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US-China Phase-One Agreement

China Needs Range of Agricultural Imports, not Just G&O

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Summary

- In the US-China 'phase-one' trade and investment agreement, China has agreed to purchase an extra USD 32bn of US agricultural products over a two-year period. 2020 and 2021 imports will reach USD 36.5bn and USD 43.5bn, respectively.
- According to Rabobank's projections, G&O imports will only reach 50% to 60% of the purchase targets in 2020 and 2021. This means China will have to buy large quantities of non-G&O agricultural products, such as meat, seafood, dairy, and cotton to make up the difference. To facilitate the high procurement, most of the existing retaliatory tariffs are expected to be removed soon.
- The phase-one agreement is subject to an enforcement mechanism. There's still the risk of a trade war in the second half of 2020, if China's agreed purchasing pace is slower than required, especially in a US election year.
- This article focuses on the direct impacts of the phase-one agreement on agricultural trading between the US and China. Rabobank will also release publications addressing the implications on domestic participants and on the potential long-term structural changes to China's F&A industry.

US-China Phase-One Agreement Calls for Large Purchase of US Agricultural Products

The US and China signed the 'phase-one' trade and investment agreement on January 15. The agreement includes a sharp increase in sales of US goods and services to China, stricter intellectual property right protections, wider market access to China's financial market, etc. All of these provisions are subject to an enforcement mechanism.

In the agreement, China pledged to buy an additional USD 200bn of US goods across 2020 and 2021, above the level in 2017. For US agricultural products, the agreement states that China will buy an extra USD 32bn over the two-year period, on top of 2017's USD 24bn of trade value (see *Figure 1*). China also agreed to increase market access for US products such as dairy, poultry, beef, seafood, paddy rice, fruit, feed, and pet food.

Figure 1: Purchase targets for US agricultural exports to China

USD billion	Base 2017	2020	2021
US agricultural exports to China	24	36.5	43.5

Source: US-China Trade Agreement 2020

Purchase Target Requires More Than Just G&O Trading

To achieve the purchasing targets, China will have to increase imports of US agricultural products. Rabobank projects that China's potential procurement of key US agricultural products, such as grains, oilseeds, pork, beef, poultry and seafood, should contribute to the majority of the target purchases. Other agricultural products are also discussed, such as dairy and cotton. These projections serve to provide Rabobank's view on this rapidly evolving development and are based on the information at hand, which will change over the year. Rabobank will endeavour to update the scenarios as new information surfaces.

Grains and Oilseeds

In 2018 and 2019, China's grain & oilseed imports from the US were hampered by the lingering trade war. With the phase-one agreement now in place, China will have to boost import volumes to new levels in 2020 and 2021, higher than the base year 2017, to achieve the purchase targets stated. To facilitate this higher procurement, the retaliatory tariffs are expected to be removed soon.

Figure 1: Historical and projected import volume of major US G&O products to China

<i>million metric tons</i>	<i>2017</i>	<i>2020f</i>	<i>2021f</i>
Soybeans	32.9	38	48
Corn	0.8	5	7
Wheat	1.5	3	5
Sorghum	4.7	5	8
DDGS	0.4	5	8
Bioethanol	0.2	5	8

Source: China Customs, Rabobank 2020

Soybeans remain the focal point in US-China agricultural trading, due to the sheer size. As a result of the trade war and depressed demand due to African swine fever (ASF), China's imports of US soybeans declined significantly, falling in the range of 15m to 20m metric tons and losing large shares to Brazil. Over 2020 and 2021, the Chinese government is likely to design a mechanism to encourage crushers to purchase US beans over Brazilian ones. Possible policy measures might include, but will not be limited to, subsidies, using special import permits to restrict import origins, harsh inspections and quarantines on Brazilian beans, and, where necessary, direct state procurement. As a consequence, trade dispute risks with others partners might arise. The import volume of US beans will reach over 40m metric tons per annum.

As for corn and wheat, the Chinese government stated clearly that there would be no changes to the current import quota system. Therefore, upside potential is relatively limited. China is expected to buy more US corn at the expense of Ukrainian corn, and more US wheat at the expense of Canadian and Australian wheat. Paddy rice is another grain protected by import quotas. Due to limited US rice production, and Chinese taste preferences, China will only buy a small quantity of US long grain rice in the coming years.

Previous anti-dumping investigations and high tariffs amid the trade war, have led China to significantly lower the import volume of US sorghum and DDGS in recent years. The import

volume of sorghum and DDGS used to peak at 10m metric tons and 6m metric tons, respectively, mostly from the US, as these products are not protected by a quota system. In 2020 and 2021, depending on sufficient supplies and competitive prices, China would be able to ramp up the import volume of these feed materials rapidly. Barley is another grain without import quota protection, but trade volume will be limited as the US is not a sizeable barley exporter.

Bioethanol is an indispensable agricultural product, of which the trade volume could experience an explosive growth, helping China achieve the purchase targets. The Chinese government has an ambitious plan to promote the national use of E10 bioethanol. China's domestic production is currently around 2.5m metric tons, but with the promotion of the national use of E10, this may grow to over 13m metric tons. Direct imports of US bioethanol will help move the timeline for implementing the E10 mandate forward.

It is worth mentioning that although the purchase targets in terms of trade value are listed in the main body of the agreement, there may also be minimum trade volume requirements for each agri commodity in the side annex – this has not been released to the public. As commodity prices are volatile, it is challenging to project the FOB prices of US agricultural products. We have taken the 2017 FOB prices as a reference. China's import value of US G&O will reach USD 19bn in 2020, achieving 52% of the trade target, and USD 26bn in 2021, achieving roughly 60% of the target.

Other Agricultural Products

Animal Protein

In the animal protein sector, China has agreed to import more pork, beef, poultry, and seafood. China already imports a large amount of US pork, despite the high retaliatory tariffs. China's strong demand for pork imports will continue in 2020, as ASF outbreaks have led to significant supply shortage issues in China. We expect Chinese pork import requirements to increase by 30%-40% in 2020 from 2019 levels. This suggests there will be significant pressure on the global supply side. In 2019, China's pork meat imports reached 2.108m metric tons, rising by 75% YOY. Total imports, including variety products, might exceed 3.2m metric tons in 2019. US pork meat shipments in the first 11 months of 2019, made up 196,000 metric tons of that total, up 134% YOY, and offal made up 142,000 metric tons, down 18% YOY. We expect the growth of US pork shipments to be stronger than other exporting countries in 2020, particularly compared with European countries, given the price competitiveness of US pork. In 2020, China's pork meat and offal import volume from the US is expected to increase by at least 300,000 metric tons over 2019.

China lifted the ban on US beef in 2017. But due to the requirements on cattle age, traceability, HGP, and ractopamine, imports from the US to China have seen modest growth so far. Although the ractopamine issue is not solved and needs further assessment, the phase-one deal relaxes the requirements on age, traceability and HGP, suggesting a much larger amount of US beef readily available for the Chinese market. We expect robust growth in US beef shipments to China in 2020, which will also affect other exporting countries, particularly Australia, as they compete with the US for more or less the same market in China.

China and the US previously reached an agreement to import poultry in December 2019. The phase-one deal does not further affect poultry trade. We already expected US poultry shipments to grow significantly in the coming years, and Brazil will feel the pressure as the largest poultry supplier to China.

Dairy

The phase-one agreement should be positive for US dairy exporters, but could potentially have some negative impact on exporters from New Zealand and EU and be mildly negative to neutral for the Chinese dairy sector. However, the impact may be difficult to quantify.

In value terms, the US was the fourth-largest origin for Chinese dairy import, accounting for only 5% of key dairy categories (under the headings HS0401-0406, 1901), amounting to about USD 443m in 2017, before the trade war broke out. This is significantly behind the EU (47%) and New Zealand (39%). As a result of the trade war and ASF outbreaks, the US share of dairy import value fell in 2018, to less than 4%, and further in 2019 to less than 2% (on an annualized basis).

In volume terms, the US had a disproportionately higher share in Chinese dairy imports – at about 12% in 2017 (LME). Whey is the largest item imported by China from the US in 2017. Nearly 70% of all dairy imports from the US (LME) was whey, followed by SMP (18%), cheese (8%) and WMP (4%), whereas liquid milk, cream, and infant milk formula were minimal.

As such, there are two ways that China may potentially increase dairy imports from the US under its commitments in the deal: more volumes and/or more value-added categories. In the full text of the phase-one deal, US-originated liquid milk products and infant milk formula were particularly highlighted. Currently, the Chinese import of these categories is dominated by the EU and New Zealand, as is the cheese category. US-originated consumer dairy products will therefore be up against EU and New Zealand brands, as well as local Chinese brands, to gain the attention of Chinese consumers. For bulk dairy commodities, the EU and New Zealand may encounter some competition from US-originated SMP, whereas the EU, which benefited from the trade war between the US and China briefly on whey, will likely see rising competition from the US again. For New Zealand, there could be some competition from the US on WMP, but it will depend on whether US exporters are able to quickly respond to supply China's dairy sector with comparable product specifications and at a similar pricing to New Zealand.

Ultimately, China's dairy imports from the US are much smaller than those of grains and oilseeds and animal protein. A doubling of import value, from base year 2017, would contribute only less than USD 0.5bn to the committed increase in purchasing. And this is dependent on how quickly the Chinese industry (and consumers) accept the US product specifications relative to other main suppliers in the EU and Oceania.

Cotton

US-China cotton flows have been heavily suppressed following the implementation of trade tariffs between the US and China. Subject to 25% tariffs, US cotton sales to China fell almost 40% YOY in the 2018/19 season. In terms of market share, the US share of Chinese demand fell from 43% to just 16%, as China looked elsewhere, to Australia and Brazil for example, to import cotton. Tariffs have negatively impacted both nations – China has had to pay higher premiums for non-US origin cotton, dampening national consumption of the fibre. In contrast, the loss of a key customer has softened US export demand – assisting a forecast 50% rise in US ending stocks from 2017/18 to 2019/20. The impact has also been felt across the broader cotton market, with a lack of confidence in the Chinese textile market stemming cotton imports into other spinning hubs, namely Bangladesh and Indonesia.

Rabobank expects phase one of the US-China trade deal to quickly reignite cotton flows, and with large volumes involved. After half a decade of destocking, China will need to address a domestic supply deficit in coming seasons, likely through an increase in imports – Rabobank expects China to import 12m bales in 2020/21, a seven-year high. Without US-origin cotton, this volume of imports would be simply impossible. This demand will also favor the US in addressing its hefty 2019/20 inventory levels, forecast at 12-year highs. The bad news is for non-US cotton exporters who, for the past two seasons, have enjoyed preferential access to the Chinese market. Countries such as Australia and Brazil will now need to compete with US cotton once again.

Imprint

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