Summary of the projections

Chapter I Prospects for agricultural markets in the European Union

Introduction

This chapter summarises the main results and underlying assumptions of medium-term projections for some key agricultural products in the European Union for the period 2002 - 2009. The results presented are **based on the statistical information available in April 2002**.

These projections are not intended to constitute a forecast of what the future will be, but instead a description of what may happen under a specific set of assumptions and circumstances. The most important assumptions concern agricultural and trade policies, as well as the evolution of the $/€ exchange rate:

(1) All policy instruments and measures are expected to operate under the current rules or within the changes already decided by the end of April 2002 for the 2002-2009 period. In that perspective, the implementation of the **reform of the Common Agricultural Policy** adopted in the framework of **Agenda 2000** is fully taken into account from 2000 onwards. By contrast, the implications of the new **US Farm Bill, the Farm Security and Rural Investment Act of 2002,** have not been incorporated into the present analysis.

(2) **It is assumed that all commitments taken within the Uruguay Round Agreement on Agriculture (URAA), regarding in particular market access and subsidised exports will be fully respected.** Thus, subsidised exports are expected not to exceed the annual URAA limits, whereas imports under current and minimum access are fully incorporated. **In addition, the URAA commitments are assumed to remain unchanged over the 2002-2009 period**.

(3) The trade agreements that have been concluded by the EU, notably with the LDCs and with the 10 CEECs candidate countries until April 2002 have been taken into account in these market projections. **They mainly concern the EBA initiative** with duty-free and quota-free market access on all products, except arms, originating in the LDCs and the "**double-zero"** agreements with the 10 CEECs candidate countries.

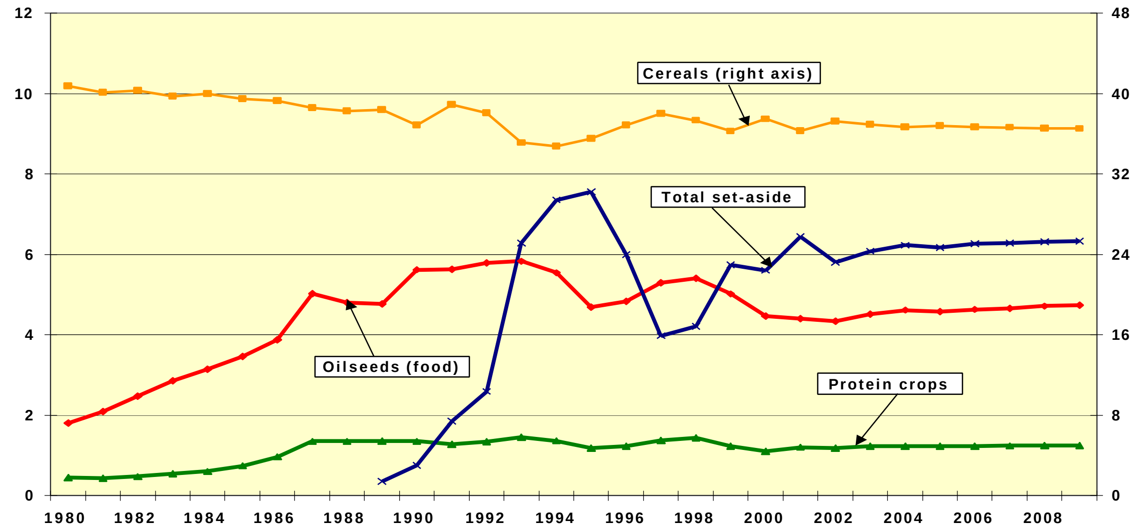
(4) After trading at low level against the US dollar in 2001, the **euro** is assumed to strengthen over the medium term as the impact of the short-term factors contributing to the current strong depreciation of the euro may be expected to weaken. The **$/€ exchange rate** would rise from 0.91 in 2002 to 0.95 in 2003 and would appreciate further towards **parity by 2006**.

Arable crops

Cereals

In the framework of a *status quo* policy, the medium-term projections depict an outlook for the EU cereal markets that would appear rather favourable for most EU cereals, with the noticeable exception of rye and –to a lesser extent- barley. In spite of a further expansion in cereal production, total cereal stocks would remain constrained at reasonable levels for most of the projection period as the full implementation of the Agenda 2000 CAP reform would strongly improve cereal competitiveness on both the internal and external markets. This outlook relies on the expected recovery in world cereal markets and the assumption of a relatively favourable currency environment -in comparison with historical developments- that would also contribute significantly to the overall balance of EU cereal markets. However, after the reduction in cereal support prices and the renewed shift in agricultural support further away from direct price support towards direct payments under Agenda 2000, the relative stability of EU cereal markets becomes increasingly dependent upon the developments in world market prices and in the $/€ exchange rate.

Graph i   Outlook for arable land allocation in the EU (‘mio ha), 1980-2009



In 2001, total cereal area dropped to 36.3 mio ha owing to the difficult climatic conditions at sowing times and, to a lower extent, to the recovery in oilseed prices. The return to a normal climatic situation and the third cut in direct payments in the oilseed sector are foreseen to generate a swift rebound in **total cereal area** in 2002 to 37.2 mio ha. Cereal area would also benefit from market prices above support levels for common wheat, maize and durum wheat and by the return of voluntary set-aside to more normal levels.

From 2003 onwards, the overall decline in average cereal prices –concerning especially feed cereals- and improved price prospects for oil-rich oilseed prices (i.e. sunflower and rape seed) would entail a slow decline in total cereal area of around 0.7 mio ha over the next seven years as direct payments are fully harmonised across arable crops.

Total cereal area would gradually decrease to 36.5 mio ha by 2009. These overall developments would not be uniform across cereals as **wheat** and **maize** would mainly gain with an area increase estimated in 2009 at around 3-4 % relative to the average 1999-

2000. By contrast, less favourable profitability perspectives would affect barley area that would exhibit a 9 % drop by 2009/10.

Yield trends observed since the mid-1980s are assumed to continue over the projection period, although at a lower rate (around 1.1 % per annum). Average cereal yields would reach 6.20 t/ha in 2009/10, with the highest increases for maize, soft wheat and rye. After a record cereal crop at 213.7 mio t in 2000, **total harvested cereal production** is estimated to drop below 200 mio t in 2001/02. It would then bounce back from 2002/03, driven by increasing yields that would largely more than compensate the gradual fall in total cereal area and expand significantly over the medium term to reach 226.5 mio t in 2009/10.

Owing to higher area and yield projections (2 % and 12 % respectively as compared to 1999-2000), **common wheat production** would rapidly expand over 100 mio t and reach a historical high of 106 mio t in 2009. In contrast, **coarse grain production** would fall in the short term from the high levels recorded in 2000, before rising slowly to approximately 111 mio t by 2009/10 as yield growth would somewhat outpace the slow decline in area.

The reduction in the cereal support prices following the implementation of Agenda 2000 and its translation into lower market prices for feed cereals would combine with the moderate recovery in the prices of the oilseed complex to boost cereal competitiveness and to generate a significant increase in domestic demand for cereals. **Total cereal demand** is projected to increase steadily over the medium term, from 186 mio t in 2000/01 to 200 mio t in 2009/10. This 14 mio t growth in cereal demand would be broadly shared between feed and non-feed uses. **Total cereal feed usage** would continue to increase over the medium term to reach 124.4 mio t by 2009/10, though at a **much more moderate pace than after the 1992 CAP reform** due to slower projected growth in meat production and lower gains in the price competitiveness of cereals. **Total cereal non-feed uses** are also foreseen to rise by some 7 mio t, from 69 mio t in 2000/01 to 76 mio t in 2009/10 driven mainly by industrial demand (especially soft wheat).

The implementation of Agenda 2000 CAP reform and the projected decline in average cereal prices in the EU would combine with a moderate recovery in world cereal prices and a sustained increase in world cereal import to **improve EU cereal competitiveness** and set the stage for a **sustained recovery in EU cereal exports** over the next seven years. These favourable perspectives for EU cereal exports would be reinforced by a relatively favourable $/€ exchange rate that is anticipated to further enhance the ability of the EU to export beyond its URAA limits on subsidised exports.

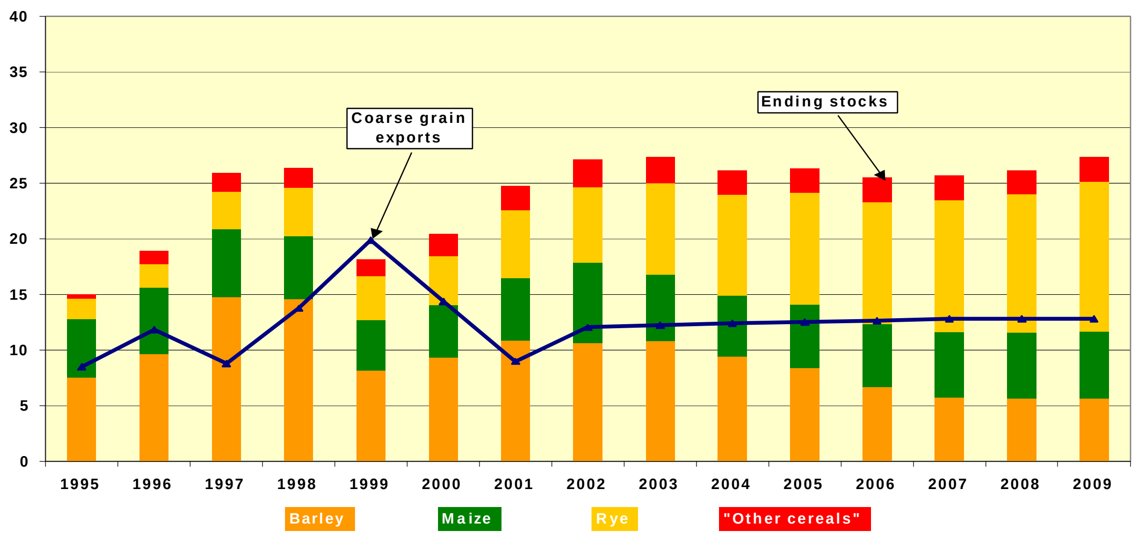
After a first fall in 2000/01 to 28.7 mio t from a high of 36.9 mio t in 1999/00, **total EU cereal exports** are estimated to decline dramatically in 2001/02 to 17.5 mio t. Over the medium term, they are projected to recover substantially -driven by wheat exports- thanks to greater availability and exceed the annual limit for subsidised exports set by the URAA as durum wheat, some common wheat and barley/malt would be exported without subsidies (these projections for cereal exports remain conditional upon an export policy that ensures the full use of the URAA limits).

Total cereal imports are estimated to almost double in 2001/02 to reach 11.9 mio t, with 8.5 mio t in wheat (of which 1.5 mio t of durum wheat), turning the EU into the world's largest wheat importer in 2001/02. This situation results from a combination of short-term factors, including a relatively low wheat crop in the EU, very low or even nil import duties and very large export supplies available in Russia, Ukraine and in some Eastern European countries at extremely competitive prices. Over the medium term, the existence of large exportable surplus from the Black Sea region is not expected to consistently stay at present levels. Total cereal imports are foreseen to fall to approximately 8.0 mio t in the near term, still above the most recent averages, and to remain relatively stable over the medium term.

Although short-term developments are expected to remain dominated by the existence of large cereal stocks, the medium-term outlook tends to display a **rather favourable situation for the EU cereal markets** with **total cereal stocks** broadly constrained at reasonable levels for most of the projection period. After a short-term increase at around 43 mio t, total cereal stocks would slowly decline until 2006/07 as the expansion in cereal production would be somewhat limited by the increase in voluntary set-aside and oilseed production, and mainly absorbed by a growing domestic feed demand and higher exports. From 2006/07 onwards, total cereal stocks would resume growing slowly to reach 40 mio t by 2009/10, about 13 mio t of which will be in public stores (practically all in rye).

The markets for soft wheat, durum wheat and maize would continue to remain rather tight. Despite an increase in production levels, these cereals would benefit from a steady growth in domestic and/or external demand, which is foreseen to keep their market prices substantially above support levels. The **barley market** would improve gradually and become broadly balanced around 2006/07, when the slow decline in production levels and the prospects for sustained exports outweigh the erosion of barley's share in the feed market.

Graph ii Allocation of the coarse grain production surplus in the EU, 1995/96 – 2009/10 (mio t)



In contrast to other cereals, **the market for rye in the EU is foreseen to display a continuous and structural imbalance** as the potential for adjustment in the supply and demand of this cereal remains largely constrained by its relatively high market prices and lack of market outlets. Limited import demand on the world market, low price competitiveness on both the external and domestic markets, feed nutritional limitations and a stagnating domestic human demand in the EU are all foreseen to make public stores an increasingly attractive outlet for the domestic surplus of this cereal. The latter, estimated at approximately 0.9 mio t, is projected to accumulate over the whole period and entail a gradual increase in total rye stocks that would reach 13.5 mio t in 2009/10, of which 12.8 mio t in intervention stocks.

Oilseeds

The medium-term prospects for the oilseed sector show a significant improvement in the **production potential of oilseeds** in the EU over the medium term as they would benefit from productivity increases and **improved price prospects**. World prices of oilseeds and oilseed products are projected to strengthen over the medium term fuelled by an improved demand, notably for vegetable oil that should translate into a stronger pattern for oil-rich oilseeds. Higher demand –in particular from the livestock sector- would generate an increase in the consumption of oilseeds and oilseed products that should however remain rather moderate due to the greater competitiveness of EU cereals.

After a marked fall of around 0.5 mio ha in 2000, the **"food" oilseed area** is estimated to have stabilised in 2001 at 4.4 mio ha. In spite of high market prices, total food oilseed area is projected to decline further in 2002/03, when it would bottom out at 4.3 mio ha with the full implementation of the Agenda 2000 CAP reform. Total food oilseed area would then rebound to 4.5 mio ha in 2003/04 before gradually increasing to 4.7 mio ha in 2009/10.

Soybean and **rape seed area** is expected to fall by 32 % and 14 % respectively in 2002/03 relative to 1999/00, before recovering beyond 300 000 ha and 2.4 mio ha respectively over the medium term. After a short-term moderate decrease, **sunflower seed area** is foreseen to slowly increase below 2.0 mio ha until the end of the period on account of favourable prices. Non-food oilseed area is estimated to adapt to the level of the set-aside rate and to stagnate at around 0.9 mio ha over the 2001/02–2009/10 period (mainly rape seed).

Despite a certain decline over the last two years, **oilseed yields** are expected to resume their increase in the medium term and reach 2.8 t/ha on average in 2009/10, i.e. an average annual growth of 1.1 % between 2002/03 and 2009/10. After falling for two consecutive years, **oilseed (food) production** is projected to increase slightly over the medium term to reach 13.5 mio t in 2009/10 as yields resume rising and oilseed area recovers. Non-food oilseed production would evolve together with the level of set-aside and stabilise around 2.6-2.7 mio t over the medium term.

Prospects of higher demand for marketable feed products from the livestock sector would generate over the medium term an increase in the **demand for oilseeds and oilseed products** in the EU. Notwithstanding the impact of the ban on the use of meat and bone meal in animal feed, this increase in the consumption of oilseeds and oilseed products should remain rather moderate as these protein-rich feed products would face greater competition from EU cereals. Given the medium-term perspectives for oilseed production in the EU, this demand should give rise to a slight increase in imports.

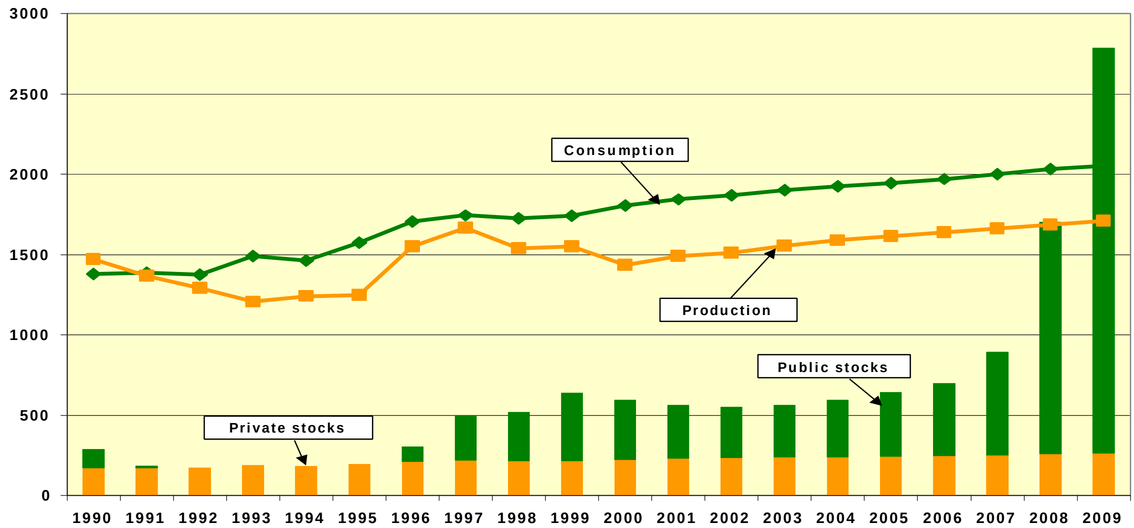
Rice

The combined impact of a strong increase in rice production during the most recent years –in particular in 1996/97 and 1997/98- and a swift rise in rice imports resulted in a rapid build-up in public stores which stood at more than 600 000 t of paddy rice at the beginning of the 2001/02 marketing year. In spite of a modest short-term improvement, the current global market imbalance is forecast to weigh heavily on the medium-term prospects of the sector which are expected to demonstrate a gradual deterioration until 2006/07.

The progressive reduction in tariff for rice imports from LDCs adopted in the EBA initiative is then foreseen to dramatically worsen the overall outlook as EU domestic demand would become increasingly -and by the turn of the decade almost entirely- satisfied by more competitive imports from these countries, generating a rapid, dramatic and unsustainable increase in public stores.

However, these global perspectives mask widely diverging trends between japonica and indica rice markets. Unlike historical developments in the sector, indica rice is projected to display a growing role over the medium term both on the supply side (in terms of area allocation and yield developments) and on the demand side (in terms of consumer preference).

Graph iii Outlook for the EU rice market ('000 t of milled equiv.), 1990/91-2009/10



But the steady increase in domestic consumption of indica is not foreseen to meet the pace of a rapidly expanding availability -fuelled by an increasing production and the regular rise in imports- and the indica market would exhibit a growing imbalance. By contrast, the outlook for the japonica market would benefit from the continuation of the improvement in the overall market balance which started in 2000/01 as total production would stabilise at levels close to domestic and external demand. But there again, the implementation of the EBA initiative is expected to strongly deteriorate the overall market situation from 2008/09 onwards.

Uncertainties

These projections for the EU cereal, oilseed and rice markets are based on a number of assumptions regarding future economic and market developments. In that respect, they are subject to some uncertainties that could have significant implications for the EU arable crop markets, notably the future developments on the **world cereal, oilseed and rice markets**, the medium-term outlook for the **€/$ exchange rate** and **the impact of existing and future trade agreements**. Furthermore, the implications of the new **US Farm Bill, the Farm Security and Rural Investment Act of 2002,** have not been incorporated into the present analysis. Any change in any of these assumptions could significantly alter the medium-term perspectives. A sensitivity analysis shows that if a weaker € environment would not drastically change the overall market perspectives for the arable crop sector, a stronger € (i.e. a $/€ exchange rate rising to 1.1 by 2005 and then stabilising at that level) would in contrast generate a negative impact, with in particular a further increase in total coarse grain stocks of around 19 mio t (concerning mainly barley and –to a lesser extent- rye).

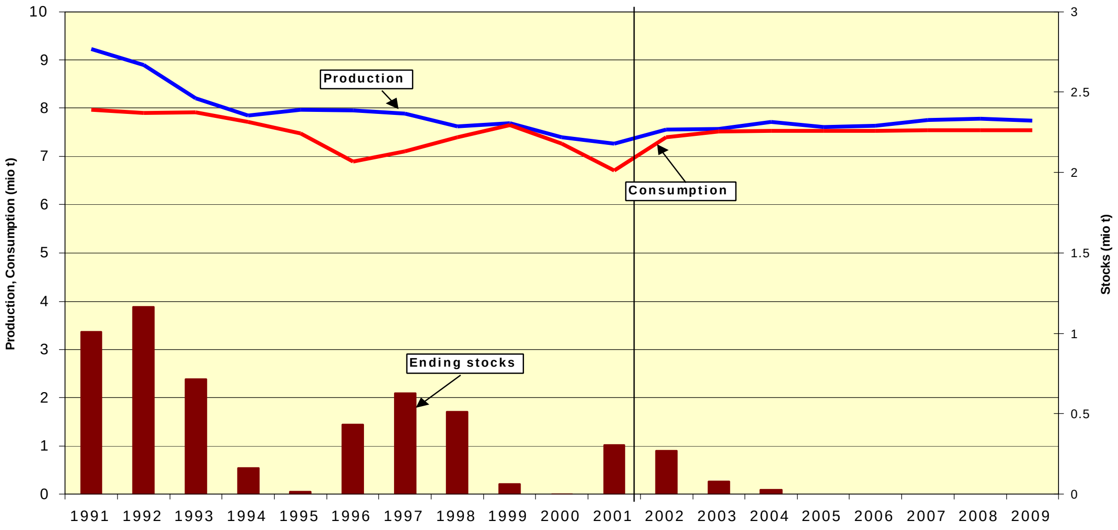
Meat and livestock

Beef and veal

Since the beginning of the second BSE crisis in October 2000, new measures have been taken in order to reduce the growing gap between supply and demand and to reassure the consumers concerning the increased safety standard of EU beef meat. During the year 2001 and the beginning of 2002, supply-side measures like the “Purchase for Destruction” scheme and the "Special Purchase" scheme withdrew and destroyed the meat of around 1.1 mio animals. Furthermore the culling linked to the appearance of outbreaks of Foot and Mouth disease (FMD) in the UK, the Netherlands, France and Ireland concerned around 850 000 cattle, essentially in the UK. As a result, and in the presence of a smaller *backlog* of animals than previously announced, **beef production** for the year 2001 dropped to 7.26 mio t, -1.8% compared to the low level of 2000.

However, even with those measures in place, the dramatic drop in **beef consumption**, which fell by around 12% compared to 1999 levels, put strong pressure on prices, which dropped below intervention level and even below the safety net (for a short period and only in Germany and the Netherlands). At first, intervention stocks grew rapidly and reached around 259 000 t by mid December 2001. The situation has showed signs of recovery since March 2001 and beef prices have continued to improve to reach around 90% of intervention level by the end of the year (except for cow meat, where prices remained low throughout the year 2001).

Graph iv   Outlook for the EU beef market (mio t), 1991-2009



Net production is estimated to increase in the year 2002 and 2003, as beef production returns to more normal conditions, with improved prices and no destruction schemes in place after March 2002 (except for the OTMS in the UK, which is assumed to be maintained until Spring 2004). However, the estimated impact of some of the special measures decided in June 2001 as part of the beef plan has been taken into account, notably the reduction of the stocking density rate and some temporary measures in the suckler cow premium for 2002 and 2003. Beef and veal production is therefore estimated to increase up to 7.7 mio t. in 2004 and then decrease slightly in the following years as the beef production cycle reaches its minimum by the year 2005/06 at around 7.6 mio tons. Beef production should then slightly increase to reach 7.75 mio t by 2009.

The lower production in 2001, the assumed prolongation of the OTMS scheme in UK, the quick recovery in beef meat consumption and the impact of the special measures taken in 2000 and 2001 indicate that the balance of the EU beef market is likely not to worsen in the next few years. **Intervention stocks** could be cleared already in 2003 and no buying-in is expected over the forecast period. Variations in **exports** would be expected to be sufficient in order to cope with the cyclical up and down in production.

Pig meat

At the beginning of 2001, the outbreak of FMD in UK and then in Ireland, France and the Netherlands also perturbed the pig meat sector. Animals slaughtered and destroyed for sanitary reasons in the areas touched by the outbreaks (around 580 000 pigs were slaughtered and destroyed in the FMD containment and Livestock Welfare Disposal Scheme in the UK) affected **pig meat production** in 2001, which reached just over 17.5 mio tons. Pig meat production is expected to increase by around 2 % in 2002, following the positive developments of producer prices and margins over the last year and taking into account the negative impact of the recent sporadic outbreaks of swine fever in Spain, Germany, Luxembourg and France. However, a part of the anticipated increase in production will take place in 2003, which is foreseen to reach 18.1 mio t (+1% compared to the previous year). Over the long term, there is a certain scope for further expansion, but at a slower rate than in the past. Pig meat production, which is assumed to be driven mostly by demand (internal and external) is, thus, projected to continue its growth and reach around 18.7 mio t by the end of the forecast period.

The drop in beef per capita consumption, which has been recorded since November 2000, had a positive impact on pig meat consumption (but clearly less than on poultry). For the year 2002 **pig meat consumption** is expected to increase by around 1.5 %. The medium and long-term outlook for pig meat consumption is in general positive since pig meat is likely to continue to be favoured by consumers, although clearly less than poultry. Pork per capita consumption is projected to increase from 43.7 kg in 2001 to around 45.6 kg by the year 2009.

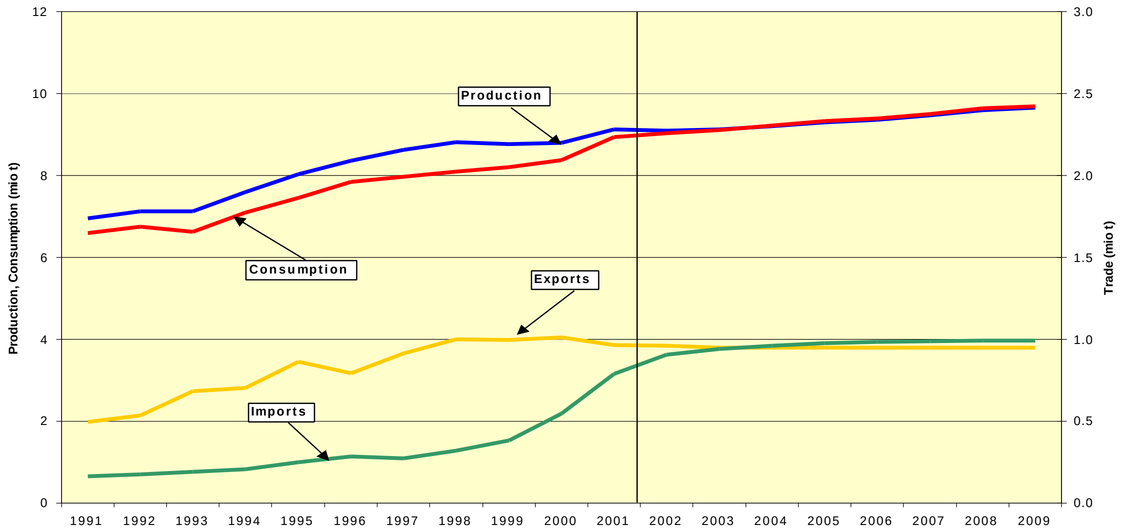
Imports are forecast to increase over the medium term, following the increased market access commitments allowed under the double zero agreements with 10 accession countries. Compared to the relatively low level of 2001 due to export restrictions that followed the outbreak of FMD in Europe, **exports** are likely to be higher in 2002 and 2003, due to larger domestic availabilities. Exports are projected however to adapt to the supply situation, and therefore contract somewhat in 2004 and then to slightly increase over the medium term in line with higher EU production and growing international trade.

Poultry

The new BSE scare in the beef sector, which, like in the 1996 crisis, was translated into a switch in demand towards other kinds of meat, has mostly benefited the poultry sector (consumption increased by 6.8% in 2001 compared to 2000). **Poultry production** was much quicker than pig meat to respond, with an increase estimated at around +3.7 % in 2001 compared to the previous year.

In the medium and long term, the outlook for poultry production is relatively less positive than in the past. The recent strong increase in poultry imports (+407 000 tons between 1999 and 2001) clearly undermines the EU production potential, as most of the consumption growth is satisfied by imported poultry meat from Brazil and Thailand. Furthermore, more and more traditional EU export markets are being taken over by the very same competitors on the world poultry meat markets, limiting our export possibilities.

Graph v Outlook for the EU poultry market (mio t), 1991-2009



Competitive prices with respect to other meats and strong consumer preference should, however, continue to play in favour of poultry. Per capita **consumption** is projected to increase from 23.7 kg in 2001 to around 25.2 kg by the year 2009. This evolution is in line with the long-term growth of consumption that has been observed in the past.

After the strong increase recorded over the last few years, **imports** are assumed to continue to increase, but at a lower pace, over the medium term. This continued increase in poultry imports is expected to lead, over the next few years, to a position where the **EU may become a net importer of poultry meat**.

Sheep and goat

Production of sheep/goat meat in the EU was strongly affected by the Foot and Mouth epidemic (more than 5 mio sheep were slaughtered and destroyed in the wake of the FMD epidemic) and fell by around 9.6 % in 2001. In the medium and long term, after an expected gradual recovery, a slight downward trend both for **production** and per capita **consumption** is expected. Since the beginning of 2002 the sheep and goat sector is governed by new rules in which the ewe premium is granted at a flat-rate level, i.e. it is no longer linked to market price fluctuations. First impact assessment of this reform indicate that, with the current high price level and a predictable direct payment there would be an incentive to re-stock the sheep flock after the FMD epidemic.

Sheep and goat **imports** could increase slightly in response to somewhat better use of market access commitments granted to some third countries as well as the possible impact of increased quotas under the double zero agreement with 10 CEECs.

Milk and dairy products

Milk

Milk deliveries mainly reflect the evolution in the milk reference quantities that are governing the milk sector since their introduction in the year 1984. First estimates for the year 2001 indicate an increase compared to the low level of the year 2000, and are expected to stabilise at around 114.5 mio t in the following years. Milk deliveries are projected to increase again by the end of the forecast period in line with the quota increase in the years 2005-2008 which forms part of the second reform step and that is linked to the cut in support prices.

Milk production is expected to follow the developments projected for deliveries as on farm milk use, which is not governed by quotas, is assumed to continue its decreasing trend and direct sales are not concerned by the increase of milk quota.

The higher milk production, linked to the quota increases decided with Agenda 2000, is likely to slow down somewhat the long-term decline of the **dairy herd**. Assuming a further increase of milk yields by around 1.4 % per year on average over the forecast period, the number of dairy cows in the EU is projected to decline from 20.2 mio animals recorded in 2001 (December survey) to around 18.1 mio animals by the year 2009.

Dairy products

The internal and external analysis carried out in the framework of the preparation of the Mid Term Review of the CAP has been the opportunity to cast additional light on the EU dairy sector, also through new methodological approaches. These analyses give a somewhat more optimistic outlook for the EU dairy sector, notably on the demand side, than those presented in last year's projections and allowed to adapt somewhat the cautious approach as regards long term-projections for the major dairy products.

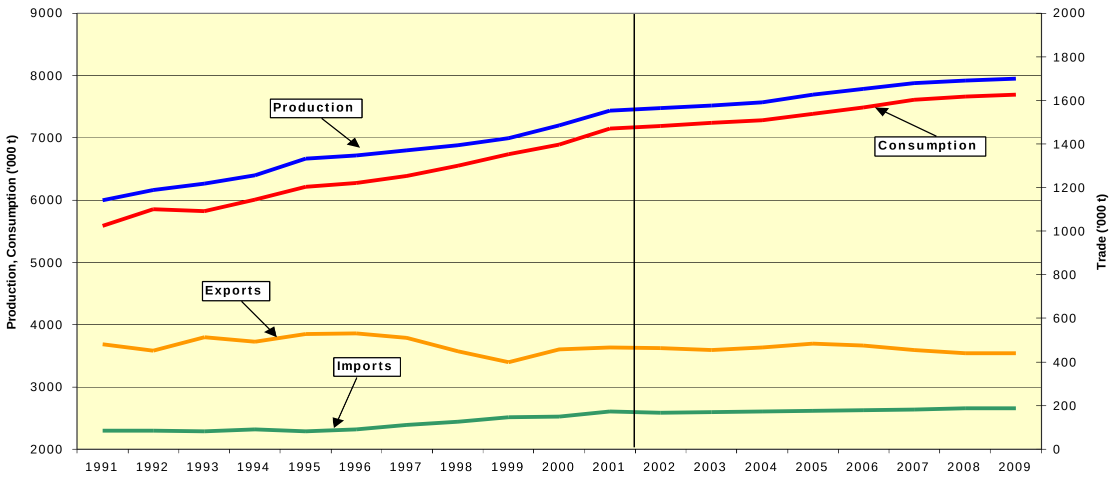
Cheese

The medium and long-term outlook for **consumption** is in general positive, but with a slowdown in the growth rate after the big increase recorded in 2000 and 2001 (+7% in two years). Per capita consumption is projected to rise from 18.9 kg in 2001 to about 20 kg by the year 2009.

Exports are likely to slowdown somewhat after the increase recorded in 2000 and 2001. Over the medium term, it is expected that exports could reach about 480 000 t by 2005-2006 thanks to larger milk availabilities linked to Agenda 2000 quota increases. This small increase should be seen against the background of the gradual implementation of the cut in milk support price that, together with expected higher world market prices, should contribute to increase the competitiveness of European cheese on the world market.

However, for the period 2006-2009, the steady growth in domestic consumption is expected to absorb most of the increase in cheese production, leaving less to be exported. We expect cheese exports to decrease slightly and stabilise somewhat at around 440 000 t by 2009.

Graph vi Outlook for the EU cheese market ('000 t), 1991-2009



Imports are forecast to continue to increase over the medium term, reflecting improved market access granted to third countries within the GATT Uruguay Round and some bilateral trade agreements like the double zero agreements with 10 CEEC countries.

Consequently, cheese **production** is projected to continue its steady increase, but at a relatively lower rate in comparison to the recent past. The expected average yearly growth rate for production is similar to that of total cheese consumption, i.e. at around +1 % per year until 2007, and then slow down somewhat.

Butter

In spite of the current slow down in cheese production growth, which has resulted in more milk being channelled in butter production (creating a situation of weak prices and intervention stocks), **butter production** is projected to decrease slightly over the medium term. The Agenda 2000 quota increases foreseen for the period 2005/06-2007/08 are not expected to change this downward trend as the production of other dairy products is expected to absorb most of the additional deliveries. Furthermore, the lower intervention prices decided with Agenda 2000 will make it less attractive to sell butter and SMP into intervention.

Butter **consumption** tends still to decline despite some signs of stabilisation observed over several years. Projections for per capita consumption are set at 4.47 kg by the year 2009, compared to around 4.67 kg currently. This forecast implies an annual rate of change of around –0.5 % for per capita consumption and –0.4 % for total consumption, due to the expected small population growth

Imports of butter are projected to continue to increase somewhat over the forecast period to reach up to 150 000 t over the medium term, following the increased market access commitments allowed under the double-zero agreement with 10 candidate countries. Butter **exports** are set to reach around 200 000 t by 2005, and then to decrease over the medium term, following the decrease in production. World market forecasts for butter trade show some increase in the medium term but the biggest part of the anticipated increase is likely to be supplied by New Zealand and Australia, which are continuously expanding their milk production and exports of dairy products.

The balance sheet for butter shows that, after a certain short-term situation of over-supply, decreasing production should ease somewhat the pressure on **intervention stocks**, which are expected to be gradually reabsorbed starting in 2004.

Skimmed milk powder

In the medium and long term, the downward trend both for production and consumption of SMP should continue after a short interruption in 1999. Over the medium term, the projections suggest a reduction of SMP **production** from 980 000 t in 2001 to around 780 000 t by the year 2009 (i.e. more than 20%). While human **consumption** of SMP is projected to remain more or less stable, the use of SMP in the animal feed sector, after the sharp drop observed in 2001, is projected to recover over the short term and then to decline slightly over time.

Imports are projected to increase slightly each year over the medium term. SMP **exports** are set to increase in the short term to reach up to 220 000 t by the year 2004 and are then expected to decrease in line with lower production.

Overall, the strong reduction in production that is projected over the long-term (in line with that observed in the past) together with the expected stabilisation in consumption (that will benefit of lower prices following the implementation of the Agenda 2000 price cut) is expected to gradually reduce current intervention stocks to zero after 2004.

Chapter II Prospects for agricultural markets in the candidate countries from Central and Eastern Europe

This chapter provides an overview of the current and expected medium-term developments in a number of the main agricultural commodity sectors in the 10 Central and Eastern European Countries (CEECs) which are candidates for accession to the European Union[1]. The projections are **based on a status-quo policy hypothesis**. **No assumptions** have been made concerning the date and conditions of entry to the EU by the candidate countries. **The projections for agricultural products are based on the assumption of a continuous trend of real appreciation of exchange rates for national currencies against the euro and the US dollar**, which has been visible in recent years. This leads to continuous competitive pressure on CEEC agriculture and requires rapid restructuring, especially of the labour-intensive part, in order to maintain competitiveness. Restructuring, and in some countries rural poverty, remains the prime political challenge in most CEECs over the medium term.

The year 2000 was a year of extremes in the CEECs. The adjustments following the collapse of the Russian market became fully apparent in the production figures for the animal sector. In addition, many countries were affected by the worst drought since the start of the transition process. Prices for agricultural commodities, especially for crops, increased considerably as a response to the limited supply of cereals. Relatively high world market prices and the practice of some Candidate Countries to largely maintain high import tariffs and to neutralise preferential imports, which marked a significant change of policies compared to similar situations in previous years, contributed to this price increase.

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1 Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.

In many respects the year 2001 presented a change of conditions for CEEC crop production. Good weather conditions throughout the year led to good yields and exceptional harvests in most CEECs. The exceptionally good weather conditions of 2001 seem unlikely to be repeated in 2002.

In 2001 and 2002 the new import and market policies of some CEECs contributed to relatively high prices for those crops where internal production has been insufficient or where available storage capacities allowed for the removal of critical surpluses from domestic markets. In addition, high cereal prices have contributed to further reduce the internal competitiveness of livestock production, particularly for pork. This has been partly compensated for by market interventions for pork in some countries.

However recent surpluses and larger stocks for a number of agricultural products, due to tight export markets and high transport costs, have led to reductions in agricultural prices in a number of countries, most notably in Hungary. The market and storage situation in net importing countries such as Poland seems also to indicate emerging pressure on prices for cereals, some milk products and pork unless stock capacities would be further increased. The foreseen average harvest in 2002 might put further pressure on domestic prices in the CEECs, if levels of stocks were maintained at current levels. Under these conditions, agricultural prices are expected to significantly decline in the coming years and would not reach again the extraordinary levels of 2000 and 2001 in most CEECs.

Despite these obvious pressures, which might lead to a change of market policies in a couple of CEECs in the medium term, **in the simulations policies are assumed to remain unchanged over the projected period.**

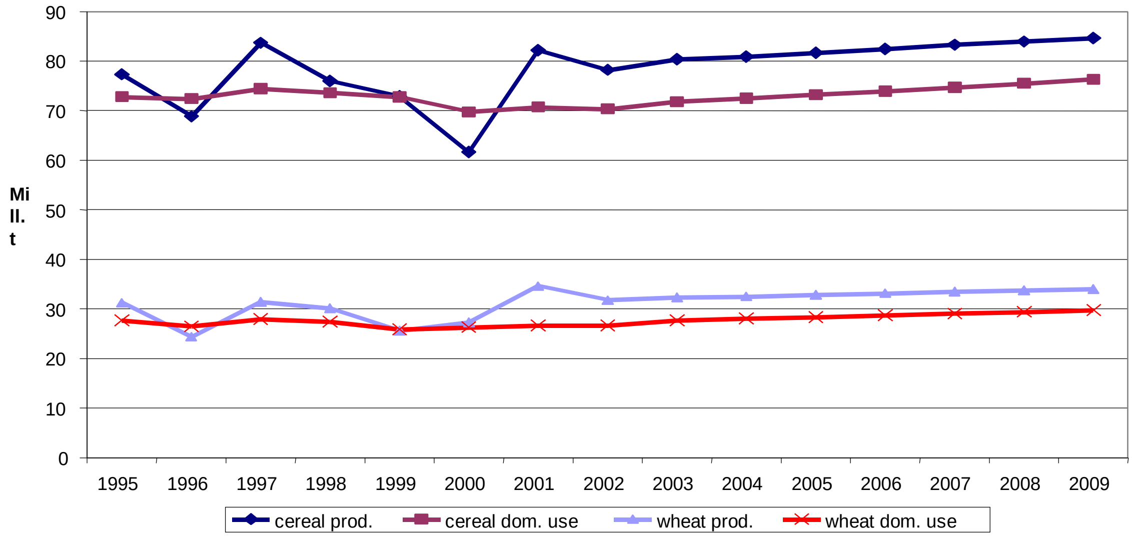
Cereals

Total cereal production in the CEECs increased from 63 mio t in 1992 to around 76 mio t in 1998. Due to weather-related problems the cereal harvest was reduced in 1999 to 73 mio t, and the drought in 2000 resulted in a crop of only 62 mio t, the lowest harvest since the beginning of transition. Very favourable weather conditions and the incentives provided by the high price levels in 2000 led to a production of 82.2 mio t in 2001, while production for 2002 is expected to be 4 mio t lower than this. The general tendency towards a slight intensification of cereal production, supported by domestic policies and a favourable world market price development, is expected to lead to an expansion in production up to levels of 85 mio t by 2009. Poland, Romania and Hungary should remain the largest producers of cereals over the projected period. Current policies in Poland would encourage the expansion of wheat production and especially that of rye, which appears to be a problematic crop for exports.

Internal use of cereals is expected to expand over the projected period from 71 mio t in 2001 to 76 mio t in 2009, due to rising incomes and increasing meat production. Of the increase of 5.5 mio t, food consumption would increase by 2.3 mio t and feed use by 3.2 mio t.

In recent years, total **exports** and **imports** have fluctuated significantly due to weather-related changes in production and varying incentives given by national agricultural policies. The unfavourable conditions of 1999 and 2000 led to a reduction in the exportable surplus to 0.2 mio t in 1999 and to a deficit of 8 mio t in 2000. In 2000 cereal prices peaked in the CEECs due to the large demand for imports and the high level of import tariffs. Prices for common wheat, barley and rye approached price levels for cereals in the net-importing EU Member States.

Graph vii Development of production and domestic use of cereals and wheat in the CEECs (mio t)



The projected slight expansion in production and the development in domestic use stabilise the amount of cereals available for exports until 2009. Even under the assumption that cereal storage would be increased where necessary, domestic prices would become less dependent on import prices and could be expected to fall. Consequently the exportable annual surplus stagnates at around 8 to 8.5 mio t until 2009.

Oilseeds

The area in the CEECs under oilseeds reached a peak in 1999 of around 3.8 mio ha. This was the result of the relatively attractive oilseed prices in 1998, as well as weather-related problems during cereals sowing (for instance in Hungary and the Slovak Republic). The oilseed area then fell sharply in 2000 to only 3.1 mio ha, and the high prices for cereals in 2000 led to a further decrease of harvested area in 2001 compared to 2000. In 2002 this downward trend is expected to reverse due to a favourable development in oilseed prices particularly in Hungary, Romania, and Bulgaria. This would lead to an expansion in area and a slight increase in oilseed production. The **area under oilseeds** would rise from 3.1 mio ha in 2002 to 3.6 mio ha in 2009, while production would increase by 1 mio t from 5.1 mio t in 2002 to 6.1 mio t in 2009. The main expansion in production is projected as being for the relatively low yielding sunflower seed in Hungary, Bulgaria, and Romania.

Since 2000 **internal use/crushing** has been increasing again to levels of 4 mio t and is expected to increase further in 2002 to 4.3 mio t. In the medium term internal crushing might stabilise at that level, if demand for protein-rich oilmeals remains limited in the CEECs. However, increasing quality and lean meat content might add to an expansion of the use of protein-rich feeds, which could trigger additional investments for expanding crushing capacities in the CEECs. With existing crushing capacities exportable oilseed surpluses might increase from the present 1 mio t to 1.7 mio t by 2009.

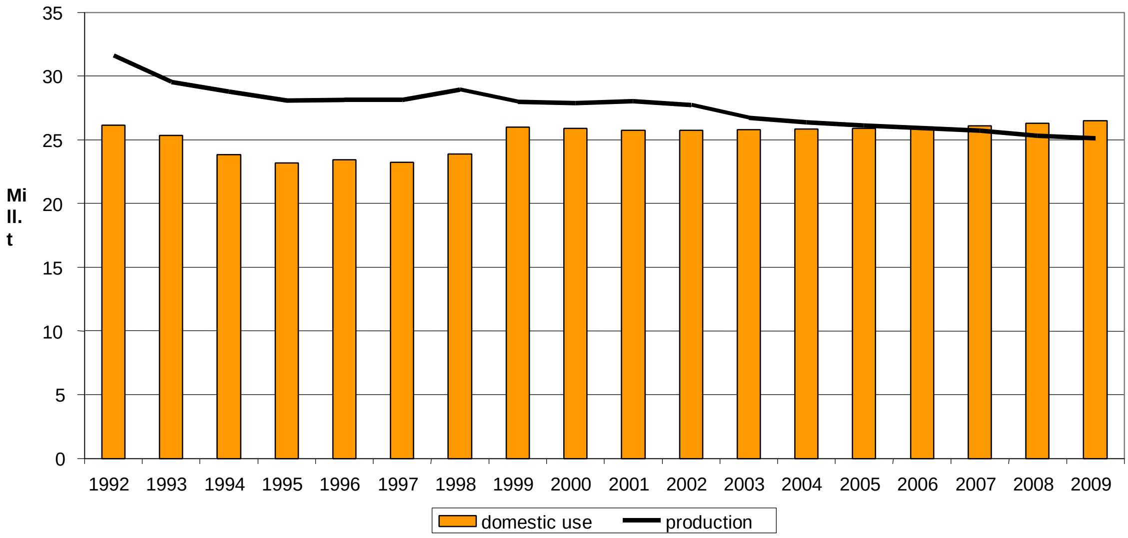
Milk

Milk production is projected to remain under pressure under the assumption of continuing current policies. This pressure arises from appreciating real exchange rates and tight export markets for skimmed milk powder and butter. This generally leaves little room for domestic prices to increase. Higher investment in dairy farms, which would contribute to achieving economically viable and cost-competitive production, is generally still too limited to offset the competitive pressures.

Under the provision of unchanged national policies domestic prices for milk would not remain at the high level seen over the last two years. The number of **dairy cows** fell from over 10 mio in 1992 to 7.2 mio in 2001 and a further decrease to 7.1 mio is foreseen for 2002. This downward trend is expected to continue over the projected period, with total cow numbers falling to 5.5 mio by 2009.

The recent reduction in cow numbers has been partly offset by the increase in the average milk yield, which is expected to reach 3.9 t/cow in 2002. The average **yield** is projected to continue to increase and to reach a level of 4.6 t/cow by 2009. However, the effect on production of the decline in the number of dairy cows would be stronger than the positive impact of the yield increase. In fact milk production is expected to fall from 27.7 mio t in 2002 to 25.1 mio t in 2009. This reduction in production is expected to be most apparent in Bulgaria, Poland and Romania.

Graph viii Production and domestic use of milk in the CEECs (mio t)



As in past years total food demand for milk and dairy products in the CEECs would continue to increase. Between 2002 and 2009 **human consumption** would increase by 2.6 mio t from 23.1 mio t to 25.7 mio t. Rising consumer incomes are projected to result primarily in increased consumption of cheese and fresh milk products, while butter consumption would remain more or less stagnant. Per capita consumption of milk and milk products is foreseen to increase from 221 kg/capita in 2002 to 244 kg/capita in 2009. At the same time feed use of milk declines alongside the reduction of the dairy herd. As a result **total domestic use** increases only by 0.7 mio t from 25.8 mio t in 2002 to 26.5 mio t in 2009.

The CEECs as a group were net-exporters of milk and milk products in the 1990s, especially of milk powder and butter. It is expected that under present national policies the

CEECs would become **net importers** of milk in the medium term. The Baltic states, Slovenia, the Czech Republic, and Slovakia would, however, remain net exporters of milk, though exports would follow a declining trend.

Beef and veal

The production of beef and veal in the CEECs is mainly linked to size of the dairy herd, since only limited suckler cow herds are present in the CEECs. Due to the long production cycle, the build up of suckler cow and specialised beef production is slow. Specialised beef production therefore does not affect total beef production to any great extent over the projection period. Beef production is much more linked to the development of the dairy herd than, for example, in the EU.

The beef meat sector has been the sector that has experienced the largest decrease in production since the beginning of transition. From 1989 to 2001 production decreased by more than 40 %, to less than 1 mio t.

During the projection period the number of **animals slaughtered** would decrease in line with the reduction in the number of dairy cows, and despite specialised beef production being foreseen to increase, beef and veal production would decline by 0.23 mio t, from just under 1 mio t in 2001 to 0.77 mio t in 2009.

Per capita consumption of beef continued to decline in 2001 and 2002. However, declining domestic prices, increasing incomes and increasing prices for pork and poultry should tend to stabilise domestic consumption at 9.3 to 9.5 kg/capita in the projected period. Total **internal use** in the CEECs would be relatively stable at levels of approximately 1 mio t through to 2009. As a consequence of stable use and declining domestic production, net imports are expected to increase to 214 000 t by 2009.

Pig meat

Pig meat is the most important meat produced and consumed in the CEECs. For the CEECs as a whole **production of pork** is estimated to increase from its low level in 2001 of 3.97 mio t to 4.07 mio t in 2002. The upward swing is expected to continue and production should reach 4.65 mio t by 2009, though somewhat dampened by relatively high cereal prices, which affect the costs of production. The biggest producers and consumers of pork would continue to be Poland, which would be able to dynamically expand production through to 2009 under domestic policies.

Increasing incomes would lead to increasing consumption. Per capita **consumption** would expand from 39 kg in 2001 to 45.2 kg in 2009. Consumers in Hungary, Poland, and in Slovenia currently consume over 50 kg/capita and would increase their consumption further through to 2009.

Total consumption in the CEECs should expand by 610 000 t from 4.15 mio t in 2002 to 4.76 mio t in 2009. During the projection period the CEECs as an aggregate would appear to slightly increase their balance deficit from 100 000t in 2001 to 110 000 t in 2009.

Poultry meat

Compared to pork production the poultry industry is generally structured on a large scale, and foreign direct investments play an important role, which partly explains the ability to continuously expand production over the last decade. However, in several countries small-scale production is highly important. Three countries dominate poultry meat production, namely Poland, Hungary and Romania.

In relative terms the expansion of demand for poultry meat has been the strongest for all the meats. The projections confirm this trend, which is particularly linked to the increase in income. **Consumption** would expand from 1.72 mio t in 2002 to 1.87 mio t in 2009. Per capita consumption should increase by 8.5%, from 16.4 kg in 2002 to 17.8 kg in 2009.

Total production of poultry meat would increase to just over 2 mio t in 2009 compared to 1.85 mio t in 2002, slightly faster than domestic use. Therefore the exportable surplus would expand from 130 000 t in 2002 to 160 000 t in 2009. Hungary remains the most important exporter of poultry meat in the region.

Chapter III Prospects for world agricultural markets

The prospects for world agricultural markets are mainly based on reports and projections released by the most prominent institutions in this field, namely the FAPRI, the OECD[2] and the USDA. These organisations provide for a short-term outlook marked by the continuous, albeit slow, recovery of agricultural markets after a longer than expected downturn. The medium-term prospects for agricultural markets would be mainly driven by an improved macro-economic environment with more broadly based, robust and sustainable growth. Combined with higher population, urbanisation and changes in dietary pattern, particularly in many emerging economies, these prospects for stronger economic growth would support a steady increase in food demand.

World trade in agricultural commodities would demonstrate strong growth, as demand for food products would outpace production in many developing countries. The tightening of the stock-to-use ratio would in turn sustain commodity prices over the medium term. Most of the growth would come from the non-OECD regions, which would constitute the main driving force behind these relatively favourable perspectives.

Notwithstanding the relative improvement in the market fundamentals of most agricultural sectors that is projected over the medium term, a prudent interpretation of these favourable perspectives is deemed necessary. These projections remain subject to many uncertainties that can be expected to moderate the positive pattern forecasted for future trade and price growth. The most important include the future course of agricultural policy in many regions (notably the recently approved US Farm Security and Rural Investment Act of 2002), the new round of multilateral trade negotiations, the future macro-economic perspectives and the scope for further productivity growth in some regions.

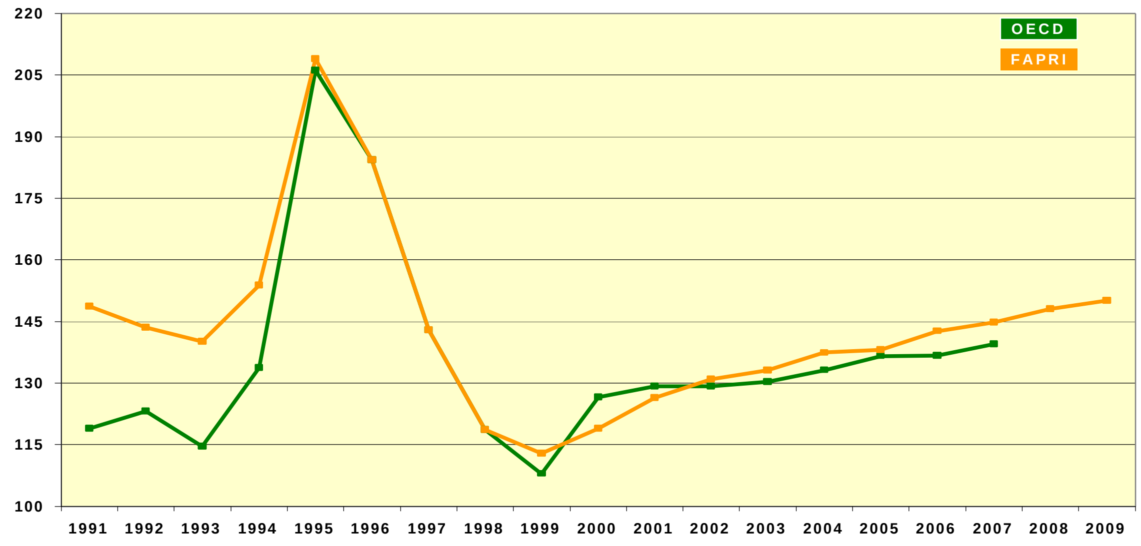
2 It should be noticed that the OECD outlook consists of the preliminary projections established by the OECD Secretariat whose final results are scheduled to be declassified after discussion by the OECD Working Party on Agricultural Policies and Markets at its meeting on 21 and 22 May 2002. These final projections which should be published in the OECD Agricultural Outlook, may be subject to some modifications in the light of the discussion by the Working Party.

Cereals

The world cereal markets are anticipated to slowly emerge from a prolonged downturn. An improved economic environment, population growth as well as changes in the dietary pattern in some major importing countries are foreseen to generate a strengthening of world demand and a tightening of stock-to-use ratios. Higher demand would outpace domestic supply in many developing countries, including China, North Africa and Latin America, and trigger a sustained expansion in global cereal trade. Total cereal trade would increase by between 40 and 47 mio t to 2009/10, i.e. at a much quicker pace than in the 1980s and 1990s.

Global trade in wheat would strengthen with annual growth averaging about 2.3 %-3.1 %, whereas coarse grain trade would exhibit a similar pattern with an annual average ranging between 2.0 % and 3.1 % over the 2001/02-2009/10 period.

Graph ix Outlook for world wheat prices, 1991 – 2009 ($/t)



Ref.: US FOB Gulf, HRW.

After having bottomed out at the turn of the century, world prices are projected to display a slow and moderate recovery over the medium term as supply adjusts and global demand strengthens. HRW wheat prices would reach approximately 145-150 $/t by 2009/10 according to the OECD and FAPRI projections[3]. Maize prices would exhibit a similar trend, standing at 110-111 $/t at the end of the projection period. Barley prices would also trend upwards, rising from 121$/t in 2000/01 (Portland reference) to 139 $/t in 2009/10 in FAPRI projections and from 96 $/t to 100 $/t in 2007/08 in the OECD outlook (St Lawrence reference). A similar outlook is projected for durum wheat prices that would rise from 175 $/t in the short-term to around 180 $/t by 2009/10.

Oilseeds

If the short term developments of the oilseed sector are expected to continue to be affected by policy and macro-economic factors, the medium-term prospects are foreseen to demonstrate a relatively moderate recovery. The vigorous growth in demand for

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[3] The SRW wheat, which broadly corresponds to EU wheat quality, generally quotes around 10 % below the HRW wheat reference.

oilseed and oilseed products anticipated over the medium term by most agencies is forecast to contribute to the gradual restoration of market balance as supply exhibits more moderate increases. Global demand would benefit from the recovery in world economic growth which is projected to generate increased human consumption of vegetable oils as well as higher use of oilseed meals for the livestock sector. Trade in oilseeds is anticipated to increase faster over the projection period than in the 1980s, but more slowly than in the early 1990s.

The prices of oilseeds would display a continuous recovery over the next seven years driven by long-term demand growth. However, several factors including the sustained yield growth, the large production potential in South America and the continuation of a production-inducing policy in the US are expected to moderate future price trends. The OECD projections provide for average oilseed prices (i.e. soybean, rape seed and sunflower seed) at 237 $/t by 2007/08, whereas the FAPRI forecasts soybean prices at 229 $/t in 2009/10. Rape seed and sunflower seed would benefit from more favourable long-term vegetable oil demand -in comparison to meal- and would accordingly exhibit a stronger price pattern than soybean, with prices at 240 $/t and 271 $/t in 2009/10 respectively in the FAPRI projections.

Oilseed meal prices are expected to weaken in the short term on account of strong production growth, before increasing slowly over the rest of the period supported by an expanding consumption, and ranging between 178 $/t and 214 $/t.

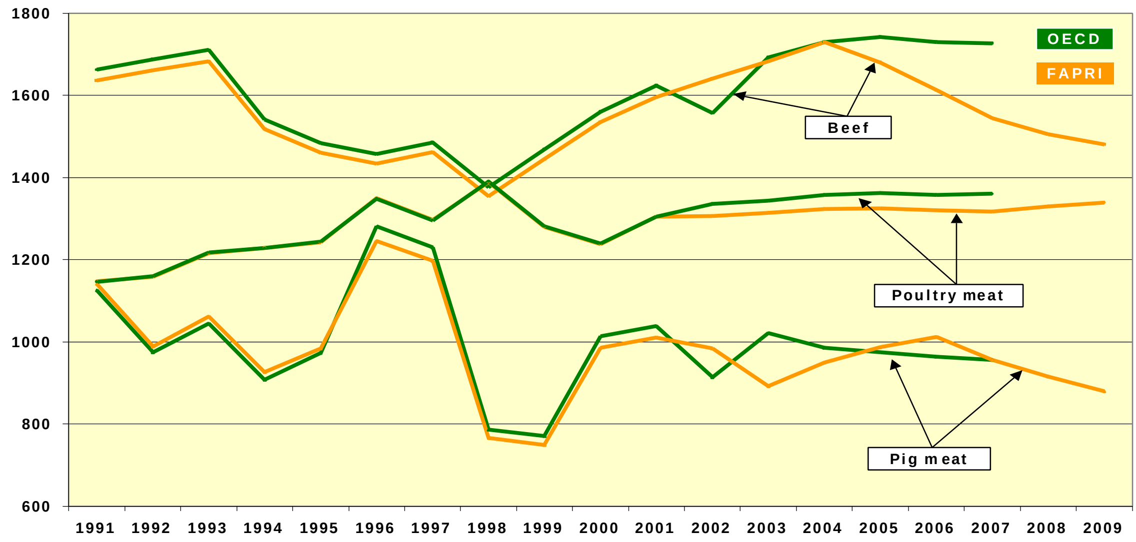
Prospects of rising incomes drive the solid expansion in vegetable oil consumption. Palm oil and soybean oil would capture the greatest share of an expanding demand for and trade of vegetable oil. Growth in oilseed oil trade would average between 1.7 % and 2.8 % per annum, i.e. a much lower rate than in the 1990s. The strong dependence of trade in vegetable oil from developing countries, notably China and India, makes the outlook very sensitive to the economic prospects in these countries.

Meat

The medium-term perspectives for the meat markets would exhibit higher production, consumption and trade. The increase in meat consumption would be mainly supported by a favourable macro-economic environment of sustained income growth, in particular in the emerging economies of Asia and Latin America, and by changes in dietary pattern in many regions. As higher meat demand would take place in many net importing countries, world trade would rise and world prices would show moderate strength. The FAPRI and USDA projections exhibit a sustained rise in beef trade ranging between 1.2 mio t and 1.5 mio t over the 2001-2009 period (i.e. some 30 %), with most of the growth from Asia, Russia and Mexico. After a short-term fall due to lower availability, weaker economies and animal health crises, the medium-term outlook for pig meat trade is projected to display a renewed and marked expansion over the same period (by between 0.75 to 1.15 mio t), driven by strong import demand from Japan, China, Mexico and Russia.

Poultry meat would capture the largest proportion of the increased global meat demand thanks to low production costs (relative to beef and pig meat) and consumer preferences in many parts of the world. Trade in poultry meat is also projected to trend upwards, with increases in the range of 1.3 to 1.8 mio t. Much would depend on the prospects for import demand from China and Russia. On the export side, a weak currency, large availability of cheap feed grains and strong investments in the meat sector are all anticipated to enhance Brazil’s market share over the medium term.

Graph x Outlook for world meat prices, 1991 – 2009 ($/t lw)



Beef prices would be supported over the medium term by a strong import demand, although the changing structure of the world beef market, the emergence of new exporting countries and the increasing competition from other meats should restrain upward beef price tendencies. Poultry and pig meat prices would display modest gains over the projection horizon as the continued improvement in feed efficiency, structural changes and the swift emergence of low-cost producers would maintain world market prices under pressure.

These perspectives rely heavily on the assumption that the recovery from the recent economic downturn will turn into sustained economic growth over the medium term. They also assume that the recent disruptions in world meat markets caused by sanitary issues will not occur over the projection period as they could trigger higher market segmentation and limit market access for some potential meat exporters.

Milk and dairy products

The OECD and FAPRI foresee that the medium-term outlook for the dairy sector would remain dominated by a strong expansion in global demand for dairy products. The latter would reflect not only income growth in many regions of the world, but also changes in consumer preferences towards dairy products (as meat substitutes). Demand growth is projected to be strongest in the non-OECD zone, notably in Asia, Latin America and the Middle East.

World milk production would grow at the sustained pace of between 1.2 % and 1.9 % on annual average over the 2001-2007 period, supported by higher demand and price rises in a number of countries, mainly outside the OECD area and in those OECD countries not subject to production quotas.

If dairy consumption in the OECD area is not expected to demonstrate significant changes over the medium-term (with the exception of cheese and –to a lower extent- whole milk powder), solid and sustained growth in the demand for dairy products is projected in developing countries fuelled by growing population, rising disposable income, urbanisation and changing dietary pattern.

Although a significant part of this increasing demand is expected to be met by domestic production, scope for additional, albeit increasingly regionalized, trade is foreseen in Asia, the Middle East and the FSU. The structural change in world trade of dairy products from bulk dairy products (SMP and butter) towards higher value-added products (such as cheese and whey powder) that has been observed since the mid 1980s would consolidate over the next seven years according to the OECD outlook (although trade in butter and SMP would still remain substantial). Technological advances are also projected to stimulate a rapid development in milk components.

The perspectives of stronger economic growth and a strengthening demand for dairy products are projected to generate a sustained recovery in world market prices of dairy products over the medium term. However, the rapid expansion of milk production in low-cost producing regions (such as Oceania) is expected to moderate this price pattern. In spite of a short-term weakening, cheese prices should display the strongest pattern among the prices of dairy products. In contrast, the pace of price increase is forecast to be more moderate for milk powder, notably for SMP, which should face greater competition from WMP and whey powder. Butter prices would recover modestly and gradually, benefiting also from the expected rise in vegetable oil prices.

These medium-term perspectives remain strongly dependent on the future development in some key (existing or emerging) markets such as Russia and East Asia as the world dairy market is foreseen to remain relatively thin. Furthermore, the trend towards further concentration and globalisation of the dairy industry, and greater differentiation of dairy products is expected to make trade projections for dairy products increasingly complex and dependent on dairy firms’ cost structure, production and marketing strategy.

Key issues

If the outlook for agricultural markets over the next seven years appears relatively favourable, as agricultural markets would gradually emerge from a prolonged downturn, it clearly remains subject to some uncertainties. In this respect, three main areas of uncertainty can be identified:

- *The economic prospects:* the medium-term projections from the FAPRI, OECD and USDA depend heavily and critically on the robust and sustainable economic growth which is expected over the medium term in many developing regions (in particular China, South East Asia, Latin America, North Africa and the Middle East). Strong and sustainable economic expansion, population growth, urbanisation and dietary changes in these regions constitute the main driving force behind the projected recovery in most agricultural markets as they are all foreseen to lift global food demand and stimulate solid growth in world trade.

  However, significant sources of risks to the sustainability and durability of the economic recovery remain. They concern notably the imbalances that developed in the late 1990s in the US and the global economy, in particular the large US current account deficit, the apparent overvaluation of the US dollar and undervaluation of the euro, the outlook for the Japanese economy and the situation of financial markets that may still embody relatively optimistic expectations for corporate profitability and the pace of recovery. Moreover, the volatility of oil prices may become a potential risk to the recovery, especially if the security situation in the Middle East were to deteriorate further. Recent developments in Argentina show that considerable downside risks still exist in this country, with possible contagion to other emerging countries of Asia and

Latin America. Significant changes in relative exchange rates could still significantly affect agricultural trade and markets.

- *The scope for production growth:* the projected moderate increase in trade and prices over the medium term, one of the major outcomes of the projections, remains strongly conditioned by the slow adjustment of agricultural supply to the rapid expansion of food demand in some regions of the world. Yet, the extent to which production would become outpaced by a rising domestic consumption remains unclear as the scope for further production increase in some major importing regions constitutes a key uncertainty for the medium-term outlook, notably for crop products. If total cereal productivity growth is forecast to be broadly comparable over the next seven years to that of the 1990s, it should remain significantly lower than in the previous decades. In this context, policy management and development in some major producing countries - such as China, Russia and India- and exporting countries -such as the EU and the US with the land set-aside instrument- could have significant implications for the future level of world agricultural supply.
- *The policy and trade environment:* future changes in agricultural and trade policies as well as the new round of multilateral trade negotiations may have important implications for the medium-term outlook for agricultural production, consumption, trade and prices as well as the functioning of agricultural markets. They include notably:

  - the recently approved US Farm Security and Rural Investment Act of 2002: although preliminary analysis tends to indicate moderate downwards impact on US prices, further in-depth economic and trade analysis is needed, notably with respect to its repercussions for international trade and prices. The economic (mainly price-depressing) impact of the new counter-cyclical payments are of specific interest –as the main thrust of the subsidy regime- since they have the effect of reducing market signals, thus leading farmers to over-produce in times of surplus.

  - the EU Mid-term review of the Agenda 2000 CAP reform planned in 2002 and 2003 and the enlargement of the EU to the candidate countries of Central and Eastern Europe;

  - as regards trade policy, the outcome of the new trade round at the WTO, the recent accession of China and Chinese Taipei to the WTO, the adoption of the so-called “double-profit” agreements with the CEECs candidate countries and the EBA initiative of the European Union;

  - the emergence of new issues related to food safety, food quality and the environment.