

Bi-weekly Bulletin

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CHINA: OILSEEDS SITUATION AND OUTLOOK

The demand for oilseeds, protein meal, and vegetable oil in China is forecast to increase significantly over the medium-term due to higher population, income growth, urbanization, and the general transformation of China into a dynamic, large-scale, market-oriented economy. China's oilseed production is also projected to increase but at a much slower pace because of constraints on the availability of arable land and the slow growth in yields. Thus, imports of oilseeds are expected to rise as China attempts to maximize the level of domestic crush. Access to China's market for oilseeds and oilseed products will be improved with China's accession to the World Trade Organization (WTO). However, Canadian exports will be pressured by large supplies of soybeans from the United States (U.S.) and South America. This issue of the *Bi-weekly Bulletin* examines the situation and outlook for the oilseed market in China.

Canada/China Trade

Trade between Canada and China is expected to rise sharply aided by the signing of the Canada-China Bilateral Agreement, on November 26, 1999, formalizing and protecting the legal framework governing the growth in commerce between the two countries. These agreed changes are expected to take effect when China joins the WTO. In 1998, China was Canada's fourth largest trade partner, behind the U.S., Japan, and the United Kingdom (UK). When trade with Hong Kong is included, China is Canada's third largest trade partner, well ahead of the UK.

In 1998, Canada's exports to China were valued at \$2.5 billion, of which almost \$0.9 billion consisted of agri-food products. In 1998, 55% of Canada's exports to China consisted of cereals and oilseeds, various seeds, fruits, wood pulp, and fertilizer. Chinese imports of agri-foods from Canada were variable through the 1990s, ranging from a low of \$0.46 billion to a high of \$1.35 billion. Near the beginning of the decade, almost all of Canada's agri-food exports to China consisted of wheat and malting barley. By 1997 and 1998, shipments of grain declined significantly and were replaced in importance by the expanded exports of oilseeds, which consisted mostly of canola with a relatively small quantity of soybeans.

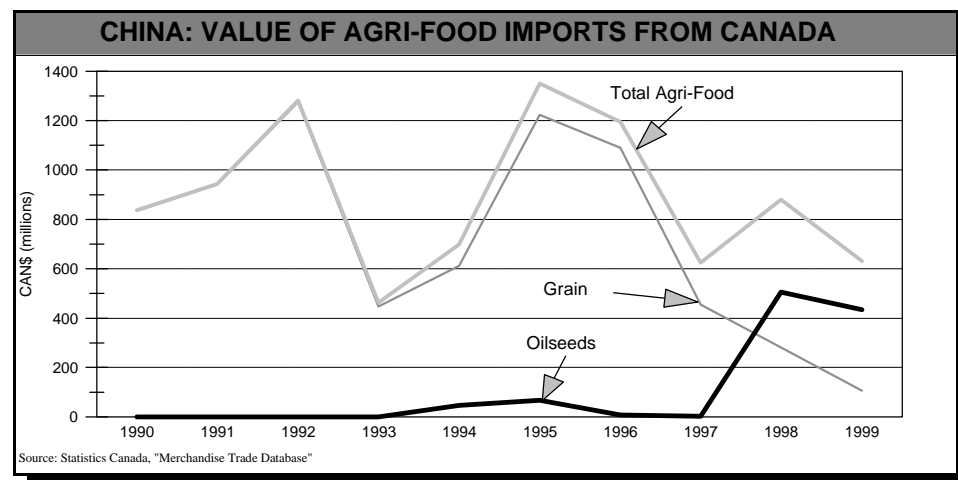
Chinese Oilseeds and Product Imports

Throughout the 1990s, China has been a major importer of oilseeds, vegetable oil, and protein meal. The United States Department of Agriculture (USDA) data indicates that during the crop years from 1995 to 1997, China officially imported an average of 3.2 million tonnes (Mt) of vegetable oil of which soyoil, palm oil, and rapeseed/canola oil represent 50%, 40%, and 10%, respectively. In addition, prior to 1997-1998, smuggling of edible oils, reportedly from Hong Kong, Malaysia, and Indonesia, was high because of the high domestic prices relative to the world level, the growing domestic demand for edible oils and the high import tariffs and tight import quotas. In 1997-1998, in part to support its domestic crush industry, China

clamped down on the non-government sanctioned imports. In response to the decreased availability of vegetable oil, imports of oilseeds nearly doubled by 1998-1999.

The rise in imports of oilseeds has been supported by the rise in Chinese disposable incomes, leading to an increased demand for meat, poultry and edible oils. Per capita consumption of edible oils has increased by 2.1 kilograms (kg) from 1995-1996 to 13.1 kg for 2000-2001, although this is only about two-thirds of the world average and less than one-third of the Canadian average.

In turn, this increased demand for soybean meal and edible oils, has made China



the world's largest growth market for oilseeds and products. In the last five years, China has become a major importer of oilseeds, including rapeseed/canola - which increased from zero in 1995-1996 to an expected 3.85 Mt for 1999-2000, accounting for 40% of the world trade. Simultaneously, the country has become the world's second largest consumer of soyoil and meal, behind the U.S. Total protein meal usage has increased by almost one-third since 1995-1996, and is expected to reach 26 Mt for 1999-2000, about 15% of total world use.

SITUATION: 1999-2000

Oilseed Usage Rising

Chinese oilseed crushing has expanded by 33% since 1995-1996, with much of the growth related to joint ventures. Rapeseed/canola and soybeans are each estimated to represent about one-third of the oilseed crush for 1999-2000 with peanuts and cottonseed dominating the remainder. China is expected to crush 12.2 Mt of rapeseed/canola for 1999-2000, or about one-third of the world rapeseed/canola crush, and 14.0 Mt of soybeans, or about 10% of the world soybean crush.

The Chinese oilseed crushing industry has overcapacity with a large number of small plants with a typical crushing capacity of 50-100 tonnes per day (t/day), compared to 5,000 t/day for a large crusher and 3,000-3,600 t/day for a large Canadian crusher. In a large number of plants, the crushing and processing of oils are rudimentary with the final product containing large amounts of impurities. In 1999-2000, Chinese processors were troubled by the high degree of green colour (chlorophyll) in some of the

rapeseed/canola and were searching for refining techniques to counteract this. However, some plants are currently under construction, with state-of-the-art technology developed in China which should improve the quality of the vegetable oil.

Vegetable Oil and Protein Meal Production Increases While Imports Decline

For **vegetable oil**, production has increased by one-third since 1995-1996 with the production of soyoil and rapeseed/canola oil increasing by about 80% and 50%, respectively. For 1999-2000, production is estimated to increase to 8.7 Mt largely due to the clampdown on smuggling and increased consumption. As a result, vegetable oil imports declined by 25% during the crop year.

For **protein meal**, China became more self-sufficient in 1999-2000,

importing only 1.4 Mt versus 4.6 Mt in 1995-1996 partly due to the imposition of a 13% value-added tax (VAT) on soymeal. Production of protein meal has increased by over one-third since 1995-1996, with the largest growth occurring in soymeal, which rose by 75%.

Benefits of Canola Meal

Production of rapeseed/canola meal has also increased significantly during the same period but has been troubled by the overheating or "toasting" of canola meal during processing. When processing rapeseed, domestic crushers typically heat the rapemeal to greater than 120 degrees Celsius (EC) to degrade the glucosinolates, which also degrades its nutritional value. Crushers have also heated canola to the same temperature. However, because canola is very low in glucosinolates, the only impact was to degrade the quality of the protein.

As a result, the price of both rapemeal and canola meal are only about 30% of the price of soymeal in China, versus 55-65% from canola meal in Canada. This is estimated to have resulted in a CAN\$80 million loss to Chinese processors in 1999-2000 alone. Rapemeal and canola meal have been

CHINA: OILSEEDS SUPPLY AND DISPOSITION

	1998	1999	2000
	-1999	-2000	-2001f
million tonnes.....		
PRODUCTION			
Cottonseed	8.1	6.9	6.9
Peanut	11.9	12.6	12.5
Rapeseed/Canola	8.3	10.1	11.0
Soybean	15.2	14.3	15.0
Sunflowerseed	<u>0.9</u>	<u>1.3</u>	<u>1.3</u>
Total	44.4	45.2	46.7
IMPORTS			
Soybean	3.8	9.0	7.3
Rapeseed/Canola	<u>2.2</u>	<u>3.9</u>	<u>2.5</u>
Total	6.0	12.9	9.8
SUPPLY			
Cottonseed	8.1	6.9	6.9
Peanut	11.9	12.6	12.5
Rapeseed/Canola	10.4	14.0	13.5
Soybean	19.0	23.3	22.3
Sunflowerseed	<u>0.9</u>	<u>1.3</u>	<u>1.3</u>
Total	50.3	58.1	56.5
CRUSH			
Cottonseed	3.1	3.3	3.3
Peanut	11.5	12.0	12.0
Rapeseed/Canola	9.5	12.2	12.0
Soybean	12.0	14.0	13.6
Sunflowerseed	<u>0.7</u>	<u>1.0</u>	<u>1.0</u>
Total	36.8	42.5	41.9

f: forecast, AAFC, August 2000
Source: USDA, Oil World

CHINA: VEGETABLE OIL SUPPLY AND DISPOSITION

	1998	1999	2000
	-1999	-2000	-2001f
million tonnes.....		
PRODUCTION			
Soybean	2.0	2.4	2.6
Rapeseed/Canola	3.2	4.1	4.0
Peanut	1.2	1.2	1.2
Other	<u>1.1</u>	<u>1.0</u>	<u>0.7</u>
Total	7.5	8.7	8.5
IMPORTS			
Palm	1.2	1.2	1.5
Soybean	1.0	0.6	0.9
Rapeseed/Canola	<u>0.2</u>	<u>0.0</u>	<u>0.1</u>
Total	2.4	1.8	2.5
CONSUMPTION			
Soybean	3.1	2.8	3.5
Palm	1.2	1.2	1.5
Rapeseed/Canola	3.3	4.2	4.2
Peanut	2.0	2.0	2.0
Other	<u>1.3</u>	<u>1.5</u>	<u>1.3</u>
Total	10.9	11.7	12.5

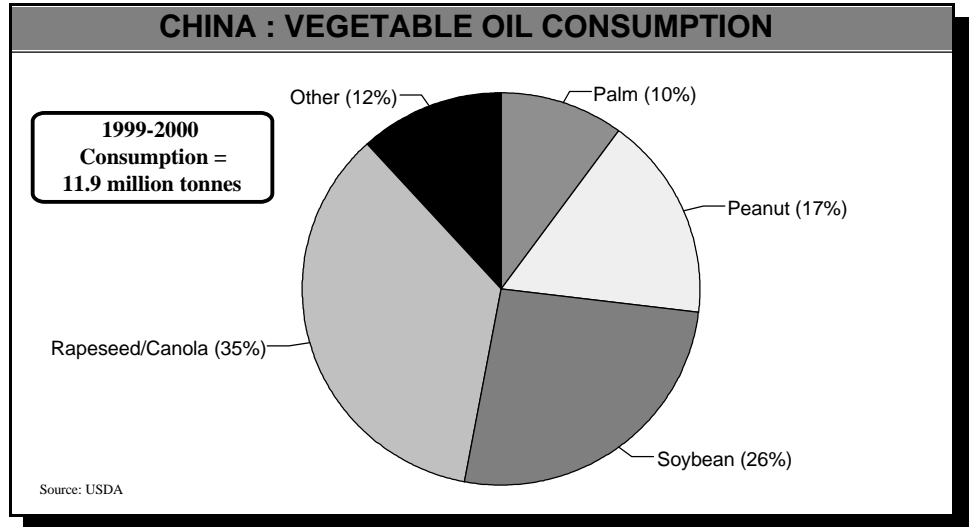
f: forecast, AAFC, August 2000
Source: USDA

largely treated as a worthless byproduct in China and has been dumped. In the meantime, Chinese exports of rapemeal have doubled in 1999-2000, including shipments of Canadian canola meal, with many of the exports going into South Korea and disrupting Canadian export markets.

Educational activities by the Canadian industry to demonstrate the benefits of lowering the temperature when drying canola meal to 100EC-105EC are ongoing. Processors in China are encouraged to enter into joint feeding trials with large-scale integrated livestock operations to assess the nutritional value and rate-of-gain of pigs fed the appropriate level of the properly cooled canola meal. Upon demonstrating the nutritional value of the canola meal compared to soymeal, processors could then sell the canola meal to livestock feeders.

OUTLOOK 2000-2001

Oilseed Production Rising Slightly
Production of **oilseeds** in China is expected to increase marginally for 2000-2001 as an increase in the seeded area for rapeseed and peanuts offsets a decline in yields arising from the dry growing conditions. The area seeded to winter rapeseed reportedly expanded by



10%, due to relatively attractive prices compared to wheat and coarse grains, resulting in a sharply higher output. However, production of soybeans is expected to decrease due to the drought reduced yields.

Oilseeds Imports Pressured By Poor Crush Margins

Chinese imports of oilseeds are expected to decline from 12.9 Mt in 1999-2000 to 9.8 Mt for 2000-2001, due to lower domestic prices for protein meal and vegetable oils. **Soybean** imports are projected by USDA to decrease by about 6% to 7.3 Mt, with the majority originating from the U.S. and Argentina.

Rapeseed/canola imports are expected to decline from 3.8 Mt in 1999-2000 to 2.5 Mt. However, imports from Canada are expected to remain stable at 1.2 Mt, while imports from Australia and the European Union (EU) decrease sharply because of the decline in production in those regions.

Oilseed supplies are expected to decrease, as the reduction in the volume of oilseeds imported more than offsets the expected rise in production. While the volume of vegetable oils and protein meals that can be imported at a low tariff will increase with China's accession to the WTO, the agreement is expected to be delayed until at least late in 2000-2001. However, soybean imports are expected to decrease for 2000-2001, despite the strong domestic demand for protein meal and the 13% VAT on soymeal imports. The VAT on soymeal was scheduled by the State Taxation Commission to be removed in June 2000, but this was overturned by the Chinese Cabinet under pressure from the domestic soybean producers and processors.

Domestic processing of oilseeds is forecast to remain stable or decrease slightly as crushing margins are pressured by the decline in protein meal and vegoil prices. Carry-out stocks are

expected to remain relatively unchanged as the growth in domestic demand keeps pace with supplies.

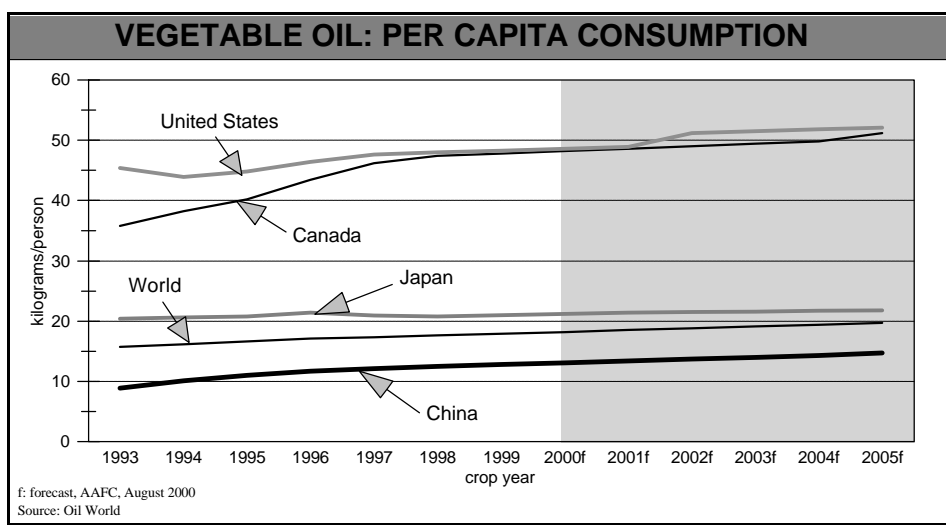
Vegetable Oil and Protein Meal Imports Rising
Production of **vegetable oil** is forecast to decrease by about 2% due to the reduced output of rapeseed/canola oil

CHINA: PROTEIN MEAL SUPPLY AND DISPOSITION			
	1998 -1999	1999 -2000	2000 -2001f
million tonnes.....		
PRODUCTION			
Soybean	9.5	11.2	10.9
Rapeseed/Canola	5.9	7.6	7.2
Other	3.9	3.6	3.7
Total	19.3	22.4	21.8
IMPORTS			
Soybean	1.4	0.6	1.5
Fish	0.6	0.8	0.9
Total	2.0	1.4	2.4
CONSUMPTION			
Soybean	10.9	12.5	13.7
Rapeseed/Canola	5.6	6.9	6.8
Other	6.8	6.8	6.8
Total	23.3	26.2	27.3

f: forecast, AAFC, August 2000
Source: USDA

CHINA: RAPESEED/CANOLA IMPORTS BY COUNTRY				
August-July crop year	1997 -1998	1998 -1999	1999 -2000e	2000 -2001f
thousand tonnes.....			
Canada	0	1,269	1,200	1,200
EU	24	755	1,200	600
Australia	110	418	1,430	650
Other	181	83	20	50
Total	315	2,525	3,850	2,500

e: estimate, AAFC, August 2000
f: forecast, AAFC, August 2000
Source: OilWorld, Statcom



and soyoil resulting from the decline in the volume of crush. Lower production is forecast to be offset by the projected increase in vegetable oil imports as Chinese importers take advantage of the historically low world prices. Soyoil imports are expected to decline sharply from the U.S., while the imports of palm oil increase only slightly, despite the sharp rise in production in Malaysia and Indonesia. Consumption of vegetable oils in China is forecast to increase by 3% due to the strong growth in disposable incomes, although per capita consumption of edible oils continues to be sharply below the world average.

Protein meal production is forecast to decrease slightly due to the decline in oilseed crush, resulting in the lower output of rapeseed/canola meal and soy meal. As a consequence, the imports of soy meal are projected to rise sharply, as the historically low prices and the large available supplies in the U.S. and Argentina, offset the impact of the VAT on soy meal. Imports of fish meal are expected to be relatively stable. Due to higher domestic livestock feed demand, Chinese consumption of protein meals is forecast to rise, with usage of soy meal increasing while rapeseed/canola meals decrease marginally. Carry-out stocks of protein meals are projected to remain low for 2000-2001.

FACTORS TO WATCH

Soybean Imports Increase Due To Constrained Production

Oilseed production in China is expected to increase slightly by 2005-2006 due to

slow growth in yields, and limited availability of land, which is already intensively cultivated. The slow growth is due to the limited use of fertilizers, in part caused by inadequate infrastructure to get the supplies to the producer, and the slow adoption of new high-yielding varieties.

Soybean usage is projected to grow the most due to the strong protein meal demand, as the continued growth in the Chinese economy leading to the rise in meat and vegetable oil consumption. Imports of **soybeans** are projected to remain strong because of the strong growth in protein meal demand which favours the importation of soybeans. Also, continued high soybean production in the U.S. and South America will ensure that soybean supplies remain high while prices

remain low.

Canola Imports Restricted

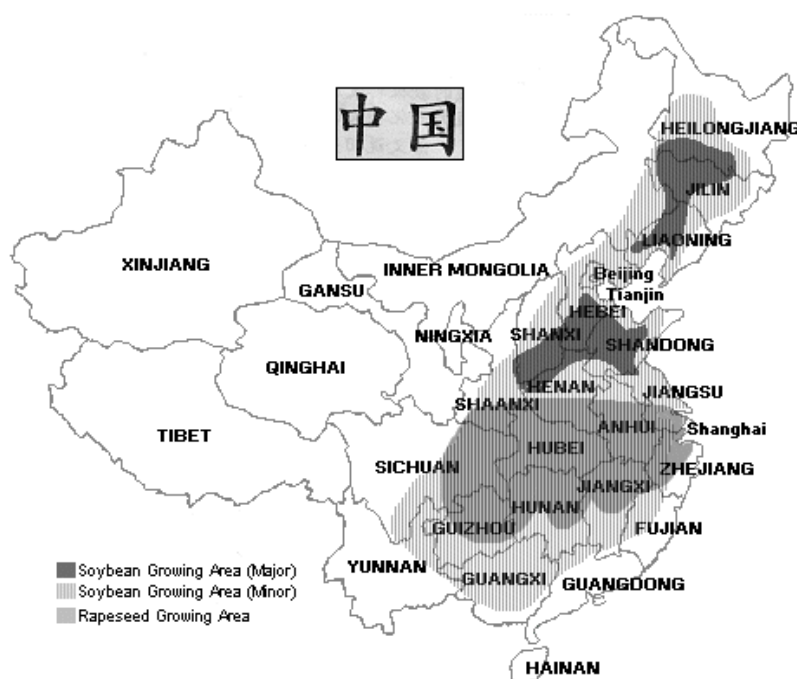
Due to historically low prices, world production of rapeseed/canola is forecast to remain low for the medium-term. Demand is expected to exceed production.

Chinese imports of **rapeseed/canola** are expected to decline from the record highs set in 1999-2000 due to (a) the tightening of world supplies vis-a-vis soybeans, (b) the expansion of the Tariff Rate Quotas (TRQs) on soyoil and rapeseed/canola oil upon China's entry to the WTO, which will have a larger impact on the crops with higher oil content, and (c) the underdeveloped domestic market for canola meal is expected to favour imports of soybeans over the medium-term.

Sharply Higher Demand And Imports For Protein Meal and Vegoil

Crushing of **oilseeds** in China is forecast to increase by 2006-2007, with the processing of soybeans making up over one-third of the total oilseed crush. Crushing of rapeseed is projected to increase modestly with growth limited by the lack of importable supplies and higher vegetable oil imports.

For **protein meal**, demand is forecast to increase significantly due to strong



growth in poultry and pork production. Over half of the protein meal used will be soymeal. Due to the VAT of 13% and the high volume of oilseed imports, imports of protein meal are projected to rise slowly before increasing sharply by 2006-2007. However, the removal of the VAT, a faster than expected increase in demand, or restrictions on oilseed imports, will result in a rise in protein meal imports. Argentina, Brazil,

and the U.S. will remain the major suppliers of soymeal to China as these countries are expected to have a large exportable surplus.

For **vegetable oil**, demand is projected to outstrip production requiring a doubling of total edible oil imports from 1999-00 levels. Production is projected to increase over the same period, with the production of soyoil rising due to the strong demand for

protein meal. The output of rapeseed/canola oil is projected to rise slowly as crushing is limited by a lack of raw supplies and/or an increase in rapeseed/canola oil imports. Imports of soyoil are expected to quadruple from 1999-2000 due to insufficient domestic supplies, the introduction of sharply lower tariffs and the higher TRQs. It is expected that with China's accession to the WTO, the TRQ for soyoil will increase

CHINA'S ENTRY INTO THE WORLD TRADE ORGANIZATION (WTO)

China is one of 30 governments currently seeking accession to the WTO. A substantial part of China's accession process involves bilateral negotiations between China and WTO members. At the last Working Party in June 2000, China concluded negotiations with a number of WTO members including the U.S. and the EU. Other WTO members are still engaged in bilateral negotiations with China.

On November 29, 1999, **Canada and China** signed an agreement on a wide range of market access issues related to China's entry into the WTO. In the agreement, China committed itself to reducing tariffs on imports of Canadian industrial products, and liberalizing access into China's burgeoning services market, including telecommunications and financial services. China will also significantly improve access for many agricultural goods including canola, canola oil, wheat, barley, and malt.

When the terms of China's accession to the WTO were negotiated by Canada, a generous growth in the volume of vegoils were assumed. The Tariff Rate Quota (TRQ) on canola oil, which will be eliminated within six years, will start at 600,000 t upon accession, and will rise to 1.13 Mt in five years. Canola oil will face the same tariff level as its main competing oil, soyoil. No TRQ will apply to canola seed. These commitments will come into effect upon China's accession to the WTO.

While **China and the U.S.** signed a bilateral accession agreement as part of the WTO entry process, China's membership may be delayed until and unless the U.S. Congress grants Permanent Normal Trading Relations (PNTR). Previously, Congress had granted a temporary Most Favoured Nations Status to China, which had to be reintroduced annually. The House of Representatives has ratified the PNTR, but Senate approval is expected by September 2000. At the time of writing, the U.S. Administration, including U.S. President Bill Clinton, was lobbying the Senate to ensure speedy passage of the bill granting the PNTR.

According to USDA, under the terms of accession, private companies in China will be allowed to import products that were formerly limited to state trading enterprises (STEs). The trading rights will be phased in over three years. Trade in some commodities, such as wheat, corn, rice, cotton, and soyoil will be controlled by STEs but a minimum quantity of import quotas will be allocated to private companies.

TRQs will be established for major bulk commodities including wheat, corn, rice, cotton and soyoil. For these goods, a specified quantity of imports will enter at a low duty, with additional imports assessed at a higher duty. The TRQ quantities are expected to begin after China's accession and will increase annually over the years with a specific implementation period for different products. The TRQs will be subject to disciplines that base import decisions on commercial, not political, factors. A share of the TRQ will be reserved from import by non-STEs.

Additionally, China commits not to use export subsidies for farm products and to cap and reduce trade-distorting domestic subsidies.

The implications of China's accession into the WTO are for increased imports of bulk commodities. Wheat, corn and rice imports are forecast to be below the limits allowed under the TRQs as high domestic supplies and low prices constrict import demand. No TRQs are established on soybeans or soymeal and both goods will continue to be imported freely under relatively low tariffs of 3% and 5% respectively.

Soyoil TRQs will start at 1.7 Mt and will increase over five years to 3.3 Mt. The in quota duty will be 9% and the over quota will fall from 74% to 9% over these years. During the implementation period, the share reserved for importation through entities other than state trading companies will grow from 50% to 90%.

up to 3.26 Mt in the five years after its accession and expanded private trading will make trade more price and profit responsive. Imports of **palm oil** are projected to increase due to burdensome Malaysian and Indonesian supplies and low prices. Palm oil is primarily used in snack foods and food products such as instant noodles and for frying foods. As a consequence, the growth in import demand for palm oil will largely be determined by the growth rate of the processing sectors in China. Imports of **rapeseed/canola oil** are projected to be constrained because of burdensome supplies of soyoil and because of large imports of rapeseed/canola.

Due to the expected expansion of the palm oil sectors and the continuation of policies in the U.S., which stimulate oilseed production, supplies of vegetable oil are expected to remain large for the medium-term. In general, this will put

constraints on any major price increases for vegetable oil, barring an unexpectedly large increase in demand.

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CANADIAN CANOLA EXPORTS

In 1999-2000, Canadian exports of canola were estimated to be 0.2-0.4 Mt below the potential as Canadian canola remained \$10-25 per tonne overpriced vis-a-vis Australia and the EU. This was due to the Canadian producer's ability to store grain on-farm, versus the Australian and EU system of commercial storage which promotes turnover. In 1999-2000, Canadian producers stored a substantial portion of their canola rather than accept the low market price, resulting in record large carry-out stocks of about 2.0 Mt. Canadian exports of canola to China were also restricted by Canada's rail transportation system, which was unable to respond quickly to the demand for rail transportation during China's unexpected critical buying period in October-November 1999.

For 2000-2001, Canadian exports of canola to China are forecast to remain unchanged at around 1.2 Mt. Although Chinese imports for rapeseed/canola are forecast to decline, competition from Australia and the EU is also expected to decline due to lower production. In Canada, the "new" rail transportation system, which takes effect August 1, 2000, allows shippers of canola and rail carriers to make their own arrangements directly through contracts and it allows more flexibility in rate-setting. Exports of oilseeds may also be stimulated by a strengthening of world prices or an appreciation of the Chinese yuan against the Canadian dollar.

Over the next two years, Canadian production of canola is expected to decline from the record high of 8.8 Mt set in 1999-2000 due to the projected low prices for oilseeds relative to cereals and special crops. While new varieties and agronomic practices are reducing the cost-of-production, canola prices are projected to remain under pressure from the burdensome supplies of U.S. soyoil and Asian palmoil. Both are long-term factors that remain unresponsive to short-term price movements. The production of canola is projected to decline to 6.2 Mt in 2002 before trending upwards to about 7.9 Mt by 2006.

Domestic crushing of canola is projected to rise over the medium-term and reach 3.6 Mt by 2006 as low seed prices relative to vegetable oils and protein meal increase Canadian crush margins. Production of vegetable oils is expected to rise from 1.22 Mt in 1999 to 1.5 Mt by 2006 while the output of canola meal rises from 1.8 Mt to 2.23 Mt for the same period. As a result of lower than average production and increased crush, exports of canola are projected to decline over the medium-term, falling to a low of about 2.6 Mt in 2003 before rebounding to 3.8 Mt by 2006.

For more information on the medium-term baseline projections, visit the
Economic and Policy Analysis Directorate (EPAD) Website at
<http://www.agr.ca/policy/epad/english/pubs/chrtbook/june2000/toc.htm>