

FERM: Economic Update

September 2007

Summary

As the 2006/2007 marketing year draws to a close, the European rice industry faces a period of fundamental adjustment. Global changes in the rice supply, combined with domestic environmental and regulatory factors, are stimulating substantial increases in the cost of preparing rice for the European market. As a result, increased costs for the consumer are considered to be inevitable in coming months.

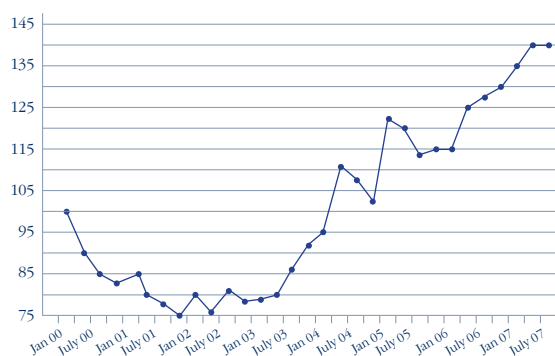
5 factors are particularly significant in creating pressure for price adjustments:

- Rising world market prices due to global shortfall in rice production
- Continued upward trend in European paddy prices
- Soaring Basmati prices
- A surge in freight costs
- Maintenance of maximum import duty for brown rice

A. Turbulent world market prices

World paddy production declined by 4 million tonnes in 2006 largely due to an erratic monsoon season in Asia and the development of an El Nino event in late 2006. This coincides with an increase in global consumption of around 5 million tonnes, a situation which has reduced world rice stocks to their lowest level in 25 years (Source: FAO). This global structural rice shortage is a major factor in stimulating a substantial growth in world rice prices (see Table 1).

Table 1: International prices index (IPI) Base 100 = Jan 2000

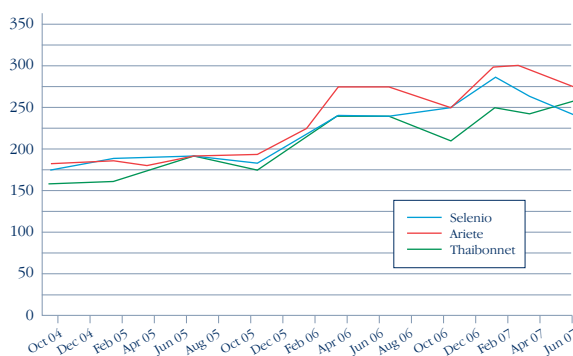


B. Continued upward trend in European paddy prices

With the accession of Bulgaria and Romania to the EU in 2007, European rice requirements have increased by around 100 000 tonnes. Rice production in the new Member States is marginal and existing Member State production has essentially been frozen following post-CAP reform to subsidies of rice production. Combined with limited competition from imported rice due to rising world market prices, this increased domestic demand for rice has continued to force up European paddy prices. For some Italian varieties, prices since market the reform in September 2004 have risen by as much as 60% (see Table 2).

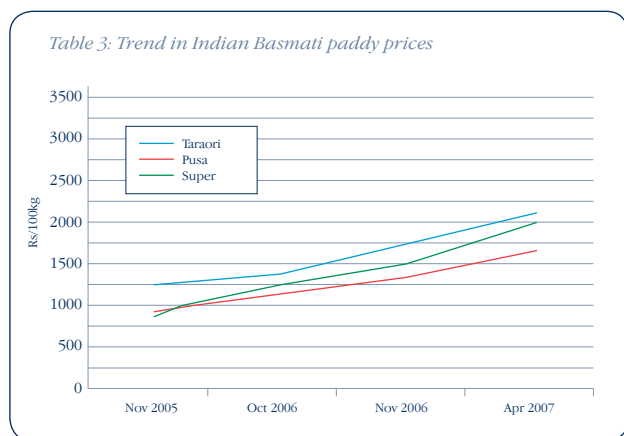
With the 2007 harvest in Spain reported to be significantly lower than normal due to this year's water shortages, the market is expected to tighten further and continued price rises are anticipated.

Table 2: Trend in Italian paddy prices

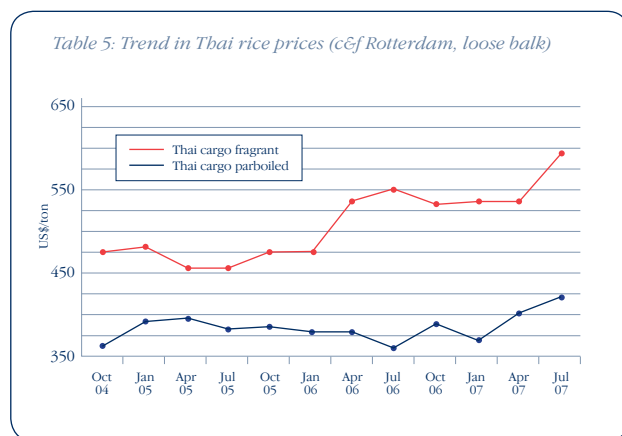


C. Soar in Basmati prices

Of the rice varieties imported into Europe, the Basmati market has proved the most volatile. Shortfalls in both Indian and Pakistani crops (the latter due to crop loss following excessive rainfall) have stimulated domestic price rises. Moreover, fears about potential US military action in Iran has encouraged this country to stockpile rice, thereby distorting normal regional trade patterns. As a result, the prices of traditional varieties such as Taraori Basmati and other varieties like Pusa and Super increased in excess of 60% over 18 months (see Table 3).

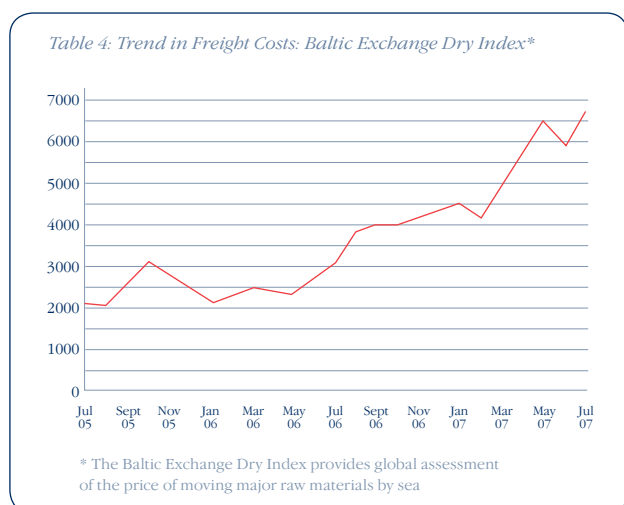


The rapid rise in freight costs has meant that even where domestic market prices are relatively stable, European importers have faced significant increases in costs. In Thailand, a chronic shortage of containers combined with weakening of the US dollar against the Thai Baht (down 14% over the marketing year) has led to rising prices of both parboiled and Thai Jasmine (see Table 5).



D. Rapid rises in freight costs

Increased trade, particularly between Asia (notably China) and the Middle East and Europe has significantly tightened vessel availability, leading to a surge in freight rates. Freight costs are currently at a record high (see Table 4). For rice importers, freight costs have increased by as much as 40% over the last 18 months.



E. Maximum import duty retained

Post-CAP reform trade negotiations between the European Commission and trading partners established a three-tier import duty mechanism, which varies between 30/t and 65/t according to imports. Agreed prior to EC enlargement to 27 members, the thresholds for triggering higher duty did not take into account increased demand for rice from Romania and Bulgaria. 2006/7 imports therefore inevitably triggered a 65/t import duty in March 2007 which is likely to be maintained throughout the 2007/8 marketing year. This maximum level of duty exacerbates the cost pressure created through rising raw material prices.

