The Keystone Report

February 10, 2004

Maximize Profits by Managing Market Risks

G7 Meeting fails to alter fundamentals in Foreign Currency Markets

This weekend's meeting of foreign finance ministers did little to alter the massive adjustments, which are taking place in foreign exchange markets.

Central bankers and finance ministers of the Group of Seven countries warned against "excess volatility" in currency values in a vague statement issued after their two-day meeting. Hosted by Federal Reserve Alan Greenspan and Treasury Secretary John Snow, the meeting brought together their counterparts from the G7 - Japan, Germany, Britain, France, Canada and Italy.

Officials from participating nations of the G7 - which includes the USA, Japan, Germany, Britain, France, Canada and Italy - worry the dollar's decline will sap strength from their economies. Japan in particular has been very active with US dollar purchasing intervention strategies in an attempt to keep the Yen from rising further against the US currency with the resultant negative impact on the export position and health of the Japanese economy.

Those concerns are expected to fall on deaf ears while the dollar's decline is seen as a boost to the U.S. economy. Snow and other U.S. officials have given no sign they are considering attempts to stem the dollar's fall, facing problematic twin budget and current account deficits. It will continue to be in the interest of the US economy to allow its currency to find a level that will restore the competitive position of the world's largest economy.

Currency movements can directly affect economies. When the dollar depreciates, it makes U.S. goods cheaper on world markets and makes foreign goods more expensive for Americans to buy. In this manner the current account deficit which is the difference between what Americans purchase from abroad and that which they sell to foreign customers will narrow.

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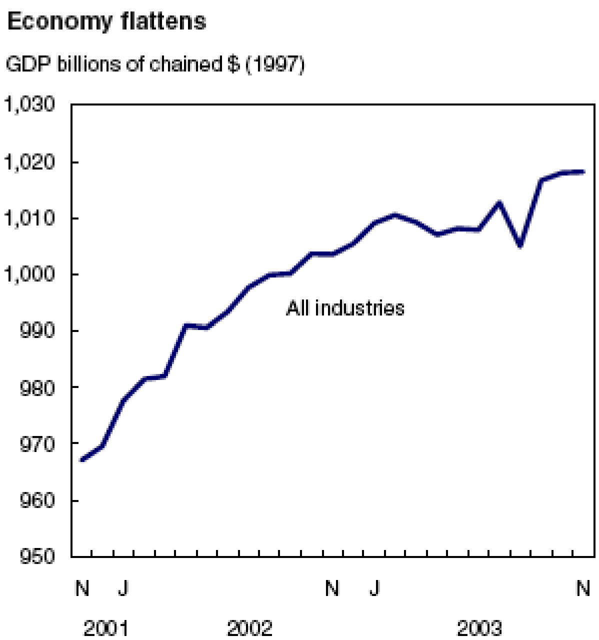
The impact on economies such as Europe and Japan can be quite significant as the long period of time in which they have enjoyed a competitive trade position particularly in manufactured goods and natural resource exports (Japan, Europe and Canada) will now be severely challenged.

Recent data on Canada's gross domestic product for the month of November indicated that the economy grew by a much slower pace than had been earlier forecast.



For the first 11 months of 2003, GDP was up 1.8% over the same period in 2002. Activity in the retailing sector which makes up a significant component of the domestic economy fell 0.5% in November.

Manufacturing output remained flat in November as gains by producers of chemicals and information and communication technologies (ICT) equipment were offset by losses by food and wood product manufacturers. Of significance was the decline in new motor vehicle sales that fell 3.2%, the fourth consecutive monthly decline, reflecting fewer sales incentives.

Eastern Canada Feeling the Impact of Trade and Currency Re-Alignment

With Canada enjoying a large trade surplus with the United States in the automotive sector, the impact of a stronger dollar will come to bear in a negative fashion on this all-important contributor to Canada's domestic economy. As a result further declines in the US currency and a resumed uptrend in the Canadian dollar would project increased concern and media attention, particularly in Eastern Canada, and calls for renewed action on US trade relationships on the part of Federal Government of Canada.

This will provide the natural resource sector, the grains, livestock and lumber economy, an historic opportunity to obtain a sympathetic hearing from the all powerful eastern lobbies, to facilitate fundamental institutional change in the conduct of business with Canada' s most important trading partner the United States.

Canadian Business Conditions Survey: Manufacturing industries January 2004 Statistics Canada

Manufacturers were cautiously optimistic regarding the outlook for the first quarter of 2004, after being dealt a series of economic blows in 2003, as a result of SARS, BSE (mad cow disease) and a major power blackout. With these events fading into the past, business confidence improved and greater satisfaction was expressed for production, finished products inventory levels and orders received. However, manufacturers still expressed some concern with low levels of unfilled orders.

Level of unfilled orders a source of concern

With 10% of manufacturers stating a higher-than-normal backlog and 23% expressing a lower-than-normal backlog, the balance of opinion concerning the current level of unfilled orders stood at

-13 in January, 1-point lower than October. Producers in the transportation equipment, machinery and fabricated metal product industries were the major contributors to the negative balance. According to the Monthly Survey of Manufacturing, manufacturers posted a 0.8% drop in unfilled orders in November to $37.2 billion, their lowest level in over six years.

Canadian manufacturing employment projects weaker

The balance of opinion for employment prospects for the next three months slipped 3 points to -2 in January. While 83% of manufacturers stated that they would keep or add to their workforce, 17% indicated that they expected to decrease employment in the coming quarter. According to the year-end report of the Labour Force Survey, manufacturers hired fewer employees in 2003.

Since November 2002, the number of manufacturing jobs declined by 82,000. On a monthly basis, manufacturing employment edged down 0.2% (-4,100 jobs) in December, following November's 1.0% boost. At year's end, there were just under 2.3 million people employed in Canadian factories.

Implications for Canadian Natural Resource Economy

The recent setback in the Canadian dollar has been largely driven by expectations that the Bank of Canada will continue to cut interest rates in order to offset the slower economic growth projections and the sharp rise in the value of the Canadian dollar.

At present Canadian interest rates remain at a 1.5 % premium to their US counterpart, such that a further rate cut would discourage a fresh influx in foreign capital flows. This assumption ignores the offsetting potential of a general increase in demand for natural resources for which Canada has an abundant supply. The global supply and demand balance for natural resource products is resulting in low carryover stocks for base metals, grains and energy supplies.

The ability to pay for these resources will be a function of a growing appetite from overseas economies that are seeking to improve their standard of living, such as the Asian economies, and notably China. *We will look for a resumption in the trend of the Canadian dollar to new higher levels and a demand based price appreciation in natural resource currencies and commodities*

Canadian Grain Stocks

Stocks of major Canadian grains, including both on-farm and commercially stored grains, were up sharply as of December 31, 2003, compared with the same date in 2002. The increase was the result of improved field crop production after the drought-reduced harvest of 2002 according to Statistics Canada.

Total stocks of grain at December 31

	2002	2003	2002 to 2003
	'000 tonnes		% change
All wheat	13,752	17,646	28
Wheat excluding durum	10,231	13,777	35
Barley	5,276	8,276	57
Grain corn	7,390	7,639	3
Durum wheat	3,520	3,869	10
Canola	3,178	4,060	28
Oats	1,533	2,165	41
Soybeans	1,612	1,272	-21
Dry peas	939	1,310	40
Flax	419	410	-2

Source: Statistics Canada

While the past year's improved growing conditions have resulted in a sharp rebound in production, overall stocks remain below long term averages in concert with declining global carryouts.

The wheat stock situation is of particular interest, both those on farms and those in commercial positions, amounted to 17.6 million tonnes as of December 31, 28% higher than the drought reduced level of 13.8 million tonnes in 2002.

Despite the gain, this amount was still well below the 10-year average of 21.1 million tonnes.

Stocks of durum wheat amounted to 3.9 million tonnes, up 10% from 3.5 million tonnes in December 2002., but well below the five-year average of 4.5 million tonnes.

Stocks of wheat excluding durum were 13.8 million tonnes, a 35% increase from the 10.2 million tonnes in 2002, but much below the 10-year average of 16.7 million tonnes.

The most visible price discovery instrument reflecting Canadian hard red spring wheat values are found on the Minneapolis Grain Exchange that has traded continuously since 1883.

At present the nearby March 2004 contract is challenging contract highs at the $4.20 per bushel mark, with the market playing close attention to further export business and the US new crop winter wheat crop condition in the major growing states of Kansas and Oklahoma.

A solid breakout from this level would establish a large upside price window into the $5.00 per bushel area last visited in the 2002 drought year and prior to the severe sell off which took place resulting from export competition from Russia and the Ukraine.

It would appear that the market is content to view the forecast rebound in this year's world wheat production as the dominant price setting force at present. The demand side of the equation has been receiving much less press, however export sales figures and the recently released January 13, USDA report, which indicated a decline in US winter wheat seedings, is providing for a mixed outlook to the wheat market.

US Export Sales: Weekly Sales Totals-Feb 5 2004

	wk's net change in commitments		total commitments		undlvd sales	
	this year	next year	this yr	last yr	this yr	next yr
wheat	545.5	30.0	25675.2	18201.9	6549.7	1001.0
corn	986.3	0.0	29357.8	22205.1	9043.2	56.7
soybeans	368.2	0.0	22428.7	23170.1	5114.7	2332.0
soymeal	21.8	31.8	3178.3	3770.3	1318.2	68.1
soyoil	2.5	0.0	175.7	422.2	70.9	4.4

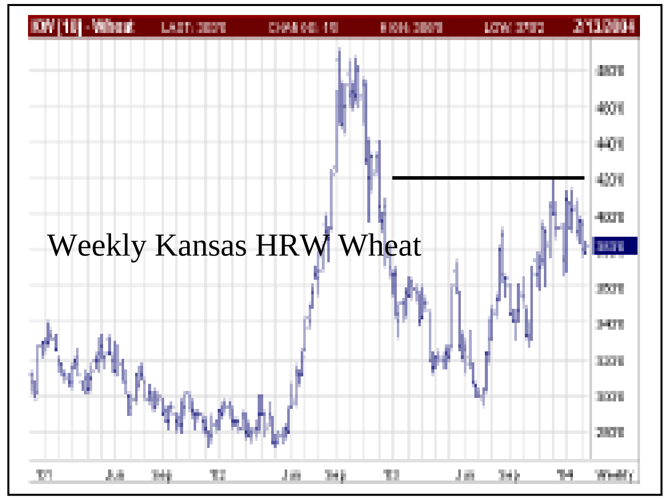
US wheat export sales are now running 41% ahead of year ago levels, with further sales increase likely prior to the onset of new crop winter wheat supplies and the steadily improving US export position along with the declining US dollar.

With strong soybean and corn markets, the prospects for a cut in spring wheat acreage in tomorrow's updated USDA Supply and Demand Report is likely.

Crop budgets calculated by a North Dakota State University extension farm management specialist suggest northern Plains farmers seeking to maximize profits should forget spring wheat and seed more acres to soybeans, sunflowers, malt barley or dry edible beans this season.

A similar scenario is developing in Canada, with canola prices providing the most optimistic new crop price outlook amongst competing grains in the coming year's seeding plans.

Should new crop wheat acreage estimates continue to decline in competition with oilseeds and feed grains, the prospect of a tighter than expected global wheat supply and demand balance sheets will pressure wheat futures to higher levels.



A recent winter storm has the potential to improve soil moisture conditions across the hard red winter wheat region. Areas from western Kansas into central Nebraska received from 4 to 8 inches of Snow, with snow also accumulating in the western Oklahoma and the Texas panhandle.

The moisture from the snow is greatly needed in the western HRW wheat, which has struggled for months with extreme dryness. The Kansas crop report confirmed that precipitation in January was light in most western areas, with heavier amounts in the central and eastern districts. At the start of February, Kansas topsoil moisture levels were rated 55% short to very short. The Kansas crop was rated 42% good to excellent at the start of the month, compared to 53% one month earlier and 33% for the same time last year.

The Oklahoma crop was rated 40% good to excellent, down from 45% last month. The Texas crop was listed at 11% good to excellent, up from 9% last week, but down from 16% in early January.

The Texas report said small grain conditions appeared to be improving in locations that received recent moisture, but that in the Plains, much of the wheat was stressed from freeze damage and lack of precipitation.

Overseas Wheat Markets

Ukraine

Ukraine 2004 spring wheat plantings are forecast at 500,000 to 600,000 hectares down from a previous estimate by the agriculture ministry of one million hectares, the Agrarian Policy Minister reported last Tuesday. The reduction in acreage is blamed on a lack of input resources.

Demand from the Ukraine following this year's short crop, is projected at 700,000 metric tons of milling wheat during the February-March 2004 time period , according to the Deputy Prime Minister of that country. Much of the Ukraine's import needs will be sourced from Kazakhstan, projected at between 200,000 to 300,000 tonnes, while the rest would have to come from the U.S., Canada and Australia.

Australia

Australian wheat production is forecast sharply higher following last year's severe drought, which reduced production to less than 10 million tonnes. Australia's 2003-04 wheat harvest is projected at a near-record 23.5 million metric tons, unchanged from the previous forecast, according to a report issued by the U.S. Department of Agriculture attaché and posted on the Foreign Agricultural Service Web site.

Australia has also been the primary beneficiary of recent export sales to Egypt that is a major overseas customer for US wheat.

Egypt

Egypt's main-state wheat buyer, the General Authority for Supply Commodities, or GASC, recently reported purchases of a total of 240,000 metric tons of US and Australian wheat in its tender for Feb. 16-29 delivery on a free-on-board basis. Of the total, GASC bought two 60,000-ton cargoes of Australian standard soft white wheat at $154.00/ton from AWB Ltd. as well as a cargo of Australian hard white wheat from AWB Ltd. at $166.75/ton. The US business amounted to only one 60,000-ton cargo of U.S. soft white wheat from Louis Dreyfus reported at $153.90/ton. When questioned as to why a larger quantity of more expensively priced Australian wheat instead of cheaper US white wheat in its recent tenders, GASC's general manager stated that: "Australian wheat is better value because of its higher quality. It has less moisture."

Other reasons for the preference for Australian wheat included an ocean freight differential amounting to approximately $20 per ton that Australia currently enjoys over the US.

Argentina

Currently Argentina's Agricultural Secretariat estimates 2003-04 wheat production at 12.4 million metric tons, which is close the December USDA forecast of 12.5 million. The Buenos Aires Cereals Exchange forecasts the 2004 Argentine wheat crop at an even larger 13.75 million tons, up from its previous estimate of 13.51 million. Today's revised USDA Supply and Demand report will be closely watched to see if last month's estimates by USDA will be revised higher as is expected for Australia.

China

While Egypt has been a traditional importer of North American and particularly US origin wheat, the wild card in export equation for the wheat market will be the amount and timing of additional Chinese imports.

Obtaining verifiable estimates of Chinese wheat production and stocks has been a rather inexact science at best, with Chinese traders being particularly adept at not showing their hand.

It is widely believed that China has been reducing its wheat stocks and is under some pressure from the US to step up purchases of US products to correct an ever widening trade surplus.