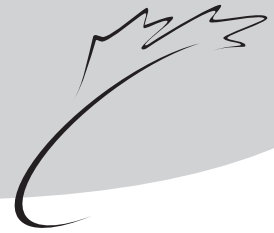




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OATS: SITUATION AND OUTLOOK

The Canadian oat market has changed considerably over the past decade, as production has shifted to the eastern prairies of western Canada from the western prairies and processing has expanded considerably. In addition, oats have become increasingly important as greenfeed. The 2002-2003 drought reduced production sharply and adverse harvest conditions reduced the quality of the crop. Oat prices are expected to remain strong throughout 2002-2003. Assuming a return to normal growing conditions for 2003-2004, oat production and exports in Canada are expected to increase significantly and return Canada to its dominant position in the world export market for oats. This issue of the *Bi-weekly Bulletin* examines the situation and outlook for oats.

WORLD PRODUCTION AND TRADE

The European Union (EU), Russia, Canada, and the United States (US) produce the majority of the world's oats, and total world production is estimated at 26 million tonnes (Mt) for 2002-2003. Although Russia is a very large producing country, its oats are generally consumed domestically, or are of low quality, and, as a result, it is not an important player in the world oat export market.

Canada is typically the world's largest exporter, usually representing 50-70% of world trade, with world trade averaging about 2 Mt over the past five years. The EU usually holds 20-30% of world trade, with Sweden and Finland being the main exporting countries within the EU. Oats are typically

exported from these European countries to horse feed markets in the southern US, with some sales also made into US milling markets. Australia is the only other significant player in the oat export market, making up 5-10% of world trade. The US accounts for about 80% of the world's imports, while Japan, Mexico, and the EU assume most of the remainder.

IMPORTERS

United States

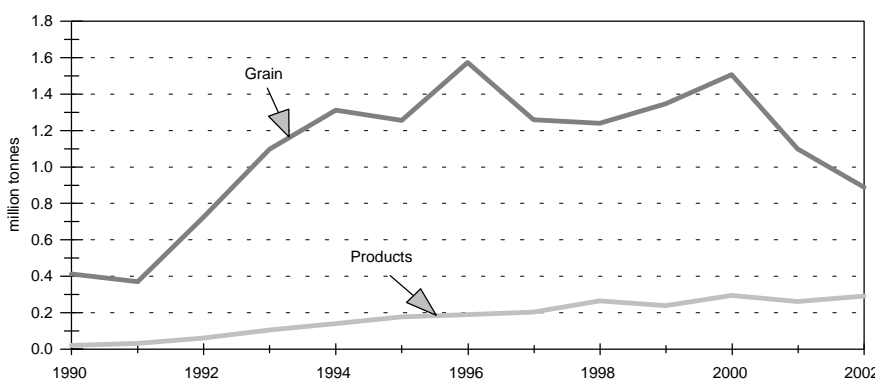
US oat production has decreased for several decades. The use of oats for horse feed has fallen, food demand has not increased significantly, and the economics of producing other crops have been more attractive. Oats have been disadvantaged by US farm policy, as other crops receive higher support. Also,

millers have exhibited a preference for Canadian oats over US oats. The Canadian climate produces oats with thinner hulls, which yield more output in the milling process.

The US is the world's largest oat importing market, with most Canadian exports being shipped to the US for milling use. Minneapolis is the main pricing point for milling oats, with several major mills located in the area. Minnesota accounts for about 25% of Canadian oat exports, with other significant importing states including Iowa, Wisconsin, and Ohio, accounting for about 20%, 15%, and 10%, respectively. As US oat production has declined, imports from Canada and the EU have increased significantly. Oat imports rose steadily over the 1980-1995 period, but levelled off in recent years as they filled most US commercial markets. Imports of raw oats for milling purposes are unlikely to increase further in the near future because significant growth in food use is not expected. Food use of oats has essentially been flat for the past decade, actually peaking in the late 1980s. US imports of Canadian oat products have increased steadily over the past decade.

For 2002-2003, US oat supplies have continued their long-term declining trend, with production remaining near the historical low despite a 14% increase in area seeded. Hot and dry conditions in the US negatively affected production in the important oat producing state of North Dakota, and caused yields to decline by 7% from 2001-2002. US imports are forecast to remain similar to last

CANADA: OATS EXPORTS



Source: Statistics Canada

year, although a relatively high percentage of imports are expected to be made up of imports from the EU as a result of the tight Canadian supplies. Since 1995-1996, the EU has not made up more than 35% of US oat imports but in 2002-2003 the EU expected to make up about 50% of US imports.

EXPORTERS

European Union

The EU is generally the world's second largest oat exporting region behind Canada. Subsidies by the EU have pressured world prices of oats over the past decade, with export subsidies of US\$60/t being observed as recently as 1999-2000. EU export subsidies on oats have fallen since then for a few reasons. High US prices have helped the EU to be competitive in US markets without subsidies, and the EU has been attempting to reduce its subsidies as it prepares to add eastern European countries to the European economic union. International trade agreements may also have been considered in recent EU export programs, as the EU has had to limit its subsidies on coarse grains to 10.8 Mt under *Agenda 2000*.

The EU had an excellent crop in 2002-2003, with production reaching its highest level since 1991-1992. Quality has generally been good, and the EU is forecast to have its largest export program in modern times. EU oat exports are expected to double from 2001-2002, to 1.2 Mt, based on increased EU production and ample export opportunities given the reduced Canadian and US supplies. The higher production and exports from that region will prevent US oat prices from trading at as large a premium to corn in 2002-2003 as they did in 2001-2002, although the premium will remain historically high.

The EU does not intend to use export subsidies for 2002-2003. In 2002-2003, with the strong North American oat prices and the large EU oat production, the EU has been able to compete in North American markets without offering export subsidies. In the recent past, the EU has exported oats primarily into southern US markets for use as premium horse feed. However, in 2002-2003, the EU has been able to offer very competitive prices, with industry sources indicating that EU oats are being imported into markets in the northern US, which have traditionally been

average yields and reasonably good quality were recorded.

Seeded area increased in Canada by 26% in response to high prices in 2001-2002 and the lowest carry-out stocks of modern times. A high percentage of the crop was not harvested for grain, as the poor crops and the shortage of feed, in drought affected areas, caused many farmers to harvest the crop for greenfeed, while others were unable to harvest the crop due to difficult harvest weather. Canadian oat production was estimated by Statistics Canada at 2.7 Mt in December. Based on this production estimate, supplies are quite low at 3.1 Mt, down from 3.6 Mt in 2001-2002 when prices jumped sharply relative to other coarse grains.

However, much of the decline in production occurred in Alberta, which is not a large milling and exporting province (much of Alberta's oat area is now used for forage rather than for grain). Conversely, Manitoba production is considerably higher in 2002-2003. Saskatchewan production is very questionable both in terms of quantity and quality, and this province is a large exporting province. Saskatchewan Agriculture, Food and Rural Revitalization reports that 30% of production is expected to grade No.4 Canada Western, which is not suitable for milling. Only 31% of oat production is in the top two grades which are the main milling grades. About 39% of oats are reported to be No.3 Canada Western, and could also be used for milling.

Canadian exports, including products, are forecast to decline by about 0.2 Mt, to 1.25 Mt, which will be well below the five-year average of 1.5 Mt. Competition for the US market by the EU has increased. If the pace of EU exports continues, then Canadian exports may be even lower than currently forecast. Feed use is forecast to decline as a result of the lower supplies, and carry-out stocks are projected to fall below the level observed in 2001-2002.

Imports of oats into Canada are a possibility, and they might be used for either feed or milling purposes. About 34,000 t of feed quality oats were imported into Canada from Ukraine in 2001-2002, and imports of feed oats from the Baltic Sea region could happen again in 2002-2003 since prices of feedgrain in Canada are very high relative to prices in eastern Europe. With respect to milling oats, EU oats may periodically be attractive for Canadian oat millers given the tight supplies of milling oats in Canada. This is unlikely to occur, at least not in large quantities, given the high transportation costs associated with shipping oats to prairie mills.

CANADA: OATS SUPPLY AND DISPOSITION

	2000 -2001	2001 -2002	2002 -2003f
Seeded Area (000 ha)	1,820	1,907	2,399
Harvested Area (000 ha)	1,299	1,238	1,298
Yield (t/ha)	2.61	2.17	2.12
thousand tonnes.....		
Carry-in Stocks	1,122	854	365
Production:			
Manitoba	1,016	748	1,018
Saskatchewan	1,377	961	972
Alberta	657	592	285
Other	339	390	473
Total Production	3,389	2,691	2,748
Imports	8	53	15
Total Supplies	4,519	3,598	3,128
FSI ¹	268	328	360
FWD ²	1,632	1,467	1,160
Loss in Handling	5	9	8
Total Domestic Use	1,905	1,804	1,528
Exports:			
Grain	1,461	1,069	890
Products	299	360	360
Total Exports	1,760	1,429	1,250
Carry-out Stocks	854	365	350
Average Price ³	114.49	202.28	190-220

¹ Food, Seed, and Industrial Use

² Feed, Waste, and Dockage

³ Nearby Chicago Futures Contract

f: forecast, AAFC, December 2002

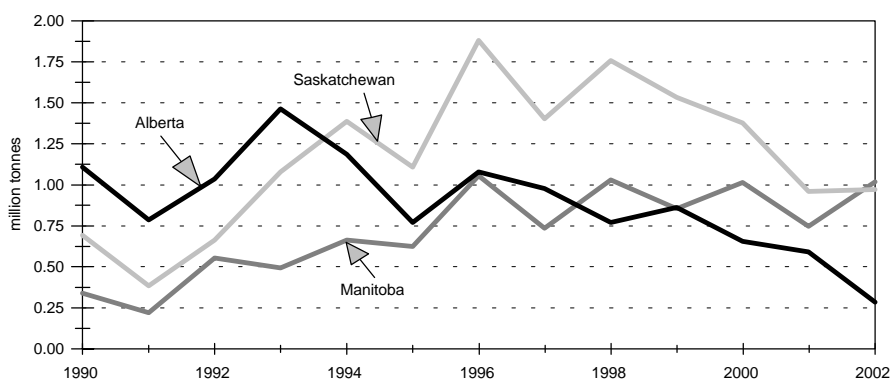
Source: Statistics Canada

milling markets for Canadian oats. The tight Canadian supplies of milling quality oats and high prices have made EU oats attractive to US buyers.

Canada

A host of adverse conditions played havoc with grain production in Saskatchewan and Alberta during the growing season of 2002-2003. Slow development in the spring, extreme drought during the summer, legions of grasshoppers, frost in August, late season rains resulting in secondary growth and a delayed harvest, and rain and snow during harvest all combined to make the season one that many farmers will want to forget. However, these problems did not affect all oat producing regions. In fact, in Manitoba, which produced about 45% of the oats in western Canada, conditions were generally favourable as adequate precipitation was received, and above

WESTERN CANADA: OATS PRODUCTION BY PROVINCE



Source: Statistics Canada

PRICES

The size and quality of the Canadian oat crop largely determines the relationship of oat prices to other coarse grain prices. US corn prices underlie all world coarse grain prices, including oats. In most years, when ample supplies of oats are available in Canada, the US, and the EU, oats are priced at a discount to corn and barley on a per tonne basis, as oats generally have a lower nutrient value in feed rations. The premium for milling oats relative to feed oats is low when ample supplies of oats are available, since the inelastic milling demand for oats can easily be

met by the large supplies. In years when the supply of milling quality oats is low, prices for milling oats can rise dramatically relative to feed oats, barley, and corn. The milling industry bids up milling oat prices sharply, relative to feed prices, in an attempt to source high quality oats since there are no alternatives which can be used as substitutes.

For 2002-2003, the price of oats has been supported by the shortage of barley. Barley, the main feed ingredient in western Canada, is normally priced on an export basis. However, in 2002-2003 the shortage of barley in western Canada means that it is priced competitively

with the landed cost of imported US corn. Due to the shortage of barley, feed barley prices are much higher than they would be otherwise (perhaps \$30/t or more depending on location, based on Pacific Northwest export prices for barley). As a result, feed oats, which are priced competitively with feed barley, are priced much higher than they would be in other years. This, in turn, supports milling oat prices, with milling oats priced at a substantial premium to feed oats. The relatively tight supplies of milling oats due to low production, record low carry-in stocks, and below normal quality ensures that there is a significant premium for milling oats over feed oats and further supports oat prices.

For 2002-2003, oat prices are expected to remain strong until increased production forecasts for 2003-2004 become more certain, late in the spring of 2003. Chicago oat futures are forecast by Agriculture and Agri-Food Canada (AAFC) to average US\$1.90-2.20 per bushel (/bu) for the 2002-2003 crop year, or about CAN\$190-220/t, based on current exchange rates. With the tight supplies of milling quality oats in western Canada, there is some potential for Chicago oat prices to increase to US\$2.25/bu, as seen at times during 2001-2002, if end-users are caught uncovered. However, the increase in supplies of oats in Manitoba of about 0.2 Mt and the large export program being undertaken by the EU make the chances of that somewhat

DEVELOPMENTS AFFECTING THE CANADIAN OAT MARKET

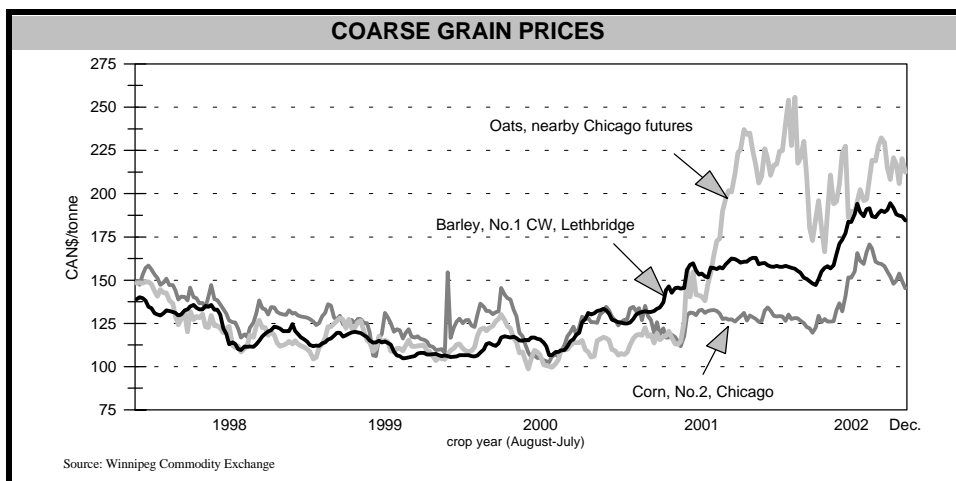
Elimination of tariffs on oat products through *The Canada-US Free Trade Agreement* and *The North American Free Trade Agreement* was one of the factors that encouraged domestic processing of oats. Tariffs on oat products were about \$18 per tonne (/t) in 1988, and these gradually fell to zero as the agreement was implemented. The removal of tariffs on oat products increased the attractiveness of Canadian oat products to US buyers.

The removal in 1995 of domestic transportation subsidies formerly provided under the *Western Grain Transportation Act (WGTA)* had a significant impact on Canadian oat markets, as transportation costs to export positions increased markedly. For instance, the cost of shipping oats from the Peace River region (Alberta), a significant oat producing region, to Thunder Bay (Ontario), increased from \$20/t in 1994-1995 to about \$43/t in 1995-1996. The cost has increased marginally since that time to about \$45/t in 2002-2003. A dramatic shift in the location of oat production in Canada occurred as a result of the increased transportation costs. At the beginning of the 1990s, Alberta was the largest oat producing province in Canada, producing 1.1 Mt of oats and exporting about 245,000 tonnes (t) compared with 0.3 Mt of production and 0.05 Mt of exports for Manitoba. Oat production shifted east into Manitoba and Saskatchewan with the removal of the transportation subsidy, as transportation costs to important US markets were lower from that region. For 2002-2003, Manitoba produced 1.0 Mt and is forecast to export about 0.7 Mt of oats in raw and processed forms, making it the largest oat exporting province for the first time in recent history. Exports from Alberta are expected to be about 0.05 Mt.

The elimination of the transportation subsidy also increased the incentive to process oats domestically. The oat hull accounts for about 35-40% of the oat's volume but it has relatively little commercial value. During the milling process the hull is removed to extract the oat groat, which is the valuable part of the oat that is used for human consumption. By removing the hull, transportation costs are reduced substantially, with the oat groat being a much denser product than raw oats. Canada's exports of oat products have grown remarkably, from about 12,000 t in 1990-1991, to about 360,000 t in 2001-2002.

Another factor affecting the Canadian oat market is the expansion of the livestock industry in western Canada. This is likely linked to some of the above factors, the removal of the WGTA in particular, and it has helped to encourage the use of oats for greenfeed and silage, rather than for grain. This has been very evident in Alberta, where only about 20% of oats were harvested for grain in 2002-2003, compared with about 70% in 1990. A substantial amount of the decline is directly attributable to the drought of 2002-2003, however, a clear decline in the percentage of harvested area has been observed in Alberta since the elimination of the grain transportation subsidy. Increased use of oats for greenfeed has also been observed in Saskatchewan but to a lesser extent.

Prior to the 1989-1990 crop year, exports of oats were under the monopoly of the Canadian Wheat Board (CWB). However, the CWB's mandate for oats was removed on August 1, 1989 by the federal government, and its impact has been widely studied with various results.



unlikely. End-users in the US did not have the option of large EU supplies available to them last year which contributed to the very high prices observed at that time and to the large premium for oats relative to corn. Oats are expected to be priced at a premium to corn on a per tonne basis again in 2002-2003, but the premium is forecast to be lower than in 2001-2002.

MEDIUM-TERM OUTLOOK

Forecasts for 2003-2004 are highly uncertain at this time considering weather related risk, the amount of time between now and the start of the 2003-2004 harvest, and the unpredictability of policy and market factors. However, for 2003-2004, area seeded to oats is forecast by AAFC to increase, especially in Saskatchewan, as high prices for raw oats and greenfeed in 2002-2003 are both supportive of increased area. The shortage of hay in 2002-2003 is expected to be an important factor in planting considerations, as farmers are projected to try to rebuild their supplies of hay and reduce pressure on pasture. In the US, the *Farm Security and Rural Investment Act* (FSRIA) is not expected to have a significant impact on area seeded to oats, as strong prices are expected to encourage farmers to react to market signals rather than to the parameters of the FSRIA program. US oat production and imports are forecast to be similar to 2002-2003. In the EU, production is forecast to be similar to 2002-2003.

Prices are forecast to be considerably lower for the 2003-2004 crop year as a result of increased supplies of feedgrain in western Canada. Oat prices are also likely to be pressured in 2003-2004 by lower prices for US corn and western Canadian feed barley, assuming normal weather conditions in North

America results in increased yields and an easing of the tightness in world coarse grain supplies. US corn prices are forecast to decrease by 5-10% due to higher corn production in the US.

Based on long-term price patterns and assuming normal yields, Chicago nearby oat futures prices are expected to range between US\$1.20-1.60/bu, with an average of about US\$1.40/bu. In other words, farm prices are forecast to fall by about a dollar (Canadian) per bushel from 2002-2003 prices, and they are expected to be priced competitively with corn and feed barley. Price declines may be even larger in some parts of the prairies, such as Alberta, where the drought of 2002 has driven oat prices sharply above long-term price levels.

The EU might consider export subsidies in 2003-2004, depending on the price relationships between the EU and US markets, and political considerations such as the upcoming expansion of the EU-15 to the EU-25.

Over the medium-term, in 2004-2005 and beyond, oat production in Manitoba will likely continue to benefit from lower transportation rates relative to Alberta and western Saskatchewan. Similarly, Canadian oat processing and exports of oat products are forecast to continue to expand to take advantage of the lower transportation cost of shipping processed oats. Area seeded area to oats in Alberta and western Saskatchewan may also expand, however, the growth of oat production in those provinces will most likely be driven by demand for greenfeed rather than from the milling industry.

Fusarium head blight (FHB) is starting to become a problem for oats, especially in Manitoba, and there is some concern that it could become a major disease in the medium-term. There are currently no oat varieties with FHB resistance, and research into the problem is continuing.

Total imports by the US are not expected to grow significantly in the medium-term. Program parameters for oats under the FSRIA have not changed significantly from the previous US farm bill, so it is not expected to result in major changes in US oat production.

The EU is expected to remain an important competitor in US markets. The expansion of the EU to eastern European countries will be a factor to watch as these countries have the potential to increase EU oat production considerably, which could have implications for world oat markets.

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