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Market Update

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Report Highlights:

MY07/08 will be the first year for the Bulgarian grain industry to operate on the common market. This challenge is complicated by lower than expected wheat and barley crop due to severe spring drought. However, local grain supply will meet the consumption needs and may leave some quantities for exports. The GOB plans to pay full or partial drought compensations to about 4,000 farmers. Grain prices skyrocketed and trade is likely to be slow due to high price expectations of most suppliers. Weather forecast for a hot and dry summer may make post-harvest trade at the Danube ports more difficult and expensive.

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Production

Fall crops

Severe drought conditions affected grain and oilseeds crops from end-March until mid May this year. At the end of March, despite unusually mild, warm and dry winter and early spring, fall crops were developing well and experts forecasted a very good crop. April and May, however, which are traditionally critical for the development of wheat and barley reproduction parts, were extremely dry, hot and windy. Reportedly, dryness in this period was comparable to the record dry year of 1974. Rains which began in mid-May were late and could not reverse or compensate the losses caused by the drought to fall crops. Moreover, floods and hail storms at spotted locations caused additional losses and lodging.

Pressured by farmers' protests, in mid-May, the MinAg established an independent evaluation team of local researchers who made grain field observations and a comprehensive crop evaluation report as of early June. This report (www.mzgar.government.bg) had several key findings:

- 13,000 HA (1.2% of total planted areas- 1.045 MHA) of wheat and 4,000 HA (2.3% of total planted areas – 173,000 HA) of barley will not be harvested due to severe damage;
- wheat: 23% of area is in good to very good condition (including 14% in excellent condition); 44% is in satisfactory condition; and 33% is evaluated as in bad condition (345,000 HA). The report authors estimate potential yield from the area in bad condition at about/below 1.0 MT/HA or total 330,000 MT.
- barley: 22% of area is in good to very good condition (incl. 17% in excellent condition); 41% is in satisfactory condition; 35% of area is in bad condition (66,000 HA). The report estimates potential yield from the area in bad condition at about/below 1.0 MT/HA or total 61,000 MT.
- overall, barley development is slightly better compared to wheat, a difference of 3%-4%, and in some areas barley can produce higher yields than wheat;
- 94% of wheat and 92% of barley are fertilized with nitrogenous fertilizers; 84% of wheat and 80% of barley was treated with herbicides;
- pest infestation was rather high (affecting wheat, barley and sunflower) – especially leave lice (*Brachycandus helichrys*);
- Main area where wheat and barley are in good condition: Stara Zagora, Sliven;
- Main area where wheat and barley are in mediocre/satisfactory condition: Varna, Dobrich, Vidin, Montana, Plevan, Plovdiv, Razgrad, Rousse, Yambol
- Main area where wheat and barley are in bad condition: Bourgas, Vratza, Silistra, Turgovishte, Shoumen. Overall, Northern Bulgaria which is the main grain production region was the most seriously affected as the hardest hit were areas along the Danube river. Rainfall in this region in April and May were below 10% of the norm.

Drought related crop estimates produced in May/June varied considerably. Some farmer groups estimated wheat (and barley and oats) crop at almost 3 times lower than in 2006 (yields from 1.0 MT/HA to 1.2-1.5 MT/HA) at a total of 1.5 MMT. Others estimated wheat crop at only 15%-20% less than in 2006. Most multinational grain traders believe that about 10% of both wheat and barley will not be harvested, about 10% is in excellent condition, and the rest 70%-80% will produce yields 30%-50% below average. Their estimates are from 2.2 MMT to 2.9 MMT, mainly around 2.5 MMT. Government and industry associations are still afraid to produce any estimates, mainly because of current financial and political implications.

In mid-June, barley harvest has already began 10-15 days earlier than the usual time, and similar early harvest is projected for wheat. Some leading farmers reported high barley yields despite drought, at 5.1 MT/HA compared to 2.0 MT/HA or 30%-50% lower yields than in 2006 for the majority of other farmers. To date, most reports about barley yields vary from 1.3 to 2.7 MT/HA and for wheat, from 1.3 to 2.9 MT/HA.

AgSofia estimates are based on a more optimistic scenario. The wheat estimate assumes 5% non harvested areas but this figure can easily increase to 10% and thus, wheat production can drop to 2.5 MMT. The volume of production will predetermine export potential in both scenarios, from 300,000 MT to 500,000 MT (not counting price and other market factors and behavior). For other crops, export potential is estimated at 100,000 MT – 150,000 MT of barley; 220,000 MT-245,000 MT of corn; up to 350,000 MT of sunflower.

Table 1. Ag Sofia unofficial crop estimates, MY2007/2008

	Wheat	Fall barley	Corn	Sunflower
Planted area, HA	1,045,000	173,000	353,000	650,000
Harvested Area, HA	990,000	168,000	350,000	650,000
Average yield, MT/HA	2.7	2.65	3.54	1.2
Production, MT	2,660,000	450,000	1,250,000	780,000

Note: AgSofia unofficial estimates.

Adverse weather or weak management

Significant discrepancies in yields among various farmers shows that the amount of farmers losses in 2007 is dependant more on the applied technology than on the weather conditions. Many experts comment that extreme weather conditions helped to more clearly identify weaknesses in farm practices and agricultural technology. Late planting, use of not certified seeds, and lack of modern equipment are among the most common mistakes. Some large farmers try to expand their planting areas too quickly which does not allow them to properly take care of all crops.

Farmers who make insurance against adverse weather conditions are rather an exception. On the other hand, insurance companies in Bulgaria do not offer any insurance against drought. Currently, 12 insurance companies provide services to farmers but none of them makes drought insurance. According to sources in this sector, only 15% of all cultivated agricultural areas are insured in 2007. To date, the MinAg has not initiated any risk management/diversification programs, however, voices are raised that the Government should establish a special public-private indemnity fund to provide drought insurances on a shared risk principle.

Spring crops

Unfavorable weather affected also corn and sunflower planting campaign. Farmers reduced their corn area compared to their initial intentions and substituted it with sunflower as a more dry resistant crop. Due to the long dry period (a month and half), many expected that the country will not have any corn and sunflower crop since seeds were not able to germinate. Abundant rains which began in mid-May saved the spring crops, however, they remained under stress. Rains were unevenly distributed and the situation was very different from field to field. Currently, sunflower development is visibly uneven – unusually, there

were fields in flowering stage in early June. Some trade sources reported that up to 40% of late sowings were damaged; weeds and pests (propagation of gray corn weevil and other pests) were also a problem at early stage vegetation. Although detailed evaluation of spring crops is not done yet, trade estimates that 2% of corn and sunflower are in bad condition; about 90%-93% in satisfactory/average condition, and 3%-5% is in excellent condition.

Crop estimates about spring crops are more consistent. Traders estimates for sunflower area vary from 550,000 HA to 650,000 HA (650,000 HA is the government published data), with forecast production of 700,000 MT-850,000 MT, and average yield of 1.2 MT/HA - 1.4 MT/HA. Corn estimates are in the range of 250,000 HA to 420,000 HA (350,000 HA is the official published data) and expected production of 1.2 MMT - 1.3 MMT.

Weather forecast for June-August

Current locally produced weather forecast (www.meteo.bg) is for a hot summer with rainfall below the norm.

According to the Ministry of Environment of Waters report produced in May, drought is threatening not only irrigation but even availability of drinking water. As of May, drinking water dams were full at 72% of their capacity which may be still sufficient to meet drinking water needs. Irrigation dams were full at 47% of their capacity which is considered low. The level of underground water was the lowest since 2000. It was unusual and alarming that the river flow was fed by underground waters and not visa versa. Average river flow was below the norm what was also very untypical for May. The lowest was the river flow along the Black Sea – 37% of the norm.

According to recent statements of local transportation authorities, hot summer weather is likely to lead to almost complete termination of vessel transportation along the Danube river by August. At mid June, the level of Danube waters was already more than 2 meters below the norm for the season, and the projection is for a stagnation and further decline in levels. If this forecast occurs, grain trade from/to Bulgaria and Central and West Europe will be more difficult and expensive, especially during post - harvest time.

Trade

The MY07/08 is the first year when Bulgaria will trade its grains and oilseeds on the common market. New market situation is further complicated by drought and reduced crop. Many traders and farmers do not know how to evaluate new market conditions and how to behave. Reportedly, some had to cancel or modify their contracts and to bear not well thought risks. In the new conditions, trade is likely to be sluggish in the beginning of the marketing year.

Traders are not united in their expectations for MY07/08. Some expect little exports of feed wheat to the EU market and imports of small quantities of milling wheat; others think that the wheat crop will not be so small and in general, Bulgaria will be able to be a net exporter of 300,000 MT to 500,000 MT of wheat depending on the final harvest data; third think that trade will be difficult, especially in post-harvest time due to significant difference in price expectations of suppliers and traders which may result in slow sales, accumulating of extra stocks and uneven grain distribution.

Prices

Grain prices reacted shortly after the grain industry voiced their concerns about a low crop. A significant factor for quick price development was the Ukrainian Government restriction on grain exports from July 1. Bulgarian grain is traded as a part of the Black Sea regional

market where usually Ukraine has a leading position in price setting. In mid-June, farmers began to offer new wheat crop at 230-300 leva (115-150 Euro/MT) which is 42% or about 50 Euro/MT more than the price in the same time a year ago. Buyers are offering not more than 100-125 Euro/MT which is 54% more than in June 2006. Most millers are ready to start buying the new wheat crop at not more than 110 Euro/MT. Currently, new barley crop is already traded at 190-220 leva/MT (95-110 Euro) or higher due to good export demand to the Middle East.

Higher wheat prices are affecting other grain and oilseeds prices and force producers to restrain from offers and insist on high quotations. Sunflower is traded now at 420 leva/MT (210 Euro/MT) or 20 Euro/MT more than a week ago, corn prices have increased by 20 Euro/MT for the past week to 280 leva/MT (140 Euro/MT) - 330 leva/MT (165 Euro/MT). However, supply is very limited.

Demand

Expected poor grain crop, open common market and unclear future of spring crops provoked local experts and traders to reconsider current grain balance and make more detailed estimates about local consumption.

Traditionally, government and trade were considering local wheat food use at well above 1.0 MMT. In early 1990s, food consumption was at 1,600,000 MT; in late 1990s it came down to 1,400,000 MT. The most recent statistical data showed that bread consumption per capita in 1995 was 151 kilos while ten years later, in 2005, this consumption declined 23% to 117 kilos which translates into roughly 900,000 MT of bread. Reasons for lower consumption are the improved diet, higher consumer income and the fact that rural habitants stopped using bread to feed backyard livestock. Thus, new updated wheat food consumption estimate ranges from 1.0 MMT to 1.2 MMT.

Both government and trade are concerned about a sufficient supply and quality of wheat and barely planting seeds for the fall planting. Bulgaria uses only locally produced wheat seeds, about 230,000 MT to 300,000 MT, most of which produced at the Wheat and Sunflower Wheat Institute, located in one of the most affected areas. Since prices of planting seeds are forecast to stay high (about 300 Euro/MT), it is likely that many small/medium farms will again prefer to use lower quality not certified seeds.

Lower wheat and barley crop and record high prices may have a very negative effect on feed consumption which is estimated to decline 10%-30%.

Due to poor quality of barley, breweries are forecast to buy less local barley and import 10,000 MT -15,000 MT of malting barley, most likely from France.

Regarding consumption of sunflower, one of the biggest crushers, Bunge, has announced its decision to shut down its factory in Bulgaria (estimated crush 70,000 MT – 80,000 MT of sunflower seeds) but keeping its trade branch and grain storage (100,000 MT). It is expected that Bunge's market share will be captured by two local competitors working in the same region (Papas Oil and Slunchevi Luchi/TIM) but overall demand for crush will not drop. Thus, weaker crop will likely result is lower than traditional exports.

Demand for corn will face two controversial trends: on one hand, demand for processing into starch is expected to increase due to new installed capacities; on the other hand, expensive corn may lead to lower feed use.

State Intervention

In May/June, public attention was focused on the biggest to date scandal with the State Reserve Agency which involved a number of politicians and top level government officials. Media was flooded with new data about corruption deals among which the grain intervention deals played a central role. According to various sources, the loss born by the state budget due to questionable grain deals in the period 2000-2006 was between 220 and 600 million leva (110-300 million Euro). More than 800 cases of suspicious trade deals were submitted to the Prosecution Office.

However, despite the public light on nontransparent grain deals, the State Reserve Agency continued to be managed in the same way. In the period March – May, total about 100,000 MT of wheat was sold on the market under unclear terms. Moreover, these sales were executed during the time when the Government and the grain industry raised their voices about drought compensations and concerns over the low 2007 wheat crop.

Drought economic impact

Bulgaria traditionally exports above 1.0 MMT of wheat. Due to poor crop, wheat exports are under question. Experts estimate losses from reduced exports at \$300 million. The budget may lose another \$100 million paid as drought compensations to farmers. Since wheat is a major export earner, the country may not have a positive ag trade balance in 2007, and potential imports can deteriorate already considerable current account deficit.

Milling, baking, brewing, vegetable oil crushing, biofuel, feed and livestock industries will be all affected by reduced crop and record high prices which inevitably will be paid by consumers of staple food products. By tradition, bread is the number one staple product for Bulgarians and large social groups are very sensitive about bread prices. Therefore, potential increase in bread prices may easily cause certain political implications.

Agricultural policy and domestic support

In May and June, there were a number of public, regional and nationwide, farmers' protests against MinAg grain policy. Producers were blaming the Government in lack of serious interest and support in solving their problems.

As a result of this pressure, a special crisis management working group was established at the MinAg. Every week, MinAg regional experts are monitoring fields and make weekly reports. A complete monitoring and evaluation report was done in early June and sent to the EC (see key findings of the report above).

The MinAg offered the following drought compensation model to farmers:

- farmers who will not be able to harvest their crop due to severe drought damage will be 100% compensated at 450 leva (225 Euro)/HA for wheat and 400 leva (200 Euro)/HA for barley, after detailed MinAg spot checks. The compensations will be paid in July/August so that farmers can purchase the necessary inputs for the fall planting.
- farmers who have as minimum 30% lower yields compared to the average for the last 3 years, to be compensated at 170 leva (135 Euro)/HA for barley and 270 leva (135 Euro)/HA for wheat (80% of the full compensation as required by EC 1857/2006);

- on-site spot check and individual drought evaluation reports should be prepared before the start of the harvest. The MinAg will prepare a special public register of compensated farmers.
- funds for drought compensations will be allocated from the current account of State Fund Agriculture and Tobacco Fund.
- Current loans borrowed by farmers from the State Funds Agriculture will be rescheduled for later payments; new soft term credit lines will be extended to grain farmers in the fall.

The MinAg has approached the EC with a request to use EC 1857/2006 to provide drought compensations. According to the Ag Minister, drought compensation plan/payment can be enforced only after an explicit approval by EC expected in July.

Farmers' reaction to the MinAg proposal was not positive although the pressure reduced. Farmers protested against the loss evaluation methodology since they consider the European regulation (EC 1857/2006) as not fully applicable for Bulgaria. Major reasons are lack of reliable and long production history per a farm; vulnerability of local grains prices and significant price fluctuations over the last 5 years. Producers are dissatisfied with the size of compensations as well as with the complicated application and approval procedure. They insist on compensations at 200-250 leva (100-125 Euro)/HA higher than those approved by the MinAg or total of 250 to 340 Euro/HA. The main concept is that compensations should cover the full size of all planting and growing expenses, especially for small/medium farmers who can easily go bankruptcy (about 30% of all). Growers insist on having all compensations earlier, in July/August and not in November when the fall planting is over, which subsequently can jeopardize the amount of planted area in MY08/09. Another claim is to increase the rate of free of excise tax fuel from 72 liters/HA to 85 liters/HA.

As of June 15, about 3,700 farmers have applied for full drought compensations, mainly from areas of Pleven (450), Rousse (185), and Veliko Turnovo (212). Total losses are estimated by farmers at 200-250 million leva (100-125 million Euro) while the MinAg estimated drought compensations at 100-150 million leva (50-75 million Euro). In fact, the MinAg allocation for drought compensation is currently at only 20 million leva (10 million Euro): 15 million leva from State Funds Agriculture and 5.0 million leva from the Tobacco Fund. The MinAg plans to request more funds from the national budget later in the year after/if they receive explicit EC approval for these payments.

Shall we support our farmers?

Many grain traders and processors disagree with farmers' position and are against significant state compensations. With the new record high grain prices, traders think farmers will not be at loss despite their low yields. In addition, spring crops production is forecast as stable and in size meeting not only local needs but also sufficient for exports, thus the overall farmers' income may not drastically suffer, according to many experts.

Some larger farmers think that similar compensations discriminate them against other farmers who suffered more losses not only due to drought but because of worse technology and/or management.

The media gave floor to other public voices against farmers' compensations. Questions like who pays; why all taxpayers should pay the price of missing ag insurances; why farmers should be paid additional compensations if they are already getting their first EU subsidies; why other farmers such as fruit and vegetable growers are not compensated as well (for example, cherry, apricot, peach and vegetable gardens were severely damaged), etc. hinted

that some Government decisions are taken not because it follows a strict agrarian policy but because it is under significant and mainly, visible pressure.