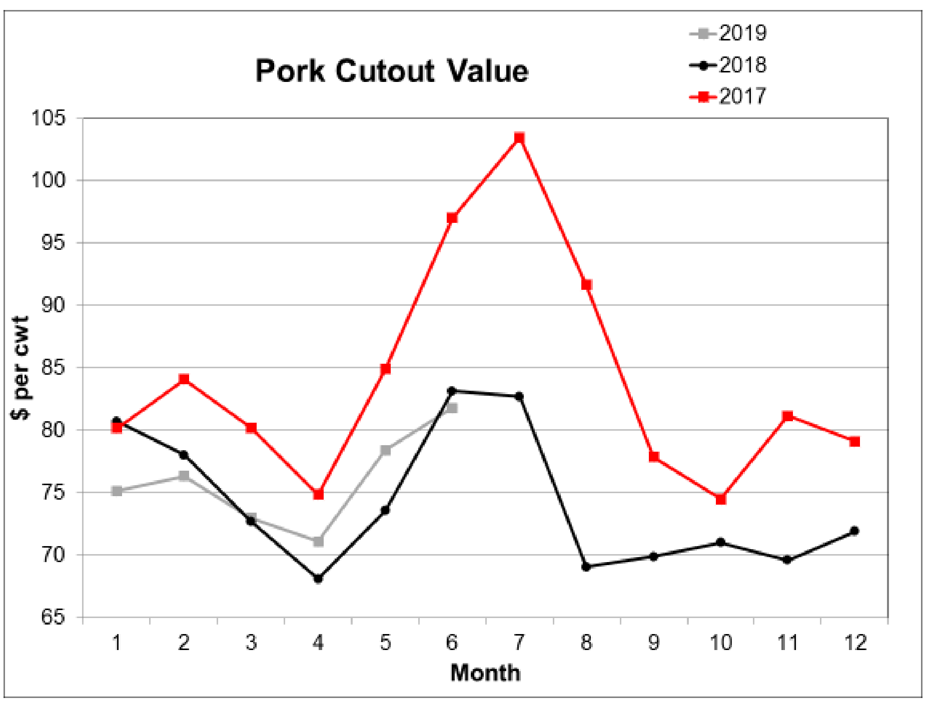
Chinese tariffs that were activated in early July. Total exports to this group in July were practically equal to a year earlier. My assumption is that they will continue to match a year earlier through the balance of 2018, despite the onerous tax, and then track above a year earlier in the first half of 2019. Even so, these export projections do not even approach the volume of business that probably would be done if the herd reductions in China turn into a full-blown disaster. And I should mention that the retaliatory tariffs do *not* apply to direct purchases by the Chinese government.

My current thinking is that total U.S. pork exports will exceed a year earlier by about 5% in the fourth quarter and by about 7% in the first quarter:

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

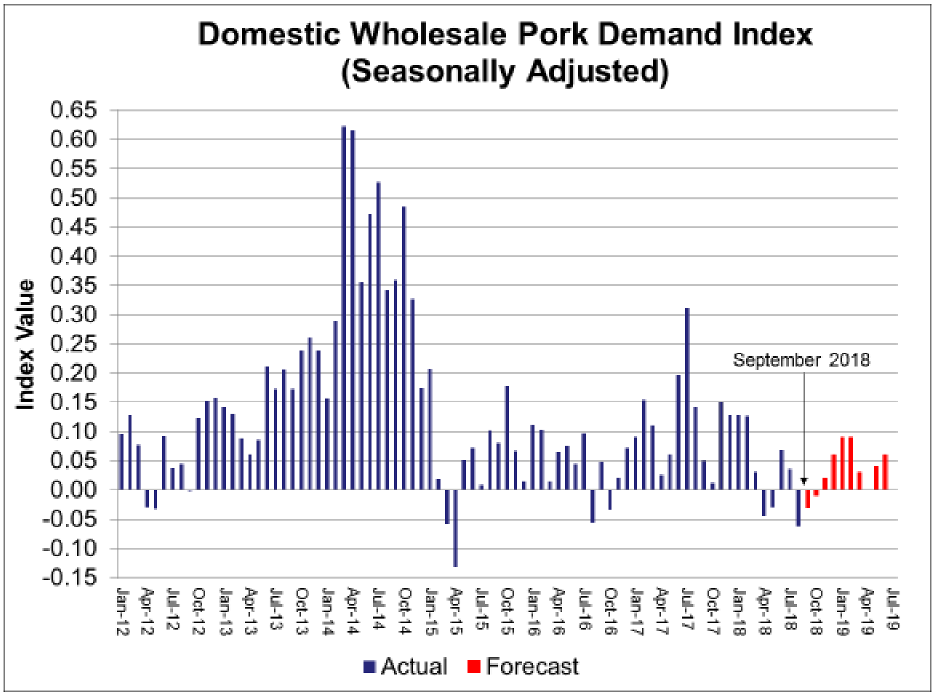
	Q3 '18	% Chg	Q4 '18	% Chg	Q1 '19	% Chg	Q2 '19	% Chg
Mexico	423	0	490	-0.9	475	+3.9	470	-2.1
Japan	282	+0.9	325	+1.5	328	+4.4	315	+5.2
Canada	135	-4.0	138	+0.4	121	-3.1	124	-0.5
Korea	126	+64.6	207	+30.3	250	+18.7	223	+14.5
Colombia	67	+53.0	82	+23.4	75	+15.6	75	+7.9
China/HK/Taiwan	90	-6.1	150	+3.5	160	+13.7	195	+58.1
Australia	46	+13.3	57	-4.1	63	+1.7	52	+2.8
Total	1330	+8.2	1624	+5.2	1626	+7.3	1631	+7.4

….which would, if USDA's reported farrowing intentions are accurate and if wholesale pork demand recovers to "mid-range" levels relative to 2016-2017 from its currently depressed standing, result in monthly average cutout values as shown below:



Something else to consider, though: if Chinese demand for imported pork were to balloon significantly beyond the volumes shown in the table, then demand for pork at the wholesale level would also "spike"—because this is what happens when supplies fall materially short of expectations. Remember that demand for bellies, ham, and trimmings *at the wholesale level* is largely inelastic, because the retail prices of the finished products made thereof are largely fixed for periods of months at a time.

The last time that domestic pork supplies fell so short of expectations was in 2014, as a result of the Porcine Epidemic Diarrhea virus in the U.S. herd. In the picture below, it's pretty easy spot 2014 without looking at the horizontal axis. The impact on wholesale pork demand is obvious. It goes without saying that a big surge in U.S. pork exports due to African Swine Fever would render my current demand projections as vastly understated.



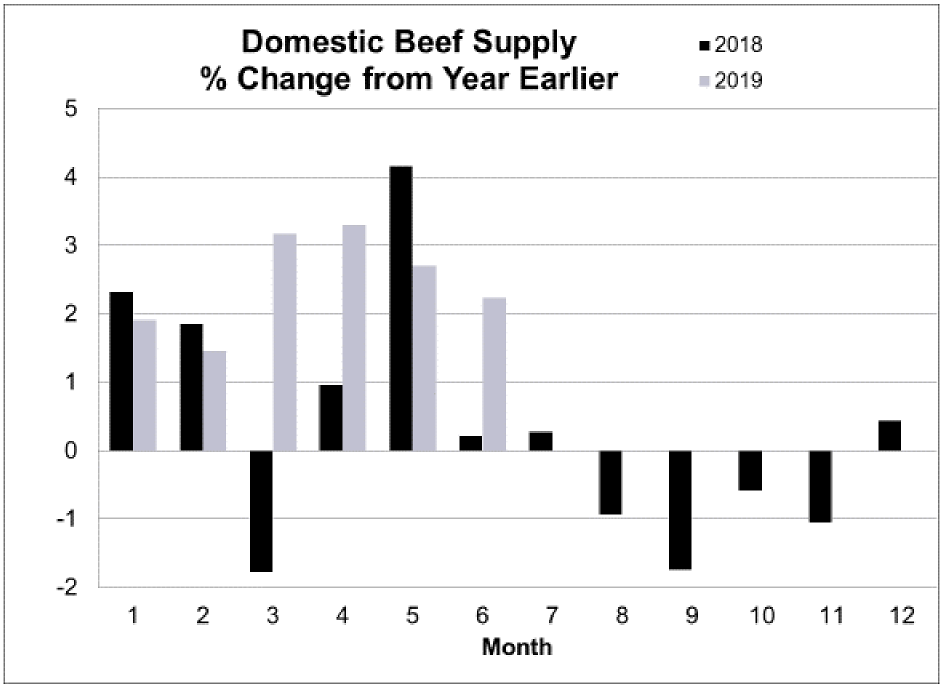
Moving on to the beef market, I might as well continue with the theme of exports. It is a healthy picture without many blemishes that I can think of. And so it is reasonable to expect that the current trends in export volumes will remain in place.

There is plenty of talk about Chinese beef demand increasing out of temporary mistrust of pork, and that theory has some merit; but I would think that Australia would be the primary beneficiary, since retaliatory tariffs make U.S. beef considerably more expensive, and since Australian production is expected to be up due to drought. The Chinese market is more lucrative than the U.S. market to Australian exporters.

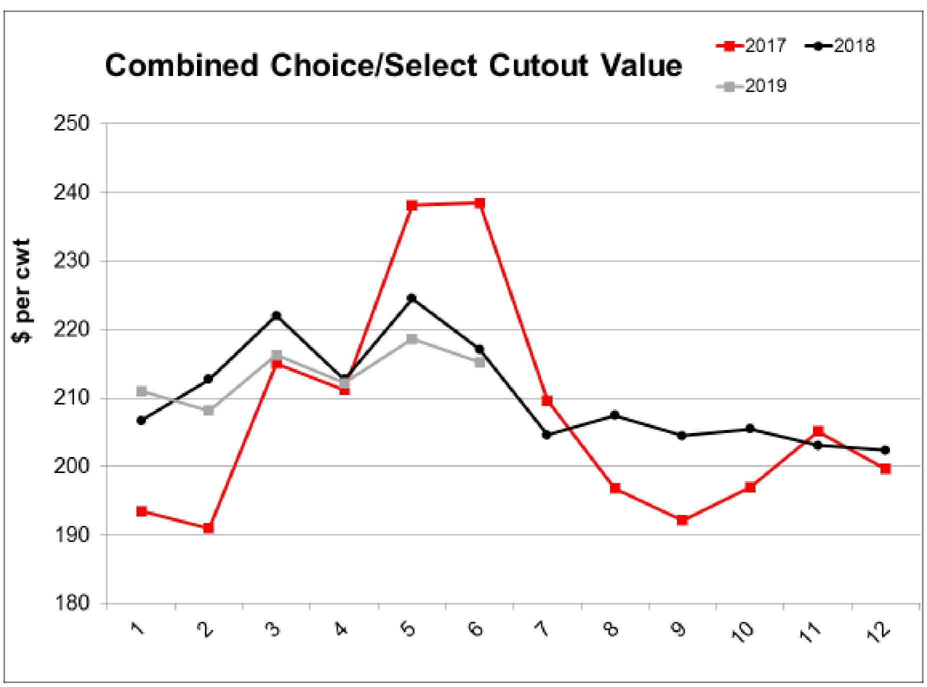
U.S. Beef Exports (million pounds) & Change from Year Earlier

	Q3 '18	% Chg	Q4 '18	% Chg	Q1 '19	% Chg	Q2 '19	% Chg
Japan	237	+1.6	203	+6.6	208	+5.4	232	+0.4
Korea	190	+50.9	180	+33.2	153	+12.7	171	+3.6
China/HK/Taiwan	120	+1.7	168	-5.5	135	-3.6	127	+2.6
Mexico	125	+10.4	122	+9.6	104	+5.8	113	-1.1
Canada	76	-3.2	79	-0.6	75	+5.7	78	-4.5
Total	833	+11.6	847	+8.3	761	+4.2	810	+1.3

It is still likely that fed cattle slaughter will run 1-2% below a year earlier over the next three months, and if carcass weights follow their typical seasonal path, then they will remain close to a year earlier. It is only because of larger cow slaughter that total beef production will be unchanged to up slightly during the September-November period. But after we factor in a rather sizeable increase in exports, it looks like net domestic beef supplies will be down about 1% this fall.



Meanwhile, demand for beef at the wholesale level has followed a normal seasonal trajectory ever since it hit a cyclical low point in July. There is nothing in the way of retail prices or margins or forward bookings to compel me to think that it will veer from this path any time soon. When I apply this assumption to the supply picture shown at left, I come up with a relatively flat pattern in the combined Choice/Select cutout value through the fall, one which would place the next low at about $200 per cwt in the first week of October, and the next peak three weeks later at about $210.



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