

ADVERTORIAL



Brazil:

The rising softs basket of the world

ONE OF THE most exciting developments in Latin America is Brazil's emergence as an agri-power. With commodities in general, and soybeans in particular, now in the spotlight – due to an unprecedented rise in futures prices – attention to soft commodities is timely. In fact, when viewed in the context of the shifting balance of world trade, driven in no small part by the imports of the Asian markets, softs, including grains, may well be worth renewed focus and attention.

Agribusiness is an integral business focus of Citibank in Brazil, where we have had an uninterrupted presence since 1915. In light of our ongoing commitment, as well as ongoing developments, Citigroup is currently ramping up a commodities trade finance group. Brazil's large and well-developed agricultural, mining, manufacturing, and service sectors now form the basis of an economy that outweighs that of all other South American countries and is an expanding presence in world markets.

With an area of 3,265,076ⁱ sq miles, slightly less than the landmass of the United States, Brazil is the largest country in South America and the fifth largest in the world. A full 62% of this resource rich country is comprised of agriculturally suitable land, the equivalent of all the acreage in the world currently devoted to wheat, corn, rice and soy crops and employs a full 23% of the labour forceⁱⁱ.

Behind the statistics

As might be expected with a landmass this large, there are two distinct agricultural environments. The southern one-half to two-thirds of the country with its semi-temperate climate and higher rainfall has significant advantages in terms of higher technology and input use, adequate infrastructure, and more experienced farmers. Along with the Central West or "Expansion Region", it produces most of Brazil's grains and oilseeds and export crops, including coffee, cotton, oranges, tobacco and wheat.ⁱⁱⁱ

Although the drought-ridden Northeast and Amazon basin have none of these

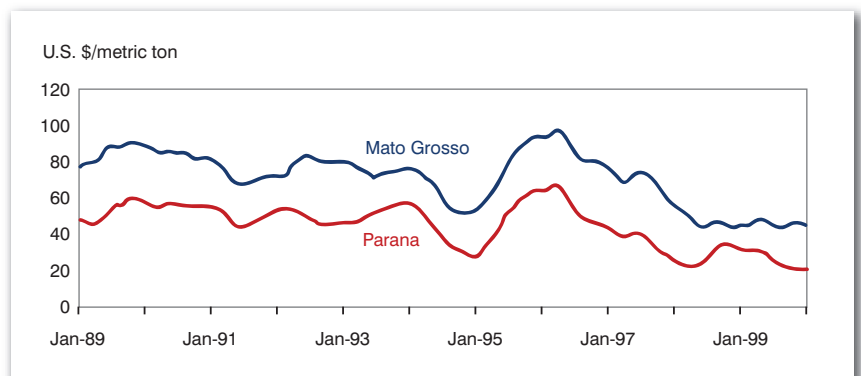
advantages, these regions have become increasingly important to exporters of forest products, cocoa, and tropical fruits.

Within this setting, the ascendance of Brazil to the world's second-largest producer/exporter of soybeans is far from an overnight success story. Instead, it is a work-in-progress that began in the 1960s, when a national network of agricultural research and experiment stations, under the auspices of the Brazilian Agency for Research on Agriculture and Animal Husbandry (EMBRAPA) began working closely with private agricultural research groups.^{iv} One of their greatest successes was the development of the tropical soybean. Prior to this, production had been limited to small farms in the south, due to the sensitivity of soybeans to length of daylight and light intensity.

Ongoing infrastructure improvements

With the construction of the Trans-Amazon Highway, it became possible to move production of the new and improved bean to the large Central West area, which is characterised by immense, sparsely treed savannah. Today, much of Brazil's growth is associated with this region where large-scale farms utilise the full array of modern input and technology to achieve significant economies of scale. In the late 1990s, an analysis of the cost structures underlying soybean production, transportation and marketing, from principal growing regions to a common export destination, indicated that total production costs were not only

Soybean f.o.b. - to - farm price differences are declining as infrastructure develops



Source: farm prices, Getulio Vargas Foundation Brazil; F.O.B. prices (Rio Grande do Sul), Oil World. Reprinted from USDA article, Agriculture in Brazil and Argentina/WRS-0103. By permission of Mary Burfisher, Economic Research Service.



lowest in this zone, but also lower than those in the US.

As you can see from the chart, the ongoing construction of important infrastructure projects, such as the Madeira-Amazon Waterway, which facilitates the transport of soybeans to international markets via the Amazon River, has had a significant effect on total production costs.

A second waterway, the Tiete-Parana is also expected to reduce freight costs for soybeans grown in the central-west area. Presently the most developed waterway in Brazil, it includes 13 dams, 10 locks and more than 1000 navigational buoys.

Other transportation improvements, both railroads and waterways are also under construction or in the planning stages. Overall, the potential cost savings are expected to improve producer prices by as much as \$10-20 per tonne.

The growth in agricultural exports

According to Brazil's National Agricultural Confederation, in 2003, agricultural sales reached R\$169.8bn (\$58.4Bbn). Fifty percent of this total was generated by sales of soybean (\$12.8bn), poultry (\$5.0bn) and pork (\$1.8bn), sugar cane (\$4.2bn), raw cotton (\$0.8bn), coffee (\$2.0bn), orange (\$1.4bn) and tobacco (\$1.4bn).

When you break out the figures on soybeans, you can see that stocks worldwide are estimated to reach 50.2m tonnes in 2004/05, up almost 28% from last year's 36.2m tonnes. Most of this increase is due to sharp rebounds in US and Brazilian yields (US yield is projected up 14.5% at 39.6 bushels per acre with Brazil up 12.1%, with a higher number of planted acres.) Brazil is expected to increase acreage by another 10% for the spring 2005 crop year. The result is the largest estimated world stock figure for soybeans in history.

Furthermore, demand has remained strong even with Brazilian exports this year estimated at a record 23m tonnes, and US exports at around 28m tonnes, up 16% over last year. The import projection for China alone is 23m tonnes of soybeans, up sharply from last year's 16.9m tonnes.

Not surprisingly, there's a lot of activity in soybean futures prices, which recently reached their highest level in 16 years. This activity was caused by the disappointing US crop, combined with surging demand from China, which drove up prices to more than \$10.50 per bushel. As a result, both US and Brazilian farmers have ramped up planting acreage to take advantage of the higher prices. In other words, even with demand so strong, producers have the supply to meet it – unlike last year when drought and

early frost hurt both the US and Brazilian crops.

With such strong demand, exemplified by China's early purchases of 76m tonnes of the US new crop, the US can expect Brazil to become a very strong competitor. For instance, in view of its large stock, Brazil has extended its shipping season, which normally begins in April, to continue through October.



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MAUREEN DEROOIJ, CITIGROUP

Traditionally, Brazil is just about out of soybeans when the US begins its own shipping season in September. This is not the case in 2004, which could exert pressure on soybean prices once the US crop begins moving out of the field.

One of the most confirming developments has been the interest on the part of the Chicago Board of Trade, which is sufficiently impressed with the rapid growth of Brazilian soybean production to consider the launch of a soybean futures contract, with physical delivery in Brazil. There should be tremendous potential for this contract for Brazilian producers – as well as for the commodity banker who uses hedging in its structures to mitigate price risk.

In summary, there is good reason that Brazil soybean output continues to grow and develop, not only in actual size of crops but also in yield per acreage and reduced transportation costs. At Citigroup, we anticipate that as financial instruments such as hedging become more sophisticated, an even broader range of structured commodity product will become possible.

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