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Brazil

Grain and Feed Update

Record Corn Harvest as Second Crop Production Surpasses First Crop; Exchange Rate Boosts Rice Exports; Tight Wheat Supplies Characterize Market

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Report Highlights:
Post raises 2011/12 corn production estimate to 71 million metric tons, due to optimal weather. Corn export records are anticipated for 2011/12 and 2012/13. Thanks to a favorable exchange rate, 2011/12 rice exports have proven robust even without government support. Rice consumption trends downward. Tight wheat supplies are anticipated for 2011/12 and 2012/13. Wheat production area is forecast to lose area to corn and soybeans.

Commodities:

WHEAT

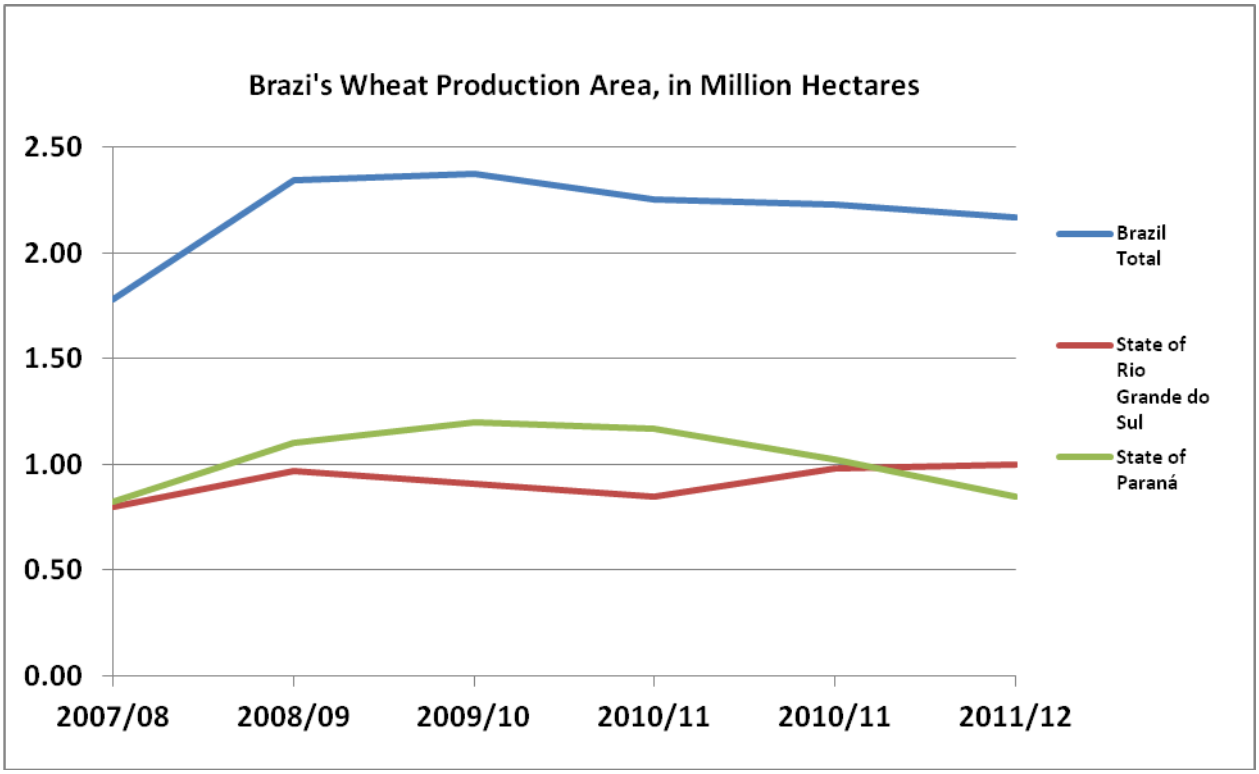
Wheat Brazil	2010/2011		2011/2012		2012/2013	
	Market Year Begin: Oct 2010		Market Year Begin: Oct 2011		Market Year Begin: Oct 2012	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Harvested	2,150	2,150	2,170	2,170	2,100	2,000
Beginning Stocks	2,598	2,598	1,862	1,862	1,762	1,162
Production	5,900	5,900	5,800	5,700	5,000	5,200
MY Imports	6,699	6,699	7,300	6,500	6,700	7,000
TY Imports	6,746	6,746	7,000	6,300	7,000	7,100
TY Imp. from U.S.	405	405	0	500	0	700
Total Supply	15,197	15,197	14,962	14,062	13,462	13,362
MY Exports	2,535	2,535	2,000	1,600	500	1,500
TY Exports	2,539	2,539	1,850	1,600	500	1,500
Feed and Residual	200	200	500	600	200	300
FSI Consumption	10,600	10,600	10,700	10,700	10,800	10,800
Total Consumption	10,800	10,800	11,200	11,300	11,000	11,100
Ending Stocks	1,862	1,862	1,762	1,162	1,962	762
Total Distribution	15,197	15,197	14,962	14,062	13,462	13,362
1000 HA, 1000 MT, MT/HA						

2012/13 Wheat Supplies: 2012/13 area harvested to wheat is forecast at two million hectares, eight percent lower than the estimated 2011/12 harvested area and five percent lower than the official USDA forecast. Liquidity concerns and the conversion of wheat production to corn production are responsible for this significant decrease in production area. In comparison with other commodities, particularly soybeans and corn, wheat traditionally has had very low liquidity. Many producers are moving away from wheat production in the pursuit of greater economic certainty. In addition to increased liquidity, corn production holds the appeal of higher profit margins for producers. Many of these producers plant wheat in the winter and then soybeans in the spring. A certain symbiotic relationship has developed between wheat and soy in the South. With the forecast shift to corn, many producers, particularly in the state of Paraná, will continue to plant soybeans in the spring and then second crop corn in the late summer. Forecast production at 5.2 million metric tons (mmt) is 13 percent lower than 2011/12 production, due to the decline in production area. Post's production forecast, four percent higher than the official USDA forecast, reflects historic yields; there has been little to indicate that yields will be other than normal.

Post forecasts tight supplies for 2012/13, given the reduction in harvested area and the shrinking quantity of wheat available for export from Argentina, Brazil's largest wheat supplier.

2012/13 Wheat Trade: As a result of the forecast decline in production, many are already predicting that 2012/13 wheat imports will register the largest import volume in six years. Imports are forecast at 7 mmt. As Brazil's Mercosul partner countries will have a difficult time meeting Brazil's consumption needs, Post forecasts imports of 700,000 mt of U.S. wheat.

2011/2012 Wheat Supplies: There is little change in 2011/12 production estimates: the estimated area harvested to wheat is maintained at 2.17 million hectares, and production estimated at 5.7 mmt. In line with Post's earlier reporting, production has indeed shifted south. Paraná's production is the lowest in five years. For the first time in 12 years, the state of Rio Grande do Sul overtook the state of Paraná as the state with the largest amount of area harvested to wheat. One reason for this shift is that producers in Rio Grande do Sul have been tempted to plant wheat as a way to recover from the losses resulting from the December-January drought that significantly reduced corn and soybean yields, subsequently taking a hit out of their profitability. Another factor is that wheat producers were pleased with the last year's yield and higher product quality. The climate in Rio Grande do Sul has proved itself more propitious. Nevertheless, frosts at the end of the winter can still jeopardize yield and quality. Finally and most importantly, Paraná producers are looking to plant more soybeans and corn instead of wheat. Many regions in the state of Paraná are able to harvest second crop corn (*safrinha*) and producers in these regions over the past two to three years have been gradually shifting from wheat to second crop corn production. Unless there are drastic movements in prices and liquidity, this production shift will become the new reality in the South. Rio Grande do Sul is unable to produce second crop corn: wheat does not face the threat of second crop corn there.



2011/12 stocks will be tight. 2011/12 carry-over wheat stocks are some of the lowest on record. Brazil is facing a trend of diminishing domestic area harvested to wheat. In addition, production regions in its Mercosul partners, who have traditionally provided Brazil with the majority of its wheat imports, are decreasing by an estimated average of seven percent. As domestic wheat consumption is slowly increasing, Brazil will need to look to alternate suppliers if Mercosul partners are unable to meet Brazil's consumption needs.

2011/2012 Wheat Trade: 2011/12 wheat exports are estimated at 1.6 mmt, 20 percent lower than the official USDA estimate, and imports are estimated at 6.5 mmt, 12 percent lower than the official USDA estimate.

Imports have been particularly affected by the growing conditions in Brazil and in its Mercosul partners, especially Argentina. Imports were particularly high for May and June, as many mills and trading companies began accelerating imports in anticipation of a reduced harvest.

Brazil's agricultural support program, the Premium for Product Flow (PEP), has been significantly aiding wheat exports. In so far as wheat exports have benefitted from PEP, there are two important factors affecting the eligibility of product: (i) the new minimum price and (ii) the new quality standard.

(i) The New Minimum Price: many of Brazil's agricultural support programs hinge on the stipulated minimum price, a price of reference that triggers a product's eligibility for participation in the program. The minimum prices for winter crops, including wheat, were revised and published on May 7, 2012. The minimum price for wheat, active July 2012 to July 2013, was raised from US$238.50 (R$477) to US$250.50 (R$501) per ton.

(ii) The New Quality Standard: after years of intense political discussions that pitted producer groups against industry groups, a new quality standard came into force this July. Domestic producers and industry have been at odds as the former have tended to place greater emphasis on yield and agronomic characteristics of the wheat produced and the latter have tended to place greater emphasis on the wheat quality and milling characteristics. The new standard, known as Normative Instruction 38, is anticipated to have a two-fold effect. On the one hand, producers that meet the standard can get a better price for their product, as the wheat quality average should rise. On the other hand, producers who are unable to meet the quality standard will be unable to qualify for PEP auctions.

Post's preliminary analysis has estimated at least 2.53 mmt of wheat has been auctioned this year through PEP. This represents 44 percent of the total wheat production. Undoubtedly, these estimates under-represent the true support to be verified/confirmed at the end of the year.

Wheat Program (Aug-Jul Year)	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12*
PEP	0	425.5	1,113.20	3,261.30	1,786	2,525
Production	0	2,233.70	4,081.90	5,026	5,881.60	5,700.00
Percentage of Total Production Supported by PEP	0.00%	19.05%	27.27%	64.89%	30.37%	44.30%

Unit: 1,000 metric tons; percentage

*Post's preliminary estimates

Commodities:
CORN

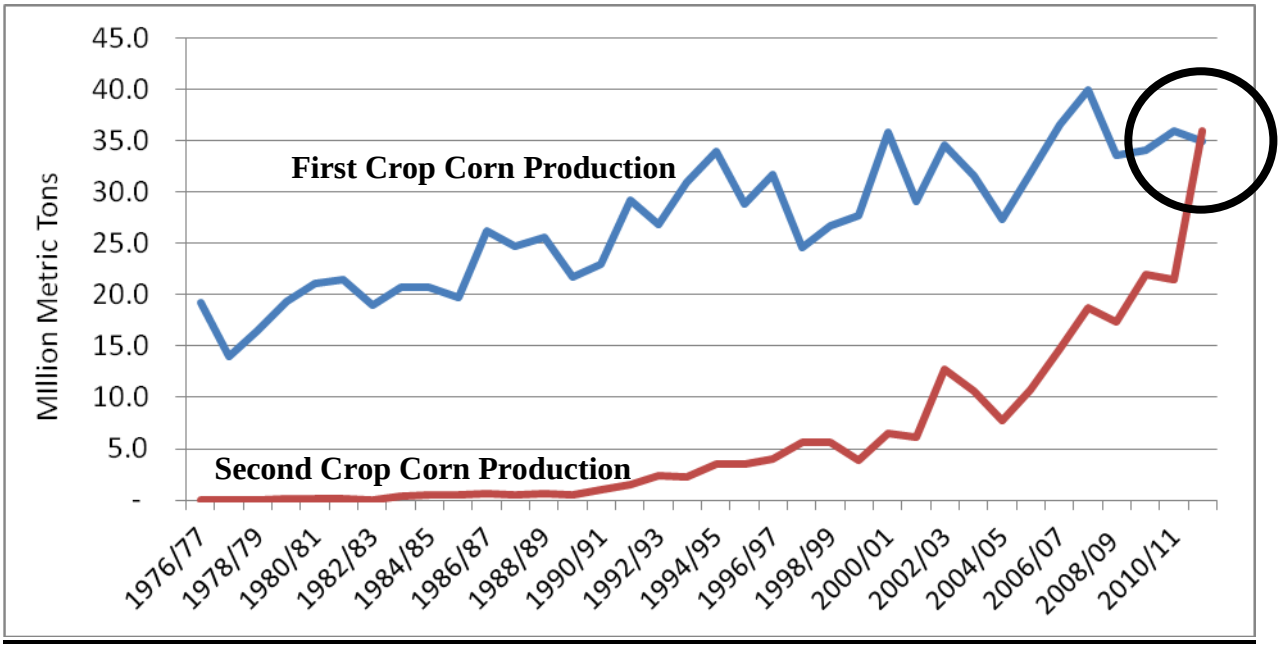
Corn Brazil	2010/2011		2011/2012		2012/2013	
	Market Year Begin: Mar 2011		Market Year Begin: Mar 2012		Market Year Begin: Mar 2012	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Harvested	13,800	13,800	15,200	15,000	15,800	16,000
Beginning Stocks	9,989	9,989	10,276	10,276	13,076	15,126
Production	57,400	57,400	70,000	71,000	67,000	69,000
MY Imports	791	791	800	850	800	800
TY Imports	287	287	1,100	950	800	800
TY Imp. from U.S.	0	0	0	0	0	0
Total Supply	68,180	68,180	81,076	82,126	80,876	84,926
MY Exports	8,404	8,404	14,000	13,000	12,000	13,500
TY Exports	11,583	11,583	11,000	11,500	12,500	14,000
Feed and Residual	42,500	42,500	46,000	46,000	47,500	47,500
FSI Consumption	7,000	7,000	8,000	8,000	8,500	8,500
Total Consumption	49,500	49,500	54,000	54,000	56,000	56,000
Ending Stocks	10,276	10,276	13,076	15,126	12,876	15,426
Total Distribution	68,180	68,180	81,076	82,126	80,876	84,926
1000 HA, 1000 MT, MT/HA						

2012/2013 Corn Supplies: 2012/13 forecast area harvested to corn is raised to 16 million hectares, a slight increase over the official USDA forecast and an eight percent growth from the 2011/12 harvested area. Post forecasts production at 69 mmt; this production forecast is three percent lower than the 2011/12 production estimate. In reality, Post is forecasting the 2012/13 production based on average yields and growth trends. As such, 2011/12 production has been atypical, a unique result of (i) on-time second crop planting thanks to new shorter-season soybean varieties, (ii) phenomenal weather patterns during the second crop (excellent precipitation and the lack of abnormal destructive weather events), (iii) and increased last-minute decisions to plant second crop corn based on the heavy loss of first season corn due to the summer drought. 2012/13 production will have increased harvested area. Second crop corn production will continue to grow and outstrip first crop corn production. Second crop corn production will increase in all states possible in the South, Southeast and Center-West, with marked growth in Mato Grosso and Paraná. The second crop corn will be augmented thanks to a number of states in the Northeast also entering the second crop corn production arena. Questions remain concerning the logistics involved in moving the corn from production regions to consumption regions, and in particular to export markets. Some analysts envision a slight decrease in the 2012/13 area harvested to first crop corn, while other analysts foresee that harvested area holding steady or even increasing 2-3 percent. At the end of the day, area harvested to first crop corn will be contingent on world prices, which will be linked to the U.S. corn crop yields. Any minimal decrease in 2012/13 area harvested to first crop corn will be entirely offset by the increase in area harvested to second crop corn.

2013/2013 Corn Trade: Post forecasts 2012/13 corn exports at 13.5 mmt, which could be a record export year, contingent upon Brazil's highly-anticipated 2011/12 corn export performance. Some analysts have recently predicted exports even reaching 16-17 mmt. While a possibility, logistical bottlenecks, increased domestic consumption trends, and international competition will be restraining factors. Imports are held steady at 800,000 mt.

2011/2012 Corn Supplies: The 2011/12 area harvested to corn is estimated at 15 million hectares, an eight percent increase from the 2010/11 area harvested to corn. This estimate is slightly lower than the official USDA estimate, as many analysts believe that the record corn crop is more a factor of yield increases in the second crop corn as opposed to the increase in area harvested to second crop corn. Overall, the 2011/12 area harvested to second crop corn increased by 61 percent. In Mato Grosso alone, the second crop corn production is estimated at 14.2 mmt, a massive 104 percent increase from the 2010/11 second crop corn production. In some of the largest production regions of Mato Grosso (e.g., Sorriso), average yields are reaching 6-6.6 mt/hectare.

***Safrinha* is no longer *Safrinha*:** *safrinha*, the Portuguese term for *the small harvest*, officially became a misnomer as the safrinha, or the second crop corn, is estimated to have surpassed the first crop corn production, *safra*. Undoubtedly the summer drought took a toll on the first crop corn production. Regardless, second crop corn production will continue to grow and occupy ever more space in Brazil. First crop corn production may swing back to exceed second crop corn production in 2012/13, but Post believes it is inevitable within the next 1-3 years that it will become a new trend for the second crop corn to out-produce the first crop corn.



Delayed implementation of new corn quality standard: the Brazilian Government announced a delay in the implementation of Normative Instruction 60/2011, as stated in Announcement 611 which was published on July 5, 2012. Normative Instruction 60/2011 contains new identity and quality standards for corn sold in Brazil; initially slated to enter into force on July 1, 2012, the standard has had its implementation postponed until September 1, 2013. The stated rationale for the delay was to provide producers with more time to adjust to the new classification system, a system that must be used to make producers eligible to participate in government programs. Major changes follow:

1. acceptable humidity level moves from 14.5 percent to 14 percent
2. reduction of foreign material and impurity shifts from three percent to two percent
3. reduction in the varied defects alters from 27 percent to 20 percent

Brazilian corn prices have benefitted from the drought in the United States. In mid May, analysts and traders became aware of the super second crop corn harvest and prices began to decrease as a response. However, reports of the drought in the United States began to bolster the market and prices have risen and stabilized over the last weeks, following the general trends of the global market. The U.S. drought proved to be a boon to Brazilian corn producers, sparing them low prices in a market flush with excess supply. If sales continue to go as they have gone over the past month and prices continue to rise, as expected till mid-August, agricultural producers will look to corn production very favorably for the next crop year.

Storage for this record second crop corn harvest will be difficult to come by. Brazil's storage capacity has been limited as it is, but the additional production will place increased pressure on a traditional logistical bottleneck that has been already squeezed. Nevertheless, those with storage capacity will most likely hold their production in storage to hold out for peak prices.

2011/2012 Corn Consumption: Domestic livestock producers have benefited from the abundant domestic supply of corn but are noting that the prices of soy meal, another typical feed ingredient blended with corn, are up 70 percent in comparison with this same period last year. As such, livestock producers are claiming that feed prices increased 30 to 40 percent in comparison to last year. Swine and poultry producers are experiencing the feed price squeeze.

2011/2012 Corn Trade: 2011/12 corn exports are estimated to reach record highs at 13 mmt. Post bases its estimate, which is seven percent lower than the official USDA estimate, on historical export trends, coupled with the available supply. The first four months of the 2011/12 marketing year registered the highest export levels over the last three years, but in reality, these exports were significantly lower than the same period of time from 2005 to 2009. Exports are expected to be strong, given international demand. Furthermore, the abundant supply of corn in Brazil can definitely facilitate record exports.

Export paths: Almost half of all Brazil's corn exports are leaving through the Port of Paranaguá, in the state of Paraná. This includes both the first and second crop corn. The western region of the state of Bahia, a fertile plateau known for its high agricultural productivity, is exporting corn for the first time in 2011/12. Western Bahia has already had a tradition of exporting soybeans and cotton. As the region increased its corn production this year by 60 percent, western Bahia continues to lead average corn yields in Brazil with an average of 9.3 mt/hectare. Western Bahia has filled at least five ships at the state's Port of Ilheus with corn destined for international markets.

China factor: In early June, the Government of China presented to Brazil a formal bilateral protocol, defining sanitary and phytosanitary specifications, that would facilitate Brazilian corn exports to China. China and Brazil first met back in February/March of 2012 to discuss China's interest of supplementing its Northern Hemisphere corn imports with Southern Hemisphere corn imports. It was rumored that Brazil and China would both sign the protocol on the margins of the Rio+20 Conference in late June. However, it appears that the signing did not take place. While it was expected that the protocol would take immediate effect, varieties and volume eligible for export have not been defined. Argentina also received a protocol from China in February but protocol negotiations are ongoing.

The *Price of Product Flow* (VEP) is the sister program of Brazil's *Premium for Product Flow Program* (PEP). When market prices dip below the official minimum price, PEP auctions negotiate contracts for private stocks at the market price plus a premium paid by the government. VEP functions in the same way except that it auctions public stocks instead of private ones. In late May, the Brazilian Government announced that it would auction 500,000 mt of public stocks of corn to supply the drought-stricken regions of the Northeast of Brazil. Throughout June and into July, multiple VEP auctions have taken place. All VEP auctions have specified that the purchases would need to have specified states in the North and Northeast as their final destination. These announcements precluded the option of international exportation.

	Auctioned (mt)	**Sold (mt)**	**Premium (US$)**
June	120,000	37,721.12	$5,375,270
July*	30,000	5,857.50	$780,835

Unit: 1,000 metric tons; US$

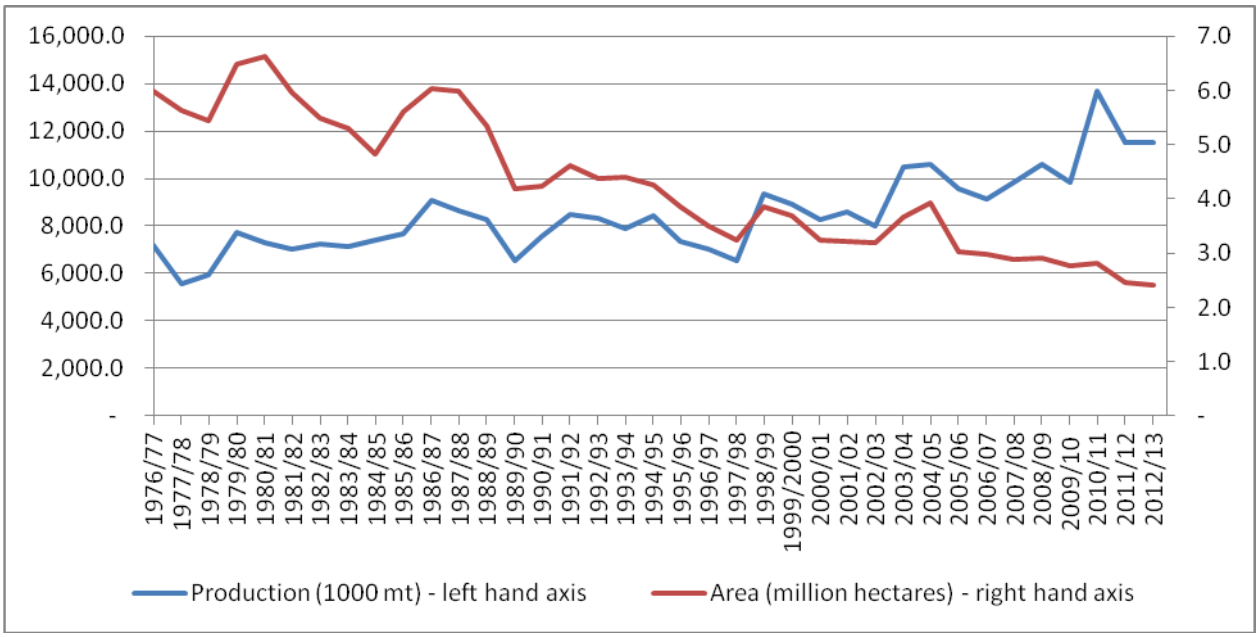
*As of July 11, 2012

In government and industry meetings prior to the price escalation caused by the drought in the United States, there had indeed been discussion on whether the Brazilian government should activate PEP auctions for corn should contract options fail to provide producers with the needed support. This possibility should be moot in the current environment of high prices.

Commodities:
RICE, MILLED

Rice, Milled Brazil	2010/2011		2011/2012		2012/2013	
	Market Year Begin: Apr 2011		Market Year Begin: Apr 2012		Market Year Begin: Apr 2012	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Area Harvested	2,833	2,833	2,450	2,450	2,750	2,400
Beginning Stocks	550	550	803	803	383	223
Milled Production	9,300	9,300	7,860	7,820	8,670	7,820
Rough Production	13,676	13,676	11,559	11,500	12,750	11,500
Milling Rate (.9999)	6,800	6,800	6,800	6,800	6,800	6,800
MY Imports	632	632	700	700	610	650
TY Imports	591	591	660	690	610	620
TY Imp. from U.S.	0	0	0	0	0	0
Total Supply	10,482	10,482	9,363	9,323	9,663	8,693
MY Exports	1,479	1,479	850	1,200	900	700
TY Exports	1,296	1,296	900	1,450	900	850
Consumption and Residual	8,200	8,200	8,130	7,900	8,100	7,800
Ending Stocks	803	803	383	223	663	193
Total Distribution	10,482	10,482	9,363	9,323	9,663	8,693
1000 HA, 1000 MT, MT/HA						

2012/2013 Rice Supplies: The 2012/13 forecast area harvested to rice is lowered to 2.4 million hectares, 13 percent lower than the official USDA forecast and a two percent decrease in area harvested to rice compared to the 2011/12 area.



A general trend indicates that area harvested to rice has gradually decreased over the decades but that yield increases have more than compensated for the loss in area. After excessive oversupply in 2010/11, many of the rice producers located in suitable growing areas opted for soybean and corn production in 2011/12. Post forecasts that most of these producers will not return to rice production in

2012/13 but rather continue in alternate crop production and that area harvested to rice will further decrease. Better financing options and price concerns are driving factors in this production shift.

2012/2013 Rice Trade: 2012/13 rice exports are forecast at 700,000 mt, a steep 30 percent drop from the 1.2 mmt estimated in exports from 2011/12. A short supply, consisting of low carry-over stocks and decreased production, will leave very little rice available for export. The only conceivable factor that could boost export numbers will be an increase in imports. However, imports are forecast at 650,000 mt, in line with historical trends.

2011/2012 Rice Supplies: 2011/12 area harvested to rice is held constant at 2.45 million hectares and production is estimated at 11.5 mmt. The harvest concluded in May.

2011/2012 Rice Consumption: Over the years, there has been a consistent decrease in rice consumption in Brazil, due to (i) the growth of the middle class and perceptions, and (ii) the inability of the Brazilian rice industry to meet the needs of the modern consumer.

(i) Middle class growth and perception: Brazil's middle class has been consistently growing over the past decade, with this growth particularly apparent in the last five years. These new consumer entrants to the middle class frequently look to other products instead of rice. Rice and beans, while hailed by many researchers as an ideal staple diet that meets the Brazilian consumer's nutritional needs, are frequently perceived as the food of the lower classes. Many new middle class consumers try to differentiate themselves from the lower classes by shopping for different types of food and eschewing—or, at a minimum, reducing—rice consumption. This has been a significant trend leading to overall lower domestic rice consumption in Brazil.

(ii) The Brazilian rice industry has been slow to adjust its products to the needs and desires of the modern consumer. Middle class consumers, and consumers across the board, are looking for ready-to-eat food dishes or dishes that are quick and easy to prepare. While the average middle class Brazilian consumer may reduce purchases of traditional bags of rice at the supermarket, he or she may be quick to purchase and consume prepackaged dishes with already prepared rice, or processed meals that include rice along with meats, vegetables and other types of food. However, these products are not readily available and consumption has continued to decrease.

2011/2012 Rice Trade: 2011/12 rice exports are estimated at 1.2 mmt, 14 percent higher than the official USDA estimate. Unlike the past two years, thus far in calendar year 2012 all rice exports have been negotiated without subsidies from the Brazilian Government. Brazilian rice exports have benefited from the depreciation of the Brazilian real. Without the exchange rate factor, exports would not reach their estimated level. Post opines that the growth of Brazilian rice exports is not a flash in the pan. With or without the government subsidies, the Brazilian industry and producer groups are keen to continue exporting rice in increasing quantities. As noted for 2012/13, export feasibility is contingent upon product availability. Brazil's target export markets will continue to be Africa, Central America and the Middle East.

In its annual exercise to revise minimum prices in late June, the Brazilian government held constant the minimum price for rice. There had been speculation that an upward-revised minimum price could enable the PEP program to be reactivated. While public funds were allocated for PEP auctions for rice, rice prices have been robust. As it is unlikely to be activated, the funding allocation was interpreted by most analysts as a political signal, a government safety net and guarantee for rice producers.

Rice stocks are tight. Furthermore, most of the current stocks are publicly held, as private stocks continue very low. The industry, concerned by the possibility of the short supply leading to price escalation and unhealthy inflation rates, has been asking for and anticipating the government's auction of public stocks via the VEP support program. Theoretically, the government could stipulate in the VEP announcements, as has been done with June/July VEP corn announcements, that the product be shipped exclusively to domestic locations in need. Whether that be the case or not, VEP auctions would either directly or indirectly aid Brazilian rice exports merely by augmenting the total supply available.

Brazil's Mercosul Imports: The primary countries supplying Brazil's rice imports are its Mercosul partner countries. In 2004, a legislative error exempted rice imports of the PIS/Cofins tax, an exemption intended only for domestic production. Since then, rice imports have been exempted from paying the 9.25 percent tax. In late July 2012, Brazil's House and Senate will vote on a measure to remove the PIS/Cofins exemption from rice imports, thereby making domestic producers more competitive.

MERCOSUL FACTOR

Mercosul continues to shape Brazil's trade panorama. The tariff exemptions granted to Mercosul partners are a large factor leading to these countries' export competitiveness in Brazil, particularly in the commodities rice and wheat, among others. Mercosul partners consistently supply Brazil with abundant wheat imports and Brazil's relatively scant rice imports are also primarily from Mercosul partners.

Worthy of note are the evolutions in Mercosul. In July, Venezuela was voted into Mercosul as a full member. U.S. industry members, and particularly bulk commodity exporters, should be wary of the impact Venezuela's addition to Mercosul could have on U.S. commodity competitiveness (e.g. rice) in Venezuela. Further market opportunities and challenges may arise as Mercosul evolves.

Related Report References:

2012 Brazil Annual Grain and Feeds Report
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