July 2009

MAP - Brief

Monitoring Agri-trade Policy

European Commission

Directorate-General for Agriculture and Rural Development

The Medium-Term World Agricultural Outlook 2009: Calmer after the storm?

Prices still projected to remain historically high in the medium term

This year once again, the Directorate General for Agriculture and Rural Development has published a comparative analysis of projections for agricultural commodity markets. What a difference a year makes! Last year the focus of the Outlook reports was high prices. A year later the main theme of DG AGRI's report is the depth of economic recession and uncertainty about the speed of recovery.

Each of the Outlooks[1] uses different commodity and geographic aggregates and relies on different macro-economic assumptions and data. Nevertheless there are common themes.

Both FAPRI and OECD-FAO note that the strong supply response to the last two years of high prices together with the economic downturn have brought commodity prices down well below their 2007/08 peaks. The continued crisis is likely to put a damper on commodity prices for the near future.

However the medium term projections are still upbeat, with prices expected to remain well above pre-2007 peaks. On average OECD-FAO projects that nominal prices for all sectors will be 15-60% above the levels of the decade before the 2007-08 peaks. FAPRI also expects prices to remain strong over the projection period, though they are less bullish than OECD-FAO about dairy prices.

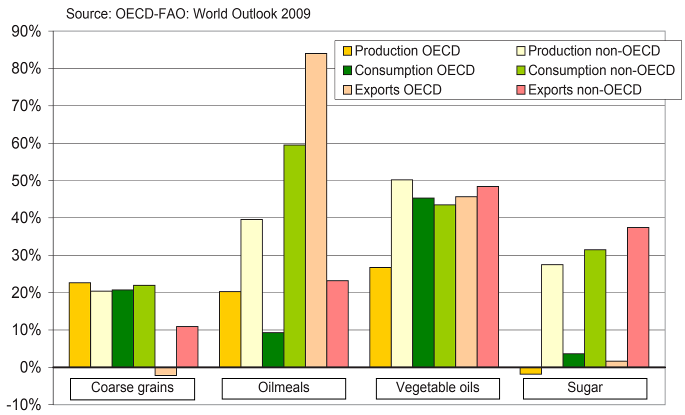
1 The comparison report draws mainly on projections by FAPRI (March 2009) and OECD-FAO (June 2009)

Agriculture is expected to cope better than other sectors with the economic crisis due to the relatively low income elasticity for food, at least in developed countries. However, the question of food security in developing countries remains a concern.

Growth is in developing countries rather than OECD

Although not immune to the current economic malaise, developing countries are projected to remain the main source of growth in world demand and trade once economic growth resumes (see graphs 1 and 2)[2].

Graph 1: Crop projections, % growth from 2006-2008 to 2018



2 The graphs are based on OCED-FAO as this Outlook produces an aggregate for OECD and non-OECD countries which we loosely assume to be synonymous with "developed" and "developing" countries.

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FAPRI expects the biggest increase in grain and oilseeds demand to be in Asia, Africa and the Middle East, driven by population growth, the expansion of livestock production and increased demand for biofuel feedstocks. Increasing incomes are also accompanied by diversification of diet and higher consumption of animal based proteins both as dairy and meat, in Asia, Africa and the Middle East.

OECD-FAO agrees and is projecting oilmeal use in developing countries in 2018 to be up almost 60%, butter and poultry about 50%, vegetable oil and whole milk powder about 40% and sugar some 33% above average consumption in 2006-08.

This compares with lacklustre growth in consumption in OECD countries for most of these products, except for vegetable oils where growth still exceeds that of developing countries.

Except for wheat and coarse grains, production is also increasingly shifting away from developed countries to emerging and middle income developing countries. Both organisations project 25% growth in oilseeds production over the coming decade. FAPRI predicts that over 40% of this growth will come from expansion of soybean area in South America.

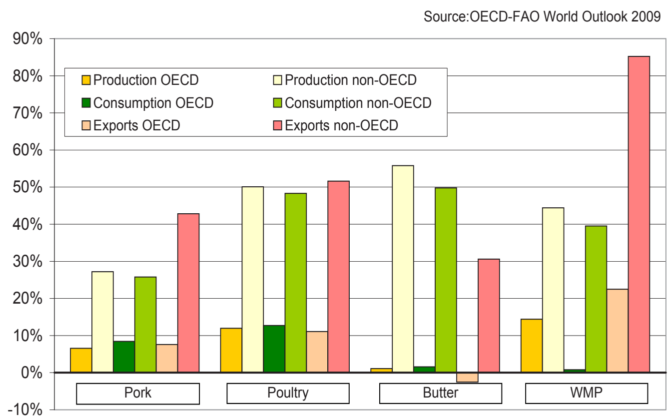
OECD-FAO projects production increases of around 50% for vegetable oils and over 40% for oilmeals in developing countries. FAPRI expects growth in world sugar production to come from the major cane producing countries, while OECD-FAO projects a contraction of 2% in sugar production in OECD countries.

Trade also reflects the growing shift in production to developing countries. According to OECD-FAO, these countries account for 90% of vegetable oil and sugar exports. Only exports of oilmeals are expected to grow faster in OECD countries (albeit from a lower base). Coarse grains even contract in OECD countries (which have 69% of exports) by around 2%.

The Outlooks also agree to a large extent on the prospects for the dairy and meat sectors. Developing countries are expected to show the fastest export growth for these products according to OECD-FAO. Growth in dairy production and exports is projected 4-5 times higher than in OECD countries.

FAPRI projects that almost half of the growth in milk production will take place in Asia, mainly in China and India (which also accounts for 90% of growth in butter) and roughly one third in the Americas, primarily in the US and Brazil. FAPRI points to Brazil, Argentina and Ukraine as increasingly important players in international dairy markets.

Graph 2: Meat and dairy projections, % growth from 2006-2008 to 2018



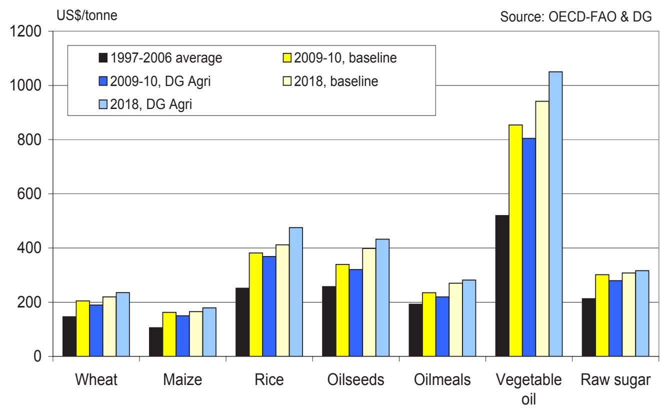
For meats non-OECD production is expected to grow twice as fast as in the OECD countries, especially poultry with a 50% increase projected, mainly in China, Brazil and India.

Both Outlooks agree that traditional exporters such as Australia, Canada, EU, US, Brazil and Argentina will remain key players in international meat markets in the coming decade. Indeed Brazil is forecast to account for 64% of the increase in total world meat exports between 2009 and 2018.

Sensitivity analysis

Given the uncertainty surrounding the extent and speed of economic recovery, the baseline results described above should be interpreted with caution.

Graph 3: Crop prices projected under Baseline and DG Agri simulation

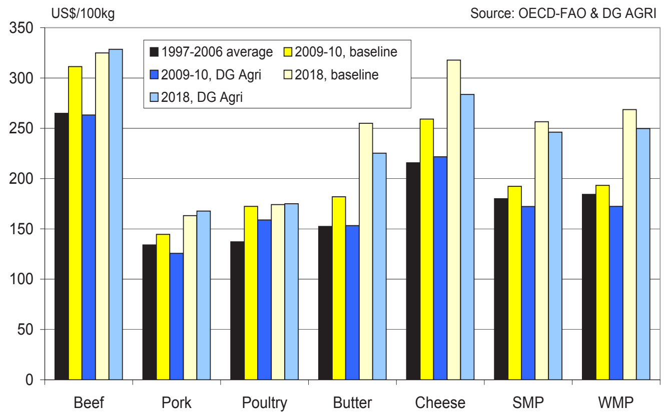


Because the macro-economic assumptions used in the OECD-FAO and FAPRI baselines have been overtaken by the rapid evolution of the current economic and financial crisis, DG AGRI has conducted its own sensitivity analysis using the same model as OECD-FAO but taking into account the macroeconomic projections of June 2009 (with lower GDP growth and a higher oil price).

The results, outlined in DG AGRI's report, compared to the OECD-FAO baseline[3] are shown in graphs 3 and 4. In the short-term (until 2011) the effect of the crisis is bearish on all products compared to the baseline due to lower GDP growth. Nevertheless, in most cases prices still remain above the historical average for 1997-2006.

In the medium-term all prices are expected to rise in line with the anticipated economic recovery, supported by higher oil prices.

Graph 4: Meat & dairy prices projected under Baseline and DG Agri simulation



Because crop prices have a significantly higher sensitivity to oil price changes than livestock products, crop prices are expected to show a greater increase. All nominal prices are projected to remain above their historical levels of 1997-2006.

3 DG Agri's assumptions concerning GDP, exchange rates, inflation and crude oil are taken from IHS Global Insight June 2009. Compared to the OECD-FAO baseline, the growth forecast for 2009 is worse for most countries, though it improves around 2011–12. EU, US and Russia's growth prospects are lower throughout the projection period than in the baseline. The oil price is the same as the OECD-FAO baseline assumption of 70 USD/barrel until 2012 then increases faster to reach 100 USD/barrel by 2018.

Price Volatility

While the Outlook price projections are based on annual averages, the reality of course is that prices fluctuate daily. The price spikes of 2007-2008 have drawn attention to the issue of price volatility.

DG AGRI's report also includes an analysis of historical price volatility for wheat, maize and soybeans in the US and milling wheat and rapeseed in the EU. Daily settlement prices in commodity exchanges have been used.

The analysis concludes that in the commodity markets observed, volatility has increased. It appears that trend lines for volatility and prices have moved together and that periods of high prices overlap with increased volatility.

An inverse relationship was observed between stocks and prices while volatility peaks seem to coexist with decreased stocks. As to the link with oil price volatility, since May 2006 volatility in maize and oil prices show similar paths.

In the medium term, both FAPRI and OECD-FAO project stabilisation of stocks which hints at decreasing levels of price volatility on a yearly basis. However, yearly price changes projected in the baselines are a poor indication of potential volatility since commodities undergo price adjustments daily. In addition, the projections assume normal weather conditions and relatively steady economic recovery.

The full report can be found at:

http://ec.europa.eu/agriculture/analysis/tradepol/index_en.htm

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