As the 2017-18 marketing year (MY) winds down, our January forecast holds fast for corn production, which should remain profitable in 2018. Wheat won’t likely be profitable despite some recent upside in pricing. Global uncertainty has helped drop the soybean price to levels that, if sustained, likely mean breakeven profitability or only slightly better.

The US$0.78 loonie helped boost Canadian revenues during the first six months, offsetting increases to interest rates, and fuel and fertilizer prices.

Corn

Global corn production in 2018 is forecast up from a year ago, helping to meet global demand which is expected to grow 2.0% by the end of the 2018-19 marketing year. Despite those production increases, world ending stocks are expected to shrink 40 million metric tons in that time which, if realized, would be the lowest stocks on record since 2012-13.

With fewer acres seeded to corn and lower yields expected, U.S. year-over-year corn production is forecast down in 2018. Exports should also be reduced throughout 2018-19, but corn used for ethanol should increase, reflecting expected gasoline consumption growth. With supply slowing more than demand, the 2018-19 U.S. ending stocks are forecast down 475 million bushels from last year.

Although the 2017-18 corn price received (US$3.40) has barely changed since January, corn futures prices for the 2018 crop had risen until the end of May because of those expected low stocks levels. The USDA projects the U.S. 2018-19 farm price to average US$3.80, up US$0.40 from the 2017-18 average. But the December 2018 corn price is under pressure with a higher-than-expected U.S. 2018 supply. Assuming this translates into a proportional pressure on Canadian corn prices, the 1.6% annual increase in Canadian corn acres planted in 2018 may not be large enough to raise corn revenues.

Soybeans

The USDA now expects higher ending stocks for U.S. soybeans in the 2018-19 marketing year because of China’s tariff on U.S. exports. The 2018 production will likely decline from the 2017 record U.S. crop given the estimated drop in acres. While solid demand and a sustained strong pace of imports is expected to keep global ending stocks for 2018-19 constant, overall soy prices are quite uncertain given China’s escalating trade tensions with the U.S.

That’s not necessarily a slam-dunk win for Canada. Chinese buyers faced with paying U.S. tariffs may buy more Canadian soybeans, but that positive impact might be more than offset by negative consequences. Given China’s capacity to determine the world price – they import close to 2/3 of the world’s soy imports – they can shift global trade flows between and among the world’s major traders in ways that might disadvantage Canada, and ultimately lower the U.S. reference price.

Uncertainty will, at the very least, introduce price volatility and an ambiguous U.S. farm price (US$8.00-$10.50 per bushel compared to US$9.35 per bushel in 2017-18). Despite the potential for risk, we expect the sector to weather the storm. Canada’s total area seeded to soybeans is projected to have decreased in 2018 after rising to a record-high 7.3 million acres in 2017.
Wheat

U.S. wheat production is projected to increase 8.0% in 2018, yet U.S. ending stocks for 2018-19 are forecast to hit a 4-year low. Global ending stocks should also decline this year, thanks to continued strength of demand and Russian production reverting back to normal levels after the large 2017 crop.

As a result, the average 2018-19 price is expected to slowly rise above the 2014-15 price for the first time. Statistics Canada expects Canadian farmers to have increased the area sown to wheat by 10.4% in 2018, given it might offer a better price and more profitable options than pulse markets. Spring wheat margins are projected to be slightly negative, on average, for the rest of the year, but efficient operations should be able to achieve positive margins.

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.
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. wheat, corn and soybeans.
- Brazilian seeded acres of soybeans and corn in response to price volatility and trade disruptions.
- Fertilizer and fuel prices, which are expected to stabilize after tightening agriculture margins when they rose 5.4% (on average) and 14.0%, respectively, in the first five months of 2018.
- Strength in Canadian farm income in the latter half of the year. That strength will go a long way in determining the growth of Canadian farmland values, which are expected to appreciate moderately in 2018. They grew 8.4% in 2017, outpacing farm revenue growth, but volatile crop prices and higher rates are likely to moderate future increases in land values.

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

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