



HIGHLIGHTS

- The extent of volatility this year has failed to match that of 2007-08, but the unanticipated events of recent months have continued to put the planning and risk management capabilities of Canadian farmers to the test.
- Going forward, farmers will be adversely affected by the strength of the Canadian dollar vis-à-vis the U.S. dollar, rising costs of wages, transportation and potash, as well as by U.S. country-of-origin labeling (COOL) regulations.
- We expect net farm income in Canada to post a modest fall in 2010 before rebounding in 2011.
- At the regional level, provinces are on track for a 3-6% rise in farm cash receipts in 2010, with the exceptions of Saskatchewan and Manitoba which are anticipated to decline by 5.0% and 0.5%, respectively. In 2011, farm cash receipts are forecasted to grow from 3.7% in PEI to 7.0% in Saskatchewan.

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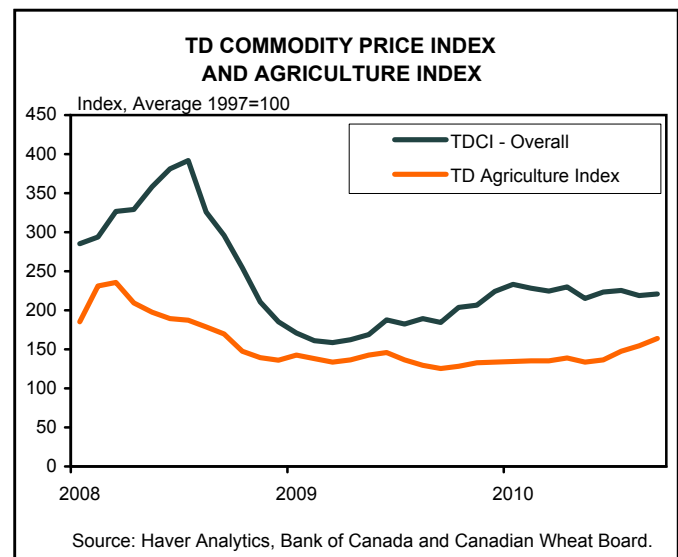
THE MANY FACES OF CANADIAN AGRICULTURE

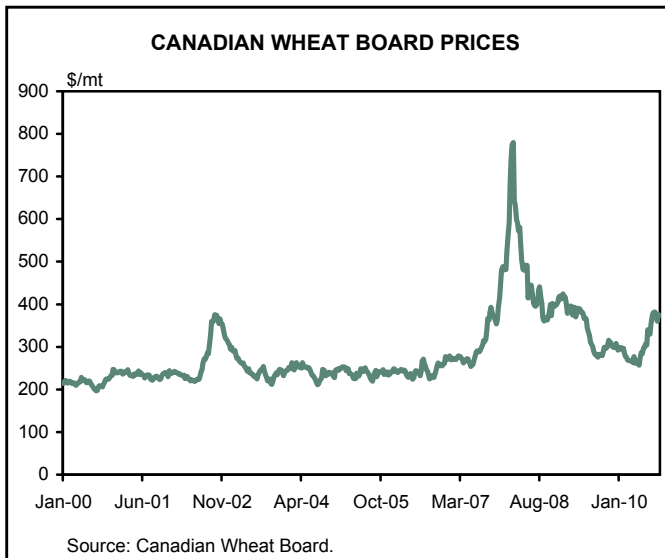
2010 will go down as another eventful year in the agriculture sector, with flooding in western Canada, droughts in Eastern Europe, price swings and gyrating currency markets making headlines both at home and abroad. The extent of volatility this year has failed to match that of 2007-08, when prices went into orbit before staging a dramatic pullback. Still, the unanticipated events of recent months have continued to put the planning and risk management capabilities of Canadian farmers to the test. On average, Canadian farm income is likely to decline moderately this year from last, dragged down in part by the squeeze from higher input prices.

While the global nature of agriculture often puts national performances in the spotlight, it is important to avoid painting Canadian agriculture with one brush. The truth of the matter is that the total agricultural sector in this country is the sum of many regional markets, all of which having unique strengths and challenges. This past year continues to highlight this reality in spades. Production and income performances have varied widely from coast to coast driven by factors such as differing industry mixes and growing conditions. While floods have hurt the wheat crop in the Prairies (notably Saskatchewan), favourable weather conditions have been supporting a good year for soybeans and other crops in Ontario and Québec. In this – TD’s fourth annual outlook report on Canadian agriculture – we shift the focus to the diversity of the Canadian agriculture sector and how this characteristic will be reflected in differing income prospects across the nation in 2010 and 2011.

World agriculture prices perk up in the 2nd half of 2010

Despite the volatile ride that agriculture prices have experienced since 2007, the path embarked upon during the 2008-09 global recession and the early part of the recovery has actually been relatively mild when compared to that of other major commodities. In the early stages of recession, global agriculture managed to hold up relatively well as food represents a basic consumption requirement. Hence, while energy and non-precious metal commodities went into a free fall, agriculture prices (as measured by the TD Commodity Agriculture Price Sub-Index) declined less markedly. This more muted decline during the downturn and ample world stocks for grains and





soybeans explained in large part why world prices for crops and livestock recorded a more subdued rebound in the early stages of recovery beginning midway through last year.

However, since the middle part of this year, prices for key benchmark agriculture commodities have moved significantly higher. For wheat and barley, several factors have been providing a boost to prices, such as expectations that wheat supplies will tighten owing to the drought in Russia and the Black Sea region of Eastern Europe; the subsequent embargo on grain exports from Russia; a slowdown in shipments from Ukraine; and a subpar production level of wheat in Canada, Ukraine and Kazakhstan. But while there have been increasing concerns of potential food shortages, prices have remained well below their 2007 peak levels, when fears of food shortages were rampant. This is because increased output from countries such as the U.S. and Australia has helped to take up some of the slack in world supplies. Indeed, year-end stocks for wheat and barley are expected to run moderately above their 5-year averages this year. Meanwhile, livestock prices have disproportionately benefited from the global recovery given that red meat tends to be most sensitive to shifting world income fortunes. Cattle and hog herd sizes in North America have also continued to shrink this year, lending a further helping hand to prices.

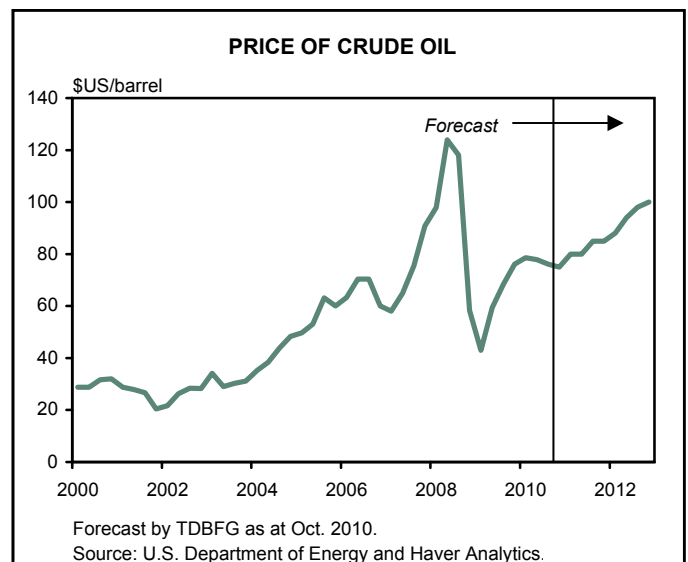
But while market fundamentals have been moving in the right direction, the upward price pressures in world agriculture markets have been driven in large part by substantial investment flows into commodities.

In an attempt to support the slow U.S. recovery, the Federal Reserve has announced that it will ease monetary policy further through additional injections of cash into the system (commonly known as quantitative easing). Given

low investment returns in the U.S., an important share of this cash is being invested in alternative currencies around the world as well as in commodities. While it is difficult to measure these impacts accurately, trends in non-commercial net long positions on commodity exchanges show that both crop and livestock prices have benefited from the investment interest. What's more, the increase in world crude oil prices back to just above US\$80 per barrel recently has breathed some new life into ethanol and cellulosic ethanol markets and, in turn, given an added fillip to the pricing of corn and oilseeds.

Looking ahead to 2011, the risk to prices is tilted to the downside as some of the recent speculative inflows – which tend to be temporary in nature – likely reverse course. We expect the U.S. dollar to find firmer ground as the economy avoids a double-dip recession and as investors contemplate the end of the extraordinary measures to ease monetary policy. At the same time, however, the continued rapid growth in emerging markets will help to put a floor under world crop and livestock prices. Among the five benchmark commodities that TD Economics tracks in its U.S.-dollar Commodity Price Index, prospects for further gains in prices are brightest for cattle and hogs on the back of recent declines in North American supply. On the flip side, with some of the momentum in crude oil cooling in light of the modest economic recovery, we see canola, corn and soybean prices retracing some of this year's increases.

With agriculture prices commonly quoted in U.S. dollars, Canadian farmers have been negatively impacted by the rising Canadian dollar in 2010, which strengthened from about 93 U.S. cents at the start of the year to a high of 99 U.S. cents in October. This impact is shown in the accompanying





**TD ECONOMICS AGRICULTURAL COMMODITY PRICE FORECAST
2010-2011**

US\$ PRICE FORECAST

	2002-09 Average	2010F				2011F				Q4/Q4 % chg	
		Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F	2010F	2011F
Wheat (\$/mt)	358	279	261	305	285	275	270	275	285	0.4	0.0
Barley (\$/mt)	129	143	146	158	155	150	155	160	165	6.2	6.5
Canola (\$/mt)	331	393	408	455	440	425	410	415	420	9.8	-4.5
Corn (cents/bu)	288	343	332	390	382	374	367	359	352	6.0	-7.8
Cattle (cents/lb)	88	90	94	92	90	92	95	98	100	7.7	11.1
Hogs (cents/lb)	66	70	82	81	78	76	80	82	85	35.1	9.0

C\$ PRICE FORECAST

	2002-09 Average	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F	2010F	2011F
Wheat (\$/mt)	382	283	278	314	291	281	273	272	279	-3.1	-3.9
Barley (\$/mt)	156	145	156	163	158	153	157	158	162	2.5	2.3
Canola (\$/mt)	397	399	434	468	449	434	414	411	412	5.9	-8.3
Corn (cents/bu)	348	348	353	401	390	382	370	356	345	2.3	-11.4
Cattle (cents/lb)	102	91	100	95	92	94	96	97	98	4.0	6.8
Hogs (cents/lb)	76	71	88	83	80	78	81	81	83	30.4	4.7

Source: Forecast by TD Economics as at October 2010

Wheat: 1 CWRS, Canada: St Lawrence, 13.5% (C\$/mt)

Barley: Canada: Cash Prices: Feed Barley: Lethbridge: Grade 1 CW (C\$/mt)

Canola: Canada: Cash Pr: Canola: Instore Vancouver: Grade 1 Canada NCC (C\$/mt)

Corn: #2 yellow: Central IL:(\$/bu)

Cattle: Live Cattle Futures Price: 1st Expiring Contract Open (cents/lb)

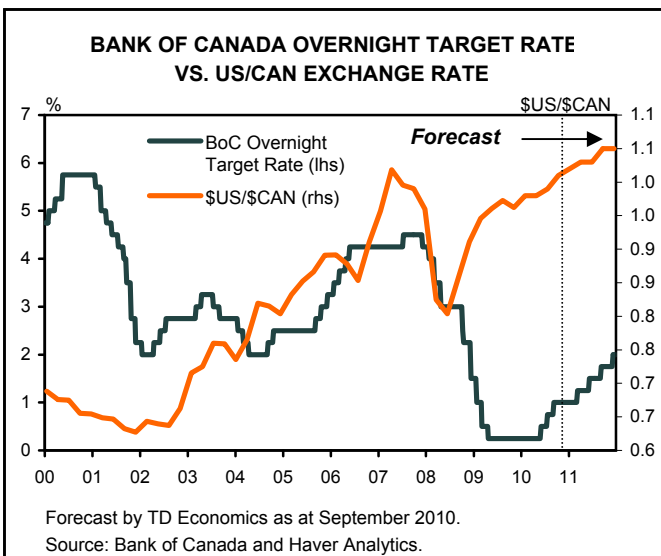
Hogs: Lean Hogs Futures Price: 1st Expiring Contract Open (cents/lb)

table of several key agriculture commodity prices in both US and Canadian dollars. Next year, we expect the loonie to rise to roughly parity on average, as international investors continue to be lured into Canadian-dollar investments by higher short-term interest rates relative to the United States. Despite the hit from the stronger currency, prices for most key agriculture commodities are projected to remain above their longer-term (2002-09) averages in 2011.

Prospects for Canadian farm incomes in 2010 and 2011

Pricing is only part of the income equation, however. As we discuss in somewhat more detail in the commentary on regional prospects, flooding in western Canada has been one key factor impeding the outlook for this year's fall harvest. But as importantly, net incomes will take a hit from increases in input costs. Energy prices are estimated to be about 20% higher this year than last. Similarly, fertilizer prices – with the exception of potash – have also risen above last year's levels as inventories were depleted. Other costs, including wages and transportation, have also risen off their recessionary lows. In addition, the livestock sector is facing higher feed costs and is still coping with uncertainty associated with U.S. country-of-origin labeling (COOL) regulations.

While the squeeze from higher prices is expected to remain a challenge for Canadian farmers in 2011, pressures from higher input costs could lose a step compared to this year as the pace of growth globally stabilizes in a moderate range. We suspect that adequately supplied world oil markets will keep the price of crude within its recent trading band of US\$75-85 per barrel. With respect to the outlook for potash pricing, uncertainty has been reduced following the rejection by the federal government of the proposed



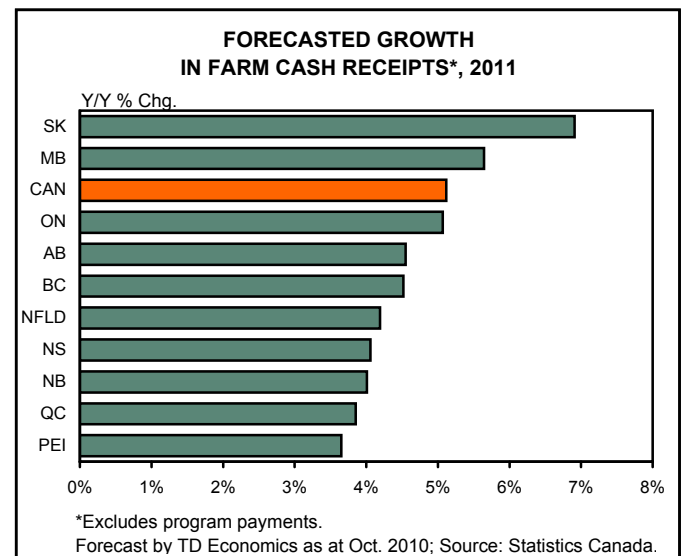
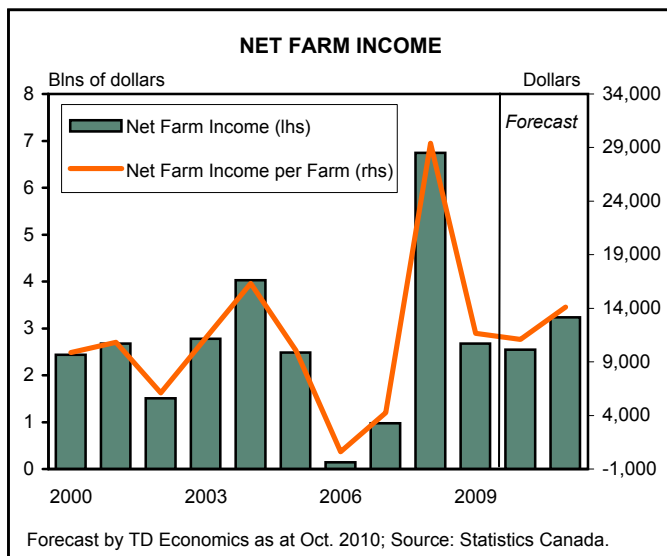
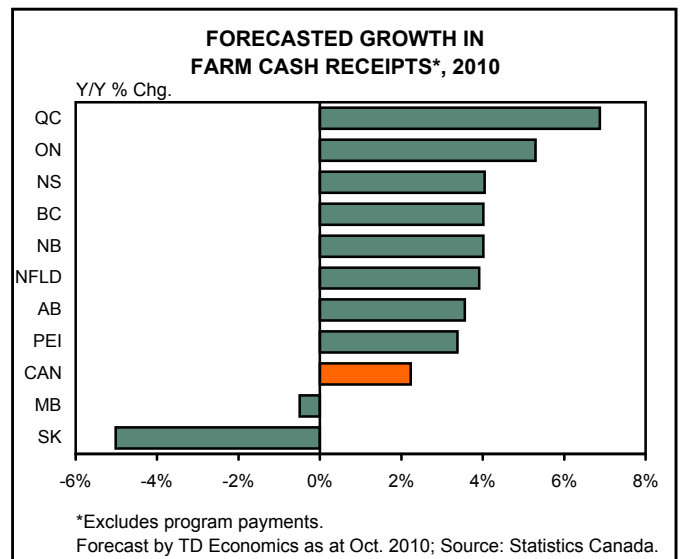
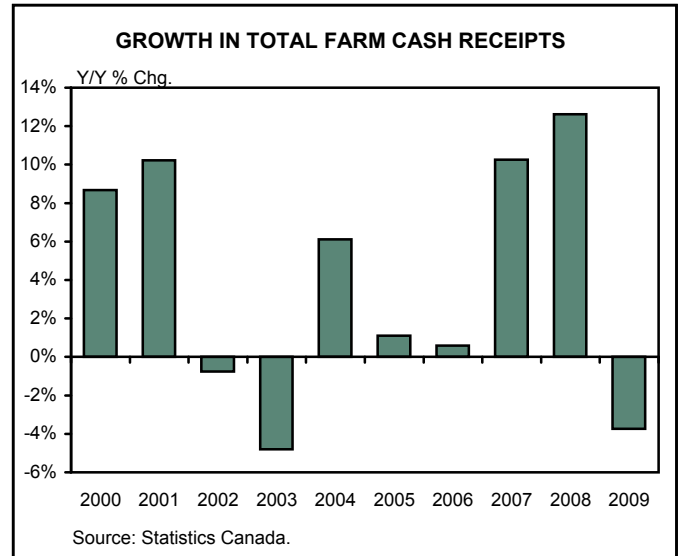
takeover of Saskatchewan's Potash Corp by BHP Billiton. Our base case forecast is for potash prices to rise in 2011, but only modestly.

One particular piece of good news for farmers on the cost side is that interest rates are likely to remain low. In the face of a slowing economy, the Bank of Canada (BoC) rate is expected to raise its overnight rate from its current level of 1% to only 2% by the end of 2011, which is equivalent to zero in real (after-inflation) terms. This shallow upward trend in the BoC rate implies that borrowing rates will remain unusually low over the near-to-medium term. A low interest rate environment, combined with a high Canadian dollar, will provide farmers with an opportunity to replenish their stock of machinery and equipment and thereby improve their level of competitiveness.

Adding it all up, we expect net Canadian farm income to fall from \$2.7 billion in 2009 (or about \$12,000 per farm) to the \$2.5-2.6 billion range in 2010 (or about \$11,000 per farm). For 2011, significant improvement in net farm incomes appears likely as farm cash receipts rebound largely as a result of a rebound in yields from this year's depressed level and to a lesser extent, higher prices. Still, at \$3.2 billion (or \$14,000 per farm) in 2011, our projected net income tally for the agriculture sector as a whole is slightly higher than the average of just under \$3 billion (or between \$13,000-\$13,500 per farm) recorded over the last ten years.

Varying regional performances in 2010 and 2011

Looking at the story through a national lens tends to conceal the true picture. In terms of farm cash receipts, annual changes in 2010 are expected to vary from a decline of 5% in Saskatchewan to growth of 5-7% in Ontario and



NET FARM INCOME					
	2009	2010F		2011F	
	Level (thousands of dollars)	Level (thousands of dollars)	Y/Y % Chg.*	Level (thousands of dollars)	Y/Y % Chg.*
BC	-225,773	-73,722	67.3	108,759	247.5
AB	-403,048	37,602	109.3	100,290	-166.7
SK	2,096,000	1,317,927	-37.1	1,526,659	15.8
MB	552,504	338,456	-38.7	381,898	12.8
ON	-50,606	97,069	291.8	230,017	137.0
QC	705,579	797,812	13.1	833,796	4.5
NB	36,910	38,494	4.3	40,552	5.3
PEI	7,675	9,109	18.7	10,925	19.9
NS	-40,808	-15,239	62.7	1,727	111.3
NFLD	-2,330	-790	66.1	530	167.2
CAN	2,676,074	2,546,720	-4.8	3,235,154	27.0

*Negative value equals decline.
 Forecast by TD Economics as at Oct. 2010. Source: Statistics Canada.

Québec. In terms of net farm incomes, the swing is likely to be even more considerable. Notably, Ontario and Alberta are likely to see swings from a net loss to a net profit position in 2010, while the red ink in British Columbia is poised to fall markedly. Consistent with the weaker receipts projections, Saskatchewan and Manitoba are likely to experience lower profitability in absolute terms and on a per-farm basis.

The big story in Saskatchewan this year was excessive moisture conditions and below seasonal-average temperatures that are likely to hit both quantity and quality of wheat and barley. Alberta, Manitoba and to a lesser extent British Columbia have also been hit by the excessive moisture conditions. However, the impact of poor growing conditions on farm cash receipts is likely to be less substantial than in Saskatchewan due to their stronger orientation towards livestock and – in the case of British Columbia – supply managed industries, where cash receipts are projected to have grown this year. Manitoba's overall performance is expected to be lifted by an estimated record soybean crop. Elsewhere, Ontario and Québec will benefit from respectable turnouts in soybeans, corn, certain fruits and vegetables and livestock receipts, which together will keep farm cash receipts growing at a respectable 5-7% clip this year. In Atlantic Canada, healthy rainfalls during the summer will help boost 2010 production levels for several commodities, including small fruits and vegetables. In that region, potato cash receipts are expected to fall moderately this year, despite production gains in Prince Edward Island.

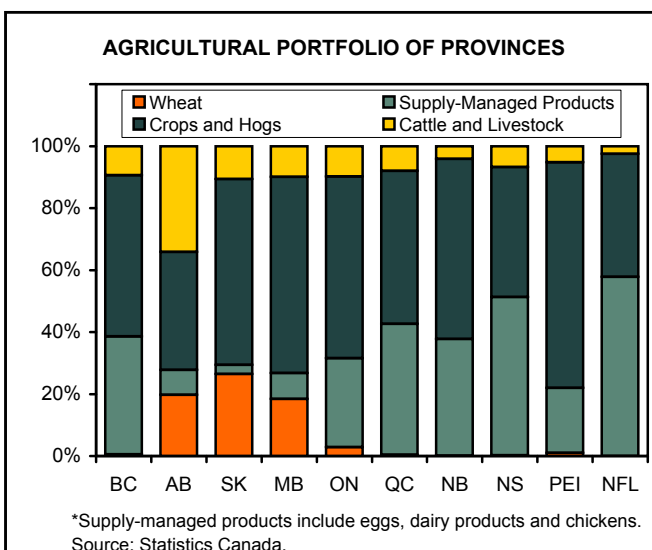
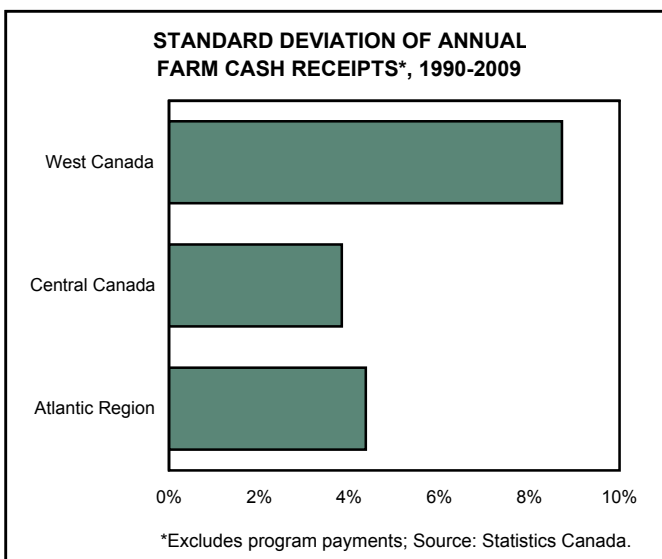
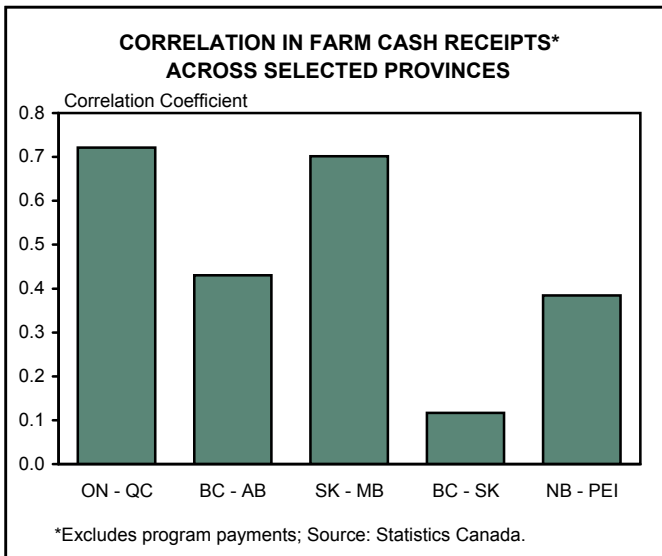
In 2011, look for provinces hit by this year's flooding to enjoy a return to more normal levels of production, lifting cash receipts and farm incomes accordingly. We show expected changes in the accompanying table. Net incomes

in the west are set to improve, but remain below their recent peaks in 2008. On the plus side, net income in Québec is expected to reach a new high next year.

Agriculture is all about location

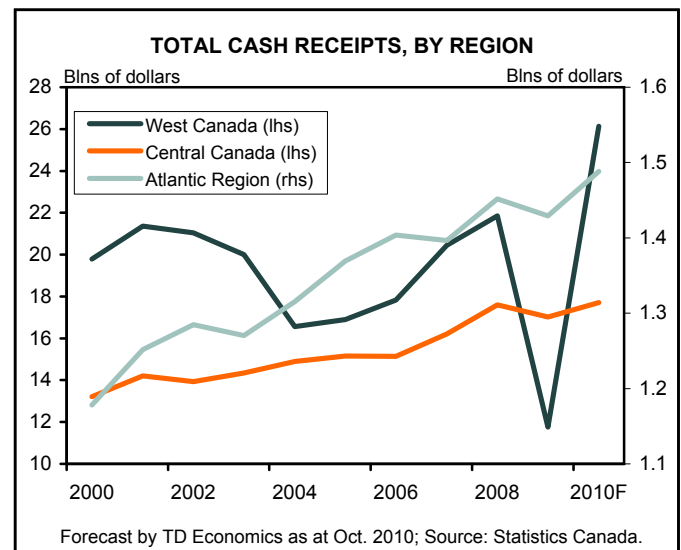
The variation in regional performances expected in 2010 and 2011 is hardly atypical in Canada. While housing comes a close second, there are no major markets where regional conditions tend to vary to such a degree in any given year as agriculture. Put another way, no two provincial agriculture sectors are mirror images of each other. They differ in terms of growing conditions, average moisture levels, and proximity to export markets among many other factors. In addition, some provinces are home to more diversified product mixes across supply-managed, crop and livestock businesses that make a region less vulnerable to shocks affecting a particular industry. These drivers tend to explain both short-term variations as well as differentials in longer-term performances. A closer look at agricultural sectors from coast to coast yields some interesting observations:

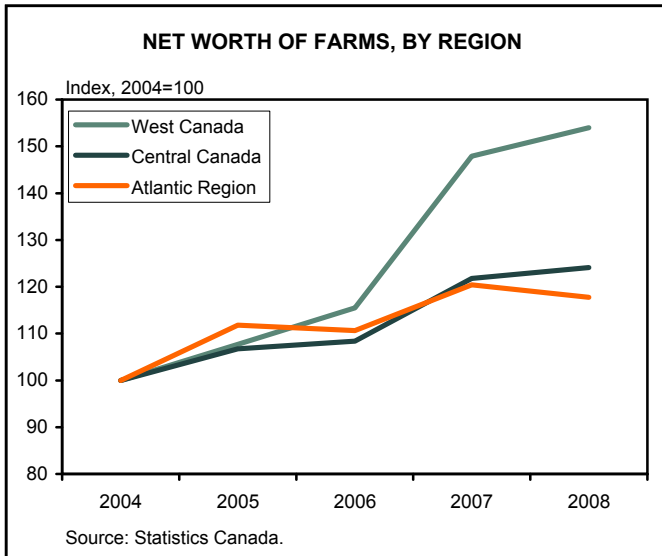
- In terms of sheer number of commodity offerings, Ontario, Manitoba and Québec are home to the most diverse agriculture sectors among the provinces, while Newfoundland and Labrador and Prince Edward Island occupy the other end of the spectrum.
- Still, a province can offer many commodities but still be heavily reliant on just a few. Thus, an alternative measure of diversity asks which provinces have their cash receipts more widely spread out across commodities. Based on this gauge, Saskatchewan (where nearly 60% of receipts are attributable to wheat, barley and canola) would join Newfoundland



and Labrador and Prince Edward Island on the list of provinces with a lower degree of diversification. In contrast, Ontario continues to enjoy a relatively high level of diversification.

- Historically, those provinces with greater diversity tend to record less volatility in terms of changes in farm cash receipts, excluding provincial stabilization and crop insurance programs. The flip side is also true. Despite the shock-absorbing impact of government insurance and stabilization programs, provincial farm cash receipts and net incomes still tend to be more volatile in those provinces with weaker diversification.
- Given the large variation in commodity mixes seen across the nation, provincial farm cash receipts, excluding government programs, are generally poorly correlated among provinces. In other words, a good year in one part of country in terms of cash receipts and net income provides little information on how other regions have performed. If payments made through government stabilization programs and other insurance-type programs are included in the count, the observed correlation across provinces strengthens but not substantially.
- There are exceptions to the rule, however. Not surprisingly, larger similarities in product mix and growing conditions in the prairies leads to a higher-than-average correlation in annual turnouts. Still, due to its large cattle sector, the fortunes of Alberta farmers in any given year show a lower correlation to those of their prairie counterparts than is the case between





Manitoba and Saskatchewan. At the same time, annual performances in Ontario, Québec and British Columbia tend to be relatively highly correlated, owing largely to the significant supply managed components to their agriculture portfolios. In contrast, despite their close proximity, Newfoundland and Labrador and Nova Scotia's agriculture sectors are weakly correlated with those of Prince Edward Island and New Brunswick.

Above all, regional unique characteristics have also been reflected in varying longer-term growth rates in agriculture sectors across the country. In order to assess longer-term growth rates, we looked at annual farm cash receipts and real gross domestic product (GDP). Based on these measures, Manitoba and Saskatchewan have displayed the strongest growth in agriculture over the last decade, while Prince Edward Island and Nova Scotia have shown the slowest rates. These growth performances also line up well with figures from the Farm Financial Survey on growth in assets and net worth. Farmers in the strongest two growth provinces also registered the largest gains in assets and net worth between 2004 and 2008, the period during which the

last survey was conducted.

The factors driving the stronger rates of long-term growth in certain provinces cannot be pinned down to one or two factors. Suffice it to say that the faster-growing regions have ridden the wave of growing trade with the United States – and most recently, emerging Asia – in wheat, oats, barley, soybeans and canola. The more recent push to alternative fuels from conventional fuel types has also assisted growth prospects in recent years. In order to capitalize on these opportunities, farm sizes have increased over the last few decades, driving improved efficiencies. For other provinces, slower growth rates recorded over the past decade may be more to do with their link to sectors that have suffered significant setbacks – notably Bovine spongiform encephalopathy (BSE) and COOL in the livestock area – than sub-optimal business strategies. In addition, a large representation in the supply-managed businesses tends to lead to slower growth potential but less annual volatility in farm incomes.

Still, we don't subscribe to the view that there exists a "trade-off" between achieving a diversified agriculture sector and one that records rapid long-term growth. For example, success in leveraging rapid expansion in certain niche markets – such as organics, bio-fuels and other higher value-added areas – as well as in emerging markets could help regional agriculture sectors accomplish this double-headed aim. Improving cost competitiveness through innovation and risk management strategies to contend with an increasingly volatile global economy would support these goals.

Bottom Line

After an up and down year in 2010, Canadian farm income prospects appear brighter in 2011. As what is typically the case, however, conditions are likely to vary across the country. Notably, those in Saskatchewan and Manitoba are expected to lead the way, bouncing back from a difficult 2010, while other regions record more moderate growth.