



Rabobank

Beef Quarterly Q3 2018

All Eyes on the US Protein Complex

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The US market is the focus in this Beef Quarterly, however, there are a number of other important issues that are continuing to influence global beef markets.

North Asia increasing imports

Japan and South Korea beef imports are on the rise. In 2017, combined imports by Japan and South Korea were up 9%, and at their highest level since 2002. Along with improved economies and lower global beef prices, the availability of beef from Australia and the US is fuelling this growth. Australian exports to Japan and South Korea are up 11% for the YTD (June), while the US appears to be focusing more on South Korea, with exports up 41% while up only 6% to Japan. Japan has also granted access for Argentina to export fresh beef into the country for the first time with the first shipment, albeit small, arriving in July. This decision would be a positive indication for Brazil who is also entertaining the prospect of gaining access to Japan.

Margin pressure starting to show

At the start of 2018, Rabobank referred to growing competition and complexity in global markets, and the opportunities and pressures this could bring to margins along beef supply chains. Part way through the year we have seen corporate results reflecting this mix of challenge and opportunity. Some global beef companies have revised down their earnings expectations, due to a combination of trade disruptions and ample protein supplies, while others have credited beef with contributing to high earnings. On balance, we see more margin pressure looming.

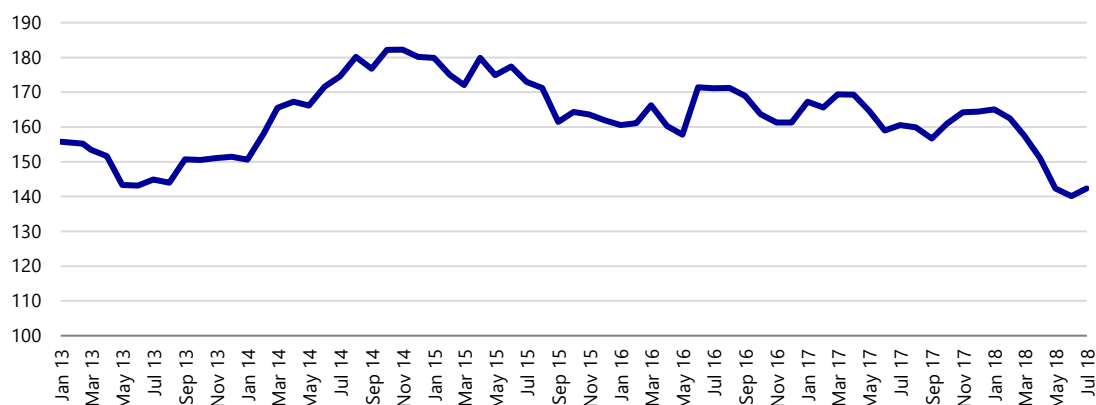
African Swine Fever outbreaks

Several outbreaks of African Swine Fever (ASF) were recorded in China in recent months, which raises the possibility of China – the world's largest consumer of pork – being caught short. While the extent and timing of any herd liquidation remain uncertain, if ASF takes hold, it is likely that China will increase imports of pork – and other meats such as beef – in 2019. An associated lift in global pork prices could also benefit beef supply chains in other regions.

Rabobank Seven-Nation Cattle Price Index

A slight lift in the US, and stable prices in other markets, saw the Seven-Nation Index rise slightly in July after falling for the first six months of the year (see *Figure 1*).

Figure 1: Rabobank Seven-Nation Cattle Price Index, Jan 2013-Jul 2018



Source: Rabobank 2018

Feature: The US – a global protein focal point

In 2018, it seems any conversation about global beef trade or total animal protein trade quickly shifts to activities in the US. While we have seen prices in the first half of 2018 hold remarkably well given the production levels, increased supplies of total proteins and potential trade fallout will be a concern for the second half. There is a whole laundry list of issues creating uncertainty and market volatility in the US, most of which affect global beef trade. The most important of these issues are:

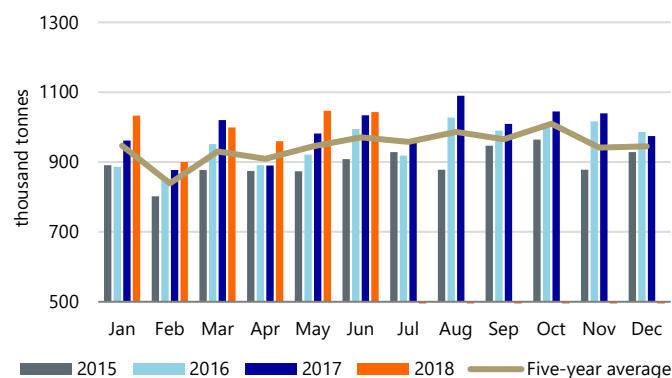
Growing US beef supplies

YTD beef production is up 3% (see Figure 2). This is slower than expected – early estimates had production up by 5%. The slower rate of expansion has been the result of exceptionally strong basis levels through the first half of the year, encouraging hedged producers to market cattle aggressively. Also contributing to lower volumes is the general fear that increased numbers of cattle on feed and seasonal considerations would drive prices lower. Early expectations are for beef production in 2019 to be up 2.5% to 3%. Growth in domestic production is also squeezing imports, which remain static compared to 2017.

Plethora of protein

The pork complex is the main driver behind expanding total protein supplies. Year-to-date pork production is up 4% with a 4% to 5% increase also expected in 2019. Poultry production has been up 2.5% in 2018, and price pressure and negative returns to processors are expected to hold expansion in check in 2019, despite new processing facilities coming on line. Absorbing some of this, total domestic protein consumption is 222 pounds and is expected to be up to 226 pounds in 2019. However, the increased production has the US needing to increase exports across all proteins.

Figure 2: US Monthly Beef Production, Jan 2015-Jun 2018



Source: USDA, Rabobank 2018

Trade uncertainties

US beef exports are up 14% year-to-date (June), as increased production has needed to be consumed. Exports to South Korea are up 41% and Hong Kong up 11% YTD (see Figure 3).

The unnerving fact about current US trade policy is its frequent changes. The trade war with China is impacting pork trade, forcing exported product back on to an already full domestic market. Beef has been less affected given the low volumes going to China – the market was only reopened last year. It has, however, stalled the momentum of US beef export growth into China.

The bigger worry for US beef exports is the slow process to renew the NAFTA with Mexico and Canada. Since Mexico's Presidential election in July, bilateral talks have progressed well, but progress with Canada remains quite slow. Rabobank expects that a successful renewal will be reached, the uncertainty is to when.

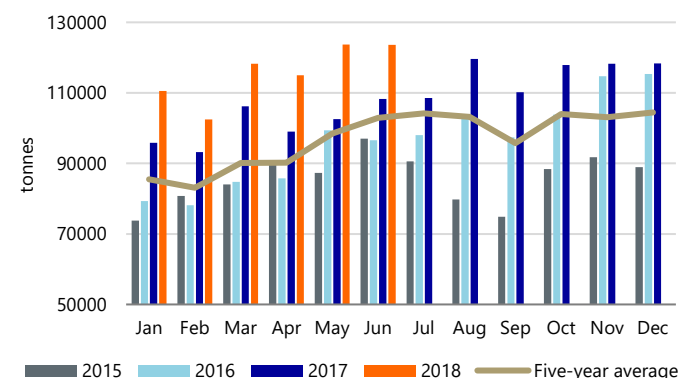
US drought

US drought conditions are a mixed bag. The USDA is expecting record corn yields and a production estimate of 14.59 billion bushels, down only 1% from a year ago. On the other hand, pasture and range conditions are a different story. Currently 15 states have extreme to excessive drought conditions and half of the US beef cow herd resides in these states. The risk of cow herd liquidation is high, with little doubt of forced liquidation in some areas. However, in aggregate, the ratio of cow slaughter to total slaughter, and heifers as a percentage of feed, and heifers as a percent of fed slaughter suggest the US is still expanding at a very slow pace.

Market performing well, but no guarantees ahead

Favourably, beef demand and clearance against the other proteins is performing strongly. A combination of lower retail prices and the strong economy means consumers have been continuing to purchase beef. Together with very strong exports this has been continuing to move product through the system. However, with such a saturated market it will not take much to tip it over.

Figure 3: US Monthly Beef Exports, Jan 2015-Jun 2018



Source: USDA, Rabobank 2018

Regional outlooks

Australia: Dry season continues to bite

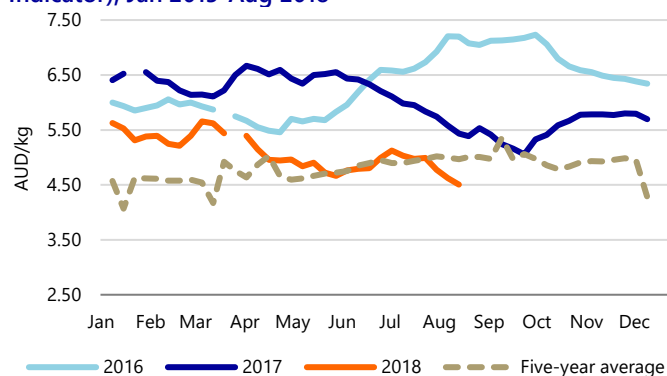
Dry conditions continue to have a softening effect on the Australian cattle market. After rising slightly, prices fell through July with the increased deterioration in the season. The Eastern Young Cattle Indicator fell to AUD 4.50/kg in mid-August – the lowest point in three years (see Figure 4). The drier than average rainfall forecast is expected to keep downward pressure on prices for younger, lighter classes of cattle and cows, with the potential for a more dramatic drop in spring if seasons don't improve. Without significant rain, many cow calf producers calving in Spring will face limited feed supplies, which could be expected to lead to increased culling.

Cattle slaughter numbers for June (685,000 head) eased slightly from May but still remain higher than 2017 volumes with the month of June 4% higher than in 2017. Year-to-date slaughter numbers are up 9% on 2017. Females continue to make up a large proportion of the total, increasing to 54% of the national slaughter number.

Beef exports increased in July. July exports (105,157 tonnes swt) were 13% higher than July 2017 and bring the total for the year to date to 640,891t swt, 13% higher than 2017. Despite the higher cow slaughter generating an expected higher volume of lean trimmings, year-to-date (July) shipments to the US – the traditional lean trimming market – are only up 1%. Meanwhile exports to China, South Korea and Japan are up 48%, 12%, and 11% respectively.

While total live cattle exports dropped slightly in July, year-to-date total exports are up 23% with volumes to the key markets of Indonesia and Vietnam similar to 2017 for the year-to-date, other markets are taking increasing volumes.

Figure 4: Australian cattle prices (Eastern Young Cattle Indicator), Jan 2015-Aug 2018



Source: MLA, Rabobank 2018

Brazil: Signs of improvement

Strong export markets and the normal seasonal decline in cattle supply are providing the foundations for improved cattle prices in Brazil in Q3 2018.

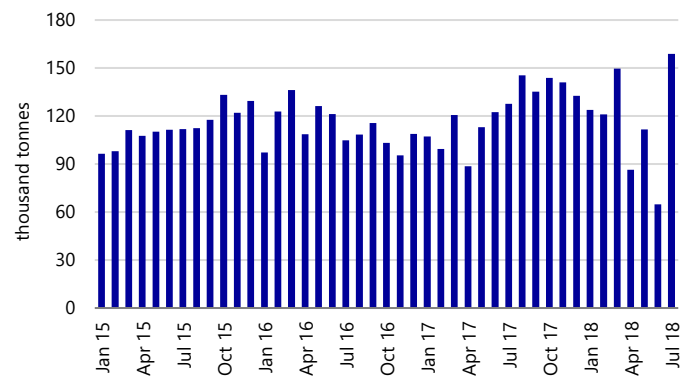
After suffering a large fall in June 2018, Brazilian beef exports rebounded strongly in July. The national truckers' strike, commencing in late May and lasting almost two weeks, severely limited exports. However, strong exports have seen volumes increase by 8% in the first eight months of 2018 (see Figure 5).

Hong Kong continues to be the main international destination for Brazilian beef, buying 212,000 tonnes, an increase of 18% compared to the first eight months of 2017. China – the second largest buyer of Brazilian beef – increased its imports by 44% in the same timeframe. Rabobank expects that Brazilian beef exports will finish 2018 up more than 5% in volume terms compared to 2017.

Despite ongoing uncertainties around the Brazilian economy in 2H 2018 – driven principally by the general elections in October, which has already resulted in volatile consumer and investor confidence – the outlook for meat consumption in Brazil in 2018 is positive. Beef consumption is gradually improving from the low levels driven by the recent recession (2014-2016). Preliminary numbers for 2017 show local beef consumption increased by 1% against 2016, and Rabobank expects a further increase of around 2% in 2018.

With the start of winter in the southern hemisphere (dry season in Brazil), average live cattle prices increased by 2% in July 2018 compared to June 2018. Overall, prices are anticipated to continue to gradually increase during 2H 2018 as a result of the seasonally lower supply through winter. By early August, live cattle futures prices (October contracts) were being negotiated 5% above July levels.

Figure 5: Brazilian beef exports, Jan 2015-Jul 2018



Source: Brazilian Ministry of Industry, Foreign Trade, and Services; Rabobank 2018

Canada: Full steam ahead

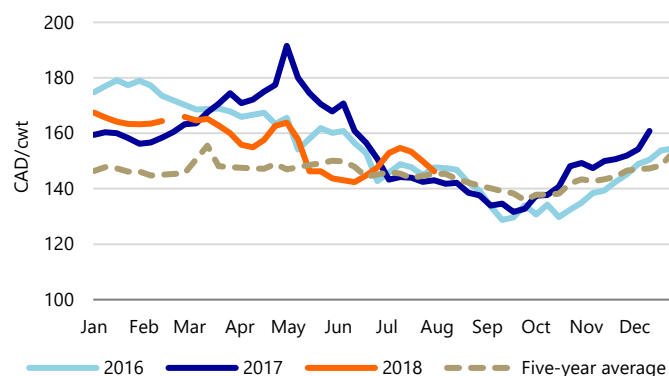
The Canadian fed beef industry is running at full steam. Average cattle on feed for the year-to-date is up 4% compared to 2017 and Canadian fed steer and heifer slaughter has averaged a 10% increase YOY. The aggressive cattle feeding pace has been supported by exceptionally strong basis levels when calculated to the Nebraska fed steer cattle price or to the CME. However, while basis levels are strong, they do appear to be slowly eroding. Fed cattle prices are closely following a normal Canadian seasonal pattern and as such are expected to remain under pressure before making a seasonal low in late September to early October (see Figure 6).

Feeder cattle prices started the year under pressure but have since rallied. Prices have been supported by Canadian feedyard buying activities, largely due to the strong basis. Supplies of feeder cattle are expected to become exceptionally short before the fall shipment of new crop calves gets underway. Despite the large domestic placement of cattle on feed, feeder cattle exports to the US have also been heavy, up 62% YOY – although this magnitude of increase is due to the abnormally light shipments of feeders to the US in 2017.

Making the feeder market even more interesting are reports of a surprisingly large numbers of feeder cattle coming from the US. While strength of the US dollar over the Canadian dollar alone makes this hard to understand, the comments are that a large share of the cattle are Holstein calves following the reduction in Holstein feeding and processing in the US. The increased Holstein feeding will likely reduce turnover rates owing to the additional feeding time needed for Holsteins.

Weather conditions across many of the cow/calf regions (British Columbia, Saskatchewan, Ontario) are under heavy drought stress. The dry conditions have limited pasture growth and sharply curtailed hay growth for the season. The dry conditions are not only expected to force early shipment of calves but could easily increase pressure on feed supplies and drive up feed prices.

Figure 6: Alberta fed steer prices, Jan 2016-Aug 2018



Source: USDA, Rabobank 2017

China: Strong demand continues

China's beef market continues to perform strongly, despite a modest decline in prices as a result of the seasonal drop in demand. Beef is now three times more expensive than pork – the staple meat in China – with the margin close to the record set in 2014 (see Figure 7). Such price performance suggests that domestic demand has been very strong. Premiumisation and dining out trends greatly benefit the beef market, as consumers tend to diversify meat intake compared to the more normal staple of pork.

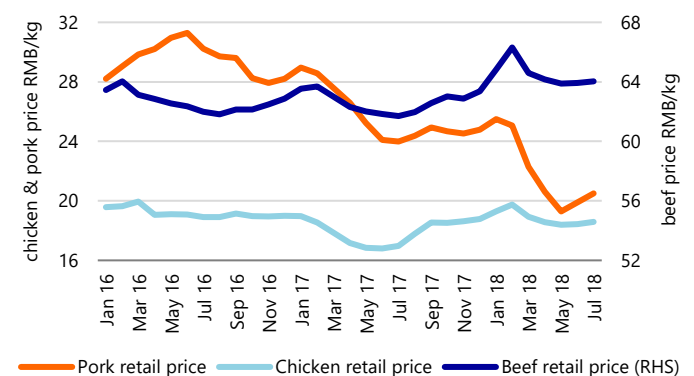
China's official beef imports increased strongly in 1H 2018, reaching 456,000 tonnes, a 40% increase YOY. Strong domestic demand and tight local supply are believed to be the drivers for rising imports. However, the possible decline in grey channel trade following stricter inspections on the borders is also expected to be contributing to increased official trade.

China continues to open up to new beef trading partners. In the past few months, a number of European countries, including Ireland, the Netherlands, Denmark, France, and the UK, have moved through the approval process to export frozen beef to China. The first shipment of Irish beef arrived in July and it is being marketed mainly through online channels.

In July, over 9,000 Angus cattle were shipped out of Uruguay and arrived at the port of Jiangsu province for breeding. The cattle will be transported to Inner Mongolia after 45 days of quarantine, where they will become part of a breeding herd for a local beef cattle reproduction project run under the governmental theme of poverty alleviation.

Despite increasing imports, strong domestic demand is also supporting the local cattle industry. The China Statistics Bureau released the agricultural data in July, showing that domestic beef production in 1H 2018 increased by 1.1% YOY, to 2.81m tonnes. Live cattle and calf prices have also increased 6%-7% in June compared to June 2017, while live hog price decreased by 17%.

Figure 7: Chinese retail meat prices, Jan 2016-Jul 2018



Source: Chinese Ministry of Agriculture, CAAA, Rabobank 2018

EU: Further decline of the cattle stock

Drought is having a major impact on the EU beef complex. Higher slaughter numbers have been recorded across large parts of Northern Europe (Northern Germany, Denmark, Sweden, Poland and Ireland). Feed prices are expected to continue rising, reducing producer margins and leading to additional cattle liquidation, in particular older animals and young stock. Higher slaughter numbers will cause the cattle inventory to continue to fall in Europe, although an improving milk price may support dairy cow retention and offset some of this fall in the coming months. With continuing dry conditions, EU beef supply is expected to remain high in the coming months.

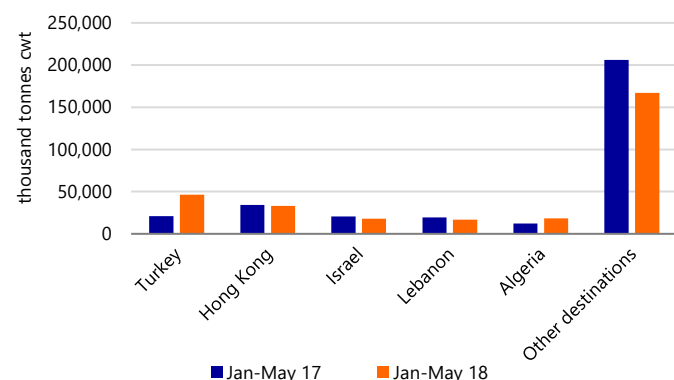
Prices are expected to pick up again in 2H 2018, to finish close to the level of 2H 2017. But potential trade complications could suppress this price increase.

At the retail level, the summer heat temporarily caused a drop in demand. In general, however, meat supply was reasonably well-absorbed by European consumers. In particular, the demand for minced meat has been strong, while the sale of prime quality cuts has been disappointing.

EU imports increased 16% in the first five months of 2018 compared to 2017. South American countries were the key to this increase and this flow is expected to continue in the second half of 2018.

EU exports fell 4% for the first five months of 2018 compared to 2017 (see Figure 8). Turkey became the most important market, with volumes doubling in the first five months of 2018 compared to 2017. Turkey now represents 15.5% of the total EU export. However with the economic situation in Turkey and devaluation of its currency, demand is expected to fall in 2H. Exports to Iran have also been hampered by the political embargo and live exports to Algeria have been interrupted after foot and mouth disease was detected there. China offers opportunities for Europe with Ireland, France and other countries recently receiving export approval.

Figure 8: EU Beef exports, Jan-May 2017 – Jan-May 2018



Source: EU Commission, Rabobank 2018

Indonesia: Retail prices easing

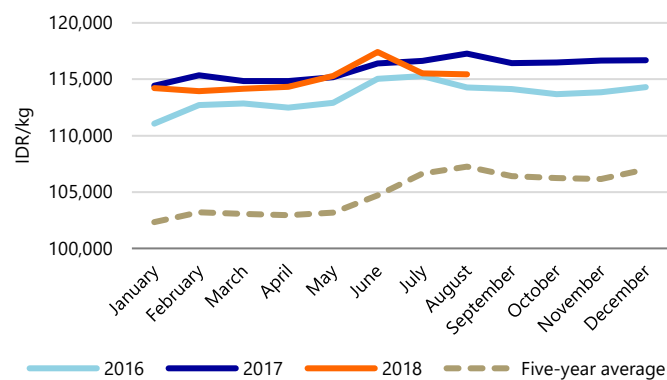
With Ramadan and Lebaran past, Idul Adha (22 August) became the next peak in beef demand. Rabobank expects beef demand (i.e. for local cattle) to remain firm. However, seasonally lower demand from the end of August will see beef prices ease.

This year's Ramadan and Lebaran season proved stronger than previous years. Demand for beef was supported by larger-than-usual government transfers (IDR 35.8 trillion) to civil servants for mandatory religious holiday allowance (paid in May) and 13th-month salaries (paid in July). Even carabeef imports failed to dampen retail prices. Export data from APEDA India indicated that January to June 2018 frozen carabeef shipments to Indonesia totalled 25,984 tonnes (versus 60,000 tonnes previously reported), supporting demand for slaughter cattle from feedlots. Average slaughter cattle prices recovered to IDR 40,000/kg lwt in August, from IDR 39,000/kg lwt in May.

Between May and early August, monthly beef retail prices averaged between IDR 113,900 and IDR 117,400/kg (see Figure 9) – spiking during Lebaran. Retail prices are currently IDR 116,800/kg. Rabobank expects beef prices to ease by end August 2018 on seasonally lower demand, higher feeder imports (May-June 2018), and continued arrivals of Indian frozen carabeef.

For feedlotter, the real test will come in September. The government's first audit of the 5:1 feeder/breeder ratio is due to occur in December 2018. Since the introduction of the regulation in October 2016, it is estimated that breeder imports into Indonesia have not even reached 20% of the 500,000 feeders needed annually. Except for a few that have imported breeders, many feedlotter may face penalties for not meeting the ratio. The significant potential to disrupt supply that may result from enforcing the regulation could lead to either more beef imports or a modification of the regulation.

Figure 9: Indonesian national beef prices, Jan 2016-Aug 2018



Source: Indonesian Ministry of Trade, Rabobank 2018

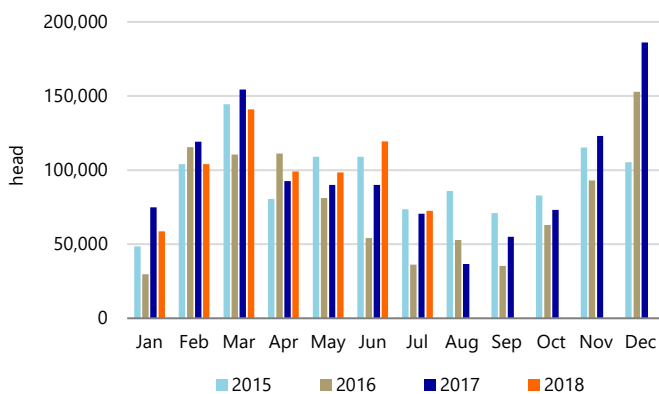
Mexico: Production growth continues

Mexico continues to expand beef production, growing 2.7% in the first six months of 2018 to 1.12m tonnes compared to the same period in 2017. The growth has been driven by an increasing number of head being processed, with FI slaughter 5.2% higher than last year (January-June). Production growth is expected to continue at the same pace into 2H 2018, reaching a total of 1.96m tonnes. Prices have dropped 4% from the seasonal high of MXN 74/kg in May to MXN 71/kg in July.

Cattle exports made a strong recovery compared to the first four months of the year (see Figure 10). While cattle exports between January and April were down 8.7% compared to the same period last year, in the period May to July Mexico exported 290,000 head, totalling 693,000 head from January to July of this year. This has left cattle exports flat compared to last year. While exports have recovered to last-year levels, heifer exports continue to increase and for the year-to-date in July they are up by 21% compared to last year. The strong recovery and the amount heifers exported to the US have been caused by the drought conditions in the north of Mexico.

The gap between beef exports and imports continues to close. In the period January to June 2018, exports totalled 113,000 tonnes, while imports totalled 96,000 tonnes, reducing the gap to 17,000 tonnes. In 2017, over the same period, the gap was 44,000 tonnes. Beef exports in the first quarter of the year were 16% lower compared to Q1 2017, and while there has been some recovery in the second quarter, beef exports in the first six months of this year are 14.8% lower than last year. On the other hand, given current beef expansion in the US and competitive prices, the amount of beef imported from the US continues to increase and is 8.8% higher in the first six months of the year compared to same period last year.

Figure 10: Mexican monthly cattle exports, Jan 2015-Jul 2018



Source: GCMA, Rabobank 2018

New Zealand: Seasonal decline in supply lifting prices

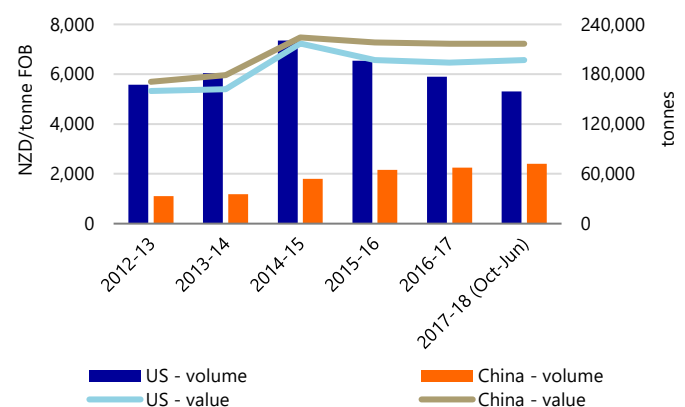
Prices across all classes of cattle lifted over the last quarter, with the seasonal production decline increasing procurement competition among processors. The weaker New Zealand dollar has also helped to support this pricing increase. Both factors were particularly evident in the manufacturing beef trade. Bull prices between May and August lifted 4% in the North Island and 7% in the South Island. The cow market experienced the biggest increase, with prices over the three-month period rising by 11% and 20% in North and South Islands respectively.

Rabobank expects continuing competition for a declining supply, combined with a weaker New Zealand dollar, to support some further upward price movement through to the end of the 2017/18 season and into the new season (starting October). However, once New Zealand production begins to lift there is potential for prices to come under pressure from weakening global beef prices.

New Zealand's season-to-date production (Oct-Jun) is up 8% on last season. This has predominately been driven by a marginal increase in season-on-season herd numbers, in combination with the culling of cattle impacted by the M. Bovis disease outbreak. As of late July, just over 32,000 cattle from infected properties had been culled. The government has indicated that up to 152,000 cattle could be culled over the next two years as part of the phased programme to eradicate the disease.

Exports have risen in line with the production increase, totalling 325,663 tonnes (up 8%) from October-June. A significant proportion of this increase went to China, up 33% on last season. Exports to the US are also up 7%. The US and China combined account for 71% of New Zealand's 2017/18 beef exports. The current average export value New Zealand is receiving from both the US and China, is in line with the largely consistent strong returns that have been extracted from both markets since 2014-15 (see Figure 11).

Figure 11: NZ beef exports to China, 2012-18



Source: NZ Meat Board, Rabobank 2018

US: Weather conditions the biggest driver in the market

Given all of the noise in the market and all of the potential trade conflicts, US retail beef prices have held together exceptionally well, especially when considering the quantity of total protein production in North America. The average monthly retail beef price is holding in the USD 5.70/lb to USD 5.75/lb price level. Total domestic protein consumption for the year is estimated to be 222 pounds per capita, and is expected to ratchet up to 226 pounds in 2019. In addition, US beef exports are up 15% compared to 2017, year-to-date.

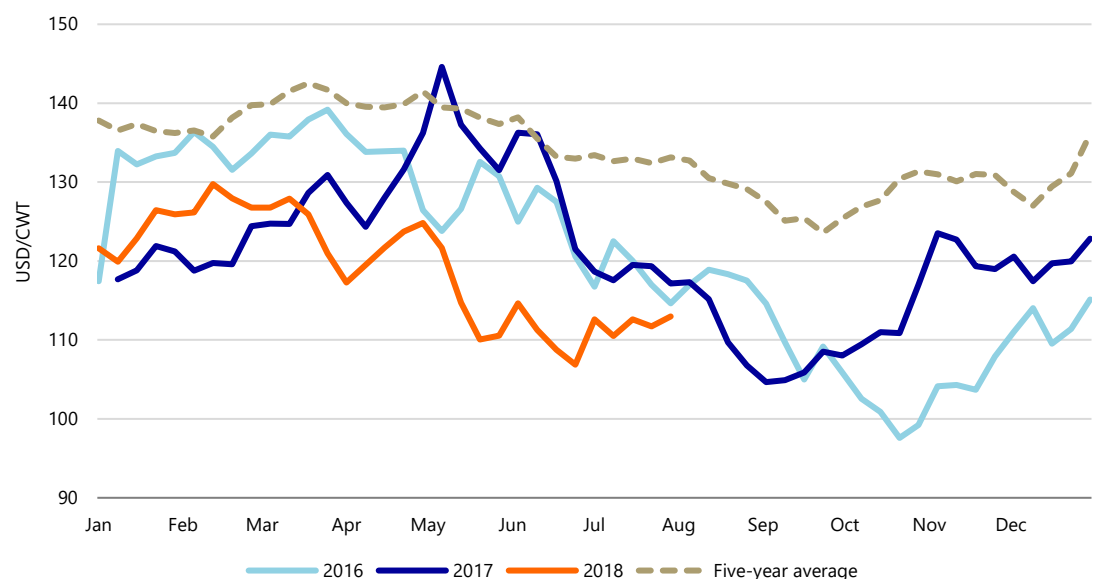
Cattle on feed numbers have eased to being up 4% to 5% over a year ago. The easing of numbers has been caused by slower placement rates and higher marketings. Aggressive forced placement in Q4 2017 and Q1 2018 due to weather have forced placements to be slower. Meanwhile, marketings are up due to the exceptionally strong basis that was encouraging hedgers to market cattle as aggressively as possible, plus record-breaking packer margins supported increased processing of cattle.

The long-term seasonal trend is for fed cattle prices to bottom in late July or early August and rally during 2H (see *Figure 12*). That historical pattern has been delayed over the past three years, with seasonal lows not occurring until late September or October. Right now, the market is at a crossroads to determine if conventional summer lows were placed or if additional price pressure is yet to come. Given the market performance of the past couple of weeks, the bias is shifting to more price pressure to come.

Feeder cattle prices have seen a typical seasonal rally from May lows to an August high but look to be reaching a seasonal top. Weakness in deferred live cattle futures is serving somewhat as a cap on cattle feeders' willingness to pay. Expect feeder cattle prices to come under seasonal pressure from increased offerings as cattle are forced to market early because of dry conditions. Low grain prices from tariff fall-out and a larger than expected crop should provide underlying support to feeder cattle prices.

Heifer retention for herd expansion appears to have ground to a near halt, resulting in an increasing number of heifers in the feeder mix. Cull cow prices have eroded into the high USD 0.50/cwt price level due to forced movement of cows following dry weather. Prices have also been pressured from limited non-fed slaughter capacity, which is providing extreme market leverage to cow processors. Margins to fed cattle processors have been at record levels in a range of USD 150 to USD 300 a head and estimates are that margins to cow processors are even better.

Figure 12: US Five-Market Area Steer Price, Jan 2016-Aug 2018



Source: USDA, Rabobank 2018

Dashboard

Legend and units

Production	Exports	Imports
1,000 tonnes	1,000 tonnes	1,000 tonnes

Δ = year-on-year change

All prices in local currencies

Australia: Prices fall as production rises

Production		Exports		Cattle prices (AUD/kg cwt) EYCI		Export beef prices (AUD/kg FOB) US 90CL Cow	
Jun 18: 196.3	YTD Jun 18: 1,127.6	Jul 18: 105.15	YTD Jul 18: 640.89	Jul 18: 5.02	YTD Jul 18: 5.18	Jul 18: 5.72	YTD Jul 18: 5.80
Δ 0%	Δ +9%	Δ +13%	Δ +13%	Δ -15%	Δ -18%	Δ -7.8%	Δ -5.5%

Brazil: Production, prices and exports all rising

Production		Exports		Live cattle price (BRL/15kg)		Beef wholesale price (BRL/kg)	
Mar 18: 642.1	YTD Mar 18: 1,880.9	Jul 18: 158.8	YTD Jul 18: 843.6	Jul 18: 141.72	YTD Jul 18: 142.92	Jul 18: 9.51	YTD Jul 18: 9.77
Δ +2.4%	Δ +4.7%	Δ +24.5%	Δ +8.3%	Δ +13.8%	Δ +3.9%	Δ +4.2%	Δ -0.7%

China: Everything is positive

Production	Consumption	Import		Cattle prices (CNY/kg)		Retail beef prices (CNY/kg)	
1H: 18,790	1H: 2,810	Jun: 83.3	YTD: 456.4	Jul: 30.04	YTD: 30.05	Jul: 64.1	YTD: 64.5
Δ +0.9%	Δ +1.1%	Δ +49%	Δ +40%	Δ +6.2%	Δ +7.1%	Δ +3.8%	Δ +3.1%

EU: Production up

Production		Export		Import		Cattle prices (EUR/kg)			
						Young Bulls R3	Steers R3	Cows O3	Heifers R3
May 18: 662	YTD May 18: 3,244	Jun 18: 22.2	YTD Jun 18: 102	Jun 18: 12.9	YTD Jun 18: 109	3.66	4.1	3.05	3.89
Δ +5.2%	Δ +2.8%	Δ +8.8%	Δ -8.8%	Δ -11.1%	Δ +10.8%	Δ -1.3%	Δ -2.0%	Δ -0.5%	Δ -0.9%

New Zealand: Production volumes up

Production		Exports		Cattle prices (NZD/kg cwt)		Export beef prices (NZD/kg FOB)	
Jun 18: 64	YTD Jul 18: 568	Jun 18 : 47.2	YTD Jun 18: 325.7	Aug 18: 5.35	YTD Aug 18: 5.35	Jun 18: 7.16	YTD Jun 18: 7.24
Δ +27%	Δ +10%	Δ +3%	Δ +8%	Δ +4%	Δ 0%	Δ +2%	Δ +1%

US: Strong export growth

Production		Exports		Imports		5 Market Steer (USD/cwt)	Fed beef cutout (USD/cwt)
Jun 18: 1043.4	YTD Jun 18: 7,011.8	Jun 18: 123.6	YTD June 18: 693.5	Jun 18: 132	YTD Jun 18: 692.6	July 18: 111.87	July 18: 204.30
Δ +1%	Δ +3.3%	Δ +14.2%	Δ +14.6%	Δ -1.2%	Δ +1%	Δ -5.5%	Δ -3.7%

Imprint

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