Policy Options to Reduce Basis Levels

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OUTLINE

- What does the price basis tell us?
- The need to increase West Coast Capacity
- Policy Options to increase Capacity
- Conclusions

WHAT DOES THE PRICE BASIS TELL US?

- Current cash prices are depressed relative to export values
- The farmers deciding to sell at the current cash prices are anticipating that they will have to store their grain for many months before basis levels return to normal
- There is a much longer wait for West Coast access
- It is all very costly!

PORTLAND – SASK. CWRS WHEAT BASIS

Sask Average 13.5% CWRS Wheat Basis – Portland 13.5% DNS March 24, 2014

Date	Portland	Avg Sask Bid	Basis to Portland	Excess Basis Portland
$/t	$411.67	$203.60	$208.07	+$135.56
$/bu	$11.19	$5.54	$5.66	$3.69

Sask Average 13.5% CWRS Wheat Basis - Minneapolis March 24, 2014

	Minn Futures	Avg Sask Bid	Basis to Minn	Excess basis Minn.
$/t	$324.22	$203.60	$120.61	+$75.55
$/bu.	$8.82	$5.54	$3.28	$2.05

CANOLA BASIS INCLUDING CRUSH MARGINS

	ICE Crush Margin	ICE. Sask. Average Basis	Total Basis
March 12, 2014	$228.23	$49.46	$277.69
March 24, 2014	$217.00	$49.46	$266.46
10 year Ave	$72.12	$42.61	$114.00
Difference			
March 12, 2014	$156.11	$6.85	+$163.69
March 24, 2014	$144.88	$6.85	+$152.46

SUPPLY DISPOSITION ALL PRINCIPAL FIELD CROPS CANADA (AAFC JAN 24TH, 2014)

	2012/13	2013/14	2014/15
Yield (t/ha)	2.7	3.4	2.8
Production (Mt)	76.7	96.5	82.3
Total Supply (Mt)	89.6	107.2	106.3
Exports (Mt)	41.7	44.1	44.6
Total Domestic Use (Mt)	38.4	40.0	41.0
Carry-out Stocks (Mt)	9.5	23.0	20.7

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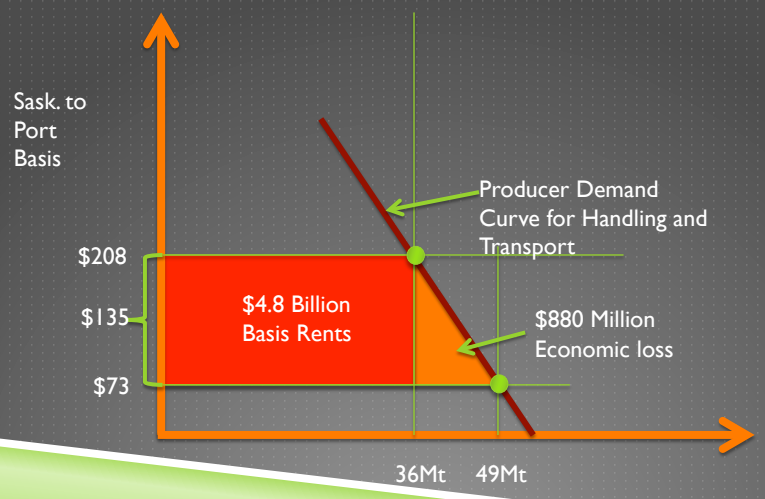
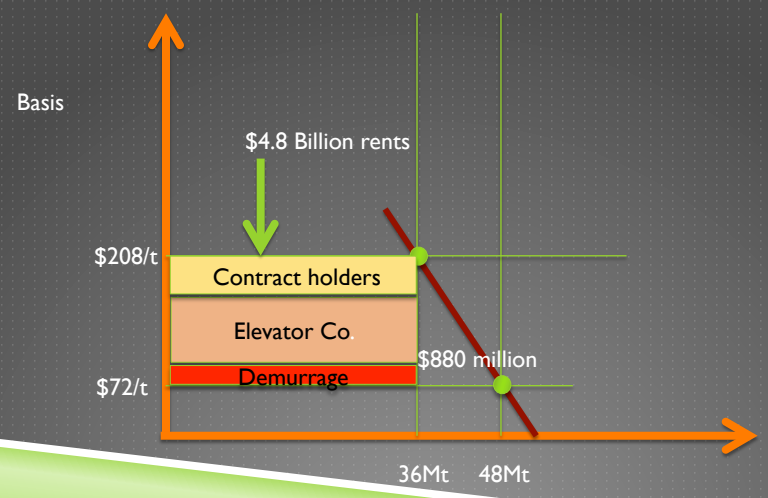
INCOME LOSSES FROM LIMITED SUPPLY OF HANDLING AND TRANSPORTATION IN 2013/14



THE DEMAND FOR HANDLING AND TRANSPORTATION (MARCH 24TH LEVELS)



WEST COAST HANDLING CAPACITY

- If rail movement increases the West Coast terminal capacity becomes the bottleneck
- The West Coast is by far the cheapest route to Pacific markets for all areas in the Western Canada
- From Brandon west it is also the cheapest route to Europe and North Africa
- The historic West Coast movement has not exceeded 22 Million tonnes

THE NEED TO INCREASE WEST COAST CAPACITY

- The Current Basis
- Pacific versus Atlantic market
  - Growth in Black Sea Exports
  - Growth in Brazil and Argentine Production
  - Leap in Asian Demand – Especially soybeans
- Production growth in Western Canada – the new normal if prices are high enough

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THE NEED TO INCREASE WEST COAST CAPACITY TO MOVE THE CROP

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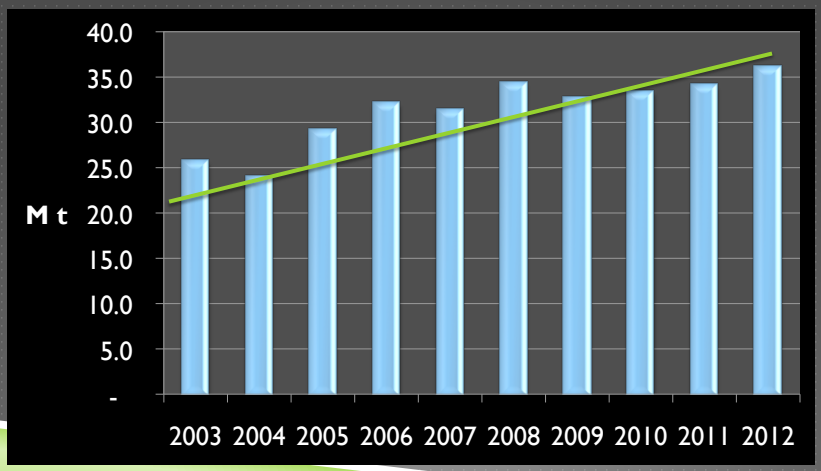
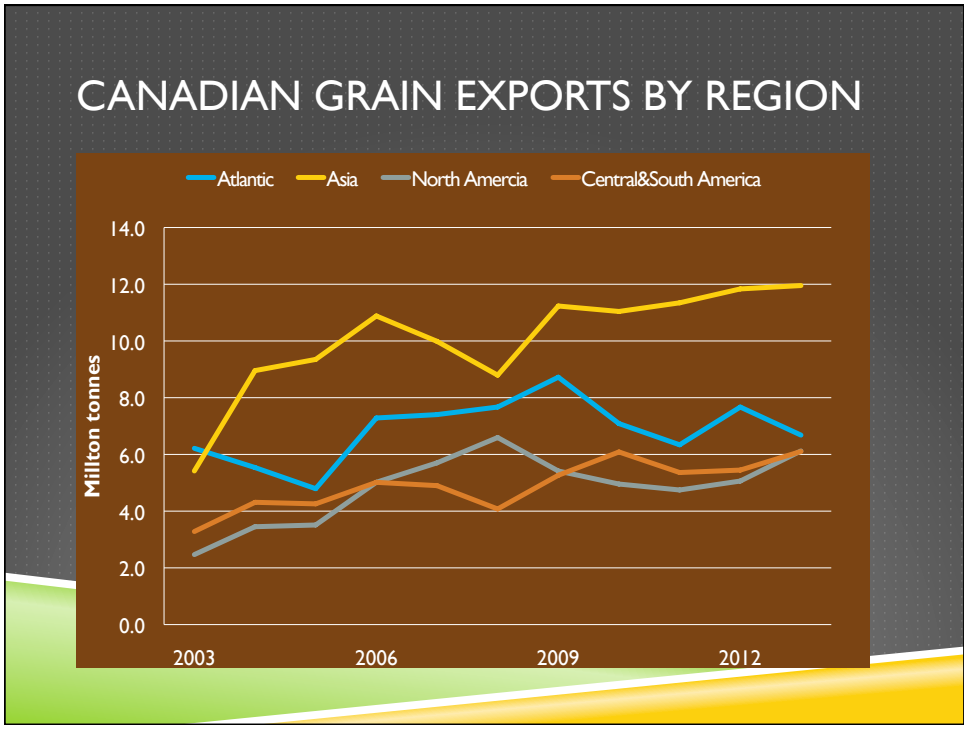
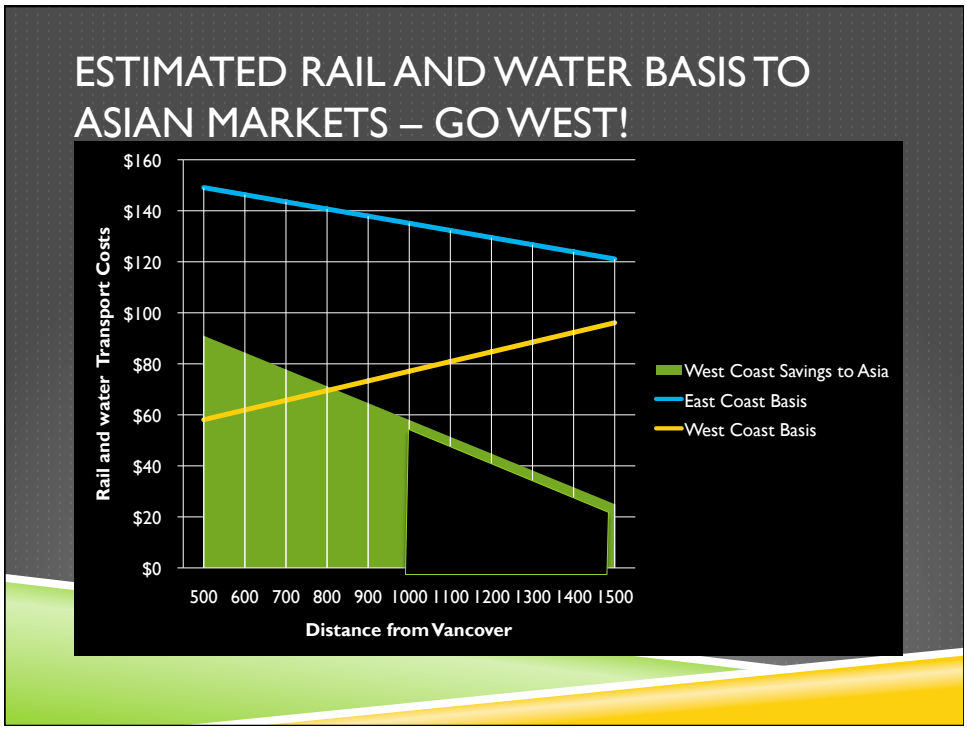
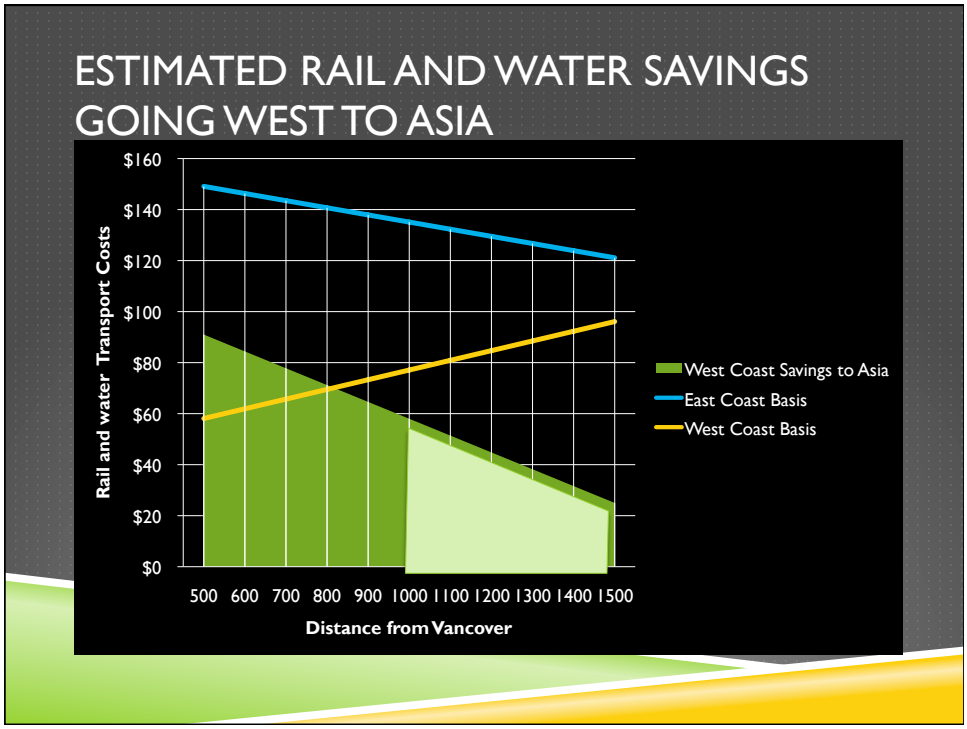
- Production growth in Western Canada– the new normal

CANADIAN GRAIN EXPORTS-LICENSED FACILITIES 2003/04 - 2012/13 (CGC)




CANADIAN GRAIN EXPORTS BY REGION
Atlantic
Asia
North Amercia
Central&South America
Millton tonnes
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
2003
2006
2009
2012


ESTIMATED RAIL AND WATER BASIS TO ASIAN MARKETS – GO WEST!
Rail and water Transport Costs
$160
$140
$120
$100
$80
$60
$40
$20
$0
500 600 700 800 900 1000 1100 1200 1300 1400 1500
Distance from Vancover
West Coast Savings to Asia
East Coast Basis
West Coast Basis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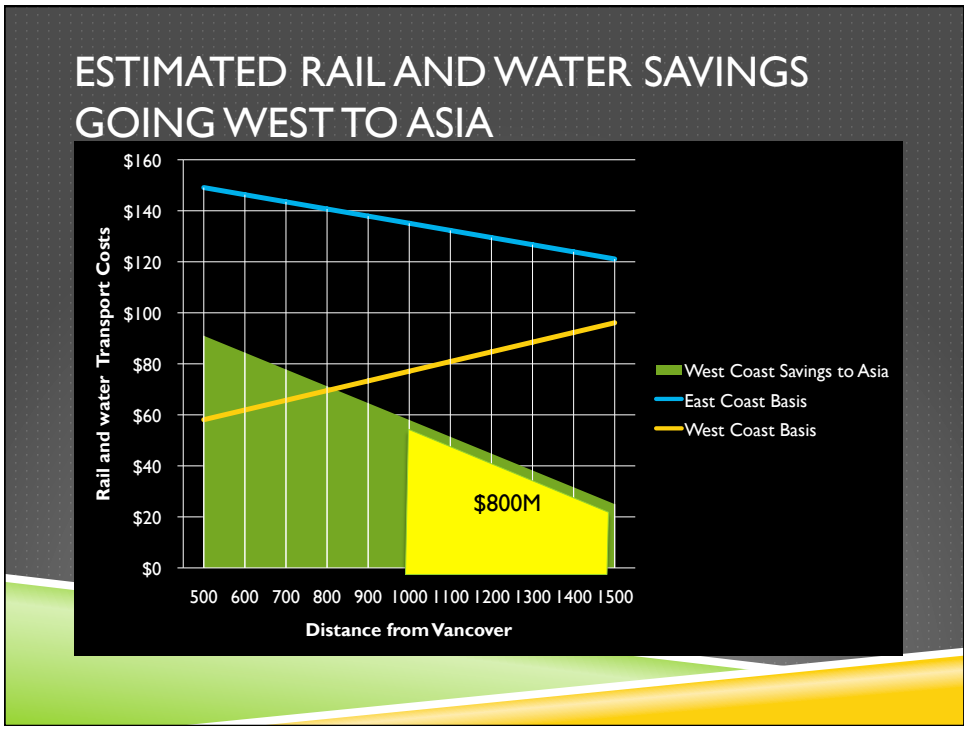
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Distance from Vancover
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West Coast Basis

MONETARY BENEFIT OF INCREASED WEST COAST CAPACITY

- This needs more study but simple calculations suggest:
  - $800M per year in transport savings
  - $3 Billion/yr in increased producer income from lower basis
  - Increased economic growth for Western Canada
  - These are large potential benefits worth exploring
    - - basis really matters!

POLICY OPTIONS TO INCREASE CAPACITY

1. Improving the Revenue CAP and rail regulation
2. Increasing physical capacity at key points in the system
3. Better information, planning, and logistics
4. Increased competition

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THE "REVENUE CAP"

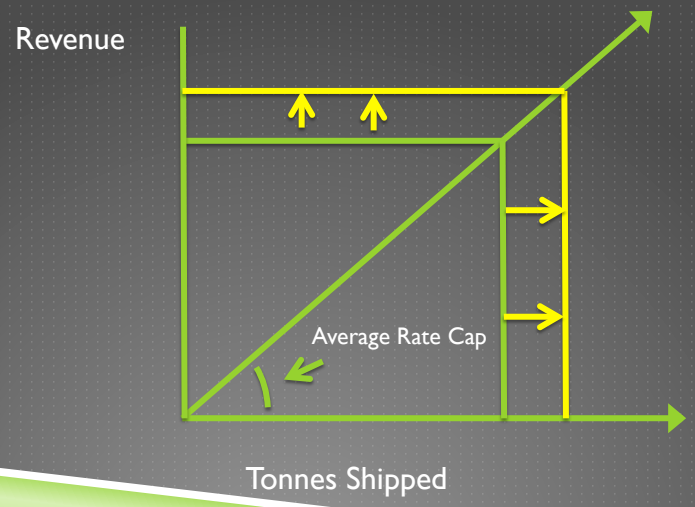
- export shipments from western Canada
- is a Regulated *Average Freight Rate* multiplied by Tonnage and distance

2013/2014 Revenue Caps

- CN = $6.33/t + 2.8 cents per tonne · mile
- CP = $8.10/t + 2.8 cents per tonne · mile

- Fully inflation indexed – with rail productivity increases it is good money

REVENUE IS PROPORTIONAL TO VOLUME



SEASONAL INCENTIVES TO MOVE GRAIN

- Average rate Cap does not change when shipment is made in August versus the following June
- Railways get paid when they ship – earlier is better for shareholders but Railways also want to fully utilize their capacity- this is efficient and reduces cost
- There is no reflection in the revenue cap of higher costs during winter months
- All parts of the supply chain need incentives to keep the pipeline full - some role for pricing

WINTER PREMIUM IN THE REVENUE CAP

Month	Winter Premium @ 10%	Average CN @ $35.5/t
August	0	35.5
September	0	35.5
October	0	35.5
November	0	35.5
December	0.1	39.1
January	0.1	39.1
February	0.1	39.1
March	0	35.5
April	0	35.5
May	0	35.5
June	0	35.5
July	0	35.5
Average E		

SEASONAL INCENTIVES TO MOVE GRAIN

- This is just a concept at this point
  - Seasonal incentives versus quantity regulation
- The specific formulas for require further study

2. INCREASING PHYSICAL CAPACITY AT KEY POINTS IN THE SYSTEM

- Existing terminals
- New terminals
- Container system
- Rail enhancement
- Public planning and incentives will help

3. BETTER INFORMATION, PLANNING, AND LOGISTICS

- Better price reporting
- West coast grain exchange could also improve logistics by facilitating cargo swaps for all terminals
- Third party rail car and/or Port allocation authority should be explored
- Better Production Forecasting

BETTER PUBLIC PRODUCTION FORECASTING

- 2012 and 2013 public crop estimates were pathetic
  - Taking farmers' opinions
  - Windshield surveys
  - Perhaps political worries over market impacts
  - Post harvest estimates are too late for planning logistics and marketing
- The cost of poor forecasts are very large

BETTER PRODUCTION FORECASTING

- We need to spend resources on better public forecasts
  - Multiple public pre-harvest crop estimates
  - Bi- weekly 2- day crop surveys by 30- 40 professional agrologists across the Prairies
  - Results to be released publically – Stats Canada?

4. INCREASED COMPETITION FROM END TO END OF THE SUPPLY CHAIN

- Port Terminals
  - New facilities/players
  - Forced sale of Prince Rupert
- Rail
  - liberal inter-switching provisions
  - Improved short line access
- Elevation/Rail cars
  - Capacity refinements
  - Maintain and enhance producer cars

CONCLUSIONS

- The grain handling and transportation will be a challenging issue for decades to come
  - Limited West Coast capacity
  - Increased production and grain traffic
  - Growth in Asian Demand
  - Other commodities including potash, oil and container traffic will have to compete for finite capacity
- Without **long range planning and action** basis levels will remain high stifling farm income and economic growth

INFLATION FACTOR

- This is calculated each year by the CTA based on input prices
- labour, fuel, material, leased cars, depreciation and cost of capital, each having its own price index
- In 2007-08 there was a reduction of 8% due to hopper car maintenance
- In 2012-13 new capital cost calculation and pension adjustment

Year	Inflation Factor
2007-08	1.06
2008-09	1.14
2009-10	1.06
2010-11	1.13
2011-12	1.17
2012-13	1.29
2013-14	1.27