



**Rabobank**

# Pork Quarterly Q1 2017

## China Imports to Determine Start of Seasonal Price Rise

**The level to which China imports pork after Chinese New Year will determine the start of the seasonal increase of the Rabobank Five-Nation Hog Price Index.** A lower-than-expected decline in imports will support prices in key exporting countries, while exchange rates remain the other important variable influencing prices. Prices will also be affected by the slow increase in global supply, supported by growing productivity and rising sow numbers.

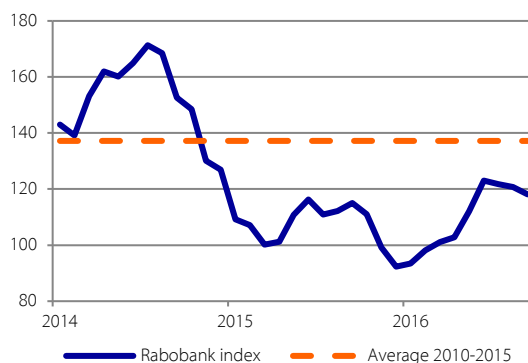
### China: positive vibes to continue

Chinese pork prices will remain elevated, but likely slightly less so after Chinese New year. The stabilising sow herd and rapidly rising productivity will not affect the market before summer, while the continuing impact of environmental policies on industry restructuring will limit expansion.

### EU: positive prospects but wildcards remain

Pressured supply and continuing exports will support prices and margins in the EU. However, rising export dependency as a result of ongoing pressured domestic consumption increases the importance of a favourable exchange rate, given rising competition from the Americas.

**Figure 1: Rabobank Five-Nation Hog Price Index, 2014-2016**  
(Jan 2006 = 100)



Source: Rabobank (based on national statistics) 2017

### US: rising supply increases industry challenge

The margin split in the US industry will continue in 1H 2017. Rising production will continue to pressure farmers' margins while demand, both for packing capacity and for pork, will support packers' margins. However, trade developments and the impact of exchange rates will be the wildcards, especially for packers.

### Brazil: export crucial for local prices in Q1

Continuing export growth will remain key for the Brazilian pork industry, given the expected 3% production increase and the expected slow recovery of domestic meat consumption. However, all signs point to a positive 2017.

**Figure 2: Rabobank currency forecasts to January 2018**

	19 Jan	3M	6M	12M
<b>USD/EUR</b>	0.94	0.97	0.95	0.91
<b>USD/JPY</b>	114.8	118.00	120.00	115.00
<b>USD/CAD</b>	1.33	1.35	1.35	1.36
<b>USD/BRL</b>	3.22	3.25	3.15	3.05
<b>USD/MXN</b>	22.00	23.0	23.00	21.00
<b>USD/CNY</b>	6.87	7.10	7.25	7.75

Source: Rabobank 2017

# Feature

**Pork production growth is often only linked with expanding the number of sows. The impact of steadily improving productivity as a driver of growth tends to be overlooked. In this feature, we analyse productivity gains for 2017.**

## Productivity—an important driver of pork production growth

Many pig producers are currently investing in new sow capacity, supported by relatively low feed costs, generally good returns and a positive demand outlook. However, pork production growth is not only achieved by increasing the number of sows—productivity growth and increasing slaughter weights are more important, as shown by recent developments in the sow herd and global pork production. In the period between 2010 and 2016, global pork production rose by 7.4m tonnes cwe, while the number of sows declined by an estimated 8m head. Resulting production per sow increased by 250 kg (+20%) to 1,550 kg, an annual increase of about 50 kg. This development includes replacing less productive ‘backyard’ sows with more productive sows in greenfield operations, and steady growth in productivity in existing barns.

This productivity improvement is the result of multiple factors, from modernisation and intensification of the industry to better genetics, farm management, standardised feed, health management, and disease prevention. Improvement is occurring in all production regions across the globe with the highest growth seen in greenfield operations in China and Russia, where modern barns, standardised feed and new genetics make a big difference. In China, for example, the continuous exit of smaller farms and expansion of industrialised players driven by policies and market competition have led to an estimated improvement in the average number of piglets reared per sow per year (PSY) from 13-14 in 2012 to 16-17 now. The productivity of China’s best farms is now comparable to European levels.

Other countries with high productivity gains are the traditional

production regions, such as the EU, Canada and the State of Santa Catarina in Brazil (see Figure 3). In these countries, thin margins, combined with relatively high feed prices and limited opportunities to expand or renew capacity, have forced the industry to increase productivity to safeguard margins.

Productivity improvements in the US and the Brazilian state of Mato Grosso in Brazil are lagging. The competitively priced and abundantly available feed, as well as the ample opportunities to expand production supports margins, and it limits the need to focus on improving productivity.

## Declining sow numbers—no impact on 2017 production

Productivity will continue to grow in the coming years. This implies that, despite the lower sow numbers at the start of 2017, rising productivity will boost global pork production by about 2.4m tonnes cwe (see Figure 4). Rising productivity adds about 3.7m tonnes cwe, while the decline in the number of sows—by about 1m head at the start of 2017—will reduce production by an estimated 1.3m tonnes cwe.

Production increases due to productivity growth are highest in countries such as China, Mexico, Vietnam and Russia, where average productivity is still low compared with other countries, and where large-scale farming also has room to grow. In China, for example, production is expected to increase by about 1.4m tonnes, despite a reduction of 1 million sows during 2016. Combined with the steady productivity improvements in traditional production countries, where the industry is even more focused on productivity, and the steadily rising slaughter weights, global pork production will continue to rise in the coming years.

With productivity being a much more important driver for pork production growth than sow herd expansion, the global pork industry should move with caution and expand the sow herd at rates that will not overwhelm the market and can therefore support positive margins.

Figure 3: Overview of pig productivity improvements

		EU	US	Canada	Brazil SC	Brazil MT
Number of pigs sold per sow (head)	2015	25.4	23.0	22.7	25.6	24.3
	Δ 2010-2015	2.4	0.3	2.0	2.4	0.3
Daily live weight gain (g/day, finishing)	2015	814	821	876	820	831
	Δ 2010-2015	47	19	-14	N/A	N/A
Slaughter-weight (cold, kg)	2015	92.4	94.6	98.9	89.6	91.1
	Δ 2010-2015	4.5	6.4	1.7	5.4	N/A
Carcass meat prod. sow/year (kg)	2015	2,345	2,171	2,241	2,289	2,215
	Δ 2010-2015	276	128	333	254	154

SC=Santa Catharina, MT=Mato Grosso; Source: Rabobank, InterPig 2017

Figure 4: Importance of productivity over sow numbers

		EU	US	Canada	Brazil	China
Number of sows (beginning stock, million head)	2017	12.17	6.09	1.23	2.97	38.80
	Δ 2016-2017	-0.13	0.09	0.01	0.01	-1.00
Carcass meat production sow/year (kg)	2015	2,345	2,171	2,241	2,252	1,275
	Yearly growth	55	26	67	41	75
Estimate pork production growth (1,000 tonnes cwe)	2017	355	348	99	143	1,410
	Extra sows	-310	198	18	23	-1,275
	Rise productivity	665	153	81	120	2,685

Source: Rabobank, InterPig 2017

# Dashboard

## Legend and units

Production	Exports	Imports	Hog price	Piglet price	Feed price
1,000 tonnes carcass weight equivalent (CWE)			kg CWE	head	kg

Δ = year-on-year change

All prices in local currencies

## EU: positive prospects remain due to declining supply, but elevated prices to impact export

Production	Exports	Hog price	Piglet price	Feed price
<b>Remains under pressure</b>	<b>Slight decline expected</b>	<b>Rising due to low supply</b>	<b>Strong seasonal increase</b>	<b>Stable due to high stocks</b>
Oct: 1,869 Δ -7.2%	Nov: 384 Δ +15%	Dec: 1.53 Δ +21.3%	Dec: 47.64 Δ +39%	Dec: 0.23 Δ -4.3%
Jan-Oct: 19,165 Δ +1.0%	Jan-Nov: 3,832 Δ +25%	2016: 1.46 Δ +4.6%	2016: 42.07 Δ +11.9%	2016: 0.23 Δ -5.8%

## China: slow replenishment

Herd (Nov)	Imports	Hog price	Piglet price	Corn price
<b>Slow replenishment</b>	<b>Growth to slow down</b>	<b>Stabilising</b>	<b>Rebounding</b>	<b>Decline due to policy reform</b>
Hogs: 375 Δ -3.4%	Nov: 113 Δ +36%	Dec: 17 Δ 4.7%	Dec: 39 Δ +33%	Dec: 1.95 Δ -9%
Sows: 36.8 Δ -3.7%	Jan-Nov: 1507 Δ +116%	2016: 18.6 Δ +23%	2016: 44.3 Δ +64%	2016: 2.02 Δ -12%

## US: supply growth slowing into summer

Production	Exports	Hog price	Piglet price	Feed price
<b>Small growth</b>	<b>Strong end to the year</b>	<b>Strong end to the year</b>	<b>To stabilise</b>	<b>A modest tailwind</b>
Dec: 1,017 Δ +1%	Nov: 231 Δ +18%	Dec: 1.25 Δ +2.5%	Dec: 0.53 Δ -7%	Dec: 1.05 Δ -3%
2016: 11,329 Δ +2%	Jan-Nov: 2,150 Δ +3.5%	2016: 1.43 Δ -2%		2016: 1.02 Δ -3.5%

Feed price: 83% corn, 17% soymeal

## Canada: 2016 will be a year marked by trade growth

Production	Exports	Hog price	Piglet price	Feed price
<b>Starting to rebound</b>	<b>Clear opportunity</b>	<b>Climbing</b>	<b>Prices are starting to rise</b>	<b>Flat</b>
Dec: 187 Δ +5%	Dec: 117 Δ +11%	Dec: 1.23 Δ +3.3%	Dec: 0.55 Δ -5%	Dec: 1.07 Δ -3%
2016: 2,054 Δ +0.7%	2016: 710 Δ +6.6%	2016: 1.40 Δ -2.3%		2016: 1.00 Δ -4.8%

Feed price: 83% corn, 17% soymeal, Herd: million head

## Brazil: pork exports to remain at record levels in 2017

Production	Exports	Pork price	Hog price	Feed price
<b>To slow down in 2017</b>	<b>Further increase expected</b>	<b>To stabilise in 2017</b>	<b>To smoothen during Q1 2017</b>	<b>To decline in Q1 2017</b>
Dec: 307 Δ +5.9%	Dec: 49.7 Δ +11%	Dec: 7.11 Δ +10%	Dec: 4.48 Δ +8.2%	Sep: 0.81 Δ +1%
2016: 2,732 Δ +7.0%	2016: 716,12 Δ +33%	2016: 5.92 Δ +1.7%	2016: 3.77 Δ +0.6%	Jan-Sep: 0.91 Δ +30%

Figure 5: Pork prices in exporting countries, 2014-2016

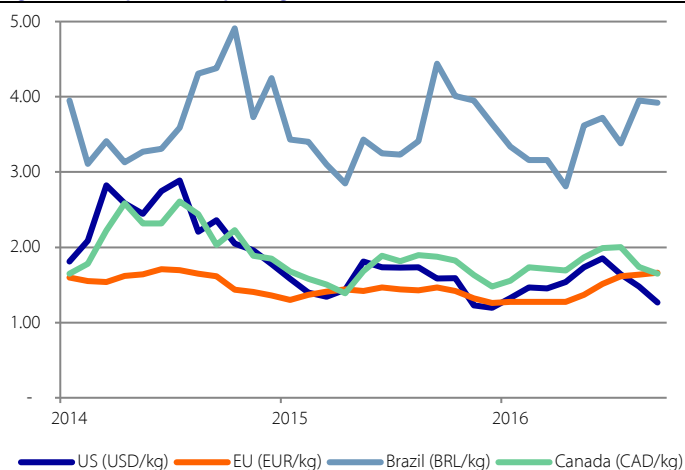
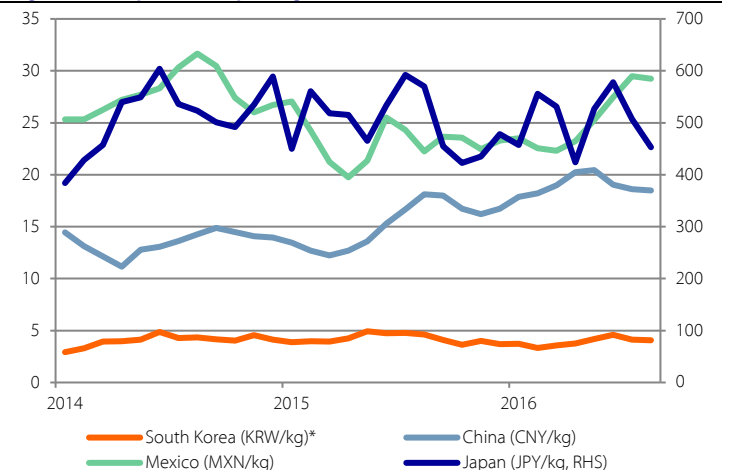


Figure 6: Pork prices in importing countries, 2014-2016



\* Note: For display purposes, the South Korean won has been divided by 1000.  
Source: Agriculture & Livestock Industries Corporation, Confederación de Porcicultores Mexicanos, Chinese Ministry of Agriculture, Korea Meat Trade Association 2017

## China

China's pork production is estimated to have dropped by 5% in 2016. This tight supply situation has kept hog and pork prices at high levels throughout 2016. Farming profitability has reached record highs while slaughtering/processing margins have been pressured, being the only additional cost that can be passed on to consumers. Entering 2017, supply is expected to remain tight in 1H, but to improve in 2H. In 2017, pork production is forecast to increase by 2%, and the slow recovery of pork production means hog and pork prices will remain above the average level of 2013-2015, although the price trend is downwards.

Prices of piglets, live hogs and pork have rebounded from the drop in previous months, reflecting farmers' positive views on the short-term market and seasonal demand increase (see Figure 7). With lower feed prices, farming margins are about CNY 600 per head for farms with a sow-to-hog model, and CNY 300 per head for fattening farms.

In 2017, environmental policies will continue to play a key role in reshaping the geographic distribution of pork production and promoting industrialisation and modernisation. Pork production expansion in South China will be restricted, while more industrialised and larger farms will emerge in the north and west. With the exit of smaller farms and continuous expansion of larger companies, the overall productivity will improve in the coming year. Although the nation's total sow inventory in 2016 continued a declining trend, we believe that the sow herd in large-scale farms has been increasing. This will be the major driving factor for production increases in 2017.

Pork imports in 2016 reached record highs, with 1.5m tonnes of pork meat and 1.4m tonnes of variety meat imported in the first 11 months, up 121% and 85% YOY respectively. The EU continues to dominate imports, with the US, Canada, and Brazil catching up quickly. We expect pork imports in 2017 to remain at high levels. Despite domestic production increases, local pork demand will likely recover and support the high level of imports.

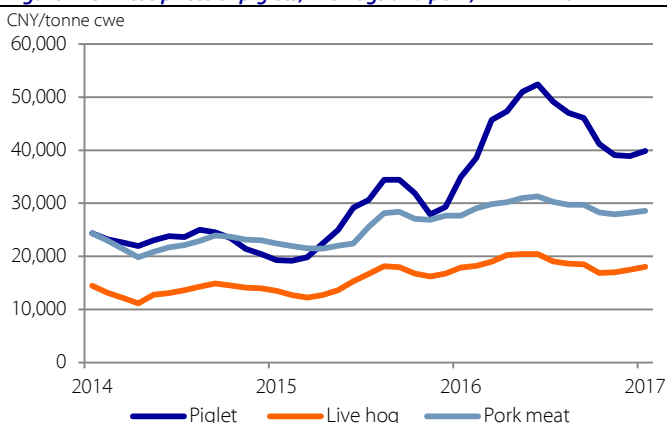
## US

The US pork sector finished 2016 with a period of incredible price swings, which was very reminiscent of Q4 2015. Prices ended the quarter very close to where they started, but there was a 20% swing from peak to trough and back to peak again during this period (see Figure 8). The chief driver of this volatility was concern over available shackle space as hog numbers during September and October not only ran well-ahead of prior-year levels but also surpassed what had been indicated by the USDA Quarterly Hog report. Thankfully, hog numbers topped out in early November, giving the market the opportunity to bottom out, and removing the risk of a repeat of 1998, when insufficient slaughter capacity pressured hog prices to historic lows. Hog producer margins reflect these weak prices with an average loss of USD 21 per head for the quarter but with margins during November being especially challenging.

The difficulties producers are facing have been mirrored by unbelievable spreads for packers, which may have reached historic highs at various points throughout the quarter. With packing capacity in such high demand and customer demand still quite strong on both the domestic and the export front, this is a great time to be in that part of the supply chain. This dynamic will shift somewhat as we progress through 2017, as about 6% more capacity is expected to come online. Most of this increase will happen in the second half of the year, so we don't expect packing margins to have fallen apart by this time next year, but it will surely be a different environment than the quarter we just had.

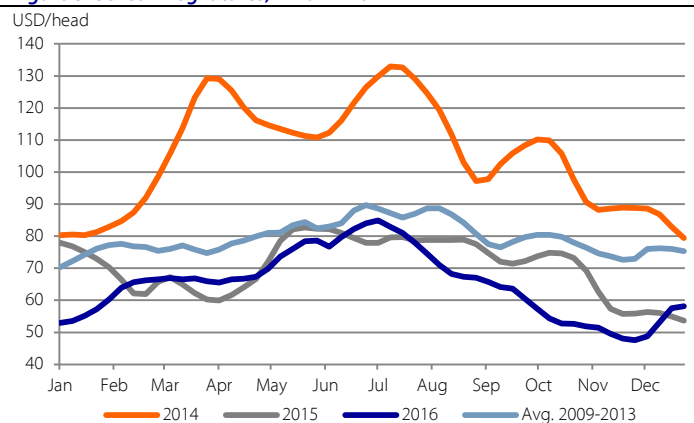
The outlook for 2017 will not just be shaped by the new plant capacity coming online but also by continued expansion in US pork production, which we estimate at 3%. This is a sizable increase from the less than 2% growth in 2016. The real wildcard for the year will be exports, which have been very volatile over the last 12 months. With Mexico and China/Hong Kong accounting for nearly half of US pork exports on a combined basis, the impact of PEDv in Mexico, the rebuilding of China's hog sector, and potential reviews of US trade policy, there is some uncertainty around how 2017 will play out when it comes to trade.

Figure 7: Chinese prices of piglets, live hogs and pork, 2014-2016



Source: Chinese Ministry of Agriculture 2017

Figure 8: US lean hog futures, 2009-2016



Source: Bloomberg 2017

## EU

Driven by continuing pressured supply and positive demand related to exports and the Christmas period, EU pork prices picked up in December after following their normal seasonal decline into Q4 (see Figure 9). The resulting EUR 1.52 per kg cwe is a reasonable level to start 2017, and hints at higher prices towards summer. Supply will remain under pressure in 1H, because the EU sow herd only started its slow recovery in Q4 2016.

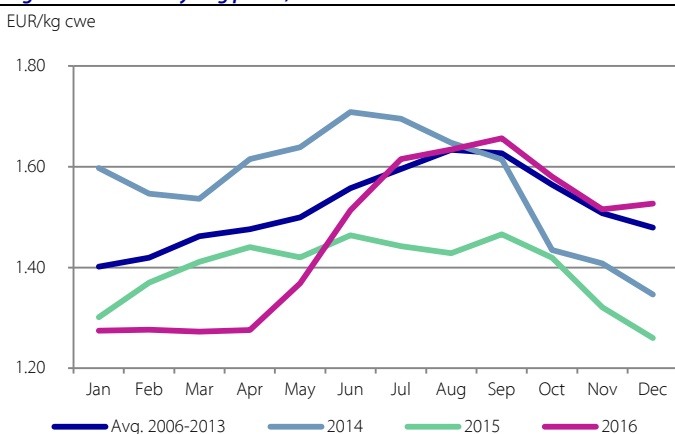
The level of the expected price peak at the end of Q2 depends on the development of both domestic and export demand, as well as on exchange rates.

Domestic demand has been sluggish at the start of the year, with relatively high prices further pressuring consumption, which has—especially in north-western Europe—steadily declined in recent years. With 86% of the domestically produced pork being consumed in the EU, halting this decline is very important. In addition to developing new innovative products to cater to rising health awareness and the demand for higher quality and better taste, a clear marketing strategy to promote the positive attributes of pork and the pork industry is needed to counter the negatives.

Exports are forecast to decline slightly in 2017, after a record-high estimated 2.4 million tonnes pork cwe (+30% YOY) and 1.7 million tonnes of fat & offal cwe (+20% YOY). Next to rising competition from the Americas in all export markets, China's import demand will not grow in 2017. In 2016, China was the main driver of EU exports, with volumes more than doubling to an estimated 1.1m tonnes cwe, and fat & offal up 40% to 930,000 tonnes cwe.

The appreciation of the US dollar against the euro is positive for exports, also because EU pork prices are likely to remain above competitors' levels. In contrast, the declining value of the British pound will pressure export returns.

**Figure 9: EU monthly hog prices, 2006-2016**



Source: European Commission 2017

## Brazil

Chinese imports will continue to be one of the main drivers of Brazilian pork export growth in 2017. After reaching a total of only about 5,000 tonnes in 2015, Brazilian pork exports to China boomed in 2016, exceeding 87,000 tonnes cwe, which has given Brazil the opportunity to present itself as a competitive option for Chinese pork importers (see Figure 10). In total, Brazilian pork exports increased by around 33% in volume in 2016, compared to 2015, exceeding 715,000 tonnes cwe.

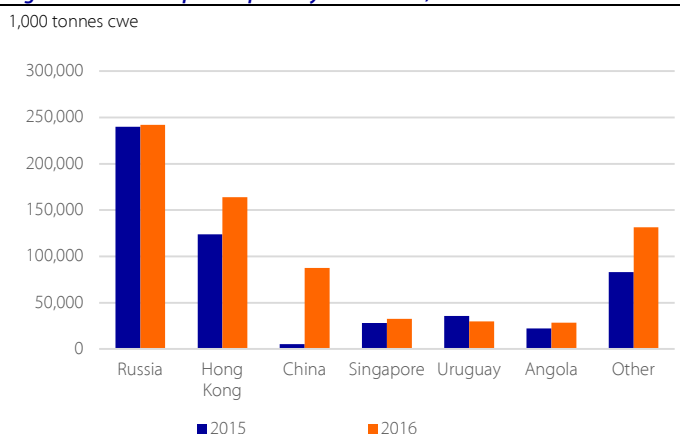
Moreover, Brazilian pork exports to China are expected to exceed 100,000 tonnes cwe in 2017, making China the third main destination for the Brazilian product, surpassed only by Russia and Hong Kong. This, coupled with Brazilian authorities' efforts to open new markets—such as South Korea through the state of Santa Catarina, which is expected to be announced during 2017—is likely to contribute to another positive year for Brazilian pork exports.

In terms of supply, official numbers show that Brazilian pork production increased by 7% between January and September 2016, compared to the same period in 2015. However, we expect a slowdown for the Q4 2016 figures, which would contribute to a more modest YOY increase. It is worth noting that in December 2016, pork prices were around 13% higher than the previous month's average, and 10% higher than December 2015, in nominal terms.

Regarding costs, after reaching record levels during 2016, domestic corn prices are expected to decline in 2017, as the domestic summer corn crop is expected to result in a 10% YOY increase. Additionally, Brazil is now able to import GMO corn varieties from the US, which represents a 'corn price hedge' in case the national crop disappoints.

Overall, given the more positive economic scenario for Brazil projected for 2017, Rabobank expects an initial recovery in local meat consumption, particularly in 2H 2017, which in turn should keep domestic pork prices firm. However, during 1H, export performance will be crucial also for local prices, as an increase in pork supply of around 3% is expected in 2017.

**Figure 10: Brazilian pork exports by destination, 2015-2016**



Source: Associação Brasileira de Proteína Animal 2017

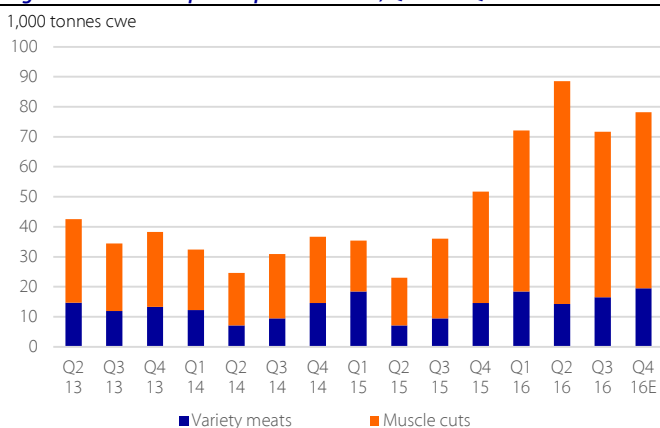
## Canada

The Canadian hog sector had a weak end to 2016 as the drop in hog prices in the US was also felt in Canada, dragging producer margins into the red. Based on our math, the average Canadian producer lost USD 11 per head during Q4, with most of the losses occurring in October and December. These losses weren't as bad as the pain on the US side of the border, but it did put a damper on what had prior to that been a very strong year.

The primary bright spot for Canada's hog sector was the increase in pork trade with China, as trade there skyrocketed during 2016 (see Figure 11). While the EU continues to dominate this trade flow, Canada increased its share and likely participated more in the market than the US did. Canada's significant ractopamine-free supply is a clear advantage in this regard, helping trade to China increase by an estimated 115% over the year.

We expect production growth to slow in 2017 compared to the 4% growth rate in 2016, but to still remain at a healthy rate of 1% to 2%. Given the volatility in North American hog prices and the Canadian dollar, 2017 is a year that could really go either way in terms of production and profitability, not just in Canada but across North America.

Figure 11: Canadian pork exports to China, Q2 2013-Q4 2016e



Source: Statistics Canada-Canada.ca 2017

## Mexico

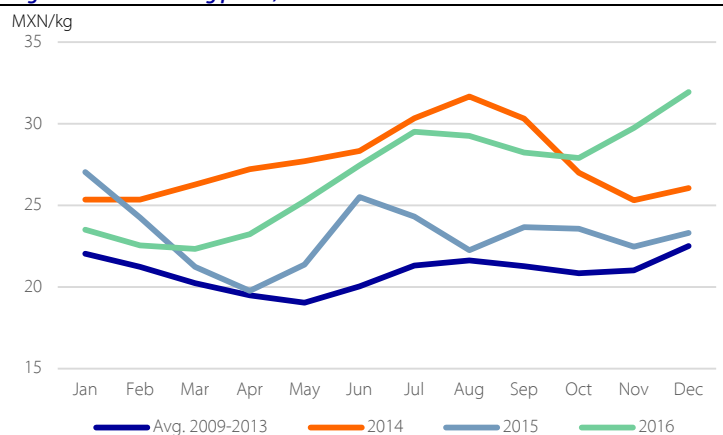
Mexican hog producers continue to encounter PEDv, but every year the impact seems to be smaller, as hog producers continue to invest in biosecurity. This creates a tailwind for pork production, which is helped by an expected increase in the sow herd of 53,000 head, to a total of 928,000 head in 2017. As sow beginning stocks continue to increase, we expect an overall increase in pork production of 1.4m tonnes, which is a 4.5% increase from last year.

Mexican hog prices were quite strong at the end of 2H 2016. Prices reached a national average of MXN 34/kg and are expected to remain well-supported in the first half of 2017. The price increase has been driven by the increase in imports from the US, which this year are expected to increase by 2.4% compared to last year. Despite lower pork prices in the US, the strong US dollar will continue to support hog prices in Mexico (see Figure 12).

Domestic pork consumption is expected to increase marginally, by 94,000 tonnes (cwe) in 2017, which is a 2.3% increase YOY. Pork prices continue to be relatively competitive with chicken. However, if prices continue to increase throughout 2017, we could see domestic pork consumption decrease as consumers start to 'trade down'.

Mexican exports continue to increase. The depreciation of the peso, which started in Q4 2016, has made Mexican pork exports more attractive in export markets. Total Mexican exports are expected to reach 165,000 tonnes in 2017, up from 150,000 tonnes in 2016.

Figure 12: Mexican hog prices, 2009-2016



Source: Confederación de Porcicultores Mexicanos, Rabobank 2017

## Japan

The Japanese pork market has followed its seasonal decline in Q4 2016, but prices remained at relatively good levels. The market performed well due to rising consumption, which covered large parts of the increasing supply. Consumption increased by about 2.7% to 1.75m tonnes cwe, the highest level in the last decade. Domestic production increased by 2.2% to almost 900,000 tonnes cwe, while imports reached 860,000 tonnes (+9.0%). This resulted in relatively low stocks of about 164,000 tonnes at year-end.

All major suppliers increased import volumes in 2016. However, despite a slight 1.4% increase in volume, the share of the leading supplier, the US, declined by 2 points to 31%. Other important suppliers such as Canada, Denmark and Mexico stabilised their shares, reflecting rising competition in this important high-value import market.

Prospects for the Japanese market are positive. The impact of the sow herd's decline by 4.6% last February will affect the market from the start of 2017 onwards. This, combined with relatively low stock levels, will support prices and imports. Countries in the Americas, especially the US and Canada, are well placed to fill most of the import growth, due to rising production and likely competitive prices.

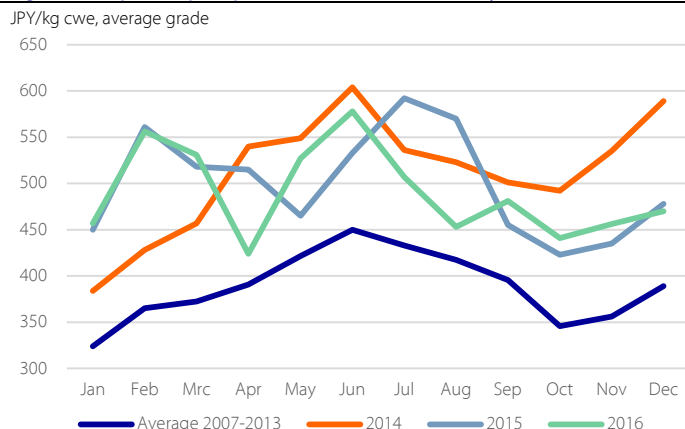
## South Korea

Pork imports into South Korea remained under pressure in the last part of 2016, which resulted in an almost 40,000 tonne cwe (-11%) drop of the import volume for the whole year. Remarkably, imports declined for all cuts except bellies, showing the ongoing strength of consumption in South Korea, which improved after clear and strong marketing during recent years and the 2.4% price decline in 2016.

Imports declined in 2016, due to the 4.2% increase of slaughter numbers to 16.8m head, which resulted in pressured prices. Hog and wholesale pork prices dropped by 8.3% and 8.0% respectively.

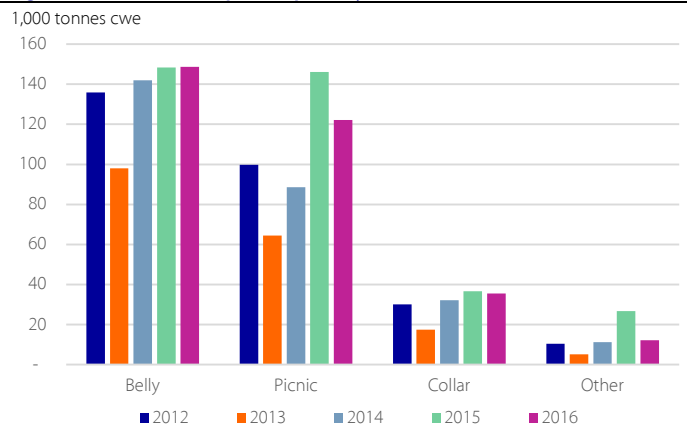
Prospects for 2017 remain weak due to the expected continued rise in production as a result of further sow herd expansion. The sow herd increased by 41,000 head (+4.3%) to 984,000 head in September 2016. This followed a 3.0% and 3.6% increase in the March and June quarters, respectively. Rising domestic production will result in further pressure on prices and imports in 2017.

**Figure 13: Japanese pork prices, wholesale market Tokyo, 2007-2016**



Source: Agriculture & Livestock Industries Corporation 2017

**Figure 14: South Korean pork imports by cut, 2012-2016**



Source: Korea Meat Trade Association 2017

## **Rabobank**

RaboResearch Food & Agribusiness Animal Protein Global Sector Team Analysts

Global Strategist – Justin Sherrard  
[justin.sherrard@rabobank.com](mailto:justin.sherrard@rabobank.com)

US – William Sawyer  
[william.sawyer@rabobank.com](mailto:william.sawyer@rabobank.com)

US – Don Close  
[don.close@rabobank.com](mailto:don.close@rabobank.com)

Brazil – Adolfo Fontes  
[adolfo.fontes@rabobank.com](mailto:adolfo.fontes@rabobank.com)

China – Chenjun Pan  
[chenjun.pan@rabobank.com](mailto:chenjun.pan@rabobank.com)

Australia – Angus Gidley-Baird  
[angus.gidley-baird@rabobank.com](mailto:angus.gidley-baird@rabobank.com)

New Zealand – Matt Costello  
[matthew.costello@rabobank.com](mailto:matthew.costello@rabobank.com)

New Zealand – Blake Holgate  
[matthew.costello@rabobank.com](mailto:matthew.costello@rabobank.com)

EU & Russia – Albert Vernooij  
[albert.vernooij@rabobank.com](mailto:albert.vernooij@rabobank.com)

EU – Gorjan Nikolik  
[gorjan.nikolik@rabobank.com](mailto:gorjan.nikolik@rabobank.com)

EU & Russia – Nan-Dirk Mulder  
[nan-dirk.mulder@rabobank.com](mailto:nan-dirk.mulder@rabobank.com)

EU – Beyhan de Jong  
[beyhan.de.jong@rabobank.com](mailto:beyhan.de.jong@rabobank.com)

Mexico – Andrick de la Payen Diaz Vega  
[andrick.payen@rabobank.com](mailto:andrick.payen@rabobank.com)

[far.rabobank.com](http://far.rabobank.com)

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