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Department of Agricultural and Consumer Economics, University of Illinois Urbana-Champaign

Weekly Outlook: Pork Tariffs Sour Industry Outlook

Chris Hurt

Department of Agricultural Economics
Purdue University

April 2, 2018

***farmdoc daily* (8):57**

Recommended citation format: Hurt, C. "Weekly Outlook: Pork Tariffs Sour Industry Outlook." *farmdoc daily* (8):57, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, April 2, 2018.

Permalink: http://farmdocdaily.illinois.edu/2018/04/pork-tariffs-sour-industry-outlook.html

The 2018 outlook early this year was for modest profitability. Now, it has shifted to losses. The reasons are clear. Higher costs and lost exports as China has implemented a 25 percent tariff on U.S. pork that goes into effect today, April 2, 2018.

Several forces are driving costs higher, but feed is the primary culprit. Since the start of the year, corn futures are about 27 cents per bushel higher and soybean meal futures are about $55 per ton higher. This means that feed cost are nearly $3 per live hundredweight higher. This is composed of $1.20 higher because of corn prices and $1.75 due to higher meal prices.

Other costs of production are rising as well. Energy costs are expected to rise with the government Energy Information Agency forecasting a nine percent rise for on-road diesel prices this year and a seven percent rise in retail gasoline prices. The tight labor market is expected to result in a three percent rise in wage rates. Interest rates are also rising. The Chicago FED reports the average interest rate on farm operating loans in 2017 was 4.9 percent. If that rate rises by 100 basis points this year to 5.9 percent, that is a 20 percent increase. Finally, the Trump tariffs on steel and aluminum will likely put upward pressure on metal prices that are important to buildings and equipment used in pork production.

China has inflicted a blow to the U.S. pork industry with a 25 percent tariff on pork they are buying from the U.S. effect April 2. The impacts look different from the Chinese side versus the U.S. side of the trade dispute. For the Chinese, tariffs on U.S. pork appear to be a good strategic decision. The reason is that U.S. pork imports were fairly large at $1.1 billion last year, so it gets the attention of the U.S. quickly as retaliation. The tariff will hurt the U.S. pork industry in key states that were generally strong Tump supporters. This gives a potential political victory to China. In addition, China has been increasing their own domestic production and was expected to import less pork this year anyway. Finally, China produced 97 percent of their own pork last year and the 1 percent of their pork consumption they buy from the U.S. can easily be replaced by the European Union and Canada. If China buys no U.S. pork it only has small implications for them.

While China seems to have chosen well by selecting pork for these tariffs, the negative implications are deeper and focused on the U.S. pork industry. So, the view looks different from here in the Midwest pork center.

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The U.S. sold China 525 million pounds of pork in 2017 worth $1.1 billion. This was nine percent of our total export volume last year. More importantly, Chinese purchases represented only two percent of U.S. production. The 25 percent tariff will make our pork higher priced in China allowing pork from the European Union and Canada to be cheaper than U.S. origin. We can anticipate losing most of the export business with China.

How big is the downward price impact from lost Chinese business? We can start by looking at the impact if we lost all two percent of our demand represented by Chinese volume. That would be expected to lower U.S. prices by about 4.4 percent or around $2.20 per live hundredweight or about $6 per head. On a carcass basis this about $2.75 per carcass hundredweight that is roughly equivalent to lean hog futures prices.

This is a measure of the biggest potential impact on prices, but the actual price reduction will most likely be less. U.S. pork prices will drop due to the Chinese tariff and these lower U.S. prices will help sell some added pork domestically. In addition, the increase in EU and Canadian export volume to China means they will export less to some countries and the U.S. will pick up some of that export business. The point is that even if we lost all of the Chinese business there will be some compensating increases in the volume sold domestically and to some alternative export destinations.

Clearly, the outlook has weakened! On a live weight basis hogs are now expected to average about $48.50 this year with cost now estimated near $53. Losses of $4.50 per live hundredweight or about $12.50 per head are expected. This hog price forecast is based on lean hog futures for the rest of the year on April 2. Current estimates are for losses per head in every quarter of 2018 at: 1st quarter -$7; 2nd -$11; 3rd -$5; and 4th -$27.

More trouble over trade issues for the pork industry loom in continuing NAFTA negotiations. While China bought two percent of U.S. production in 2017, Mexico purchased seven percent and Canada an additional two percent. That is nine percent of U.S. production that could be affected in NAFTA talks.

The trade hammer has fallen on the U.S. pork industry. Chinese tariffs on U.S. pork along with rising costs have shifted the outlook for 2018 to losses expected to be about $12.50 per head. Uncertainties surrounding NAFTA remain a grave concern as well.

There remains much to be worked out in the early stages of these trade conflicts and U.S. agricultural must continue to argue for the merits of freer and fairer trade. If the current outlook shift toward losses prevails, all expansion projects still currently on the drawing board should be reconsidered. Further, if the current negative outlook prevails, some downsizing of the breeding herd into 2019 may be needed to move supply downward to provide breakeven prices.