TD Bank Financial Group

TD Economics

Special Report

November 6, 2008

2009 PROSPECTS FOR CANADIAN AGRICULTURE

Weaker C$, Easing Cost Pressures to Backstop Farm Incomes Next Year

2008 will go down as a memorable year for Canadian agriculture. It was only this past spring that world crop prices were soaring on the back of concerns about global food shortages, growing excitement about the use of food as a source of fuel and a surge in speculative financial investment in commodity futures markets. Fast forward six months. Food supply fears have eased considerably as this year's global crop will exceed earlier expectations. And growing worries about the global financial and economic landscape have dampened expectations for both world food consumption and investment appetite for commodities. The huge gains in crop prices have evaporated even more quickly than they occurred.

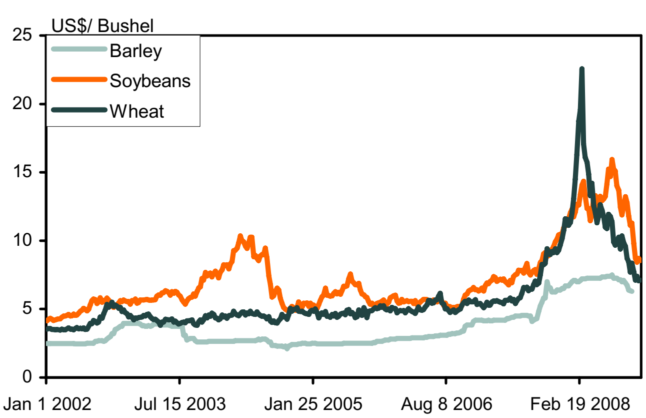
In the aftermath of this roller-coaster ride, farm producers in Canada must be left wondering where the sector will head once the dust settles. In the very short term, the risk to agriculture prices continues to be tilted to the downside, as financial markets remain unsettled and worries about the global economy stay at the forefront. However, by mid-2009, we expect prices to regain their footing, including those in the beleaguered hog industry. In spite of global headwinds, farmers are expected to receive an offsetting boost in the near term from a weaker Canadian dollar and some easing in cost pressures.

A year ago, TD Economics released a report entitled, *Canadian Agriculture Begins a New Era*. Our thesis was that even though agriculture markets would always be prone to short-term swings, the sector's overall longer-term fortunes – notably for crops – had brightened significantly in the wake of rising incomes in emerging markets, government mandates for ethanol and other growing opportunities in areas such as organics. Notwithstanding the

HIGHLIGHTS

- **US$ crop prices not expected to retest recent highs any time soon, but should remain above their 5-year averages in 2009.**
- **A weaker C$ should help to cushion Canadian farmers from the impact of lower US$ prices.**
- **Farm incomes will be further supported by a simmering down in energy, global transportation and fertilizer costs.**
- **Credit crunch expected to ease over the next 12 months.**
- **Despite benefiting from an easing in cost pressures, Canadian livestock producers face another challenging year in 2009.**

CROP PRICES



Source: Wall Street Journal, Haver Analytics
Last Date plotted Oct 28, 2008

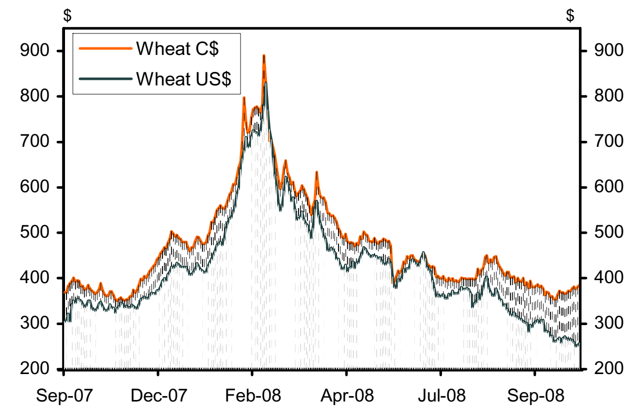
flurry of events over the past year, we stand by that assessment.

What a wild ride it's been in crops

This year's run-up in crop prices – followed by the subsequent decline – was tumultuous indeed. CBOT benchmark prices on wheat and soybeans shot up by about 40% and on corn by nearly 70% during the first half of the year, only to retrace those gains during the summer and fall. In the case of wheat, the retracement has left prices at 16-month lows**.** Canadian crop prices have also embarked on a wild ride, although not quite to the same extent as U.S. prices for similar commodities.

To some extent, the shift in sentiment in the global crop market reflected movements in the usual supply-demand

WHEAT PRICE GAP*



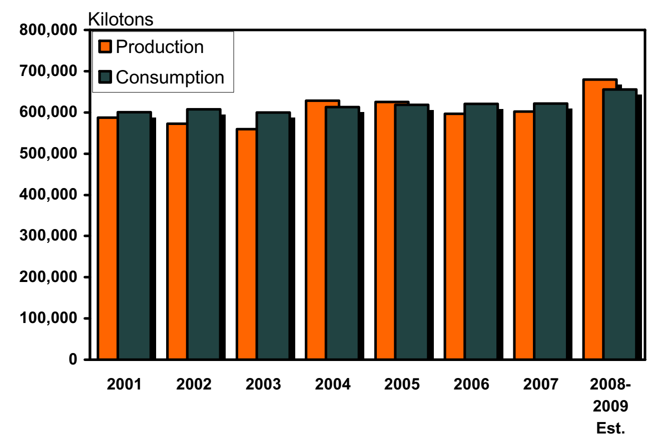
*C$ Wheat price from CWRS, US$ Wheat price, Wall Street Journal Spring Minneapolis converted to Metric Tonnes. Last date plotted: October 24 2008
Source: TDCI, Wall Street Journal, Haver Analytics

fundamentals. After **two** straight annual declines in output and demand from emerging markets on the rise, the world entered 2008 facing critically low grain and oilseed stocks. If that wasn't enough, ambitious government mandates for grain-based ethanol and biodiesel production continued to drive a wedge between global supply of crops and their traditional uses in feeding both households and livestock. Indeed, it has been estimated that 30-40% of U.S. corn production will be diverted to ethanol this year. And with global agricultural markets projecting that these various trends would continue well into the future, fears about food shortages escalated. Riots were even sparked in countries such as Haiti, Indonesia, Mexico and Egypt.

What a difference six months can make. Despite expectations that global supply of crops was relatively fixed, world crop production managed to respond to the high price signals this year. Seeded acreage around the world rose sharply, especially in wheat. With weather cooperating well, world wheat output is poised to grow by an astounding 12% this year, compared to a 6% gain in global consumption. In almost one fell swoop, global inventories have been restored close to their 5-year average. Other major world crops also enjoyed strong yields this year. Barley output is on track to grow 12%, while consumption will likely advance only 4% and canola yields are the highest on record, with increased production in Canada, Australia and the Ukraine. On top of the improved yields, agricultural commodities have not been immune to growing worries about the impact of a global economic slowdown on consumption.

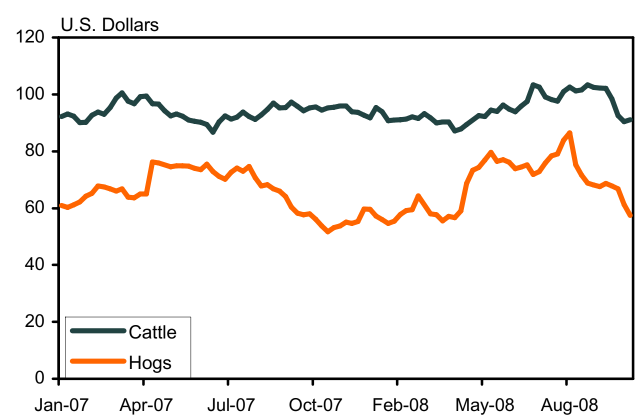
But while changes in expectations about fundamentals

WORLD WHEAT PRODUCTION AND CONSUMPTION



Source: OECD-FAO Agricultural Outlook, 2008-2017, 2008-2009 Est. by TD Economics

LIVESTOCK PRICES



Source: TD Commodity Price Index
Last Date Plotted October 24, 2008

Speculation in Crop Markets has Accentuated Price Swings

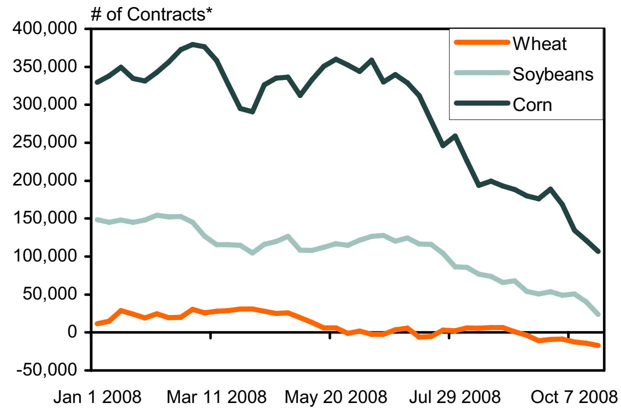
Speculation can be defined as the purchase or sale of a commodity or good in the hope of reaping a profit from changes in its price.[1] In the case of commodity markets, a form of speculation that has been significant is the purchase of futures and options contracts as an investment strategy rather than a way to manage risk related to the purchase or sale of commodities.

Pinning down the extent of investor speculation in commodity markets over the past few years is not made easy by the lack of hard data on the subject. Nonetheless, there is a good case to be made that the speculative element has played an increasingly big role in setting prices.[2] According to some ballpark estimates, financial players – including commodity index funds, hedge funds and exchange traded funds – held as much as US$400 billion in commodity futures around the recent peak in prices earlier this year – roughly double its 2005 level. And while the energy markets accounted for much of the interest, agriculture markets were also a prime target, making up roughly US$50-120 billion. In the U.S. corn market, index funds controlled a record 4.5 billion bushels of corn, wheat and soybeans through CBOT futures, equal to half the amount held in U.S. silos on March 1st.[3]

It is hard to say how much of these speculative positions have been reversed since mid-2008. The Chicago Board of Trade generates data on non-commercial transactions (a proxy for speculators) for key crops. Based on that count, speculative activity has cooled off significantly. Indeed, non-commercial net long positions for corn are now sitting at about 106,000 contracts, compared to 380,000 in February. Perhaps even more pronounced was the transition in wheat holdings, which moved from a net long position of about 31,000 contracts to a net short position of 17,000. Some of the recent selling also reflects liquidating positions to cover margin calls and to raise liquidity.

It does appear that the upward price pressure from speculative buying was fuelled in part by the fall in the U.S. dollar. There has been some fundamental appeal of the U.S. dollar/commodity price relationship. Since agricultural and other commodity prices are quoted in U.S. dollars, a falling (increasing) U.S. dollar boosts (lowers) the purchasing power of crops of many importing countries, thus impacting demand patterns. Hence, a trading pattern started to emerge with short positions in U.S. dollar (i.e., positions created via short sales) being offset by long positions in crops and other commodities. Since mid-2008, a rebound in the U.S. dollar has led to a reversal in this type of trade.

NET COMMERCIAL SHORT VS. LONG POSITIONS



Source: Chicago Board of trade
*Noncommercial Long Positions - Noncommercial Short Positions

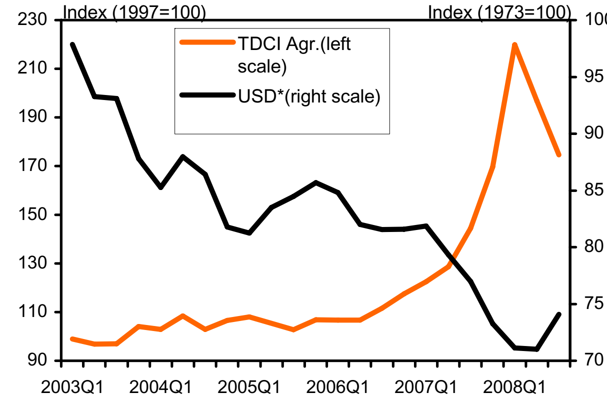
The recent price swings have prompted a call to action by many individuals to clamp down on financial-market activity in commodity markets. Many farmers, who use futures markets to hedge risks, have been opposed to speculative activity, as they argue such activity distorts market signals. And, indeed, the role of speculators has been coming under increased scrutiny from regulators and public officials, notably in the United States. A counterargument in favour of financial market participation in futures markets is that it increases liquidity.

Regardless of changes made to regulations going forward, we doubt that speculators will jump back into commodity markets nearly to the same extent as in 2007-08. The commodity investment was driven by a mix of influences that are unlikely to be repeated to the same extent, chief among them include the perceived hedge against inflation, a substantial further drop in the U.S. dollar and a lack of other investment opportunities. The deleveraging process is likely to take several years to run its course, limiting the extent to which investors take on bets.

have been a major factor at work in crop markets, fingers have also been pointed at speculators and the trend in the U.S. dollar as key culprits behind the massive moves in prices. We discuss this issue in the accompanying text box. In addition, many have argued that during the peak of the run-up, fears of crop hoarding – such as rice in Asia – also appeared to contribute to the unsustainable price escalation.

Although most of the drama has taken place in the crop markets this year, livestock prices – and in particular hogs – have also been subject to significant turns in fortunes. Despite surging feed and other costs, an abundance of U.S. inventories kept prices at a low levels at the start of the year, before a strong pickup in global export demand underpinned price rallies during the spring and summer. In the case of hogs, prices surged about 50% since the end of 2007. However, subsequent indications that export demand has softened considerably in the autumn in tandem alongside a softening global economy and sharp increase in the U.S. dollar has erased the gains recorded earlier this year.

TD AGRICULTURAL PRICE INDEX VS. THE US DOLLAR*



*Trade weighted index against major currencies, last Date plotted 2008Q3
Source: Haver Analytics; TD Economics

Where are prices heading?

TD Economics' near- and medium-term price projections for key agricultural commodities are shown in the table below. (We will include a table showing US$ and C$ prices for key agriculture commodities by quarter through 2010.) Implicit within this forecast is the following macr-

TD ECONOMICS AGRICULTURAL COMMODITY PRICE FORECAST 2008-2010

	2002-07	2008				2009				2010				Q4/Q4 % chg		
	Average	Q1A	Q2A	Q3A	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2008	2009	2010
US$ PRICE FORECAST																
Wheat ($/mt)	210	611	481	389	300	275	250	260	270	275	280	290	300	-27.9	-10.0	11.1
Barley ($/mt)	115	212	237	216	150	140	135	137	140	145	150	153	158	-24.7	-6.7	12.9
Canola ($/mt)	285	624	623	539	340	330	320	325	330	335	340	345	350	-28.1	-2.9	6.1
Corn (cents/bu)	244	488	589	536	400	375	350	355	360	370	380	390	395	-11.1	-10.0	9.7
Cattle (cents/lb)	83	92	93	101	90	85	90	95	97	98	95	98	102	-4.9	7.8	5.2
Hogs (cents/lb)	59	58	73	74	55	52	58	62	65	68	70	72	75	-1.7	18.2	15.4
C$ PRICE FORECAST																
Wheat ($/mt)	269	614	486	405	375	352	325	346	346	344	342	351	354	-9.7	-7.8	2.4
Barley ($/mt)	147	213	239	225	188	179	176	182	179	181	183	185	186	-5.6	-4.4	4.0
Canola ($/mt)	365	627	629	561	425	422	416	432	422	419	415	417	413	-10.0	-0.6	-2.2
Corn (cents/bu)	312	490	595	558	500	480	455	472	461	463	464	472	466	11.3	-7.8	1.2
Cattle (cents/lb)	106	92	94	105	113	109	117	126	124	123	116	119	120	19.2	10.4	-3.1
Hogs (cents/lb)	76	58	73	77	69	67	75	82	83	85	85	87	89	23.1	21.0	6.4

Source: Forecast by TD Economics at November 2008
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)

oeconomic assumptions:

- While TD Economics forecasts the global credit crisis to ease in 2009, the path to improvement will be gradual.
- Even if credit market conditions begin to turn the corner, a global economic recession now appears to be a slum dunk in 2009 and only a moderate bounce-back in world growth is in store for 2010.
- Over the next 12 months, developing markets – such as China and India – will account for all global growth, as the major industrialized economies post little or no economic expansion.

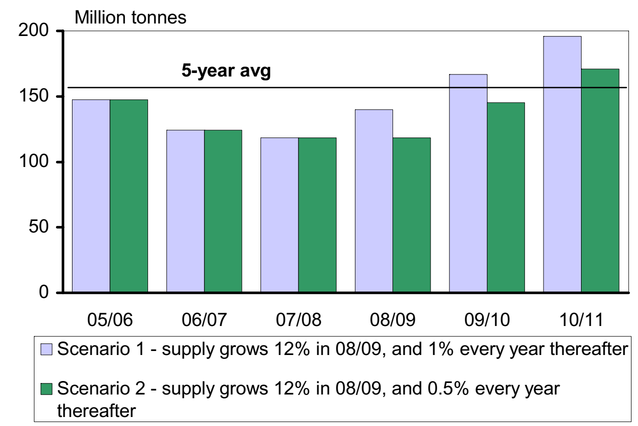
In this environment, we see the risks to agriculture prices tilted to the downside, as global economic and financial headwinds continue. As has been the case of late, most vulnerable to further selling are crop prices, which despite the clearing off of much of the speculative froth built up in 2007-08, remain especially prone to further liquidation of commodity positions by hedge funds and other institutional investors. Livestock prices – notably hogs – have less scope for declines since they are already at low levels.

Still, there are several reasons to suggest that any further weakening in crop prices from current levels will likely represent an "overshoot", with prices undergoing a firming trend throughout the remainder of 2009 and into 2010. For one, most crop markets are heading into this period of global downturn enjoying relatively well balanced supply-demand conditions. Even then, demand for food tends to be less sensitive to deteriorating global income gains than other commodity areas. Furthermore, a bigger threat to the credit crisis is on supply rather than demand, as ongoing credit problems globally could dampen sales of machinery, fertilizer and other inputs, thus impeding next year's output.

Higher price plateau for crops to remain intact

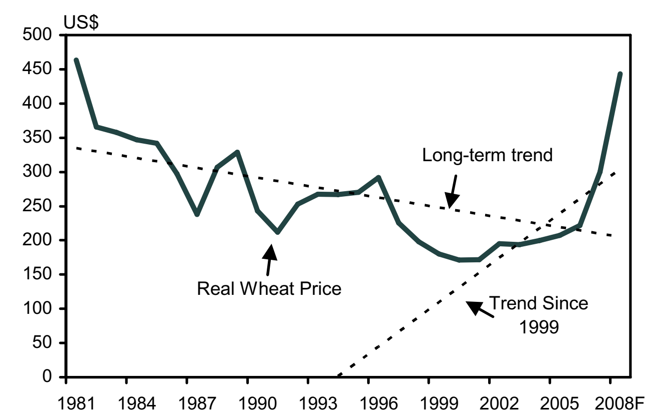
Above all, we continue to see longer-term support for agricultural prices still at play – a development that was front and centre in last year's TD Economics' report discussing a new era for agriculture. For several decades, crop prices globally had been falling in real inflation-adjusted terms as the contribution of rising productivity on global supply outstripped the impact of gains in demand. However, even discounting the major up and down in prices in 2007-08, a trend pickup in global consumption growth

GLOBAL WHEAT YEAR ENDING STOCKS



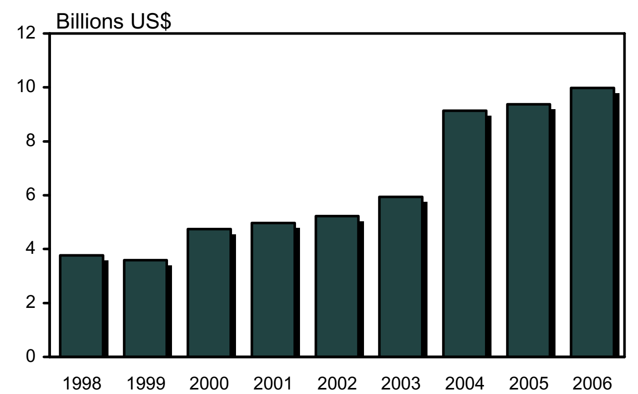
Consumption grows 6% in 08/09, and 0.7% every year thereafter in both scenarios
Source: U.S. Department of Agriculture, forecast by TD Economics

REAL WHEAT PRICES*



* Nominal Prices deflated by U.S. Core CPI
Source: TD Commodity Price Index, Haver Analytics

CHINESE FOOD AND LIVE ANIMAL IMPORTS*



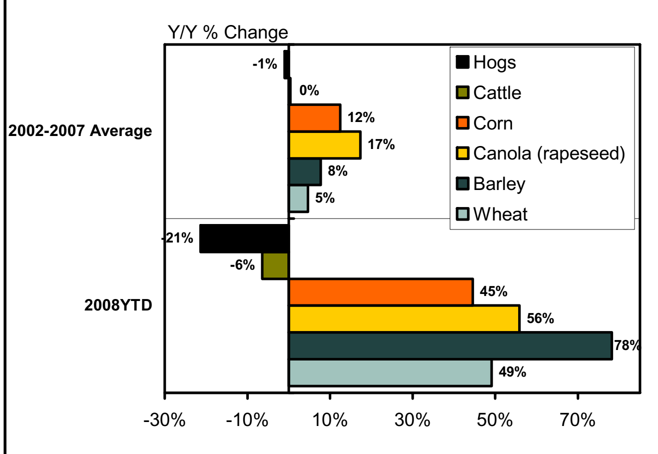
*Includes Raw Agricultural products as well as Micellaneous food preparations imports from all source countries.
Source: UN Commodity Trade Statistics Database

vis-à-vis productivity has reversed the long-term decline in real crop prices since the early 2000s. And, we don't foresee that trend halting over the next several years.

Certainly, one catalyst has been the growth in demand from expanding economies in China, and India, among others. China, in particular, has made waves in agricultural markets, with imports of food and live animal products more than doubling since the start of the decade. And, while these economies won't buck the trend to slower growth next year, they are likely to continue to grow at a clip at least 3 times of that of developed countries over the next decade. TD Economics forecasts the economies of China and India to expand by 8.5-9% and 6-6.5%, respectively, in the 2009-10 period. This growth will continue to benefit both crops and livestock sectors.

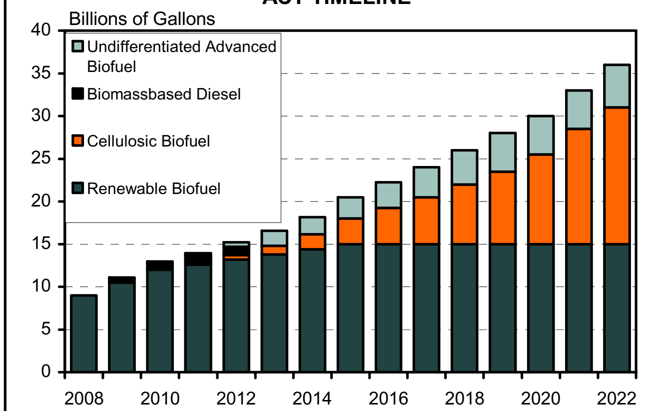
But as importantly, we have not dropped our assumption that growing ethanol and biodiesel production will continue to underpin crop demand in the United States, Canada and elsewhere around the globe next year and over the longer haul. Recent developments on this front have been mixed. The push to develop alternative energy sources, such as ethanol, has been dealt a setback by the recent dramatic decline in prices of competing crude oil, while more individuals are questioning the longer-term environmental benefits of ethanol vis-a-vis fossil fuels. What's more, the recent flare-up in concerns about the global economy appear to have pushed the environment lower down on governments' list of priorities, at least temporarily. On the flip side, the easing global food shortages has also pushed the "food versus fuel" debate to the backburner, which had been a growing threat for grain-based biofuels.

GROWTH IN CANADIAN FARM CASH RECIEPTS



Source: Statistics Canada

U.S. ENERGY INDEPENDENCE AND SECURITY ACT TIMELINE



Source: RFA Ethanol Industry Outlook

As well, the newly-elected U.S. President appears steadfast in his support for the development of alternative energy sources.

We expect that the latter forces will win out, keeping the existing biofuel mandates and subsidy programs intact in the United States. Supported by this incremental demand, crop markets are projected to stay relatively tight and prices at a healthy margin above their 5-year averages.

From a Canadian perspective, the growing ethanol industry is a mixed blessing. While ethanol provides support to prices received by crop farmers, it raises the cost of livestock feed. Canada has traditionally grown more feed corn than demanded by livestock producers, with the surplus then shipped abroad. But with a growing amount of domestic production of corn used in the ethanol process, the country now records a corn trade deficit, which places prices on a higher import basis. These impacts on feed costs are mitigated by the fact that a byproduct of grain used in ethanol production can be enhanced and used as cattle feed.

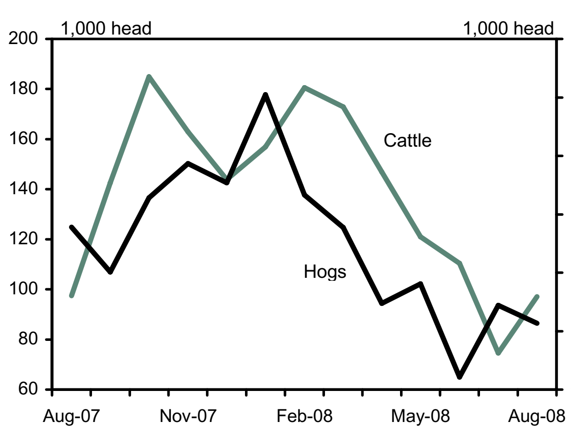
Canadian livestock prices may not follow U.S. prices higher in 2009

With tightening global credit conditions and slowing economies around the world to lead to a slackening in red meat demand over the next few quarters, the hog and cattle markets are not expected to buck the continued downtrend in prices in the near term. However, we not only see scope for further near-term price declines in U.S. markets relatively limited, but we see some significant upside once the global economy begins to gain traction later in 2009 and into 2010. The price story is linked to the outlook for tightening supplies, reflecting in part the recent weakness in financial returns in the industry, the Canadian federal government's Cull Breeding swine program and new legislation on country-of-origin labeling (COOL). These factors are expected to have a major negative impact on Canadian exports to the United States over the forecast period.

- In order to help the hog industry restructure, the Canadian federal government announced the Cull Breeding Swine program this year. Through providing compensation to farmers, the aim of the program is to reduce swine breeding herd stocks by approximately 10%. The application deadline was September 1, 2008, at which time about 8% of the breeding herd had been culled or were eligible to be culled. Similarly, it has been estimated that about 16% of Canadian hog farmers have opted to leave the industry.

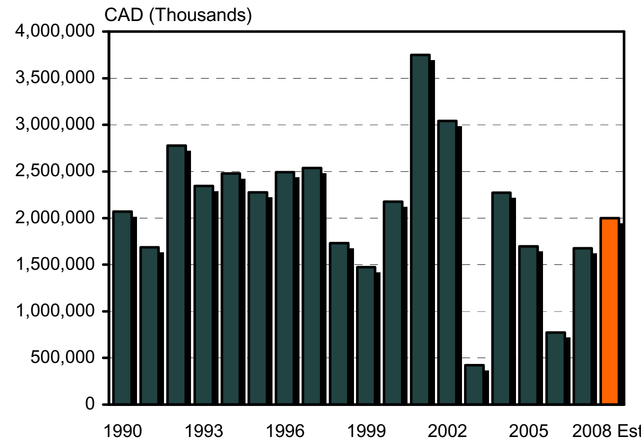
- On September 30, 2008, the U.S. introduced origin-of-country labeling (COOL) for beef and pork products. While several U.S. packers had proposed to use a single label denoting a product of Canada, the U.S. and Mexico – even for U.S.-origin products – in order to cut the amount of segregation required and thus lowering the hit on costs, the U.S. agriculture department reversed an earlier position and ruled against such a move. As a result, several large beef packing plants in the U.S. have already stopped accepting Canadian imports or have announced that they will do so. Already, the impact on Canadian livestock exports has been visible. Feeder cattle shipments were already down by as much as 60% ahead in the four weeks leading up to September 30th. Similarly, market hog exports to the U.S. were down by 78% Y/Y in the two weeks following the COOL implementation.

U.S. LIVESTOCK IMPORTS FROM CANADA



Source: USDA

CANADIAN REALIZED NET FARM INCOME



Source: Statistics Canada, 2008 Estimate by TD Economics

Given that Canada is an important market for the U.S. – accounting for about 90% of U.S. live hog imports and 60% of live cattle – the impact of these developments is likely to leave the U.S. market in somewhat of a tight spot as 2009 progresses, thus boosting U.S.-dollar prices. But while higher U.S. prices normally spill over to Canadian prices, and particularly during a period of a downtrend in the loonie, the weakening demand Stateside for Canadian hog and cattle exports will likely preclude a lockstep increase on this side of the border. Thus, as we discuss next, the top lines of livestock producers are expected to remain under pressure next year.

Outlook for Canadian farm incomes in 2009

Based on recent price patterns, we turn to the near-term outlook to Canadian farm incomes. The most recent data cover 2007, when realized net farm income rose to $1.7 billion. While this was double its 2006 level, it remained below the levels of $2-$3 billion recorded earlier in the decade.

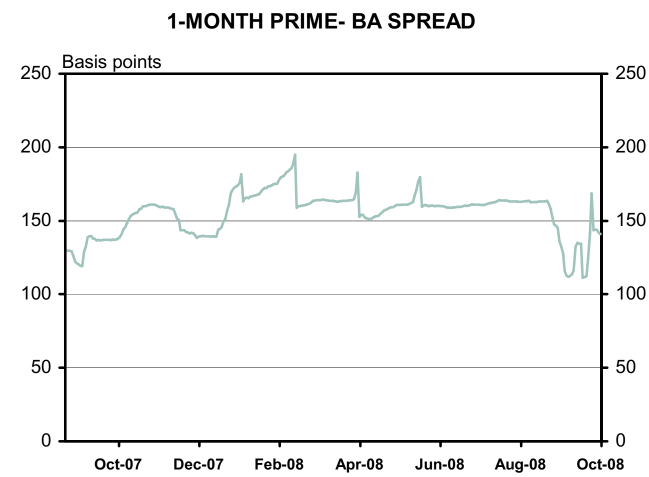
For 2008, the picture is decidedly mixed. So far, only figures on farm cash receipts (a proxy for top-line farm revenue performances) for the first and second quarters of the year have been released. And by that count, Canada's farm sector is poised to turn in a stronger showing this

Impact of the Credit Crunch

With the global credit crisis spilling over to Canada in recent months, there have been concerns raised about access to credit. These concerns are natural given the extreme distress present in the global financial system and the stories about the dramatic decline in banking lending in the United States. In Canada, there is some evidence that credit conditions have tightened. The Bank of Canada Senior Loan Officer Survey showed that 47% of respondents reported tighter pricing and 53% indicated tougher non-pricing aspects of lending.

It is critical to recognize the difference, however, between the U.S. and the Canadian experience. In many cases credit is not available in the U.S. at any price, which is why there had been a massive government intervention in the banking sector, with the U.S. Treasury injecting more than US$1 trillion to get lending flowing again. In contrast, credit is available in Canada to businesses, although the cost of funds may not be as attractive as in the early part of this decade. This is why the Canadian government response has been far more subdued. For lenders that pursued prudent practices in the past there has been no need to dramatically tighten up on loan conditions. And, this can be observed from the fact that tightening observed in the Bank survey is only slightly greater than the experience in 2001.

The reason for the tighter pricing and availability has to do with an increase in the cost of borrowing to financial institutions. The accompanying chart shows the spread between the Prime lending rate and the 1-month Bankers Acceptance (BA) rate. The Prime lending rate is the benchmark for many loans. The BA rate is the cost to financial institutions of raising cash. In recent months, the Prime lending rate has declined as the Bank of Canada cut rates, but the BA rate has not fallen in tandem. Canada's largest lenders take in deposits and make loans, but the loans are greater than the deposits. The difference must be financed in international markets, which are currently demanding elevated interest rates and impairing profitability. Policy makers in the U.S., Europe and Canada have introduced significant measures to address this problem in an effort to lower interbank lending rates. These actions are likely to be successful eventually, but it won't happen overnight. When the financial strains do subside, businesses should find that credit pricing and availability improves. However, given that the excess credit was the root of the recent financial problems, the availability and price will not return to the lows in the early part of this decade.

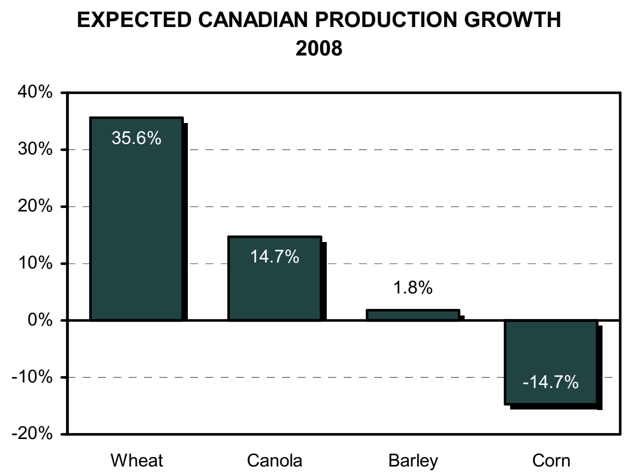


Need to see a return to the long-run average of 160 bps to ensure adequate margins

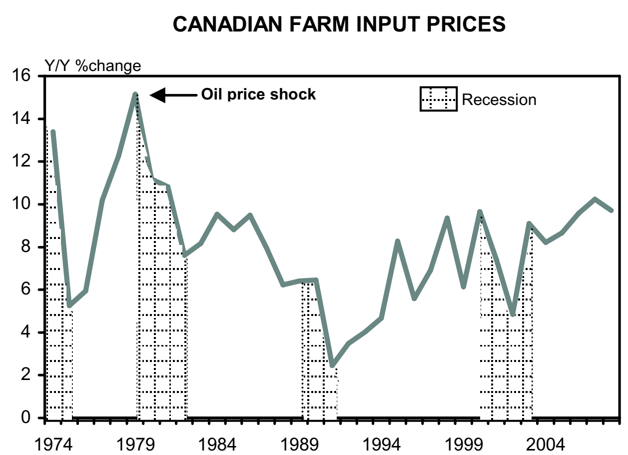
year. During the year's first half, total receipts shot up by 11% Y/Y, as a 31% surge in crop receipts more than offset a 4% decline in the livestock tally. Such a strong start to the year might suggest that farm incomes should exceed the level in 2007. In reality, the picture is considerably murkier for several reasons.

First, crop prices have retreated significantly since mid-year, so the year is likely to end off on a weaker footing. But even there, the Canadian dollar has plunged in tandem with U.S.-dollar prices, partially shielding Canadian farmers.

Second, in addition to prices, output is a key driver of revenues. And early readings of Canadian crop production in the all-important autumn harvest have been generally favourable. As of September, total wheat production is expected to rise 36% in 2008, with canola and barley up 14% and 2% respectively over year-ago levels. With prices of these crops on the rise, farmers increased acreage at the expense of corn. As such, corn production is expected to fall 15% in 2008. Still, the jury remains out on the grade/quality of the crop. In contrast, in view of the impact of COOL and the Swine Breeding program, cattle and hog production almost certainly lost ground this year. In the hog industry, Canadian inventories fell by about 11% Y/Y as of October. Cattle inventories, which are reported semi-



Source: Statistics Canada September Estimate of Production of Principal Field Crops



Source: Statistics Canada,Haver Analytics

annually, were down 4% as of July 1st.

Third, perhaps the greatest uncertainty revolves around how much profit margins in 2008 were reduced by rising costs. Sky-rocketing energy and fertilizer costs, tight markets for labour and high freight costs were a major challenge for crop farmers in 2008, despite some likely reprieve in some of these areas later in the year. Within the livestock industry, farmers were not only forced to deal with pressures in these areas, but also escalating feed prices. Many farmers attempted to lessen the cost blow by implementing changes in technologies and in process, including expanding farm sizes to reap economies of scale and moving away from the expensive corn feed, towards lower cost feeds such as barley and wheat.

Unfortunately, even fewer indicators have been released on farm input prices for 2008, so forecasting whether the cost or revenue side will win out in 2008 is a tough call. In our view, total net realized farm income will come in moderately higher than last year – in the $1.5-$2 billion ballpark. Keep in mind that this tally hides the stark divergences in sector and regional performances. Many farmers that are highly reliant on livestock farming – and notably hogs – will face a struggle recording a profit this year. On the plus side, many livestock farmers in Canada also own significant crop operations, which have been providing an important counterbalance.

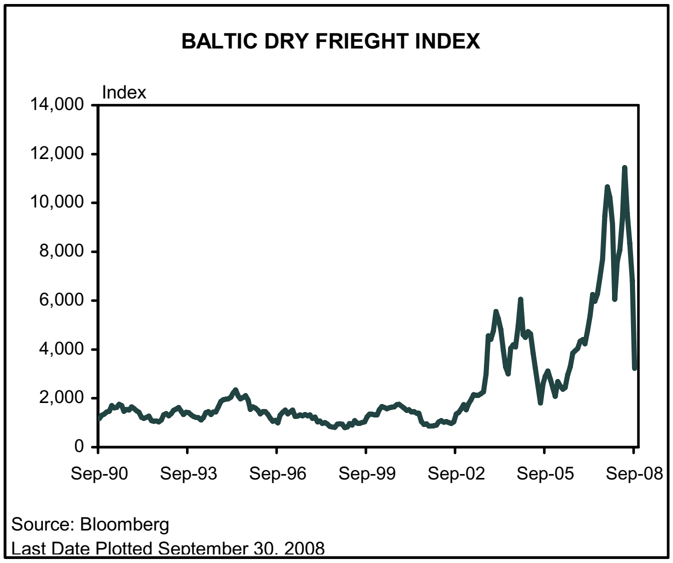
A look ahead to the net income picture in 2009 also contains significant cross-currents. In general, the price side will be a downward influence on net incomes next year compared to 2008, especially on the crop side. However, a number of other factors will provide offsetting support to bottom lines in the farm sector:

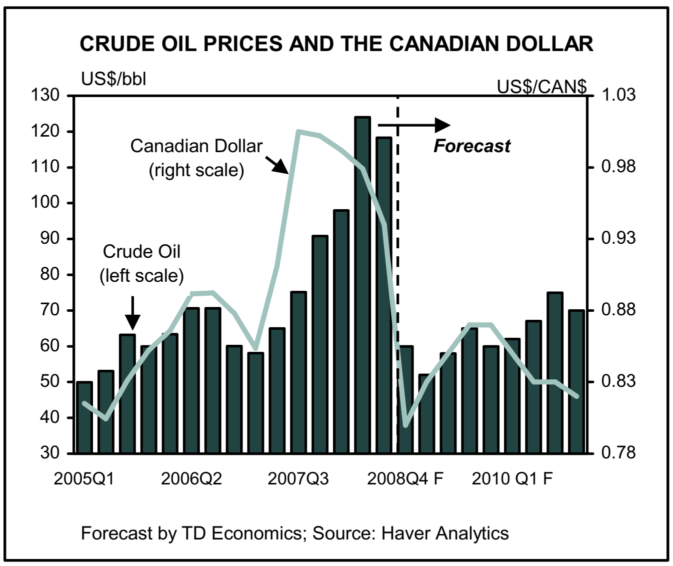
- *Canadian dollar to remain soft* – next year, we expect the loonie to continue to trade in the range of 80-90 U.S. cents**,** lower than its recently over-valued levels of 95-100 U.S. cents that was recorded just prior to the intensification of the global credit crisis this autumn. A combination of weak crude oil prices, growing concerns about the Canadian economy and flight to safety in the U.S. dollar will keep the Canadian dollar in check in coming months. While unambiguously positive for Canadian farmers from an output-price perspective, a weak currency raises the cost of U.S.-made inputs, such as farm machinery.

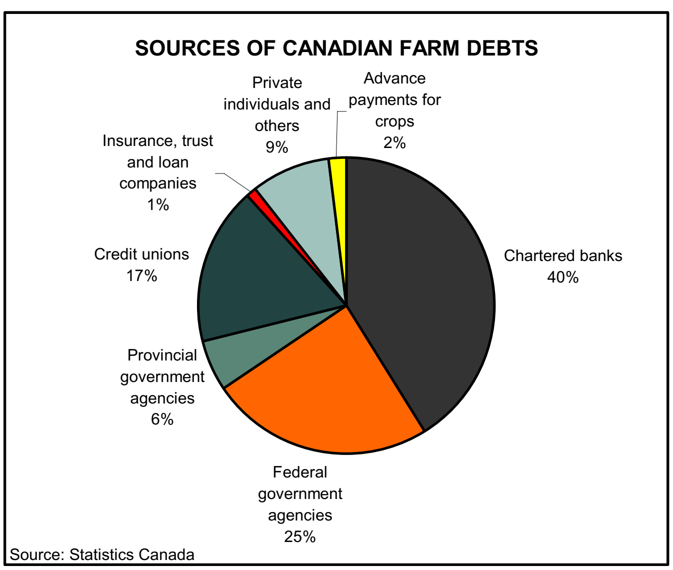
- *Energy prices falling out of the stratosphere* – Crude oil prices are now trading at less than half of their recent peak of US$147 per barrel. While the price of crude should be supported by a pickup in global economy later next year, we see prices averaging a more manageable US$65-75 in 2009. As well, we don't see a return to US$100 per barrel over the next few years.

- *Fertilizer prices should come down* – While prices of nitrogen and phosphate fertilizer are expected to continue easing in tandem with crop prices over the first half of 2009, potash prices are likely to remain extremely elevated due to labour strikes and weak world production levels. Overall, however, crop farmers should see some reprieve in this all-important cost area.

- *Transportation costs slackening* – the easing in global growth is expected to take pressure off international







Food safety takes centre stage in 2008

While trade-related issues will likely remain in the forefront in the year ahead, a challenge facing the overall food industry that has been trumping all of late is food safety. Not that increased regulation is a new concern to the food sector. Indeed, as evidenced in survey after survey, Canada's agribusiness community cites high regulatory costs – with food safety being a part of that – as the number one barrier to competitiveness ahead of taxation and international trade subsidies.

Yet recent developments globally are putting heightened pressure on governments around the world to take action. In China, there have been health scandals related to milk and eggs that have made waves around the world. But in 2008, Canada was shaken by its own crisis when an outbreak of the disease listeriosis from tainted meat claimed 18 lives. According to a Globe and Mail report, there were more than 440 food products recalled so far in 2008 because of exposure to the bacterium listeria, with most tied to a single production line at a Toronto meat processing plant.[4] Nonetheless, it is difficult to pinpoint whether this surge reflects more testing or what many critics argue is Canada's relatively lax standards for food safety. What is clear is that the focus has shifted to recent federal changes that allowed private industry to conduct more of its own testing rather than leaving it in public hands.

Just prior to the election, the federal government called for a probe into the recent crisis. The concern of the food industry is what changes to regulation will flow from that probe. The release of the report is set for March 15th 2009.

freight costs, as evidenced by the steep drop in the Baltic Dry shipping index in recent months. This trend is likely to remain intact in 2009.

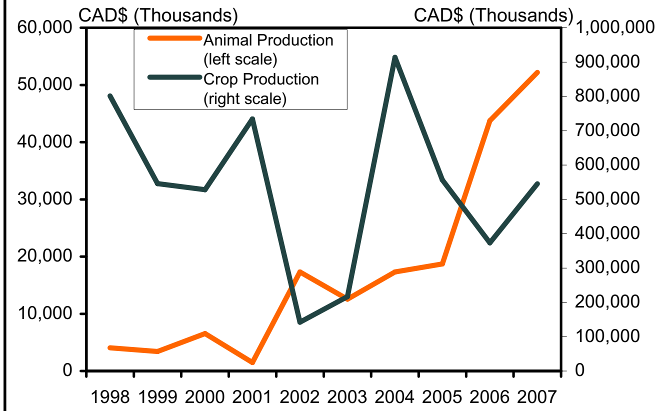
- *Hike in Canadian jobless rate to rein in wage growth* – the unemployment rate in Canada is projected to rise in 2009 toward 7%, which should lead to a moderate easing in wage pressures.
- *Cost of credit* – the global credit crisis has put upward pressure on the cost of availability of credit worldwide (see box on page 9). While Canada has not been hit to the same degree, the impacts have been observable in the higher pricing of debt faced by banks and other large players, including many in agricultural sector, in the commercial paper market. In light of this stress, dealer

finance programs are under threat, further limiting credit availability. The strains on credit markets are expected to recede as 2009 progresses, supported by efforts by world central banks and governments to boost liquidity, backstop inter-bank lending and lower short-term interest rates. In Canada, the central bank is expected to reduce its short-term interest rate by another 50 basis points in late 2008, to 1.75% and to hold them at that low level until early 2010.

Putting it all together, the mix of still relatively-high crop prices, a weak currency, and a simmering down in most cost pressures bode well for a further improvement in total farm income in 2009. As usual, the end result will depend to a large extent on growing conditions, although we do anticipate that total area cropped will remain healthy and on par with this year.

That said, there remain several clouds on the horizon. Obviously, forecasting during periods of global economic turmoil is riddled with higher-than-usual uncertainty. We have already touched on some of the difficult changes underway in the livestock market, including COOL, the swine breeding cull and still-lofty costs of feed. These developments add to a growing list of competitive woes in the livestock and meat processing sectors in Canada. Even at a Canadian dollar at 80-90 U.S. cents, many Canadian meat processors are still rendered uncompetitive. What's more, COOL is not likely to be the only challenge on the trade front facing Canada's farm sector. There are concerns that the U.S. government could turn increasingly protectionist in the aftermath of the November 4th election.

CANADIAN AGRICULTURAL EXPORTS TO CHINA



Source: Industry Canada

The current challenges in the U.S. facing Canadian exporters of hogs and cattle underscore the importance of looking overseas for sales opportunities in the future. Increasingly, the agricultural market is becoming global in scope. Yet Canadian farmers have been slow to take advantage of the potential of markets such as China and India, which are growing by leaps and bounds above that of North America. Certainly, efforts on this front will need to be backed by government moves to forge new bilateral trade relationships.

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Endnotes

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[2] Ingrid Angermann, Dresdner Bank, Frankfurt, *Commodity Market Correction – Back to Earth With a Bump*, Journal of Current Economics, September 2008.

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[4] Karen Howlett, Globe and Mail, "Lax Standards to Blame for Rise in Food Recalls, Experts Say," September 22, Page A4.