USDA Agricultural Outlook Forum 2007

US and Mexico

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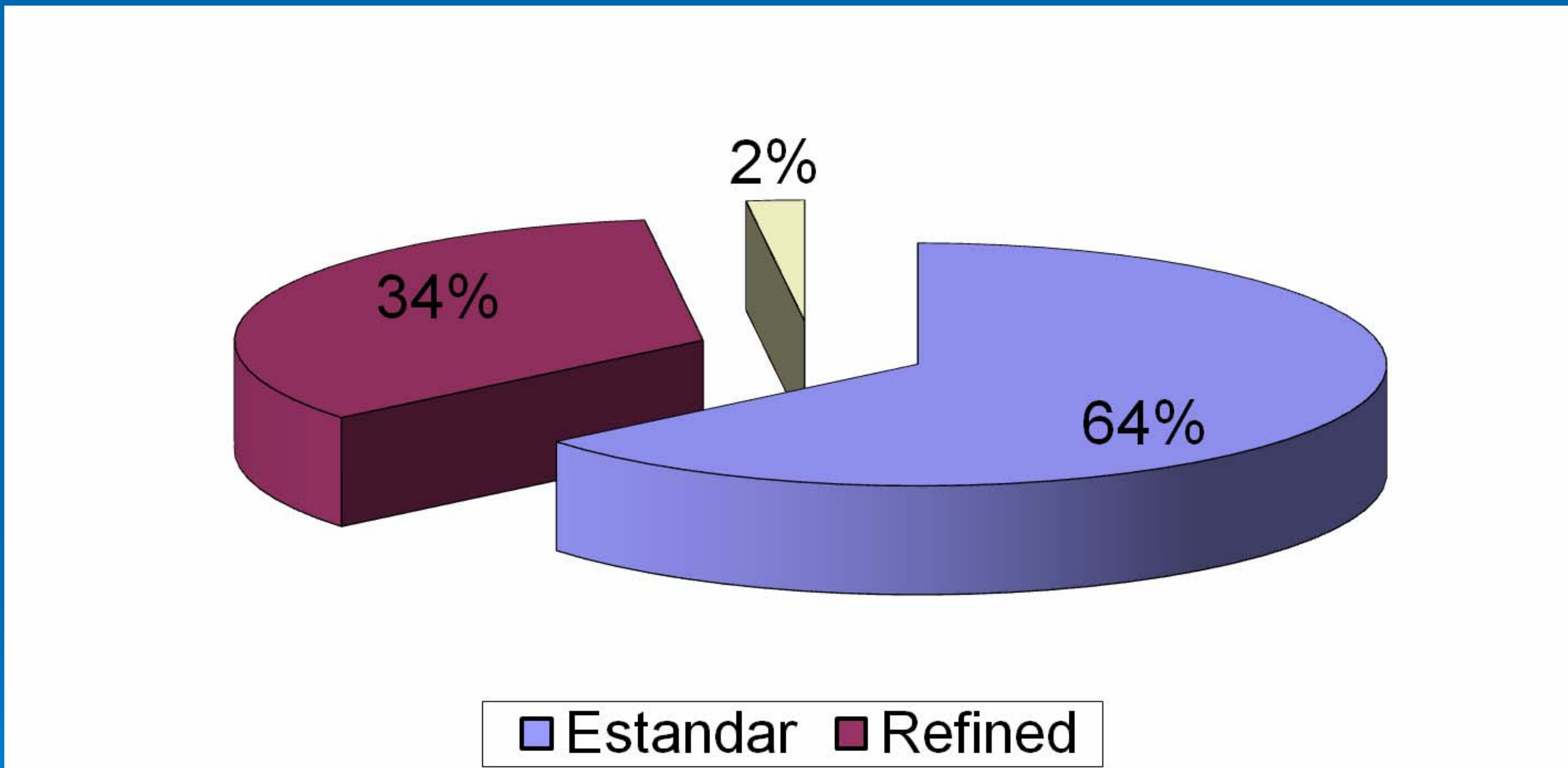
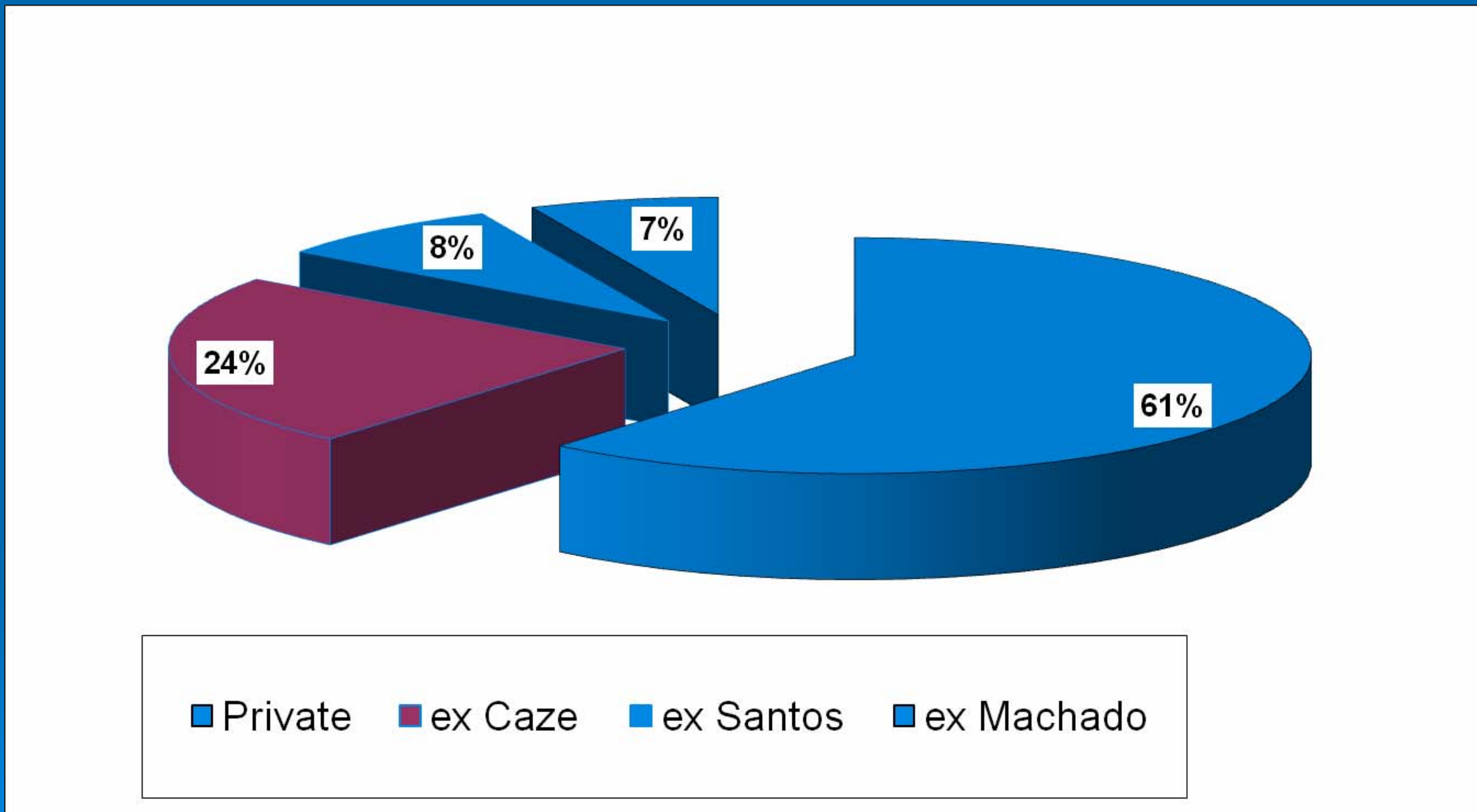
Mexican Production



Mexican Production Split:
Private and Government



Mexican Production

Summary	1-Dec 2005	1-Dec 2006	1-Dec 2007
Beg stock	700	1,000	595
Prod	5,900	5,300	5,050
Consumption	5,100	5,100	5,250
US Import to PITEX		150	250
Export US	250	505	-
Export PITEX	250	250	100
End Stock	**1,000**	**595**	**545**

Mexican Sugar Production

2004-05, 2005-06, 2006-07

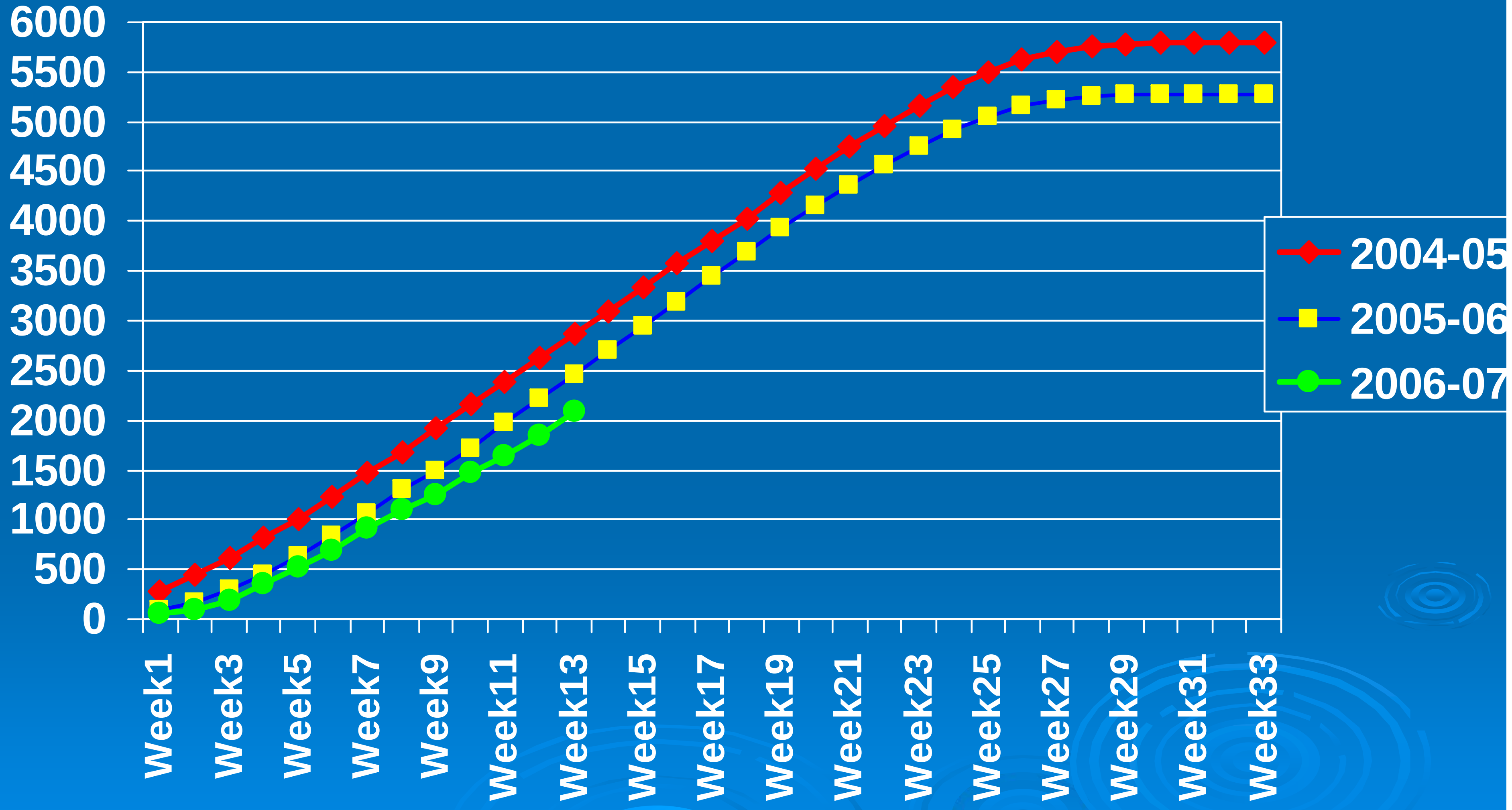
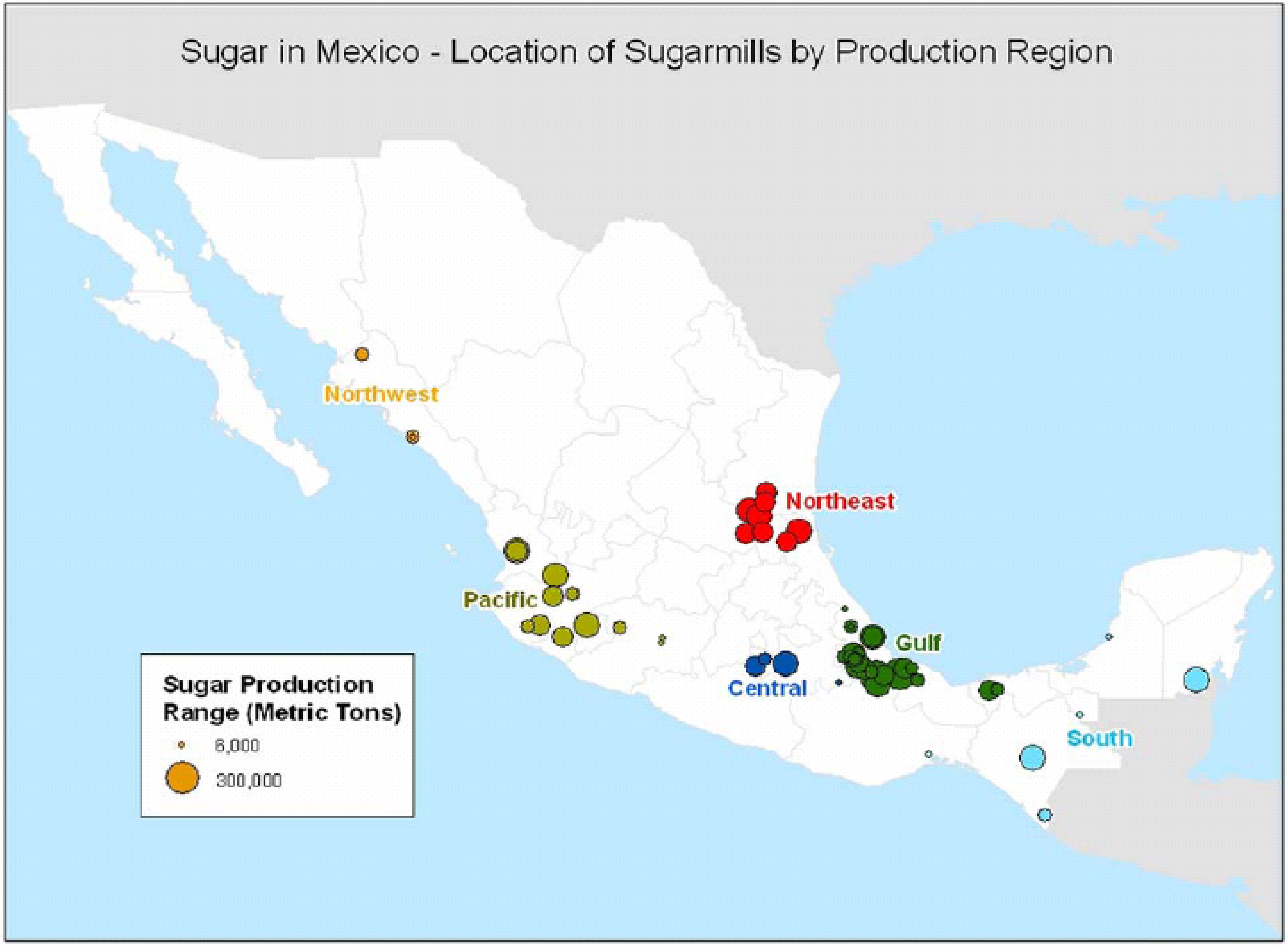


Figure M4


Sugar in Mexico - Location of Sugarmills by Production Region
Northwest
Northeast
Pacific
Gulf
Central
South
Sugar Production
Range (Metric Tons)
6,000
300,000

Mexican Industry Data

- Cane:
  - 2006 Cane Production 46 MM MT
  - Cane yield 77.5 per ha
  - 50% more cane area harvested than US (but only 29% more sugar production)
  - Cane Price = 57% avg sugar price about **$30/mt**! This compares to about $12-$17/mt for the cost of cane in countries such as Guatemala, Nicaragua and Brazil whether purchased or owned. The problem with the Cane Decree in Mexico is a) high price of sugar and b) atomization of cane land ownership.

Mexican Industry Data

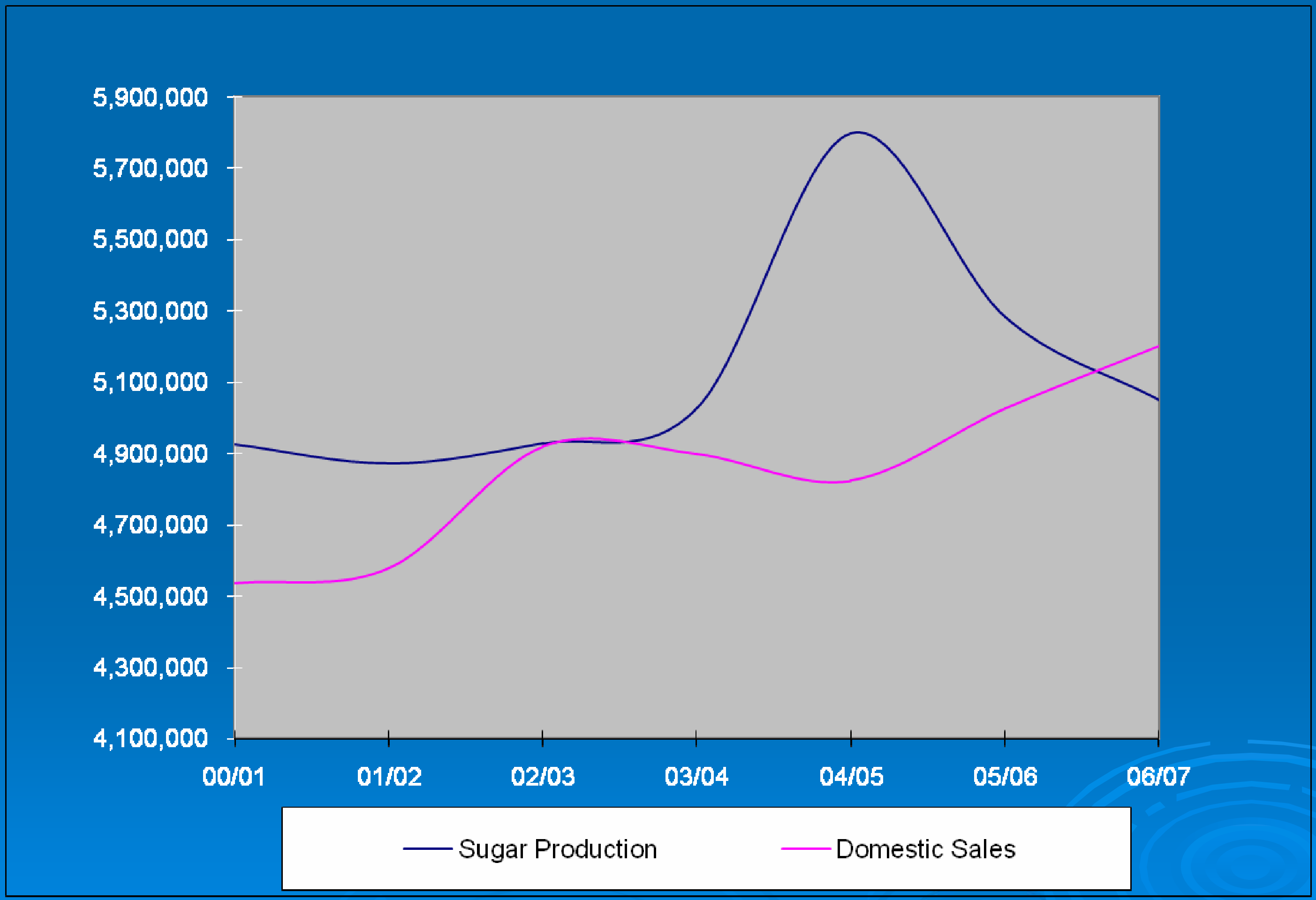
…(cont'd)

- <u>Yields and other</u>:
  - Sugar yield = 8.7 MT / ha raw value (9.25 in US)
  - Industrial yield about 11%
  - Irrigation about 39% vs 51% in US (almost all regions except Louisiana – no need)
  - 58 mills including 14 refineries (Unlike US, no stand-alone refineries and NO waterfront refineries). Largest mill San Cristobal 18,000 TC/day capacity avg mill is 6,100 tc/day
  - Average farm 3.9 ha vs 415 ha in US (115 for beet). 78% of Mexican farms below 5ha (Smaller the farm the less productivity)
  - All ethanol produced from molasses

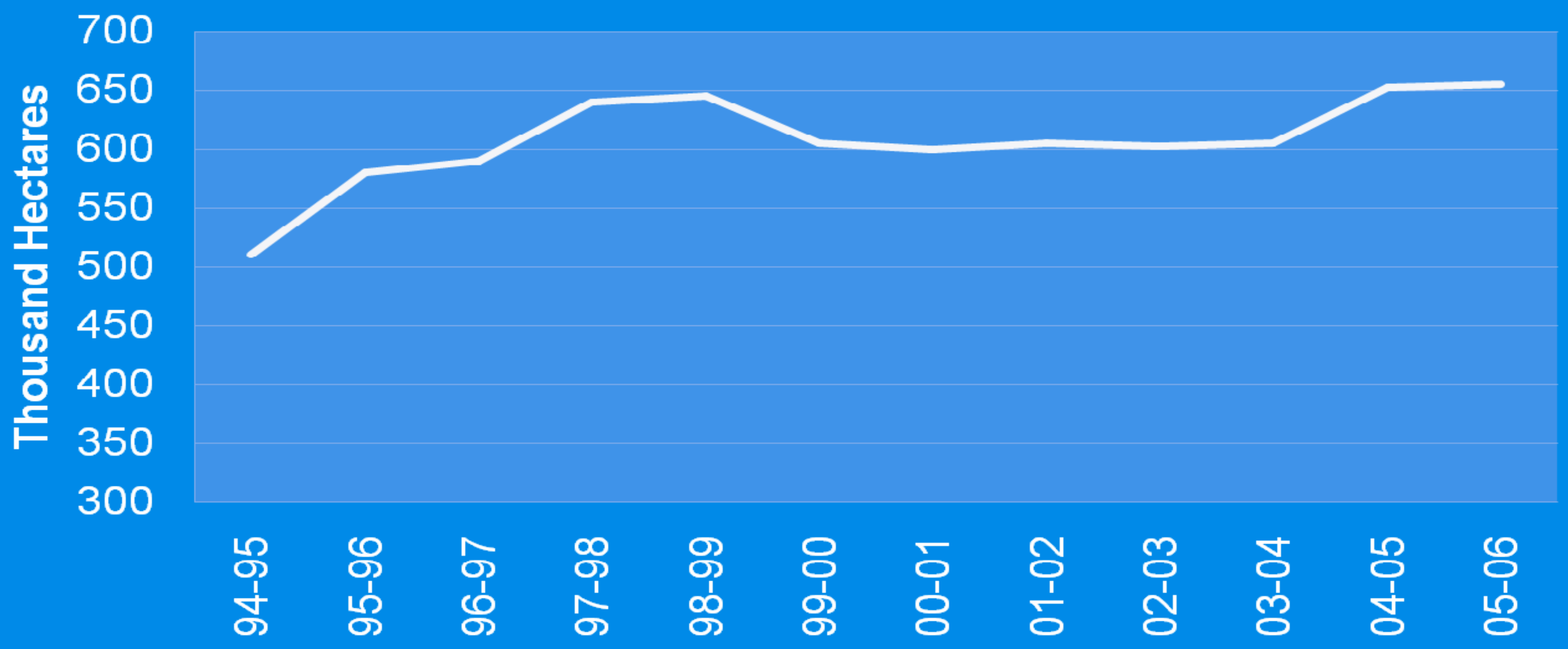
Mexican Consumption

- Sugar consumption 45KG + HFCS 5KG
- Consumption: recently growing at upto 4% of which 1.5% is demographics.
- 65% industrial / 35% direct. Bottlers consume 2 MM MT of sugar and up to 0.5MM MT of HFCS. Confectioners represent 0.6 MM MT fragmented in 250 firms.
- In 2006-2007, HFCS sales should have returned to 0.6MM MT of sugar displacement (400 bottler, 200 confectioners).

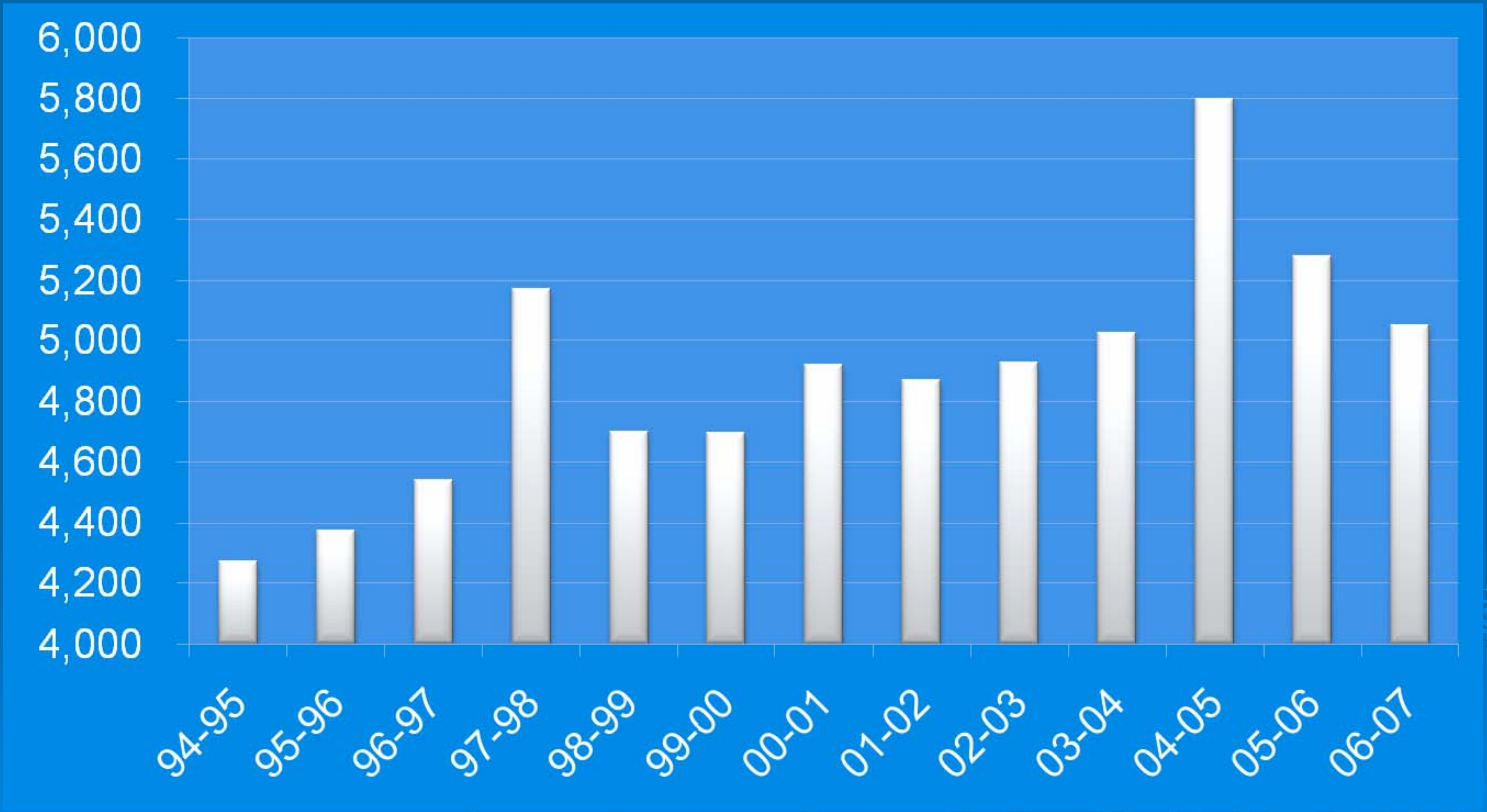
Mexican Production & Consumption



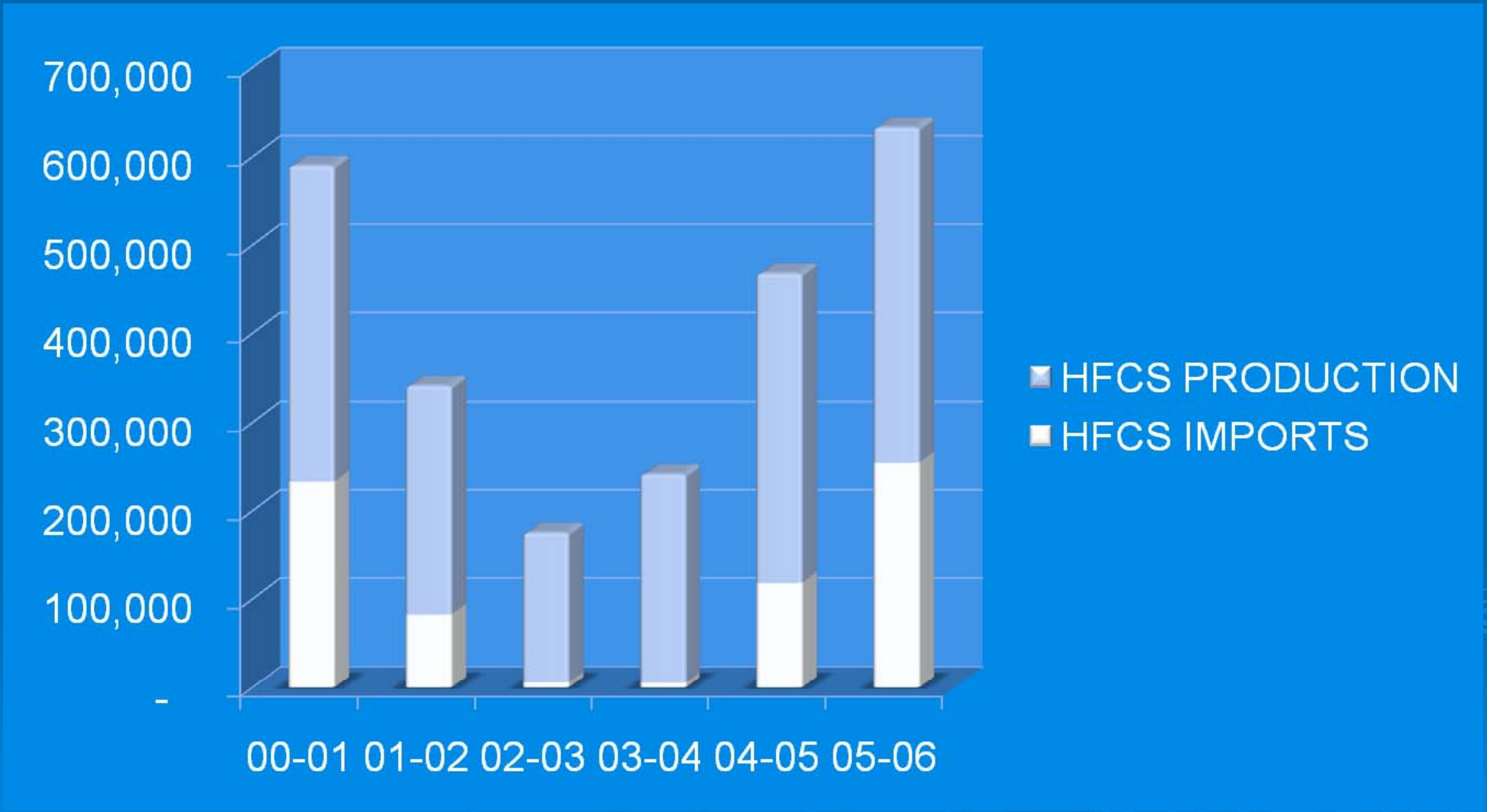
Mexican Cane Acreage



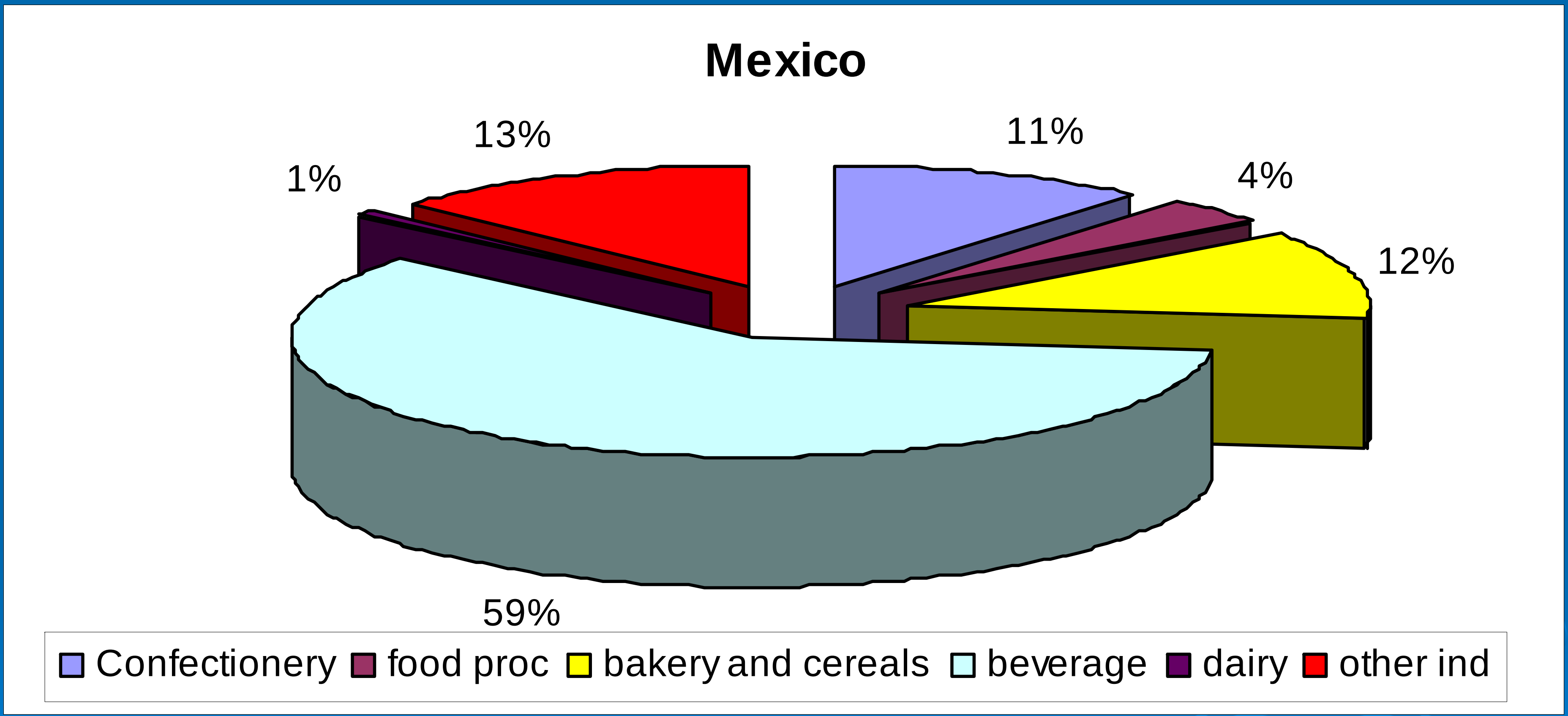
Mexican Production (MT)



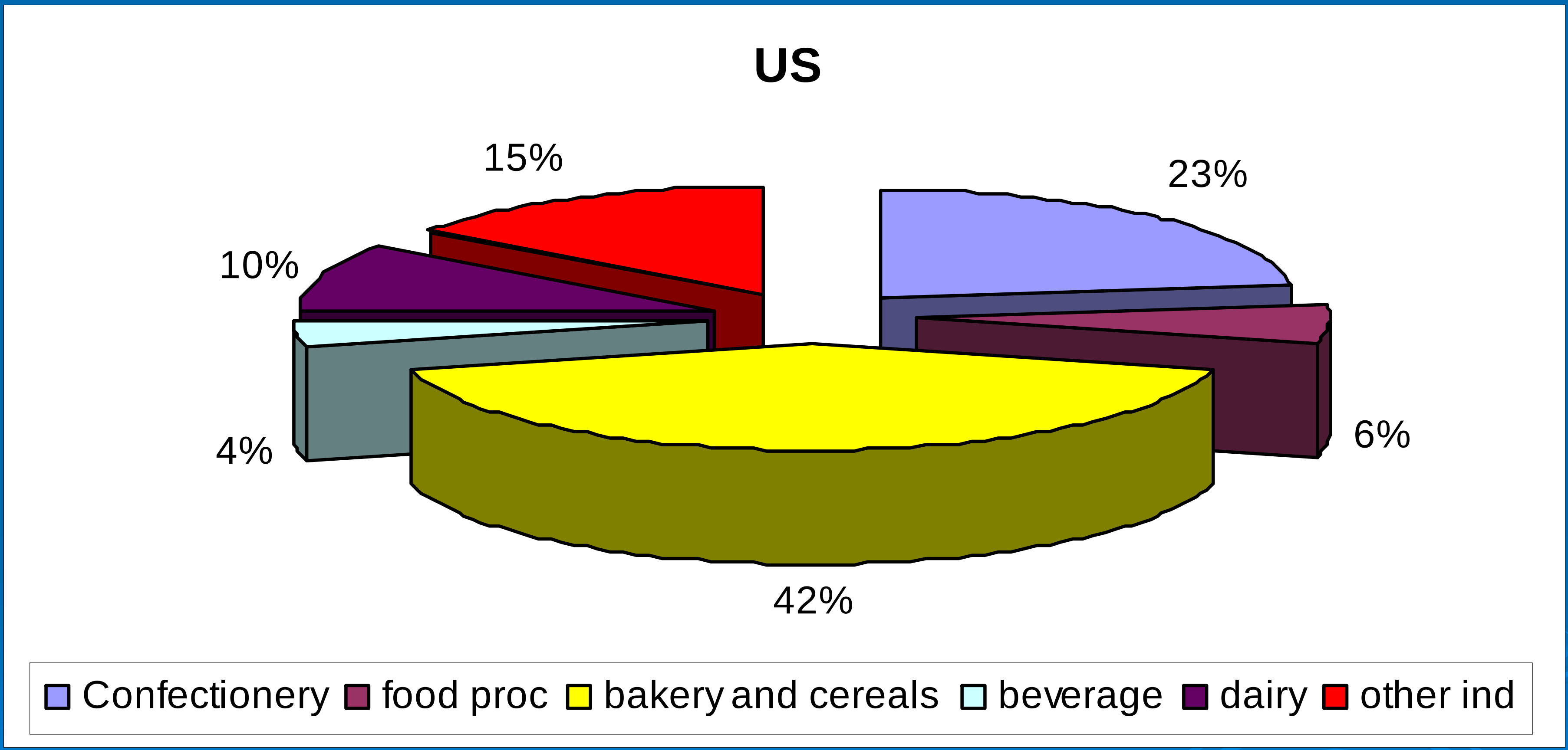
Mexican HFCS Consumption



Mexico Consumption



US Consumption



Mexican Duties and FTAs

- Non-NAFTA:
  - 338 $/ton for raws
  - 360 $/ton refined
- NAFTA:
  - To the US: 2007: $35 / 2008 and on: $0
  - From US to Mexico: 2007: 12.5 cts/lb 80% of MFN / 2008 and on: $0
- FTAs:
  - Nicaragua has duty free access equal to 10% of Mexican import quotas
  - Costa Rica has duty free access equal to 26% of Mexican import quotas

Mexico's Recent Events

- 9/2001: expropriation of 27 mills: but Supreme Court ruled it unconstitutional
- 9 Caze mills expropriated (to be privatized). 6 Santos mills expropriated – 5 were returned. 6 GAM mills expropriated - 4 returned. 4 Machado mills expropriated – 3 returned. 2 other mills already under government ownership (one sold, one shut down)
- US changes in sugar containing product duties have created a vacuum effect ➔ Sugar confectionery export to US have increased 1500% since 1994
- 2005: US supply crisis (hurricanes) accelerate export of Mexican surplus to US

Mexico's Recent Events

…(cont'd)

- 2006: Mexico exports 810,000 MT to US and creates year-end shortage. Prices got to $900/MT
- 2006: Imports of 150,000 MT in November – December
- Calendar 2007: US Quota export potential of 425,000 MT but US market is below Mexican market. Surplus Beet and re-export sugars are imported by PITEX buyers
- 10/1/2008: End of NAFTA duty between US and Mexico

Comments

- Mexico is not a competitive sugar producer at World level:
  - Cane produced in small farms
  - Cane grower/price protection
  - Fragmented milling and refining
- Mexican sugar prices have been kept artificially high making sugar milling very profitable.
- Mexican exports 100% of its surplus to the US at double world prices.
- Should HFCS become an important substitute to granulated sugar for bottlers, Mexican market could have a huge surplus. But high US corn demand for ethanol and politics should delay granulated consumption replacement in Mexico.

US Farm Bill 2008

- Only meaningful change proposed is the elimination of the marketing allotments “trigger”
- No proposed change in loan support → continued floor price
- Blocked stocks can be sold to Mexico → legal circumvention of the US marketing limits since the sugar could make its way back to the US market.
- Incentive will be for both US and Mexican producers to increase production as long as variable cost of production is below net selling price to the US

Trend of Sugar Flows

Conclusion

- US loan support will act as a floor price to Mexican surplus sugars as long as the US loan rates are maintained
- Mexican surplus to disappear as US destination prices weaken
- Consolidation / rationalization of Mexican sugar industry will be slow and forced by market forces. With rural population at 24 MM (24.5%), politicians will protect sugar cane growers (Sugar is the 2nd employer of Mexico after the oil industry).
- The 2008 Farm Bill must re-adjust the US sugar program in order to keep the program at ‘reasonably acceptable’ cost to taxpayers.
- If loan rate is reduced, the least competitive US/Mexican production will be eliminated making way for more imported sugar from world / US quota origins.

“Ex USDA Under secretary JB PENN: “the border being completely open in 2008 will mean that we’ll have to modify the sugar program in some way. We cannot continue to operate a supply-controls system if we cannot control the supply”