The General Economy

So maybe things weren’t as bad as you thought. Third quarter figures show that the economy grew at a real rate of 4.1 percent, something of a surprise to a lot of economists and investors. There was some dark news hidden among the bigger figures in that increases in inventory drove a substantial amount of that growth. If consumers don’t empty those shelves in the fourth quarter, that may signal a manufacturing sector slowdown in the months ahead.

But even with that cautionary note, overall real growth in the Gross Domestic Product (GDP) will come in at or above the 3.0 percent mark, the first time since 2005 we have seen a figure that high. Those manufacturing figures discussed earlier rose at a 0.6 percent rate in November and is projected to grow at 3-4 percent per year in 2014 and 2015. Housing starts have also jumped noticeably, exceeding the 1 million unit rate in November. You have to go back to February 2008 to find that high a number. New permits have also run above a million units for the last two months suggesting this is a trend that may be in place for a while.

Job starts have also been higher than we’ve seen the last several years and are now averaging in the 200,000 new starts a month. Unemployment numbers, still hovering around the 7 percent figure, are expected to dip toward the 6.5 percent level by the end of 2014.

Taking all these factors into account, the Fed has decided to begin the tapering process and cut back on their purchases of long-term and mortgage-backed securities. Expectations are that the Federal Reserve will back completely out of this behavior by the middle of the year. While stepping away from this action, the Reserve does have a number of other levers they can pull to continue to juice the economy even in the absence of Quantitative Easing. Since the start of this downturn, the Fed has been paying banks interest on excess reserves left at the Fed. Lowering the rate they pay or even stopping those payments could kick a lot of funds back into the market looking for returns. However, this will be a very delicate process as there are several hundred billions of dollars that could come into the money supply if not handled very carefully.
The most important piece of the overall GDP pie is consumer spending. November data suggests that the consumer is back with a vengeance. On an annual basis, November spending jumped by 6.7 percent. After adjusting for inflation, spending was still up a whopping 4.7 percent annualized. These numbers are well above the income growth for the month which suggests there has been some pent up demand out there that is finally busting through. The real question is whether or not that spending bump will make it through all of December.

So, three percent growth in 2014 growing to four percent by 2015? Could be. Housing market activity at recent levels will give a noticeable boost. If we can see some housing price improvement that will add to consumer’s overall wealth picture, maybe even lead to some shuffling of residences come spring, we may be talking about a self-fulfilling prophecy. However, if we see those spending numbers suggesting that November was a fluke and we roll into weak housing sales come March or so, then we will be back to the same kind of disappointing story this recovery has been since the beginning.

**Livestock Update: The Way We Were - 2013 in Review**

This will, obviously, be the last livestock market update of 2013. Given that this newsletter is coming out during Christmas week, I should probably offer a substantial bounty to anybody out there who actually reads it. Being the economical type, though, I will refrain. Reading this newsletter in the warm glow of your Christmas lights will just have to be its own reward.

The end of the year is an opportune time to look back at the defining events of the past twelve months. In the livestock and meat industry, we have seen a fair number of noteworthy stories in 2013. I will highlight a few in the following paragraphs. These are roughly in chronological order; though not all of these events correspond to a discrete date on the calendar. This will not be an exhaustive list of notable news – just a few of the things that I think held the most significance for the sector this year. Your list – were you to compile one – might look different from mine. In fact, if you feel strongly enough about it, send me your list. I would love to see it.

**Mandatory Price Reporting for Pork**

In January, mandatory price reporting went into effect for the pork industry. The original mandatory price reporting act was passed in 1999, and it went into effect in 2001. However, it only covered slaughter cattle, boxed beef, slaughter hogs, and slaughter and boxed lamb. Pork was not included. This changed with the Mandatory Price Reporting Act of 2010, which included an amendment adding wholesale pork cuts to the list of items covered by mandatory reporting. This reporting went into effect in January 2013. The rule governing MPR for pork was produced under a negotiated rule-making procedure that involved the active participation of numerous affected USDA agencies, industry stakeholders, and various other technical experts and advisors. This behind-the-scenes process was quite complex; its timely and successful completion represents a notable achievement for all involved.

Under the terms of MPR, we now have access to a broader, more frequently publicized set of wholesale pork market information than ever before. As in other sectors previously brought
under MPR, I have no doubt that this information will quickly (in fact, already has) come to be considered indispensable.

**Normalized Beef Trade with Japan**

On February 1, Japan began allowing imports of U.S. meat from cattle up to 30 months of age. This was a real milestone for the beef industry, which had been diligently working to regain full access to the Japanese market since the discovery the first U.S. case of BSE in 2003. Japan had for some time been accepting meat from cattle up to 20 months of age, but this age restriction made it impossible to secure adequate supplies to meet demand in that market.

The move to accepting product from cattle up to 30 months of age has had a major impact on U.S. beef exports to Japan. In April, for example, the volume of beef exported to Japan nearly doubled compared to 2012. For the year through October, beef exports to Japan were over 47 percent higher than the prior year. It is likely that Japan will easily surpass Canada this year to become the number one destination for U.S. beef – both in terms of quantity and value. Figure 1 shows monthly U.S. beef and veal exports to Japan (not including variety meats) as reported by USDA Foreign Agricultural Service.

![Figure 1. Beef & Veal Exports to Japan: 2012 and 2013](image)

**Figure 1.** Beef & Veal Exports to Japan: 2012 and 2013

Data Source: USDA Foreign Agricultural Service - Global Agricultural Trade System Online.

While we’re on the subject, this is a good time to point out that this week marks the 10th anniversary of the first U.S. case of BSE – known not-so-affectionately as the Cow that Stole Christmas. Restoring access to the Japanese market was always a top priority in the wake of the BSE event, and access for meat from cattle up to 30 months of age more-or-less accomplished that. But the adverse trade effects of the BSE event have still, after all these years, not been fully expunged. Most notably, there is still no official access for U.S. beef to China. Now, in 2003 this was not too big of a deal: China was, despite its enormous population, a small market for beef. Clearly, things have changed in the last decade – even just over the last two or three years. China represents a substantial market for beef now, and its potential is only just beginning to be tapped. There are a number of ways to illustrate this point, but here are just a couple of items to
consider. First, for 2013, Chinese beef imports are projected to be 10 times higher than they were in 2010 (USDA-FAS). Second, for 2013 China’s beef imports are projected to be 8 percent larger than South Korea’s beef imports. As recently as 2008, China’s beef imports were less than 5 percent the size of South Korea’s. This is, to say the least, a market with vast potential for the beef industry. To be denied access to that market on the basis of BSE-status when every developed country in the world – including Japan! – has restored our access is clearly utter nonsense. There are some signs that progress is being made, though. Last week, it was reported that both U.S. and Chinese negotiators were hoping to conclude an agreement by next summer that would allow U.S. beef back into China. If that happens, it may well lead my list of top stories next year.

**Beta-Agonist Issues**

In February, Russia announced their intention to halt imports of beef, pork, or turkey that had received any feed additives containing ractopamine – a common growth promoter in livestock feed. Around that same time, China announced that it would begin requiring third-party certification of U.S. pork as being ractopamine-free before it could enter that country. These restrictions appear to have had a significant effect on trade, particularly with Russia. Through October, pork exports to Russia are down by 93 percent compared to a year ago. In other words, pork exports to Russia have effectively ceased. Exports to China remain historically quite high, but are down 23 percent compared to 2012. Some of this lost volume has been made up with strong growth in some other markets, notably Taiwan and several Central and South American countries; overall, pork exports are expected to decline about 8 percent in 2013. Disruptions with China and Russia have played a significant role in this decline.

Ractopamine is in a class of compounds called beta-agonists. Zilpaterol is another beta-agonist compound that is commonly used as a feed additive in finishing cattle rations, and it too made news in 2013. In August, Tyson Foods announced that it would soon cease accepting cattle that had been fed zilpaterol, citing problems with non-ambulatory animals, a condition that the company believed was linked to zilpaterol consumption in the feedlot. Other packers eventually followed suit, and Merck – the company selling the zilpaterol feed additive under the trade name Zilmax – voluntarily pulled the product from the market pending the results of further study.

The impact of zilpaterol feeding on beef production had not been inconsequential. Research indicates that feeding zilpaterol to cattle for 30 days prior to slaughter added an average of 28 pounds to hot carcass weight. The move away from zilpaterol will thus likely show up in 2014 as a leveling off of carcass weights after several years of growth. Average carcass weights could post year-over-year declines for much of 2014. In fact, steer dressed weights have been below year-ago levels already for much of this year’s fourth quarter. Steer dressed weights are illustrated in figure 2. Note that weights for the most recent two years are well above the preceding 5-year average and that the year-over-year growth in weights appears to have stalled.
Weights may be held steady at something close to current levels by a shift to an alternative ractopamine-based product as well as by the fact that lower corn prices will support more aggressive feeding regimens. However, the gain in carcass weights witnessed over the last two or three years is probably at an end.

**Record Corn Crop**

The preceding point leads conveniently to the next big story of 2014: the record large U.S. corn harvest in 2013. According to the latest *World Agricultural Supply and Demand Estimates* (*WASDE*) report from USDA’s Office of the Chief Economist, the 2013 corn crop is estimated at 13.989 billion bushels: over 3 billion bushels larger than the drought-ravaged 2012 crop and well above the 13.1 billion bushel crop of 2009, which represents the previous high-water mark. With the large 2013 production, 20013/14 carryover is projected to increase to almost 1.8 billion bushels, a stocks-to-use ratio (S/U) of 13.7 percent. This will be, if realized, the first time in three years that the corn S/U has climbed above 10 percent. The corn market has reacted predictably to this significant change in corn market fundamentals. The marketing year average (MYA) price for corn in 2012/13 worked out to $6.90. Current projections for the 2013/14 corn MYA are about $4.40. A recent sharp increase in USDA’s estimate of world wheat production is also weighing on grain markets. Tight U.S. soybean stocks are providing the primary fundamental support for grain and oilseed prices, but if anticipated large South American production actually materializes over the first quarter of the New Year, that support will erode as well. In short, multiple years of high commodity prices may be coming to an end as surging global production catches up to recent demand growth.
**Chinese Company Acquires Smithfield Foods**

In late-May, Smithfield foods – the world’s largest pork processor and hog producer – announced that it was being acquired by Shuanghui International Holdings limited, a privately-held Chinese company holding a controlling interest in China’s largest meat processor. Given the size of the Smithfield company as well as its stable of internationally-recognized brands, this deal would have been big no matter who the second party was. The fact that it was a Chinese company makes the deal a blockbuster.

The Smithfield acquisition was reviewed and approved by the U.S. Committee on Foreign Investment (an inter-agency committee operating out of the U.S. Treasury Department) and the deal was consummated in late September. It is probably fair to say that there is a baseline level of squeamishness about foreign acquisition of domestic assets in general; however, the acquisition of such a significant U.S. food company by a Chinese firm has generated more than the usual angst. To be sure, Chinese firms do not have the most sterling reputation in the areas of food safety, environmental stewardship, worker protections, etc. The prospect of Chinese standards being applied to a sizable chunk of the U.S. meat processing industry, as well as to Smithfield’s 460 Murphy-Brown hog production units, stirred fear among many. There is, however, little basis for such fears. Smithfield and its subsidiaries will continue to operate under all applicable local, state, and federal standards.

What Smithfield undoubtedly expects to get out of this deal is improved access to the largest consumer market in the world. Conversely, Shuanghui hopes to get a secure supply of high-quality U.S. product with well-known brand names to market to Chinese consumers. Smithfield management has certainly emphasized the market access component of the deal while offering reassurances regarding its management standards. From CEO and President, C. Larry Pope, in a press release announcing the conclusion of the deal in September:

> “Our partnership ensures the stability of our business for all our stakeholders … while simultaneously unlocking exciting opportunities for growth in the large and growing Chinese pork market. This is a new era for Smithfield, but one that will continue to be defined by the strictest adherence to the highest standards of food safety and quality, an unwavering commitment to giving back to our communities and acting as a responsible global corporate citizen.”

We shall see.

**EPA Announces Proposed Rule for 2014 Renewable Fuel Standard**

At the end of November, the Environmental Protection Agency (EPA) announced their proposed rule for the 2014 Renewable Fuel Standard (RFS) program. It was no surprise that EPA lowered the advanced biofuel requirement under the RFS. A substantial increase in cellulosic ethanol production is anticipated in 2014, but even if production matches expectations, the available cellulosic volume will fall well short of prescribed levels under the RFS. This has been the case

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every year so far. EPA’s proposed 2014 volumes in each renewable fuels category along with EISA prescribed volumes are shown in Table 1.

**Table 1. Proposed 2014 Renewable Fuel Volumes vs. EISA Prescribed Volumes for 2014**

<table>
<thead>
<tr>
<th>Category</th>
<th>EISA</th>
<th>EPA Proposed</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Renewable</td>
<td>18.150</td>
<td>15.210</td>
<td>-2.940</td>
</tr>
<tr>
<td>Advanced</td>
<td>3.750</td>
<td>2.200</td>
<td>-1.550</td>
</tr>
<tr>
<td>Cellulosic</td>
<td>1.750</td>
<td>0.017</td>
<td>-1.733</td>
</tr>
<tr>
<td>Biodiesel</td>
<td>1.000</td>
<td>1.280</td>
<td>0.280</td>
</tr>
<tr>
<td>Other Advanced</td>
<td>1.000</td>
<td>0.903</td>
<td>-0.097</td>
</tr>
<tr>
<td>Conventional</td>
<td>14.400</td>
<td>13.010</td>
<td>-1.390</td>
</tr>
</tbody>
</table>

What was a surprise is that EPA lowered the total renewable fuel volume required under the RFS by more than the amount by which they lowered the cellulosic standard. In effect, EPA also lowered the standard for conventional ethanol for 2014 below the volume specified in the EISA.

EPA clearly has specific authority to adjust RFS volumes. The agency has cellulosic waiver authority allowing it to reduce required cellulosic volumes if that product is not available. This authority extends to allowing a reduction in the total renewable volume by an amount equal to the reduction in the cellulosic volume. EPA also has general waiver authority that allows it to reduce the total renewable volume if implementing the standard would cause severe economic or environmental harm or if supplies are not available. The debatable question raised by EPA’s proposed rules is whether or not it has appropriately used its waiver authority in this particular case. Interestingly, EPA is attempting to establish a very broad interpretation of its authority to waive the RFS in the case of inadequate supply. Here is the gist of their argument from the proposed rule:

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EPA has not previously interpreted or applied the waiver provision in CAA [Clean Air Act] section 211(o)(7)(A)(ii) related to “inadequate domestic supply.” As explained in greater detail below, we believe that this ambiguous provision is reasonably and best interpreted to encompass the full range of constraints that could result in an inadequate supply of renewable fuel to the ultimate consumers, including fuel infrastructure and other constraints. This would include, for instance, factors affecting the ability to produce or import qualifying renewable fuels as well as factors affecting the ability to distribute, blend, dispense, and consume those renewable fuels. (P. 71755)

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In other words, EPA interprets the “blend wall” (i.e., the difficulties associated with moving blends of higher than 10 percent ethanol into the market due to infrastructure limitations) as a supply issue. This is a pretty creative interpretation (though, to be fair, EPA does go to considerable length to argue that this interpretation has precedent in other similar statutes). No doubt, this interpretation will be vigorously challenged. The renewable fuels industry has more than enough capacity to produce in excess of the 14.4 billion gallons of conventional biofuel.

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prescribed for 2014 by the EISA, so there is clearly not, strictly speaking, a supply limitation. This story may have begun in 2013, but its resolution will have to remain a story for 2014 (or perhaps beyond).

**Miscellaneous Items**

It is impossible to give fair treatment to all of the noteworthy events that have affected livestock and meat industries in the past year. Indeed, it is not even possible to discern which events may ultimately end up having the most lasting significance. Here are a few items in parting that don’t appear to warrant extensive explanation, but should probably not go unnoticed either.

USDA released a revised *Country of Origin Labeling* rule in May. The new rule, an attempt to address concerns raised in an adverse WTO ruling on the issue, increases the amount of information on the origin and location of animals from birth through production and processing. The rule has been sharply criticized by our Canadian trading partners and will, without question, receive another WTO challenge.

Also in May, *Porcine Endemic Diarrhea Virus* (PEDV) was identified in the U.S. for the first time. PEDV is not a new disease, having been identified in numerous other countries across Europe and Asia since the early 1970s. The disease does not really have trade-restricting implications, but it is a concern for its potential impact on production. PEDV has the potential to cause severe production losses, with a particularly severe mortality rate in suckling pigs. So far, the production impacts of the disease have been fairly modest as farmers appear to be doing a good job of managing the disease. This is one that has the potential to be a bigger story in 2014. Let’s hope that it isn’t.

October started with a *government shutdown* as congress failed to pass a continuing resolution before the end of the fiscal year. Overall, the effects of the shutdown were relatively minor, though for agricultural markets, the loss of AMS and NASS reporting resulted in virtually an information blackout. This stimulated great interest in the offerings of private data providers, who were probably about the only beneficiaries of the shutdown.

In November, USDA Animal Plant Health Inspection Service released new import regulations related to BSE. The new *BSE rule* aligns U.S. import rules with those of the World Organization for Animal Health (identified by its French acronym, OIE). This closer alignment is expected to pay dividends in the form of making it easier for the U.S. to challenge BSE-related barriers to its beef by other countries (see the China item above, for example).

In December, after two years of intense bargaining, Congress finally passed a new five-year *Farm Bill*. Oh wait…scratch that. It’s still not finished. Well, there’s always next year.

Here’s wishing everyone a happy new year!