TD Economics: After a challenging year, the outlook is bright for agriculture

- *Crop output in Canada expected to be decent for 2012*
- *Smaller livestock inventories to help producers get back on track*
- *Unpredictability remains one of the biggest challenges facing the industry*

TORONTO – Unfavourable weather conditions and unexpected disease contributed to a "wild year" for the agriculture sector in 2012. However, the outlook for the farming sector remains fairly bright, particularly for crop growers.

"Similar to last year, much of the volatility in prices this year stemmed from the impact of unfavourable growing conditions across the globe," said Dina Ignjatovic, Economist, TD Bank Group. "Several key areas – including the Black Sea region, Australia and parts of Canada – endured hot, dry weather, reducing crop production. But it was the severe drought in the U.S. – the worst since the 1950s, affecting 80% of the country – that hit markets hardest this year, sending crop prices higher by 15%-40% (June to July), and subsequently sinking hog prices by 26%."

Higher prices impact crop and livestock producers differently

Despite lower yields, output in Canada is expected to be decent, allowing crop growers to reap the benefits of higher prices. Quebec is the only province to enjoy higher yields, and farmers expect record soybean production this year, despite a drop in acreage. In Ontario, a mid-season drought lowered yields, but a record harvested area is expected to result in higher overall corn production, contributing to an 8% increase nationally. In the Prairies, canola production is expected to fall below year-ago levels, but is still likely to come in well above the 10-year average. Meanwhile, higher harvested area for barley and wheat are expected to result in a rise in production in the grainbelt. As a result, many crop farmers in Canada will benefit from stronger prices, and end the year on sound financial footing.

However, higher feed costs present a challenge for livestock producers. North American producers, particularly hog producers, began to sell off their animals because they were becoming too expensive to feed. While cattle prices managed to remain healthy, hog prices sank 26% in August. Higher feed costs will remain a challenge for livestock producers; however, cost pressures will ease somewhat as feed stocks are replenished and prices for the animals rise in response to smaller inventories.

Overall, tighter crop supplies and smaller livestock inventories will help keep agricultural commodity prices propped up in the near term.

Looking long-term

"While global economic growth has downshifted this year, TD Economics expects it to stabilize and pick up some steam next year and in 2014." said Mrs. Ignjatovic. "Emerging markets will continue to be the main drivers of world growth, although most of these economies will be growing at a slower pace than what was seen prior to the recession. Still, positive growth rates will underpin stronger demand for agricultural products, particularly animal products, highlighting the importance of gaining access to these markets. Continued demand from the biofuels industry will also support demand for crops."

However, producers will continue to face with a number of challenges.

Fertilizer prices have been trending up over the past couple of years, and, while lower than the levels seen during the spikes in 2008-09, prices of all fertilizers are higher than their pre-2007 levels. Especially after a year like this one, where yields were down across the board, farmers are likely to increase fertilizer use in order to maximize production so they can take advantage of higher crop prices. Longer term, that trend is likely to remain intact, given that yield growth is expected to decelerate.

The Canadian dollar is also likely to remain a challenge for farmers who export their products. The loonie has been trading at close to parity for a few years now, and it is not expected to move materially in the foreseeable future. Moreover, farmers looking to expand their operations, or those looking to enter the industry, must also contend with rising land prices. Continued low interest rates are likely to lead to a further escalation in land prices and worries about the potential for a medium-term price correction.

Opportunity to grow

The current low interest rate environment presents an opportunity for borrowers and in particular producers looking to invest and expand. Investing in new technologies and research and development can greatly improve productivity and the competitiveness of the Canadian agriculture sector, perhaps even uncovering new ways to make crops more disease and weather resistant. This in turn would help combat the unpredictable nature of weather conditions, and reduce price volatility.

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