EXECUTIVE SUMMARY

Agricultural market developments have attracted considerable attention recently, due to increasing consumer food prices and sharp short-term price fluctuations of agricultural commodity prices. This medium term outlook provides a projection for major EU agricultural commodity markets and agricultural income until the year 2020, based on a set of coherent assumptions.

Under the assumptions made, agricultural commodity prices are expected to stay firm over the medium term, supported by factors such as the growth in global food demand, the development of the biofuel sector and a prolongation of the long-term decline in food crop productivity growth. High prices at world level would support EU agricultural exports in spite of the decline in competitiveness, particularly with the assumed appreciation of the EUR.

EU commodity markets are expected to remain balanced - on average - over the outlook period, without the need for market intervention. Prospects for agricultural income display a small growth rate at EU level after 2011, resulting from continuing decline in labour input rather than from income increases at sector level.

Policy and macroeconomic assumptions

The present medium-term outlook for EU agricultural markets and income is based on a *status quo* assumption for agricultural and trade policy. The Common Agricultural Policy (CAP) is assumed to follow the Health-Check decisions and global trade policy is assumed to respect the Uruguay Round Agreement on Agriculture. Macroeconomic assumptions include a low EU GDP growth in 2012 of 0.6% and thereafter a return to a modest growth of about 2% per year, and a steady appreciation of the EUR to around 1.50 USD/EUR in 2020.

This outlook, however, remains subject to a number of uncertainties regarding future market developments, as well as the macroeconomic and policy settings. Part II of this publication presents a selected analysis of alternative macroeconomic assumptions, as well as the impact of a policy-driven slow down in economic growth in China in order to curb price inflation. Furthermore, the impact of yield variations, e.g. due to weather conditions, and the impact of increasing production costs in the EU is examined.

Other factors, such as future changes in agricultural and trade policies, e.g. with a possible agreement within the current Doha Development Round negotiations and/or in bilateral/regional trade discussions, or renewable policies could have far reaching implications for the future pattern of EU agricultural markets.

Arable crops

The medium-term prospects for EU cereal markets are characterised by tight market conditions, low stock levels and prices remaining above long term averages. These developments are driven by moderate supply growth reaching 305 mio t by 2020, mainly the result of low yield growth rates (0.5% per year on average), and an increase in the domestic use of cereals in the EU, most notably due growing demand by the ethanol and biomass industry in the framework of the 2008 Renewable Energy Directive (RED). Some reallocation between crops in the context of a stable overall cereal area is expected, with maize and soft wheat further increasing their share (up to 16% and 39% respectively) at the expense of other cereals, notably barley which drops to 21% or total cereal area.

Similar drivers impact upon the medium-term prospects for the EU oilseed markets, which show a positive outlook for producers with strong demand and high oilseed oil prices. Supply

growth is expected to result from moderate yield growth and to a lesser extent from a slightly expanding oilseed area. The expected increase in domestic use of oilseeds in the EU would also be driven by additional growth of the biodiesel and biomass industry following the initiatives taken by Member States in the framework of the RED. The trade balance is not expected to improve over the medium term as additional imports are required to meet the biofuel targets.

The medium-term prospects for EU sugar markets are mixed. The growing demand for ethanol in the framework of the RED supports a growth in sugar beet production geared towards ethanol. On the other hand, for food consumption, isoglucose is expected to increasingly replace beet sugar, following the expiry of quotas in 2015.

Overall, the projected growth in domestic consumption of cereals, oilseeds and sugars is largely dependent on the assumptions for bioenergy use.

Meat

EU total meat production is expected to continue its recovery over the outlook period from the decline suffered in 2008 and 2009, and is expected to show a further moderate increase of 2.4% by 2020. The outlook differs between ruminants and non-ruminants, as beef/veal and sheep/goat meat production is estimated to drop by 1.3% and 7.9% respectively between 2011 and 2020, while pig and poultry meat production would expand by 3.6% each.

The driving factor for production growth is the increasing poultry and pig meat consumption. EU total meat consumption per capita would reach 83 kg in 2020 which corresponds to a slight increase compared to 2010. Poultry meat consumption would increase most, followed by pig meat. Pig meat is expected to remain the preferred meat in the EU with 41.6 kg per capita consumption in 2020, compared to 23.6 kg for poultry, 15.8 kg for beef/veal and less than 2 kg for sheep and goat meat.

The net trade position of the EU is projected to deteriorate over the outlook period, driven by an increase in meat imports (of beef/veal, sheep and goat and poultry meats) and a parallel decline in exports of poultry. Aggregate meat imports and exports would grow by 6.1% and 1.9% respectively, leaving the EU as a net exporter of pig and poultry meats in 2020.

Milk and dairy products

Medium term prospects for dairy markets appear favourable. Continued expansion of world demand, resulting from global population and economic growth, combined with increasing preference for dairy products (also as a result of growing per capita consumption) are expected to be the main drivers. Sustained import demand, particularly from emerging countries, would have a positive impact on dairy commodity prices, thus fuelling EU export potential. Nevertheless, EU market shares are projected to deteriorate for most dairy products (but stay rather stable for milk powders), due to the assumed strengthening of the EUR that limits the competitiveness of EU exports.

EU milk production is expected to grow moderately, showing a cumulative increase of 7% for the period 2009 to 2020. This increase comes as a result of a slightly higher growth rate for milk quantities delivered to dairies and a continuous decline of production for on-farm use.

Projections for cheese and fresh dairy products are quite positive. EU production of fresh dairy products (including drinking milk, cream, yogurts, etc) is projected to increase by about 6% (from 2009 to 2020) and cheese by almost 10%. Demand prospects on both the domestic and world markets look positive, and despite a strengthening EUR, substantial demand on the world market would allow for a progressive increase of EU exports. However, the EU will

gradually lose world market share, though it still account for around 27% of global exports in 2020.

Whole milk powder production in the EU is expected to stay relatively stable over the short term. The medium term prospects for exports are supported by an increase in world demand, led by China. The EU share in global exports is expected to decline gradually to 20% by 2020 (from 25% in 2009).

EU skimmed milk powder production is projected to increase by 10% throughout the outlook. A strong global import demand would contribute to a balanced market, driving a favourable outlook for exports. The EU would see its world market share improving by 4 percentage points over the period to reach 23% of global exports in 2020.

The outlook indicates continued market stability for butter, resulting from positive market conditions over the projection period, with prices at relatively high levels and firm EU demand.

Agricultural income

In 2011, agricultural income per working unit in the EU-27 increased for the second year in a row, thus further recovering from the significant low in 2009. Today, EU-27 agricultural income is roughly 25% higher than in 2000. It is expected to show further moderate cumulative growth over the 2011-2020 period so that by 2020 it would be around 9% above the 2007-11 average (base) level. This overall gain would mask opposite developments for the EU-15 and EU-12: whereas agricultural income in the EU-15 would show a slight decrease (-3.5%), it is foreseen to display a sharp growing trend in the EU-12, rising almost 35% above the base level by 2020, thus slightly converging towards the EU average. The assumed decline in agricultural labour remains an important factor behind the income prospects for both EU-15 and EU-12, with the increase in subsidies granted to agricultural producers in the EU-12 over the phasing-in period a key driver of income growth in this group of Member States.

Caveats

Despite the improvements in the economic model (modified version of the AGLINK-COSIMO from OECD/FAO) used to generate the market prospects, there are still some limitations that need to be addressed in future exercises (e.g. aggregation of demand for coarse grains and oilseed sector, developments in farm structure, or trends affecting other players in the supply chain such as the processing industry and the retail sector).

Notwithstanding the efforts to base the outlook for agricultural markets and income on the latest statistics and information, as well as the most plausible expectations on the future, the outlook presented in this publication has to be interpreted with caution due to the rapidly shifting global economic situation, which renders the underlying assumptions on the global market uncertain. Changes in these assumptions affect the interaction of the economic with the policy setting, and impact upon additional hypotheses linked to the income estimation, including those for sectors not covered by the model.