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New Forces Shaping Future UK Beef Imports

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Covid-19 and its impacts on beef markets, and China's import demand, continue to dominate global beef markets. A summary of Covid's impacts is below, with more details in the regional columns. Our feature article looks at the Brexit trade talks and the future of UK beef imports.

Australia – A second wave of infections in Victoria has resulted in restrictions being put in place for meat processing facilities in that state. Lower livestock availability leads us to believe the disruptions to beef slaughter volumes will be minimal.

Brazil – Some regions are experiencing second waves, while others are still in their first wave. Still, the number of new cases and fatalities in July remained stable, with reductions in some regions. The foodservice sector has resumed business in some states, but with reduced capacity.

Canada – Following a drastic reduction in slaughter rates during April and May due to Covid-19 outbreaks at plants, weekly slaughter rates have recovered. Although a fed cattle backlog still remains, there will be ample opportunity to clear the backlog in Q3.

China – Covid-19 is largely under control, but local government actions to control the spread of new cases is slowing the recovery of foodservice. Given suspected connections between new Covid-19 cases and packaging of imported seafood and other animal proteins, imports and cold storage are under surveillance, leading to delays and uncertainties with imports.

Europe – Foodservice across Europe has resumed operations, although with restrictions, and as a result, demand for beef has not fully recovered. Covid-19 cases are increasing again in some countries, but are being managed regionally, rather than complete lockdown of countries.

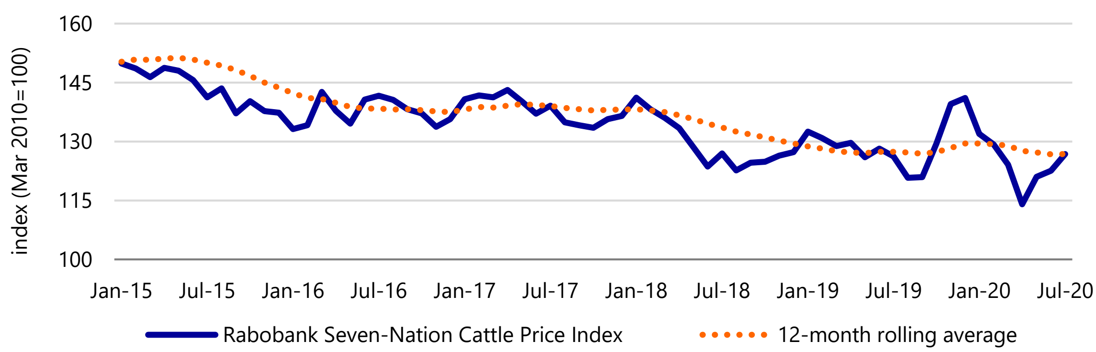
NZ – Processing capacity returned to normal levels in May, although the disruptions created during Level 4 restrictions in late March/April did create a backlog of cattle to be killed through June and July in some parts of the country that has only just now been worked through.

US – Weekly fed slaughter capacity has recovered to 97% to 98% of pre-Covid-19 levels, and as a result, comprehensive cutout prices have returned to more normal levels. US foodservice continued to show signs of recovery through July and August.

Rabobank Seven-Nation Cattle Price Index

Cattle prices around the world showed signs of recovery from May through July. Cattle prices (in USD) in most major exporting countries increased, while the US saw cattle prices decline, resulting in an overall lift in the index (*see Figure 1*).

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



Source: Rabobank 2020

Feature: Forces Shaping Future UK Beef Imports

The UK is an attractive market for beef exporters, so current trade negotiations around Brexit are drawing a lot of attention. The UK represents a big, high-value market, and once outside the European bloc, we expect it to become the fifth or sixth largest beef-importing country in the world. While pure economic reasoning and geopolitics normally play strong roles in trade negotiations, we believe that, in the case of the UK, consumer acceptance and non-tariff barriers will be equally significant in determining which countries ultimately supply the UK beef market in the future.

EU-UK Trade Negotiations Delayed

Trade talks between the EU and UK have been delayed. In June, the parties decided to intensify trade talks over the summer, with more rounds of negotiations being held through to October 2, 2020 (*see Figure 2*).

It is difficult to predict the outcome of these negotiations at the time of writing. Both parties have stated a clear desire to conclude a deal during the transition period, but time is short, and there is a long list of issues to resolve, such as managing borders, collecting tariff payments, and negotiating access to UK fishing waters. Beef trade is just one of the many product lines being negotiated.

Tariffs May See the Competitiveness of Irish Beef Vanish

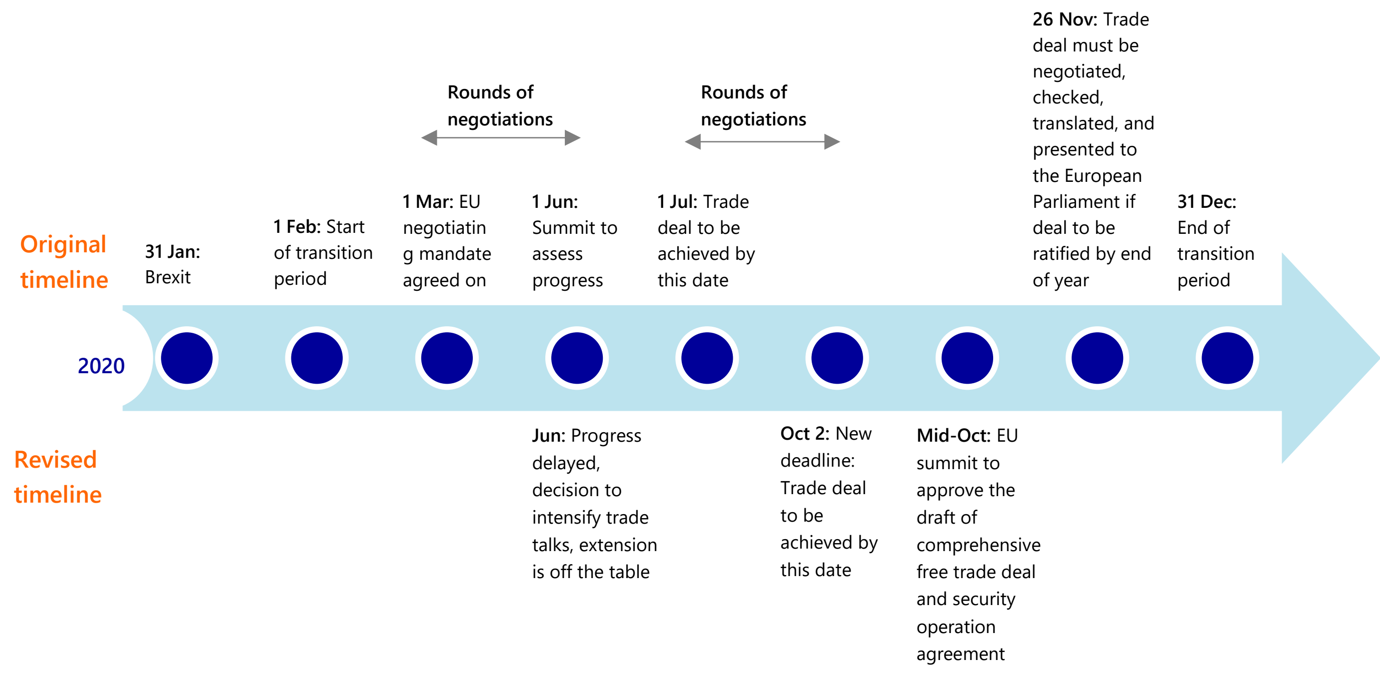
Currently, Ireland is the major supplier of beef to the UK, representing 70% of total UK beef imports in 2019 (*see Figure 3*). Brazil – the second largest supplier – accounts for a large proportion of processed beef imports, with a 38% share. However, Brazil's volume of the fresh and frozen carcasses and cuts trade, which makes up 82% of total UK beef imports, is relatively small.

Currently, a select number of major beef exporters to the EU-27 are granted tariff-rate quotas, allowing them to import certain quantities of beef at reduced or zero tariff rates. Once the Brexit transition period finishes on December 31, 2020, these quotas will be divided between the EU and the UK, affording those existing EU suppliers access to the UK at the reduced tariff rates.

If the EU and UK fail to agree on future trade terms, it is likely that the UK would fall back on WTO rules, meaning the application of Most Favored Nation (MFN) tariffs. These tariffs are expected to remain high for most imported beef products, with all EU exporters, including Ireland, treated the same way as non-EU exporters. That would put Irish beef in a vulnerable position.

The importance of the tariff arrangements for Irish beef is compounded by the competitiveness of Irish beef. Average import values reflect that countries like Australia and New Zealand supply higher-value products (*see Figure 4*). Meanwhile, Ireland's average import value is

Figure 2: Timeline for the post-Brexit transition period (2020)



Source: Rabobank 2020

similar to other competing countries, such as Brazil, Poland, and Germany. The production costs of an Irish beef finishing farm amount to EUR 410/100kg deadweight, whereas production costs are about 15% to 20% lower in Australia and the US.

Geopolitics Will Bring Other Parties to the Table

The UK government is also pursuing new trade deals with countries outside the EU. This includes Australia, New Zealand, and the US, all of which are major beef exporters. New trade deals could further challenge Ireland's position in UK imports if it opens the possibility of broader low- or no-tariff access to the UK market for these other beef exporters.

The UK will look for new strategic alliances outside the EU after the transition, and trade is usually a part of strengthening such alliances. As the UK is a major F&A importer, it should be expected that new alliances will be with F&A exporters that value increased access to the UK market.

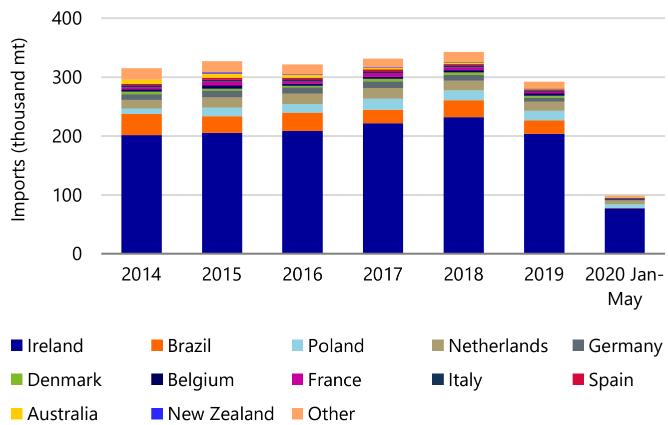
But UK Consumers and Non-Tariff Barriers Might Save the Irish

All major beef processors in the UK market are Anglo-Irish companies. They are deeply entrenched in the market, with strong relationships with food retail and foodservice companies that are the major buyers of beef. This will provide them with significant leverage to influence the way that beef is bought – locally and from importers – and sold in the UK. This is not about influence on political processes or trade deals. It is about what happens at the market level, and specifically the purchasing and production-system standards used by food retail and foodservice companies.

Standards required by food retailers and foodservice companies could pose a secondary barrier to any country or company that is looking to lift exports to the UK market. At present, these standards benefit the Anglo-Irish suppliers and other EU suppliers that are already delivering on these standards. For example, several UK food retailers have already announced that they will not be changing their current purchasing standards around chicken. Specifically, they have announced they will not accept product from countries that have different food-safety management practices, such as the US, even if such product gains improved access to the UK under a new trade agreement.

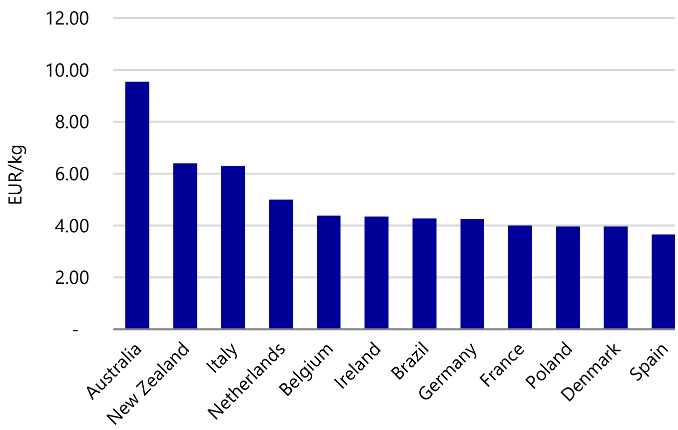
At the moment, it remains unclear who might win and who might lose under future trade deals with the UK. We expect more clarity as we approach the end of the second phase of EU-UK negotiations, spanning to October 2. What is already clear, though, is that food retail and foodservice company purchasing and production-system standards will play an important role in determining which product can be sold in which channel. With this in mind, we believe that the current Irish suppliers are well-placed to maintain their role as the dominant beef supplier to the UK.

Figure 3 : Major beef importers to the UK, 2014-May 2020



Source: Eurostat, AHDB, Rabobank 2020

Figure 4 : Average beef import value, 2019



Source: Eurostat, Rabobank 2020

Regional Outlooks

Australia: Low Numbers Continue to Drive the Market

Cattle prices remain very strong despite global Covid-19 disruptions and slowing economic conditions. The EYCI closed at AUD 7.52/kg cwt on July 31. Finished cattle prices, while still strong, started to ease in late July, suggesting that the softer demand resulting from Covid-19 is starting to impact the cattle market (*see Figure 5*). We believe August will see cattle prices drift slightly lower, as Covid-19 continues to weigh on global demand, but limited domestic cattle supplies will limit any downside price movement.

National cattle slaughter for the month of June (612,000 head) was down 14% YOY. Year-to-date national slaughter is down 7% for 1H 2020. Beef production is down 5% in 1H, with average slaughter weights in June up almost 10kg on June 2019. Such low slaughter numbers are having an impact on the efficiency of processing facilities, and one of Australia's largest abattoirs will close for a two-week period on August 24. Victoria has gone into Stage 4 lockdown, requiring abattoirs to reduce capacity by 33%. Despite these slowdowns, we believe the limited availability of stock will mean there is limited impact on slaughter numbers.

Reflecting the lower production volumes, Australia's beef exports (88,785 metric tons swt) dropped 23% YOY in July. Big reductions were seen in the markets of Japan (down 24% YOY), South Korea (down 14% YOY), and China (down 56%). Compounding the situation of reduced production, export volumes to China are also impacted by the suspension of beef export licenses to China for four plants in May and the triggering of the safeguard tariff measures in July. The Australian dollar has also appreciated in recent weeks, compounding the higher prices driven by low supply and challenging the competitiveness of Australian beef.

Brazil: Production Increases, but Consumption Is a Concern

Deterioration of local economic conditions pose concerns for domestic consumption. After a two-month extension, the financial aid package offered by the government is scheduled to end in August, and if this happens, we believe the impacts on domestic beef demand would be immediate. The current aid has strongly supported consumption, and extension of the program for another two months (which is currently being considered) would give greater support to retail prices.

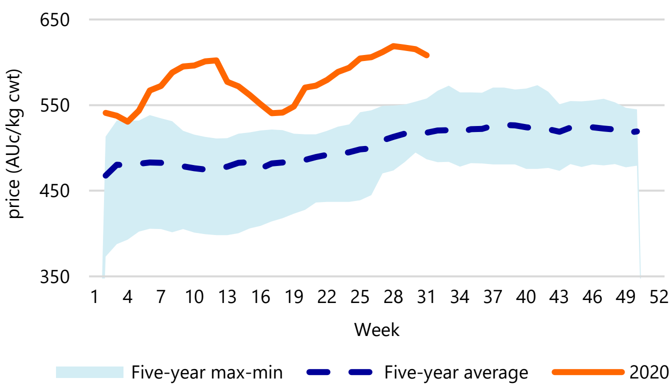
Q1 production was down 13%, compared to Q4 2019, as lower cattle inventory started to have an impact. However, with the increased demand from China, we expect to see Q2 volumes increase, although we still believe total production for the year will be down 2.5%. The spread of Covid-19 still represents a risk for local production, although the number of new cases is stabilizing and even declined in some regions in July.

Strong export markets drove local production. Exports to China continued to increase, with volumes up 158% YTD in June (*see Figure 6*). China now represents 41% of total exports. Another highlight is Egypt, which – after certifying 15 more plants in March – has increased volumes in recent months. Total shipments for the period (January to July) are 1.1m metric tons, an increase of 12%, with a value of USD 4.7bn, an increase of 26%.

Live cattle prices increased through July. Live cattle prices lifted 5.5% MOM in July and are 45% higher than the same period in 2019.

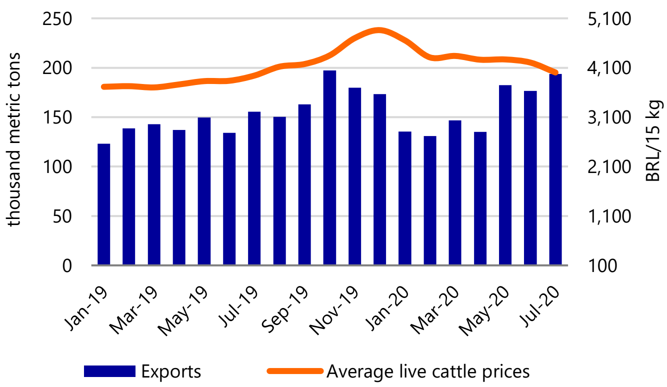
For the coming months, we expect exports will remain strong, especially to China. Domestic consumption, and therefore domestic beef prices, will be contingent on further extension of the financial aid package. That, in turn, should define the future direction of live cattle prices, as well as the intentions for feedlots in the second campaign that will start at the end of Q3.

Figure 5: Australian medium steer price, 2015-2020



Source: MLA, Rabobank 2020

Figure 6: Brazilian beef exports and cattle prices, Jan 2019-Jul 2020



Source: MDIC, Rabobank 2020

Canada: Slaughter Rates Recovering

Weekly slaughter rates have recovered dramatically, following a drastic reduction in slaughter rates during April and May (multiple weeks as low as 40% of year-ago levels) due to Covid-19 outbreaks at major plants. With all but one week in July seeing a year-on-year increase, the month ended with Canadian beef production down 6.7% YOY, a big improvement on previous months.

There remains a fed cattle backlog in the system, although progress is being made to clear it. With net placements from March to May down 29% YOY, there will be ample opportunity to clear the backlog in Q3. Good rain and forage availability should help mitigate the pressure that will come with backlogged feeder cattle and weaned calves vying for the same bunk space in late Q3 and Q4, but pen space could still be tight. As of July 1, cattle on feed was up 4.9% YOY and up 17% against the five-year average.

Feeder cattle exports to the US were down 51% YTD in July, and were running well below 2019 levels even before Covid-19 supply chain disruptions caused major backlogs in the US. Canadian fed cattle basis against the US five-market fed steer price averaged USD 18.96/cwt in May, supporting a 43% increase in YOY slaughter cattle exports for the month. Through July, slaughter cattle exports were up 7%. Beef exports through 1H were down 13% YOY.

As packing capacity has been restored, fed cattle prices have recovered from their June lows, but continue to face downward pressure from reduced foodservice demand, slower economic conditions, and ample spot beef supplies (*see Figure 7*). With the recent rally in deferred live cattle futures implying a reopening economy and a rebalancing cattle supply chain, Alberta feeder cattle prices have rallied to year-ago levels. A sustained recovery in cattle prices will depend on the reopening and recovery of both the Canadian and US economies.

China: Beef Consumption Showing Signs of Resilience

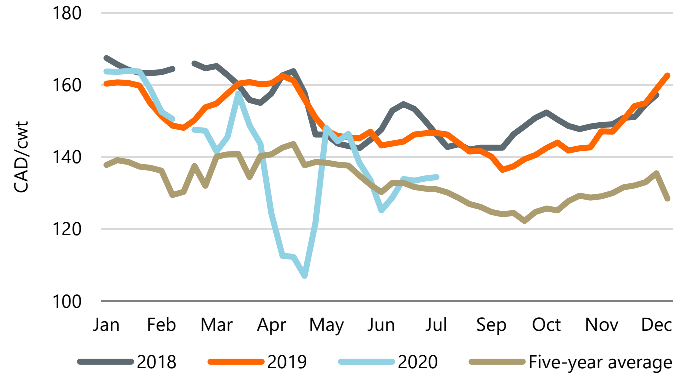
China's beef consumption has shown some resilience amid the sluggish economy resulting from Covid-19. In comparison to pork and poultry, which saw big price drops in Q2, beef wholesale prices have stayed firmly above Q4 2019 prices. Beef retail prices dropped only slightly, from CNY 80.6/kg in February down to CNY 78.3/kg in June, then quickly rebounded in early July (*see Figure 8*). This is in line with normal seasonal movement and reflects a relatively resilient demand, even in a slowing economy.

We believe the consumption volume via foodservice has dropped considerably. Trade volume in major wholesale markets – which is mainly distributed to wet market, foodservice, and institutional users – has declined by more than 40% YOY in the first seven months of 2020. There has been an active shift from foodservice to retail, especially e-commerce, as the price gap between beef and pork has narrowed significantly since Q4 2019. With a further recovery of foodservice, we expect beef prices to increase further in 2H 2020.

Beef production has fallen. According to China Statistics Bureau, beef production in 1H 2020 was down 3.4% YOY, to 2.78m metric tons. Beef cattle slaughter dropped 2.1% YOY, to 18.79m head. We expect beef production for 2020 to be flat or increase slightly.

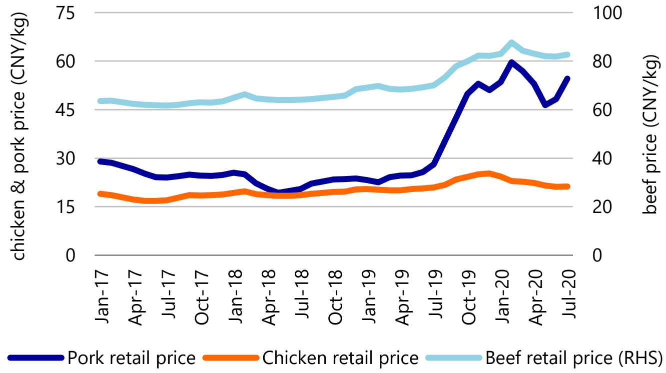
China's official beef imports reached 997,000 metric tons in 1H 2020, despite lockdowns in Q1 and disruptions to processing plants in exporting countries. This is 43% higher than the same period last year, and still 4% higher than 2H of 2019, when beef imports surged. Brazil has seen the strongest growth among major supplying countries, with its market share rising from 24% in 2019 to 35% in 2020. This is followed by Argentina (22%), Australia (16%), Uruguay (11%), and New Zealand (8%). We expect beef imports in Q3 to slow down due to strict inspections at borders.

Figure 7: Alberta fed steer prices, Jan 2017-July 2020



Source: Canfax, Rabobank 2020

Figure 8: Chinese retail meat prices, Jan 2017-Jul 2020



Source: Chinese Ministry of Agriculture, CAAA, Rabobank 2020

Europe: Beef Production Remains Sluggish

We expect beef production in the EU-27+UK to contract by 2% YOY in 2020, due to Covid-19-related processing disruptions and soft demand in foodservice. The impact of Covid-19 on beef production is evident in the period January to May, when EU-27+UK beef production was down by 5% YOY. Drops in production were experienced in all major producing countries. Italy saw the biggest decline, with production falling 16% in the first five months. Germany (-5%), Ireland (-5%), Spain (-4%), and France (-3%) also recorded substantial weakening in this period, whereas production in the Netherlands (-2%), UK (-1%), and Poland (-1%) was less affected.

The EU average carcass price has been stable in recent weeks, close to 2019 levels (*see Figure 9*). The stability of prices can likely be explained by the fact that supply has adjusted to reduced demand levels. Also, an improvement in demand as foodservice reopens has helped with carcass balance and pricing. We expect prices to remain below the five-year average into Q4, as demand has not yet fully recovered. The EU Private Storage Aid (PSA) was closed on July 17. Interest in the PSA for beef was reportedly limited – less than 10% of the total quantity available was utilized. As such, we expect that volumes coming to the market from storage will have limited impact on beef prices in the coming period.

EU-27 beef trade contracted as a result of softening demand, production disruptions in January to May, and Europe's lower attractiveness relative to China for exporters. EU-27 exports were down 9% and imports down 25% for the period January to May, resulting in a self-sufficiency rate of 111% for the bloc in the first five months of the year. Still, exports to China and Japan were strong, up 21% (31,000 metric tons) and 147% (5,000 metric tons), respectively, from January to May. UK beef imports from EU-27 also declined, down 9% in the first five months of the year. The main reason for this was reduced supply from Ireland following Covid-19-related disruptions at slaughter and processing plants.

Indonesia: Stabilizing at Lower Consumption Levels

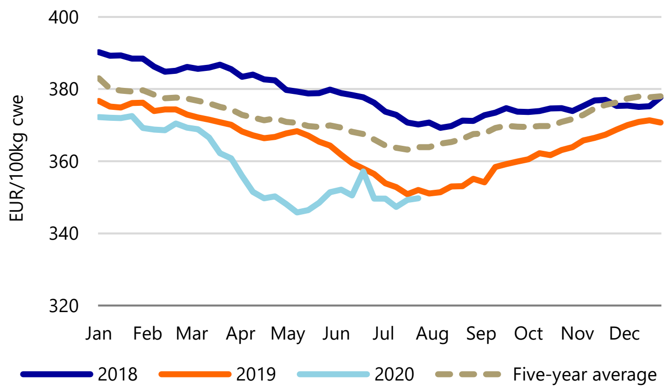
Rabobank's forecast for Indonesia's feeder cattle imports remains unchanged at a 15% to 20% decline for the full year. Year-to-July, Australian live feeder cattle import volumes were down by 18% YOY, to 293,845 head. This included volume recoveries in May and June, which were driven by lower feeder cattle prices and stronger Indonesian currency against the Australian dollar (*see Figure 10*).

We expect Q3 2020 live feeder cattle import volumes to remain behind last year's numbers, as feeder prices have increased and the Indonesian rupiah has depreciated. Australian feeder prices have jumped by more than 5% since June. This offsets the in-quota 5% import tax exemption under the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), which came into force on July 5. Based on the July feeder price indicator of AUD 3.55/kg lwt and finished steer price of IDR 40,000/kg lwt, we estimate that Indonesian feedlotters would have already incurred a negative margin, even with no import tax.

We do not expect any significant increase in Indian carabeef imports in Q3 2020. Weaker purchasing power continues to drive consumers to trade down to cheaper protein, such as chicken. Indonesia's state-owned trading companies have slowed their purchases of Indian carabeef YTD, with no imports through April.

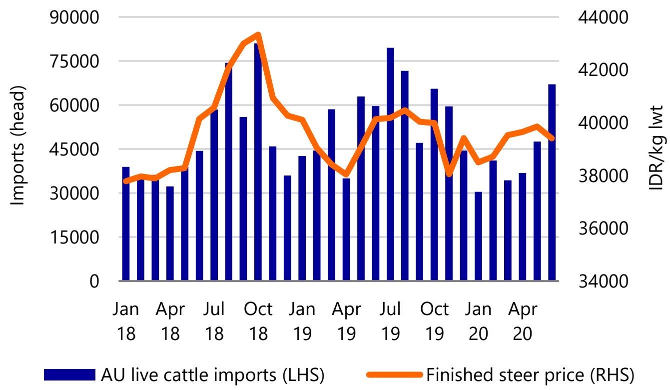
Retail beef prices saw a small bump during the peak Lebaran demand season in May, but have stabilized at IDR 118,200 in June and July, despite reduced feeder cattle and carabeef imports YOY. Demand for offal and hide has also recovered since social distancing measures in the capital were lifted in early July, providing some relief in slaughtering margins. Demand for local slaughter cattle is typically higher ahead of Idul Adha (July 31), with some temporary spillover demand to finished bulls from feedlots.

Figure 9: Average EU carcass price, Jan 2018-Jul 2020



Source: European Commission, Rabobank 2020

Figure 10: Indonesian beef and cattle imports, Jan 2018-Apr 2020



Source: MLA, UN ComTrade, Rabobank 2020

Mexico: Macroeconomic Drivers and Currency Support Exports

So far, the Covid-19 story for Mexico's beef industry has been one of macroeconomics and currency values. Mexico's Q2 GDP fell 18.9% YOY. The Mexican peso has devalued to record weakness, peaking at over MXN 24/USD in April and since then leveling off between MXN 22 and MXN 23/USD, a roughly 20% increase over pre-Covid levels. Meanwhile, Mexican packing plants have been minimally impacted by Covid-19 outbreaks, compared to their US and Canadian counterparts.

With economic stress eroding domestic beef demand and the recent US and Canadian supply chain disruptions, growing Mexican beef production – up 2.3% YOY in 1H – and currency weakness have generated a net export boon for Mexico. Through June, beef exports to the US were up 24% YTD versus 2019, with May and June up 50% and 58%, respectively. As of August 1, feeder cattle exports were up 8% and 24% YTD against 2019 and the five-year average, respectively (*see Figure 11*).

Despite the export increase and domestic currency weakness, economic challenges and the US cattle backlog have countered with downward price pressure. Although US feeder cattle prices have recovered to near year-ago levels, June #1 and #2 feeder cattle prices were down 30% and 6% YOY, respectively, in Mexican peso terms. June carcass prices were down 7% YOY.

Concerns moving forward include a continued decline in domestic beef demand as economic woes linger. There is potential that beef producers may start to curb production accordingly. If beef production stays at or above year-ago levels, favorable exchange rates should support export markets for the remainder of 2020. With the January 1 beef cow herd up 2.5%, feeder cattle prices should find seasonal support through Q3 before heavy supplies deteriorate prices in Q4.

New Zealand: US Demand Underpinned Export Returns

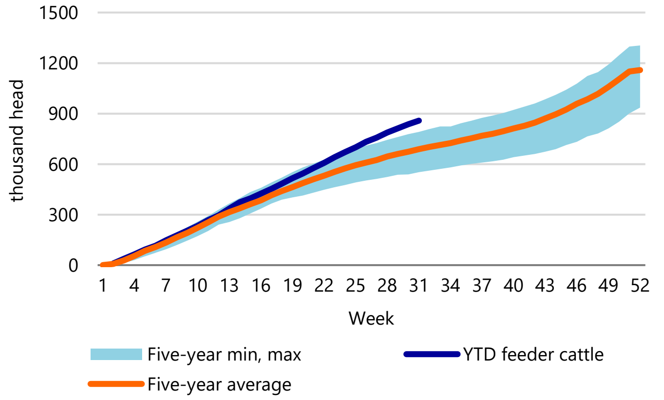
New Zealand cattle prices strengthened over the last three months, recovering from the sharp decline experienced during the previous quarter. As of late July, the North Island bull price was sitting at NZD 5.45/kg cwt and South Island bull at NZD 4.70/kg cwt, a 12% and 8% increase, respectively, since mid-May. Pricing in the South Island didn't lift to the same extent due to higher supply levels. While prices in the North Island are largely in line with where they were a year ago, South Island prices are down 10% to 14% YOY.

New Zealand beef exports performed solidly over the last quarter, largely underpinned by demand from the US for manufacturing beef. Average export returns from May to July were slightly ahead of the same period last year, at NZD 8,182/metric ton (up 3% YOY). However, export data from July shows NZ export returns are starting to feel the impact of challenging market conditions, with average returns for the month down 2% YOY. This is the first month this year in which average returns have been down YOY.

Export returns for beef exported to China have been weakening consistently since April. For the month of July, average returns from China were down 12% YOY. As a result, NZ exporters are directing increasing volumes of exports into the US market (July export volumes were up 94% YOY) and away from China (July export volumes were down 45% YOY) (*see Figure 12*).

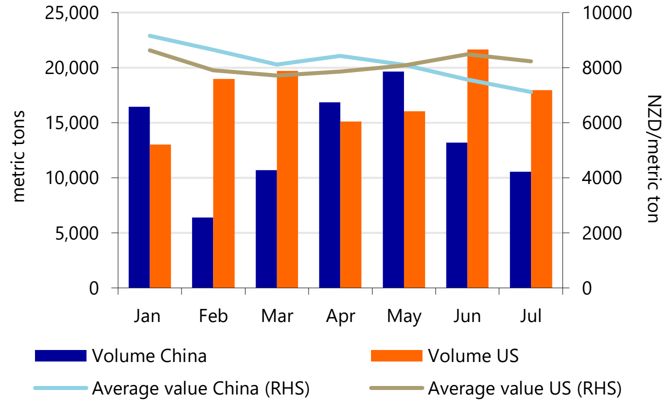
New Zealand's processing capacity recovered to normal levels during May, although Covid-19 restrictions put in place late March/April did cause a backlog of stock to be killed, particularly in the South Island where the seasonal kill wasn't as advanced as the North Island. That backlog has now largely been worked through, and New Zealand's STD cattle kill is now marginally ahead of last year's kill (+0.7% YOY). This is reflected in STD total export volumes, with 386,178 metric tons of New Zealand beef exported to all countries from October to July (up 2% YOY).

Figure 11: Mexico to US feeder cattle trade



Source: USDA AMS, LMIC, Rabobank 2020

Figure 12: NZ beef exports Jan-July 2020



Source: B+L NZ Economic Service, Rabobank 2020

US: Better Than Expected Recovery, Long-Term Caution Continues

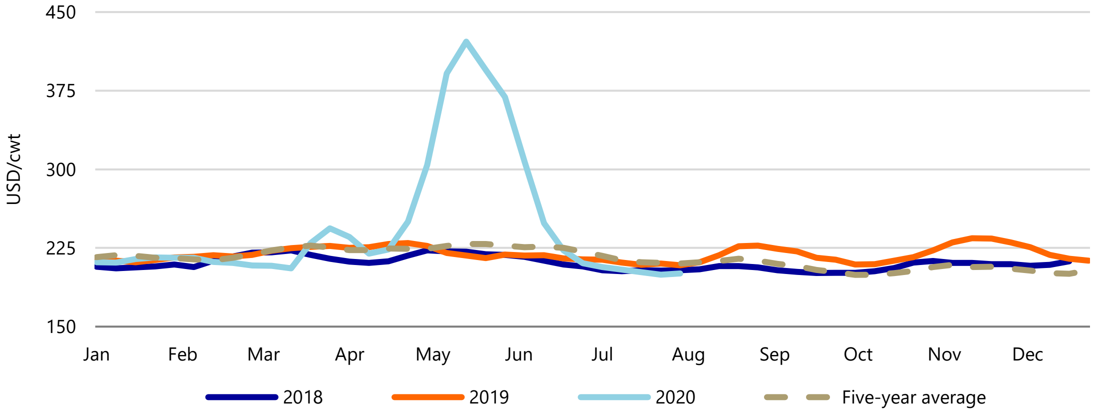
US fed slaughter capacity has done an incredible job of recovering from the worst of the Covid-19 slowdown. Weekly fed slaughter capacity has recovered to 97% to 98% of pre-Covid-19 levels, and as a result, comprehensive cutout prices have returned to more normal levels (*see Figure 13*). Due to the backlog of fed cattle and additional days on feed, carcass weights are still roughly 30lb above a year ago, elevating weekly beef production, which has been running 2% to 3% above a year ago. Year-to-date production is still off 2%, after the sharp reduction in May. Our expectations are for beef production to be up 1% to 1.5% for the year.

Fed cattle prices recovered USD 5 to USD 7 during July. Fed cattle offerings have tightened up across the Corn Belt, as slaughter rates have recovered. Cattle supplies continue to be heavy through the Plains states. Fed cattle marketings are expected to start eating into the backlog of cattle during August and beyond. As the sharp reduction of cattle placements in March and April starts to work its way through, fed cattle supplies are expected to balance slaughter capacity by mid- to late Q4. Seasonal consumer demand considerations are expected to weigh on prices during August. As fed cattle supplies balance, prices are expected to trade at the USD 110/cwt to USD 115/cwt level by late Q4.

A 10% decline in the US dollar since the highs in late March has provided much needed support to US agriculture exports, including beef. Asia continues to be the focal point, with increased exports to Japan, and while still small, tonnage to China is posting solid growth. Beef shipments to Canada have been strong, while shipments to Mexico are off sharply, due to Covid-19 and economic weakness.

Seasonal trade in both feeder cattle and calves has been brisk. Feedyard demand for true yearling replacements has been stronger than we expected, given the backlog of fed cattle. Feeder cattle prices have been strong, exceeding expectations. That will require fed cattle prices to be at or above year-ago levels early in 2021, in order to provide a positive return. Seasonal movement of calves has started earlier than normal, due to dry conditions across much of the western US that are forcing some cow calf producers into early weaning programs. The mid-year Cattle Inventory Report, released on July 24, showed a 1% reduction in beef cows, as we expected. The report did show a larger-than-expected total inventory, reflecting the slowdown in cattle movement of all classes through March to June. Increased liquidation of cows is expected through the second half of the year, due to the continuation of retraction and likely accelerated by drought conditions through much of the western US.

Figure 13: US comprehensive cutout, January 2018-Jul 2020



Source: USDA, Rabobank 2020

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Banking for Food