Rabobank

China Beefing up Imports to Supplement Domestic Production

Great Challenges for Local Production

Rabobank International

Food & Agribusiness Research and Advisory

Chenjun Pan
chenjun.pan@rabobank.com
+86 10 56951155

www.rabotransact.com
www.rabobank.com/f&a

Contents

China's government is beginning to support local beef supply. However, support remains limited compared to that received by other livestock sectors. More importantly, the local beef production system has lagged behind other beef-producing countries in many aspects, and the gap in productivity is getting wider. With local players facing many challenges, domestic production is having a difficult time catching up with demand in China's beef market. To cover the supply gap, China will need to allow more beef imports, which are expected to increase by 15 percent to 20 percent each year for the coming five years.

Introduction

A growing shortage of domestic beef cattle supply saw China become a huge importer of beef in 2013. Import volumes reached 297,000 tonnes, which is 3.79 times that of 2012. In response to the limited supply, the Chinese government launched its 'Guideline for Beef Industry Development Towards 2020', which aims to support the beef industry and increase the current local production volume of 6.3 million tonnes to 7.17 million tonnes in 2015 and 7.86 million tonnes in 2020.

China's beef industry faces great challenges even with the addition of government support. On the consumption side, the beef market has great growth potential due to the ongoing rise in urban income levels (CAGR of 12 percent in the past decade), which is expected to continue in the coming five years. On the supply side, all players are facing the dilemma of where to source the beef supply. There is some question as to whether the new policy will allow China's domestic supply to catch up, or if beef will become the next 'soybean' for China. In other words, China might still need to rely on beef imports. If domestic supply is unable to catch up, the growing gap between demand and supply has the potential to see China become an important export destination for major suppliers worldwide. In our view, China's domestic production will slowly recover but not fast enough to catch up with the accelerating demand. The structural supply deficit will force an increase in beef imports of nearly 20 percent—including smuggled beef—or even double the current import volume by 2018.

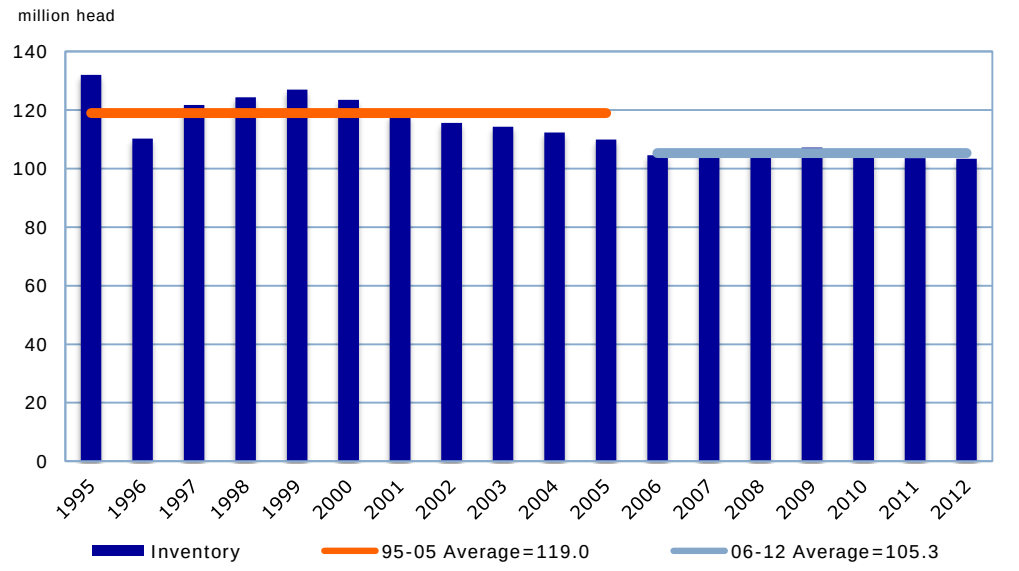
Low production, high prices

According to official statistics, China's beef cattle stock has been in continual decline since 2004, falling significantly in 2006 and 2011 and remaining static in the other years (*see Figure 1*). Between 2006 and 2012, the average cattle herd decreased by 14 million head, a 12 percent drop on the previous ten-year period. However, the situation could even be worse; in some agricultural regions that previously specialised in cattle farming and slaughtering, the importance of beef cattle has dwindled as farmers have shifted to other forms of agribusiness.

There are a number of underlying reasons why China has seen such a serious drop in beef production. First, until recently, there has been lack of government support. Compared with the pork and poultry sectors, beef cattle receive the least amount of support (*see Figure 2*). While the beef cattle sector mainly receives only limited support from local government, hog farming receives various subsidies from both central and local governments—up to eight times the subsidy received by cattle farmers in specific areas. This places beef in a weaker position when competing with other livestock for land, water, feed and labour. Second, China's beef cattle productivity is very low compared with other major beef-producing countries, making China uncompetitive and allowing imports to gradually eat up local market share. Comparing key productivity parameters, the meat yield in China's beef sector

is only between 40 percent and 45 percent, while meat yield in both the United States (US) and Australia is 55 percent. The slaughter weight is 500 kilogrammes in China compared to 700 kilogrammes in the US, due to poor beef genetics technology in China. Third, there are few Chinese cattle farmers willing to invest or expand the herd due to a shortage of labour as well as the longer production cycle and higher capital requirements compared with other livestock production.

Figure 1: Beef cattle inventory, 1995-2012



Source: China Statistics Yearbook, 2013

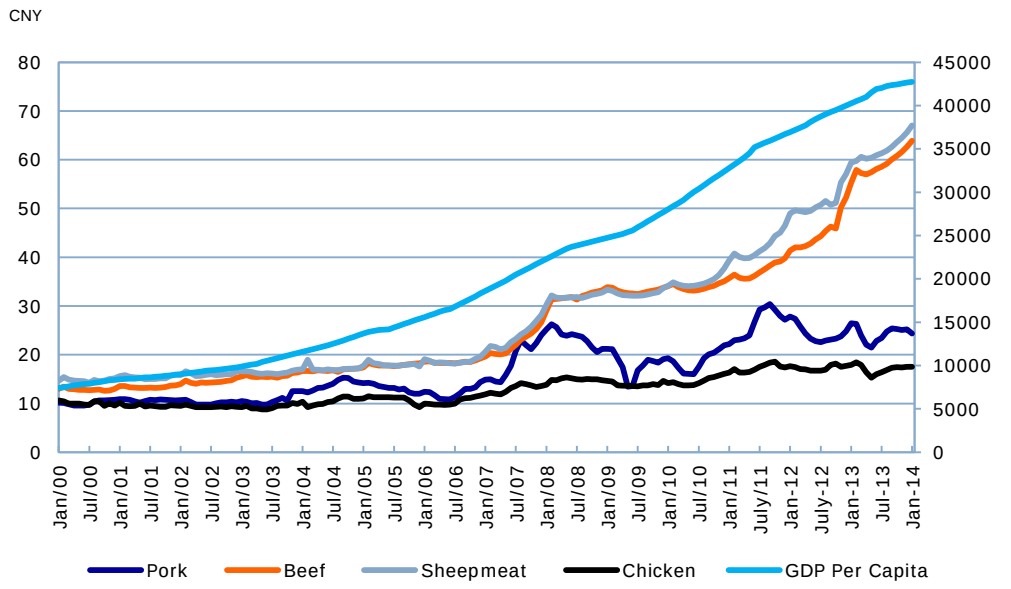
Figure 2: A snapshot of China's subsidy policy on pork, poultry and beef in recent 5 years

Item	Pork subsidy	Poultry subsidy	Beef subsidy
Subsidy on farming	Hog farms with slaughter numbers between 500-999/year receive a one-off subsidy of CNY 200,000; farms with slaughter numbers between 3,000-10,000/year receive CNY 800,000	N/A	Harbin 2013: Cattle farms receive CNY 25,000 per 1,000 square metres for newly built barns with slaughter numbers over 500/year; Breeding farms receive subsidised one-year loan interest Xinjiang 2013: Breeding farms or barn construction programmes receive financial subsidy of no more than CNY 350,000
Harmless disposal subsidy	Hog farms that apply harmless disposal methods for dead pigs receive CNY 80/pig	N/A	N/A
Disease epidemic subsidy	During serious disease outbreaks, backyard farmers receive CNY 640 each; Standard scale breeding farms receive CNY 480/pig	During avian influenza outbreak in 2013 (e.g. Shanghai), there were three policies totalling CNY 32 million. Breeding farms received a production sustainability subsidy of CNY 15/bird; hatcheries received CNY 0.5/bird; poultry farms received a one-off subsidy	N/A
Livestock fine breed subsidy	Farms receive CNY 100/sow; CNY 10/pig semen	N/A	CNY 10/breeding female cattle
Insurance	80% insurance fee covered by government	N/A	N/A
Major production county subsidy	Counties with high slaughter numbers may apply to Dept of Agriculture and Dept of Treasury for a subsidy of at least CNY 1 million	N/A	N/A

Source: Rabobank, 2014

In response to the supply shortage, beef prices in China have been on a significant upward trend. Indeed, since 2000, beef prices have increased over fivefold, with an average YOY growth rate of 13 percent and two significant price surges in 2007 and 2012 (*see Figure 3*). Beef price movements have shown close correlation with GDP growth, which increased by the same pace over the same period. This reflects the fact that growing income levels and economic prosperity are enabling beef prices to reach their current levels, although the underlying reason for the soaring price is a supply shortage. During the same period, pork and poultry prices varied greatly, but saw a total increase of only 2 and 1.3 times, respectively, due to ample supply and government support. Given the beef supply shortages that are likely to remain in the coming years, prices will continue to stay at high levels.

Figure 3: Retail prices for beef, sheepmeat, pork and poultry in China, 2000-2014



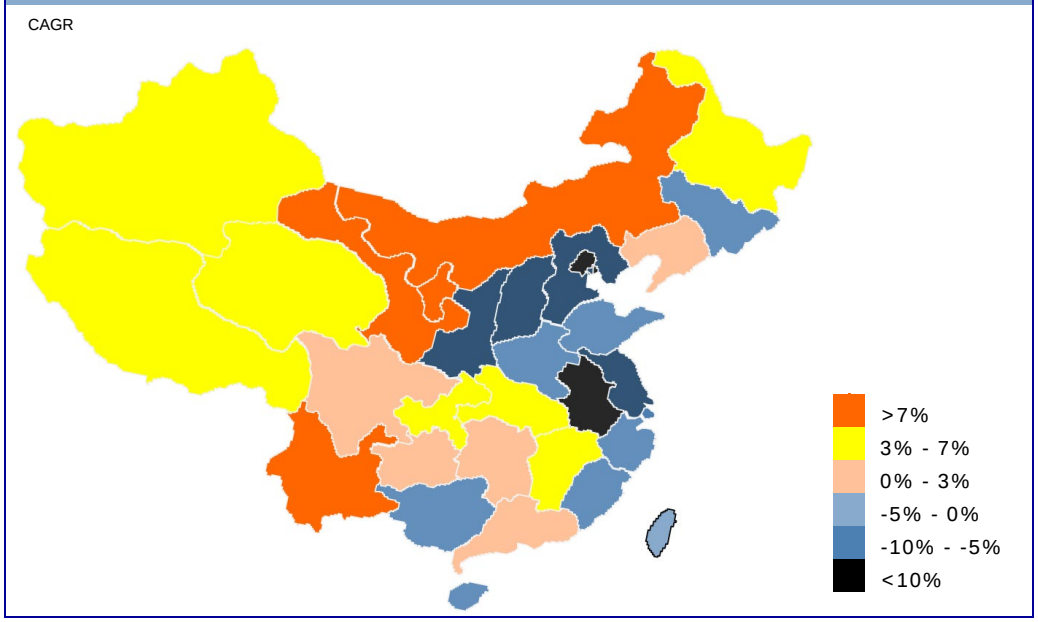
Source: CAAA, Rabobank, 2014

Government support still falls short

In September 2013, the Chinese government issued a 'Guideline for Beef Industry Development Towards 2020' with the goal of supporting beef and sheepmeat production in key production regions and rebuilding beef cattle and sheep stocks. The aim is to increase beef output from the current 6.3 million tonnes to 7.17 million tonnes in 2015 and 7.86 million tonnes in 2020. The policy will support production in several regions, including three important agricultural provinces (Henan, Hebei and Shandong), western China (Xinjiang, Gansu, Ningxia, Inner Mongolia, Sichuan, Tibet, Yunnan and Qinghai), which is a grazing region, and northeast China, an emerging region for beef cattle. Key measures in the policy include financial and technological support. Both central and local governments will provide subsidies to medium to large-scale farms with annual slaughter rates exceeding 100 in western China and 200 in agricultural regions as well as the Northeast.

This is the first time that the Chinese government has provided support to the beef sector at a national level. Back in the 1980s and 1990s, government support was regional and promoted the technology of feeding fermented crop straw to beef cattle in agriculture regions to reduce the burden on grazing regions and protect grassland. These measures significantly increased beef cattle production in agricultural regions in the 1990s, making these areas the fastest growing and largest beef suppliers in China. However, with urbanisation putting pressure on land and labour and competition for labour, feed and capital from the production of other livestock, beef cattle production in those regions has decreased significantly since 2006. Meanwhile, cattle production in both western and northeast China has shown stable annual growth of between 3 percent and 10 percent (*see Figure 4*).

Figure 4: China's beef cattle production growth by province, 2004-2012



Source: China Statistics Yearbook, 2005-2013, Rabobank

However, as the subsidy is very small compared with what the pork and poultry sectors receive, the jury is still out on whether the new policy can effectively help build up beef cattle production. The total subsidy offered by the Central Finance Department is CNY 1.7 billion for the period of 2013 to 2020, of which, 1.3 billion will be granted to midsize and large-scale farms and 0.4 billion will be granted to breeding farms. Moreover, it is important to note that government support alone cannot solve all of these problems; policy plays only a secondary role in addressing the structural needs of the industry.

Marginal domestic growth, rising imports

China's beef cattle supply shortage is a structural issue and the industry itself faces many challenges. It lags behind other major beef-producing countries in all the key aspects, such as genetics, breeding, productivity, farm management and grassland/feed resources. The Chinese government will need to decide which agricultural products it wishes to maintain (or achieve) self-sufficiency in and which it will allow to be more exposed to imports. Beef is not a strategically important agricultural product in China, although the government needs to keep a certain ratio of self-sufficiency to ensure beef supply to the Muslim population. Support for beef producers in China will increase but will remain lower than support for other livestock sectors, leaving beef producers to face the challenges of limited land, water and grass/feed resources.

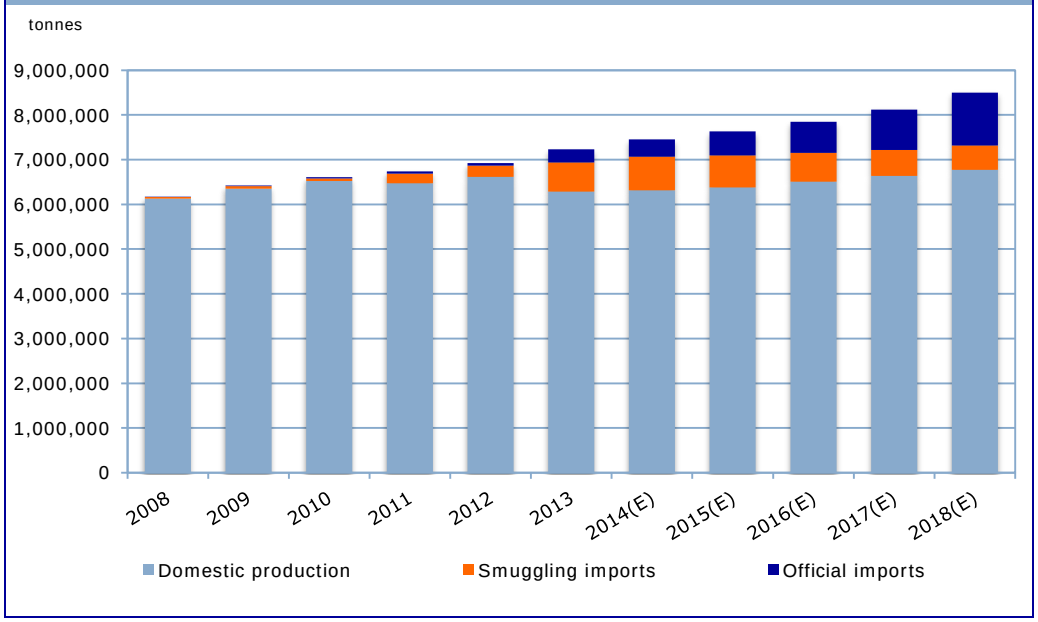
Given the great challenges facing the industry, beef production is expected to see only marginal growth in 2014 to 2015. Female cattle stock will be restored to a limited extent through government support. Production will likely see further increases between 2016 and 2018, assuming that the whole herd size benefits from the recovering female cattle stock in the previous years.

Even with the expected slight recovery of domestic beef supply, China will no doubt continue to increase its reliance on imports. China's attitude towards opening markets to more countries has become more positive, and the ban on Australian fresh and chilled beef imports has just been lifted. China is likely to open the door to Brazilian beef in the coming months, and by the end of 2014, may open the market to US beef. Clearly, the Chinese government is actively seeking solutions to solve the domestic supply shortage.

China became a huge importer of beef in 2013. Import volumes reached 297,000 tonnes, which is 3.79 times that of 2012. In addition to official imports, more shipments are also coming from grey channels. It is estimated that imported beef, including smuggled beef, accounted for 13 percent of total supply in 2013. Smuggled beef is estimated to account for over two thirds of total imports at the moment. However, once China allows entry to US and Brazilian beef, a portion of smuggled beef's share will become official imports. Nevertheless, it will be difficult to completely stop smuggling given the long border line. Total beef imports will increase by between 15 percent and 20 percent each year in the coming few years,

reaching 1.7 million tonnes by 2018, and will likely account for 20 percent of supply (*see Figure 4*). This will position China to become an even more important destination for global beef in the coming years.

Figure 5: China's projected domestic beef production, beef imports and smuggled beef, 2008-2018



Source: Rabobank, 2014