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U.S. Pork Export Outlook: How to Save Our Own Bacon as China Rebuilds

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Key Points:

- U.S. pork exports to China have skyrocketed this year as African Swine Fever (ASF) eroded two-thirds of China's hog herd and drove its hog prices to new record highs.
- Greater China now accounts for nearly 8% of U.S. pork production, but China's pork market is showing the early signs of herd rebuilding: Hog prices have fallen 30% from their peak a year ago.
- The opportunistic nature of China's buying of U.S. pork when their supplies are tight increases the risk of U.S.-to-China pork trade returning to pre-ASF levels.
- China's pork production is expected to recover in the next 3-5 years. This increases the risk of an oversupply of U.S. pork if exports to other markets, primarily in Asia and Latin America, are unable to absorb this supply.
- The loss of exports to China would likely lead to difficult conditions for producers and processors alike, but the U.S. pork sector can take steps to help dampen the stress of this loss in demand.

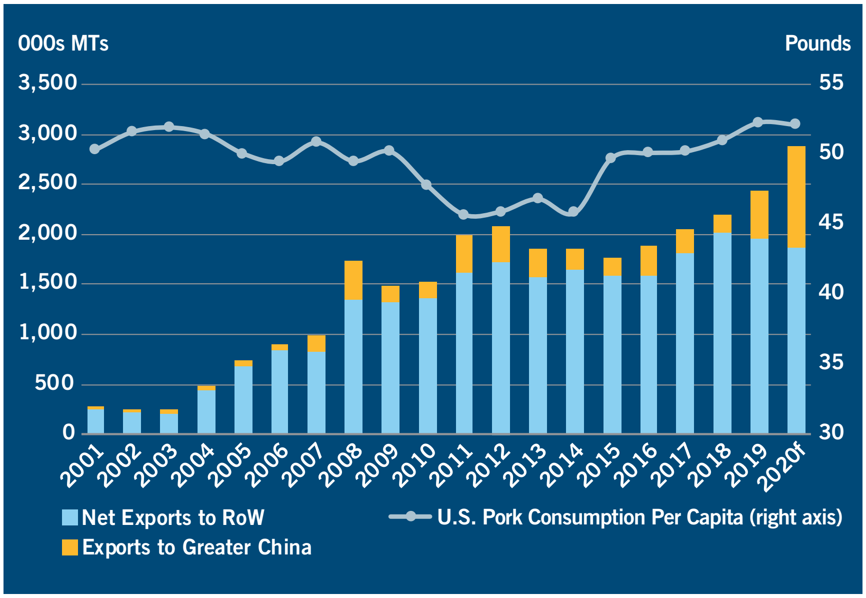
Introduction

The U.S. pork industry has built multiple new plants over the past four years, increasing U.S. packing capacity by 12% with much of this new capacity eyed for international markets. As processing capacity has expanded, so has production. Compared to 2016, the USDA's September 2020 Quarterly Hogs and Pigs report reflected a 5% larger breeding herd and an 11% larger inventory of market hogs.

If there was ever an example of a "if you build it, they will come" strategy, it's the U.S. pork sector in recent years. International customers have bought more U.S. pork than ever before, allowing the industry to set export records each year since 2016. As the U.S. pork sector has grown, so have exports driven by shipments to

China – especially this year *(Exhibit 1)*. By our math, two-thirds of the industry growth since 2016 is being shipped to Greater China. China's strong demand and overall export growth has kept domestic availability of pork relatively tight, as per capita consumption in the U.S. increased just 2% since 2016. But this growth has made the U.S. pork industry more reliant on Chinese demand; the Greater China region now accounts for one-third of all U.S. pork exports and nearly 8% of U.S. pork production.

EXHIBIT 1: U.S. Pork Exports and Consumption



Source: USDA AMS, CoBank Estimates

In September, ASF was discovered in Germany, initially in a single wild boar on the border with Poland. Since then, ASF has been found in dozens of wild boars; the virus can quickly become endemic in wild boar populations as we have seen in Eastern Europe and China. More significant for global trade, many key pork importing countries have banned German pork, opening the window for increased shipments from the U.S. and other key pork exporters. This gives the U.S. a short-term opportunity to increase market share in China, as Germany represents approximately 14% of China's pork imports. The ban may not last forever, and with China's hog prices showing signs of weakening, the U.S. may still feel the pressure of reduced Chinese pork imports.

ASF Situation in China

The supply and demand environment for pork in China has always been difficult to pinpoint for numerous reasons, but the spread of ASF through China's hog herd has made it even more difficult. We do know that the virus claimed over half of China's hog herd over the last two years, and that it has driven China's hog prices to record highs. Those record prices have held for nearly a year, other than a brief decline in April and May due to COVID-19. But since July, China's supply growth appears to be driving the decline in prices.

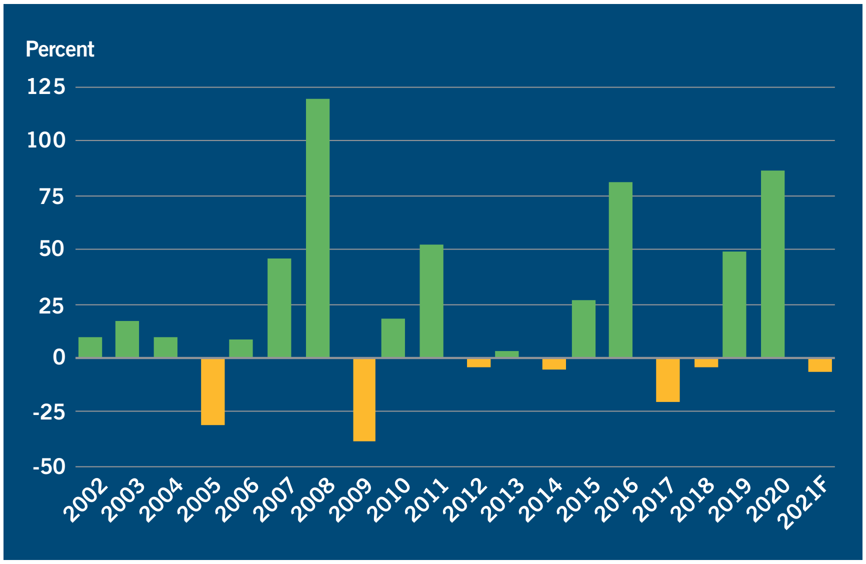
Official Chinese government data indicates growth in their hog herd and breeding herd versus prior year levels. Some market participants look at these numbers with skepticism but we are starting to see the "green shoots" of the rebuilding of China's hog herd. These signs include billions of dollars of Chinese investments in large-scale production over the last couple of years, diminishing national and provincial subsidies and incentives for hog producers, and hog prices that have declined almost 25% in the last three months.

Unlike previous hog cycles in China where pork imports fell nearly as quickly as they climbed, the impact of ASF may mean that China's imports will fall far more slowly *(Exhibit 2)*. ASF has been known to linger in hog herds for decades, stunting the local industry's ability to fully recover. ASF will likely remain an issue in China's hog industry for years if not decades. However, the financial incentive to expand production is quite compelling, as producer margins in China have averaged hundreds of dollars per head for months now. A flood of investment is building massive production facilities with very high levels of biosecurity to help keep ASF out.

Strategies for Success

2020 has been one of the most challenging years for the U.S. animal protein sector, including the pork industry. The COVID-19 pandemic temporarily closed nearly half of U.S. pork processing capacity and drove a rapid shift in U.S. food consumption from restaurants to home. In the midst of this domestic market volatility, U.S. pork exports have skyrocketed, driven by massive shipments to China. To put it in perspective, U.S. shipments to Greater China accounted for about 2% of U.S. pork production in 2018; just two years later, Greater China accounts for nearly 8%. This growth in exports has more than offset the rapid growth in U.S. pork production and processing capacity over that time.

EXHIBIT 2: Greater China Pork Imports, Year-over-year Change



Source: USDA-FAS

These strong trade flows may not last forever though as we are beginning to see those "green shoots" of expansion in China's hog herd and the early signs of lower hog prices. China's hog prices returning to Earth has signaled a decline in China's pork imports in previous hog cycles whether that be in 2008, 2011, or 2016. Each time, U.S. pork exports to China declined in the years following the peak in prices. Lower trade flows with China to pre-ASF levels would bring a good deal of stress to the U.S. pork sector but there are strategies and changes the pork industry can make now to help dampen that impact:

1. **Shift the trade relationship from transactional to strategic.** While we do not expect China to change overnight from being an opportunistic buyer of animal proteins, we do see avenues for U.S. packers to strengthen the relationships they have with the importers and customers of their end products. In 2001, Russia accounted for a similar proportion of U.S. chicken exports as Greater China accounts for U.S. pork exports today. While the U.S. knew that Russia had every intention of being self-sufficient for its meat and poultry needs, the U.S. chicken industry and USA Poultry and Egg Export Council built strategic relationships with Russian importers and customers that helped keep the trade flow for as long as possible. With all major pork-producing countries eyeing the Chinese market, suppliers with strategic relationships in China will fare far better during the down cycle.

2. **Pursue trade diversification.** With Greater China accounting for one-third of U.S. pork exports and nearly 8% of U.S. production, efforts by industry associations like the U.S. Meat Export Federation (USMEF) to spur demand from other markets is an imperative. These growth opportunities may come from U.S. pork's core trade partners but by also expanding trade opportunities with secondary customers. Markets like Japan, Korea and Mexico are critical, making trade agreements like the U.S./ Japan Trade Agreement and the USMCA vital for the U.S. pork sector to retain and grow exports. But the U.S. pork sector has great export opportunities in numerous smaller markets, especially in the Caribbean, Central and South America.

3. **Better appreciate customers at home.** The greatest opportunity and possible challenge for the U.S. pork sector is the U.S. market itself. With few exceptions for the last 30 years, annual per capita pork consumption in the U.S. has been range bound between 48 and 52 pounds. While the chicken sector has grown domestically through increased consumption and the beef sector by way of a focus on quality and higher prices, the pork sector has struggled. The National Pork Board has many initiatives to improve pork consumption, as described in "Time to Tango: Latinos are Pork's Future." This group represents nearly 20% of the U.S. population and has the potential to help offset the losses of reduced Chinese purchases.

4. **Make yourself too big to fail.** One of the many lessons from the COVID-19 pandemic of 2020 is the necessity of having a strong relationship between producer and packer. This is true in both beef and pork, as those producers who had a deep and strategic relationship with their packer fared far better during the plant shutdowns and slowdowns in April and May 2020. The relationship between a hog producer and their packer can become "strategic" in many ways, whether that be by contract, ownership, geography, size, and/or efficiency. In an environment where demand is falling as exports shrink, producers with the deepest relationships will better weather any changes in plant capacity.

5. **Know your numbers and raise the bar.** Benchmarking is a crucial management tool for most hog producers in the U.S. Benchmarking data has given the industry and producers the ability to see how they stack up but has also illuminated the significant disparity between the best and the worst in the industry. But benchmarking is valuable only if the producer uses the data to identify and address the weak points in their operation. Productivity in the U.S. pork industry improves each year, but with the headwinds of weaker demand, efficiency is critical not only for individual producers but the industry's global competitiveness as a whole.

6. **Liquidity, liquidity, liquidity.** If all else fails, the liquidity in the U.S. pork sector could be the key in helping some producers and processors through a difficult period. Going into 2020, equity and working capital at the producer level was good but had fallen after the influx of capital during the porcine epidemic diarrhea virus outbreak of 2013 and 2014. Margins for producers have been reasonable the last five years, but producers' operations – and their balance sheets – have expanded in sync with the new processing plants. Now that producer margins average a loss of nearly $10 per head in 2020 on an unhedged basis, liquidity takes on even greater importance.

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