



Brazil's Agriculture: a Survey

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This is the first in a series of MAP reports focusing on the agricultural giants of the developing world – Brazil, India and China. Our overview of world agricultural commodity markets (MAP 05-03) identified the key role they play. The impact of each player on world markets is very distinct. Brazil's growing export capacity affects almost exclusively the supply of agricultural products, China's growing economy mainly influences their demand, while India could go either way.

Starting with Brazil seems an obvious choice. Brazil's tremendous agricultural export potential, was first identified by the Economic Research Service of the US Department of Agriculture in the late 1990s. But although this potential was expected to be realised over a longer period, a series of events, described in the OECD's recent report on Brazil, allowed it to materialise much sooner. This had a twofold consequence.

On the one hand, the impact of Brazil's growth was immediately felt on the world markets. Brazil's exports sometimes met growing demand without any major price impact, while on other occasions they have increased price pressure, where markets have been oversupplied. In WTO, Brazil has come to prominence in the DDA negotiations having emerged as the leader of the developing countries.

On the other hand, the impact of this growth was also felt in Brazil, raising questions about the feasibility of sustaining this momentum, particularly as some of the macroeconomic reasons for this export growth (such as the depreciation of its currency) have reversed direction.

This report will try to shed some light on the potential impact of these developments on the export capacity of Brazil, with a special focus on the main agricultural commodities. And although concrete answers rarely exist, there are indications that in some sectors growth will continue, while in others it will depend on Brazil's response to the new challenges it faces.



1. An emerging agricultural giant

To those who say that “Brazil is a country of the future” the response must be that Brazil is very much here and now. Today it is the 9th largest economy in the world. It is Latin America’s biggest economy with a population of over 180 million people, the fifth most populous country in the world. And it is expected to grow by a further 20 million over the coming decade.

Although it is a developing country, Brazil qualifies as an “upper middle income” country with GDP per head of 7600 US\$ (measured in terms of Purchasing Power Parity). However this masks extremes of income distribution. Poverty is still prevalent, with 1 person in 5 managing on less than 2 US\$ a day. The OECD estimated in 2000 that 1/3 of the population is living in poverty, which is higher in rural (61%) than in urban areas (25%).

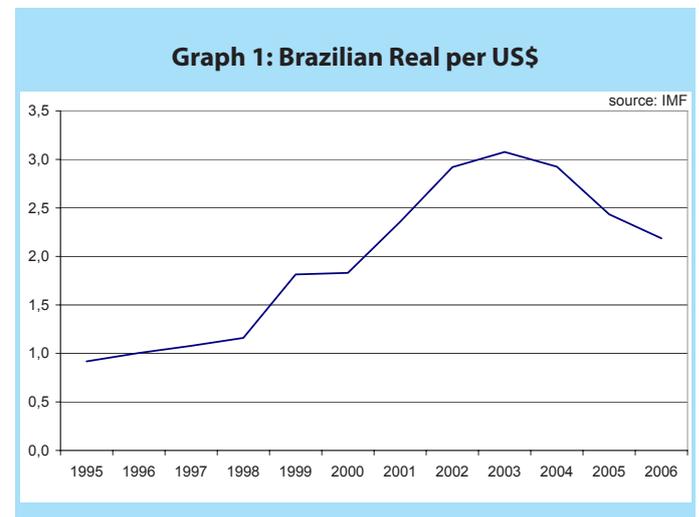
Although Brazil is already a major world player in agriculture, there is still room for expansion and the economy as a whole has yet to fulfil its enormous potential. Overall economic growth has been sluggish in recent years trailing behind other Latin American countries, Asia and the OECD. From 2000-2002 Brazil’s growth was just 2.5% compared to 4.1% in OECD. A small improvement was recorded in 2003-2005 with growth of 2.9% and that trend is expected to continue, with stronger growth of between 3.5% and 4.5 % projected for 2006 and 2007.

There is still a lot of catching up to do, which is a legacy from the economic upheavals of the 80 and 90s. Up until 1985 government intervention in agriculture was high. The exchange rate was controlled and agricultural import tariffs were high. After the end of military dictatorship in 1985, Brazil faced a number of economic crises, to which the government reacted by liberalising the economy and reducing support for agriculture.

As part of these reforms the Brazilian Real was introduced in 1994, but by the late 90s the country had accumulated high levels of foreign debt and the Real was floated in 1999 (graph 1). The devaluation that followed enabled exports, and especially agricultural exports, to become

the driver of economic growth and to finance the foreign debt burden.

From 1999 to 2002 the value of the Real fell sharply by 40% in relation to major international currencies, from US\$/1.8R to US\$/3.1R. Since then, however, it has appreciated to reach US\$/2.2R in 2006, as a result of high domestic interest rates aimed at keeping inflation under control and the depreciation of the US currency.

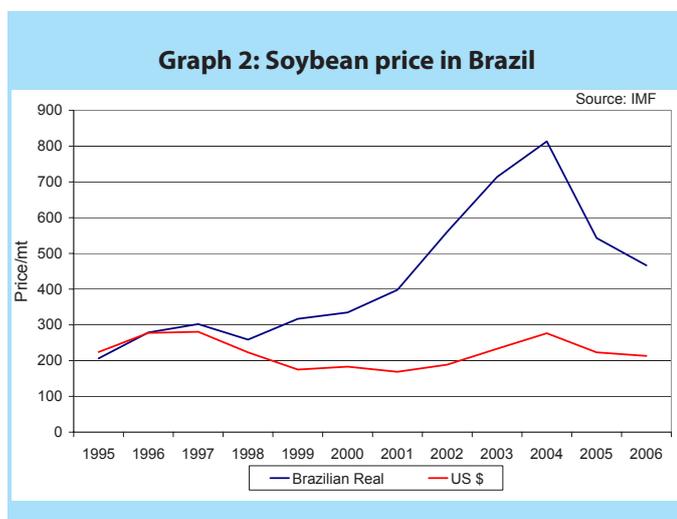


This development has raised the prospect of agriculture becoming a victim of its own success. High agricultural exports generated foreign currency while high interest rates attracted foreign capital, leading to an appreciation in the Real. In a country so dependent on exports of commodities that face additional price variations, the fluctuation of its currency has fed through to domestic prices, since exports are traded in dollars, causing financial crisis in agriculture.

This becomes evident if one considers the price Brazilian soybean producers receive for their crop (graph 2). Due to the weakening of the Real, but also partly driven by favourable world market prices, the soybean price expressed in Real, doubled between 2001 and 2004 and peaked at 800 R/mt. Following the subsequent strengthening of the currency, soybeans lost almost half their record value and are currently quoted at levels seen five years ago.



Farmers reacted with violent demonstrations earlier this year, calling for interest rates to be eased back. And although the government is unlikely to slacken the reins of macroeconomic policy, these developments have raised some doubts concerning the immediate outlook for producer prices.



Government intervention in agriculture today is limited. There is minimum price support for a limited number of commodities. Trade distorting support as measured by PSE was worth around 3% of farm income in 2002-2004. This is considered to be comparable to levels of support in Australia and New Zealand and is well below the OECD average of 30%. Instead, the bulk of support in Brazil is focused on preferential credit schemes. Following pressure from the farm lobby, the government introduced an aid package in May/June this year for the second year running, in response to the current crisis in agriculture. The total support package is worth around R\$60 billion (US\$30 billion) for the 2006/07 crop year, a 12% increase on 2005/05 and includes some emergency measures.

As Brazil liberalised its agricultural policy, it has also pursued a more liberal trade policy. In 1994 Brazil came together with Argentina, Uruguay and Paraguay within the Mercosur Customs Union to apply a common external tariff. Venezuela signed an agreement to become the 5th member in July 2006, but this is still subject to ratification. As well as being a key player in the WTO

negotiations, Mercosur is also engaged in bilateral free trade negotiations with its major trading partners. Today approximately 60 % of Brazil's agricultural imports come from within Mercosur, with the EU and US share at 15% and 10% respectively.

Within WTO, Brazil is a leading member of the G20 group of developing countries and the Cairns group pressing for major trade liberalisation. In general Brazil's tariffs are lower for agricultural than non agricultural goods. Although the bound tariff was 35.6%, the average agriculture tariff applied in 2004 was 10.4%. But although 2/3 of tariff lines are actually below 10%, there are still high tariffs on some agricultural products notably dairy and sugar.

Brazil's focus in the WTO is to improve access to its key export markets. Its concerns are in particular high tariffs in key markets and to a lesser extent, tariff escalation (higher tariffs in developed countries on processed products, which discourage further processing within Brazil) and TRQs which do not match its export ambitions. The allocation of TRQs reflects the state of agriculture during the Uruguay round when other exporters had a greater share of world markets than Brazil. However Brazil's ambitions as an exporter are also mitigated by its ambition to lead a group composed of other developing countries, including India, with different trade interests and sensitivities.

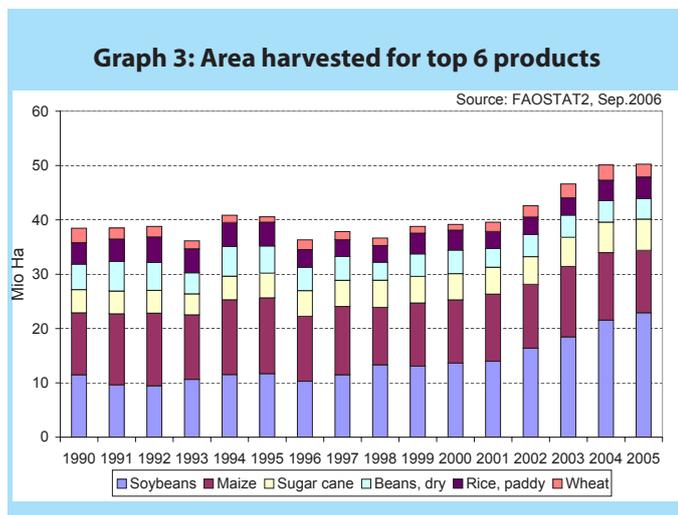
2. Brazilian agriculture at a glance

Brazil's agricultural area of 264 mio ha is vast, surpassed only by China, Australia and the US. Three quarters of the agricultural land is permanent pasture, less than a quarter is arable land and the remaining 3% is planted with permanent crops.

Brazil's agriculture still plays an important role in the overall economy and in easing the country's balance of payments problems. Primary agriculture accounts for 8% of GDP and about 30% of exports. Including upstream and downstream activities the agrifood sector reaches around 30% of GDP.



Agriculture's share of GDP has not changed much over the past 10 years. However the structure of output has evolved considerably with deregulation and trade liberalisation. Graph 3 shows the evolution of area of the top 6 harvested crops. The biggest change is in the area of soybeans, which grew from 13 mio ha in 1999 to 23 mio ha in 2005, in line with the increase in domestic prices following the devaluation in 1999. Sugar, wheat and cotton have also gained acreage while the area of maize has fallen.



Total crop and livestock production grew by 4.5% annually over the past decade 1995-2004, almost double the increase in the overall economy (2.5%). Most of Brazil's production is aimed at the domestic market, with on average just a quarter of output destined for export. But production in exportable sectors has experienced phenomenal growth. Brazil is the world's leading producer of sugar cane, the second biggest producer of soybeans and the third largest poultry producer.

Primary agriculture accounts for a fifth of total employment, a reflection of low labour productivity overall. Major structural changes are taking place however, with the number of people employed in agriculture falling by 13% between 1992 and 2002.

Brazilian agriculture falls into 2 distinct areas, based on geography and climate; the northern and the southern/central area. The North is the largely undeveloped

Amazon tropical rainforest, where infrastructure is poor and agriculture is small scale and subsistence. The North East is part tropical and part semi-arid with limited agriculture potential. Traditional crops like sugar cane and cocoa dominate.

The southern part of the country, which takes up between a half and two thirds of the area, has a semi-temperate climate, good soils, modern inputs and technology, reasonable infrastructure and generally efficient farms. The South and South East regions, which are the most densely populated areas of Brazil, have traditionally been the dominant centres of agriculture activity. This area is known as the bread basket of Brazil, growing soybeans, maize and wheat.

But it is the Centre West that is the key to the enormous expansion of Brazilian agriculture. It is estimated that in this area, there are at least another 90 million hectares of potential new agricultural land. The upshot is that a modern efficient agriculture exists alongside subsistence and small scale farming.

Given the huge disparities in farming structure, there is really no such thing as the average farm. There were nearly 5 million farms in Brazil (based on the 1995 Census data) of which 85% were considered to be family farms with an average farm size of only 26 ha. These farms accounted for 38% of output. The rest were commercial farms with nearly 70% of the land.

The average commercial farm is 430 ha but this also masks wide variation. The shift in farming to the Centre West where land is cheap, as well as the move to exportables has tended to result in larger farms. Nearly half the land (46%) is in the hands of just 1% of farming businesses of over 1,000 ha. (The structural changes of recent years are not reflected in these data). Commercial farms account for the lion's share of output in the key sectors.

Brazil's big competitive advantage is access to cheap land. Deforestation of the Amazon remains highly contentious with around 1.4 mio ha of forest lost every year to cattle ranching. The planned development of new roads



in the North would also speed up deforestation. But measures are now being taken to address the problem, with a significant increase of land under protection. Although the growth in soya production is concentrated in the undeveloped parts of the Centre West rather than the rainforest, it is argued that soya has indirectly caused deforestation by displacing cattle ranchers and subsistence farmers. The Centre West itself is also vulnerable as the newly cultivated or grazed savannah becomes degraded after a time. Although land prices may rise, the fact that Brazil can continue to push back the agriculture frontier means that cheap land will be a competitive advantage for some time to come.

Brazil still has relatively cheap wages and agricultural incomes have not kept pace with non agricultural income in rural areas. Income inequality actually deteriorated in the 90s for the poorest rural families. However, the government has introduced policies targeted at tackling rural poverty with land reform and social schemes aimed at family farms.

But here too the overall picture hides wide variation. Wages are above average in the booming Centre West. Commercial farms and larger family farms with an average of 60 ha generate income which is on a par with the more affluent half of urban households. And despite low wages in general, labour costs are high in Brazil compared to many of its competitors, because of low labour productivity. As agriculture expands this is likely to put further pressure on wages.

An additional pressure comes from difficulties in access to credit. The real interest rate on loans is currently around 15%, which is among the highest in the world and beyond the reach of many producers. This policy has succeeded in bringing inflation, which is now around 6%, under control, but high interest rates demonstrate that the economy is still somewhat unstable. And although easier access to credit has been afforded in recent years by government schemes targeted at agriculture, the inability to service debt remains a problem for producers.

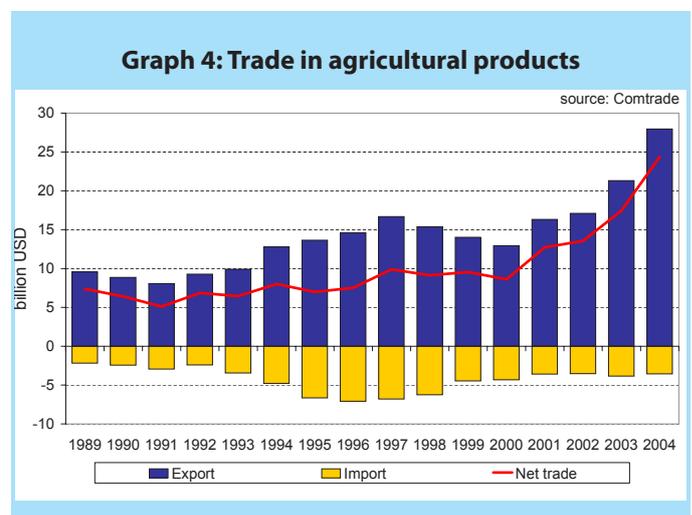
But perhaps the biggest constraint for Brazil is its

underdeveloped infrastructure. Transport represents a significant cost, as agricultural exports tend to be unprocessed bulk commodities transported mainly by truck. Even road transport needs major investment with only 10% of roads paved today, compared to 29% in Argentina. Shifting traffic from road to rail and waterways is a medium term policy goal and without significant investment, lack of infrastructure could act as a major break on future development.

Nevertheless, Brazil is still a low cost producer. The rapid growth in soya production arose because of the availability of new technology and large tracts of cheap land, making Brazil the lowest cost producer in the world. But recent studies indicate that although the cost of production in Southern Brazil is lower than in Argentina or the US, variable costs and especially freight costs are higher in Brazil. Furthermore rising energy prices have led to sharp increases in the costs of fuel, fertilisers and machinery in recent years. This makes the exchange rate crucial for Brazil and continued appreciation of the Real puts its long term competitiveness at risk.

3. Brazil's agricultural trade

Brazil became the third largest agricultural exporter in the world in 2002. The value of its exports is approaching US\$30 billion (graph 4).

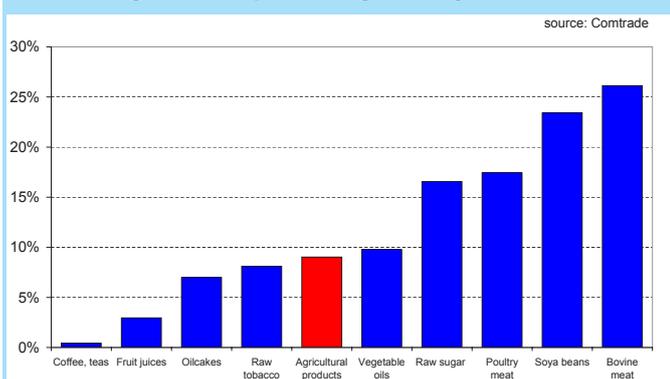




Soybeans and soya products together account for 37% of the value of exports, followed by raw sugar and poultry, at just under 10% each and beef at 7%. Although the share of exports reached 30% of production in 2004, this is low compared to other big exporters like Canada (41%) or Australia (74%). Agricultural imports vary from year to year at levels of around just \$4 billion. Wheat is the single biggest import and Argentina is the largest supplier.

The explosion in exports has been accompanied by a change in the direction and composition of trade. Graph 5 demonstrates this by comparing the rate of annual change in the value of Brazil's exports for its main exportable agricultural products. Brazil has shifted its focus away from traditional tropical products like coffee and orange juice, to soybeans and soya products, sugar and meats, especially beef and poultry. The biggest growth over the past decade has been in soya beans, beef and poultry, but the value of sugar and soya meal and oil has also risen sharply.

Graph 5: Growth in agricultural export value average annual percentage change, 1995-2004



The EU remains the key market for Brazil, taking 40% of its agricultural exports. However emerging markets are now the biggest growth market for Brazil, as South-South trade expands, with China now the second most important market, accounting for 10% of exports. Russia too is a big growth market, while the US share has fallen to just 8%.

4. Brazil's main commodities

Maize

Brazil is the third largest maize producer in the world after the US and China. Maize is by far the most important grain grown in Brazil with production in 2004 at around 47 mio mt. The crop is grown essentially for domestic animal feed, so output is driven by growth in the poultry and pigs sectors. Yields improved dramatically in the late '90s mainly due to double cropping. Since 2000 production has outstripped feed demand, with the result that Brazil became a net exporter for the first time that year. In 2003/04 Brazil was the fourth biggest exporter in the world but only achieved self sufficiency the following year. Expected expansion in the meat sector will prevent Brazil from becoming a consistent maize exporter.

Soya

Brazil is the second largest soybean producer in the world and the second largest exporter after the US. Until recently, it was expected to overtake the US as the world's leading exporter in the near future. Unlike maize, half the crop is exported. The area of soya almost doubled from 12 mio ha in 1995 to 22 mio ha in 2005 and OECD and FAPRI predict that it will grow by another 10 mio ha in the next decade. About half of the 2006 soybean crop is estimated to be GM herbicide resistant, which has cut production costs by a fifth.

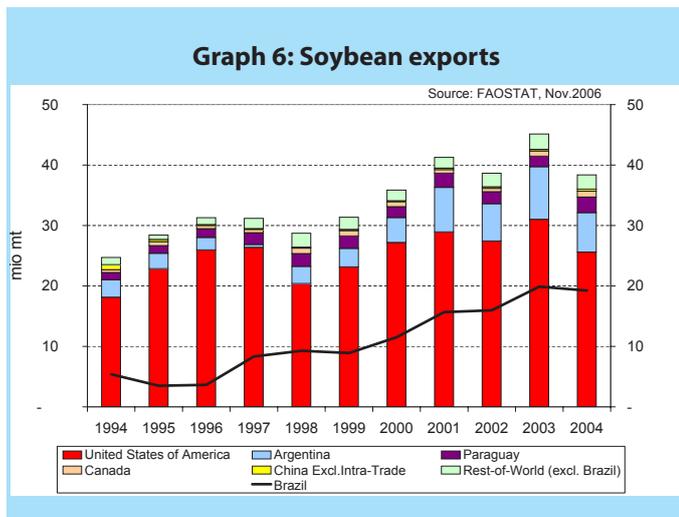
The short-term outlook is for a slowdown in the expansion of the sector as a result of reduced profitability, declining competitiveness and producer indebtedness. The latest estimates for soybean plantings even point to a fall in area of 4-10% for 2007/08.

Brazil's net exports of soybeans and products grew from 16 mio mt in 1995/96 to 37 mio mt in 2004/05. The main markets for Brazilian beans and products are the EU (17 mio tonnes) and China (8.5 mio tonnes). Brazil accounts for 33% of world trade, roughly the same as the US. Its share is forecast to grow to 45% over the coming decade, leaving the US trailing behind Argentina at 21%.

Ten years ago 90% of production was crushed at home, whereas currently this rate has fallen to about 50%. A



number of constraints have arisen because the expansion of production in the Centre West is located far from the crushing plants. In addition, some crushing has moved to Argentina, due to the introduction of differential export taxes in Argentina on soybean exports.



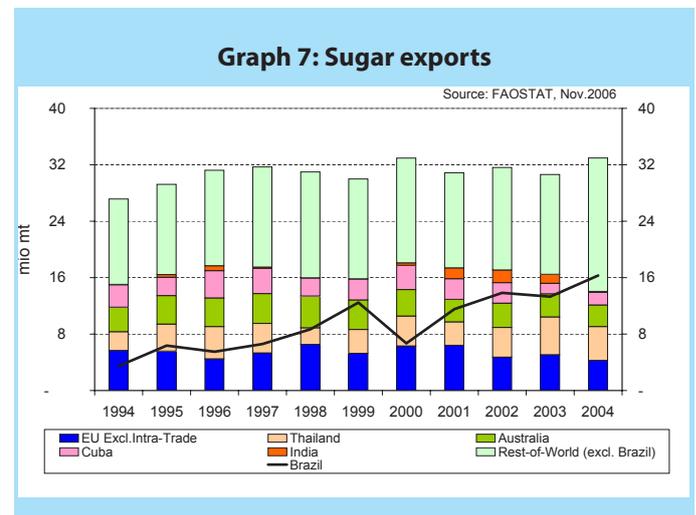
Around 2/3 of soya meal production is exported, mainly to the EU. Domestic demand has been driven by expansion in the livestock sector, in particular poultry which accounts for 2/3 of domestic consumption. Experts take different views on Brazil's export potential, depending on the growth of domestic livestock production as well as Brazil's GM status.

Soya oil production and exports have been fairly static in recent years. Industrial demand is likely to grow as biodiesel blending with fossil fuel becomes obligatory in Brazil from 2008. In addition the EU's biofuel target of 5.75% in petrol by 2010, could stimulate export demand.

Sugar,

Brazil is the world's leading producer of sugar cane, accounting for almost a third of global production. The sector is currently the fastest growing part of Brazil's agri-business. More than two thirds of the cane grown in Brazil is sold within the country, in the form of either sugar or alcohol. Brazil is the world's largest exporter of both ethanol and sugar.

Cane output is roughly split half and half between sugar and ethanol. Due to high prices for both products, the area of sugar cane is expanding, using acreage diverted from soybean and citrus cultivation. It is thought that up to 20 mio ha idle land in the Centre West could be used for cane. Production leaped from 328 mio mt in 2000 to 416 mio mt in 2003 and is expected to reach 500 mio mt in the next 6 to 7 years. A jump in productivity is also anticipated from about 2010-15, when GMO sugar cane comes on the market.



Sugar production in 2006/07 is estimated at 30 mio mt and could reach 40 mio mt by 2013. As the leading world exporter, mainly of raw sugar, Brazil accounts for around one third of trade. Russia is its biggest market, taking around 30% of exports. The rapid growth in Brazilian exports, which doubled from 2000 to 2003, explains to a large extent, the equally rapid and significant decline in world prices, as outlined in MAP December 2005. Whether Brazil will be able to fill the 5 mio mt gap in white sugar exports left by the EU, following the reform of the EU's Sugar regime, remains to be seen. If anything, recent announcements on future investments indicate that this is the most likely scenario.

Ethanol

Since 1975, Brazil has actively promoted the use of ethanol as a fuel. Flex-fuel cars now account for about three quarters of all new cars sales. The government plays a key role in the market, setting the percentage



of ethanol in gasoline between 20-25%. In 2006 the government increased its control of the market by declaring ethanol a strategic product. This allows the creation of buffer stocks and means exports have to be sanctioned by the National Petroleum Agency, which is strongly influenced by government.

Ethanol production in 2006/07 is estimated at about 17 bn litres. Exports reached 2.6 bn litres in 2005/06 and could be higher this season, following government adjustment to the gasoline blend. Brazil's share in the international ethanol market is close to 50%. In 2004 one fifth of Brazilian ethanol exports went to India. The US and South Korea were also important markets. Export potential is currently constrained by lack of infrastructure. However the potential is vast if biofuel demand in the EU and other developed markets expands as predicted (e.g. in Japan, new laws are anticipated requiring 3% blending of biofuels).

Cotton

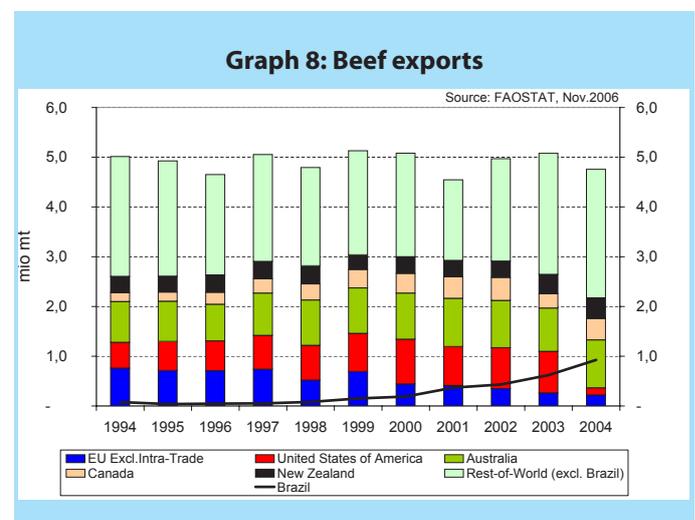
Brazil is the 5th largest cotton producer in the world after China, the US, India and Pakistan. Production is now concentrated in the Centre West, so with the increase in available land in this area, there is significant potential for expansion of production. Brazil's exportable surplus has grown and exports now account for around 40% of production. Brazil is also an importer of cotton, mainly from the US, but has the potential to become an important exporter in the next few years.

Beef

Brazil has the second largest cattle herd in the world after India and is the second biggest beef producer after the US (with 7.5 mio mt). Three quarters of production is on specialised farms, half on farms with over 500 cattle. Nearly all beef is extensive grass-fed. Cattle production is fairly evenly spread across the country, though over 1/3 is concentrated in the Centre West given the availability of cheap pasture.

Beef output has grown steadily since the early 90s, though the sharp increase in production is a relatively recent phenomenon since 2002 and has been export driven. Around 10% of certified slaughterhouses are

approved for export to the EU. However, it is estimated that up to half of the total production is outside the official slaughterhouses, destined for domestic consumption. Per capita consumption is high on average at 25 kg, but unequally distributed and so has strong growth potential as incomes improve.



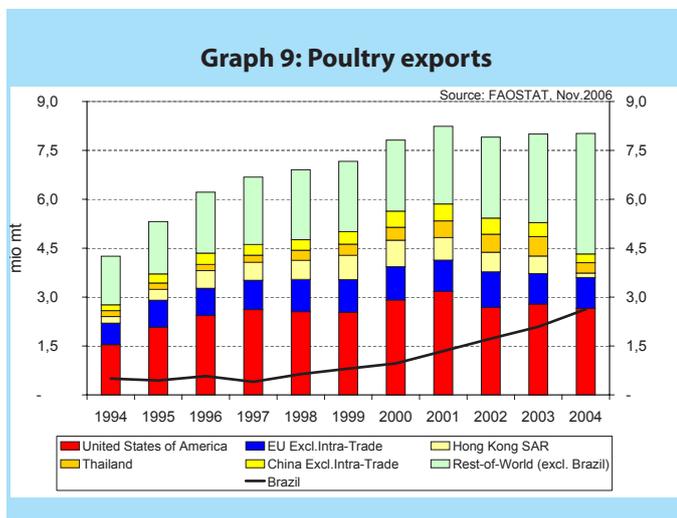
Exports have risen dramatically in recent years. The share of exported production jumped from 10% to 20% between 2002 and 2004, thanks to a competitive exchange rate, rising global demand and the near elimination of Foot and Mouth Disease (FMD) in most parts of Brazil. Brazil is now the world's leading exporter in volume terms. (Australia is the leading beef exporter by value). Brazilian beef exports hit a record 1.4 mio mt product weight in 2005, up from 1.2 mio mt in 2004, despite the outbreak of FMD late in October 2005. However some markets such as Chile (important in 2005), closed their borders to Brazilian meat in 2006.

Russia and the EU make up almost half of the beef market by value. The EU is currently the only developed market open to Brazilian fresh meat exports. The US does not allow imports of fresh beef although it is the leading destination for processed beef. Brazil has made serious attempts to move up the value chain and today most exports are fresh product (1.1 mio mt). The challenge now is to improve disease control to exploit potential new export markets in the USA and Asia, if the phenomenal growth in this sector is to be sustainable.



Poultry

The poultry industry is another Brazilian success story. Brazil is the third largest producer after the US and China. The industry has been expanding rapidly with an annual growth rate of 13% since 1990 and has the potential to expand further. The industry is modern and competitive and shows a high degree of vertical integration. It is also highly concentrated with a few large companies dominating the export market.



Production currently stands at 8.4 mio mt and is expected to increase by 50% over the next decade. This will have implications for maize and soya meal demand, as it accounts for 65% of domestic soya meal consumption. Domestic consumption of poultry meat currently accounts for around 70% of production. As demand is unlikely to keep pace with the expansion in output, there will be a growing exportable surplus.

Brazil has recently turned into the world's leading exporter of poultry meat with nearly 40% of the market. Exports tripled from 0.9 mio mt in 2000 to 2.8 mio mt in 2004. Over 30% of exports are sent to the Middle East in the form of whole poultry. However the market for poultry cuts is growing and now accounts for 60% of exports. The most important markets are the EU (again the only developed country market), Asia and Russia.

Pork

Big investment is anticipated in the pigmeat sector in the expectation that Brazil will become an important exporter in this sector too. Brazil is now the fourth largest producer in the world after China, the EU and the US. It is also the fourth largest exporter after the EU, US and Canada. Production has grown rapidly in recent years. The organisation of the sector is similar to that of the poultry sector, being highly concentrated and vertically integrated. At 2.7 mio mt in 2005, output has doubled since 1995. Consumption stands at just over 2 mio mt.

Pigmeat is not widely eaten in Brazil and there is room for growth in domestic consumption. Growth of the sector is mainly export led. Exports grew from just over 100,000 mt in 2000 to around 500 000 mt in 2004. Russia is the main market accounting for 60% of exports. There are currently no exports to developed countries. In this sector too, Brazil will need to tackle disease control if it is to avoid potential oversupply.

Fruits

Brazil, a growing net exporter of fruits in general, is also the largest orange producer in the world with over 18 mio mt, followed by the US and Mexico. The harvested area has fallen from 1990, making way for sugar cane, but yields have improved and production has increased. Around 80% of production is processed into juice and destined for export, with Brazil accounting for 80% of the world market. Over 70% of its exports are destined for the EU, followed by the US and Japan. Brazil is also the leading world producer of bananas, but up to now has not been a significant exporter, as production has been directed mainly at domestic consumption.

Coffee

Brazil is the largest coffee producer in the world with production of 2.4 mio mt, followed by Vietnam, Indonesia and Columbia. It is also the world's leading exporter, with 1.4 mio mt equivalent to 30% of total trade. The EU is Brazil's biggest customer taking around half its exports.



5. Conclusions & challenges for Brazilian policy

What conclusions can one derive from this brief description of developments in Brazilian agriculture? The impressive growth in Brazil's export capacity in recent years is linked to two factors: Firstly, to the significant policy reforms and investments in infrastructure that Brazil has undertaken in agriculture. Secondly, to the impact of macro-economic policy changes that affected Brazilian agriculture.

The first of these factors allowed Brazil to exploit the undeniable potential it has in agriculture production. This potential still exists and could certainly continue to be exploited in the future. The recent crisis in Brazil's farm sector is indicative of certain constraints that have affected commodities, whose growth was considered unstoppable up to now. Therefore, some adjustments may be needed, both with respect to further investment in infrastructure and with respect to other policies (from interest rate to environment) which have an impact on these commodities. But this should not hamper continued expansion of Brazil's export capacity of key commodities such as sugar, beef, poultry or soybeans.

Where more uncertainty exists, however, is in the linkage between Brazil's macro-economic policy and agriculture. The dominance of Brazil as a global agricultural exporter means that it is exposed to the chill winds of developments in world markets. Its trade surplus has led to a strengthening of the Real and a weakening in its competitiveness. As long as world commodity prices stay relatively high, producers are cushioned from the full effect of the stronger Real and the negative impact on Brazil's exports is mitigated. When these prices return to their long-term downward trend, however, the impact on Brazil becomes more evident as the problems of the soybean sector demonstrated earlier this year.

Furthermore, the level of public debt implies significant pressures on interest rates. So far, this has been dealt with by subsidising interest rates in agriculture. However, whether this continues in the future and to what extent, will be determined not only by agricultural policies but also by demands for investment in other areas of the economy.

In summary, one question posed in our review of world agricultural markets last year, was "how much will Brazil continue to export?" The answer seems to be "a lot". Exports will still be the driver of growth, but given the constraints that have emerged recently, they may slow down. The foot is now off the accelerator and maybe even gently dabbing the brakes.

In the next edition of MAP:

**Does the trade talk match the trade walk?
Exploding the trade myths**