FCC Ag Economics

2018 Outlook for the Canadian crops (East) sector

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Farm Credit Canada
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Canada

FCC Ag Economics helps you make sense of the top economic trends likely to affect your operation in 2018. In this outlook for the Canadian crops (East) sector, we look at:

- China's strong demand for oilseeds
- Interest rates and the loonie
- Appreciation of farmland values, and
- Ethanol production

Soybean and corn production are expected to remain profitable in 2018. Winter wheat margins are projected to be negative, but Canada's high protein count in wheat bumps up the price and gives us an edge in the world market.

U.S. soybean production exceeded its five-year average in 2017, while wheat production declined roughly 15 million metric tons – a significant decrease from the 2016 crop year. U.S. and South American corn production is forecast to decrease slightly in the 2017-2018 marketing year. With steadily increasing ethanol production and feed usage, global ending stocks for corn are expected to decrease. Global ending stocks are also expected to decrease slightly in the 2017-2018 marketing year for soybeans, but increase for wheat.

Estimates of the crops' global ending stocks in 2017 are well above the five-year average, and they're likely to stabilize at that level. With global oilseed and corn production forecast to also remain steady in 2018, the combination of relatively consistent output and high ending stocks may be enough to match the expected increase in world demand for grains, meals and oils. This should limit potential price increases. The USDA projects corn's farm price received will be roughly US$3.25, soybeans at US$9.25, and $4.50 for wheat.

How will this affect your bottom line?

One way to maintain profitability in an ever-competitive global landscape is to implement the "5% rule." This golden rule shows how a 5.0% improvement in productivity (e.g., yield gains), 5.0% price increase from marketing decisions, and 5.0% gain in efficiency (e.g., lowered production costs), can result in an improvement to your bottom line greater than 100%.

Trends to watch in 2018

China's soybean demand continues to exceed projections

China's insatiable demand for soybeans is having a strong, and positive, impact on the world soy market – and is particularly good news for Canadian producers. Chinese imports of soybeans continue to exceed expectations. Their consumption is forecast to increase 7.5% from 2017 levels. This expansion in consumption is largely due to greater demand from expanding poultry and pork industries. As a direct result of their growing demand for meat proteins, Chinese soy ending stocks are also expected to shrink around 2.5%.

Interest rates to remain low while loonie to stay under US$0.80

The Bank of Canada projects economic growth in Canada to be slightly weaker in 2018 relative to 2017. They also expect inflation will trend around 2.0%, the Bank's mid-point target. Financial markets suggest there will be two or three hikes of 25 basis points in the overnight rate for 2018.

Businesses should take note: although interest rate increases will likely be muted, borrowing costs are projected to climb off historical lows reached in 2016 and 2017. Financial markets currently expect bond yields to climb moderately. For example, a 5-year, fixed-rate mortgage would be priced at the end of 2018 around 75 basis points higher than it was at the end of 2017.

The Canadian dollar is expected to be higher in 2018, though still low enough to support profit margins. It should average US$0.78, assuming West Texas Intermediate (WTI) crude oil prices trade in the US$55 per barrel range. Interest rates in Canada and the U.S. should follow similar patterns. A low CAD benefits grains and oilseed producers. A decrease of US$0.05 in the exchange rate can raise soybean profit margins over 30.0%.

Appreciation in farmland values expected to slow

In 2018, Canadian farmland values should appreciate more slowly than they have recently: 4.0 – 6.0% growth in 2017 and a further 2.0% in 2018.

That's due to slowing growth in farm income, forecast to climb 1.0% in 2018, a 4.0% increase from 2016. Interest rates, another major driver of farmland values, are also forecast higher, moderating growth in farmland values. If interest rates increase an additional 1.0% (100 basis points) above the baseline assumption for 2018, appreciation in farmland values could slow 1.5%.

Ethanol production to support demand for corn

2017 was a record-setting year for global ethanol production. Ethanol and its by-products used 36.0% of U.S. corn production in 2016-17. Demand for ethanol is expected to capture 38.6% of the available corn supply in 2017-2018.

Helping to push up that demand: oil prices hovering around US$55 per barrel, and low American gasoline prices encouraging more fuel use. The U.S. Energy Information Administration (EIA) predicts 2018 U.S. ethanol production will average roughly 1.02 million barrels per day, up from 1.0 million barrels per day production in 2017.

On the radar

- The outcome of the renegotiations of the North American Free Trade Agreement (NAFTA) will have possible implications for:
  - the value of the Canadian dollar
  - trade taxes and market access rules applied to Canadian exports and imports
  - dispute settlement procedures

  Changes in any of these could impact prices of ag commodities in Canada.
- Negotiations to revive the Trans-Pacific Partnership (TPP) agreement, leading to possible market access gains for Canadian crops.
- Shifts in U.S. acres of coarse grains and oilseeds and other large exporters resulting in a different price outlook.
- 2018 La Nina weather patterns impacting U.S. and South America production.

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