FCC Ag Economics is doing a mid-year check-in on our January 2018 Outlooks. Throughout July, we’ll update our expectations about profitability in six Canadian ag sectors (crops East and West, hogs, cattle, dairy and food processing). We’ll describe what’s happened in 2018-to-date and what we think you should monitor in the next six months.

Our January forecast for the cattle sector has held so far in 2018. Cow-calf operations have been profitable all year, a trend that’s likely to continue into 2019. Backgrounders and feedlots recorded negative margins in the first six months, with little relief in sight. Live cattle futures show a small increase between now and December, while feeder cattle futures look to hold steady.

The US$0.78 loonie helped boost Canadian revenues during the first six months, offsetting increases to interest rates, and other farm input costs such as fuel and feed.

Trends to watch

As of January, the Canadian herd hadn’t seen any serious expansion. 2017 prices for fed heifers had continued to encourage processing over retention. There were 562,000 heifers for beef replacement on-farm, a small YoY decrease to start 2018.

At the end of June, Canadian slaughter at federally inspected plants was boosted 4.2% YoY. Fed steer (Alberta) prices exceeded same-month 2017 levels early this year but they’re not likely to maintain that pace throughout the rest of the year, as more cattle come to market. A decline in Canadian live animal exports to the U.S. so far in 2018 has also helped to boost Canadian beef production. That’s likely going to increase further by December, which would surpass the 0.2% increase for 2018 production cited in our January Outlook.

Feed grain prices shouldn’t rise significantly in the next six months, given global trade tensions and expected increases to the Canadian and U.S. supply of grain. The feed outlook also depends on weather conditions in the Prairies and the resulting hay yields throughout the summer.

With more pork possibly hitting Canadian retailers in the next six months, beef prices may be put to the test. Stocks of all frozen and chilled meats in cold storage were up 22.3% YoY in April. Frozen beef stocks increased 12.6% and pork stocks rose 13.8% in the first four months of 2018.

The good news is that demand continues to be strong, both domestically and globally. Canadian beef prices have come down 0.6% YoY in May. That trend may last until December and this is good news for the cattle sector. Global markets continue to buy Canadian beef: beef exports increased 86.0% in the last five years, with the U.S. leading the growth. Japan, Mexico and China have also stepped up their imports of Canadian beef.
Interest rates slowly trend up while the loonie hovers at US$0.78

Global market forces played a big part in Canadian competitiveness and the profitability of our agricultural sectors in 2018-to-date. Several macro factors did too – and while we didn’t get everything right, our forecasts in January help explain those trends.

Our January forecast of a US$0.78 loonie was right on the money up to mid-June (see illustration). But the Canadian economy relies on the strength of export sectors. Trade tensions, currently pushing the CAD lower, could continue to pressure the loonie below the $0.78 projected 2018 average.

However, we underestimated the strength of the world economy and the resulting robustness in global oil demand: despite rising oil production in the U.S., the West Texas Intermediate (WTI) crude oil price averaged close to US$65, significantly more than our initial projection of US$55.

The Bank of Canada (BoC) has revised their projections of Canadian economic growth for 2018 since our January outlook. The Bank expects a slower rate of growth, but that the economy will operate close to full capacity this year. Inflationary pressures persist, trending higher than our forecast of 2.0%, the Bank’s mid-point target.

We also correctly anticipated the higher short-term rates in the U.S. and Canada that pushed bond yields higher. The average 5-year fixed rate on mortgages has climbed 35 basis points in the first six months of 2018 – in line with our forecast of an annual increase of around 75 basis points.

After hikes to the overnight rate in January and July (of 25 bps each), financial markets suggest one more increase is possible before the end of 2018. We believe however that the uncertain global trade and economic landscapes could make it difficult for the BoC to proceed with an additional rate hike.

In January, FCC Ag Economics forecasted 2018 ...

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<tr>
<th>Overnight rate increase</th>
<th>5-year fixed rate increase</th>
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<tr>
<td>Right on Target</td>
<td>Right on Target</td>
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<tr>
<td>FCC forecast: 50-75 bps</td>
<td>FCC forecast: 75 bps</td>
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<td>Actual Jan-Jun: 25 bps</td>
<td>Actual Jan-Jun: 35 bps</td>
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<th>USD/CAD exchange rate</th>
<th>Inflation</th>
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<tr>
<td>Right on Target</td>
<td>So close</td>
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<tr>
<td>FCC forecast: US$0.78</td>
<td>FCC forecast: 2.0%</td>
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<tr>
<td>Actual Jan-Jun avg.: US$0.78</td>
<td>Actual Jan-Jun avg.: 2.5%</td>
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<th>Oil prices</th>
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<td>FCC forecast: US$55.00</td>
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<td>Actual Jan-Jun avg.: US$64.88</td>
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Sources: Bank of Canada, Bloomberg
On the radar

• The loonie’s waning capacity to gain value in the last six months of the year. A lower loonie can help offset downward pressure on commodity prices. That may be especially timely this year, as the US trade conflicts bring uncertainty and lower prices.
• An uncertain global trade environment to close out 2018
  - North American Free Trade Agreement (NAFTA) discussions will continue (with no determined end date).
  - Full ratification of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) agreement is ongoing.
  - The full implementation of the Comprehensive Economic and Trade Agreement (CETA) is conditional on ratification by the EU member states.
• 2018 yields for U.S. corn and Canadian barley and corn.

In this series:
- Crops East
- Crops West
- Food processing
- Hogs and pork
- Cattle and beef
- Dairy

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