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Global Agricultural Information Network

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Limited Corn Supply Challenges Pork and Poultry Sector

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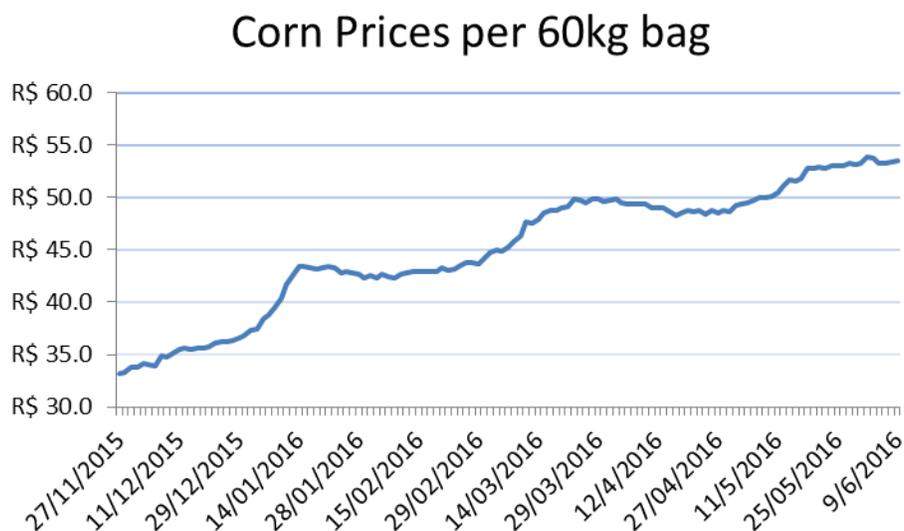
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Report Highlights:

Brazil's limited corn supply is driving domestic prices up and having a significant impact on the pork and poultry sectors.

Limited Corn Supply Challenges the Poultry and Pork Sector

A significantly lower than anticipated supply of corn continues to drive an increase in domestic corn prices in 2016. A devalued currency incentivized producers to export remaining stocks of corn, coupled with an early start to the dry season, is severely limiting available domestic supplies. Brazilian corn exports are up 138% from 2015. As a result, domestic prices increased up to 53.38 Reais (USD15.38) per 60kg bags, suggesting a port price of an estimated USD250 per ton. Stocks are estimated at a low 5.9 million metric tons (mmt), prompting buyers to seek foreign imports. Consequently, poultry and pork producers are struggling to maintain operations due to inflated feed prices.



Poultry and Pork Production Capacity Down

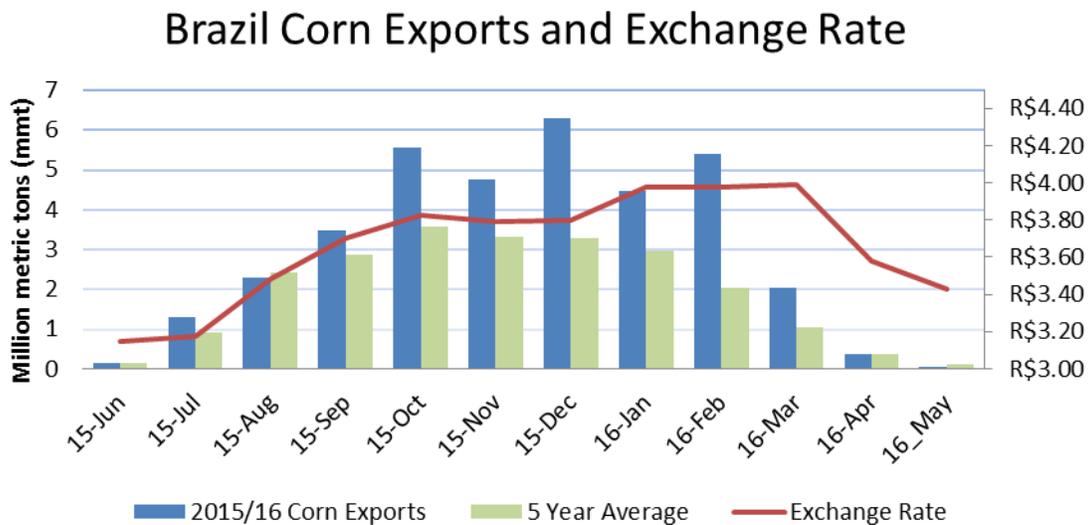
The poultry and pork industry are confronting great challenges due to rising corn prices as feed accounts for roughly 70% of production costs. Despite an initial increase in poultry production at the start of 2016, total Brazilian chicken output decreased by 10% over the past three months according to the Brazil Animal Protein Association. The Brazilian National Pork Producers Association reportedly reduced insemination of pigs by 15% to roll back costs. This reduction in processing capacity reduced Brazilian monthly meat production by 225,000 tons. Plants across Brazil responded to the increased input costs by cutting work shifts, enforcing mandatory vacation for employees, shutting down operations, and even prematurely slaughtering animals they are unable to continue feeding.

Poultry and Pork Producers Find Exports more Lucrative

Minimum poultry and pork production costs, which encompass primarily feed and energy expenses, increased on average by 50% in the first half of 2016. Meanwhile, producers continue to face persistent tighter profit margins. Like corn, the poultry and pork sector benefited from a strong dollar on exports. Producers have turned their glance outwards to survive this time of tight margins. Poultry exports reportedly rose 15.48% in 2016, with major shipments to Russia and Saudi Arabia. Pork exports rose 69.8% in 2016, with major shipments to Russia and Hong Kong.

Brazilian Government Intervention in Corn Trade

The Brazilian government sought to intervene in the corn industry to mitigate domestic costs. To relieve pressure on poultry and pork producers, the Brazilian government released nearly one million metric tons (mmt) of public stocks in May, but this did not provide substantial relief. In April 2016, the federal government considered levying a 2.8% export tax on corn and soybeans as a means to bolster revenue and encourage domestic sales. The tax was seen as widely regressive and was met with much resistance from industry players. State-led policies, like the temporary waiver of the inter-state (ICMS) tax, also attempted to limit international exports but were unsuccessful. Recently, the state of Goias reinstated the decision to limit corn and soybean exports to 70% of production, also abolishing the exemption of 3% in ICMS tax for out of state sales. Corn production in Goias accounts for about 11% of total Brazilian corn production. Producers continue to seek a solution that acknowledges the objectives of both the corn and poultry and pork industries and the state. Policies are expected to be dynamic as the producers seek to abate the situation.



Corn Imports from Mercosur Neighbors

Producers alternatively sought to import corn feed from international sources. The Brazilian government is playing an instrumental role in reducing barriers to trade and has attempted to mollify the domestic issues related to corn supply. Temporary relief was granted on the PIS/COFINS taxes that apply to imported corn independent of origin from Mercosur. Until February 2016, producers sought 99% of corn feed imports from Paraguay. Since March, producers are also sourcing imported corn from Argentina. While many producers are finding economic relief from Paraguay and Argentina, neither country has sufficient corn to export large volumes to Brazil for an extended period of time. The Brazilian government also intervened by reducing corn import taxes from eight to zero percent for non-Mercosur countries. As of June 2016, no non-Mercosul corn has entered Brazil given this incentive. This season, Brazilian corn imports are expected to reach 1.5 mmt, five times more than total imports in 2015.

Biotech Barriers to U.S. Corn Market Opportunities

The U.S. corn market is currently priced as lowest in the world, suggesting strong exports. In January 2016, a single shipment of 20 MT of corn reached Brazil through the Port of Paranagua. However, the potential to export large volumes of U.S. corn to Brazil is complicated by Brazilian biotech policy. About 13-14 bio-tech events used in U.S. corn production are not approved in Brazil, and there is a zero-tolerance policy for Low Level Presence (LLP) in corn imports. On the other hand, U.S. poultry and pork producers are cautiously optimistic for a boost in exports to Brazil.

Brazil's GDP is not expected to experience positive growth until 2018, prompting Brazilian policy makers to address inflated food prices sooner rather than later. The U.S. is strategically positioned to meet the Brazilian demand for corn and relieve pressures on both poultry and pork producers and consumers. Brazil's biotech policies indicate limited potential for U.S. imports to Brazil. Newly appointed Brazilian Agricultural Minister, Blairo Maggi, has articulated his intentions to foster a bilateral relationship with the U.S. and is expected to promote an agenda that seeks to limit barriers to trade. A broadening of biotech policy in Brazil would allow the market to equilibrate the inflated food prices and put Brazilian commodity producers back in the game.

Poultry and Pork Producers Seek Alternative Feeds

Producers are seeking alternatives to corn feed with limited success. Brazilian producers have traditionally used low-quality feed wheat in instances of a bad wheat crop. However, strong export prices have also prompted wheat producers to increase exports of lower quality feed wheat. Three producers from the South of Brazil have reportedly resorted to feeding chickens and pigs higher-quality grains normally used for human consumption in breads or cookies. Sources estimate that the meat industry has purchased 220,000 tons of bread-quality wheat since May 2016 for feed. If this pattern of human grade wheat consumption for animal use expands, flour prices will also rise. Wheat stocks are also in limited supply in Brazil and neighboring countries with extra wheat provide only a temporary solution to the struggling poultry and pork industry.

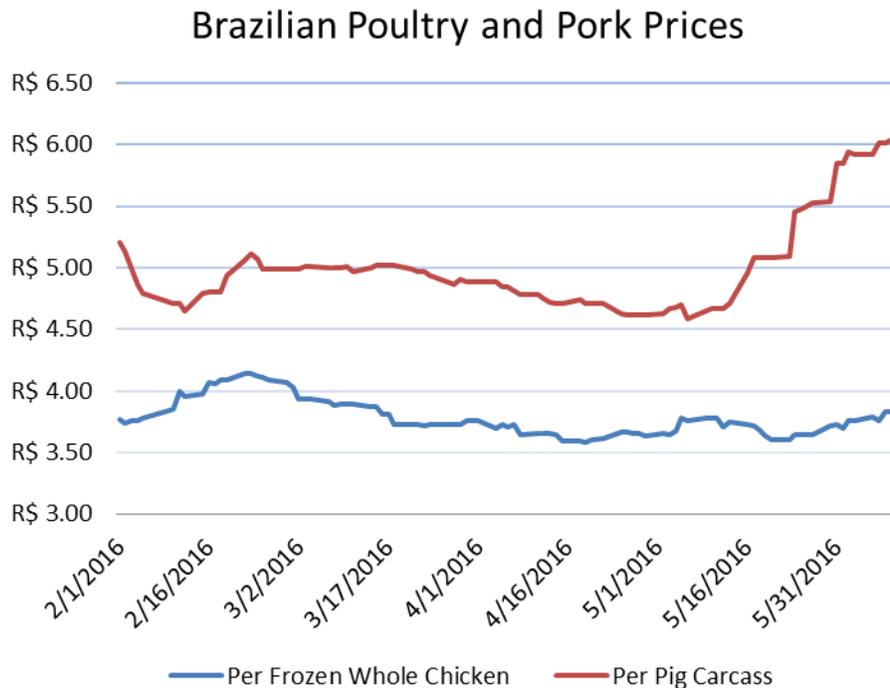
Safrinha Crop Expected to Soften the Blow

The second "safrinha" corn crop, which now accounts for 65% of total Brazilian corn crops, is expected to push domestic prices down as the harvest begins in June. However, it will likely take a full year (first and second corn crops) to recover. Inconsistent weather patterns continue to challenge producers in corn growing regions in Brazil, and set expectations that the safrinha corn crop could be reduced by up to 10 mmt from the previous year. The harvest pace will most likely have a slow initial start due to the early start of the dry season in April. Additionally, the newly appointed Brazilian Minister of Agriculture Blairo Maggi professed concern about 2017 corn prices, noting that 70% of the second "safrinha" corn crop was already forward contracted for export.

Brazilian Consumers to Feel Rising Meat Prices

Producers have resorted to raising domestic prices for poultry and pork twice in 2016 to offset feed costs, subsequently threatening the demand for domestic consumption. Consumers will have to face increased costs due to the severe economic recession that is forecasted to continue for the next two years. Negative GDP growth, rising unemployment, growing inflation, and a weakened currency are only a few factors that signal the Brazilian economic recession. Brazil's recent efforts to consolidate the middle class are now appearing to be on weak ground, as low purchasing powers threaten the population. The Brazilian middle class is the largest demographic of meat consumers. Brazilian consumers may turn to cheaper cuts of retail meat or increase consumption of

staples like rice and beans. Alternatively, Brazilians could dedicate a greater proportion of income to the purchase of meat while cutting back on other discretionary spending.



Low Income Brazilians Most Affected by High Food Prices

Acting President Michel Temer has also vocalized plans to revise the application of social programs that provide poverty relief, including the issuance of food assistance. Citizens reliant on governmental aid will particularly feel the negative repercussions of food prices. If pork and poultry producers continue to supplement feed with bread quality wheat, consumers will also face a hike in flour prices. Corn, meat, and wheat are all essential ingredients in the traditional Brazilian diet, adding heightened urgency to address the escalation in prices. An abundance of manioc presents a promising alternative to wheat, but has not yet been fully integrated into mainstream consumer products like bread, cookies, or other wheat products.

Conclusion

Corn is a fundamental commodity that dictates the success of many industries in Brazil. The decrease in domestic corn supply originated with an unexpected start of the dry season and a favorable export environment. Poultry and pork producers were significantly affected by this dynamic, with corn as a major component of production. Subsequently, increased corn prices resulted in a similar phenomenon in the poultry and pork industry. Poultry and pork prices mirrored corn prices with increasing costs and producers continue to favor exports with a strong dollar value. The Brazilian government will continue to closely monitor the situation, balancing public policy with the patterns of the domestic and global market.

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