Daily Note

CHINA WINNING AG TRADE WAR

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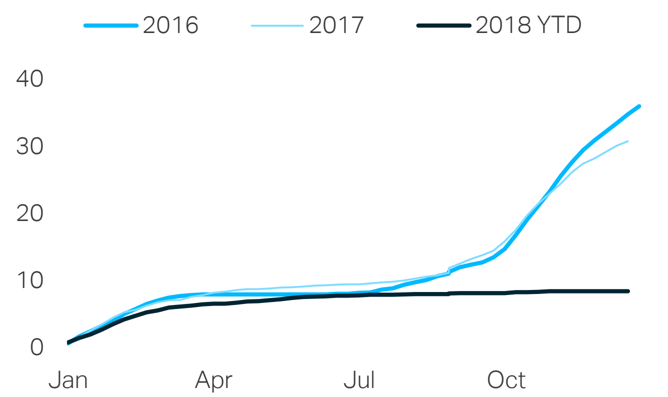
- **Large-scale Chinese soybean imports are contingent on trade truce**
- **African swine fever to weigh on China demand through 2019-20**
- **Record South American harvests add pressure on US farmers**

The 90-day truce signals a de-escalation in the trade conflict. While we believe differences over structural issues are unlikely to be resolved within this timeframe, we do expect China to offer limited concessions in order to gain multiple extensions to the negotiating period. Promising to import large volumes of agricultural products is part of Beijing's core strategy of dealing with US President Trump. For this reason, we expect China to gradually increase soybean imports during the 90-day negotiating period. Soft domestic demand and sufficient stockpiles of soybean and meal, however, mean that import volumes will likely remain modest until a permanent trade truce is agreed. Thus far, confirmed new purchases of US soybeans amount to 2mn tons, which is the equivalent of just 3.5% of China's US soy imports last year and 2% of US shipments to all foreign buyers.

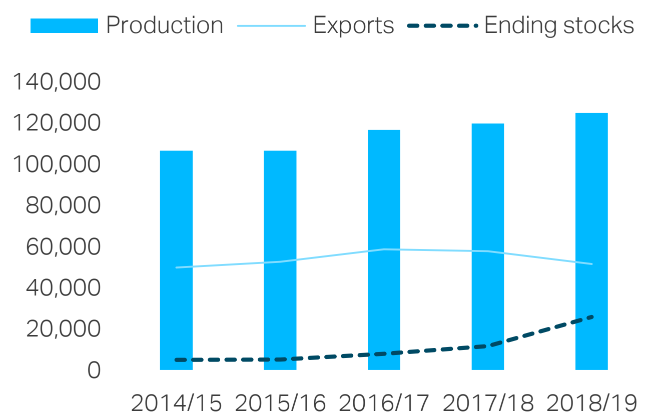
Chinese soybean purchases will not end US oversupply woes. The US, which is currently on track to have another bumper soybean crop in the 2018-19 season, saw its stocks balloon as China remained on the side-lines during the peak harvesting season. As a result, the US is expected to have nearly 26mn tons of soybeans stockpiled at the end of the current crop season – roughly twice last year's carryover stocks and from the previous year. Neither Chinese

US soybean exports to China (calendar YTD, mn tons)



Sources: USDA, TS Lombard.

US soybean production, exports and ending stocks (mn tons)



Sources: USDA, TS Lombard.

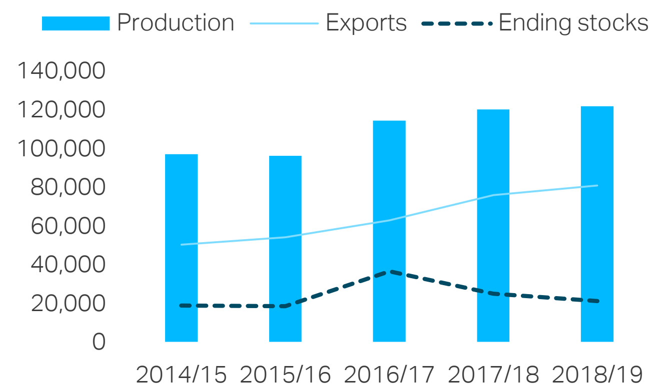
purchases nor increased demand from Europe will suffice to put a dent in US supplies, and this will contribute to a continued bearish outlook for soybean prices.

African swine fever (ASF) will weigh on global soybean demand through 2019-20. ASF first broke out in northern China in August this year and has now spread to 22 provinces, with more than 600,000 pigs culled. There is no cure for the disease and the size, concentration and interconnectedness of the Chinese market all make containment difficult. The initial impact of ASF has been to trigger the earlier slaughter of pigs, particularly sows (breeding pigs), which are big consumers of soybeans (see chart on right-hand side below). We are expecting Chinese farmers to continue to allow herd numbers to decrease until the pandemic is eradicated. Forced culling and declines in breeding stock mean it could take at least six months for pig numbers to recover to pre-ASF levels once the virus is contained.

To estimate the potential impact of ASF on soy demand, we take the outbreak of the disease in Russia last year as a baseline – albeit an optimistic one, given the smaller size of the herd and the lower pig concentration in Russia. The virus saw 8.3% of Russia's pig herd culled. Assuming an identical impact of ASF in China, the Chinese herd could be reduced 31.8mn heads, which would reduce soy meal demand by roughly 11.9mn tons – equivalent to 12.1% of the USDA 2018 forecast for Chinese total meal consumption. Swine disease outbreaks follow a standard market pattern in China and eventually turn positive for soybean prices once the disease is eradicated and pork production begins to recover. Domestic commentators are comparing the current situation in China to the "blue ear disease" outbreak in 2006, from which it took the Chinese herd almost two years to fully recover.

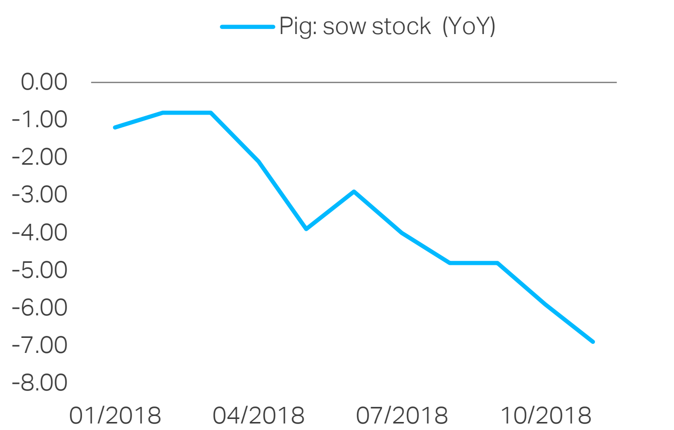
To make matters worse for US farmers, Brazil is about to harvest another record soybean crop of 122mn tons. Because the crop was planted in the ideal window and received ample precipitation, farmers will begin harvesting it later this month and in early January, which means that Brazilian soybeans will be available for shipping in late January. This massive crop will allow China to resume purchases or to take delivery of soybeans purchased on contract earlier this year. Brazilian soybeans continue to receive a significant premium over the US crop in the current trade war. According to the USDA, US soybean export bids in November, FOB Gulf, averaged US$329/ton – up US$5 from October. By comparison, FOB Brazil Paranaguá averaged US$383/ton, down US$29 from October. Similarly, Argentina's soybean crop is expected to recover in the upcoming season, providing yet another alternative to US soybeans.

Brazilian soybean production, exports and ending stocks (mn tons)



Sources: USDA, TS Lombard.

Swine fever accelerates pig herd contraction



Sources: Chinese MoA, TS Lombard.