



AgriTrends

2022

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CONTENTS

About this Report

Agriculture is a cyclical and ever-changing industry, and what happens on a socio-economic level, locally and globally, can significantly impact businesses.

The AgriTrends 2022 report provides insight from industry experts on the factors affecting agriculture in South Africa, and what this might mean for the future.

By analysing the most recent conditions, we are able to provide a forecast for the next few years, empowering everyone in the value chain to plan for the future.



02

INTRODUCTION

04

GRAINS AND OILSEEDS MARKETS

- 06. Maize Market Dynamics
- 08. Maize Look Ahead
- 10. Soybean Market Dynamics
- 12. Soybean Look Ahead

14

LIVESTOCK MARKETS

- 16. Beef Market Dynamics
- 18. Beef Look Ahead
- 20. Lamb Market Dynamics
- 22. Lamb Look Ahead
- 24. Pork Market Dynamics
- 26. Pork Look Ahead
- 28. Broiler Market Dynamics
- 30. Chicken Look Ahead

32

HIGH-VALUE EXPORT INDUSTRIES

- 34. Citrus Market Dynamics
- 40. Citrus Look Ahead
- 44. Table Grape Market Dynamics
- 46. Table Grape Look Ahead

46

THE GLOBAL CLIMATE AGENDA

- 46. Overview
- 50. Why Should We Take Note of Regulatory Forms in the EU?
- 53. Carbon Taxes in South Africa
- 54. Commercial Financing in Climate Change

56

THE FALL AND RISE OF THE OIL PRICE

- 56. Key Oil Price Drivers Over the Past 24 Months
- 58. Look Ahead

Introduction

The last multi-sector future view that Absa AgriBusiness published, was in the last quarter of 2019. Little did we know that a few months later the world would face an unparalleled health crisis with major social and economic consequences. Three years on, some of the residual effects of the pandemic remain. This includes changes in consumer spending patterns, and disrupted global shipping and manufacturing bottlenecks, due to, amongst other things, China's zero-Covid policy.

Since the start of 2022, new challenges emerged and pre-pandemic issues gained renewed momentum. Here the most

Export value share of South African agricultural products

Fruit comprises almost 70%

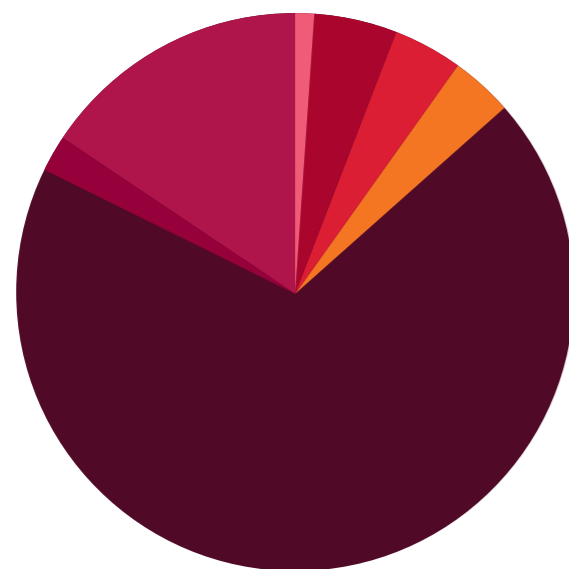


Figure 1.1

Source: Trademap, 2021

notable is certainly the intensified drive towards limiting emissions and curbing global warming within the broader Economic, Social, and Governance (ESG) context. The achievement of these goals is, however, affected by the war between Russia and Ukraine, which disrupted energy markets and added additional complexities to the global movement away from fossil fuels.

Given the explanation above, we have organised this publication around four themes or focus areas. The first, covered in section 3, deals with export focused subsectors that are still negatively affected by some of the residual effects of Covid-19 and other global disruptions. The selection of specific industries to cover here was driven by overall industry contribution to agricultural export value. From figures 1.1 and 1.2 it is clear that fruit and subsequently citrus and table grapes are the main contributors, and we have aligned our coverage as such.

Export value share of South African fruit products

Table grapes and citrus account for almost 2/3 of fruit exports in value terms

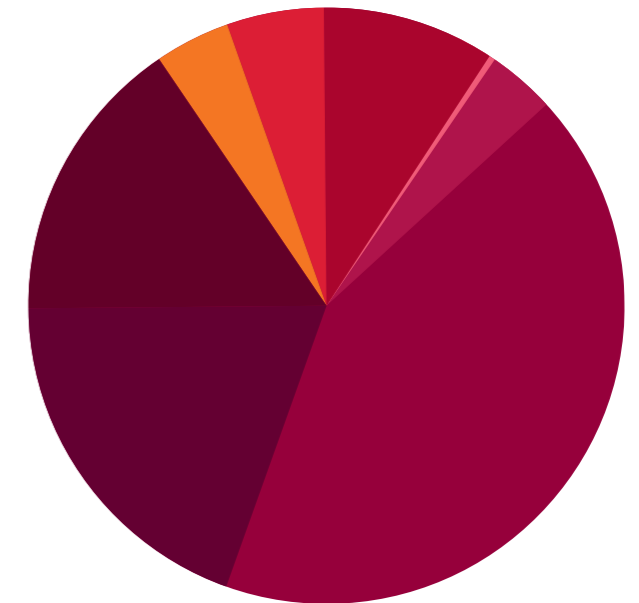
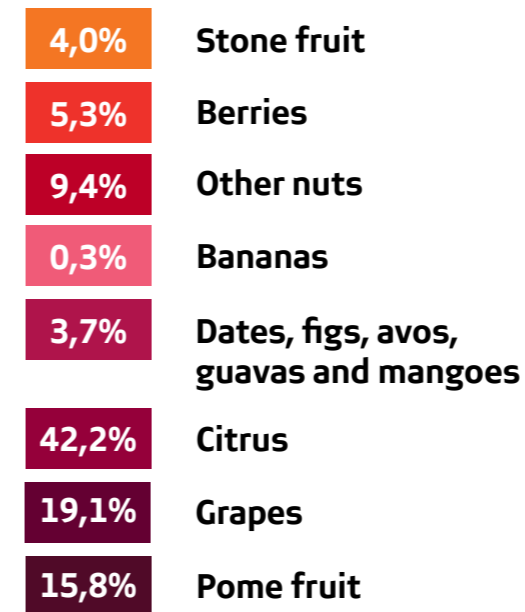


Figure 1.2

Source: Trademap, 2021

Our second focus area, covered in section 2 deals with local factors and issues such as pressures on consumers' disposable income, the widespread prevalence of foot and mouth disease (FMD), and high input costs. Here we draw heavily on the information used in our weekly reports and short-term outlooks for grains, oilseeds, and livestock. We relate it to longer-term views for these sectors, with a specific focus on the summer rainfall areas given the seasonal timing.

The third focus area deals with climate change and the broader ESG issues that are gaining increased policy and

commercial importance. This is likely to shape the way business is conducted in the future and, as a result, we've attempted to unpack the issues that could have bearing on South African agriculture.

Our last focus area is a collaborative effort between Absa AgriBusiness and the Bureau for Economic Research (BER) at the University of Stellenbosch. It deals with oil price movements over the coming years. Given the strong link between agricultural input costs and energy markets, we deem this an important sector to keep track of in the months and years to come.



GRAINS AND OILSEEDS MARKETS

“Geo political issues continue to add uncertainty and volatility to commodity markets”

The global grain and oilseed market has faced several supply disruptions over the past three seasons. The first was a persisting La Niña, that caused dry conditions in certain key grain and oilseed production regions around the globe, which included South America and the mid-west of the United States. The second factor was numerous trade disruptions which ranged from export issues and sanctions due to the Russia-Ukraine war, to export bans - for example, the 2022 wheat export restriction in India - which all added to global price momentum. Thirdly, labour issues and structural changes in palm production, due to the age of the plantations, contributed to the price run in global oilseed prices, specifically.

From a demand perspective, record grain and oilseed purchases from China, as swine herds were rebuilt after the devastating 2018 African Swine Fever (ASF) outbreak, combined with increased demand for commodities used as a biofuel feedstock, contributed to the upward price trend. Whilst speculative trade in agricultural commodities added fuel to the proverbial fire fund managers increasingly participated in agricultural, commodity trade due to the bullishness of the markets.

Currently, prices are still at elevated levels underpinned by a smaller than anticipated Northern Hemisphere harvest and persisting La Niña conditions causing dry conditions in South America. Concerns around easing global growth brought some reprieve to the markets, in July, which led to a significant price drop in agricultural commodity markets.

Northern Hemisphere harvests are lower than anticipated

Growth projections for countries like China, the US, the EU, and the UK have since mid-2021, consistently been adjusted downwards by institutions such as the World Bank and International Monetary Fund as a result of supply chain bottlenecks, energy price shocks, and associated surges in inflation. This has, in turn, also spurred aggressive contractionary monetary policy which is bound to curb global aggregate demand and would also filter through to eased demand for agricultural commodities.

Although there is a consensus amongst market analysts that agricultural commodity prices will continue to soften over the coming months there is some upside risk. Broad-based heat waves and dry spells in the Northern Hemisphere resulted in a smaller than anticipated crop. Weather patterns in key production regions will be pivotal in giving prices direction during the coming months. Since the rapid fall in corn and soybean prices in early July, three-quarters of the initial drop in prices has already been reversed due to weather concerns. Uncertainty around weather and ongoing geo-political issues are also likely to support the recent volatility in commodity markets going forward.

Maize Market Dynamics



Due to favourable local production conditions over the past four seasons, surplus maize production has resulted in prices trading at export parity over the past months. Strong global prices, high shipping costs, and a weakening exchange rate therefore all contributed to bolstering local prices to record levels. During July, when global prices eased, local prices held firm due to the offsetting effect of a rapidly depreciating exchange rate. As global prices regained momentum in August this year, local prices were again fueled by global price dynamics and a currency that was under pressure. The Rand has been under pressure, depreciating by over 25% year on year in by October 2022, as a result of tighter global monetary policy and concerns about a global recession. This was exasperated by increased incidences of load-shedding.

In terms of global dynamics, and as mentioned above, global crop progress in the Northern Hemisphere will be a notable determinant of price dynamics over the fourth quarter of 2022. In this

regard, prolonged dry spells across the U.S. have put their crop quality at risk, shown by the deterioration in the corn condition ratings, from 73% good-excellent at the onset of the 2022 rating season in June down to only 54% good-excellent for the August report. The October

Drought also affected crop quality in the US

United States Department of Agriculture (USDA) production report, also showed that U.S corn yield decreased by 4.8 bushels per acre due to persisting hot and dry conditions. Drought is weighing on Argentina's early season corn production, due to smaller area planted as poor early season rainfall outlooks are discouraging corn planting. This makes up around 40% of the total area. These factors have resulted in CBOT corn prices in September being almost 27% higher than the corresponding time last year. This effect on SAFEX yellow maize prices, in turn, was even more pronounced at 67.4%

In terms of SAFEX price dynamics between white and yellow maize, the past three seasons showed fluctuations between the discount and premium dynamics of white maize compared to yellow maize, which can be explained as follows:

From 2020 onwards

large harvests around the region limited the opportunities for regional exports. In 2020 and 2021, production conditions were favourable due to high rainfall across large parts of Southern Africa, which resulted in production for various countries in the region being above their five-year average consumption (see Figure 2.2). This caused some countries, that were traditionally net importers of white maize from South Africa, to become self-sufficient or surplus producers and for the 2021/22 marketing year, exports of white maize decreased by 34.4% compared to the year before.

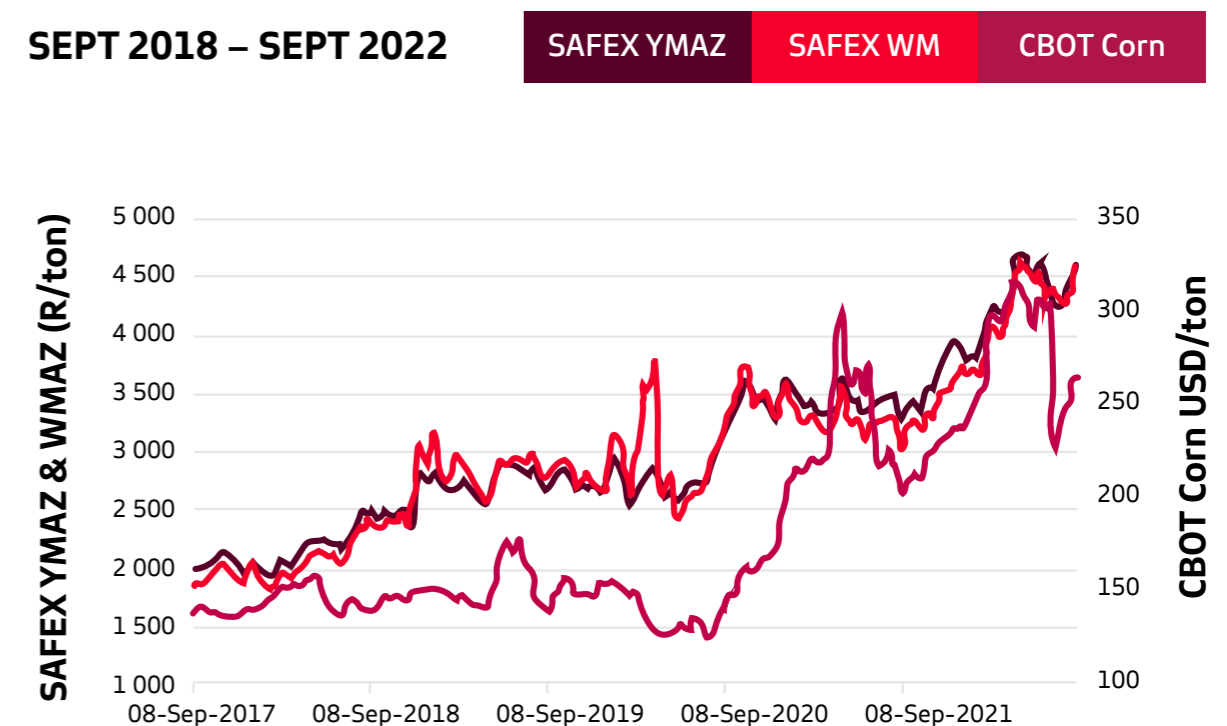
As a result

of the above, white maize prices traded largely at a discount to yellow maize since the start of 2022, but there was a short time during the start of 2022Q2 when quality dynamics in the South African harvest resulted in white maize trading at a premium.

Figure 2.1

CBOT Corn, SAFEX YMAZ, and SAFEX WMAZ Prices

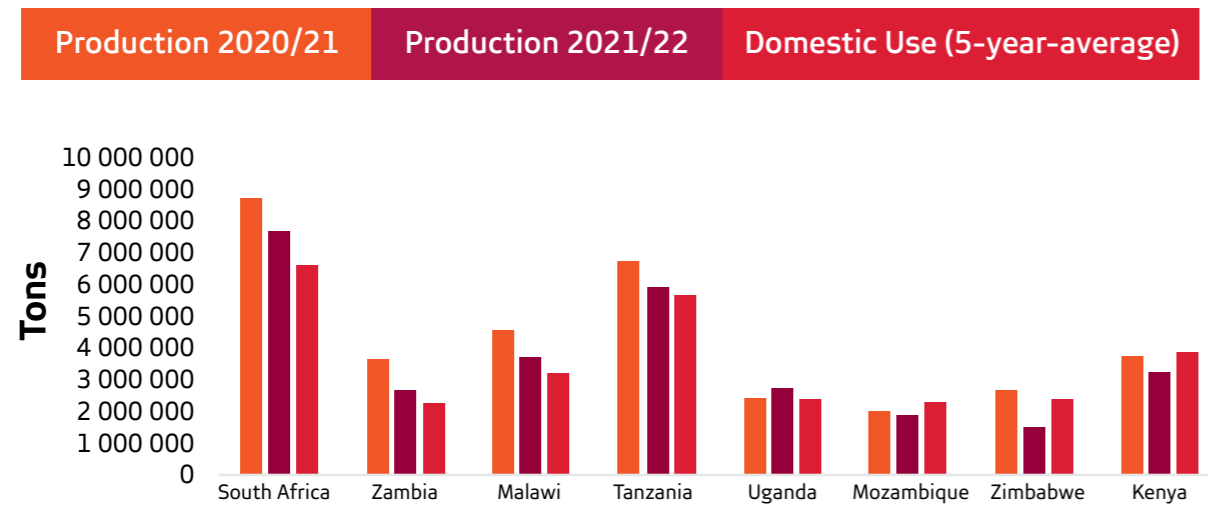
SEPT 2018 – SEPT 2022



Source: Reuters, 2022

Figure 2.2

Regional White Maize Production and Consumption 2022



Source: FAO GIEWS, 2022



Average Yellow and White Maize Production and Consumption 2022

Table 2.1

	Yellow Maize (R/ton)	White Maize (R/ton)
2019	2 696	2 805
2020	2 921	3 040
2021	3 428	3 276
Forecasts		
2022	4 351	4 300
2023	3 967	3 915
2024	3 808	3 760
2025	3 895	3 945

Source: Absa AgriBusiness, 2022

Looking Ahead

- For the price levels forecasts in Table 2.1, we assume normal rainfall in the summer rainfall areas of South Africa.
- Our view is that this will likely result in good production prospects for the coming season. White maize areas are however expected to shrink due to expansion in soybeans. This is underpinned by higher input costs for maize and the current high returns associated with oilseeds.
- Due to the above, combined with strong export demand, we could see maize prices pulling away from export parity in 2023.
- Despite this, local prices would still be influenced by global prices and the USD/ZAR exchange rate.
- Global research institutions and analysts agree that global agricultural commodity prices will come down, throughout 2023 and then more modestly into 2024. In 2025, prices are expected to start increasing again.
- Locally, we expect SAFEX prices to also decrease somewhat during 2023 and 2024 but the effect is less pronounced than in the global context due to the expected depreciation of the rand and the movement away from export parity.
- The global price downturn as explained above is underpinned by a positive supply response to high prices and favorable margins in various key production regions around the globe. Production and trade from the Ukraine remains limited. Before the invasion the Ukraine was responsible for around 10% of global corn exports. The extent to which this can be re-established, combined with climatic conditions in key production regions, will be key in giving global markets direction over the next 18 months.
- Over the coming years, we expect white maize to trade at a slight discount to yellow maize but will largely be determined by the production conditions of other countries in the region. With good

export prospects, white maize prices will likely trade at a premium. In the absence of regional export opportunities, surplus white maize will likely flow to the feed market and trade at a discount.

SAFEX maize prices could pull away from export parity due to low stock levels

Soybean Market Dynamics



The global soybean market is currently associated with high levels of uncertainty as low stock levels put production from the major soybean producers under constant scrutiny. Over the past seasons, the market was therefore highly responsive to weather developments in regions such as South America and the US where hot and dry weather prevailed. Prices continued to fluctuate at elevated levels on the back of a delay in US plantings and deterioration in US crop conditions. At the time of writing the US soybean crop was classified as 57% good-excellent from the 70% good-excellent rating at the beginning of the season. This is shown in Figure 2.4.

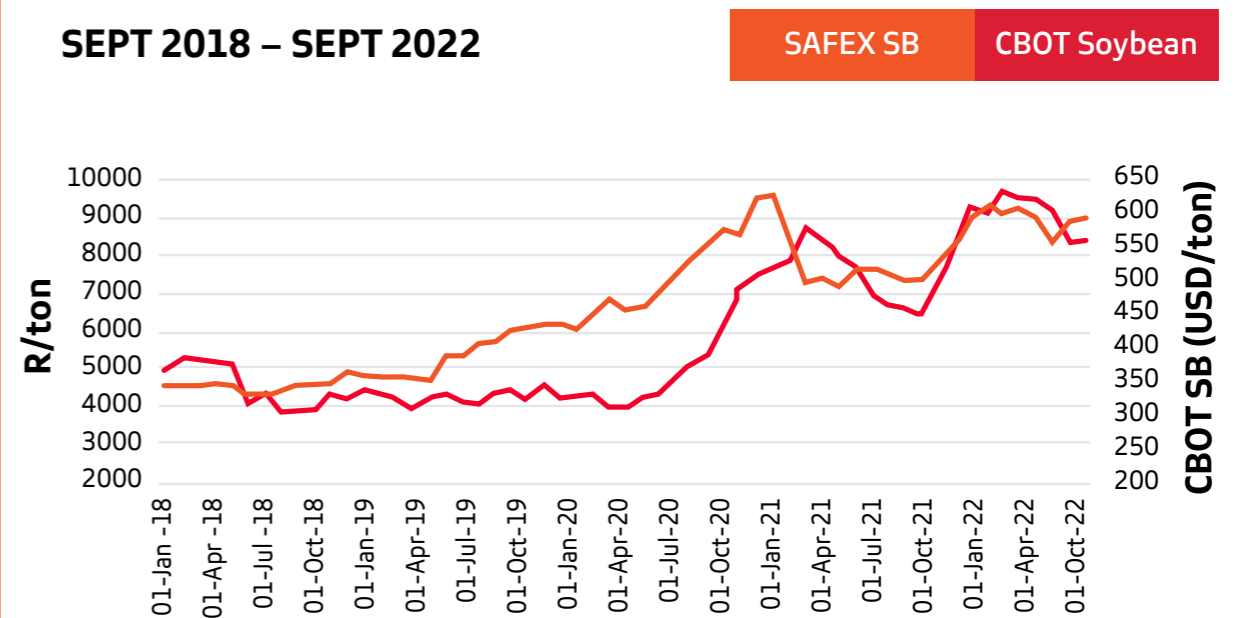
Locally, we anticipate yet another expansion in the area planted to soybeans for 2023 as shown by the CEC in their Intentions' of producers to plant summer crops for 2023 report. This shows that the intended area is expected to increase by 16.2% from the previous year where we expect a record soybean crop for the 2021/22 season at 2 01 000 tons. Production for 2023 will therefore exceed the local crushing capacity, just as the production in the 2022 season. Alternative markets have to be sought to cater to the oversupply locally.

Intensions to plant indicate another significant expansion in area

Figure 2.3

CBOT Soybean and SAFEX SB Prices

SEPT 2018 – SEPT 2022

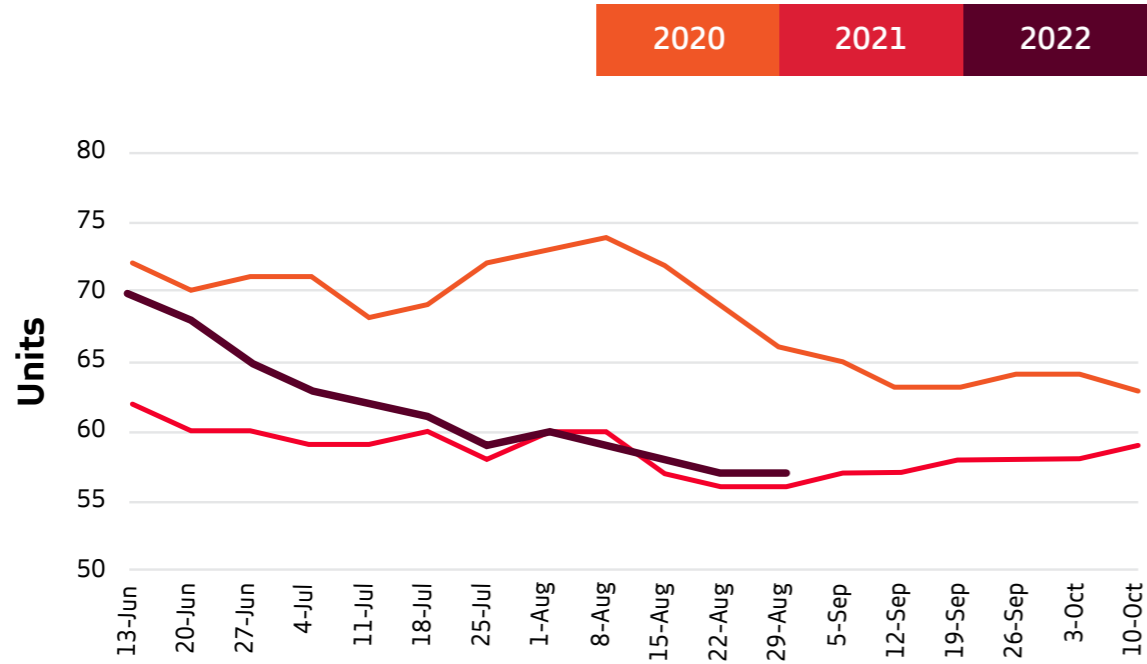


Source: Reuters, 2022



Figure 2.4

US 2020, 2021 and 2022 Good-excellent Soybean Condition Ratings



Source: USDA, 2022



Average Soybean Prices (2019-2021) and Price Forecasts (2022-2025)

Table 2.2

	Soybeans (R/t)
2019	5 326
2020	7 165
2021	7 816
	Forecasts
2022	8 830
2023	8 175
2024	8 295
2025	8 220

Source: Absa AgriBusiness, 2022

- Locally, an area expansion and the associated increase in production are bound to slow further price growth. In fact, for the 2023 season, we are likely to see notable surplus soybean production which would result in soybeans trading at export parity.

Soybean production in 2023 likely more than local crushing capacity

- With soybean exports being relatively limited, there is an option to replace imported soy cake - typically used at the coast - with local production. Since it is more cost-effective to use imported oil cake in these areas due to notable inland transport costs, local production prospects could result in pressure on local crushing margins.

Looking Ahead

- Average yearly SAFEX soybean prices for 2023 are projected to decrease by almost 7.5% compared to 2022 levels.
- This is underpinned by lower global prices as higher interest rates start to curb aggregate demand and the agricultural commodity price run of late. Record prices for vegetable oil have also resulted in demand destruction and easing global demand is expected to weigh on prices.
- Global price decreases are, however, expected to be limited due to continued demand for biofuels. As blending percentages for biodiesel are higher than that of ethanol, demand for non-fossil fuels is likely to support global prices above USD 11.00 per bushel.
- As with corn, ongoing production and trade disruptions from Ukraine could affect sunflower seed and crude oil prices, which would likely also limit the degree of price decreases for oilseeds in general.
- As discussed above, crop size and quality issues in the Northern Hemisphere present upside risk to the above price trajectory and could delay the rate of price decreases over the coming seasons.



LIVESTOCK AND MEAT MARKETS

Over the past 12-18 months, livestock and meat prices increased rapidly as the world emerged from the Covid-19 pandemic and its associated lockdowns. Price increases in these markets were so pronounced that analysts dubbed the phenomenon “meatflation”, intended to highlight the large effect that meat price increases played in overall food inflation around the globe. This was driven by both supply and demand factors.

On the demand side, as economies opened up, demand from the food service industry increased. This combined with pent-up demand during the pandemic and ensured strong demand for all livestock products.

In terms of supply, disease outbreaks, such as the BSE outbreak in Brazil and Avian Influenza outbreaks in Europe and more recently in the USA and Canada, further added to trade disruptions and supply and demand imbalances. High feed costs due to supply disruptions in grain markets also added to constrained supply.

“Weaker economic growth is likely to curb meat price increases”

In a global environment where livestock and meat prices increased rapidly, local market dynamics followed suit, although some local developments resulted in South African livestock and meat trends following a nuanced trajectory. More recently, aggressive

Global growth is easing

interest rate hikes in various countries combined with high energy costs look set to curb global aggregate demand and economic growth. This is likely to be transmitted to South African markets as well and local purchasing power would likely be impacted negatively further by increased bouts of loadshedding.



Beef Market Dynamics

Despite increased pressures on consumers, which include higher interest rates and fuel costs, beef carcass prices have been holding firm since the start of 2022 (see Figure 3.1). This was primarily driven by low slaughter numbers (see Figure 3.2), with beef slaughterings in July 2022 6.3% below the long-term average for July and a 2.8% decrease year on year. Lower slaughter numbers were, in turn, the effect of multiple factors. The first is high input and feed costs underpinned by high grain prices. Strong revenue streams from grains and oilseeds also

resulted in producers with grain and livestock enterprises to rebuild their herds more aggressively and this decreased the availability of marketed animals. The third factor relates to the ongoing Foot and Mouth Disease (FMD) outbreaks. During October 2022, South Africa had 171 open cases affecting Kwazulu Natal, North West, Free State, Mpumalanga, and Gauteng. The rapid spread of increased production risk combined with the current high production costs is limiting the throughput of animals through the chain.



In terms of weaner calf prices, the above-mentioned FMD issues and high feed prices have resulted in a downward price trajectory apparent since the start of 2022. Here, it is also expected that an increased amount of animals will start to enter the market during 2023 as a result of ongoing herd rebuilding initiatives. Being cognisant that dry conditions in the Western parts of the country have only improved since 2020, herd rebuilding initiatives in these areas could be extended into 2024 and 2025 which is likely to constrain price growth for weaner calves over the medium term.

July 2022 beef slaughterings were

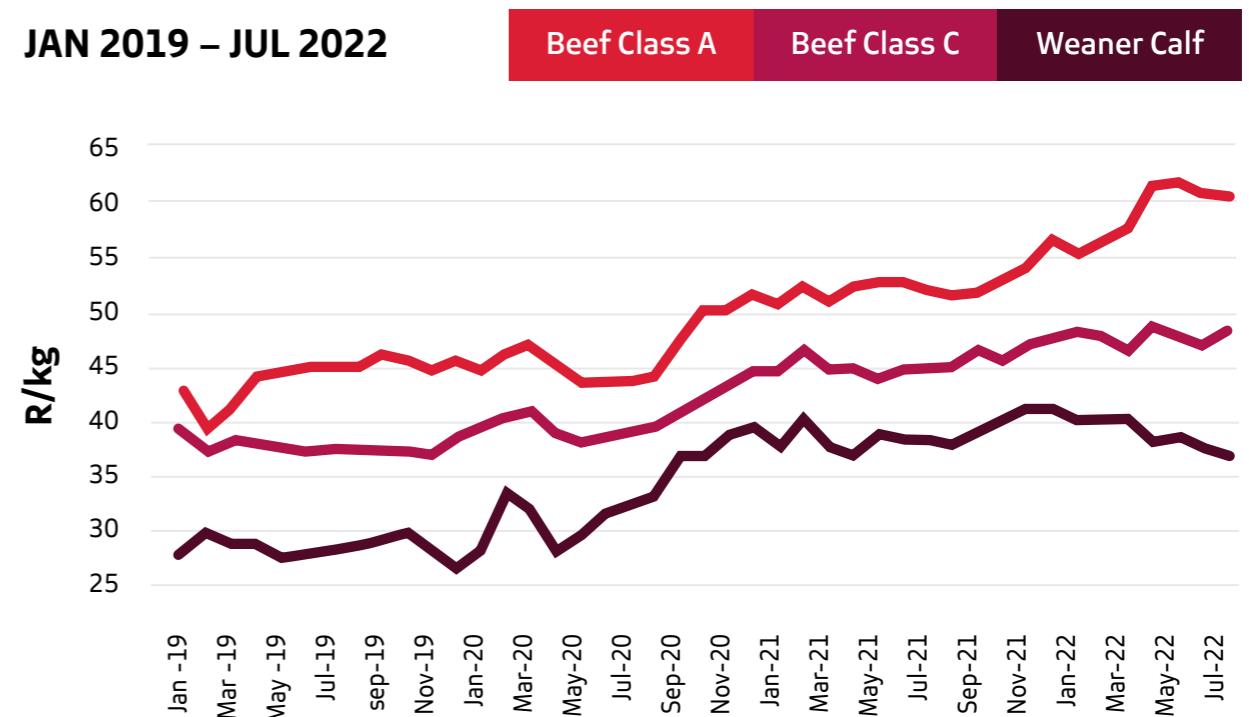
2.8%

lower than long-term average

Figure 3.1

Beef Carcass and Weaner Calf Prices

JAN 2019 – JUL 2022



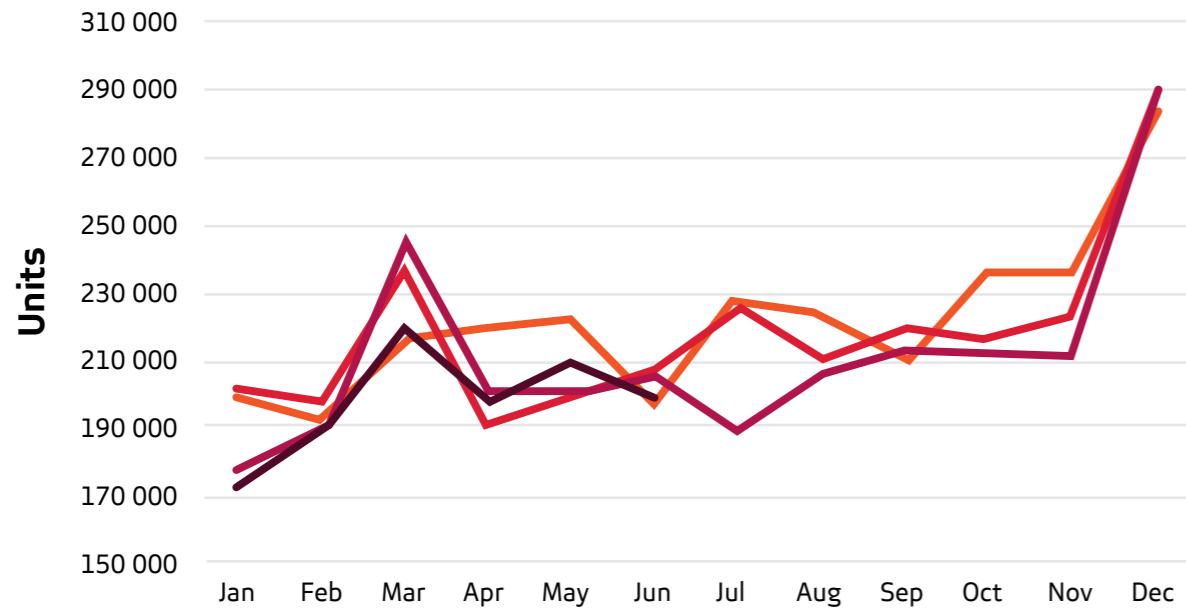
Source: Absa AgriBusiness, 2022

Figure 3.2

Monthly Cattle Slaughter Numbers

JAN 2019 – JUL 2022

2019 2020 2021 2022



Source: Red Meat Levy Admin, 2022

Average Carcass and Weaner Calf Prices (2019-2021) and Price Forecasts (2022-2025)



Table 3.1

	Class A (R/kg)	Class C (R/kg)	Weaner Calf (R/kg)
2019	43.94	43.94	43.94
2020	46.41	46.41	46.41
2021	52.48	52.48	52.48
		Forecasts	
2022	59.15	47.70	38.55
2023	55.35	43.90	34.55
2024	58.35	46.90	36.40
2025	61.35	49.90	38.40

Source: Red Meat Levy Admin, 2022

Looking Ahead

We expect carcass prices to draw back from the highs in 2022 due to constrained economic growth and ongoing pressures on consumers' disposable income. Lower grain prices and an increase in marketable animals will also contribute to this easing trend. We expect prices to pick up again into 2024 with the prospects of improved control on the FMD issues. Increases are expected

to continue into 2025 with the prospects of higher economic growth and increased bilateral exports. In the case of the latter, this is underpinned by our FMD issues improving.

For weaner calves, in turn, prices are likely to remain under pressure for 2023 but do follow a modest upward trajectory through the rest outlook period. This modest upward trend is likely to be supported by increased carcass prices and improved economic prospects. The price increases are, however, less pronounced than carcass prices due to an expected increase in the supply of marketable animals. As with carcass prospects, a key to price growth would be to get FMD issues under control.

Lamb and Mutton Market Dynamics

Except for two periods of price pressure, mutton and lamb prices have followed a steady upward trajectory since the start of 2019 underpinned by low supply (see Figure 3.3). The first notable period of decline in prices was in early 2021, after the 2020 festive season highs. This was exacerbated by intensified Covid-19 lockdowns during the start of 2021. The second period of decline was during July 2021, after a shipment of a large number of live sheep left South African shores in June 2021. The shipment of live animals in

June kept prices elevated during the second quarter of 2021 after which demand returned to normal levels.

Low supply over the past years was underpinned by prolonged drought in key production. In fact, these conditions were widespread, affecting areas such as Willowmore, Uniondale, Laingsburg, Prince Albert, Calvinia, and Williston, which all had below long-term average rainfall from 2015 to 2020 (see Table 3.2).



Rainfall conditions improved in 2021 and 2022 and producers are now rebuilding flocks in response to improved veld conditions. This is expected to restrict

Improved veld conditions leading to flock rebuilding

the number of animals available for slaughter over the near term, which could provide price support. Rising pressure on consumers' disposable income is, in turn, likely to curb price growth over the coming 18-24 months. Beef prices are a key determinant of lamb prices with lamb prices closely linked to beef with a

correlation of 80%. This suggests that high beef prices could provide room for lamb prices to also increase substantially towards the end of 2022.

Over the next two-to-three years, as the availability of marketable animals improves, price growth for carcasses and feeder lambs could moderate. It is, however, expected that substantial decreases in carcass prices would be limited due to structural issues affecting the supply growth. These include high risk due to issues such as animal theft and climatic issues where certain areas are slowly recovering from drought.

Over the next two-to-three years, as the availability of marketable animals improves, price growth for carcasses and feeder lambs could moderate. It is, however, expected that substantial decreases in carcass prices would be limited due to structural issues affecting the supply growth. These include high risk due to issues such as animal theft and climatic issues where certain areas are slowly recovering from drought.



Rainfall % Deviations from Long-term Average in Key Lamb/Mutton Producing Areas

Table 3.2

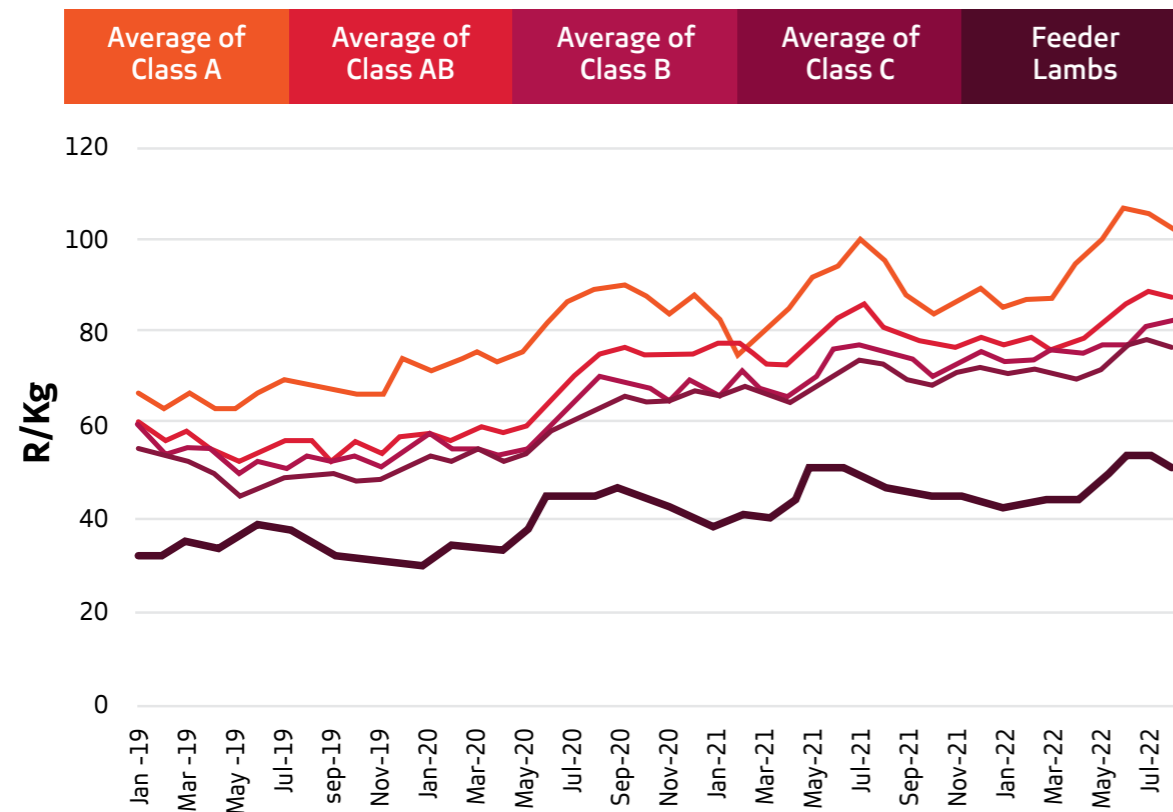
	Tankwa Matjiesfontein	Montagu Bredasdorp	Mosselbay Calitzdorp	Uniondale Oudtshoorn	George Plettenberg Bay	Willowmore Klaarstroom
2010	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
2011	7.3	7.3	7.3	7.3	7.3	7.3
2012	15.1	15.1	15.1	15.1	15.1	15.1
2013	43.1	43.1	43.1	43.1	43.1	43.1
2014	43.9	43.9	43.9	43.9	43.9	43.9
2015	-31.2	-31.2	-31.2	-31.2	-31.2	-31.2
2016	10.4	10.4	10.4	10.4	10.4	10.4
2017	-30.1	-30.1	-30.1	-30.1	-30.1	-30.1
2018	9.1	9.1	9.1	9.1	9.1	9.1
2019	1.0	1.0	1.0	1.0	1.0	1.0
2020	40.8	40.8	40.8	40.8	40.8	40.8
2021	42.4	42.4	42.4	42.4	42.4	42.4

Source: Weather SA, 2021

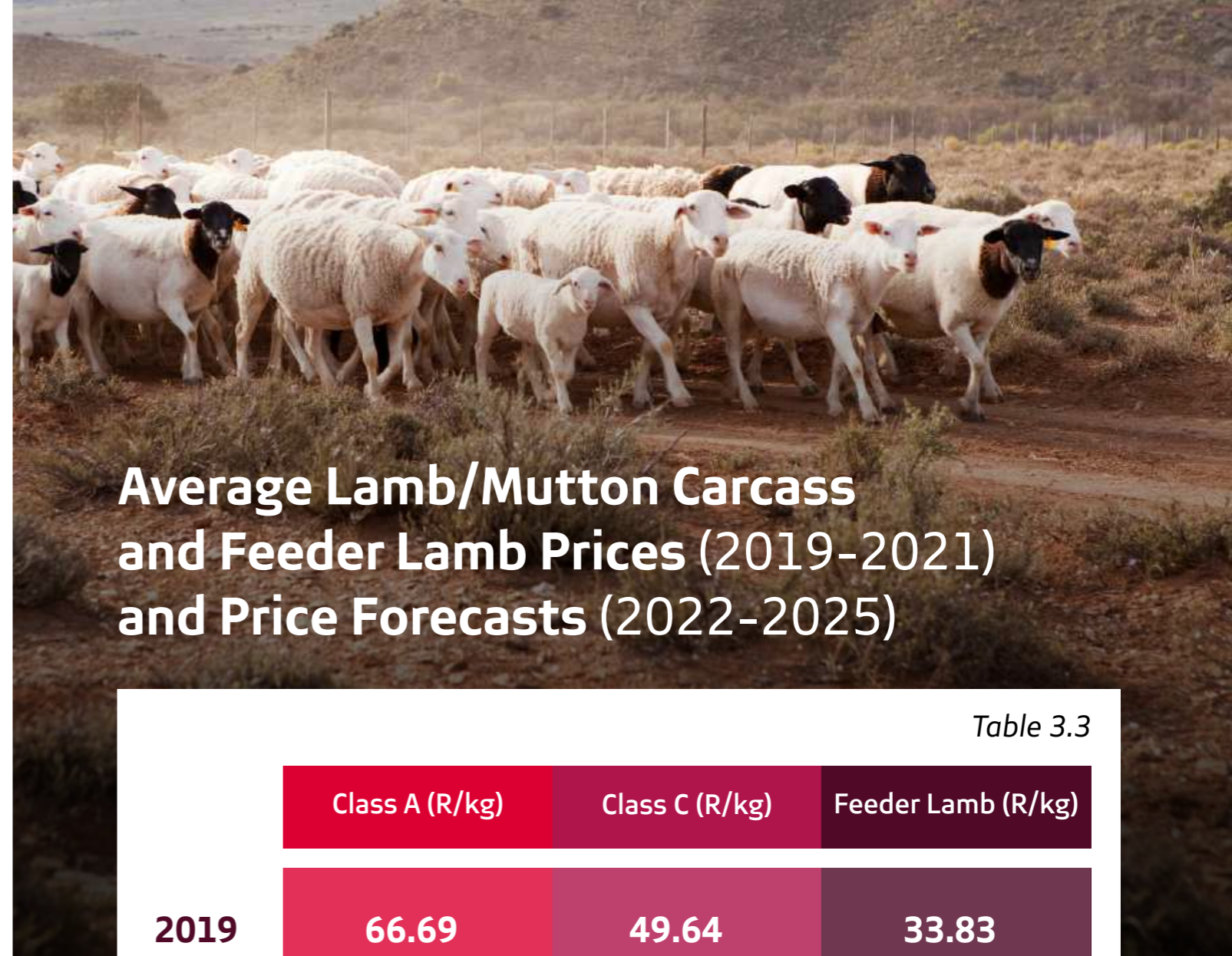
Figure 3.3

Lamb, Mutton, and Feeder Lamb Prices

JAN 2019 – AUG 2022



Source: Absa AgriBusiness, 2022



Average Lamb/Mutton Carcass and Feeder Lamb Prices (2019-2021) and Price Forecasts (2022-2025)

Table 3.3

	Class A (R/kg)	Class C (R/kg)	Feeder Lamb (R/kg)
2019	66.69	49.64	33.83
2020	81.07	58.93	39.81
2021	86.98	69.14	44.76
	Forecasts		
2022	95.20	72.80	46.85
2023	96.15	74.80	48.50
2024	99.00	77.20	49.50
2025	102.00	79.50	50.45

Source: Absa AgriBusiness, 2022

For carcass prices, we expect a moderate increasing trend into 2023. This is underpinned by flock rebuilding initiatives that are likely to limit supply over the coming months. For the outer years of the outlook and as with beef, higher economic growth and structural issues negatively impacting supply are likely to further support prices.

Looking Ahead

Feeder lamb prices, in turn, are also likely to follow a modest upward trend over the outlook period. There is some upside risk to this given an increase in exports, with those to the Middle East seemingly gaining momentum.



Pork Market Dynamics

Over the past three years, South African pork prices have exhibited the proverbial rollercoaster ride (See Figure 3.4). During the second half of 2020, pork prices increased by almost 62%. This was in response to an increase in local and regional export demand



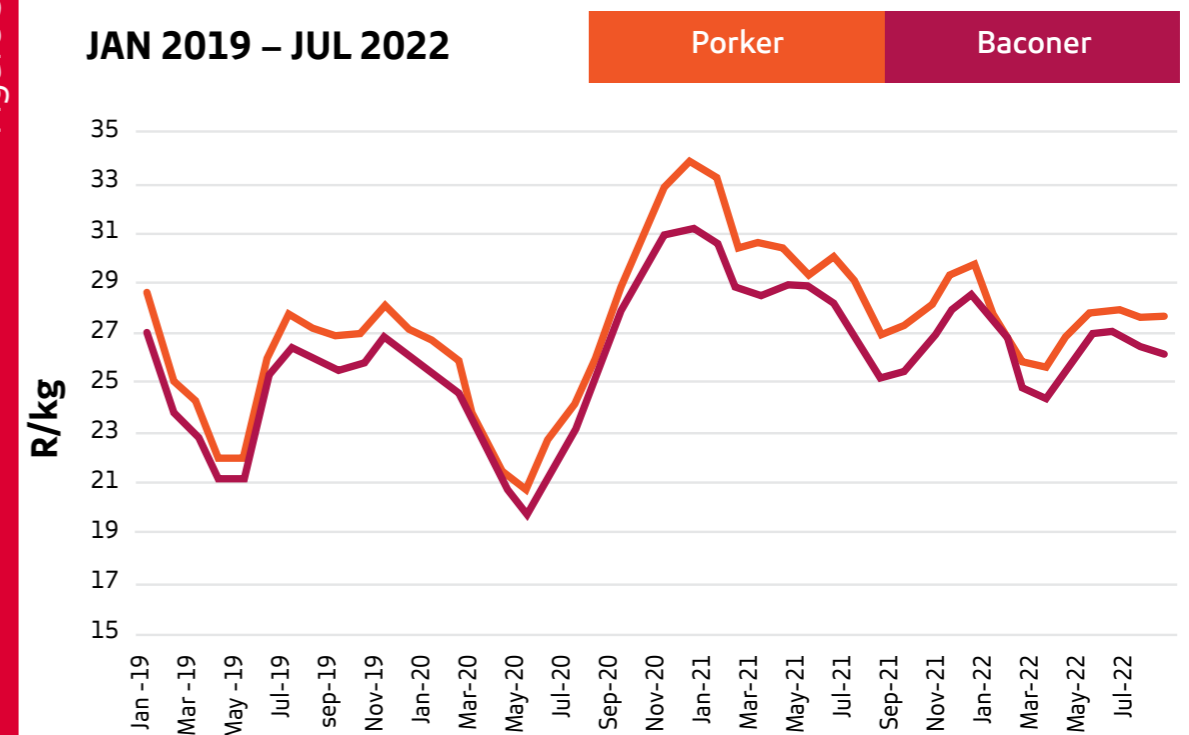
Since the highs experienced at the start of 2021, pork prices have however returned to lower levels, comparable to those in the months leading up to the pandemic, and have not experienced the elevated price levels apparent in red meat products. Since pork production is an intensive industry with a short production cycle, relatively high returns up until 2020 (see pork to maize ratio in Figure 3.5) induced expansion. This increase in production drove prices down. In addition to this, high feed costs have required producers to reduce the size of their sow units, which also added to increased production and contributed to downward pressure on prices. The local market for pork is notably smaller than markets for other meat protein products. In the context of a smaller demand base, an expansion in production can easily lead to a rapid reduction in prices as was apparent since the start of 2022. Since the third quarter of 2022, pork prices have started to gain momentum, breaching R30.00 per kg, on the back of lower supply. Despite this, profitability indicators are still under pressure due to high input costs

Despite a recent rebound in pork prices, profitability remains under pressure

Figure 3.4

Porker and Baconer Prices

JAN 2019 – JUL 2022

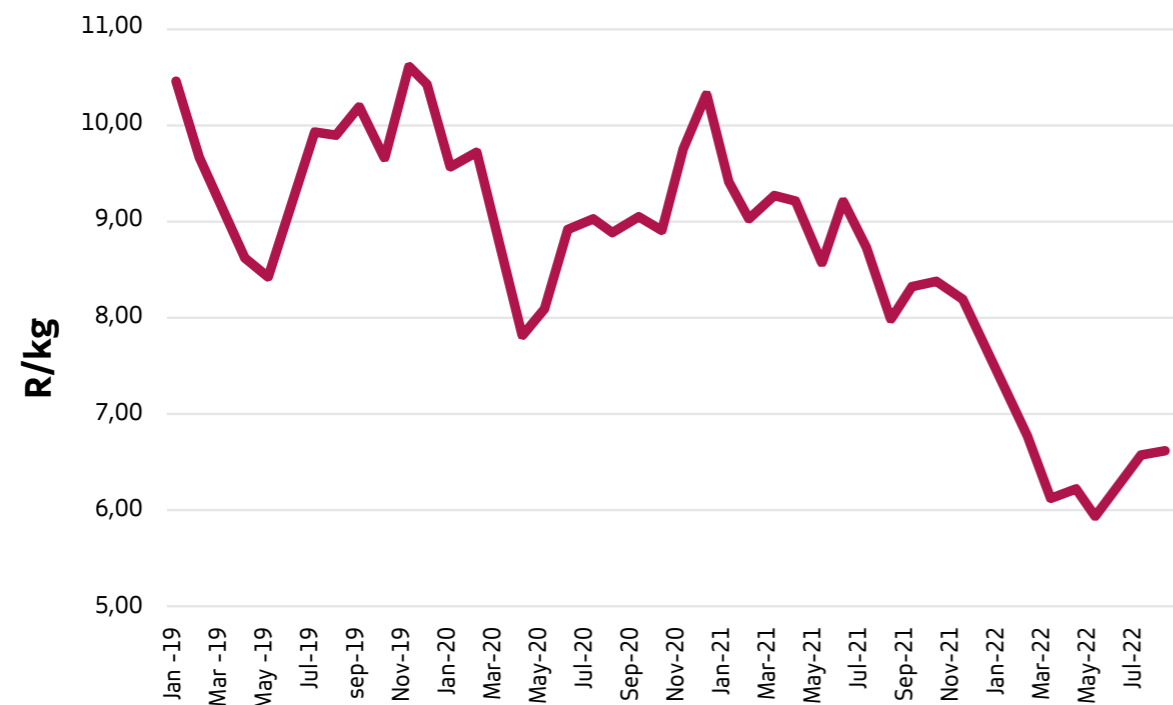


Source: Absa AgriBusiness, 2022

Figure 3.5

Pork to Maize Ratio

JAN 2019 – JUL 2022



Source: Calculated from Absa AgriBusiness Data, 2022

Average Porker and Baconer Prices (2019-2021) and Price Forecasts (2022-2025)

Table 3.4

	Porker (R/kg)	Baconer (R/kg)
2019	26.00	24.90
2020	26.47	25.28
2021	29.64	28.00
Forecasts		
2022	27.15	26.20
2023	27.80	26.85
2024	28.30	27.35
2025	28.85	27.85

Source: Absa AgriBusiness, 2022

Due to the shorter production cycle and adjustment to cost pressures in the form of lower supply, pork prices are expected to rebound in 2023. Lower grain costs are also expected to improve profitability and lead to an increase in production towards the outer months of the outlook period. This is expected to limit the degree of price increases over the coming years. Research has also indicated that pork demand is relatively inelastic to growth in consumer income. As a result, the effect of better economic growth prospects towards 2025 is likely to be more muted for pork than for the red meat industries discussed above.

Looking Ahead

Pork prices expected to remain firm during 2023



Roughly
20%
of local poultry
meat consumption
is imported



Broiler Market Dynamics

South Africa is reliant on exports for around 20% of domestic chicken consumption. In this regard, local market dynamics are closely tied to global price dynamics and exchange rate movements. Since mid-2020, global poultry product prices have followed an increasing trend on the back of high input costs and supply constraints related to disease outbreaks in the EU but also more recently in the US and Canada.

Disease issues are limiting global poultry supply

This filtered through to local prices which were further amplified by a weakening exchange rate and broad-based local input costs pressures ranging from increased cold storage costs to packaging and labour. The increasing price trend is apparent since May 2020 (see Figure 3.6 below).

In response to the high prices and food affordability concerns, Minister Ibrahim

Patel from the Department of Trade and Industry suspended import/anti-dumping tariffs on chicken imports from Brazil and the EU for one year. Although the EU has limited exportable supplies due to the disease issues mentioned above, cheaper Brazilian imports will be beneficial to consumers over the next year but are likely to put pressure on margins in an industry already under pressure due to high input costs. In the years leading up to 2018, high levels of chicken imports entered South Africa. With import tariffs being introduced from 2018 onwards, this has decreased markedly (see Figure 3.7). As mentioned concerns are now building that the suspension of tariffs could lead to increased imports, especially from Brazil, whose chicken exports to South Africa decreased by 21% between 2017 and 2021 due to imposed import tariffs. Global shortages of poultry products, as a result of disease outbreaks have however kept global prices high and to date, an influx of cheap imported products seems limited.

Figure 3.6

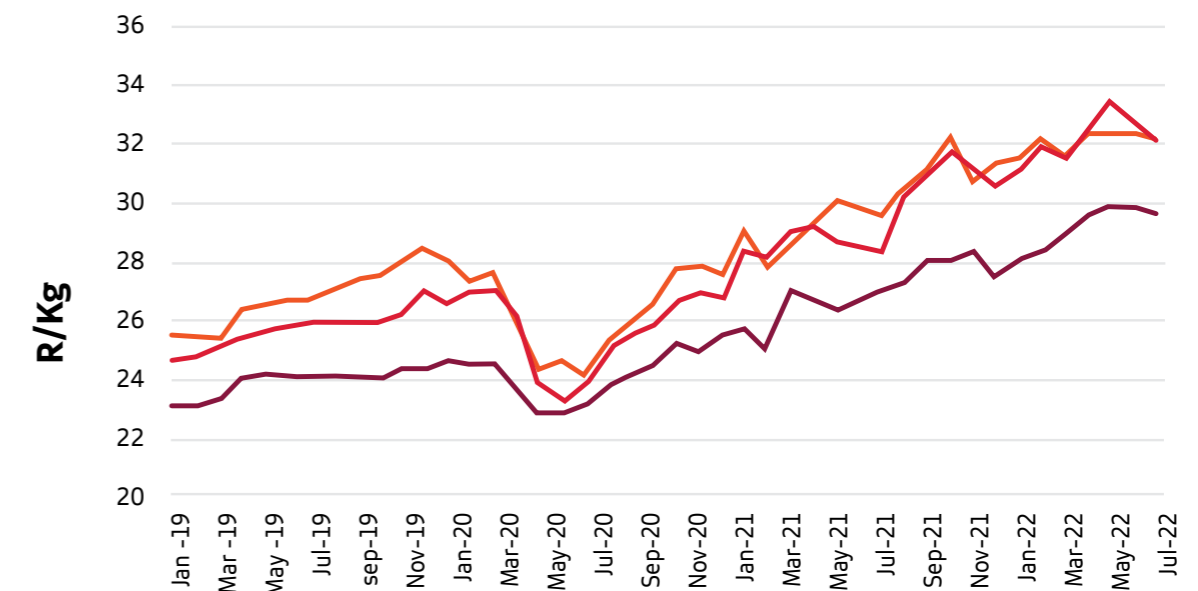
Broiler Product Prices

JAN 2019-JUL 2022

Fresh Whole Bird

Frozen Whole Bird

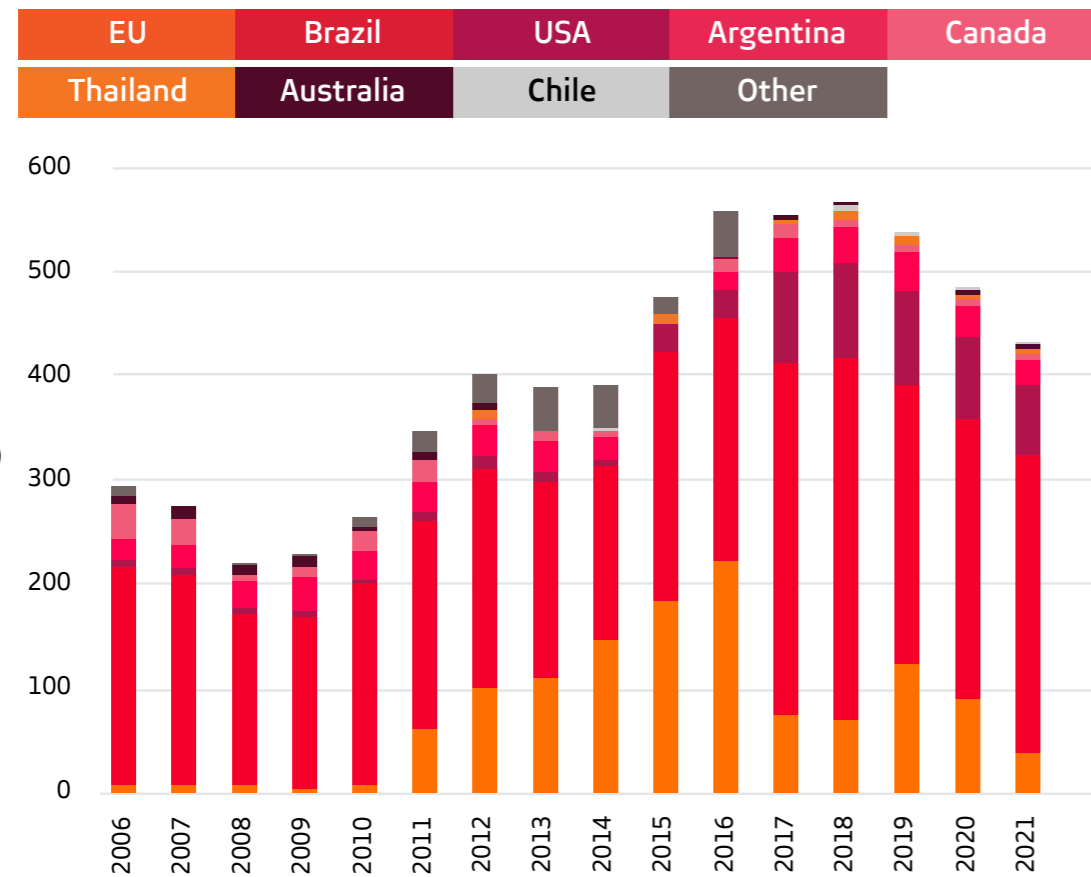
IQF



Source: Absa AgriBusiness, 2022

Figure 3.7

South African Chicken Product Import Quantity by Origin



Source: Trademap, 2022

Average Poultry Prices (2019-2021) and Price Forecasts (2022-2025)

Table 3.5

	Frozen Whole Bird (R/kg)	Fresh Whole Bird (R/kg)	IQF (R/kg)
2019	25.60	26.71	23.82
2020	25.47	26.17	23.95
2021	29.22	29.66	25.40
		Forecasts	
2022	31.95	32.20	28.88
2023	32.58	32.83	29.45
2024	33.74	34.00	30.50
2025	34.90	35.17	31.55

Source: Absa AgriBusiness, 2022

Looking Ahead

Higher red meat prices are likely to also support prices for chicken as strained consumers will move to affordable meat protein products going into 2023. This could, to some extent, be offset by

increased /cheaper imports for the next year. Towards the outer years in the outlook, prices are likely to be supported by improved economic conditions and rising red meat prices. Lower grain prices could, in turn, induce increased production although the ability of the industry to respond to lower input costs would largely be determined by the effect of imports on short-term margins and how this affects production and expansion over the medium term.

HIGH-VALUE EXPORT INDUSTRIES

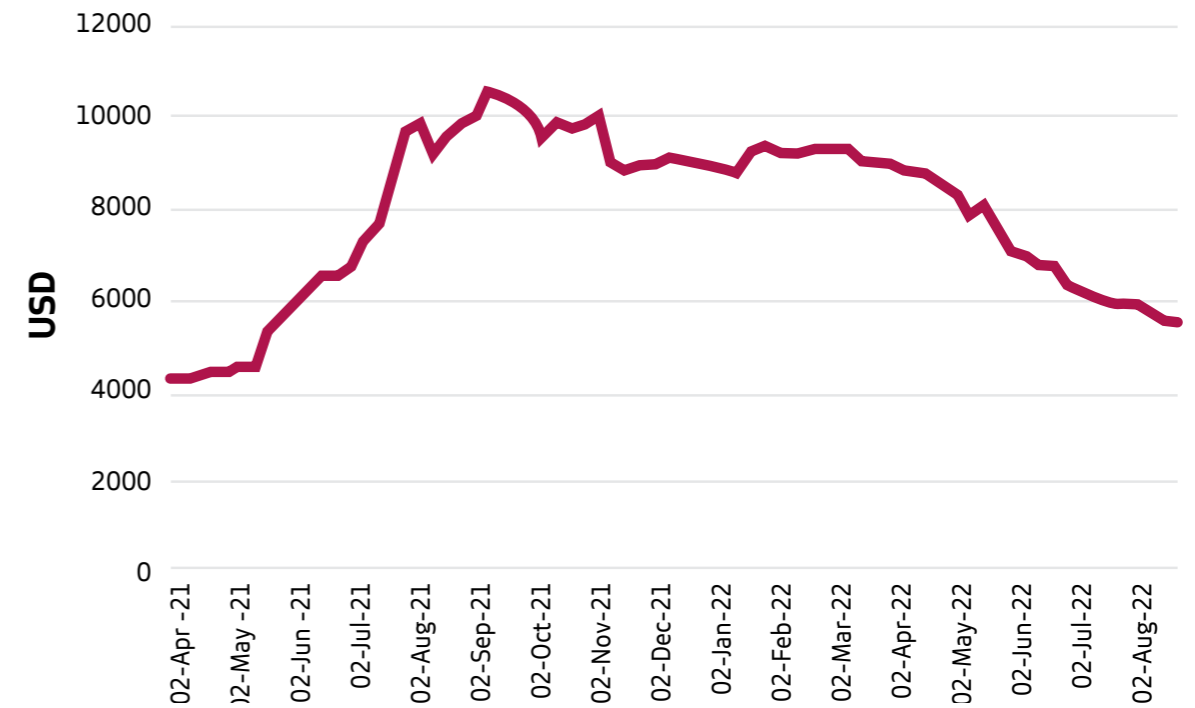


On top of multiple local pressures, ranging from climatic issues to local port efficiencies and social unrests, global shipping costs and reliability have created a challenging business environment for export-focused industries in agriculture over the past two years. During the second and third quarters of 2021, freight prices increased rapidly by more than 150% if average freight rates as those measured by the Freightos container index is considered (see Figure 4.1 below). This was on the back of high energy costs and multiple supply chain disruptions that added to unreliable shipping times (see Figure 4.2).

Since then, average shipping rates have followed a downward trajectory gaining momentum during the second quarter of 2022 as demand destruction occurred in a response to high shipping prices. Some of the supply chain issues apparent during 2021 also started to normalise. Shipping costs are however still three to five times what they were during pre-pandemic times and despite averages coming down, selected routes such as those from South Africa to Russia or from South Africa to North America remain persistently high. Our view on future shipping costs is that the downward trend apparent over the past months will continue into 2023 as additional capacity comes online and aggregate global demand eases on the back of higher interest rates. The degree to which prices can go down will, however, to a large extent, be dictated by energy, or more specifically, crude oil costs. With this projected to remain elevated over the medium term (see Section 5 for an explanation on this), we do however expect prices to continue to hold above pre-pandemic levels. The effect of lower costs could however also be more muted than in other parts of the world due to ongoing port inefficiencies and the dominance of two shipping lines for shipments from South Africa.

Figure 4.1

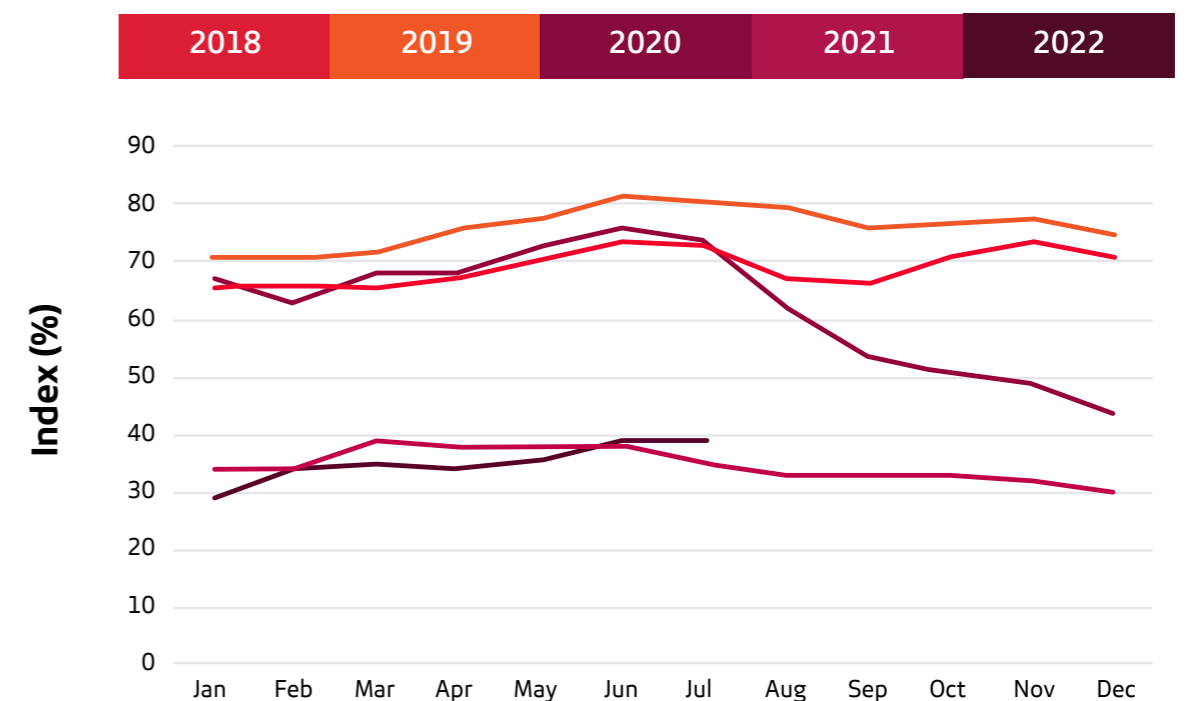
Freightos Global Container Index JAN 2019-JUL 2022



Source: Freightos 2022

Figure 4.2

Shipping Scheduling Reliability Index



Source: Sea Intelligence, 2022

Citrus Market Dynamics



Between 2017 and 2022, South African average orange export prices have traded largely sideways, except in 2019 which saw prices decreasing on the back of lower EU prices. This was a result of increased EU production during the Northern hemisphere 2018/19 season combined with a late Spanish season in which case the latter caused an overlap with imports from South Africa into the EU. In 2020, prices

Orange Market Dynamics

rebounded as a result of firm demand around the globe for products that are high in Vitamin C. This was underpinned by the rapid spread of Covid-19. In 2021, average South African orange prices came under pressure again. This was the result of two notable factors. The first is the shipping issues as explained above, which affected fruit quality and time in the market. The second was bottlenecks on roads to the Durban port and congestion at the port itself, caused by the July unrests and the hacking of the Transnet IT system. This delayed shipments. With marketing weeks lost as a result of this, increased volumes were pushed later into the season which depressed prices in those weeks. The South African marketing season also extended beyond mid-October which triggered a tariff for exports into the EU and as in 2019, South African exports again overlapped with the availability of early EU fruit.

FCM makes prospects for oranges in EU market uncertain

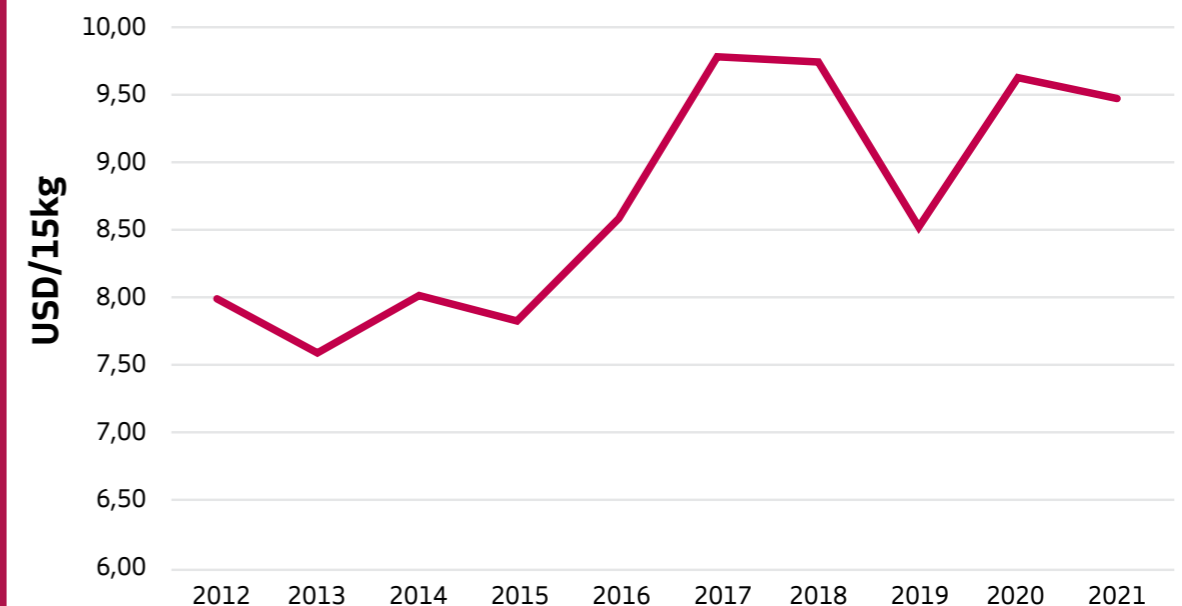
This paved the way for the European Union regulation on False Codling Moth (FCM) announced on 24 June 2022. This protocol requires Oranges to be cooled, loaded, and shipped, with a total cooling time amounting to 25 days. With current shipping times around 18 days, shipments need to be cooled before or after the shipping period for an additional 7 days to reach the total requirement

of 25 days. This contributes to costs and results in one marketing week being lost. The current protocol will come to an end in December 2022. After this, an intensified protocol will commence in 2023. This will require oranges to be loaded at a lower core temperature, shipped and stored at this temperature for 20 days. Although the shorter storing time for the 2023 protocol is beneficial in terms of a loss in time during the marketing season, the local cooling capacity would likely not be sufficient to adhere to these requirements. Although the EU has implemented the mentioned protocol only on Oranges, FCM also affects soft citrus and stone fruits. Based on this, the scientific merit of the protocol is being disputed by South Africa at the World Trade Organization (WTO). Some trade experts however note that it can take up to 2 years for issues like these to be settled.

Figure 4.3

Average free on board (FOB) export prices for oranges (2012-2021)

After strong growth between 2015 to 2018, orange prices seem to have stabilised between USD 9 and USD 10.



Source: ITC Trademap, 2022

Lemon Market Dynamics

Lemon prices showed strong upward trends up until 2016 after which the trend reversed (see Figure 4.4 below). Highly favourable returns during the early 2010's induced expansion, not limited only to South Africa, but also in Europe and South America. As the associated volumes of these expansions started to come online, prices decreased accordingly. The downward trend was further exasperated by the Covid-19 pandemic in which demand for lemons negatively affected the global hospitality sector and in 2021 logistical issues as explained under oranges also affected returns. In 2022, there were mixed signals for lemons for the various markets serviced by South African exports. In Europe, lower production in Spain and Italy, during their 2021/22 season, set the scene for good prospects for exports from the Southern hemisphere into the



European market, but rain in Limpopo during April and unrest in the Eastern Cape delayed the volumes marketed. The loss of the Russian market is, in turn, causing pressure on other markets such as the Middle East, which is also pushing average export prices down. In terms of local production dynamics, 40% of the total area is 5 years and younger. This shows that there are still significant volumes that will come online over the next 5 years. This is bound to put pressure on average export prices and returns over the coming years if additional markets are not opened.

Soft Citrus Market Dynamics

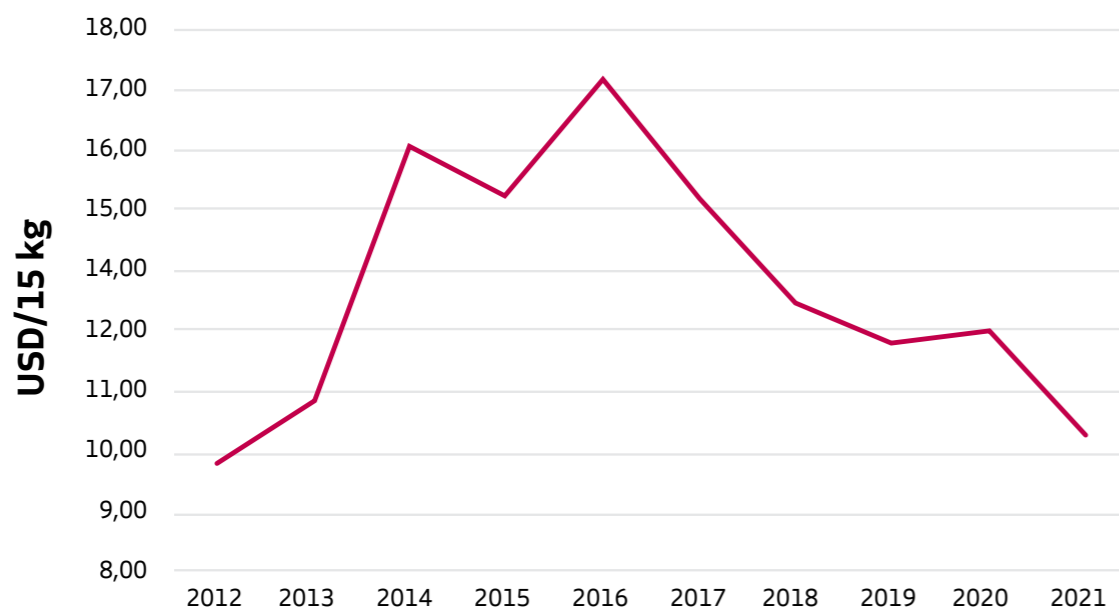


Soft citrus price trends have closely mimicked those of oranges as shown in Figure 4.3, with rapid increases between 2015 and 2018, and a drop in 2019. Some recovery was apparent in 2020 but traded sideways into 2021. Similar to other citrus categories, this was largely the result of global and local logistical issues, higher shipping costs, and increased volumes. In 2022, pressures on prices persisted with constrained access to markets such as Bangladesh, which is an important destination for class 2 fruit. In terms of local market dynamics, almost 56% of the total soft citrus area is younger than 5 years. Like lemons, increased volumes to be marketed are therefore likely to weigh on average export prices over the coming years. To sustain returns additional international markets and management of cost through the chain is imperative. The 2021 and 2022 seasons have also shown the importance of cultivar selection with selected soft citrus varieties still yielding very attractive margins.

Figure 4.4

Average free on board (FOB) export prices for lemons (2012-2021)

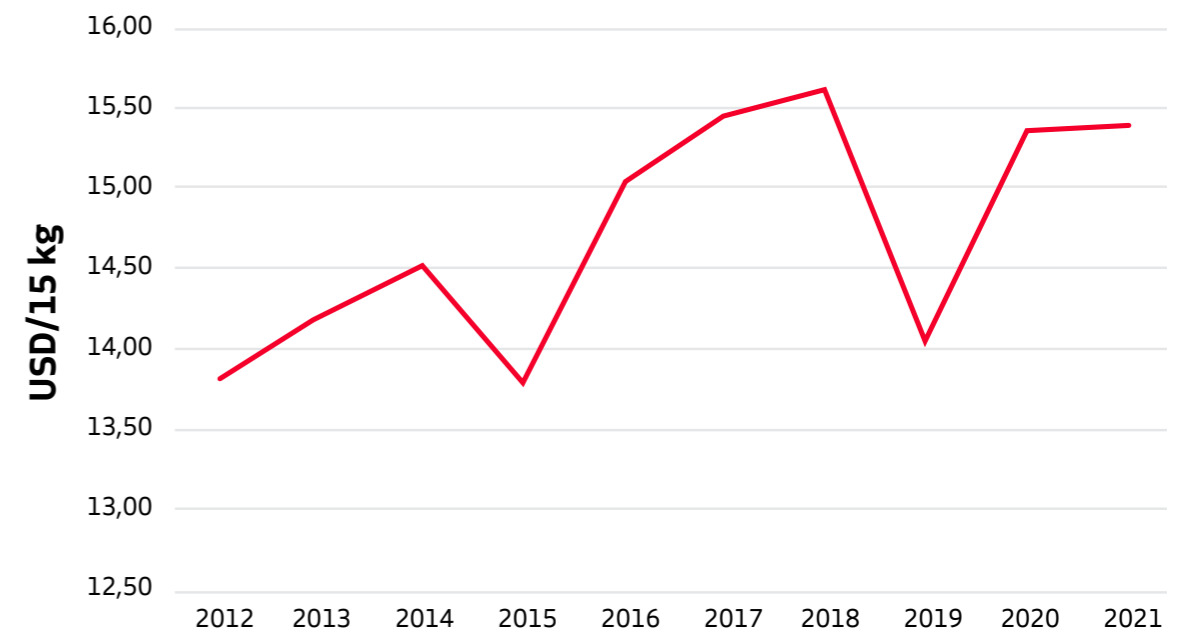
Prices in USD have been under pressure since 2016



Source: ITC Trademap, 2022

Figure 4.5

Average free on board (FOB) export prices for soft citrus (2012-2021)



Source: ITC Trademap, 2022

Grapefruit Market Dynamics



Grapefruit prices saw an increasing trend from 2015 to 2018, after which it recorded a decrease in 2019 to an average price of just above USD 8.00 per 15kg carton for 2020 and 2021 (see Figure 4.6).

Since 2019 grapefruit prices decreased

Market analysts report that grapefruit consumption is on a decreasing trend and between 2021 and 2022 global grapefruit volumes produced stabilised at 437 000 tonnes. The main destinations for South

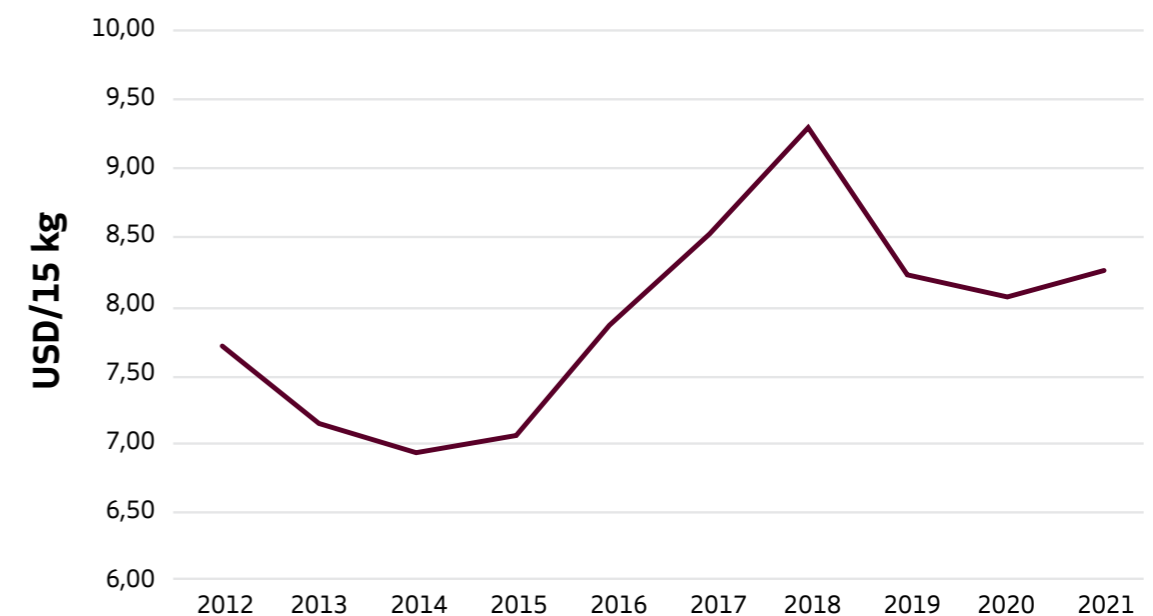
African grapefruits are China (30%) and the EU(25%) and Japan(14%). Time in the market is however crucial from a returns perspective. This year, the severe flooding in Durban and rain in the Northern provinces delayed the grapefruit marketing season, which resulted in lower prices and pressure on returns for products marketed during the 2022 season.

Flooding affected exports of grapefruits in 2022

Figure 4.6

Average Free on Board (FOB) Export Prices for Grapefruit (2012-2021)

Prices have stabilised between USD 8.00 and USD 8.50



Source: ITC Trademap, 2022

Looking Ahead

- Orange and lemon prices are expected to record higher average FOB prices for 2022 compared to 2021, whilst average soft citrus and grapefruits expected to show a decrease. In the case of soft citrus, this is however highly dependent on varieties.
- Over the next season, lower production in key EU countries such as Spain, which suffered from persistent heat waves and dry spells, would likely support prices for citrus during the early weeks of the marketing season. The prospects of shipping costs that are still comparatively high to pre-pandemic levels are also likely to see only premium products being marketed from Southern hemisphere markets. This will likely also support prices.
- In contrast to the point above, citrus demand is likely to soften somewhat in key markets such as the EU and UK due to substantial inflationary pressures in the cost of living. For grapefruits specifically, this trend is more subdued since this category has been experiencing

a trend of shrinking demand over the past years. Based on this, our projection for all groups is that prices will increase by around 2% in 2022.

- Over the medium term, ongoing profitability issues related to high shipping costs (likely to last into 2023), for South African and other Southern hemisphere producers such as Chile and Peru, are expected to bring about some consolidation in the industry. This could result in slower growth in volumes traded over the coming decade than initially expected, which could, in turn, bolster prices. For 2024 and 2025 we, therefore, expect average FOB price growth of just below 3% per annum. To achieve growth, alternative markets for South African citrus markets remain a key objective over the medium term.

Consolidation could result in future volumes being somewhat lower than initially anticipated

Table 4.1

	Oranges (USD/15kg)	Lemons (USD/15kg)	Soft Citrus (USD/15kg)	Grapefruits (USD/15kg)
2019	8.43	12.08	14.04	8.27
2020	9.50	12.31	15.34	8.10
2021	9.36	10.46	15.39	8.30
	Forecasts			
2022	9.60	11.79	13.28	8.05
2023	9.80	12.00	14.10	8.20
2024	10.10	12.35	13.95	8.40
2025	10.35	12.70	14.35	8.55

Source: Absa AgriBusiness, 2022

Average FOB Citrus Prices (2019-2021) and Price Forecasts (2022- 2025)



Table Grape Market Dynamics

Average Table grape prices have shown solid growth between 2017 and 2022, with a slight dip in prices during the 2020/21 season (see Figure 4.7). This was in December 2020, as the marketing season started, and South Africa announced its second Covid-19-related lockdown which also coincided with numerous lockdowns in key export markets. This disrupted global trade which manifested in reduced container availability and longer shipping times, ultimately affecting the arrival time in foreign markets. Quality was also affected negatively which translated to lower prices.

These challenges continued into the 2021/2022 season and were exasperated by weather and other operational challenges in the Cape Town port. As a result, although average FOB export prices continued the increasing trend apparent before the COVID-19 pandemic, these higher prices might not be reflective

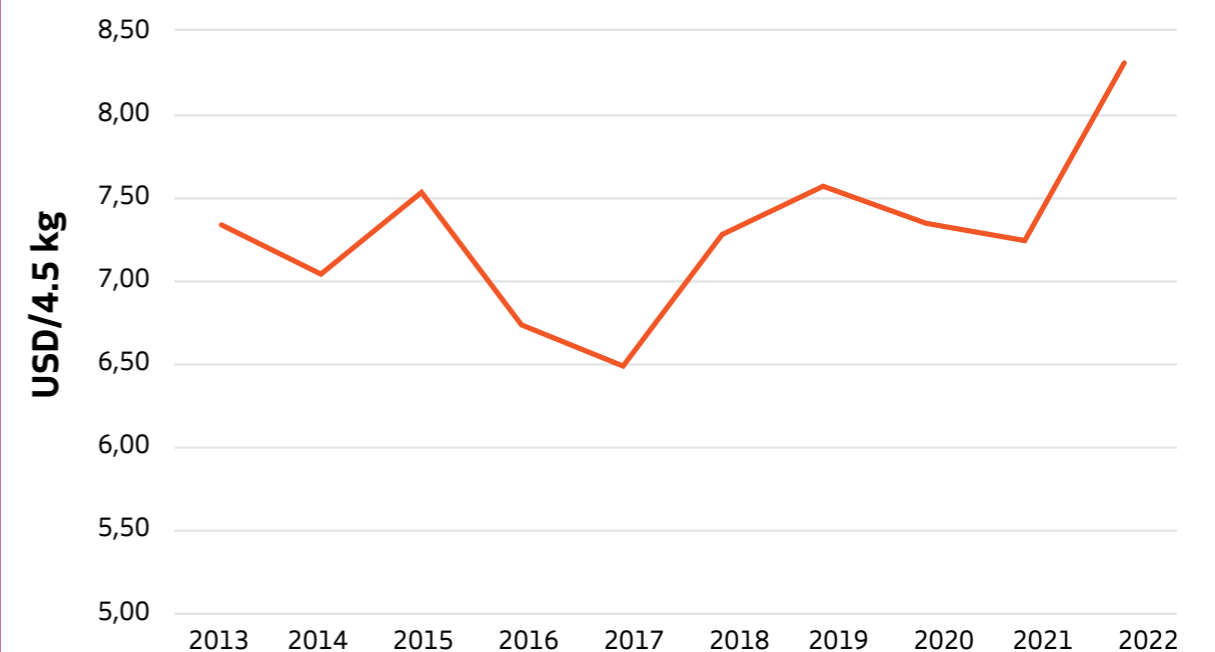
of price growth at the farm gate. Quality issues resulting from extended shipping times and other issues resulted in substantial claim rates and have affected the revenue on the farm negatively. Additional

local issues have also been added to make 2021/2022 one of the most challenging seasons that producers had to date. These issues include increased input costs and electricity issues that affected cold chain operations. Although our views here relate to average performance of table grapes, performance is very cultivar specific. Our market intelligence suggest that varieties such as Autumn Crisp, Sweet Globe and Sweet Celebration mostly outperform other varieties. In contrast to this, exporters are noting that markets for certain varieties have shrunk to the point where they will no longer consider these varieties for export. It will therefore serve all market stakeholders to consider the commercial viability of different cultivars over the coming years. Another key factor to consider is quality and how increased production could affect the ability of the product to reach export markets in a good condition in times of increased shipping costs and unreliable shipping times.

Figure 4.7

Average FOB Prices for Table Grapes Exported from South Africa (2012-2021)

Table grape prices remain favourable



Source: ITC Trademap, 2022



Looking Ahead

Cost of living pressures in export markets could limit price growth

- Higher production and export volumes from other Southern Hemisphere countries are increasing the competition in traditional export markets, which is bound to put prices under pressure.

- Inflation and the cost-of-living crisis in the Eurozone and the UK are likely to affect the purchasing power of these consumers which could negatively affect demand.
- As a result, price growth is likely to be more subdued compared to the 2017-2022 period.
- In terms of supply, although shipping disruptions and costs are reducing, higher shipping costs, compared to pre-pandemic rates, increase risks. The 2021/2022 season has shown the importance of shipping high-quality products. The increased cost and risk associated with shipping could affect volumes exported negatively (from SA and other exporters). This could provide some price support during the next season.
- Considering these factors, we expect modest price growth of around 2.5% during the coming season.
- Subdued price growth and persistently elevated input costs are likely to weigh on margins over the coming years. This is expected to cause consolidation in South Africa and other Southern Hemisphere industries which would create an upward price scope for the industries over the medium term. As a result, our forecasts for the last two seasons in the forecast period increase by 3% per annum.

Average FOB Table Grape Prices (2019-2021) and Price Forecasts (2022- 2025)

Table 4.2

	Table Grapes (USD/4.5 kg)
2018/19	7.52
2019/20	7.30
2020/21	7.21
2021/22	8.25
	Forecasts
2022/23	8.45
2023/24	8.70
2024/25	8.95

Source: Absa AgriBusiness, 2022



THE GLOBAL CLIMATE AGENDA

What it could mean for South African agriculture in the future

There is increasing evidence that agriculture is a key contributor to the environmental issues of our time. These include a loss of biodiversity, water and soil pollution, and the emission of greenhouse gasses. The latter is also the cause of what is colloquially referred to as global warming and although consumer and investor pressures are mounting to address the broader problems related to Environment, Social, and Governance (ESG) issues, the climate agenda has played center stage in this. This section, therefore, deals with climate change. More specifically, we consider how it is defined and regulated and what the risks and opportunities associated with it are for South African agricultural producers.

“Sustainability and climate need to be part of our discussions with clients”

As mentioned earlier, climate change and global warming are gaining increased importance in business and policy discussions. In response to this, skeptics often note that the earth has always been subject to periods of warming and cooling.

Climate change Tale or truth?

Scientific findings, however, indicate that the rate at which the earth is currently warming is much faster than ever before, due to large amounts of greenhouse gasses (GHG) in the atmosphere. It is therefore the rate at which temperatures are increasing that is out of the ordinary and concerning. In April 2022, the inter-governmental panel on climate change (IPCC) released its 6th assessment report which indicates that despite a slowdown in global growth and development over the past decade, annual average GHG emissions from 2010 to 2019 were higher than in any previous decade. This is leading to rapidly rising global temperatures. Some scenarios developed by climate researchers suggest average global warming of 5 °C if emissions continue unabated. This would change agricultural production systems as we know them and would make large parts of the earth uninhabitable.

The importance of **net zero** and how the rate at which we reach it will affect the climate

average global temperature can increase, on average, by 3.2 °C by 2100. The warming effect for Southern Africa is however expected to be roughly double the average for the globe and could make agricultural production as we know it infeasible.

Net zero is a state where all generated emissions (in carbon equivalents, CO₂e) can be captured by carbon sinks such as oceans and forests. The global temperature will stabilize when the world reaches net zero. According to future climate simulations done by the IPCC, if emissions can be reduced by 45% (compared to 2020 levels) by 2030 and if we can reach net zero by 2050, global warming could be limited to 1.5 °C compared to pre-industrial levels. This is what is needed to preserve a livable planet. Failing to reach net zero by 2050, and with global greenhouse gas emissions continuing to increase into the future, the

The timeline below shows how policy frameworks have evolved to address the issue of climate change globally. From this, it should be apparent that the EU is a trailblazer by pushing to become the world's first climate-neutral continent. It aims to reach net zero by adopting targets of reducing greenhouse gas emissions by 55% compared to 1990 levels in 2030 and, reaching net zero by 2050. Regulatory reforms that drive these ambitions are included in the EU Commission Fit for 55 package which aims to meet the interim target of 55% emission reduction by 2030. The Green Deal, in turn, is the policy framework under which the EU will push to reach net zero by 2050.

What are some of the **key policy measures** around the globe that are being implemented to reach net zero?

1988

UN Earth Summit the United Nations Framework Convention on Climate Change was produced as a first step in addressing the climate change problem.

The United Nations (UN) and the World Meteorological Organization (WMO) established the IPCC to review the state of knowledge on climate change.

1992

The Kyoto Protocol was adopted by various countries. Through this protocol, developed countries were legally bound to reduce emissions based on negotiated targets. The protocols first commitment period started in 2008 and ended in 2012. Its second commitment period started in 2013 and ended in 2020.

1997

At the 21st Conference of the Parties, the Paris Agreement was reached whereby countries agreed to work towards a common goal of combating climate change, its effects and to support developing countries to do so. This was also the first time where targets to limit global warming to well below 2 °C were agreed upon. Every country agreed to communicate or update their emissions reduction targets every five years to reflect their ambition and progression over time. These targets set out how far countries plan to reduce emissions across their entire economy and/or in specific sectors.

2015

At COP26 in Glasgow around 70% of the world's economy is committed to reaching net zero emissions. More than 80 countries have formally updated their targets, and all G7 countries have announced new targets that put them on the path to net zero emissions by 2050. Accounting for around half the global economy, all the countries that make up the G7 have updated their 2030 targets to put them on a pathway to net zero by 2050. This also include some of South Africa's key trading partners such as the EU with initiatives such as a Carbon border adjustment mechanism and the European Green Deal.

2021

Why should we take note of regulatory reforms on climate in the EU?

With around a third of the total value of fruit exports from South Africa, destined for the European Union, South African fruit producers and exporters would be ill-advised not to take note of policy developments in this region. As mentioned above, the EU is also the leader in driving climate mitigation and although these policies might not be directly relatable to South African agriculture, these policies could shape climate policy beyond the EU which would ultimately affect our local context.

The Green Deal and the Fit for 55 programs for agriculture

Within this context, we consider the implication of the Green Deal and the Fit for 55 programs for agriculture in the EU more broadly. Three factors included in the Green Deal has bearing on agricultural production:



A regulated emissions trading system (ETS) for the EU



Emission taxes levied in the EU



Carbon border adjustment mechanisms for imports into the EU

Assigning value to carbon

The above factors are important as they will assign a monetary value to carbon in the EU. This will allow for emitters in the EU to buy credits from carbon capturers and for regulators to tax companies or industries that emit beyond what they can trade to be carbon neutral. To extend this beyond EU borders a carbon border adjustment mechanism (CBAM) will

be implemented. This will ensure that the production of carbon-intensive products is not off-shored to other countries with lower carbon tax rates. The near-term vision for carbon border adjustment mechanisms is that it will only apply to energy-intensive industries and will initially cover six sectors namely iron and steel, aluminum, fertilizers, cement, and electricity. Experts note that these mechanisms are unlikely to extend to

agricultural products as direct agricultural emissions are mostly methane and nitrous oxide rather than carbon dioxide which are not included in the emissions trading scheme. It is however important to take note of this system as it will provide agricultural producers with financial opportunities if they are in a position to capture carbon.

Farm2Fork Strategy

The Farm2Fork strategy, as part of the EU's policy framework on sustainability, has more immediate and definite implications for South African producers, and has specific implications for trade in agricultural products to the EU. According to this framework:

- Bilateral trade agreements will include climate and sustainability goals on pesticide use, animal welfare, antimicrobial resistance, etc. These are underpinned by goals within the EU, which require the EU to reduce pesticide use by 50% by 2030, reduce nutrient losses by 50% by 2023 and decrease the use of fertilizers by 20% by 2023. The area of agricultural land under organic farming should also increase from a level of 8% in 2018 to 25% by 2030.
- Legislation will be rolled out to avoid or minimize the trade of products associated with deforestation and forest degradation
- The EU will lead the work on global sustainability standards and environmental footprint calculations. Products sold in the EU would have to be labeled accordingly.





Carbon Taxes in South Africa

The carbon tax act of 2019 came into effect on 1 June 2019 and will be implemented in three phases. The first phase, in which agriculture was not included was bound to end at the end of 2022. During the 2022 budget speech, phase 1 was however extended to 31 December 2025. The implication is also that the allowances and other exemptions on carbon taxes will apply until

Phase 2 of the Carbon tax act will commence in 2026

the end of 2025. The first phase started with a carbon tax rate of R120 per ton of carbon dioxide equivalents with industry-specific tax-free emissions allowances ranging from 60 to 95 percent. This resulted in carbon taxes ranging from R6 to R48 per ton of carbon dioxide equivalents. The tax rate has been adjusted by CPI +2% for the past two years. For 2022 this has amounted to R144 per ton of CO₂e.

Carbon trading could hold opportunities

Although the first phase of the carbon tax act may not affect

agriculture in terms of payments yet, it does hold opportunities. Producers that have carbon offsets or carbon sinks may qualify for the sale of carbon credits under the Carbon Tax Act or voluntary carbon credit sales. Here the possible advantage of selling carbon credits should be considered against the cost of compliance. To qualify for carbon credit sales under the Carbon Tax Act, off-setting projects need to be licensed and monitored through the Department of Environmental Affairs (DEA). Although the current local price of carbon (linked to the tax rate per ton) is quite low compared to international standards, prices will increase over the coming years which could make the sale of credits in relation to the cost of monitoring it more feasible. During Phase 2, which will start in 2026, the carbon tax will increase more rapidly and exemptions and allowances will fall away. At the moment, the tax is expressed in USD dollar terms. Organised business has critiqued this and noted that a tax in USD could also expedite the cost of carbon in South Africa due to a depreciating exchange rate.

Beyond 2025 the Carbon Tax Act holds risks for agriculture on two fronts. The first is through the cost of electricity. During phase 1 this tax did not impact the cost of electricity. From 2026 onwards, it will apply to electricity generation from fossil fuels such as coal, and with South Africa reliant on coal-generated electricity for much of its needs, the final cost could increase for all users and have widespread inflationary effects. The second is through direct carbon taxes to agriculture since exemptions and adjustments applicable during phase 1 will fall away during phase 2. Although the regulations around agriculture are not clear yet, development and gradual introduction of regulations for livestock and crop production are envisioned for the future.

Commercial Financing and Climate Change

Climate financing has a key role to play in funding sustainable solutions and innovations that support climate goals and commercial banks around the globe have made great strides in this. In recent years, several new methods for financing green projects have been developed, including green bonds, green banks, and village funds.

Financiers engaging in green financing have a key role to play in channeling capital or extending credit to environmental initiatives. Ways to achieve this could include offering better credit conditions for clean energy projects, the creation of innovative financial products that reward agricultural producers with good environmental practices, and market expansion through the dissemination of information about the benefits of clean energy. A strong drive to reach climate goals is therefore also emerging in the South African financial industry and Absa is committed to supporting this. In this regard, Absa is a signatory to the United Nations Environmental Program and Finance Principles for Responsible Banking. Absa Business Banking also has a dedicated unit and associated specialists that advise clients in primary

Green financing provides opportunities for the future

agriculture and the rest of the value chain on investments in renewable energy sources. At Absa, we realize that climate issues are something we can no longer ignore and that they need to be part of our conversations.

Why measure your emissions?

Understanding your carbon footprint is one of the important first steps in setting a broader Environmental, Social, and Governance (ESG) strategy and managing your broader risk profile. To enable you to play your part in climate mitigation objectives you first need to understand and measure your footprint.

As mentioned above, global trends show that financial and insurance products are being developed that will benefit producers that are producing in an environmentally friendly way. By gauging your carbon footprint, it provides a baseline from which you can work to reduce carbon emissions and receive cost benefits from service providers that can reward you for responsible and sustainable production.

Products with an export focus are likely to be required to report on their carbon footprint in company reports and on food labeling.

A summary of the opportunities and threats related to the climate agenda

Table 5.1

Opportunities	Threats
<ul style="list-style-type: none"> Carbon credit sales Retain/extend global market access Contribute to broader mitigation strategies and national climate goals Access favourable financing/ insurance opportunities for climate adaptation 	<ul style="list-style-type: none"> The increased cost of compliance Lose competitive advantage due to increased costs Market access issues – Additional tariffs/ nontariff barriers to exporting markets with higher carbon costs





THE FALL AND RISE OF THE OIL PRICE

A Covid-Induced Rollercoaster

“Oil prices expected to ease, but expect a bumpy ride on the way down”

Key oil price drivers over the past 24 months

Since 2020, we have seen dramatic swings in the oil price. The onset of the global Covid-19 pandemic and the ensuing lockdowns meant that oil demand dropped significantly. In addition, in a ploy to gain market share from the US and ultimately from each other, Russia and Saudi Arabia both increased oil production. The result was a sharp price decline to below \$20 per barrel (/bbl) in the second quarter of 2020. Both oil giants assumed the Covid restrictions and the accompanying decline in oil demand would be short-lived and lifted output, expecting that the other side would back down and bring some balance to the market. However, neither Russia nor Saudi Arabia wanted to cede market share and risk losing revenue once conditions returned to 'normal'. The oil price subsequently plunged. In the end, the Covid restrictions lasted well into 2021, with some countries, most notably China, continuing to impose curbs.

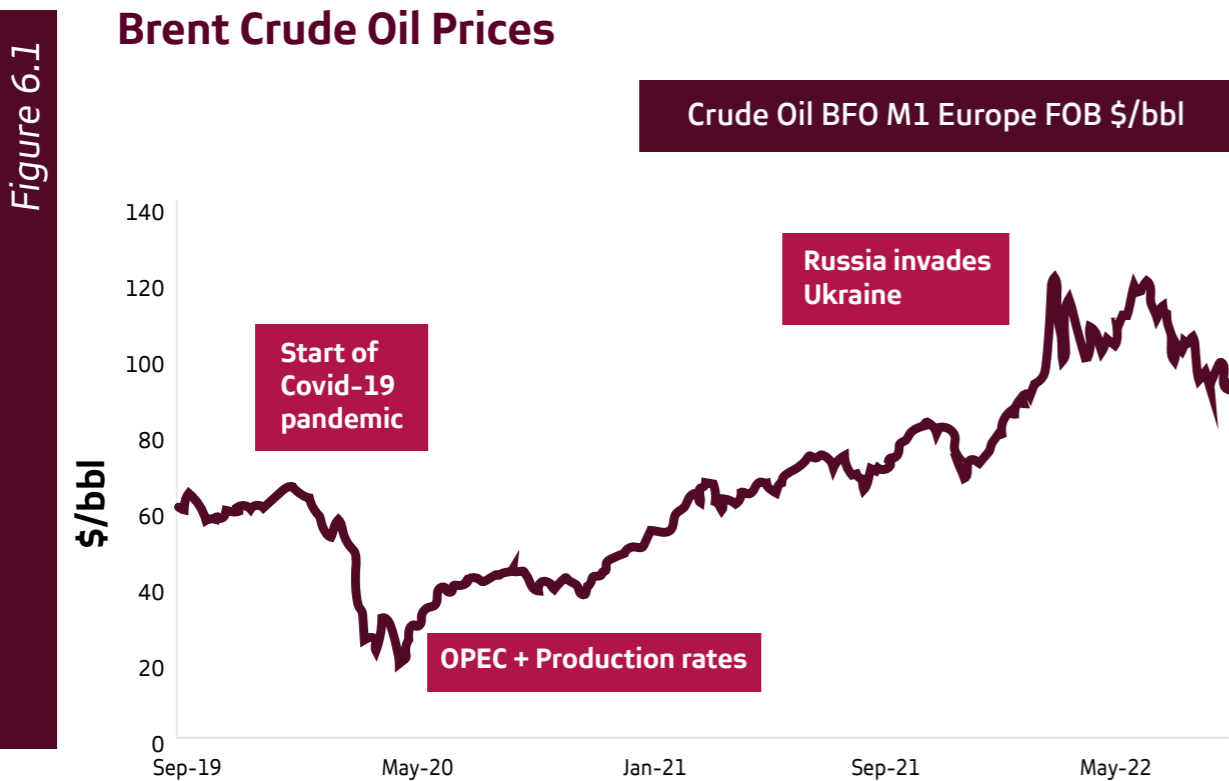
In the aftermath of the short-lived 'oil war' between Saudi Arabia and Russia, the Organization of Petroleum Exporting Countries and their allies, known as OPEC+, agreed to a coordinated reduction in oil production. Each member was given a production quota to stick to. Meetings are held regularly to determine whether they are still appropriate. As authorities gradually rolled back the hard lockdown restrictions of 2020Q2, economic

Oil producers slow to expand production after pandemic

activity resumed, and oil demand began to pick up. However, OPEC+ was hesitant to ease production cuts and increase output quotas. This resulted in a significant rebound in the oil price in the second half of 2020/2021 since the rate at which OPEC+ gradually increased production failed to keep up with rebounding demand. The demand recovery was fuelled by unheard-of fiscal and monetary policy support measures in advanced countries. Producers outside of OPEC+ have also been slow to increase production, whether by choice or inability. During the peak of the pandemic, many oil companies put less money into maintenance and investment. This has limited their ability to ramp up production and led to a tight oil market.

This chapter was written in collaboration with Ms. Tracey-Lee Solomon from the Bureau for Economic Research at the University of Stellenbosch.

Moreover, an undersupplied oil market was plunged into a further deficit when major oil producer and OPEC+ member, Russia, invaded Ukraine in February 2022. Subsequently, the oil price rose as high as \$124/bbl, a level not seen since 2012 (Figure 6.1). Prices have since cooled but remain extremely volatile as inventors grapple with upside and downside risks to the outlook.



Source: BER, 2022

Looking Ahead

On the upside, higher demand in an already stretched market amid substitution to Brent crude would lift prices. There are two main reasons for the substitution of oil, both linked to the ongoing war in Ukraine. First, sanctions on Russian oil and oil products will result in European countries seeking out alternatives. Though

some of this has already started taking place, sanctions will only fully come into effect at the end of 2022. From early December, the European (EU) will stop buying all Russian crude oil delivered by sea. This amounts to roughly two-thirds of all EU oil imports from Russia. In February 2023, the EU will further ban the purchase of all Russian refined oil products. Deliveries via pipeline have not been banned. However, Poland and Germany have stated their intention to stop importing via pipeline by the end of 2022. Germany is the biggest importer of Russian oil and their participation in the sanctions will result in the banning of 90% of total EU oil imports from Russia.

This oil will need to be replaced and the substitution towards other sources of oil puts upward pressure on their prices.

Unfortunately, Europe is not only facing an oil shortage but a broader energy crisis. The price of natural gas, used for electricity generation and heating, has skyrocketed. In August, gas prices rose to four times the level at the start of the year.

2022 will be marked as the year of energy shortages

Figure 6.2 shows the level of gas and oil prices relative to their levels at the beginning of 2022. Gas prices have increased faster than oil prices. In

Oil as a substitute for expensive gas

September, oil prices were around 1.2 times higher than the price at the start

of the year. Meanwhile, gas prices were still over 2 times higher than at the beginning of 2022. Here too, Russia is the EU's main gas supplier. Before Russia invaded Ukraine, tensions around Russia's Nord Stream 2 pipeline resulted in Russia limiting gas supplies through Nord Stream 1. This meant that gas stocks in the EU were low going into the war. Gas supply has only gotten more erratic since then. Claiming everything from maintenance to minor gas leaks, Russia has intermittently stopped gas flows to Europe. And pauses in gas supplies have become longer as the EU's measures to curtail Vladimir Putin's unprovoked war in Ukraine have intensified. As is the case with oil, limited supplies of gas have pushed up European gas prices. Oil has now become a cheaper alternative and countries that can are switching to increased oil usage. If gas supplies remain tight, switching will continue, bolstering the demand and price of oil.

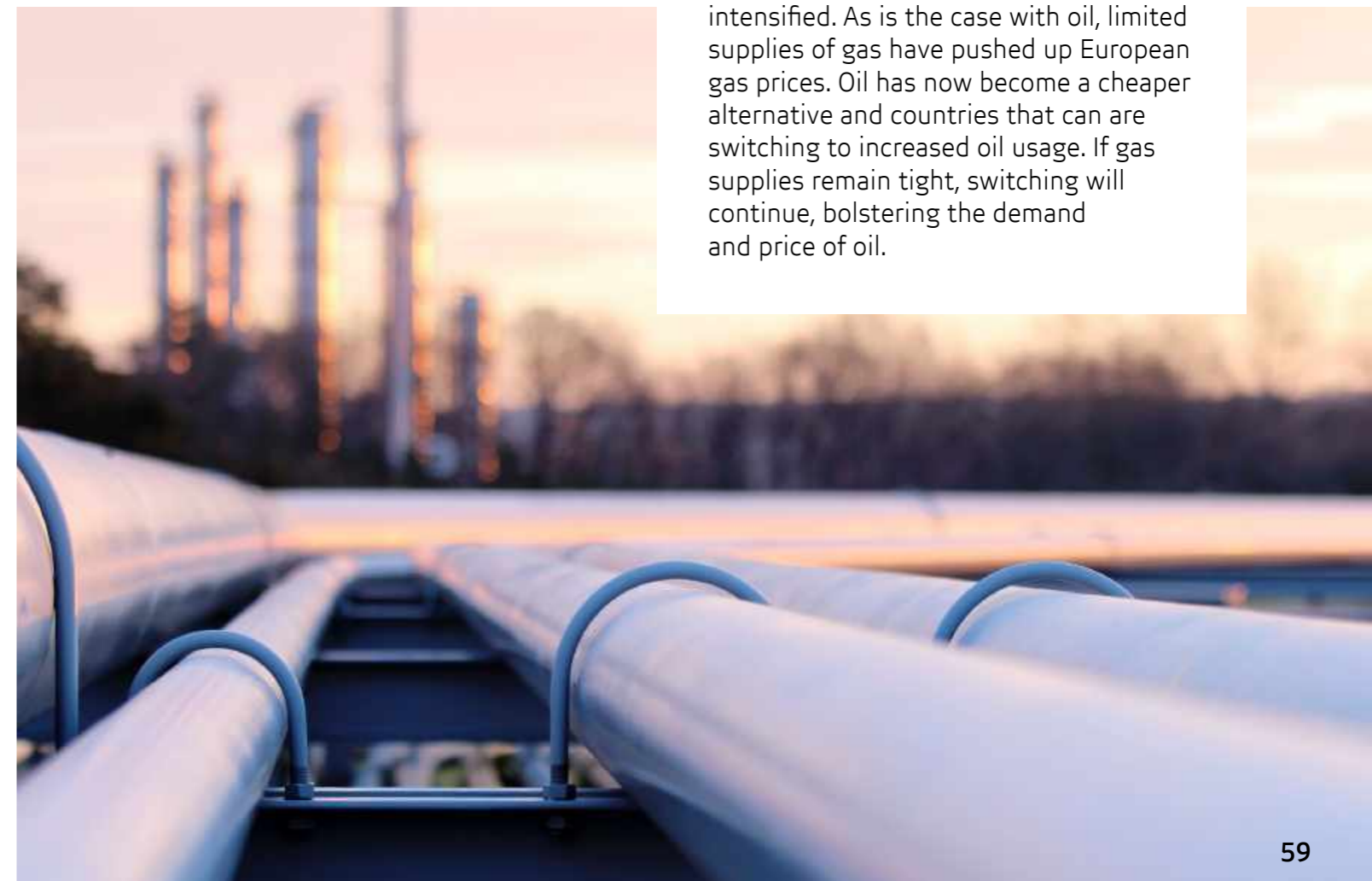
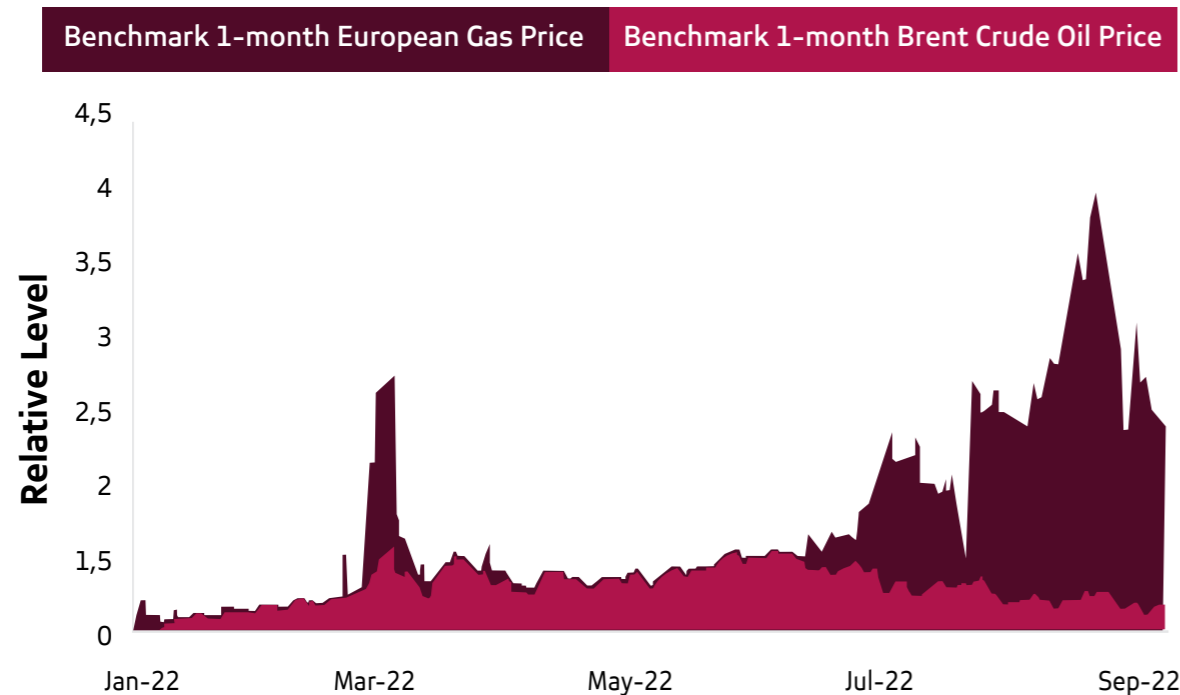


Figure 6.2

Gas vs Oil prices – Gas prices have increased considerably



Source: BER, 2022

Another potential upside risk for oil prices is the OPEC+ production policy. As mentioned, OPEC+ has slowly rolled back its supply cuts and incrementally increased production each month. However, more recently, OPEC+ decided to reduce production for the first time since 2021. At a production policy meeting in September, members agreed to cut total production by 100 000 barrels per day (b/d) in October. OPEC+ noted that concerns around global demand required offsetting action. Although the decline in production is not dramatic, it does leave the door open to more supply cuts should the cartel see fit.

Conversely, some factors could apply downward pressure to the oil price, and we've already seen some of these come through. On the demand side, after the

Oil prices are a key determinant of agricultural input prices, ranging from fertiliser and chemicals to plastics and other packaging.

initial strong global growth rebound in 2021, the outlook for the global economy has deteriorated.

Slower global economic growth over the next 12 months or so will likely reduce oil usage. Record high inflation and the rise in the cost of living have depressed consumer confidence, limiting their ability and willingness to spend. In some of the poorest countries, it has also resulted in concerns around food security. Many countries are also taking a more aggressive approach to monetary policy normalisation. Interest rates are rising faster than previously expected. Major central

banks are increasing policy interest rates by as much as 75 bps at a time (Table 1). Some economies are expected to take more strain than others. Forecasters have become increasingly downbeat on European and UK growth projections as the war in Ukraine drags on.

75 is the new 25 – Policy interest rate hikes in selected countries

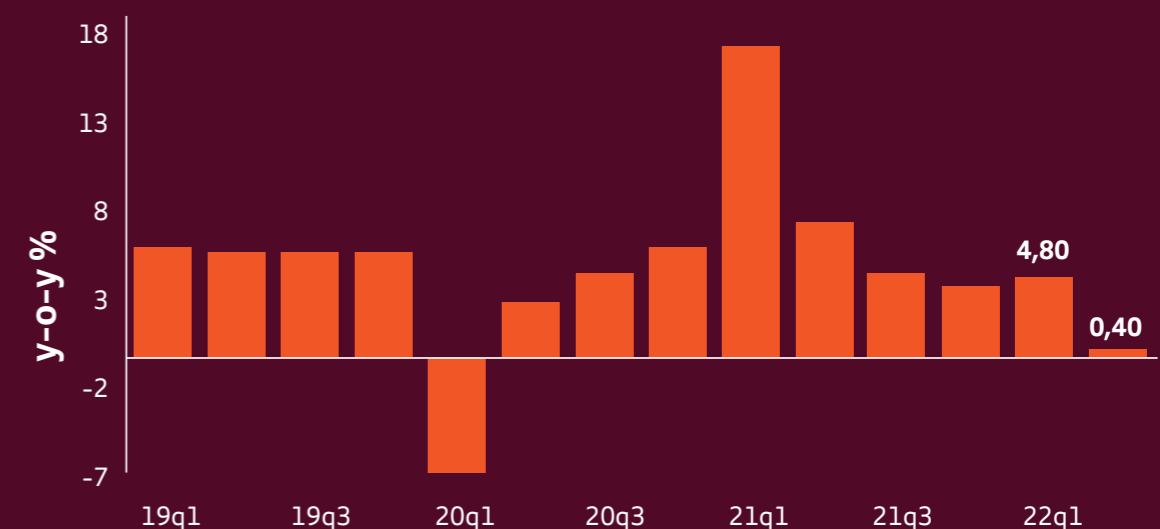
Table 6.1

	Jun	Jul	Aug	Sep
US	75 bps	75 bps	-	75 bps
EZ	-	50 bps	-	75 bps
UK	25 bps	-	50 bps	-

In addition, China's devotion to its zero-Covid policy has dragged on their economy (Figure 6.3). Easing Chinese restrictions were expected to support the global economy, but we've seen that they can be reimplemented at any moment. This places downside risks on a widely expected Chinese growth recovery that will support global growth and the demand for oil.

Figure 6.3

China's real GDP growth – Real GDP growth in China below expectations at the start of 2022



Source: BER, 2022



There are also additional sources of supply that could enter the market. So far, US production has stayed well below pre-Covid levels as oil companies choose to return bumper profits to investors. The drive towards renewable energy resulted in many fossil fuel companies reducing expenditure on the drilling of new wells which limited their ability and willingness to increase oil output. However, according to their latest Short-Term Energy Outlook report, the US Energy Information Administration (EIA) expects US production to ramp up for the rest of 2022 and into 2023. US crude oil production is predicted to average 11.8 million b/d in 2022 and 12.6 million b/d in 2023, which would set a record for the highest US crude oil production during a year. The current record is 12.3 million b/d, set in 2019. This would significantly aid the market. Iran is another country that has the potential to help ease the oil supply deficit. The US has sanctioned exports of Iranian oil since 2018 after failing to reach a nuclear weapons agreement. Should the nuclear deal be revised, as has been discussed recently, 1-2 million b/d of oil could return to the market in a relatively short amount of time. Other producers such as Canada, Norway, Brazil and Guyana could also bring more oil onto the market. However, none of them are considered producing powerhouses. Further releases of strategic reserves from members of the International Energy Agency (IEA) could also help ease tight supply. Finally, the Group of Seven (G7) recently announced that they will be placing a

Renewables affect investment in oil

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price cap on Russian oil and oil products by capping the price for which shipping companies can carry oil and insurance companies can cover oil. The cap is expected to come into effect on the 5th of December 2022, with the exact price still to be determined. The aim is to limit the revenue Russia receives from its oil without taking Russian oil off the market and risking a spike in oil prices. However, Russia has shown that it will not hesitate to retaliate, and gas is its major weapon.

Due to the above factors and less dependence on fossil fuels in the future, we are forecasting a gradual decline in the oil price over the coming years.

Brent crude oil forecasts (forecast from 2022 onwards)

Table 6.2

	Brent Crude (\$/bbl)
2021	70.9
2022	100.2
2023	92.3
2024	84.0
2025	76.0

The application of the zero-Covid stance in China in 2023 will be key in giving global energy price trends direction

In all, several countervailing factors could affect the oil price going forward (Table 6.2). In the near term, weak global growth seems to be weighing more heavily on prices. However, looking into next year we could see some upward pressure coming from the full sanctions on Russian oil by the EU, as well as faster Chinese real GDP growth if the authorities finally decide to abandon the ill-fated zero-Covid policy. Alternatively, additional sources of production could help ease supply concerns provided OPEC+ does not act aggressively to counter this.

Upside and downside risks to future oil price movements

Table 6.3

Upside Risk	Downside Risk
Substitution from gas to crude oil OPEC+ production cuts	Slower global economic growth Additional sources of supply



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