



Rabobank

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Russian Bans Won't Slow Runaway Markets

World beef markets to remain tight through 2014 due to reduced supply from key export markets.

Russian beef import bans unlikely to have a large impact on world beef markets. Brazil will be the largest beneficiary of the ban, while the impact on major exporters such as Australia and the US will be minimal given increased impediments to trade with Russia prior to the ban.

The prospects of tight supply will underpin a very strong competitive landscape for beef, supporting cattle prices that are already very high in some countries.

Consumer demand in the US still resilient in the face of high prices, although this will be tested as beef supply tightens further.

Tight supply and strong demand underpinning high cattle prices in most countries

Volatility continues to characterise the US market



Price volatility is making marketing decisions very difficult. Cattle prices continue to trade at record levels, and the consumer's appetite remains firm.

Tight supply while export demand remains strong



Brazilian exports have benefited from increased demand from Russia this quarter and will start going to China during the next six months. This strong demand and tight supplies have underpinned record cattle prices.

Rainfall still needed, but supplies will tighten



The Australian cattle industry is still looking for meaningful rain, but prices did respond on the back of some decent rainfall during August. Record slaughter continues to drive record exports, with strong international demand helping to support prices.

Increased demand forecast in line with seasonal trend



Although total Chinese imports in 2014 are expected to be lower than the record levels witnessed in 2013, demand for the remainder of 2014 is forecast to strengthen.

Rabobank International

Food & Agribusiness Research and Advisory

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Global outlook

Global beef supply is in a tightening phase, with most key producing and export regions already experiencing record tight supplies and further tightening expected throughout the remainder of 2014 and into 2015. Consumer demand and the willingness to pay are being tested like never before.

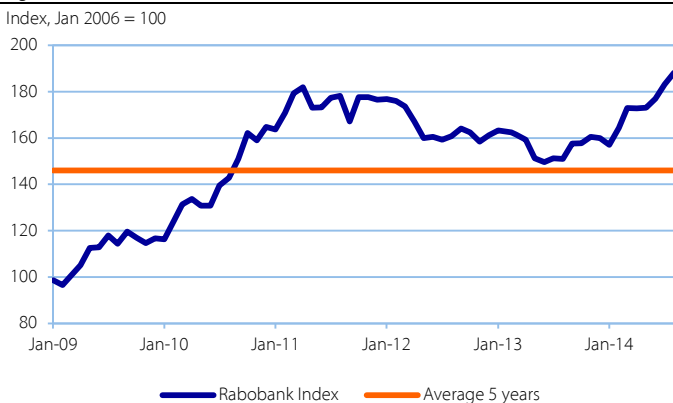
Beef producers in some countries, such as the United States (US), Brazil and New Zealand, are welcoming record prices, as supplies remain tight and international demand very strong. Processor margins will come under pressure as they compete for limited supply. However, the positive news for processors and exporters is that throughout 1H 2014—and indeed so far in Q3—consumer demand seems to be showing no sign of slowing, helping to maintain firm processor margins.

Market access developments in Q3 have shifted. Brazilian beef exports are expected to continue to grow in 2H 2014, given the reopening of the Chinese market, which has been closed since an atypical case of bovine spongiform encephalopathy (BSE) was registered in 2012 in the state of Paraná. Russia's ban on imports from the European Union (EU), Australia and the US will support an increase in Brazilian trade. It is important to note that the impact on large exporters such as the US and Australia will be minimal, as both countries have seen exports to Russia diminish in recent years, as opportunities emerged in other markets and impediments to trade with Russia had already increased prior to the ban.

Some promising rains in drought regions of northern Australia provided producers and restockers with some much-needed confidence. Given the high proportion of females already processed this year, the largest price reaction to the August rainfall was seen in cows. Australia's fiscal year total slaughter exceeded 8 million head in 2013/14, after also reaching this number the previous year. This is the first time in 35 years that Australia has recorded two consecutive years of slaughter greater than 8 million head. This will have a profound long-term impact on supplies and the herd. Indeed, with record Australian beef exports on the global market since 2013, importers will certainly feel the squeeze when Australian beef supply begins to ease.

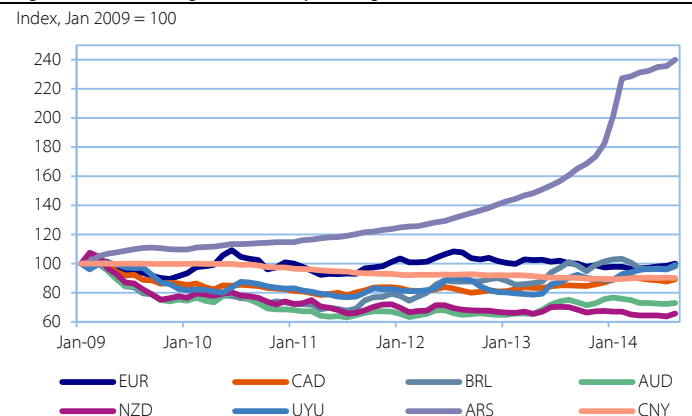
The US market continued to operate in uncharted waters in Q2, both from a record price perspective and because of the amount of product that is being imported. As is dictated by the month-over-month decline in placements, the fed cattle supply for Q4 2014 and Q1 2015 appears to be incredibly tight. Expectations are for record high price levels to continue, although the magnitude of the increases is not expected to match 2014 levels. The ultimate peak of the current market appears to rest on just how much consumers are willing to pay for beef, because the market does not have the available supply to meet current demand.

Figure 1: Rabobank 7-Nation Finished Cattle Price Index, 2009-2014



Note: Average live finished cattle prices weighted by share of global exports (Brazil, Australia, Argentina, Uruguay, US, Canada and New Zealand).
Source: Rabobank, 2014

Figure 2: Index Exchange Rate Development Against USD



Source: Oanda, Rabobank, 2014

Regional outlooks

US

Explosive volatility and record prices describe the US cattle and beef complex. In the past quarter, fed cattle prices rallied from a low of USD 144/cwt (US hundred weight) to an all-time record high of USD 164/cwt in late July, returning to USD 152/cwt in August (see Figure 3). Early September prices sought to regain the majority of the price decline, with cash sales in the range of USD 158/cwt to USD 162/cwt during the first week of September. The good news is that in spite of the unprecedented price levels, demand for both domestic and export beef continues to show no measurable evidence of slowing down.

Placements of cattle into US feed yards have declined for each of the past five months. The July placements, down 7% YOY, were the smallest July placements in the current data series, which was started in 1996. The total decline in placements for the five-month period compared to last year amounts to 536,000 head fewer cattle placed on feed.

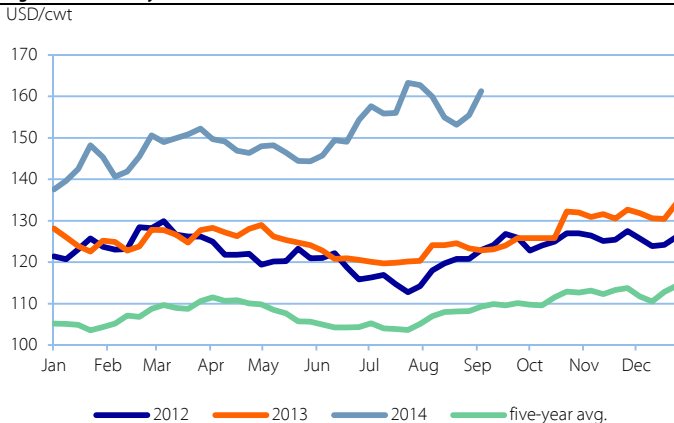
January-August imports of feeder cattle from Canada are up by 40% compared to a year ago. The huge increase in shipments is largely driven by price, but also by the revised country of origin labelling (COOL) rules that were implemented last fall. Imports of feeder cattle from Mexico are currently posting a 13% YOY increase, with shipments of heifers up 20% and shipments of steers up 10%. The bottom line is that the current runaway

market in the US has not only cleared the shelves of replacement cattle in the country, but has cleared the shelves in all of North America. What makes this situation even more concerning is that it does not look like the US market has simply removed beef from the short-term supply base; there are also indications that supplies are being cleared for the prospect of future opportunities for rebuilding.

US beef production from January-August is down 5.6%. Federally Inspected Slaughter is down 6.4%, of which fed steer and heifer slaughter is down 4.6%, dairy cow slaughter is down 12%, and beef cow slaughter is down 17%. In addition to the forceful increase in feeder cattle imports, the US has aggressively imported beef for the year. Imports have largely been a source of lean grinding beef to supplement the shortage of domestic cow slaughter in order to have a source for ground beef supplies. YOY imports from Australia are up 36%, New Zealand imports up 3%, Canadian imports up 11%, and Mexican imports up 7%.

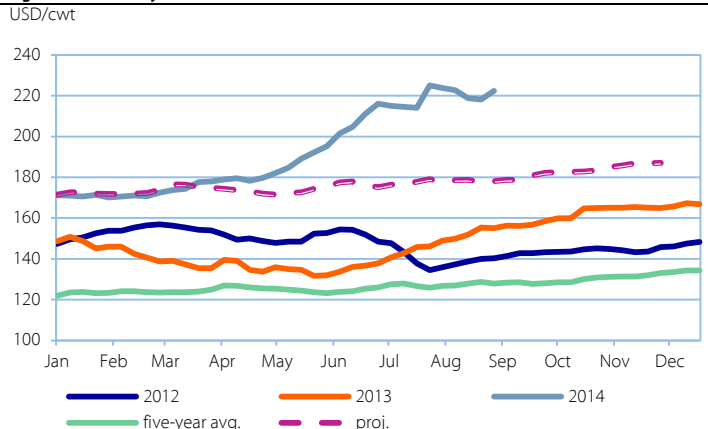
The safest assumption with regard to the market outlook is that the extreme volatility will continue for the foreseeable future. Replacement cows that are currently selling near USD 3,000 look set to remain in exceptionally tight supply. Indications suggest that feeder cattle prices will continue to trade either firm to higher (see Figure 4). Supplies of replacement cattle are expected to remain exceptionally tight. A large supply of US feed grains and feed stuffs is all but guaranteed, and the outlook for fed cattle prices remains solid.

Figure 3: US Weekly Fed Steer Price



Source: USDA, 2014

Figure 4: US Weekly CME Feeder Index



Source: USDA, 2014

Australia

For much of Q3, cattle prices remained relatively constant, but tracked below the five-year average. The Eastern Young Cattle Indicator tracked between AUD 3.33/kg CWT (carcass weight) and AUD 3.57/kg CWT for the months of July and August (see Figure 6). With the rains in mid- and late August, prices rose towards the end of the month. Saleyard prices followed a similar trend through July and August, with cow prices showing the biggest improvements, increasing 17% throughout the month of August.

In the 2013/14 year, 8.3 million cattle were slaughtered in Australia, the second year in a row in which slaughter topped 8 million head (see Figure 5). This was the first time that there were two consecutive years of slaughter above 8 million head in over 35 years. This large slaughter has seen the total Australian cattle herd reduce from just over 29.2 million in 2013 to a forecast 26.1 million in 2015.

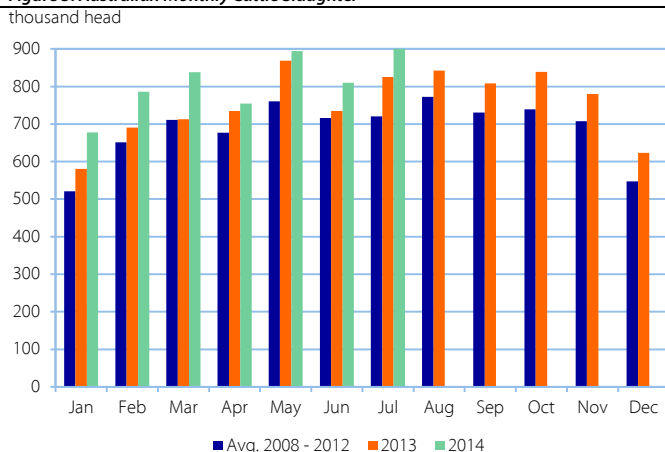
This record slaughter and beef production has been supported by a very strong export market. Monthly exports continue to track above 100,000 tonnes shipped weight (swt), with 111,872 tonnes exported in August 2014, up 14% YOY. Exports year-to-date reached 818,095 tonnes swt, 16% higher than the same period in 2013. The US has been the major market, becoming the biggest export destination with 227,107 tonnes swt exported for the 2014 year to the end of August, a 67% increase on the same period in 2013.

Trade sanctions imposed by Russia had minimal direct impact on the Australian cattle industry, due to some restrictions having been put in place in April and the relatively small volumes that had previously been exported to Russia. Domestically, interest continues to centre on developments in the processing sector, with a new processing plant in Darwin due to come on-line in September and other interest in processing facilities, particularly in Western Australia.

Live exports have also seen strong demand, with 631,961 head exported for the first six months of 2014 and 1.13 million head for the 2013/14 year, which is up 79% on 2012/13. There has been strong demand in many South East Asian countries, with numbers to Vietnam increasing by 726%, those to Malaysia increasing by 44% and those to Indonesia increasing by 130% from the 2012/13 year to the 2013/14 year.

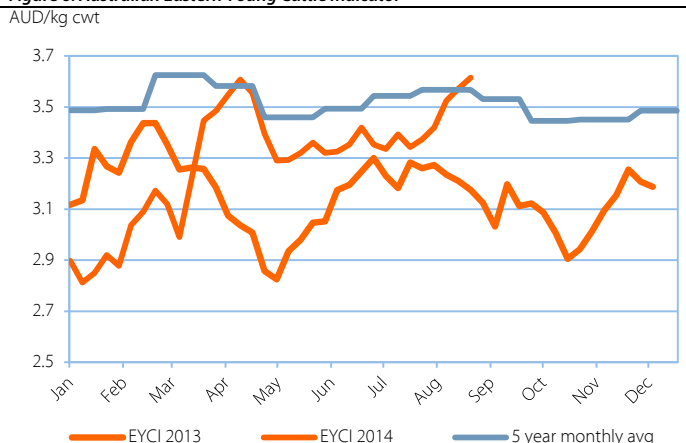
The current seasonal weather forecasts are predicting a drier-than-normal September to November for parts of the south-eastern mainland. Elsewhere, the chances of a wetter- or drier-than-normal September to November are roughly equal. With this uncertainty, it is not expected that herd rebuilding will take place on any large scale. However, the number of cattle on the market will contract due to the record slaughter levels already seen, providing challenges for buyers and exporters.

Figure 5: Australian Monthly Cattle Slaughter



Source: ABS, MLA forecasts, Rabobank, 2014

Figure 6: Australian Eastern Young Cattle Indicator



Source: DAFF, Rabobank, 2014

Brazil

Q3 began with high live cattle prices in Brazil, and in late August it registered a new record in nominal values, getting closer to BRL 130/15 kg. This has been a consequence of both low domestic supply and rising international demand for beef. Moreover, Brazilian beef exports are expected to continue to grow in 2H 2014, especially considering the reopening of the Chinese market (it had been closed since an atypical case of BSE was registered in 2012 in the state of Paraná) and the current positive trade situation with Russia.

Hong Kong and Russia have continued to be the main destinations for Brazilian beef shipments during 2014, with both countries increasing their volumes in the first seven months of the year by 6% and 4%, respectively, versus the same period in 2013. As a result of the firm demand for beef, particularly in developing countries, Brazilian beef export volumes increased by around 11% during the first six months compared to the same period last year (see Figure 7). In July, exports remained firm and increased 17% over June and by 9% versus the same month last year.

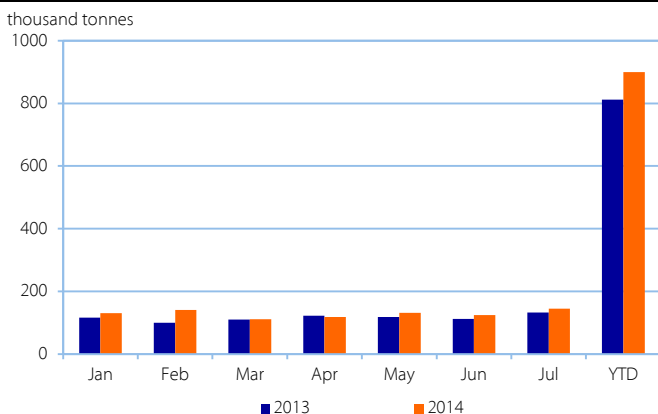
As a consequence of this strong demand, live cattle prices in August were, in inflation-adjusted terms, 18% above August 2013 and 7% above July 2014 (see Figure 8). The futures market also shows a strong scenario for cattle prices in Brazil. Early September, October and November 2014 contracts were above BRL 130/15 kg for the first time in history. An important driver for price developments in 2014 has been the shortage of finished cattle, which was reflected in a decrease of around 2% in

slaughter during the first six months. Therefore, there are no signs that prices might lose strength in the coming months.

Despite the good picture for Brazil in the international market, domestically consumers—squeezed by a slowing economy and persistent inflation—are likely to resist rising prices and substitute beef for pork. In addition, there is growing concern from consumers about the difficult economy, concerns which are likely to persist at least until October’s presidential elections.

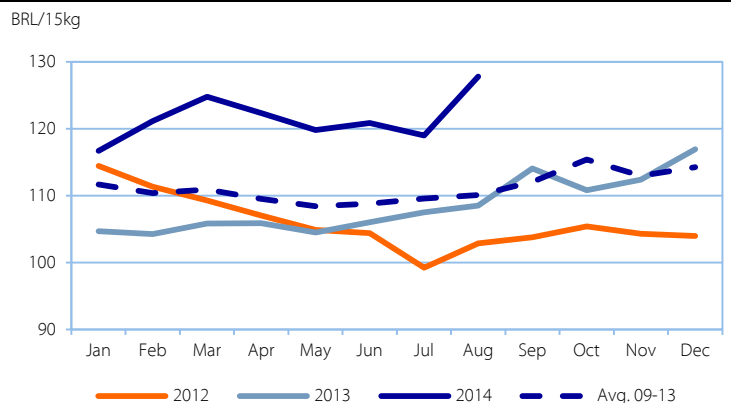
From the supply side, it is expected that beef production will gain strength in the coming months, considering that cattle which were strategically placed in feedlots during the Brazilian winter (drought season) will become available for the slaughterhouses. Production in feedlots is expected to achieve new records in the number of head confined in 2014, supported by the drop in grain prices seen over the last months. Nonetheless, Rabobank expects cattle prices to remain strong in the coming months and to achieve new record levels as a result of strong international demand. There will also be some recovery in domestic beef consumption after October, when traditionally there is a seasonal increase in meat demand, which starts to reflect holiday purchases.

Figure 7: Brazilian Beef Exports



Source: SECEX/MDIC, 2014

Figure 8: Brazilian Live Cattle Prices Adjusted for Inflation



Source: CEPEA, 2014

China

Tight supply continued in Q3 2014. Beef prices have been stable throughout Q2 and the first two months of Q3, staying at a high level. At present, the retail price is CNY 63/kg, 6% higher than the same period in 2013 (see Figure 9). As the peak season for meat consumption starts in Q3 with the arrival of festivals and cold weather, beef prices are expected to increase further throughout the remainder of Q3 and Q4 2014.

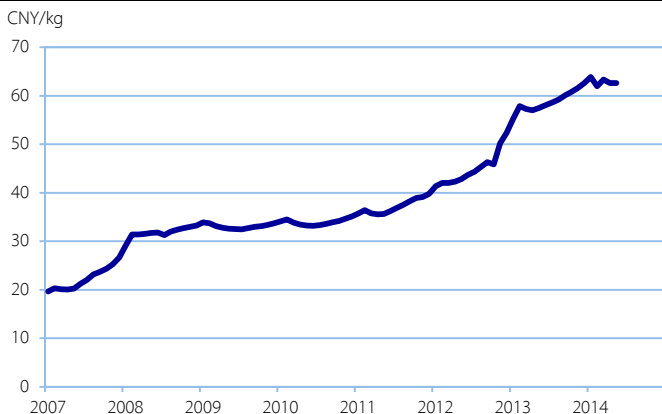
In terms of profitability spreading along the supply chain, Chinese beef farmers' margins in August increased to CNY 1450/head (each head equals 500 kg), up 16.7% compared with Q2. Slaughtering margins decreased to CNY 410/head (down 44% compared with Q2), while retail margins increased to CNY 1699/head.

China's beef imports reached 183,000 tonnes in the first seven months of 2014, up 20.3% YOY. Although this is not high compared with the astonishing 380% import growth in 2013, the import volume is still historically high. The average import price of frozen beef in the first seven months of 2014 was 4,329 USD/tonne, up 3.4% YOY. During this same period, Australia remained the biggest beef supplier to China, with the volume up 17% YOY. However, Australia's share in China's total beef imports decreased from 53% in 2013 to 47% in 2014, due to the impact of China conducting inspections of beef for hormone growth promotants (HGP). Meanwhile, shipments from Australia to Hong Kong continued to be much higher than historical levels. Uruguay still ranked as the second-largest supplier, but experienced stronger growth, with the volume

rising 33% YOY, to 51,000 tonnes. Rapidly growing imports from Argentina have been impressive. Despite only making up a small percentage of the total Chinese beef supply, imports from Argentina in the first seven months increased from 2,500 tonnes in 2013 to 7,700 tonnes this year.

In general, the astonishing growth seen in 2013 is not expected to be sustained into the remainder of 2014, as expectations of higher international beef prices will limit China's ability and willingness to pay for more expensive beef.

Figure 9: China Beef Retail Price, 2007-2014



Source: MOA, CAAA, 2014

New Zealand

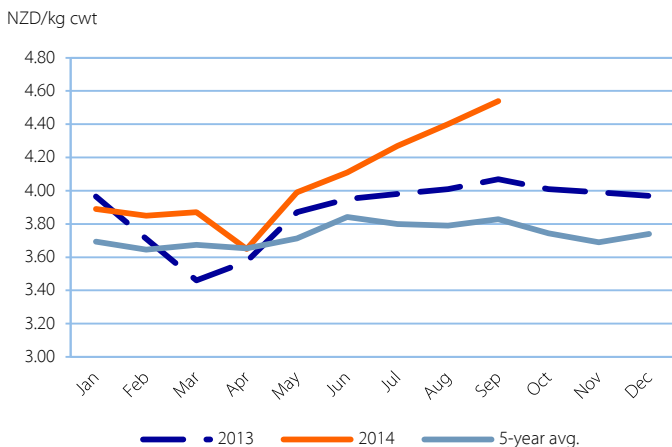
Throughout Q2 and Q3 2014, the New Zealand beef industry has benefited from very strong demand from both the US and Chinese markets, despite strong competition from the drought-induced high supply from Australia. New Zealand beef returns have remained at very strong levels, and—with a forecast of tight supplies and strong demand—the industry is very optimistic.

Farmgate prices have continually risen throughout 2014 and—as of the second week of September—remain 12% higher than the same week in 2013, with the North Island bull price averaging NZD 4.54/kg CWT (see Figure 10). With prices at this level—and in some cases above NZD 5/kg CWT—producers are receiving record returns for their stock.

Cattle slaughter for May, June and July reached a total of just over 700,000 head, 12% higher than the same three-month period in 2013. Supplies for the remainder of 2014 will contract seasonally, and farmgate prices will remain firm.

Higher slaughter underpinned increased exports during the May-to-July period, with exports 15% higher YOY, at 115,432 tonnes shipped weight. Strong demand is also translating to higher export returns, with average export values higher than last year. Given that over half of New Zealand's exports are to the US, the willingness for US consumers to pay higher prices will impact the margins of New Zealand processors and exporters.

Figure 10: New Zealand North Island Bull Price



Source: NZX Agrifax, 2014

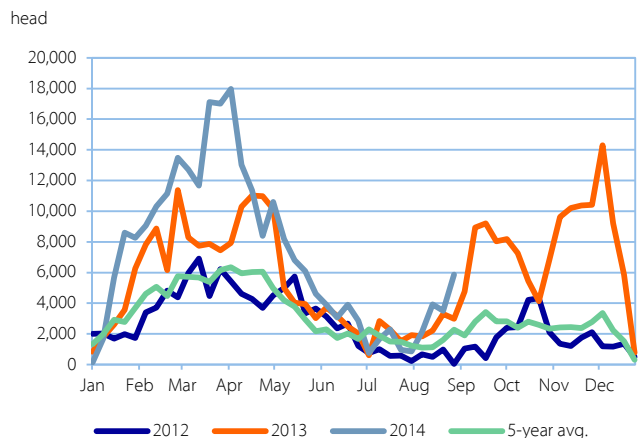
Canada

The Canadian cattle market has been enjoying the same surge in cattle prices for the year as has been seen in the US. What is surprising is that the surge in prices for all classes of cattle does not appear to be stimulating stabilisation or rebuilding of cattle numbers. In fact, it appears that producers are reacting in just the opposite direction and selling cattle as aggressively as possible, in an effort to capitalise on the current prices. The 1 July Canadian Cattle Inventory was 13.3 million head, which is a 1.5% decline from a year ago.

Canadian cattle on feed numbers have been strong all year, with the month-on-month average increasing 8% over the past year. Along with the increase in cattle on feed, Canadian shipments of feeder cattle to the US have been huge, totalling 249,456 head year-to-date, up 40% YOY (see Figure 11).

There have been two primary drivers for the huge increase in shipments: the strength of both the US feeder cattle market and the US dollar, and the impact of the new COOL rule that has encouraged shipments of feeder cattle over fed cattle. The bottom line is that Canada has aggressively been using all available cattle supplies.

Figure 11: Canadian Feeder Cattle Shipments to US



Source: USDA

Argentina

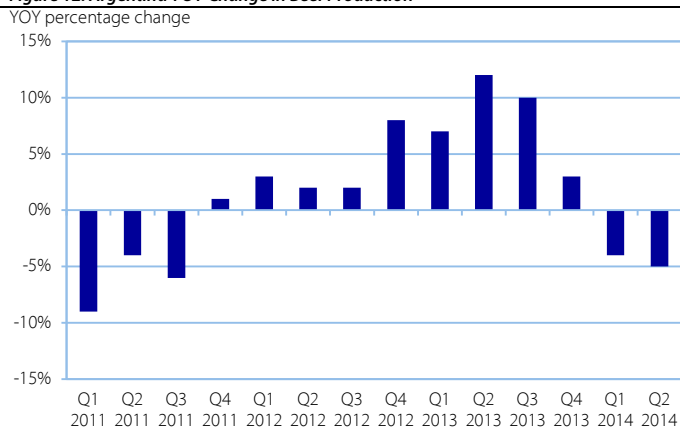
USDA's Animal and Plant Health Inspection Service (APHIS) recently added Argentina's Patagonia to the list of regions considered free of foot-and-mouth disease (FMD) and proposed to allow the importation of fresh beef from Northern Argentina. This would open the US market to Argentina, after having been closed since 2001.

Local cattle prices are increasing steadily, with Q2 and Q3 prices 76% and 95% higher than last year, more than compensating for the 40% rate of inflation. The steeper price increase in recent months is a result of continued increases in the unofficial exchange rate, which encouraged producers to hold on to stock, and abundant rains, which complicated transport. On 20 August, the Argentine government announced it would halt meat export permits for a period of 15 days. Presumably, this was meant as a signal to packers to keep local meat prices down, and prices in early September eased slightly as a result.

Beef production was down 4.6% in Q2, bringing the year-to-date decline to 5%. Exports, which declined 23% in Q1, fell by only 4.4% in Q2, and July performance was positive YOY, with a 14% volume increase (cwe). Although this is an encouraging sign, the level of exports continues to be at a historical low.

For the coming months, we expect production to increase seasonally with improved weather, but exports to continue at historically low levels, despite the encouraging trade developments with the US and Russia.

Figure 12: Argentina YOY Change in Beef Production



Source: Rabobank based on IPCVA, 2014

Mexico

Mexican beef production continues to be restrained as cattle availability remains scarce. At the end of the year, Rabobank expects beef production to increase by 0.9%. Most of this increase is due to heavier slaughter animals as a result of better pastures and cheaper feed grains.

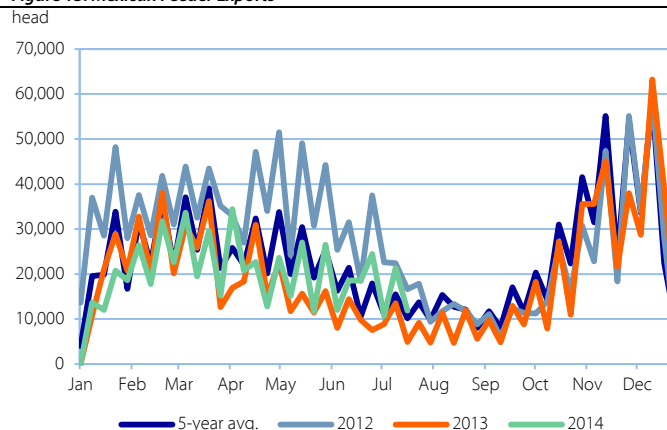
Cattle exports remain strong as US prices remain highly attractive. Despite the competition between Mexican and US feeders for Mexican cattle, exports have increased 9.4% year-to-date, while heifer exports have risen 9.4% over the past year.

Cattle prices have increased around 15% over last year, while beef prices have risen 12.5%.

Per capita consumption remains relatively weak and is estimated to drop to 15.8 kg, down from 15.9 kg in 2013. However, some beef cuts began to be more competitive, as pork and even poultry meat prices have increased significantly as a result of porcine epidemic diarrhoea virus and avian influenza.

Imports remain relatively sluggish as a result of the weak consumption and the contraction of US beef supplies. At the end of this year, total beef imports are expected to decline by around 3%. In contrast, exports are expected to increase by around 1% as domestic supplies remain tight.

Figure 13: Mexican Feeder Exports



Source: Statistics Mexico, 2014

Indonesia

The price in Q2 averaged IDR 98,260/kg, which was slightly lower than in Q1, but 12% higher than the same period last year (see Figure 14). Prices in Q3 moved up slightly, driven by demand due to the Ramadan, hitting a peak value of IDR 106,000/kg in July. However, prices have subsequently dropped since this elevated level. The average price as of the first week of September is 3% higher than in Q2 and 9% higher than at the same time last year. At the moment, there seems to be plenty of supply, and prices will come under pressure in the live cattle market as we move towards Q4.

In 1H 2014, 433,000 head were imported, which is almost double the amount imported during the same period in 2013 year, leaving approximately 431,000 head for the last two quarters to fill the permits issued. If these permits are filled it will be a record for imports, surpassing the high of 2009. However, permit numbers can change, and more could be released if prices stay above IDR 76,000 and if there is sufficient demand to import more cattle. On the other hand, better supply has resulted in softening prices, impacting finishers' profitability. This may cause lot feeders to import fewer cattle in 2H 2014. Boxed meat imports also continue to increase and are on course to reach 50,000 tonnes, a jump of 17% on the previous year.

In a recent development, Indonesia has allowed imports of beef from Japan after a four-year ban. Although the move may not lead to a significant change in trade flows, it does, however, give Indonesia greater optimism about opening to trade from other regions. The initial ban arose in 2010 due to fears of FMD. Indonesia is increasingly easing its import restrictions and looking for alternative sources of supply after record domestic prices last year. Following this announcement, Brazil has filed a dispute with the WTO, challenging Indonesia's 2010 ban on beef and cattle imports from Brazil.

Figure 14: Indonesia Wholesale Beef Price



Source: Ministry of Trade of the Republic of Indonesia, 2014

EU

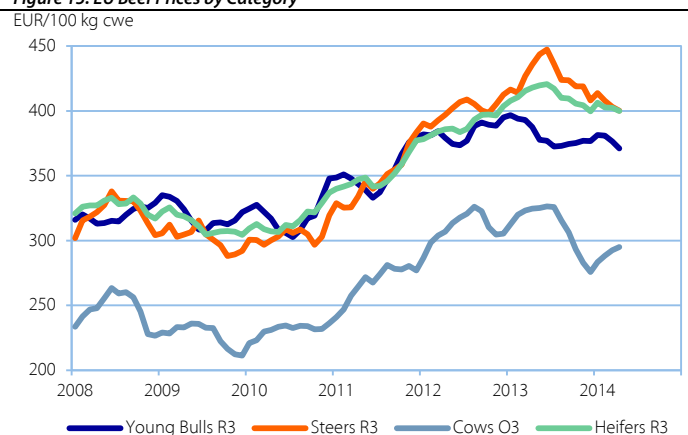
The EU beef market remained under pressure during the summer, with cattle prices declining in all categories (see Figure 14). Despite lower supply, with reduced slaughter levels (head -1.5%), lower production (volume -0.7%), higher exports (+31%) and slightly lower imports (-3%) during the January-to-June period, the lacklustre demand and changing retail requirements could not be compensated for.

EU beef demand remained pressure-driven by lasting high retail prices. Retail has not yet incorporated the declining cattle prices at farm and wholesale levels to regain part of the lost margins in 2012/2013. In these years, the rapidly rising raw material prices were just partly forwarded to consumers.

Retail requirements—especially in north-western Europe—are changing to younger and generally lower-priced animals. The main drivers are the ability to offer lower-priced beef and become more competitive in the highly-competitive retail markets in this region of the EU, along with changing consumer demand for convenience products such as (value) burgers, which require less prime beef.

For the remainder of 2014, the EU beef market is expected to remain under pressure and at best stabilise. Even the seasonal increase in demand is unlikely to result in higher prices, given the increasing competition with lower pork and poultry prices.

Figure 15: EU Beef Prices by Category



Source: European Commission, 2014

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