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Mandatory country-of-origin labeling (MCOOL) update

(Source: *The Chicago Mercantile Exchange Daily Livestock Report, February 28, 2007*)

Mandatory country-of-origin labeling (MCOOL) for meat and poultry sold through U.S. retail stores is slated to go into effect in September 2008 and the U.S. meat sector is already beginning to gear up for the huge task of documenting the place of birth, feeding and slaughter of millions of animals and carrying those designations all the way to the retail meat counter.

MCOOL was passed as part of the 2002 Farm Bill when it was inserted into the final version during conference committee negotiations after passing in the Senate and failing in the House of Representatives. Most observers felt MCOOL was a bone thrown to Senators whose bid to add a ban on packer ownership of livestock to the '02 Farm Bill had failed.

Whatever the reason, MCOOL became law. Significant battles since that time have seen the implementation of MCOOL for livestock and meat delayed twice with the current effective date being September 2008. There was some speculation that a Democrat-controlled Congress would move the implementation date back up to September of this year but it appears that the practicalities of rule-writing will put the actual start-up date well into 2008 regardless of what Congress does thus making an earlier effective date immaterial. USDA's Agricultural Marketing Service will repeat the rule-making process since the original rule was written in 2003.

Since that time, animal identification systems have changed and AMS has some experience with MCOOL for

fish and shellfish. USDA is soliciting comments regarding the economic impact of the fish and shellfish rule at the present time and those comments may have some bearing on the livestock and meat rule. Anecdotal evidence from retailers indicates that MCOOL on fish and shellfish has resulted in significant costs and no discernible benefits, a result many observers feel will repeat itself for livestock and meat.

The biggest challenge for MCOOL implementation will be accurately labeling and tracking meat products which come from imported cattle and pigs. Producers, packers and processors will have to maintain records to support any origin claims they make and, while the law doesn't apply directly to producers, it only makes sense that packers will require their suppliers to indemnify them against fines or other penalties that result from producer errors and omissions. The law states that U.S. product must be born, raised and slaughtered in the U.S. and ignores the principle of "substantial transformation" which is used to determine the source country for other goods. Therefore, products from pigs or cattle born in Canada, fed in the U.S. and slaughtered in the U.S. will carry all of that information on their label. Products from pigs and cattle born and fed in Canada and slaughtered in the U.S. will carry a different label. These different labels will mean duplicate stock-keeping units (SKUs) in packing and processing plants, thus increasing costs. Some packers will simply say "No thanks" to Canadian-origin animals — which was likely the real goal of MCOOL proponents in the first place. ■

Canadian Cow Statistics

Statistics Canada recently released its January 1, 2007 Canadian Cattle Inventory report showing that Canada's national cattle herd now stands at 14.32 million head. This is a reduction of 3.5 per cent or 515,000 head from the January 1, 2006 inventory. The national herd size peaked in the January 1, 2005 report at 15.06 million head as a result of border closure and loss of market access due to BSE. While the 2007 report represents the second consecutive reduction in the

Canadian herd size, it is important to remember that the Canadian herd today is still larger than pre-BSE levels. The January 2003 herd size was reported as 13.49 million head.

One of the areas that saw the largest reduction in inventory levels was the beef cow herd. Producers reported that they had 5.0 million beef cows in inventory on January 1, 2007. This is a reduction of five per cent or 263,000 head from January 2006. The dairy cow inventory remained vir-

tually unchanged at 1.04 million versus 1.049 million in 2006. The reduction in beef cow numbers was not unexpected as cow slaughter was significantly higher in 2006 than what was seen between 2003 and 2005. Beef calves under one year of age were down 3.2 per cent from 4.932 million head to 4.774 million. Steers over one year of age were up 0.5 per cent from 1.172 million to 1.178 million. The inventory of feeders and calves outside of the feedlot dropped by 3.6 per cent or 188,000 head from 5.202 million to 5.013 million.

The continued contraction of the Canadian cattle herd that we have witnessed over the last couple of years is not unexpected. The Canadian herd grew from 2003 through to 2005 due to reduced market access caused by the BSE crisis. The Canadian cattle herd is now adjusting in response to increased market access and it is expected that inventory numbers will continue to adjust as additional markets are regained. Increased market access for fed and feeder cattle, as well as expanded cow slaughter capacity have allowed producers to return to a more normal marketing program. Expect the Canadian herd and Canadian producers to continue to react to these market conditions and make adjustments to their herd sizes in response. ■

U.S. Corn & Bean Plantings Effects Barley & Canola

(Source: Iowa State University Iowa Farm Outlook Newsletter, February 15, 2007)

Both the corn and soybean markets for the last several months have been supported by (1) the need for corn prices high enough to slightly ration domestic corn feeding and export demand and (2) the need for a sharp increase in corn plantings this spring to over-come the current large production-use gap and a sharp increase in corn processing for ethanol that is almost certain to occur in the 2008-09 marketing year.

Indications that farmers are planning a substantial shift of cropland from soybeans and cotton to corn has strengthened soybean prices. The acreage shift points to a tightening of U.S. soybean supplies next season and most likely for the next few years. However, the percentage strength in bean prices has been much less than in corn. A year ago, corn and soybean prices in north central Iowa were \$1.78 and \$5.33 per bushel, respectively. On February 14, 2007, they were \$3.74 and \$6.86 per bushel. In other words, cash corn prices in this part of Iowa today are 110 per cent higher than a year ago while bean prices are up 29 per cent.

The more limited response of the soybean market reflects (1) indications that greater strength in soybean prices would trigger expanded South American plantings next fall and (2) potential difficulty in making biodiesel from virgin soybean oil competitive with other alternatives if bean prices were sharply higher. At least half-a-dozen alternative feedstocks can be used to produce biodiesel. Alternatives include recycled cooking oils (yellow grease), corn oil, cottonseed, sunflower, rapeseed, and palm oils, and animal fats. In contrast, corn is the main feedstock for producing ethanol at this time.

The shift of U.S. producers from soybeans to corn could move Canadian canola higher in the short run. However, if South America responds to the high soybean prices with additional 2007-08 planting the Canadian canola market could be negatively impacted in the long run. ■

U.S. Beef Sector Still Adjusting to Higher Feed Prices

(Source: University of Illinois at Urbana-Champaign Aces News Weekly Outlook: Beef Sector, February 5, 2007)

In the next two years, the cattle industry will have to adjust production down-

ward somewhat to push retail beef prices upward, said a Purdue University Extension marketing specialist.

“In this manner, calf and feeder prices can eventually recover,” said Chris Hurt.

Hurt’s comments came as he reviewed the cattle industry outlook for 2007, the most prominent feature of which is the painful adjustment to much higher feed prices.

“This will include sharply lower calf and feeder cattle prices, perhaps some further trimming of the beef cow herd, more backgrounding of calves before they enter feedlots at higher weights, and adding distillers grains to rations,” he said.

Beef production in 2006 was up 5.6 percent, with slaughter up 4.0 percent and weights up 1.6 percent. Higher feed prices in the last quarter of the year caused cattle to be marketed at weights which were up only about 8 percent. Nebraska choice steers averaged \$85.40 per hundredweight compared to \$87.28 in 2005. Steer calf prices at Oklahoma City averaged \$128 versus \$132 for the previous year.

“For 2007, beef production is expected to increase by about 2 percent,” said Hurt. “Nebraska finished steer prices are expected to average in the \$85 to \$89 range, about one to two dollars higher than last year.

“Beef exports are expected to increase by nearly 25 percent and rise to their highest level since BSE-induced restrictions at the end of 2003. USDA is currently forecasting beef exports at 1.4 billion pounds for the year, which is still just 57 percent of the 2003 level.”

Beef producers had started to increase the breeding herd in 2004 and 2005 when cow numbers increased by 132,000, a very modest 0.4 percent. Cow-calf producers reduced the cow herd by nearly 100,000 cows in 2006 offsetting most of the increases of the previous two years.

The largest decreases were in Texas (152,000), Oklahoma (75,000), and in Missouri (60,000). The largest increases were in Kentucky (89,000), Colorado (50,000), and Tennessee (43,000). Eastern Corn Belt numbers rose by 20,000 head, with Indiana up 17,000 and Wisconsin up 15,000. However, Illinois numbers were down 19,000.

Milk cow numbers were up by 0.7 percent, more than anticipated given the low milk prices in 2006 and high feed costs. Leading expansion states were Idaho (29,000), Iowa (23,000), Texas (22,000), and California (20,000). In the Eastern Corn Belt, numbers were up by 25,000 head, led by Michigan (12,000), Indiana (8,000), and Wisconsin (5,000).

“The 2006 calf crop was unchanged from 2005 at 37.6 million head,” said Hurt. “The number of cattle in feedlots is currently up 1 percent, so this leaves somewhat fewer calves outside of feedlots than one year ago.

“Higher feed prices have resulted in a sharp drop in feedlot placements in recent months. Placements started down in September and in the last four months of 2006 averaged about 9 percent lower than in the previous year.”

On Sept. 1, the number of cattle on feed was up about 10 percent, but by January that number was up only 1 percent. The largest reductions in placements in the last quarter of 2006 were for lighter weight calves. Placements of calves weighing under 700 pounds were down 13 percent.

“Higher feed prices have deeply depressed calf and feeder cattle prices,” Hurt noted. “Steer calves at Oklahoma City were \$11.77 per hundredweight lower in the final quarter of 2006 compared to a year earlier. Heifer calves were \$14.32 per hundredweight lower.

“Feeder steers were down \$11.63, while feeder heifers were down \$11.19 per hundredweight. During January 2007, those prices were continuing to run \$11 to \$15

lower than in the previous year.”

For 2007, finished cattle prices are expected to average about \$2 higher than in 2006. By quarter, prices for Nebraska steers are expected to average about \$87 in the first quarter, \$90 in the second quarter, \$85 in the third quarter, and \$88 in the fourth quarter.

“Highs in late March and early April may extend into the low \$90s,” said Hurt. “These price projections are several dollars under what futures market prices were suggesting as of Feb. 2. Futures may be providing favorable hedging opportunities.

“Calf prices are expected to be about \$10 to \$12 lower than last year. This would put Oklahoma City steer calves in a range of \$115 to \$120 for the year and feeder steers at \$95 to \$100 per hundredweight. Eastern Corn Belt prices tend to be \$2 to \$4 lower.”

Hurt said some contraction in the breeding herd may also continue in 2007 as calf prices remain under pressure and forage prices rise along with corn and soybean meal prices.

“Forage prices will rise because more land is being diverted toward crops that produce liquid fuels, thus reducing hay and forage acreage,” he said. “Weather in 2007 will also be a major factor in the direction of the beef industry.

“Weather will affect not only pasture and forage output, but also prices for corn and soybean meal. Harmful weather would likely push calf and feeder prices lower.” ■

Brazil's Booming Agriculture Faces Obstacles

(Source: USDA's Amber Waves Magazine, November 2006)

Brazil has emerged as an agricultural superpower in global food and agricultural markets thanks to economic and trade stability and regulatory reforms that encourage investment in agriculture. Brazil is an important producer and the largest exporter of sugar, ethanol, beef, poultry meat, coffee, orange juice, and tobacco.

Rising global income and Brazil's ready availability of land, water, and labor to increase crop and meat production have driven exports. Brazil exports agricultural and food products, such as soybeans, pork, and poultry, to most countries of the world, including large markets in the European Union (EU) and the United States. But soaring demand in China has been at the root of much of Brazil's export growth. Brazil's agro-food sector accounted for over two-thirds of its total trade surplus in 2005. At US\$27.5 billion, Brazil's agro-food trade surplus is the largest in the world. Brazil's success in world markets has given U.S. farmers a powerful competitor.

Although greater competitiveness in the agro-food sector can be partially attributed to market liberalization up to early 1999, new methods of providing government incentives for Brazilian agriculture also contributed to the agricultural growth. These include preferential credit, tax exemptions, financing for agricultural research, marketing and infrastructure improvements, as well as an array of Federal, State, and local subsidies.

Continuing trade expansion and diversification of markets and products remain at the core of Brazil's agricultural growth strategy. However, several constraints could hinder further long-term growth of Brazilian agriculture. Supply-side constraints include adverse macroeconomic shocks, ongoing transportation and marketing bottlenecks, financial constraints, and a slowdown on the expansion of agricultural land. On the demand side, rising consumer demand for high-value foods plus the growth of Brazil's biofuels industry could reduce the availability of Brazil's

exportable surpluses.

Agro-Food Sector Important to the Brazilian Economy

Over the past decade, Brazil—the world's 11th largest economy—has been consolidating its position as an important agro-food producer and major supplier to international markets. Production agriculture accounted for 10 per cent of the country's gross domestic product (GDP) in 2005, but with the associated supply chain, the agro-food sector (production agriculture, processing, and distribution) accounts for nearly 27 per cent of total exports and employs 18 million people, equivalent to 37 per cent of the labor force. The agro-food sector, which was valued at US\$254 billion in 2005, accounted for 28 per cent of the country's GDP.

Brazil enjoys a low-cost resource base for agricultural production and has easily raised output by expanding area and increasing productivity. Production expansion has exceeded the rate of increase in consumer demand, leaving surplus production for more exports. Major economic and agricultural policy changes, including those that encourage investment in the sector, have broadened export channels.

The value of Brazil's 2005 agricultural exports reached US\$30.9 billion, led by soybeans and products, sugar, ethanol, beef, pork, and poultry. Since 2000, the value has grown at an average rate of 20 per cent per year. Brazil also imports commodities that it does not produce competitively, including wheat. The value of those imports was US\$3.4 billion in 2005.

Exports of primary bulk, semi-processed, and processed commodities (soybeans, fresh, chilled and processed meats, coffee, flour and oils) have contributed the most to Brazil's total agricultural exports. Primary bulk agro-food products grew eight per cent annually during 1997-2005, compared with nine per cent annually for processed products and five per cent annually for semi-processed products. Horticultural products, which include fruits, vegetables, flowers, nuts, and spices, have grown at a rate of 10 per cent per year since 1997; however, both the volume and growth in horticultural exports are low as sanitary and phytosanitary regulations restrict access to foreign markets.

Since 2000, growth of exports of processed agro-food products accelerated to 20 per cent per year. The food manufacturing industry has been stimulated by the desire for higher per unit returns, access to new processing technologies and international capital, and a growing entrepreneurial class. Between 2004 and 2005, the growth in exports of processed products (fresh, frozen, and processed meats, dairy products, breakfast cereals) accelerated, expanding by 33 per cent, and now accounts for 44 per cent of agro-food exports. In 2005, primary bulk commodities accounted for 25 per cent of total Brazilian agro-food trade.

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Stability and Reforms Support Farm-Sector Expansion

Rapid expansion of Brazilian agriculture and agro-food restructuring began in the mid-1980s, with the end of a policy regime that had channeled resources away from agriculture into the industrial and services sectors. Economic reforms in 1985 sought to eliminate domestic and export taxes and restrictions on agricultural exports of soybeans, cotton, and meat and to eliminate import licenses for corn. During the early 1990s, the Government also removed much of the state intervention in agricultural markets—privatizing state enterprises and eliminating minimum support prices, government purchases of wheat and milk, and marketing boards (for coffee, sugar, and wheat).

But the most significant economic factor affecting agricultural output in Brazil since the mid-1990s was introduction of the successful Real Economic Stabilization Plan. Before 1994, Brazil had inflation levels generally well above 1,000 per cent a year. To halt inflation, a new currency, the real, was introduced, which was initially pegged to the U.S. dollar and later followed a “crawling peg” policy of nominal depreciation of the real against the dollar. The Real Plan stabilized the economy, reducing inflation to around five per cent per year and setting off a domestic demand boom that lasted for five years.

In early 1999, Brazil adopted a floating exchange rate. The real depreciated considerably, making Brazil an attractive low-cost supplier of food and agricultural products. That stimulus led to the rapid expansion in soybean and meat production.

The Real Plan was accompanied by further privatization of state enterprises and elimination of remaining barriers to foreign investment, facilitating the presence of multinational companies in Brazil. Multinationals stimulated investment in agricultural research and development of integrated supply chains that link inputs with commodity production and distribution. In addition, by granting credit to producers to buy inputs (fertilizers, seeds, and chemicals), the large multinational corporations have alleviated the difficulties that Brazilian producers had in seeking credit from commercial banks.

As a result, production of major crops (soybeans, corn, rice, edible beans, and wheat) rose to 54 million tons in 1990, double the level of 1970. During the 1990s, total oilseed area increased 1.0 per cent per year, compared with a decrease of 1.9 per cent per year for total grain area, while yield increased 5.2 per cent per year, compared with 4.3 per cent per year for grains.

Crop production in Brazil reached an all-time high of 108 million tons in 2005, a fourfold increase from that of the 1970s. In addition to expanding export markets, a principal factor fueling growth and modernization in the crop sector was expansion of Brazil’s hog and poultry industries and the accompanying rise in food demand. While output of edible beans and rice, major food staples, expanded roughly at the rate of population growth, soybean and corn production grew much more rapidly. Corn was once considered a Brazilian subsistence crop, but rising demand for meat and eggs associated with rising incomes has led to an expansion of the

mixed feed industry and increased demand for corn by Brazil's fast-growing poultry and hog industries.

Future Growth in Agriculture Could Slow Due to Supply-Side Obstacles...

Agriculture in Brazil still has plenty of room to grow. Brazil is using only one-third of its potential arable land, suggesting that continued growth of agriculture is possible. But a number of factors are likely to slow expansion in production and trade.

A more risky, less stable macroeconomic environment

The economic stability attained with macroeconomic reform during 1994-99 and a managed depreciating exchange rate signaled lower risk and stimulated investment and growth in the agro-food sector. But judging by the appreciating exchange rate, the current economic environment has dampened growth prospects for Brazil's agro-food sector. The restrictive monetary policy to keep inflation under control has resulted in rising interest rates, which in turn attract dollar-denominated capital inflows. The inflows have increased demand for reals, which have been steadily appreciating since September 2004. The appreciation has already affected Brazil's competitive pricing and the profitability of its food and agricultural exports. For example, by July 2006, the real had appreciated 32 per cent against the U.S. dollar, potentially making Brazilian export products about one-third more expensive in other countries. With the real expected to continue to appreciate, Brazilian exporters will face a deteriorating competitive position in global food and agricultural markets.

Limited access to financing

Producers are expected to see more limited access to credit for production and marketing of crops and livestock due to two factors: the high current rate of indebtedness of crop and livestock producers and the higher cost of credit available to producers because of higher interest rates. In Brazil, financing for agriculture comes from three sources: government agricultural credit disbursed through the National System of Rural Credit, SNCR (26 per cent); agricultural processors (20 per cent); and commercial banks or other government agencies (54 per cent). About two-thirds of the US\$27 billion credit line announced for the 2006/07 crop year, to be disbursed under the SNCR, will be at the subsidized interest rate of 8.75 per cent per year. The government serves as the guarantor for those loans. All other credit will have to be financed at rates close to the prevailing commercial rate—now more than 15 per cent. Agricultural industries and the commercial banks perceive credit to agriculture as higher risk due to the already high level of farm indebtedness. The current level of nonperforming loans is estimated at US\$7 billion, around 10 per cent of the value of agricultural production. For the immediate future, a much larger share of a producers' working capital and investment will have to be financed at higher rates. The reduced availability and access to low-interest credit will have a dampening effect on the investment boom underway in the Brazilian agro-food sector.

Slower land expansion. The current agricultural area is 62 million hectares, but the potential for expansion is three times this amount, including 69 million hectares in the Cerrados tropical savannah area. The amount of credit required, however, for bringing the additional land into cultivation and further expanding agricultural production is more than double the credit expected to be available in the more risky economic climate. Additionally, continued expansion in the Cerrados and Amazon forest areas is likely to be constrained by environmental concerns about the rate of land clearing. Even so, the expected rate of expanding area to crop and livestock production in Brazil will be one of the world's highest — 4.5 per cent

per year over the next 10 years, or about 1.8 million hectares per year.

Infrastructure, transportation, and marketing bottlenecks

These undermine the competitive position of Brazil in world markets and translate into higher costs. Development of storage facilities, port facilities, roads, and railways has not kept pace with the breakneck pace of growth in agricultural production and exports. In recent years, higher soybean volumes for export markets have overwhelmed loading docks at Brazilian ports, resulting in long delays (measured in days, not hours) and additional costs. Some farm commodities travel 1,000 miles or more over poor and highly congested roads to reach the port. Less than one-quarter of national roads are officially deemed in good condition in Brazil. Recent studies have shown that the cost for logistics when exporting soybeans from Brazil is, on average, 83 per cent higher than in the United States and 94 per cent higher than in Argentina.

Large investments in rehabilitating and expanding transport infrastructure are needed to keep up with expected demand growth and to lower the Custo Brazil (Brazilian cost). Custo Brazil is a term that has come to denote general cost of inefficiency from production and distribution bottlenecks, including the various logistical transactions associated with exports. Transaction export costs (an indicator of the Custo Brazil) represent 15-20 per cent of the free-on-board (f.o.b.) price for agricultural commodities. While the Custo Brazil could be reduced through investments in producer-to-market, producer-to-port, and port-to-market distribution systems to reduce delivery times and costs and to maintain product quality, those investments will come too little too late to relieve the transportation bottleneck for the next several years. ■