Impact of US-China Bilateral Trade Tension on Malaysian Palm Oil

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INTRODUCTION

China is one of the top three destinations besides Canada and Mexico for exports of agricultural and related products from the United States of America (US). In 2017, China imported USD 12.3 billion worth of soyabean from US. Purchases of US soyabean by China typically peak in October and November. Over the last five years, China takes in roughly 77% of her annual US soyabean purchases on average by 30 November.

The soyabean imports by China had not been facing hurdles until the Trump Administration announced in early April 2018 that it might impose tariffs on imported electronics, aerospace-related items and machinery from China. Since then, China has been shunning the US soyabean market and withdrawing all her US soyabean import contracts.

The bilateral trade tension between US and China actually started back in January 2018 when US imposed global safeguard measures with new tariffs on imported solar panels and washing machines originating from China and other countries. The key reasons for the tariff imposition are trade imbalance and the large US trade deficit with China which amounted to USD 50 billion a year.

The tension escalated further when US imposed additional tariffs on aluminium and steel imports on the grounds of national security. On 9 March 2018, US imposed a 10% import tariff on aluminium and 25% on steel products entering US, with exemption for similar products originating from Canada, Mexico, Argentina, South Korea and the European Union (EU) countries. Since then, both China and US have been exchanging threats and retaliatory import tariffs on various products originating from each country.

According to Bunge, on 2 May 2018, US suspended her exports of soyabean to China due to market uncertainties after both countries announced import tax increases on other goods (Reuters, 2018). The importers do not want to take any risk of the possibility of being taxed at a higher rate when the US soyabean consignments arrive a few months later in China.

Effective from 6 July 2018, US levies a 25% import tariff on USD 50 billion worth of Chinese exports. In response, China announced a 25% import tariff on USD 34 billion worth of US goods that also include soyabean, effective from the same date. Previously, the import tariff on soyabean was only 3%.

As at September 2018, tariffs on USD 250 billion worth of imported goods from China have been in force, or have been announced by the US government, while the Chinese government announced retaliatory tariffs on USD 50 billion worth of US goods. The retaliatory tariff by China has threatened particularly the US soyabean farmers, as the largest agricultural export to China is soyabean which accounts for USD 14 billion in export value.

China also took the following retaliatory actions in response to the US government's move:

- Implementing anti-dumping measures for imported goods from US. A 10% deposit based on the value of the goods will be collected from Chinese importers by the General Administration of Customs (GACC), People's Republic of China, before the shipment arrives in China. An investigation will subsequently be carried out by the Chinese authority, and the 10% deposit will be returned to the importers after the goods are cleared of being a dumping case.
- Stricter inspection of goods coming from US. GACC inspects all goods imported from US. The sampling rate for US goods has increased from 7% to 100%. This has caused delays in customs clearance for all shipments coming from US.

In the latest move, the US President raised tariffs on USD 200 billion worth of Chinese goods to

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25% from the current 10% rate. US is trying to use duties, among other tools, to push China into abandoning alleged unfair practices and to reach a potential new trade deal. The President aims to force China to the negotiating table with efforts to avoid the situation escalating into a potentially devastating trade tension.

No particular Chinese action has led to the President's recommendation. Reports leading up the announcement suggested US may take the action partly because the value of China's currency has fallen, thereby making its exports more competitive.

The 25% duty was applied to the proposed list of products previously announced on 10 July 2018.

COMMODITY TRADE

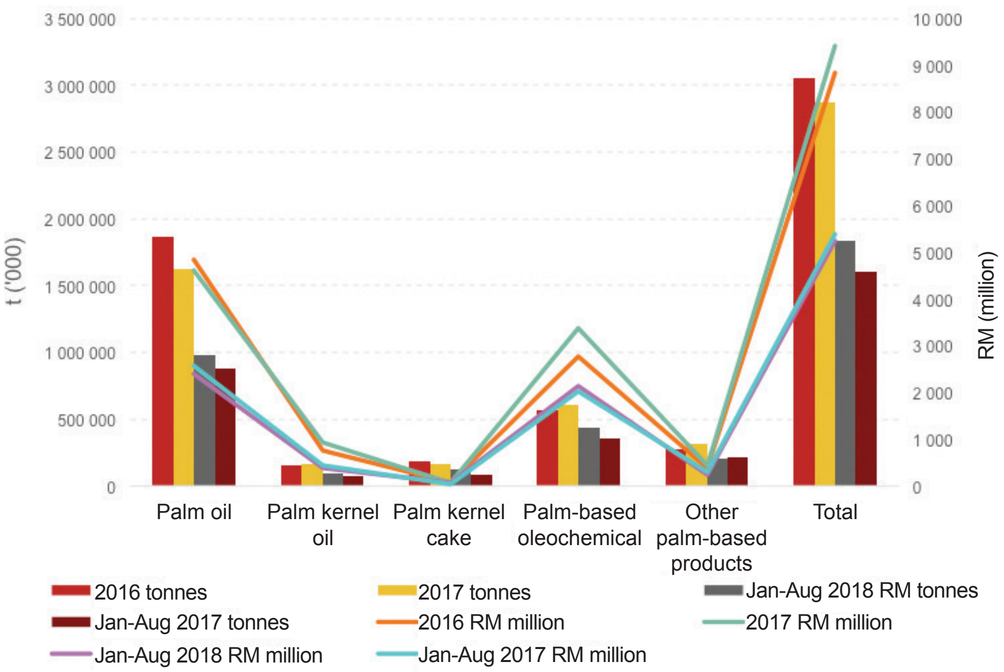
China is the third largest export market for Malaysian palm oil in 2017, coming after India (1.94 million tonnes) and the European Union (1.75 million tonnes) and it accounted for 11% of total Malaysian palm oil exports. In 2017, the total value of palm oil exported to China was RM 4.61 billion, showing a decrease of 4.8% from RM 4.84 billion in 2016.

In terms of volume, a total of 1.62 million tonnes of Malaysian palm oil were exported to China in 2017, which was a decrease by 13.4% from 1.87 million tonnes in 2016. This was attributed to the increase of soyabean imports by China, which rose by 14.8% to 95.54 million tonnes in 2017 as compared to 83.23 million tonnes in 2016.

For the period from January to August 2018, Malaysian palm oil exports to China recorded at 0.98 million tonnes, an increase by 11.6% from 0.88 million tonnes over the same period in 2017. However, the export value had decreased by 6.1% from RM 2.56 billion registered from January to August 2017 to RM 2.41 billion in the same period in 2018 (*Figure 1*).

As a result of high consumption and abundant supply, the oils and fats market in China is largely dominated by soyabean and soyabean oil. China imports soyabean mainly for the protein-rich soyameal as feed for her livestock industry. US is the major exporter of soyabean to China. In 2017, China imported 32.9 million tonnes of soyabean from US, accounting for 35% of the total soyabean imports by China.

Beginning 2013, many Chinese companies also import soyabean as a financial instrument to obtain cash from the bank through letters of credit. This is done by leveraging the advantage of the lower import tax on soyabean which is at 3%. Companies use bank credits or loans to purchase commodities from overseas. Upon arrival in China, the imported goods will be sold at a price cheaper than the imported price for cash. These companies then use the cash to purchase properties and real estate, or lend it out as loans at a higher interest rate to the small-medium enterprises. This has caused the abnormal price disparity in China where the domestic retail price of commodities is cheaper than their imported price.



Source: Department of Statistics Malaysia (DOSM), (2018).

Figure 1. Major palm oil and palm-based products exported to China.

The import of soyabean by China was only 57.3 million tonnes in 2012. However, the import increased to 94.2 million tonnes in 2017, showing a growth of 39.2% in five years. The extraordinary growth of the soyabean import was not merely contributed by the demand for protein but also caused by the aforementioned financial activity. As a result of an oversupply of soyabean and soyabean oil which exceeds their demand, the domestic price of soyabean oil in China has always been lower than the prices of soyabean and soyabean oil in the global market. This has also influenced the prices of other oils and fats in China.

IMPACT OF US-CHINA BILATERAL TRADE TENSIONS

The US-China trade tension generally affects global palm oil price and import of palm oil by China.

Effects on Palm Oil Import by China

China has shifted her imports of soyabean from US to South America, mainly Brazil. After the imposition of the 25% tax by the Chinese government on selected US goods, the cost of insurance and freight (CIF) price of Brazilian soyabean amounts to RMB 370 t^{-1}, which is cheaper than the CIF price of US soyabean (RMB 3730 t^{-1}). The US soyabean export to China has declined by 20.9% to 7.63 million tonnes during the period covering January-June 2018 from 9.64 million tonnes over the same period in 2017. In contrast, intake of Brazilian soyabean has increased by 5.4% to 35.94 million tonnes over January-June 2018 from 34.11 million tonnes during the same period in 2017. This has caused US to lose her biggest market for soyabean.

In addition, the supply of soyabean from Brazil and Argentina has been limited in the second half of the year, when it was currently close to the end of the harvesting period in October 2018; and there has been a lower production of soyabean in 2017/2018 (the lowest since 2009). In 2017/2018, the production of soyabean in Argentina was only 36 million tonnes.

The limited supply of soyabean from South America, especially during the second half of 2018, has caused tension in the soyabean supply in China. Import of soyabean by China in the fourth quarter of 2018 (estimation based on soyabean contracts) will be reduced by 32.75% (16.2 million tonnes) as compared with the import of soyabean in 2017 at 24.1 million tonnes.

The lower soyabean imports from US has reduced the oversupply of soyabean oil in China and caused an increase in the price gap to RMB 900 t^{-1} between soyabean oil and palm oil in China. Palm oil becomes more competitive when the price gap increases. As at 28 July 2018, the average price of palm oil in China was RMB 4800 t^{-1} while that of soyabean oil was RMB 5700 t^{-1}. This has made palm oil more competitive than the locally produced soyabean oil. Exports of Malaysian palm oil and palm-based products to China registered an increase by 17.5% to 1.12 million tonnes in the period from January-May 2018 as compared with 0.96 million tonnes for the corresponding period in 2017.

CPO Price in Global Market

The shift of China's imports of soyabean from US to South America has caused the significant drop in US soyabean price. This is because US has to find other markets for her soyabean which has just lost its major market, namely, China. This includes exporting soyabean at a cheaper price to countries like Brazil and Argentina that have depleted supplies of soyabean due to increased exports to China.

A drop in the US soyabean price has also caused a price reduction of its by-product, soyabean oil. The lower soyabean oil price affects the overall prices of other vegetable oils in the global market, including the decrease in crude palm oil (CPO) price.

Less Imports of Soyabean as a Financial Instrument

Soyabean imports by China will return to normal when the imports are based on real demand instead of being used a financial instrument arising from the increased import tax for soyabean from US. This will reduce the oversupply of soyabean in China.

Rapeseed or Canola Meal

Apart from buying soyabean from South America, China may shift to sourcing rapeseed and canola meals from Canada and Europe. However, their supplies are limited compared with the soyabean supply.

China is Sourcing Soyabeans from Other Places

A joint venture between Jiu San Group, one of the largest state-owned enterprises (SOE) which produces soyabean, and three Chinese plantation companies, namely Joyvio Group (agri-business subsidiary of Lenovo), Beidahuang Group and Zhihenglihai Group involves the leasing of 100 000 ha of land in the Russian Far East for planting soyabean. The joint venture company, JBA Group, plans to invest USD 1 billion in capital to build a soyabean oil refining plant in Russia that can process soyabean oil and soyameal at a capacity of 2000 t of soyabean a day, targetting the Chinese market. This can be seen as one of the measures undertaken by the Chinese government to reduce its dependency on American soyabean after the US-China bilateral trade tensions took place.

STRATEGY AND OPPORTUNITIES

Malaysia should take this opportunity to extend her commitment to China in reliably supplying palm oil and its products in the following sectors:

Animal Feed

China will encounter a shortage of soyabean supplies from the coming October 2018 onwards after the end of soyabean harvesting in the Southern Hemisphere. China may still import some US soyabean but the price will be higher due to the increased tariffs. In this respect, palm powder fats, palm calcium soaps and palm kernel cake will play a greater role in partially replacing soyabean meal to provide energy in the form of animal feed for China's livestock industry. Although palm oil cannot replace soyabean meal 100%, the fat in palm-based animal feed is still an essential source of energy for livestock growth. During the period from January-August 2018, 127 194 t of Malaysian palm kernel cake were exported to China, an increase by 60.5% from 79 263 t recorded during the same period in 2017.

In 2016, China raised 456.7 million pigs, 84.5 million cattle, 149.1 million goats and 6.2 billion poultry which provided supplies of meat and dairy to the consumers (FAOSTAT, 2018). The animal feed demand in China was 221.6 million tonnes in 2017 which included 98.1 million tonnes of swine feed, 89.5 million tonnes of poultry feed, 20.8 million tonnes of aquaculture feed and 9.23 million tonnes of ruminant feed (China Statistics Yearbook, 2017).

Replacing Soyabean Oil in Blended Cooking Oils

Palm oil used to be a major component in blended cooking oils in southern China. However, the share of palm oil in blended cooking oil was overtaken by soyabean oil after 2016 when the price of palm oil became less competitive as compared with the locally produced soyabean oil.

Following the latest development in which the price of palm oil has become more competitive compared with soyabean oil, the local oils and fats players are likely to shift to using more palm oil instead of soyabean oil, including in the production of blended cooking oils.

Biodiesel

The generally lower price of vegetable oils in the world market has stimulated the import and use of biodiesel, including the import of Malaysian palm biodiesel, by China. This is because the price of palm biodiesel has become more competitive compared with petroleum-based diesel. Based on MPOB data, for the period from January-August 2018, Malaysia's export of palm-based biodiesel increased by more than 10-fold to 50 750 t compared with only 3202 t of export recorded in the corresponding period in 2017.

THE WAY FORWARD

Although the CPO price has declined in general, the US-China bilateral trade tension has encouraged additional exports of refined and processed palm oil from Malaysia to China which is more favourable to the Malaysian oil palm industry. The Malaysian oil palm industry should take advantage of the US-China bilateral trade tension to fill the supply vacuum created by the short supply of soyabean in China.

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