FCC Ag Economics

2018 Outlook for the Canadian crops (West) sector

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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 (West) sector, we look at:

- China's strong demand for oilseeds
- Trade barriers to India
- Interest rates and the loonie, and
- Appreciation of farmland values

Profitability in the Canadian oilseeds, pulse and wheat sectors will be mixed in 2018. Assuming the CAD remains close to US$0.78 in 2018, canola profitability is expected to remain positive, while spring wheat is expected to remain slightly above average production costs. Margins for red lentils and peas are likely to be negative in 2018.

Although U.S. oilseed production exceeded its five-year average in 2017, global ending stocks are expected to decrease slightly in the 2017-2018 marketing year. Strong global demand for both meals and oils/fats should prevent prices from falling substantially over the next twelve months.

The USDA projects a 2017-18 average soybean price of US$9.25. The supply/demand balance for Canadian canola is projected to not be as tight as 2016-17, which should moderate canola prices throughout the year.

India's large tariff on Canadian exports of peas is expected to trigger a significant decrease in acres of peas (and other pulse crops) in 2018. This may lead to more canola-seeded acres in Western Canada, as it's almost certainly going to exceed the price trend for pulses. Such a move could impact the 2018 canola price in the second half of the year.

Wheat's global ending stocks are projected to increase slightly in 2018, even though U.S. wheat production declined year-over-year in 2017. China's inventories have increased, helping to push up overall stocks, yet this is not expected to lower wheat prices further. The USDA projects an average 2017-18 price of US$4.50.

How will this affect your bottom line?

One way to maintain profitability in an ever-competitive global landscape is to implement the "5.0% 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 oilseed demand continues to exceed projections

China's insatiable demand for oilseeds is a strong and positive driver of the world soy market. Chinese soy consumption is forecast to increase 7.5% from 2017 levels, largely due to greater demand from expanding poultry and pork industries. Canola is also expected to continue gaining market share in China's feed and oil markets – good news for Canadian producers. Chinese policy reforms are expected to lower their canola acres and increase their canola imports in 2018.

Canadian pulse exports to decline

In late 2017, India introduced a 50.0% import duty on Canadian pea exports and a 30.0% import duty on Canadian lentils and chickpeas. Intended to support India's domestic price, the move has already curbed Canada's competitive position.

As of December 2017, the crop-year-to-date bulk pea exports were 35.0% below last years' pace, while bulk lentil sales were 42.0% behind. India increased its production of pulses in 2017, as Canada's export competition from the Black and Baltic sea regions increased. Things may not improve in 2018. Despite the low rainfall in the pulse-producing regions, India has forecast the crop will be above the five-year average.

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. This would mean that a 5-year, fixed-rate mortgage would be priced around 75 basis points higher at the end of 2018 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 canola profit margins over 25.0%.

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%.

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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