



INSIGHT

Can Pigs Fly? Yes, in the Bond Market

June 2019

As the US/China trade war continues to heat up, can idiosyncratic risks in some sectors benefit others?

The latest war of words between the US and China has increased the likelihood of another round of import tariffs on Chinese goods.

Companies operating in both countries are already beginning to feel the impact of the trade war and increased tensions mean China is now less likely to turn to the US in times of need. However, rising geopolitical risk in some areas is also increasing opportunities for other countries to step in and develop their trading partnerships with China.

Less Pigs for Market

In August 2018, the World Organisation for Animal Health reported the first outbreak of African Swine Fever (ASF) in China.¹ ASF is a highly infectious viral disease of domestic and wild pigs with no vaccine or treatment options currently available. It has since spread rapidly throughout China, decimating the country's pig population.

Thankfully, ASF is not a risk to human health. However, given China is home to approximately half of the world's pigs, we believe it will greatly impact the Chinese pork production industry which accounts for 20% of total global protein production.² In 2018 the country was also the world's largest producer of pork (Fig. 1).

Global bank JP Morgan estimates that Chinese pork production will now fall 25% from their initial estimate of 10% and this will lead to the country importing an additional 4,200 metric tons (mt) of pork, 2,000mt of chicken and 480mt of beef.³ China is also one of the world's largest pork consumers (Fig. 2).

1. http://www.oie.int/fileadmin/Home/eng/Animal_Health_in_the_World/docs/pdf/Disease_cards/Report_2_Current_situation_of_ASF_Updated_191018.pdf

2. <https://www.economist.com/china/2019/05/25/aporkalypse-now>

3. JP Morgan, LatAm Protein report, May 6th 2019.



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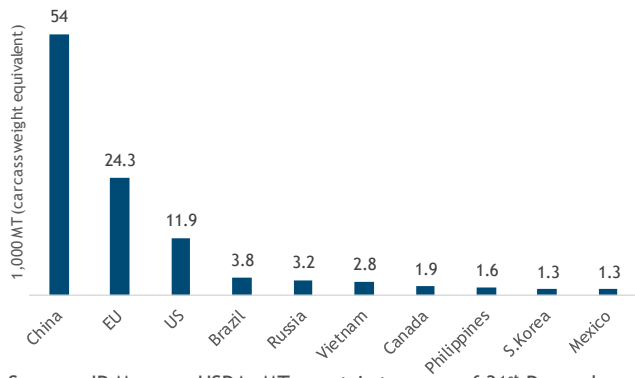
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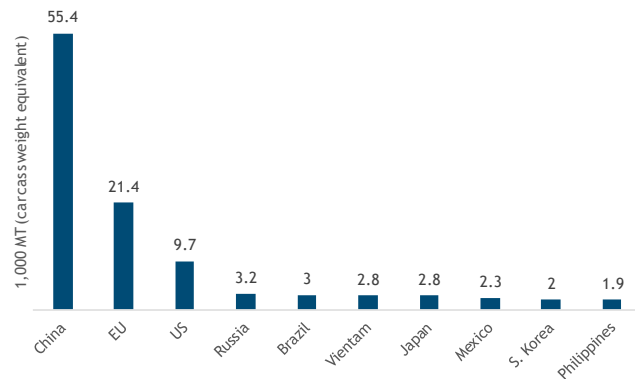
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Fig. 1 Top 10 Pork Producing Countries



Source: JP Morgan, USDA, MT - metric tons, as of 31st December 2018

Fig. 2 Top 10 Pork Consuming Countries



Source: JP Morgan, USDA, MT - metric tons, as of 31st December 2018

Noel White, Chief Executive Officer of Tyson Foods, summarised the ASF outbreak recently in an interview with The Economist, “in his 39 years in the business he had “never seen an event that has the potential to change global protein production and consumption patterns” as much as China’s epidemic of African swine fever”⁴.

As China’s pork supply diminishes, we believe the country will have to import pork and other meat products. This should benefit the producers of chicken and beef, which are key substitutes, and should therefore push these protein prices higher.

Opportunities Ahead?

Some of the biggest protein companies in the world are domiciled in Brazil (although operations are global), and as such we see opportunities there.⁵

In our view, South America is the most competitive region in terms of cattle prices, which are relatively cheap, and has a wide availability of animals.

Brazil has the world’s largest commercial cattle herd (second in absolute numbers after India) and is the world’s second-largest beef producer (15% of global production, second only to the US) and likely to remain the main exporter.⁶

4. <https://www.economist.com/china/2019/05/25/aporkalypse-now>

5. <https://www.iatp.org/the-rise-of-big-meat>

6. <https://beef2live.com/story-world-beef-production-ranking-countries-0-106885>; <https://beef2live.com/story-world-cattle-inventory-ranking-countries-0-106905>

The region may also benefit from a prolonged trade war as China could prefer to import from South America rather than the US. In our view, Brazil has ample room to increase sustainable beef production via pasture to enable it to compete with the US (which currently produces more beef than Brazil with a herd less than half its size). A weaker local currency can also benefit producers as production costs are all in local currency.

The Chinese outbreak of ASF is tragic, not only for the hundreds of thousands of animals being culled, but also for the producers, often smaller scale businesses, who have been among the hardest hit.

Yet global demand for protein remains, and increased US/China trade tensions has reduced the likelihood of China looking to the US to meet its needs.

Instead, we believe countries in South America could step in; increasing volumes and higher prices could be a boon for protein producers globally, including those domiciled in Brazil.

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