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.

The Canadian hog sector was generally profitable in the first half of 2018, as we forecasted in January. It was a mixed bag though: rising feed prices led to tight margins on finishing operations, while farrow-to-finish operations recorded profits close to $20 per head on average. Those margins will be tested throughout the rest of 2018, largely because of trade tensions and growing pork supply in the U.S.

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

With hog inventories at January 1, 2018, up 2.7% year-over-year (YoY), and seasonal highs still expected to come, Canadian hog production continues to grow in 2018. As of June, hog slaughter in Canada was down 1.0% YoY, but it’s expected to pick up in the second half of 2018 with expanded processing capacity.

Canadian exports of feeder hogs to the U.S. declined 6.4% and slaughter hogs declined 9.6% YoY as of June 1. Increased U.S. hog production and slower-than-expected growth in slaughter expansion there helped produce the slowdown. The U.S. is likely to see a further expansion in hog supply between June and December, bringing hog prices in the second half of 2018 down from the current level.

Canada’s pork exports to the U.S. also declined YoY between January and May 2018. While Canadian exports picked up a healthy 19.0% YoY growth to Mexico, and they’re growing in Japan, South Korea, Taiwan and the Philippines, an expected gain in exports to China failed to materialize in the first six months, perhaps because the Chinese hog herd’s continued growth has led to weaker import demand. Over the next six months, China’s production growth is expected to slow as Chinese hog profits face challenges.

Costs should stabilize throughout the remainder of 2018. Feed costs rose more than expected in the first half of the year, but with plenty of corn coming to market, feed barley should settle slightly over CA$5.00 per bushel. Any variation in Canadian profits in the hog sector will therefore most likely come from hog prices. Escalating trade tensions between the U.S and Mexico, and the U.S. and China and the resulting tariffs on U.S. pork exports may disrupt markets. Around 40.0% of U.S. exports wind up in those two countries. Fewer trade opportunities for U.S pork may open the door for more Canadian pork exports, but also result in reductions in the hog price that Canadians receive.
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 ...

**Overnight rate increase**  
**Right on Target**  
FCC forecast: 50-75 bps  
Actual Jan-Jun: 25 bps

**5-year fixed rate increase**  
**Right on Target**  
FCC forecast: 75 bps  
Actual Jan-Jun: 35 bps

**USD/CAD exchange rate**  
**Right on Target**  
FCC forecast: US$0.78  
Actual Jan-Jun avg.: US$0.78

**Inflation**  
**So close**  
FCC forecast: 2.0%  
Actual Jan-Jun avg.: 2.5%

**Oil prices**  
**Miss**  
FCC forecast: US$55.00  
Actual Jan-Jun avg.: US$64.88

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.

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- J.P. Gervais @jpgervais
- Martha Roberts @MJaneRoberts
- Leigh Anderson @AndersonLeigh3
- Craig Klemmer @CraigKlemmer
- Amy Carduner @ACarduner

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