AGRI-News

Magnusson Consulting Group

Growing Communities

Volume 2, Issue 1 Jan 2019

Soybeans & China – You can't have one without the other

They say timing is everything. In the world of soybean exports it is the *only* thing. The U.S. trade spat with China has resulted lost a significant opportunity to sell a major portion of its record soybean crop. *China's biggest purchases of soybeans from U.S. farmers are in October-November-December. The biggest purchases tend to come in October (our peak harvest month). In the previous two harvest of 2016 and 2017 the U.S. sold China about 250 to 300 million bushels each year in October.* This year they sold them merely 10 million bushels in October.

The 25% tariff on U.S. soybeans going to China largely made U.S. origin beans uncompetitive in China in the last-half of 2018. These tariffs caused a reshuffling of soybean flows across the globe adding additional transportation costs and creating logistic issues.

What are the impacts of the Chinese soybean tariff on U.S. soybeans sales so far this marketing year which started in September? Total sales are down 467 million bushels from the same period for the previous marketing year.

continued on page 2

In this issue:

Agricultural Outlook 2019 – Trade War Focused – Professor Russell Hillberry – Purdue University

Under normal circumstances, one might expect macroeconomic conditions to be the central focus of an annual agricultural trade outlook like this one. But in 2019, as in 2018, international trade policy will likely affect agricultural trade more than economic conditions alone. Figure 1 shows how trade policy can matter. After tracking closely for more than a decade, the prices of soybeans in the U.S. (yellow line) and Brazil (red line) diverged sharply this spring, as China responded to U.S. tariffs with their own 25% tariff on U.S. soybeans.

The price gap be-tween Brazilian and U.S. soybeans rose to as much as U.S. \$89/metric ton in October (\$2.42 per bushel lower U.S. prices). This meant that U.S. producers were bearing the full burden of the 25% Chinese tariff. The two price series have converged since then at a lower level, reflecting a variety of economic responses that one would expect in such a situation.

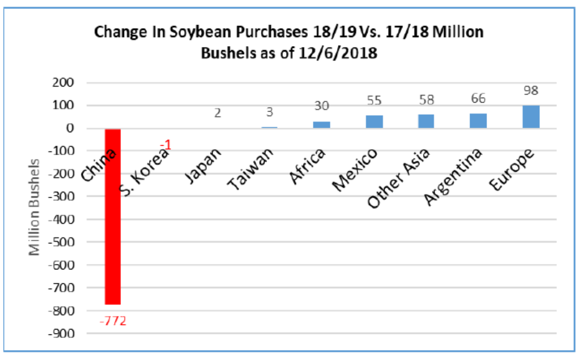
continued on page 3

continued from page 1

Soybeans & China – You can't have one without the other

What are the impacts of the Chinese soybean tariff on U.S. soybeans sales so far this marketing year which started in September? Total sales are down 467 million bushels from the same period for the previous marketing year. Soybean sales are currently down 1/3 this marketing year versus last.

Chinese purchases of U.S. beans this year (through December 6, 2018) are down 98% as they have made good (so far) on their threat to avoid buying U.S. origin. The reduction in Chinese purchases is 772 million fewer bushels, which has not been offset by 305 million bushels of greater purchases by the rest of the world. The chart shows the enormous decrease in Chinese purchases as well as several regions buying more beans including Europe, Argentina, Mexico and Africa.



Argentina sold many of their soybeans to China and then purchased cheaper U.S. origin beans for their own crushing plants. U.S. soybean prices at the Gulf of Mexico dropped to as much as $2.50 a bushel under Brazilian port prices at times this past fall. The rest of the world has purchased more U.S. beans largely because U.S. beans were lower priced this past fall than South American sources. Brazil as an example sold their beans to China and this gave an opportunity for the U.S. to sell more beans to Europe, but at low prices.

There is a lot of uncertainty on how many bushels of soybeans the U.S. will export from the 2018 crop. Of course how the trade conflict with China evolves is the primary source of that uncertainty.

The U.S. has already missed the prime shipping months for the Chinese market. China still needs some 2018 beans but it is unclear how many and when those will be shipped. This could mean it will be 2019 crop before tariff distortions can work their way through the global markets. If so, it is likely that large inventories of U.S. beans and low prices could extend to the 2019 crop.

There is a bullish possibility however. That would be a negotiated settlement with China in which they agree to buying larger amounts of U.S. Ag goods. China has already said they are willing to increase the amount of U.S. goods they purchase and Ag goods are one of the categories they have listed. In 2017 the U.S. sold them about $26 billion of Ag and food products. If a negotiated settlement increased that by $10 billion, that would represent about a 40% increase. New purchases of U.S. Ag goods in that magnitude would be bullish for a host of commodities, but soybeans and animal protein would likely be favored.

Soybean exports were moved downward to 1.9 billion bushel for the 2018 crop by USDA analyst. That is a decline of 11% from last year. *Keep in mind that no one knows how export numbers will evolve (China).* While USDA is using an 11% reduction actual sales so far are down 33% and thus pointing to a much lower export total, at least at this writing.

The contrast between the fundamentals for corn and soybeans could not be more stark. Corn inventories are coming down as usage is greater than production for the second year. On the other hand, soybean inventories are likely to be at burdensome levels.

On December 1, the U.S. and China agreed to have a cooling period of 90 days to freeze threats of additional tariffs, open some trading

Contributed by: CHRIS HURT, PROF. OF AG ECONOMICS – Purdue University

continued from page 1

Agricultural Outlook 2019 – Trade War Focused

opportunities, and to start to develop a framework to resolve the trade is-sues. On December 13, 2018 the first announcement of Chinese purchases of 2018 crop U.S. soybeans was made.

The marketing year average price (MYA) for the 2017 crop was $9.33 per bushel. With the potential for burdensome inventories, USDA lowered their 2018 crop estimate to $8.60. It is important to recog-nize that if inventories are this large, then prices cer-tainly could be lower.

Soybean prices rallied on the prospects of opening some soybean trade with China and on the possibilities of a longer term road map to settle trade disputes. March futures in the $9.20 to $9.40 range have been targets for beans that need to be sold in the short run. Most will want to hold some inventory for the possibility of a favorable negotiated settlement with China and/or for some harmful growing weather in South America in the next few months.

Like corn, soybean bids show premiums for delivery into the summer. These are 35 to 50 cents for summer delivery compared to current delivery and depends on location. Foregone interest costs to store until early summer might be 15 to 18 cents. So, those with on-farm storage can generate favorable returns from selling for early summer if premiums are 35 to 50 cents.

Unlike most years, early summer premiums may be high enough to cover foregone interest costs and commercial storage charges. This is unusual but encourages those with beans in commercial storage to examine their potential added revenues and added costs of selling for early summer delivery.

The trade policy environment in 2018 was extremely volatile. While 2019 should be somewhat calmer, it seems unlikely that all the damage done in 2018 will be undone. In circumstances like these, a review of the trade policy landscape is probably most informative for understanding the agricultural outlook for 2019.

The Unites States trade war can be described as having three fronts: 1) Canada and Mexico, 2) China, and 3) much of the rest of the world (notably the European Union). Aside from the back and forth with individual countries, another big issue for 2019 involves the President's actions to limit the effective-ness of the global system designed to defuse trade wars. We briefly review each front in the trade war, and then discuss the global dispute system and the U.S. President's actions there.

Trade war front 1: Canada and Mexico

At this time last year, there was considerable uncertainty about the ongoing renegotiation of the North American Free Trade Agreement (NAFTA). Together with his Canadian and Mexican counterparts, the President signed an updated version of the agreement on December 1, 2018. The agreement, now named the "U.S. Mexico and Canada Free Trade Agreement" (USMCA), is substantively very similar to the original NAFTA agreement. What remains to be determined in 2019 is whether or not the new agreement will be ratified by the U.S. Congress. Democratic control of the U.S. House of Representatives may pose a political hurdle to passage of the agreement (Rodriguez 2018).

The President has threatened to leave the NAFTA agreement if Congress refuses to ratify the USMCA. Last year we re-viewed the open legal question of whether the president has the authority to withdraw without the con-sent of Congress (Hillberry 2017).

continued from page 3

Unites States Trade Wars

Trade war front 2: China

Chinese exports were affected by a series of U.S. trade policy actions in 2018. U.S. “safeguard” tariffs on washing machines and solar panels were applied in January; Tariffs on aluminum and steel that were rationalized under the national security provisions of U.S. trade law were announced in March. These pro-visions affected Chinese exports, but also other countries that export the affected products. But an-other salvo in the trade war was aimed specifically at Chinese exports. $50 billion of tariffs on Chinese imports were announced in June and applied in July. China responded with retaliatory tariffs of 25% on 659 items, including soybeans. Another round of tit for tat followed in September and further escalation threats were issued. The U.S. announced subsidies for U.S. soybean growers to account for some of the losses related to the Chinese tariffs (Bown and Zhang 2018). Recent negotiations between the President and the Chinese premier seem to have halted further escalation for now, but there seems to be little progress on the removal of trade barriers that were put up this year. (Rugaber and Nicholson 2018)

Trade war, front 3: Rest of world

The U.S. aluminum and steel tariffs announced in March are the primary reason for ongoing disputes with countries other than China and our NAFTA partners. The European Union retaliated against the aluminum and steel tariffs by applying tariffs on a range of U.S. products. U.S. food and agricultural products facing higher tariffs were cranberries, orange juice and peanut butter (Bomey 2018)) Subsequent high profile negotiations stopped a further round of tit for tat, and generated an announcement that the European Union would buy more U.S. soybeans.

But the agreement offered no substantive progress back towards the initial situation. “Simply put, the EU offered what it was already going to do. And in exchange, the U.S. agreed not to do what it hasn't done yet” Livingstone and Oroschakoff (2012). Russia, India and Turkey also imposed retaliatory tariffs in response to the U.S. Steel and Aluminum tariffs.

WTO reform and/or the undermining of the dispute settlement mechanism

While the headlines have been dominated by the U.S. tariffs, the world’s reaction to them, and the economic consequences of both, a potentially much more important systemic issue has been brewing at the World Trade Organization (WTO).

One of the most important functions of the WTO is to referee trade disputes among its members, a process known as the dispute settlement mechanism (DSM). Until recently, the DSM had been quite successful in limiting the damage done by international disputes like those discussed earlier in the article. Motivated (they say) by a desire to re-form the system, President Trump and his team are threatening to break the DSM if it is not reformed in the ways that they wish. Another possibility is that Pres-ident Trump is seeking to break the DSM because the DSM is likely to find that the President’s tariffs violated U.S. obligations under its WTO commitments.

The actions the U.S. president has been taking along these lines is to block the appointment of new judges to oversee appeals to the initial decisions of the DSM (Miles 2018). When the number of appellate judges becomes too small, the WTO will no longer be able to sanction retaliation against a member country that violates its commitments to follow WTO rules. It will be difficult, in those circumstances, to use the world’s international trade rules to constrain U.S. actions, or those of any other country that wishes to violate its WTO commitments. This is a time of unprecedented danger for the DSM, which had been viewed as an important achievement of the international community, and with U.S. leadership of that community.