CHINA ECONOMIC UPDATE SEPTEMBER 2019

Pork shortfall to maintain higher inflation in the near term

National Australia Bank

NAB Group Economics

Compared with relatively soft rates at the start of the year, China's consumer price inflation has accelerated in recent months. The key contributor to this upturn has been the price of pork – a key component of the Chinese diet and a culturally significant product – due to a major disease outbreak. The People's Bank of China is not an explicitly inflation targeting organisation, meaning that the likely prolonged impact of pork shortages on inflation may not constrain monetary policy.

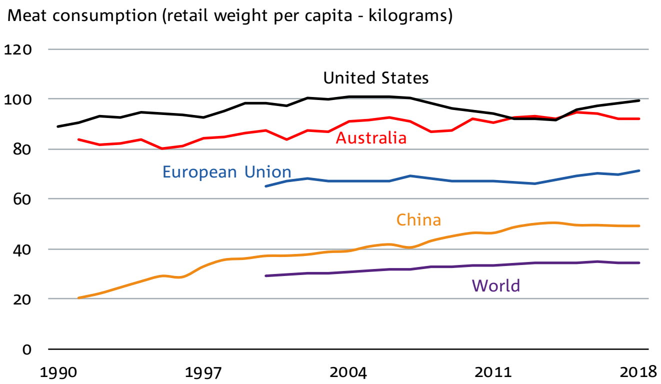
PORK'S IMPORTANT ROLE IN CHINA'S DIET

Multiple decades of rapid industrialisation and urbanisation in China have led to rising wealth and with it a substantial change in dietary patterns. In particular, there has been an expansion in meat consumption – with per capita meat consumption in 2018 around six times the level recorded in 1978 – as fewer residents have relied on the grain-intensive subsistence diets of the past.

According to data from the OECD and FAO, Chinese residents consumed almost 50 kilograms of meat per person in 2018. This was well above the global average (around 35 kilograms per capita), but still well behind advanced economy levels (particularly for the United States), suggesting that there remains longer term growth potential.

CHINA'S MEAT CONSUMPTION

Steady increase as diets change



Source: OECD-FAO, NAB Economics

Pork is China's most consumed animal protein – accounting for over 60% of the total in 2018 (compared with a global average of 35%). Beyond its importance in the national diet, pork has considerable cultural significance in China – with the meat traditionally seen as a sign of prosperity and wealth. This suggests that other animal protein sources (such as beef, lamb or chicken) are not perfect substitutes in times of shortages.

Chinese governments have maintained various agricultural reserves since the 1970s, establishing a national pork reserve in 2007 to build on existing provincial stockpiles. This reserve system can be tapped during supply shortfalls, but has also been used as an agricultural support mechanism – with additional purchases made during times of low prices to boost rural incomes. While China does not officially report the size of its pork reserves, estimates suggest that it is less than one million tonnes – equivalent to less than 2% of China's total consumption in 2018.

CHINA'S PORK INDUSTRY UNDER PRESSURE

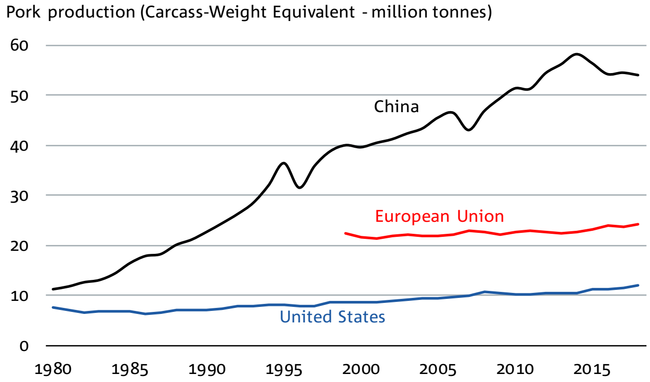
China is the world's largest pork producer – by a sizeable margin. In 2018, pork output totalled 54 million tonnes, more than twice the output of the second largest producer, the European Union. Pork production expanded rapidly in the 1980s and 1990s, but the rate of growth has slowed since this time – in part related to efforts to improve efficiency within the sector.

Date **September 2019** | Author **Gerard Burg** – Senior Economist – International

© National Australia Bank Limited ABN 12 004 044 937 AFSL and Australian Credit Licence 230686

GLOBAL PORK PRODUCTION

China the dominant producer



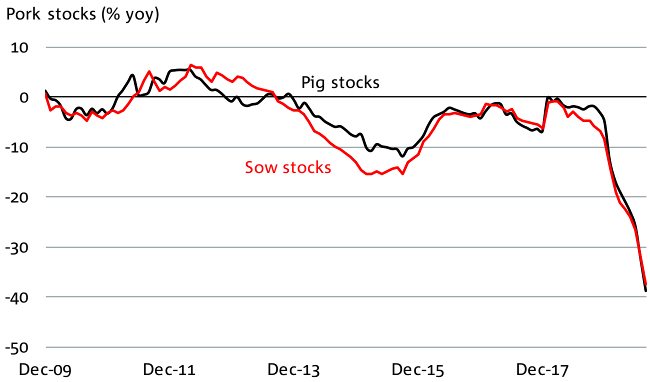
Source: USDA, NAB Economics

China's domestic demand is largely satisfied by its own supply – with net imports accounting for a little over 2% of China's total pork consumption in 2018. Imports have increased notably in the past few months, however this will have a limited impact on prices, given current domestic shortages. Given China's dominant position in terms of global production, there is little scope for international producers to fill the domestic supply gap during periods of prolonged disruption in Chinese output – such as the current environment.

China's African swine fever outbreak commenced in the second half of 2018 and quickly spread, with the Ministry of Agriculture and Rural Affairs (MOA) confirming cases in most provinces and regions of the country. The disease is highly contagious and fatal for pigs (sometimes within a week of infection), meaning that a major outbreak can result in rapid fall in pig supply. According to MOA data, pig stocks fell by 38.7% yoy in August 2019, with sow stocks – critical to breeding and therefore the resupply of pig stocks – also down by 37.4% yoy. Some private sector estimates suggest the declines could be larger than official reports.

CHINA'S PIG STOCKS

Sharp fall in sows suggests slow recovery



Source: CEIC, NAB Economics

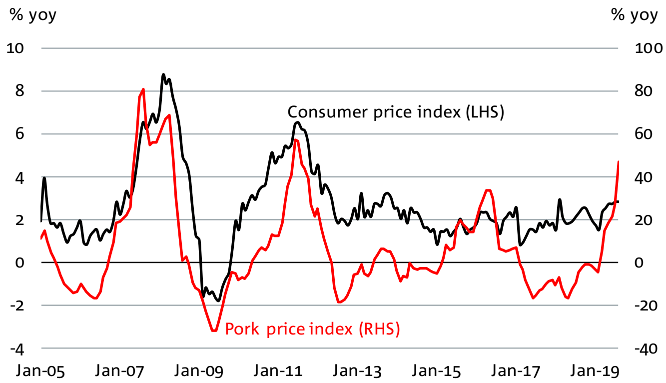
There are fears that the disease could wipe out half of the country's pigs by the end of the year. This suggests that a rapid recovery in China's pork supply is unlikely, with this liable to add inflationary pressure through 2020 (at least). Rabobank have suggested it could take five years or more for China's pig stocks to recover due to the inability to control the outbreak, the scale of the downturn and a lack of capital for restocking.

PORK ADDING PRICE PRESSURE BUT MAY NOT CONSTRAIN MONETARY POLICY

China's consumer prices rose by just 1.5% yoy in February 2019, the equal slowest rate of growth since July 2017. Since this time, the headline consumer price index has accelerated – up to 2.8% yoy in August 2019. Despite being a relatively small share of the basket – somewhere in the order of 2.5% of the total – soaring pork prices have been a major contributor to this trend. Pork prices fell by 4.8% yoy in February 2019, but rose by almost 47% yoy in August.

CONSUMER PRICE INDEX

Pork driving CPI higher



Source: CEIC, NAB Economics

Rising pork prices are causing some discontent, providing additional incentives for government responses. Some local governments have introduced quota-restricted discount coupons, others have started to auction pork reserves while there have been proposals for subsidies and low-interest loans to help farmers recover the pig stock. Beijing may also reverse earlier policies that forced the shutdown of smaller scale pig farms. It is unlikely that any of these measures will do much to limit price pressures in the short term – given the large scale fall in pig stocks.

The People's Bank of China is not an inflation targeting central bank, however the government sets a target for the annual rate at the National People's Congress each March (3% in 2019). This "target" is a rate to keep below, rather than hit, and some have argued that this could restrict the organisation from easing monetary policy. Given that monetary policy is unlikely to impact the fundamentals of the pork market in the short term, we argue that the PBoC should place greater weight on economic pressures other than pork prices, particularly given the weaker trends in non-food price inflation, the softness in the industrial sector and the impact of the US-China trade tensions.

CONTACT THE AUTHOR

Gerard Burg
Senior Economist – International
Gerard.Burg@nab.com.au
+613 8634 2788
+61 477 723 768

Group Economics

Alan Oster
Group Chief Economist
+(61 3) 8634 2927

Jacqui Brand
Personal Assistant
+(61 3) 8634 2181

Dean Pearson
Head of Economics
+(61 3) 8634 2331

John Sharma
Economist
+(61 3) 8634 4514

Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Senior Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tony Kelly
Senior Economist
+(61 3) 9208 5049

Gerard Burg
Senior Economist – International
+(61 3) 8634 2788

Global Markets Research

Ivan Colhoun
Global Head of Research
+(61 2) 9237 1836

Important Notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances.
NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it.

Please click here to view our disclaimer and terms of use.