

Bullet Points for Farm Progress Show-Decatur, IL- 8/30/05

China & Other Emerging Players on the International Ag Scene

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China: The basic problem with PRC agricultural production is declining cropland amid rapid pace of urbanization, new infrastructure and industrialization. Pro Exporter estimates that since 1998, PRC has lost an average of 3.7 mil acres of cropland annually. PRC cropland area finally stabilized in the '05 crop year. Ag productivity gains are unlikely given relatively small farm size and government preoccupation with managing the 10 mil people/year moving from rural to urban areas. Beijing's desire to minimize unemployment and their sensitivity to widening rural vs. urban income spread will preempt combining small farms into larger and more efficient economic units. PRC corn yields have flattened over last 7 years while their soybean production appears to have topped out at 15-16 mmt.

Beijing's basic food policy for many years was for domestic consumption to be met by domestic production. Historically, the Chinese have avoided becoming dependent on other countries for food supplies. As recently as '59-61—40 mil people died of starvation. That period of food "chaos" underscored the need for stable food supplies which the Chinese have been increasingly unable to meet since the mid 90's. '05/06 PRC grain demand will exceed production by 16-18 mmt—about the same as last year. PRC grain stocks are down nearly 170 mmt since the fall of 1990. PRC corn stocks at the end of the '05/06 marketing year will decline 10 mmt (making for a 100 mmt drop in 6 years). Since joining the WTO in 2001, PRC imports of US farm products has nearly tripled from \$1.7 bill to \$ 6.1 billion. Bottom line--the Chinese government today appears less stringent about maintaining self-sufficiency in food production amid the buildup of huge foreign cash reserves and the increase in the number of grain/oilseed exporters. Beijing is increasingly aware that there are commodities other than food necessary for survival and ongoing prosperity—namely crude, coal and metals.

Growth in PRC Ag imports is most apparent in the protein sector where PRC imports of oilseeds, edible oil and meal has exploded 177 fold in 10 years. Growth in soybean usage over the last 6 years has averaged 3.2 mmt/year. USDA forecasts a gain in PRC meal/oil use of 4.5 mmt in '05/06. Protein meal use in China has outpaced population growth over the last 10 years by a factor of 158. Interesting to note that China, the world's largest producer and consumer of food, will consume 40 mmt more grain in the year ahead than the total amount of '05/06 wheat and coarse grain traded globally. Beijing is well aware of how small changes in their import demand can impact global grain prices at the margin. This desire to avoid pushing global grain prices substantially higher along with the need to reduce huge grain storage costs are at the core of their decision to draw down domestic grain stockpiles rather than ramping up grain imports.

Both USDA and the trade have consistently overestimated how quickly PRC will become a net corn importer. Corn stocks are a state secret. There are strong interests in NE China that wish to maintain corn exports to nearby Asian customers. USDA, Cargill and other private sector analysts expect China to be a net corn importer within next 5 years. The best indicator to monitor for signaling PRC's transition from corn exporter to corn importer is simply watching for a sharp up trend in PRC domestic corn prices. There is strong evidence indicating that USDA is underestimating the growth in PRC feed usage suggesting that their draw down of domestic grain stocks is greater than expected **or** that domestic corn production is greater than reported.

PRC long term growth in demand for energy/metals commodities is greater than demand growth for Ag commodities. China is the number one consumer of rubber, copper, steel, cement and iron ore in addition to being the world's largest soybean importer. Jim Rogers, whose best seller "Hot Commodities" is on the reading list of fund and index managers alike, calls China "*pure potential amid rising demand for natural resources and commodities of all kinds*".

Bottom line on PRC—PRC imports of Ag commodities will register steady growth as long as prospering domestic economy fosters income growth, which leads to higher consumption of protein based edible oils and meats (which requires corn and soybeans). The potential is enormous as ½ of PRC population still lives on less than \$2.00/day. Thus against backdrop of shrinking grain stocks, robust growth in protein and corn use and prospects for continuation of strong economic growth, advise against long term shorts in US corn/soy complex futures which will be increasingly willing to carry additional risk premium on growing PRC demand for meats and edible oils. Only hazard to our positive outlook for expansion in PRC oilseed and grain imports would be trade sanctions which would slow their ability to produce and sell manufactured goods domestically and internationally.

Black Sea: FSU wheat & coarse grain exports surged from 8.4 mmt (1% of world trade) in 2000/2001 to 20.9 mmt in 01/02 & 33.4 mmt (16% of total world trade) in 02/03 before shrinking back to only 14.2 mmt in '03/04. USDA expects '05/06 FSU grain exports (72% wheat) to rebound to 25.2 mmt in '05/06 (12% of world trade) – a nearly 4 mmt increase from last year. FSU grain exports surged from 2001-2003 on the heels of favorable weather, currency depreciation, high world prices and direct loading of vessels (bypassing elevators). USDA, which recently completed a study on future Black Sea grain exports, concluded that over the next decade only moderate growth potential exists. The primary factors limiting rapid growth in FSU grain exports are productivity constraints, poor infrastructure, absence of private land ownership & contract law and FSU restrictions on meat imports which will drive domestic feed use higher. Nonetheless, FSU grain yields are still well below pre-communist era levels while additional land can be brought on line if demand from their primary export outlets in the Middle East and N. Africa continues to expand on growth in income and population. Bottom line—look for FSU to register continued modest growth, weather permitting, in grain exports amid their relatively strong comparative advantage in small grain production. The presence of the FSU as a growing factor in grain production and exports will serve to dampen or at least shorten rallies in wheat production caused by temporary shortfalls in other major wheat exporting nations.

Brazil & Argentina: Given cap on US soybean acreage and 10-11 mmt annual gains in global soybean usage, the soybean market is increasingly dependent on steady gains in S. American soybean production to supply expanding oilseed demand. Global soybean demand is expanding over 5 times faster than global population growth. S. American soybean production, constrained in each of the last 2 years by unfavorable weather, is expected by USDA to rebound 11 mmt in '06 although unfavorable economic conditions in Brazil suggest that WASDE is overestimating the rebound in soybean production by 3-4 mmt. Thus expansion in Brazilian cropland, which has averaged 7 football fields/minute since 1995, will come to a sudden halt in '06 unless the REAL weakens dramatically or soybean prices rally dramatically prior to Oct/Nov planting. Look for portion of Brazilian soybean crop exported as whole soybeans to increase over time as their domestic crushing industry struggles to compete with lower cost crushers in Argentina and China. On the Ag infrastructure front, Argentina is doing a better job beefing up roads, rail and port facilities than Brazil. Prospects for a near 60 mmt '06 Brazilian soybean crop will stain their

internal grain handling system prompting even wider basis levels to cash strapped producers. Over the long term, however, Brazil will continue to supply majority of new land for world's expanding oilseed demand. Brazil's total undeveloped land suitable for crops is equal to the US's entire cropland area. Furthermore, Brazil's dominance as a global ag superpower will continue to grow given their comparative advantage in production of soybeans, broilers, beef, cotton and OJ. Brazil's Ag trade surplus of \$24.4 bil is nearly 10X greater than the US's Ag trade surplus. Favorable climate, the large pool of untapped land, good science and entrepreneurship are a winning mix. In the long run the US soybean production industry, saddled with over-inflated farmland values thanks to generous farm programs, will continue to lose global soybean export market share to our more efficient competitors in South America. In the short term, however, the current mix of Brazilian farmer debt, the relationship of the REAL to the dollar and high Brazilian producer debt collectively suggest that current board prices are not high enough to draw additional new soybean acres into production to meet expectations for ongoing gains in global soybean demand.