Beef Quarterly Q1 2020

China in the Front Seat for Beef Imports in 2020

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With the commencement of another year we are yet again experiencing a major disruption to one of the world's largest beef importers, China. In this beef quarterly we take a look at the impact of the coronavirus and other factors that will influence demand of the major beef importers in 2020.

Coronavirus

The outbreak of the coronavirus in China has had a major impact on foodservice and trade. With foodservice as the main channel for sales, beef is expected to feel the impact more than others. Indications from the 2003 SARS outbreak suggest that once the virus is contained, sales and trade should rebound quickly. However, the timeframe for control remains uncertain.

US trade deals

Progress was made on the USMCA, and the Japan/US trade deal was approved in December. These were closely followed by the signing of the phase-one US-China trade agreement in January. Although questions remain on details of the US-China agreement, there is now concern that the coronavirus will delay the Chinese purchases of US commodities.

Brexit

The UK officially left the EU on 31 January 2020, initiating a transition period that will last until 1 January 2021. We expect the impact on the beef industry to be limited within this period, as the UK remains a member of the EU single market. However, it does allow global beef exporters, such as the US, Brazil, Argentina, Uruguay, Australia and New Zealand, to negotiate new trade deals with the UK.

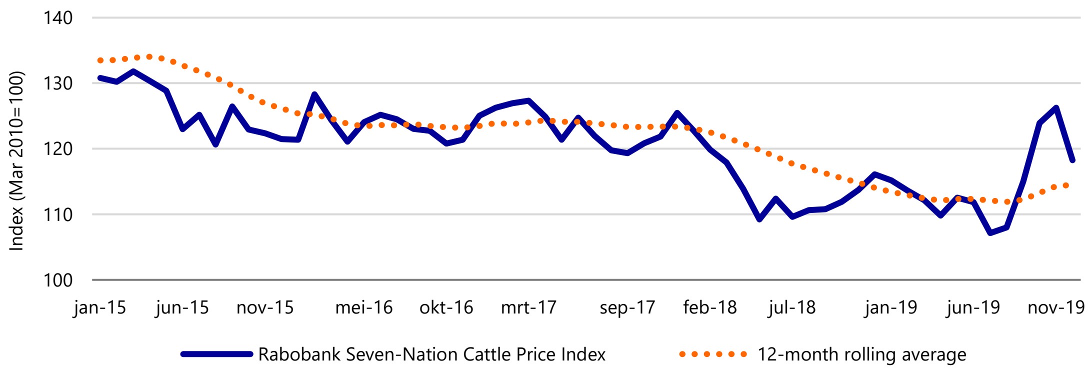
New Export taxes in Argentina

New tax measures designed to reduce the rate of inflation and alleviate poverty were announced by the Argentine government in early December. Taxes were imposed on a range of agricultural exports, including an increase in the beef tariff from 7% to 9%.

Rabobank Seven-Nation Cattle Price Index

After a major jump in the Rabobank Seven-Nation Index in late 2019, driven by increases across most countries – particularly the US and Brazil, prices eased in January, with Brazil and New Zealand experiencing big falls in cattle prices (*see Figure 1*).

Figure 1: Rabobank Seven-Nation Cattle Price Index, Jan 2015-Jan 2020



Source: Rabobank 2020

Feature: Beef Imports in 2020 – China in the Front Seat

For the four largest beef importing countries, 2019 was a solid year, distinguished by extraordinary growth from the largest importer, China (*see Figure 2*). Although most experienced a slight drop in economic growth, all saw increases in volumes imported, ranging from 1% by the US and Japan to a 60% growth for China. We expect 2020 to be another steady year for Japan, US and South Korea, but logistics, consumer activity and slowing economies are expected to take a toll on China's import demand in 1H, before recovering in 2H 2020.

China Import Demand

We expect China's beef imports to slow down in 1H 2020. The high inventory of frozen beef stored in local markets in preparation for the Lunar New Year was not used in January due to the outbreak of coronavirus and dramatically-reduced foodservice activity. Food service outlets will likely remain closed in some regions into March, while in other regions people may avoid eating out together. Quick service restaurants may be impacted the least, while hotpot and full-service restaurants will see sales decline markedly in Q1.

At the time of writing it is uncertain if coronavirus can be controlled in Q1. It is possible that some businesses, such as food service and tourism will remain disrupted through April or May, even if the virus is brought under control. This lower sales volume means beef demand will be weaker than normal years in 1H. In addition, many importers face the challenge of a limited cash flow due to unsold stock at ports and financial losses incurred in the late-2019 price plunge. All of these factors will delay the return to normal beef imports to Q2 at the earliest, and more likely to Q3. Despite this, we expect China's beef imports to continue to grow in 2020, with a strong rebound in the second half of the year. But imports will be slower than seen in 2019.

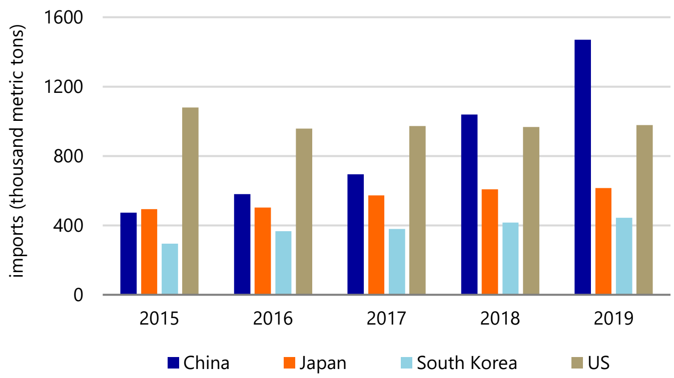
US import demand

Pressure in the global market for beef was reflected in a sharp increase – followed by subsequent drop – in the lean trimmings market into the US in October 2019. Reaching the same record levels set in 2015, at USD 3/lb, it reflected the pressure of increased Chinese buying activity in attracting Australia and New Zealand product away from the US. However, the volume and value of imports for the major importers followed similar trends, indicating that per unit prices for imports remained relatively steady (*see Figure* 3). Together, this suggests that while demand for some cuts is strong, the ability to trade up or down the range of cuts can help balance the overall trade. That being said, with Australia likely to see a reduction in production in 2020, lean trimmings may be one of the products in shorter supply, placing pressure on US imports. However, US cow herd expansion has stopped and cow slaughter has continued at an aggressive pace into January. It may be that US cow liquidation fills the gap created by reduced imports.

Japan and South Korea

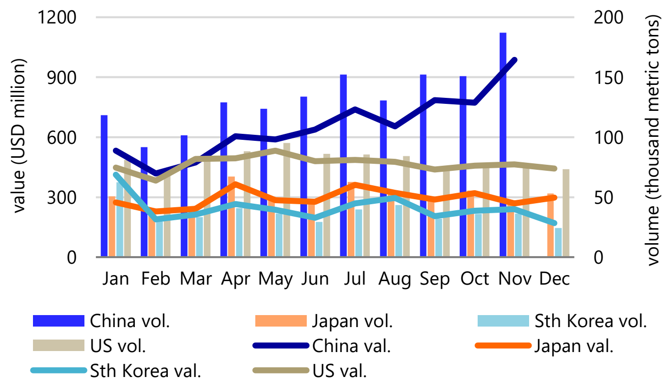
Japan and South Korea have been strong, stable performers in the global beef import market. However, the softer economic outlook suggests that consumption and beef imports may decline slightly in 2020. On the other hand, Japan removed all restriction on US beef trade in 2019 and also formed a trade agreement, providing the US with the same tariff reduction schedule as countries under the CPTPP – approximately halving the tariff charged on US product. This should reduce the cost of US product and support increased imports from the US. Both South Korea and Japan are expected to favour US product in 2020 as Australian supplies become more limited.

Figure 2: Beef imports of major beef importers, 2015-2019



Source: ITC trade map, Rabobank 2020

Figure 3: Beef imports of major beef importers, 2019



Source: ITC trade map, Rabobank 2020

Regional Outlooks

Australia: Finally Rain and Prices Lift

Good rainfall across large areas of Australia has lifted spirits and cattle prices, as competition for limited cattle supplies heats up. At the same time, reduced demand from China as a result of coronavirus will impact export sales.

The Eastern Young Cattle indicator lifted 21%, from AUD 5.13/kg cwt in November 2019 to AUD 6.23/kg cwt on 14 February 2020. Good rainfalls across much of eastern and northern Australia prompted producer restocking activity, and young stock were in high demand – most likely for short-term weight gain but also for rebuilding breeding numbers. Heavier finished cattle continued to have strong prices, reflecting the limited supplies.

The 2019 national cattle slaughter finished 8% above 2018, at 8.48m head. Cow slaughter was up 18% YOY by December, reflecting the liquidation of breeding stock due to prolonged dryness. The average slaughter weight for 2019 (283kg) was down on 2018 levels (291kg) but the increase in cattle slaughtered offset this fall, and 2019 production volumes increased 5% to 2.4m metric tons.

Beef exports finished the year on a strong note, up 9% YOY, at 1.2m metric tons swt. The strongest export growth came from China, where 2019 exports eclipsed 2018 by 84%. By year-end, China's market share of Australian beef exports grew from 14% to 24%. US exports also saw growth, albeit a more humble 9% YOY. Exports to Japan were down 9% YOY. With almost one quarter of Australia's beef exports exposed to the Chinese market, reduced demand as a result of the coronavirus is expected to reduce sales and potentially lead to lower global prices, a challenge for processors given strong livestock prices.

Brazil: a Moment of Rebalancing

After a year marked by record exports and prices, the Brazilian beef market is experiencing a moment of rebalancing of supply and demand. The unprecedented price levels registered last November, made the domestic market retract when the price increases reached the Brazilian consumer. Seasonally, January is a lower demand month for meat in general, given school holidays and higher tax expenditure commitments that reduce consumer spending.

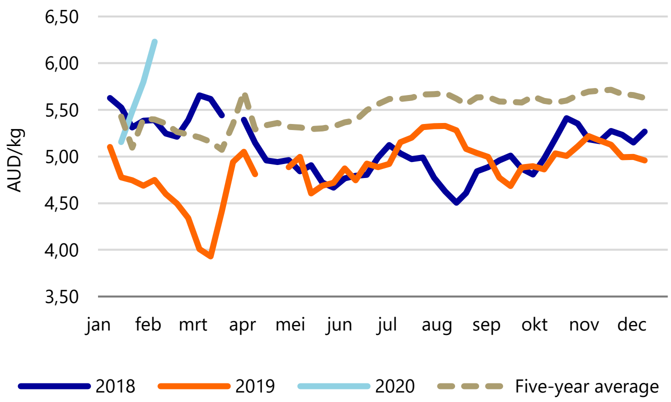
On the supply side, the rainy season generates pasture growth, lowering production costs and limiting the supply of animals sent for slaughter. With domestic consumption still considered weak and China reducing purchases due to coronavirus, abattoirs are unwilling to pay higher prices to attract increased volumes. Although still 27% higher than in January 2019, cattle prices in January (BRL 193.05/15 kg) dropped 9.8% from BRL 211.97/15 kg in December.

A challenge for those finishing cattle on grain is the high feedgrain costs. January corn prices rose 6% on December levels and we expect prices to remain high at least until the beginning of the planting of the second-corn crop, which should occur at the end of 1H.

Export volumes for January dropped 22% MOM, driven largely by a 36% reduction in imports from China (*see Figure 5*). There is a seasonality factor in this reduction, but it is worth mentioning that the last month of 2019 was the best December in the entire historical series, both in terms of volume and revenue.

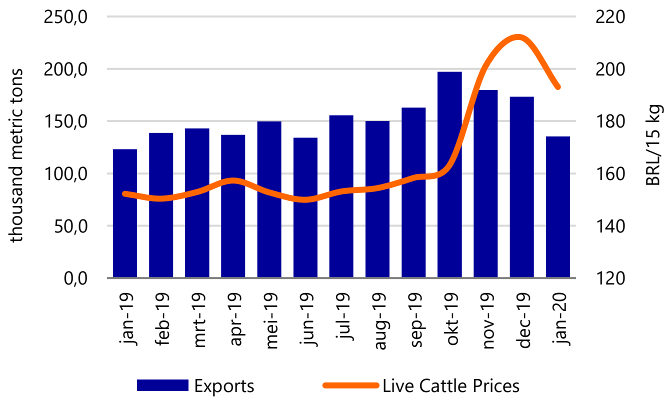
Domestic demand is expected to gain strength over the coming months with the end of the school holidays and the prolonged carnival holiday. At the same time, we expect Chinese demand to return as they look to re-establish inventories and increase domestic availability. Cattle supply, on the other hand, is expected to rise as we move into the drier, less productive months.

Figure 4: Eastern Young Cattle Indicator, 2017-Jan 2020



Source: MLA, Rabobank 2020

Figure 5: Brazilian beef exports and cattle prices, Jan 2019-Jan 2020



Source: MDIC, Rabobank 2020

Canada: Strong Performance

The Canadian cattle market had a strong year in 2019 and is off to a strong start in 2020. Supporting the strong market performance has been Canada's participation in the CPTPP – that lowered tariff rates to export markets – as well as less competition from the US which was bogged down in trade negotiations and hampered by the strong US dollar.

Cattle on feed as of January 1 (1.12m head) was up 11% over a year ago. Placements during December (106,600 head) were up 26% and marketings (116,500 head) were up 4%. Supporting the aggressive market has been the continuation of very strong basis levels when compared to the CME Live Cattle contract as well as the US cash market. Feed costs in Canada are actually more expensive than in the US. Under normal circumstances this would curb cattle on feed numbers but the combination of strong basis, a strong US dollar and export opportunities have offset the impact of feed costs. Fed cattle prices, while in line with 2019 levels, remain high compared to the five-year average.

The aggressive cattle feeding in Canada forced a reduction in Canadian feeder cattle shipments to the US, dropping 5% in 2019 compared to 2018. Even more unusual was the strong import of cattle from the US – up 39% on 2018 volumes – driven by the aggressive feeding rates and strong basis.

Fed cattle shipments to the US in 2019 were up 47% over 2018. Canada also aggressively shipped cows to the US. A large contributor to the increased shipments were large cattle on feed numbers that exceeded Canadian slaughter capacity, which were supported by the strength of the US dollar.

On top of the increased shipments of fed cattle and cows, Canadian beef shipments to the US posted a 7% increase for 2019 while US beef exports to Canada were down 11%.

China: Coronavirus Dents Demand

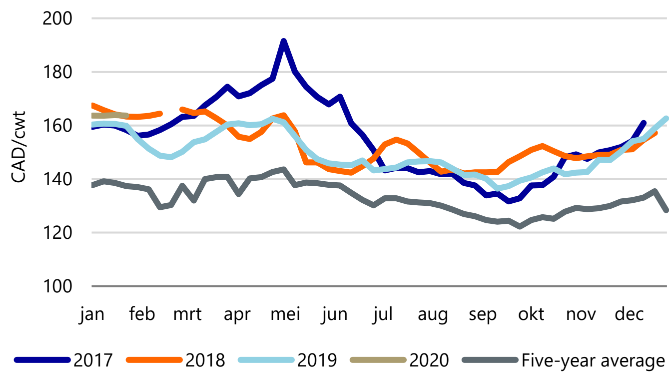
We expect beef consumption to have been hit hard by the coronavirus outbreak and associated government measures, such as lockdowns of city centres, disruption to transportation, and closure of many public areas including restaurants. China's consumption of beef, together with lamb and seafood, is generally associated with eating out, and especially full-service restaurants and hotpot. The closure of many foodservice outlets in January and February leads us to believe that sales of beef would have declined substantially.

China's fresh beef retail prices increased to RMB 83/kg in January before the Lunar New Year, up 20% YOY (*see Figure 2*). Prices moved up further to a record high of RMB 85 per kg in the first week of February. Transportation disruptions and the closure of some retail stores have caused the short supply of fresh produce, including animal protein and vegetables in many regions, forcing prices up.

Beef production in 2019 increased to 6.67m metric tons, up 3.6% YOY. This pace is much stronger than the previous years – the CAGR between 2013 and 2018 was below 1%. The shift from pork consumption to other protein consumption, including beef, as a result of African swine fever is a key reason for the strong growth of local beef production. However, we expect beef production to slow in 2020, as a slower economy and income growth will restrict consumers' purchasing power.

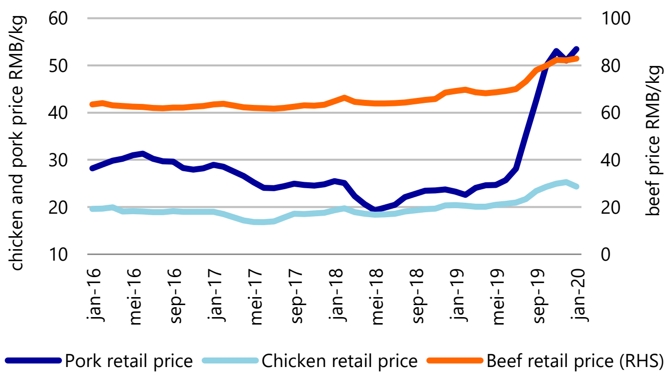
China's beef imports increased to 1.69m metric tons in 2019, up 60% YOY, driven by the shutdown of grey channels and strong local demand. With the signing of the US-China phase-one agreement in January 2020, China is expected to import more US beef. However, the sudden hit by coronavirus on China's economy will cause short-term uncertainty as higher-priced US beef is usually positioned for the high-end market, which will shrink under a slowing economy.

Figure 6: Alberta fed steer prices, Jan 2017-Jan 2020



Source: Canfax, Rabobank 2020

Figure 7: Chinese retail meat prices, Jan 2016-Jan 2020



Source: Chinese Ministry of Agriculture, CAAA, Rabobank 2020

Europe: Production Declining

We expect EU beef production to continue its downward trend in 2020, declining by about 1% YOY as beef consumption in the EU drops further. Decreasing livestock supply in Germany, France and the UK will contribute to a reduction in beef slaughter in 2020. This, together with lighter carcasses, will result in declining production, particularly in the UK. Ireland has been facing decreasing availability of animals for slaughter as a consequence of increasing calf exports. Beef production is also negatively affected by the shift from beef to dairy cows, leading to reduced carcass weight and poorer conformation. High feed prices in Poland are also expected to put downward pressure on production in 1H 2020. Up to October 2019, overall EU beef production dropped by 1.3% YTD. On the other hand, Spain and Germany increased production by 4% and 2%, respectively during this period.

With contracting production and consumption in the EU, we expect a modest increase in exports in 2020. EU beef exports increased by 1% YOY for the first 11 months of 2019. Export volumes from Ireland (+12%), the Netherlands (+26%), United Kingdom (+51%), Spain (+29%) were on the rise, whereas Poland (-44%) and France (-14%) recorded lower exports. The UK-China trade agreement finalized at the end of 2019 may further facilitate exports to China in 2020.

Uncertainties for beef trade still remain after the commencement of the transition period for Brexit. A strong dependency exists between the EU-27 and the UK in terms of beef trade. 89% of the UK's total beef imports originated from the EU-27, while 44% of EU-27 beef exports went to the UK, between January and October 2019. But major players in global beef exports have already started positioning themselves for a trade deal which could alter trade between the EU-27 and the UK.

After a prolonged period of low carcass prices on the EU market, prices improved from the mid-year low, although they are likely to remain below the average price of 2015-18 (*see Figure 8*).

Indonesia: Two Halves of 2020

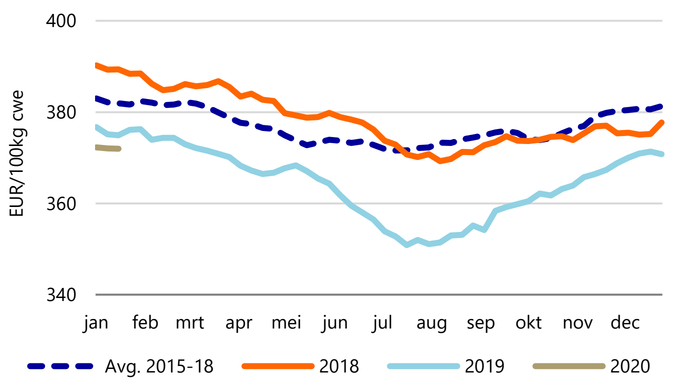
Price will be a key consideration in Indonesian beef supply in the first six months of 2020, in the absence of strong economic growth. We expect this to influence the Indonesian beef import mix, supporting more boxed beef trade.

Rabobank expects feeder imports to grow this year; although the volumes from January to June 2020 may slow compared to last year. Increased Australian feeder cattle prices are expected to cut Indonesian feedlotting margins in Q1 2020 – assuming current finished steer prices prevail – easing demand. A stronger Rupiah would only partially offset further margin erosion in Q2 2020. With IA-CEPA entry-into-force expected in April 2020, feeder imports may rebound in 2H 2020 (subject to quota). IA-CEPA is due to remove the 5% import tax that feedlotters pay to bring in Australian feeder cattle, and to halve import tax on beef to 2.5%.

In the first half of this year, imports of lower-priced frozen cuts from Brazil and India are expected to increase, with a focus on supplying the peak Lebaran demand in April and May. We expect Indian carabeef imports to reach 100,000 metric tons this year, continuing the robust 17% YOY growth in 2019 (*see Figure 9*). Additionally, 50,000 metric tons of Brazilian beef are expected to be imported through state-owned enterprises.

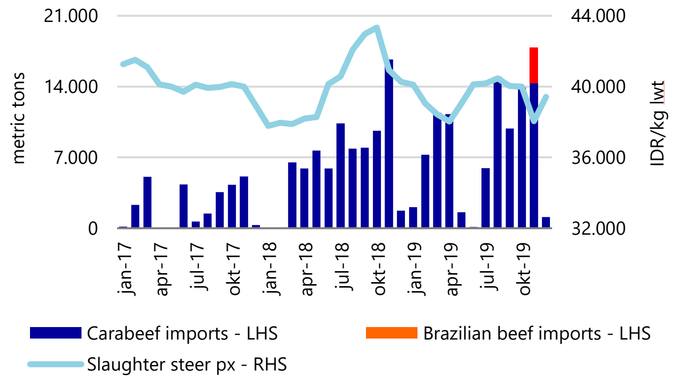
In contrast to easing slaughter steer prices, and despite the flow of carabeef imports, beef retail prices stayed within IDR 118,140-118,180/kg range throughout Q4 2019. Apart from seasonally-lower demand in January, we expect Q1 2020 retail prices to remain stable. Brazilian beef imports would directly compete with fresh beef; but its insignificant share of 1.1m mt cwt of total demand should not pressure retail prices.

Figure 8: Europe cattle prices, 2018-Jan 2020



Source: Eurostat, Rabobank 2020

Figure 9: Indonesian carabeef/beef imports and slaughter steer prices, Jan 2017-Jan 2020



Source: APEDA, Southeast Asia Beef Market Report, Rabobank 2020

Mexico: Feed Costs Reduce Slaughter Weights

Mexican beef exports reached record levels in 2019. After a record year in beef production in 2019, Mexican beef is finding its way into international markets. While the US accounts for most of Mexico's beef exports, with approximately 86% of total exports, greater volumes are finding their way to new destinations like Asia. In the first 11 months of 2019, beef exports reached 233,000 metric tons, 6% more than the whole of 2018. Beef exports to the US were 14% higher YOY. Rabobank estimates another record year in exports for 2020, increasing to a total of 390,000 metric tons, a 9% increase on 2019.

In 2020, production will be driven higher mainly due to slaughter numbers rather than an increase in weight. We expect carcass weights to be 0.6% higher, while the number of head processed will increase by 1.6% compared to 2019. Although corn prices dropped in January from MXN 4,149/metric ton to MXN 4,066/metric ton, poorer quality will require additional volume and lead to higher feed costs. We expect prices to stay in a range close to MXN 4,000/tonne and as a result, higher feeding cost should lower carcass weights in the next six months. In 2019, carcass weights grew by less than 1%, while the number of processed cattle grew by 1.5%. Rabobank's beef production estimate for 2020 remains at 2.07 metric tons cwe.

Carcass prices fell 3% in 2019 compared to 2018, driven partly by slow growth in consumption and higher production (*see Figure 10*). January prices saw this decline continue to fall by 6% compared to same month in 2019. Domestic consumption is expected to increase marginally (less than 1%) in 2020. However, as pork carcass prices continue to show an upward trend and beef carcass prices fall, consumers might begin to trade from pork to beef.

New Zealand: Slow Chinese Demand Drives Prices Down

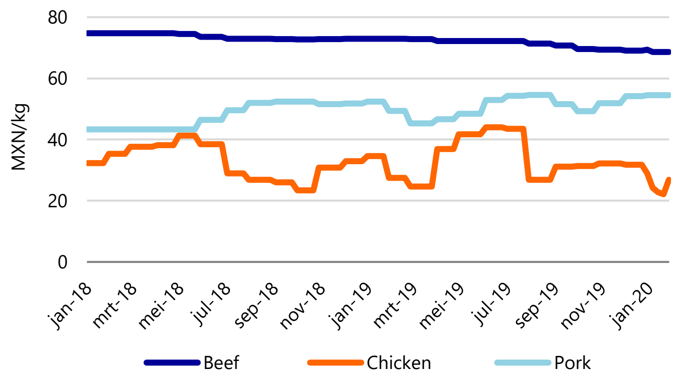
New Zealand cattle prices have been falling consistently since December. Cattle prices have declined 18%-20% since November to have both the North Island bull price and steer price sitting at NZD 5/kg cwt at the start of February (*see Figure 11*). Despite the drop, bull prices are now in line with where they were at this stage last year, although prime prices have fallen slightly behind.

Multiple factors have contributed to this pricing slide, which is well in excess of the normal seasonal pricing decline. Weaker-than-expected import demand from China post the Lunar New Year buying period saw prices start to fall in December. Prices dropped further in January as supply chain disruptions in China caused by coronavirus saw processors attempting to manage inventory levels and throughput at a time when New Zealand farmers were looking to offload an increasing number of cattle due to drying conditions. This has led to some farmers having to wait for up to four weeks to have cattle processed.

Rabobank expects China's underlying protein shortage to ensure that demand for New Zealand beef will recover once supply chain disruptions have been resolved, and existing inventory distributed. The exact timing and degree of this recovery will depend largely on how the spread of the coronavirus is managed.

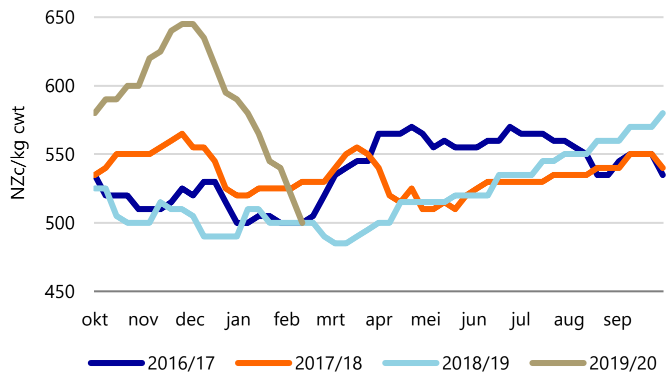
New Zealand exporters do have the ability to redirect volumes of manufacturing beef into the US market, where demand remains solid. Importantly, this will enable processors to maintain bull and cow throughput as seasonal cattle supplies increase over the coming quarter. New Zealand exporters will have greater difficulty finding alternative markets for prime cuts, with strong competition from Australia and the US in the Japanese and Korean markets. This will likely see priority given to bull and cow processing over prime cattle in the short-term, extending waiting times for farmers wanting to have prime cattle killed.

Figure 10: Mexican carcass prices, Jan 2018-Jan 2020



Source: GCMA, Rabobank 2020

Figure 11: NZ north island bull price, 2016/17-2019/20



Source: AgriHQ, Rabobank 2020

US: Getting Complicated

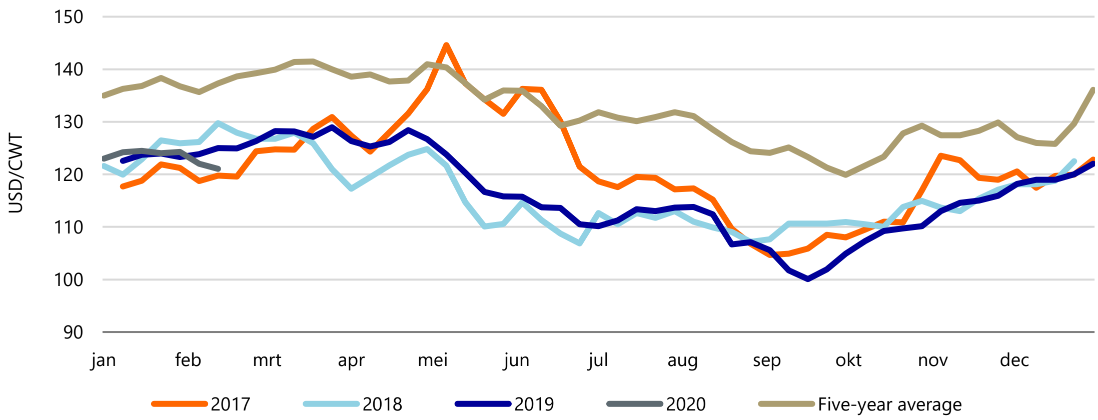
US cow herd expansion has stopped. Supplies of available cattle outside feed yards is down slightly and additional contraction is expected in 2020. The US cattle inventory as of January 1 was 94.4m head, down 0.4% from a year earlier. Beef cows (31.1m head) were down 1.2%, and the calf crop (36.1m) was down 0.7%. Steers over 500lb (16.7m head) and other heifers (9.7m head) were slightly lower, while calves under 500lb (14.7m head) were up 1.3%. Cattle on feed (14.7m head) were up 2%, while cattle outside feed yards were down 105,300 head. The degree of liquidation for the year will largely depend on weather conditions through the summer grazing season. Cow slaughter has continued at an aggressive pace in January but is expected to slow as the summer grazing season begins. While there is confirmation that the expansion is over, this corrective phase of the market is expected to be both short-lived and shallow.

Cattle on feed as of January 1, in yards in excess of 1,000 head, was 11.96m head. That is an increase of 2.3% over a year ago, and the largest number on feed for January 1 since 2008. The increase in placements has been largely driven by light weight cattle being placed on feed due to poor winter grazing conditions. On feed numbers are expected to contract as the year unfolds due to the continuation of an aggressive slaughter and reduced placement rates due to reduced numbers of cattle outside feed yards.

For the first five weeks of the year, federally-inspected slaughter has been up 4% over a year ago and beef production is up substantially due to increased numbers and carcass weights – up an average of 12 pounds over a year ago. Adding to the total protein production, pork production is up 6.5% over a year ago and total poultry has been up 7%. This huge increase in protein production is dependent on the continuation of aggressive domestic consumption but also increasingly reliant on an aggressive export pace. For the year, beef production is only expected to be up fractionally over 2019, with the increase in production being absorbed by exports. Pork production for the year is estimated to be up 4% and poultry production up 3%.

After the sharp rally last fall, cattle prices have traded in a choppy sideways pattern since November. Vulnerability and fear was further fostered by the announcement of the spread of coronavirus. The combination of fear, large production levels of all proteins and slow meat sales have triggered a sharp correction in the market, with substantially more pressure on futures than the cash market. Because of falling cattle supplies and continuation of solid demand, both domestic and export, we expect slightly higher prices for the year, accompanied by a very likely continuation of extreme volatility.

Figure 12: US Five-Market Area Steer Price, Jan 2017-Jan 2020



Source: USDA, Rabobank 2020

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Banking for Food