Current and Potential Losses to the U.S. Pork Industry from Retaliatory Tariffs
Focus on Mexico
June 13, 2018

Background

The recent implementation of duties and threats of imposing duties on U.S. imports of a wide range of goods have resulted in retaliation and threats of retaliation on U.S. exports, including red meat products, by several key U.S. beef and pork trading partners. To date, both Mexico and China have implemented new duties on U.S. pork, and an escalation of current trade skirmishes could result in further sanctions. The full trade impact of the new access constraints is difficult to assess given that the first round of new duties were rather recently unveiled (April 2 for China and June 5 for Mexico). Moreover, there continues to be uncertainty over the likelihood that new barriers will be erected.

Nevertheless, assumptions can be made about how these barriers – especially duties, which constitute an additional tax on exporters – affect the profitability of the livestock product supply chain. In general, new import duties can result in 1) decreased export volumes as U.S. products are priced out of the marketplace; 2) lower prices and margins for exported items as the trade adjusts to the new (higher) duties; 3) lower livestock prices in response to the decrease in meat prices; and 4) longer-term losses in market share due to trading partner's desire to diversify away from the U.S. These dynamics result in lower returns to livestock producers and the industry as total and unit (i.e., per ton) values of exports fall. Moreover, even when only a fraction of total production of a certain beef or pork item is exported, pricing for all output of that item is likely to move lower as a result of new export constraints. Following are estimates of the impact to date of Mexico's retaliatory tariffs on U.S. pork, in response to the U.S. implementation of Section 232 tariffs of 25% on steel and 10% on aluminum imports. We will provide further analysis on Mexico, China, the EU and Japan in an expanded paper.

Tariff Details

In response to the U.S. implementation of Section 232 tariffs, on June 5, 2018 Mexico implemented new duties on U.S. pork imports, effective immediately. Tariffs on chilled/frozen pork (HS Codes 0203.12.01, 0203.19.99, 0203.22.01 and 0203.29.99) were increased from 0% to 10% until July 5, 2018, after which they will increase to 20%. Mexico created a new HS code for pork-only sausages (1601.00.02) and applied a 15% duty; and a 20% duty was applied to some cooked ham and shoulder products (HS 1602.41 and 1602.42). By increasing the tariff on U.S. chilled/frozen pork to 20%, Mexico has effectively eliminated the NAFTA benefit, and the tariff on U.S. pork cuts is now at most favored nation (MFN) levels. The tariffs are not expected to be lifted until the U.S. rescinds the metal tariffs.

Quota Details

To minimize impacts to the marketplace, and ostensibly encourage imports from non-U.S. suppliers, Mexico has established a duty-free tariff rate quota (TRQ) for 350,000 metric tons of chilled/frozen pork open until December 31, 2018. The quota is reportedly aimed to specifically help Mexico's processing industry procure raw materials from new sources. Import licenses are distributed on a first-come-first-serve basis, with 97% allocated to historical importers. It is worth noting that Mexico's imports of chilled/frozen cuts of U.S. pork totaled 363,718 mt in the second half of last year - very close to the duty-free quota volume. WTO rules require new market access to be open to all eligible suppliers, so

Mexico does not explicitly exclude product from the U.S., but it is understood that all chilled/frozen pork cuts imported from the U.S. will be charged the 10% and then 20% duty. There has been great uncertainty about how the quota will function but USMEF has been in constant contact with the trade and now understands that companies have not been successful in applying for import licenses for importing U.S. pork. In other words, it is true that U.S. pork covered by the duties will indeed pay the respective tariff rates and will not be imported under the quota.

Market Impact

Looking at the HS0203 products (chilled/frozen pork cuts), the U.S. in recent years has accounted for 90% of Mexico's imports and Canada the other 10% on a volume basis. Mexico's imports of U.S. HS0203 pork in 2017 totaled 713,500 mt valued at $1.25 billion. These chilled/frozen pork cuts accounted for 80% of Mexico's imports from the U.S. *See table 2 below for Mexico's imports of U.S. pork covered by the duties.*

The U.S. accounts for at least 40% of Mexico's pork consumption and rising per capita consumption has resulted in growth in both domestic production and imports to meet the rising demand. Mexico is the largest volume market for U.S. pork and accounted for one third of total U.S. pork and variety meat exports by volume and 23% by value in 2017 (802,000 mt; $1.5 billion). Export value to Mexico averaged nearly $12.50 for every hog processed in the U.S. last year, an increase of $1 per head even with the 2.6% increase in U.S. hog slaughter. Through April 2018, Mexico is again the top market and exports are running ahead of last year's record pace by 7% (282,675 mt; $505.4 million).

The imposition of the new duties on U.S. pork exports and the implementation of the new pork TRQ will likely result in 1) lower volumes of U.S. pork exports; 2) lower U.S. prices (especially hams where Mexico purchases roughly 45% of total U.S. production and accounts for 86% of U.S. bone-in ham exports); 3) a lower U.S. share of Mexico's chilled/frozen pork import market (i.e. increased Mexican imports from Canada and the EU); 4) substitution of more imported turkey for pork in Mexico's processing industry; and 5) more features of poultry by Mexican retailers.

In the past Mexico's imports of U.S. pork have not slowed despite significant devaluations of the Mexican peso. Exchange rates are driven by numerous factors separate from agricultural trade flows, but a weaker peso makes Mexican imports from the U.S. more expensive. The Mexican peso has dropped 12% from its recent high in mid-April, amid NAFTA uncertainty, and devalued to 20 pesos to the USD following implementation of the steel/aluminum duties, the weakest since Feb 2017. Each percentage point depreciation of the Mexican currency essentially equals an additional 1% 'tax' on U.S. imports.

Canadian pork is likely to benefit in the short-term from the new Mexican retaliatory tariffs on U.S. pork. Canada though already exports the majority of its hams to Mexico, so its ability to ramp up sales – at least in the short-term – may be constrained. Increased trade with Mexico could mean lower Canadian exports to other destinations, but the list of markets for hams is short and mainly includes the U.S. (regional trade to U.S. processors) and China, where U.S. pork is already at a significant disadvantage, with the 25% additional duty. (Canada's exports of boneless hams to Australia have already declined from historic levels so the impact on that market is expected to be limited, even though Australia is a significant market for U.S. boneless hams). Another relevant point is that no one benefits from tariffs. Canada's hog prices are based on the U.S. market, thus the negative price pressure from the retaliatory tariffs imposed by China and Mexico have impacted Canadian producers as well.

Of more long-term concern is the establishment of a foothold for EU pork in Mexico. Currently about 60 EU slaughter plants are approved to export to Mexico, with more pending approval, and European exporters are optimistic about opportunities there, especially in light of the upgraded EU-Mexico Free Trade Agreement expected to be implemented as soon as 2020; and the current weak market in China. The U.S. maintains transportation and logistical cost advantages, and the just in time delivery system for large processors makes the U.S. the ideal supplier. While it will not be easy for Mexican processors to switch from combos of chilled U.S. pork to boxes of frozen European pork, if Mexican companies try EU product and like it, they will probably continue purchasing to help diversify away from the U.S., which under current conditions is being viewed as a less reliable supplier. It's not entirely clear whether EU exporters will be able to meet U.S. prices, and competitiveness will vary by cut, even with a duty of 20% on U.S. product. Moving new, large volumes of EU frozen pork to Mexico in the short-term will probably be challenging, but when Mexico opened the duty-free quota for poultry (due to HPAI), imports from Brazil gained momentum and grew from less than 300 mt in 2013 to more than 100,000 mt in 2017. Thus, Brazil was able to capture 10% of Mexico's poultry imports, at the expense of the U.S.

Increased Canadian and EU supplies in Mexico could result in a fall of U.S. market share from the 90% registered during Q1 2018 to 75% for the second half of this year. That would result in a decrease in U.S. exports of roughly 10,000 mt per month or more than 60,000 mt for the rest of 2018. **If unit values hold at Q1 levels, the drop in export value to Mexico would be more than $100 million over 6 months.** Given the growth in U.S. production and already large U.S. consumption, it is likely that product not going to Mexico will be absorbed in other export markets as well as in the domestic market, at lower prices. **Looking only at ham prices, the drop in the primal value could translate into losses to the industry of more than $300 million for the remainder of this year which would be roughly $600 million over the next year.** Picnics are the other primal most likely to be impacted. **The added negative price pressure for picnics and hams could result in industry losses of $425 million for July-Dec 2018 and $835 million over the next year.** Other cuts will also be impacted but hams and picnics are by far the biggest volume items. *(see Table 1 and explanation of ham and picnic price value calculation below)*

It is also important to note that our initial understanding is that the duty-free quota is specifically aimed at Mexico's processing industry. Retailers do not have opportunities to purchase pork at zero duty beyond Canada and Chile, where the potential for supply growth is limited. Prices for Mexican pork already see inflationary pressure and as other suppliers see an increase in demand (Canada and Chile), prices will increase, and retailers are likely to shift more shelf space to poultry as they might have a hard time offsetting the cost of the 20% duty on U.S. pork and inflationary pressure on domestic pork and pork from Canada and Chile. USMEF estimates that roughly 70% of U.S. pork exports to Mexico are bound for processing and 25% to retail with the remaining 5% to the HRI sector.

For processors, U.S. pork will likely remain the most price competitive option, and a decrease in U.S. market share might be limited in the near-term. Mexico's total pork imports could slow, resulting in lower U.S. prices. It is also important to note that we assume that Brazil does not gain access to Mexico.

If Mexico were to quickly lift the FMD-related restrictions and approve Brazilian pork plants, the loss in U.S. market share could be more significant, especially since Brazil's largest market, Russia, remains closed and thus Brazil's pork prices are very competitive as they seek alternative markets. Although Mexico's approval of Brazilian pork would likely have longer-term implications, at this time duty-free access through the quota only lasts to the end of 2018, after which all non-FTA suppliers will again pay the 20% duty. This should somewhat limit Brazil's future competitiveness.

TABLE 1:
USMEF Estimates of U.S. Pork Industry Trade and Value Losses from Imposition
Of Mexican Import Duties and TRQ Implementation

Factor	2018 July - December	Annual basis
Export loss: Monthly 10,000 mt decrease in exported tonnage of HS 0203 pork products to Mexico from baseline forecasts @ US $1,733/ton*	$107.6 million	$215 million
Value loss: reduction in U.S. pork output value resulting from a drop in export prices to Mexico and a fall in average ham & picnic primal values**	$425 million	$835 million

**Note that exports not going to Mexico will likely be shipped to other markets at lower prices; it is not appropriate to add the export losses and value losses above but the possible decrease in exports to Mexico will mean lower pork and hog prices as shown in the value loss estimate.*

***The decrease in the ham and picnic primal values are based on the actual 15% year-over-year decrease in April and May 2018 compared to the same period in 2017, due mainly to China's retaliatory tariff. The actual drop in value per head during this period averaged $4.75 for hams and $1.90 for picnics. We assume Mexico's retaliatory tariffs will cause ham and picnics to continue to trade at this discount to year-ago. If primal values lose another 5% on average, dropping to 20% below year-ago levels, the per head loss would be closer to $9.10, with industry losses of $585 million through the end of the year or $1.15 billion on an annual basis. Commercial hog slaughter is estimated at 126 million head for 2018, and roughly 64 million head for July-Dec.*

TABLE 2:
Products Covered by the Duties and 2017 Import Volume and Value

Mexico's 2017 Imports of U.S. Pork Covered by Retaliatory Duties			
HS	Description	Mil USD	Metric tons
020312	chilled bone-in hams/shoulders	$946.46	575,434
020329	frozen other cuts	$179.76	81,246
020319	chilled other cuts	$111	50,615
020322	frozen bone-in hams/shoulders	$6.75	3,083
1601	sausages (excl poultry)	$97	18,924
160241	prepared hams	$12.78	2,500
160242	other prepared hams	$0.52	180
Total subject to duties		**$1,354.27**	**731,982**
Total imports		**$1,647.35**	**907,691**
% of imports on retaliatory list		**82%**	**81%**

Source: GTA & USMEF

TABLE 3:
Products not Included in Mexico's Retaliation List and 2017 Import Volume and Value

Mexico's 2017 Imports of U.S. pork NOT Covered by the Retaliatory Duties			
HS code	Description	Mil USD	Metric tons
0206	variety meats	$ 173.39	148,443
0210	cured pork	$ 77.43	17,227
160249	other prep pork	$ 35.84	5,914
0201/0202	carcasses/half	$ 6.42	4,125
Total not subject to duties		$ 293.08	175,709
Total imports		$ 1,647.35	907,691
% of imports not on retaliatory list		**18%**	**19%**

Source: GTA & USMEF

TABLE 4:
Mexico’s Imports of HS0203 (Chilled and Frozen Pork Cuts) by Supplier

Mexico Import Statistics								
Commodity: 0203, Meat Of Swine (Pork), Fresh, Chilled Or Frozen								
Calendar Year: 2013 - 2017, Year To Date: 03/2017 & 03/2018								
Quantity (MT)								
Partner Country	**Calendar Year**					**Year To Date**		
	2013	**2014**	**2015**	**2016**	**2017**	**03/2017**	**03/2018**	**%Change**
World	574,536	600,528	722,672	754,693	803,476	201,116	204,763	1.81
United States	**514,395**	**531,023**	**612,521**	**646,462**	**713,503**	**181,603**	**184,569**	**1.63**
Canada	57,767	67,885	109,144	107,411	89,669	19,488	20,179	3.54
Spain	-	-	-	29	200	25	-	-100
Chile	2,127	1,335	568	723	104	-	15	n/a
Denmark	247	285	438	69	-	-	-	n/a
Australia	-	-	-	-	-	-	-	n/a
U.S. Share	**90%**	**88%**	**85%**	**86%**	**89%**	**90%**	**90%**	

Source: GTA

TABLE 5:
U.S. Exports of Bone-in Ham and Shoulder Cuts, Chilled and Frozen

United States (Consumption/Domestic) Export Statistics								
U.S. Exports of Bone-in Hams/Shoulders, chilled & frozen								
Annual Series: 2013 - 2017, Year To Date: 04/2017 & 04/2018								
Quantity (MT)								
Partner Country	**Calendar Year**					**Year To Date**		
	2013	**2014**	**2015**	**2016**	**2017**	**04/2017**	**04/2018**	**%Change**
World	415,250	462,979	482,354	521,528	546,243	185,979	193,447	4%
Mexico	**330,795**	**388,977**	**402,124**	**407,086**	**453,518**	**146,895**	**166,689**	**13%**
China	36,040	20,452	31,976	65,205	39,746	22,768	7,228	-68%
Japan	1,982	2,357	3,876	7,268	8,033	2,360	3,197	35%
Colombia	4,152	5,386	5,041	6,418	7,112	2,630	1,630	-38%
Dominican Republic	2,901	2,026	4,532	5,364	7,111	2,678	2,616	-2%
Hong Kong	6,278	8,215	6,160	8,717	6,013	1,406	1,450	3%
Honduras	3,554	3,640	3,286	1,360	5,219	2,017	975	-52%
Guatemala	2,599	2,985	2,966	3,283	3,345	960	1,235	29%
Korea, South	5,194	8,977	8,442	3,469	2,057	621	2,193	253%
Canada	1,763	2,114	1,044	1,304	1,972	292	1,992	582%
Chile	3,459	2,032	1,728	1,530	1,689	426	255	-40%
Philippines	800	603	890	310	1,167	320	866	171%
El Salvador	1,034	916	593	703	957	228	409	79%
Others	14,699	14,299	9,696	9,511	8,304	2,378	2,712	14%
Share to Mexico	**80%**	**84%**	**83%**	**78%**	**83%**	**79%**	**86%**	

Source: GTA

CHART 1:
Mexico's Imports of Total Pork and Pork Variety Meats from the U.S.

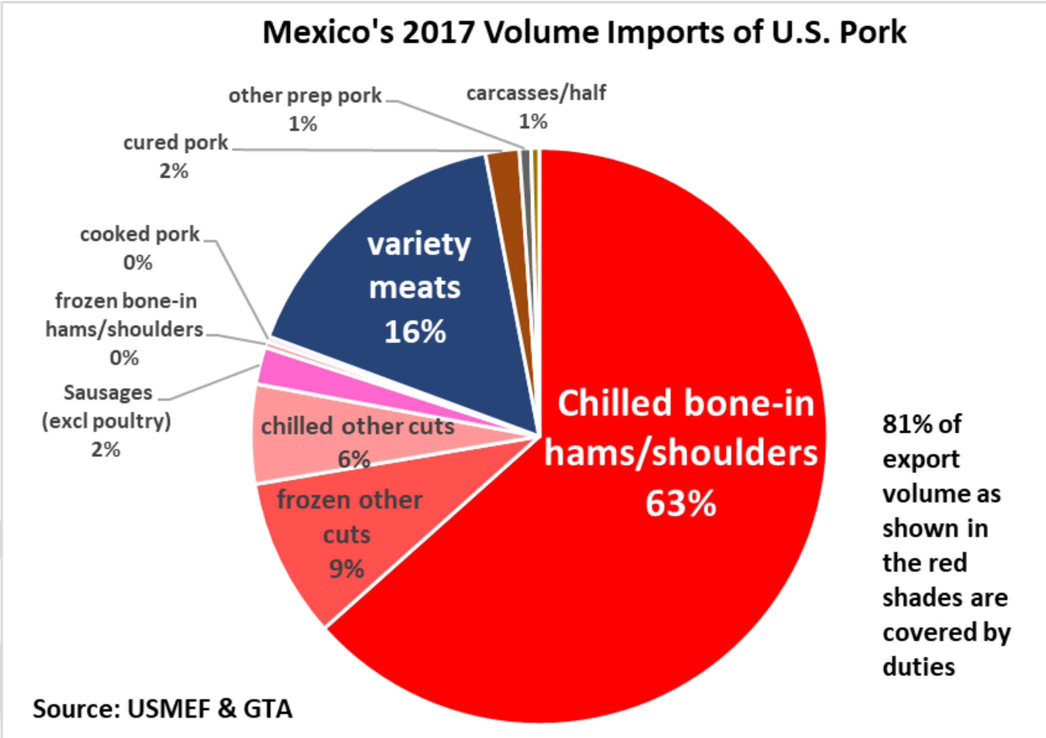

TABLE 6:
Country and Number of Pork Slaughter Plants
Currently Approved to Export Chilled/Frozen pork to Mexico

Pork Slaughter Plants Approved to Export Chilled/Frozen Pork to Mexico	
Within the TRQ, Duty is Reduced from 20% to Zero up to Dec. 31 2018:	
Denmark:	11
Spain:	28
France:	4
Germany:	4
Italy:	4
Belgium:	9
Australia:	28
Other Pork Slaughter Plants Approved	
Already at zero duty	
Canada:	20
Chile:	4

*Note that plants in the Netherlands could soon be approved
The EU-Mexico modernized FTA will eliminate Mexico's tariffs on most EU pork once implemented
New Zealand also has one plant approved, but only for offal