Canada’s Agriculture Sector Bucking the Trend Seen Elsewhere in the Economy

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Highlights

• Despite facing some obstacles along the way, Canada’s agriculture sector has held up well in 2020. The latest preliminary estimates point to a decent year for crop output, trade, and profitability.

• On balance, market conditions for crop producers have brightened. Longstanding global oversupply issues have eased for oilseeds and corn. Wheat prices also surged on weather concerns this fall. However, the latter commodity area remains susceptible to a pullback given record high global production and inventories.

• In contrast, the livestock outlook is more mixed. The impacts of the African Swine Fever on global herds and resilient international demand are providing a backstop to prices. On the flip side, plentiful supplies in North America were made worse by pandemic-related disruptions at meat processing plants. These challenges should preclude any strong acceleration in prices.

• The combination of rising crop prices and sales, and dampened input costs will be supportive to farm incomes this year. That said, livestock producers’ bottom lines are facing the squeeze of muted herd pricing as well as increasing feed costs.

• Canada’s supply-managed industries were impacted by closures in the restaurant and hospitality industries. However, revenues appear to have weathered the storm better than in the cattle and hog categories.

Like most areas of the economy, Canada’s agriculture sector was not left unscathed by the pandemic. The impacts of the crisis have been most felt in the livestock space. Outbreaks at meat-processing plants pushed slaughter numbers lower. The resulting animal backlog pressured hog and cattle prices. For the agriculture sector as a whole, reduced restaurant capacity introduced supply chain and demand uncertainties for livestock, dairy, barley, and potato farmers, among others.¹ Meanwhile, the more labour-intensive fruit and vegetable areas were impacted by outbreaks and labour supply shortages.

Notwithstanding these setbacks, 2020 is shaping up to be a decent year for Canada’s agriculture sector. For instance, both the crop and livestock industries are on track to expand production this year (Chart 1) as other key engines of growth in the economy have faltered. On the supply front, the sector’s fortunes have been lifted by favourable weather conditions. Indeed, early estimates during this harvest season point to a decent increase in production and yields. On the demand front, retail food has been among the winners of this year’s shift in spending patterns. This trend re-

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lected in surging Canadian agricultural and food exports. For livestock producers faced with more direct impacts from the pandemic, the hit has so far been less than initially feared. Meanwhile, the outlook for Canada’s supply-managed sectors (dairy, poultry) lies somewhere in the middle. Demand and production have been impacted by closures in the restaurant industry, but farm cash receipts have held up well considering the unprecedented economic contraction.

Encouragingly, the overall profitability picture has remained resilient despite the pandemic. Program payments and expected strength in crop bottom lines should offset some weakness in the livestock industry. In the first half of the year, farm cash receipts were up compared to the same period last year. Agricultual commodity prices (Chart 2) and producer deliveries have risen further in the second half of the year, surpassing their year-ago levels. The Canadian dollar has remained relatively low and stable, thus providing some additional support to revenues. Accompanying this improved revenue environment has been a drop in several major input costs.

Downside risks remain. In particular, prices for some crops – namely wheat - may have risen too fast too soon, and are now starting to pull back. Indeed, global inventory levels remain elevated for wheat. Weather concerns also remain highly uncertain in Latin America and Russia. At the same time, demand for certain products, like beef, are more sensitive to global economic downturns and income growth. However, ongoing solid demand-side fundamentals should continue to stand the sector in good stead through any short-term price turbulence.

2020 Shaping Up To Be a Decent Year for Crop Production and Demand

Total production of principal field crops in 2020 is anticipated to increase a decent 3.3% to 98.1 million tonnes (Mt). Encouragingly, harvests were running well ahead of their five-year averages in the Canadian Western Grain Belt. Earlier harvests should help farmers benefit from recent upward momentum in prices. The expected strength in production this year appears relatively broad-based (Chart 3). Wheat (durum and winter wheat), corn, and pulse production have been leading the overall increase. Of the major crops, canola and barley appear to be the only ones witnessing a decline this year.

While estimates are still preliminary, most provinces appear to be enjoying a solid outturn. All eyes are on Alberta, where production is set to increase more than 8%. Within the province, higher canola, wheat, drys peas, and barley output will lead the way. However, the provincial government’s final crop report suggests that there were notable regional divergences. The Northern and Peace River regions reportedly faced flooding and poor growing conditions, and consequently, lower yields. In Manitoba, total production is projected to increase 5.7% on the back of higher corn, canola, barley, and oats production. Central Canada is also seeing a decent year for production. In particular, Ontario’s wheat production is expected to surge this year.

Saskatchewan, which is Canada’s largest producer, is expected to see an overall production decline of around 3%. This pull back is driven by lower harvested areas and yields for canola and barley. Canola’s woes were well documented in the past year. Farmers in the province had partially
moved away from the crop, reflecting lower prices in 2019 and import restrictions in China. On the flip side, this year’s increase in canola exports and prices should provide some respite. Another silver lining is the province’s reported above-average quality for this year’s harvest.\(^4\)

Turning to the demand side, year/year export growth during the January–September period for crops and some food products have far outpaced those in all other major industries. In particular, canola, pork, and wheat exports have surged this year. More timely data from the Canadian Grain Commission point to continued solid performance going forward. The Commission’s data looks at the 2020/21 crop year, beginning in August. By the first week of November, a year-to-date, year/year surge was seen in producer deliveries and exports to licensed elevators and terminals. Domestic disappearances are also holding up well compared to the same time last year.

**On Balance, the Global Crop Price Outlook Has Brightened**

In a similar fashion to other commodity and financial assets, crop prices took a hit at the onset of the pandemic. The sell-off was relatively short-lived, with all major crop prices now trending above year-ago levels (Chart 2). On balance, producers are expected to benefit from higher average prices in 2020 and 2021. Longstanding global over-supply issues have eased for some crops within a resilient demand environment (Chart 4).\(^5\)

A confluence of factors joined to drive oilseed inventories tighter. Faced with export restrictions and depressed prices in 2019, farmers in Canada moved away from canola planting. In turn, lower acreage and production helped partially erode bloated inventories. Elsewhere, reports of poor European harvests have weighed on both global canola production and stocks over the past two years. Moving to soybeans, delayed planting and poor growing conditions in the U.S. in 2019 pressured production. Global ending stocks have shifted lower as a result, with stocks-to-use ratios anticipated to hit their lowest levels since 2013/2014. More recently, delayed planting in Brazil as a result of dry weather conditions from La Nina has weighed further on supply expectations. Stronger demand is also providing an added boost to the oilseed complex. Consistent with the theme seen across other commodities, exports to China have surged for several North American agricultural products, including soybeans, corn, wheat, and canola. China’s efforts to rebuild its pig herds should also give way to higher feed demand going forward. As a result, oilseeds have the most promising outlook amongst the major crops going into 2021 (Chart 5, 6).
A similar but slightly less supportive backdrop has emerged for corn. Global stocks-to-use ratios are also anticipated to remain below 2013-14 levels by the United States Department of Agriculture (USDA). Like soybeans, poor growing conditions in 2019 helped ease inventories. Similarly, the crop is also benefiting from a surge in Chinese and feed demand. Recent reports – though unconfirmed – suggest an impending shortage of corn in China. This would bode well for future corn exports.

In contrast, global wheat supplies remain elevated. Global stocks-to-use ratios are expected to climb to record highs (Chart 4), although balances are slightly better in the U.S. Prices have partially pulled back after spiking in the beginning of the fall season. Much of the price strength was attributed to concerns related to weather developments in Russia and the Black Sea region, in addition to surging exports. However, these forces should be weighed against the expectation of record high production, global inventories, and stocks-to-use ratios.

Elsewhere, the outlook for barley should remain stable. Like corn, rising feed demand in China and a modestly improved supply-demand backdrop should be supportive going forward.

Gazing into 2021, further strong upward momentum in crop prices should be treated with caution. Several factors are contributing to higher-than-usual volatility and increased uncertainty. The impacts of the La Nina weather system in Latin America and weather developments in Russia and Eastern Europe remain a wildcard. There is also considerable uncertainty around China’s future strategic purchasing intentions and whether its recent pace of international purchases can continue. Oilseeds appear to be the most well positioned heading into 2021.

Livestock Markets Are More Mixed

Livestock producers are facing a more unfavourable backdrop this year (Chart 7). Disruptions at meat processing plants in April halted slaughters and created a temporary backlog of animals. Over that period, divergent price trends occurred between hog and cattle prices, which tumbled, and wholesale/retail prices, which spiked (See Box 1). Since the spring, however, livestock prices have managed to gradually recover, but the outlook still rests on shaky grounds.

Within the cattle industry, the impact of plant shutdowns on backlogs earlier this year proved to be less than initially feared. At the same time, however, international demand for North American cattle has paled in comparison to pork and crops, where exports have spiked. This has translated into a smaller price boost over the summer. The fact that beef consumption is most sensitive to changes in global incomes has been a key constraining factor on demand during this year’s recession.

Hog prices are caught between two conflicting drivers. Pandemic-driven backlogs on North American farms were reportedly worse than those seen in cattle farms. Making matters worse, North American hog inventories were already elevated prior to the pandemic (largely due to an elevated U.S. hogs inventory). However, as noted, the external backdrop has been more favourable in hog markets. While pig herds in China are reportedly recovering, they remain well below pre-African Swine Fever levels. As a result, pork joined the list of commodities witnessing a surge in Chinese imports over the summer. The recent discovery of ASF cases in countries outside of China (such as Germany) has also fueled supply concerns outside of North America.

Looking ahead, we expect cattle and hog prices to follow a flat-to-slightly upward trajectory over the next year from current price levels. Still-plentiful North American inventories will continue to cap meaningful price acceleration, with resilience in international demand providing a backstop to prices, at least for hogs. Implicit in the outlook is an assumption that the global economic recovery from the pandemic will gain further traction in 2021.
Profitability: A Tale of Two Sectors

Despite the pandemic, there is reason to believe that 2020 holds some modest upside for overall farm profitability. On the revenue side of the ledger, farm cash receipts are already up a solid 6% in the first half of the year compared to the same period last year (Chart 8). However, digging into the details reveals that the bulk of this is driven by a jump in legalized cannabis receipts. Stripping away these gains leaves total cash receipts up a more modest 1.5%. Worse, removing direct payments (crop insurance and government support payments) from the equation leaves receipts down 2%. The weak spot was the dampened price and sales environment for livestock (cattle and hogs) in the first half of the year.

Since the late spring, crop and livestock prices have trended upwards, with most now above their year-ago levels. Exports have also surged over the summer. The combination of higher marketings and prices points to further upside for cash receipts in the second half of 2020.

At the same time, the pandemic has sent many input costs sharply lower. Indeed, Statistics Canada’s farm input price index was down 2% relative to year-ago levels in Q2. Costs are likely to trend upwards in 2021 as markets such as crude oil gradually recover. Even then, several input costs are expected to remain below their pre-pandemic levels well into 2021. The profitability outlook incorporates the expected input cost trajectories below:

- **Fuel Prices:** Across commodity markets, oil and gas prices have seen the biggest hit. Oil prices have rebounded, but remain more than 20% below pre-pandemic levels. A slow uptrend is expected going forward (Chart 9), but prices are anticipated to remain well below their pre-pandemic levels into 2021. For both oil and natural gas markets, risks remain tilted to the downside.

- **Interest Rates:** Interest rates in Canada and most advanced economies are set to remain low for long. Indeed, the Bank of Canada’s forward guidance over the summer suggested that the overnight borrowing rate will likely remain at the effective lower bound until 2023. Benchmark 5-year yields are expected to edge up only modestly over the 2020-21 horizon. An expectation of a gradual uptick in inflation also implies that real borrowing rates will remain dampened.

- **Fertilizer Prices:** Fertilizer prices were notably lower this year, with declines seen across all products (UREA, DAP, and potash). Prices have recently picked up in tandem with rising global demand – but divergences remain across regional markets. The World Bank’s latest commodity outlook expects prices to rise a modest 3% in 2021.

- **Exchange Rates:** This year’s unprecedented oil price shock and broad risk-off sentiment sent the value of the Canadian dollar at the outset of the pandemic before rebounding back to the 75-76 US cent level. While the loonie is expected to grind higher next year, we anticipate it will remain at the low end of its fair value range of 78-80 US cents. A lower Canadian dollar may result in modestly higher feed and other import costs. However, this should be more than offset by its positive impact on farm prices (which are mostly priced in U.S. dollars).
• **Feed Costs**: Feed costs remain low by historical standards. However, the uptrend in oilseed and corn prices this year adds upward pressure. The rebuilding of hog herds in China are resulting in an increase demand for feed. Feed is one key area that will likely contribute a wedge between livestock and crop expenses going forward.

• **Wages**: Wages are one area witnessing upward pressures. Even with labour markets witnessing the steepest contraction on record, wage growth has remained robust in the agricultural sector. Longstanding labour shortage issues in the sector were compounded by temporary restrictions on travel and inflows of temporary workers.

Supply-Managed Sectors Weathering the Storm

Demand for Canada’s supply-managed products was hit by disruptions in restaurant and hospitality businesses, but healthy retail demand has lessened the hit. In turn, dairy farmers and producers shifted production temporarily lower.

With that said, revenues appear to be holding up well considering the steep economic contraction (Chart 8). Indeed, farm cash receipts in the first half of the year were up relative to the same period last year for poultry, milk, and eggs. Over the medium term, some areas of the supply-managed sector will face changes from the phasing in of new trade agreements: the Canada–United States–Mexico trade agreement (CUSMA), the Comprehensive Economic and Trade Agreement with Europe (CETA), and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Export limits on some products destined to the United States and modestly increased market access for some foreign products may preclude any acceleration in production growth in these categories in the near term.

Bottom Line

Summing it all up, Canada's agriculture sector has bucked the trend seen elsewhere in the economy this year. While not left unscathed, the sector should weather this storm better than others. Weather, still-resilient demand, and international stockpiling have all aligned to support output, sales, and prices this year. The sector’s resilience will be supportive for Saskatchewan and Alberta, providing some offset to their hard-hit energy sectors. For Saskatchewan, a strong increase in cash receipts during the first half of the year and surging exports bode well for the province’s economy. In Alberta, a recent investment ($815 million) to improve the irrigation infrastructure in the province should bode well for future productivity in the sector. This, combined with the expected increase in crop output provide some respite amid an otherwise dampened economic backdrop for the province.

With that said, caution remains warranted. For one, several key drivers remain highly uncertain. These include China’s future purchasing intentions and recent weather developments. More broadly, economic uncertainty will remain elevated until an effective vaccine/treatment are widely available.
Textbox 1: COVID-19 and Food Price Inflation in Canada

Consumer price inflation was front and center at the onset of COVID-19. Although short-lived, headline CPI inflation dipped into deflation territory during the spring. However, price pressures diverged across the different spending categories. Most notably, food price inflation increased as price growth in most other spending categories remained subdued (Chart 10).

Zeroing in on the increase in retail food price inflation reveals that significant upward pressures were largely driven by frozen and processed meat products. The drivers of this were twofold. For one, the pandemic brought with it changes in demand and consumption patterns. Among those consumption pattern changes were increases in sales at food and grocery stores. This increase in demand came against temporary capacity reductions at meat processing plants facing COVID-19 outbreaks. Along the value chain, disruptions to slaughter and processing reflected in higher retail prices. This materialized even with prices for raw materials (hogs and cattle) slumping at the time.

Food price inflation has since moderated. Barring this otherwise short-lived episode, the food supply chain in Canada has remained resilient throughout the pandemic. The pandemic has increased risk of supply chain disruptions in the food industry. However, with Canada being a major agricultural and food producer, supply chain disruptions and a spike in food prices should be a lesser risk compared to some other economies that rely more heavily on imports.
Endnotes

1. For a discussion on COVID-19's impacts on different areas of Canada's agriculture industry, see: https://www.fas.usda.gov/data/canada-overview-covid-19-impacts-canadian-agriculture

2. Based on Statistics Canada's preliminary satellite model-based estimates, which can differ from Provincial government estimates. Final estimates for 2020 crop production will be released by Statistics Canada in December.

3. Final estimates for 2020 crop production will be released by Statistics Canada in December.

4. See: https://www.saskatchewan.ca/crop-report


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