

OECD-FAO Agricultural Outlook 2018-2027

Methodology

This document provides information on how the projections in the *Agricultural Outlook* are generated. First, a general description of the agricultural baseline projections and the *Outlook* report is given. Second, the compilation of a consistent set of the assumptions on macroeconomic projections is discussed in more detail. Section 3 provides reference to the underlying Aglink-Cosimo model, while the last section explains how a partial stochastic analysis is performed with the Aglink-Cosimo model.

1 The process of generating the *OECD-FAO Agricultural Outlook*

The projections presented in are the result of a process that brings together information from a large number of sources. The projections rely on input from country and commodity experts, and from the OECD-FAO Aglink-Cosimo model of global agricultural markets. This economic model is also used to ensure the consistency of baseline projections. A large amount of expert judgement, however, is applied at various stages of the *Outlook* process. The *Agricultural Outlook* presents a unified assessment judged by the OECD and FAO Secretariats to be plausible given the underlying assumptions and the information available at the time of writing.

The starting point: Creation of an initial baseline

The data series for the historic values are drawn from OECD and FAO databases. For the most part, information in these databases has been taken from national statistical sources. Starting values for the likely future development of agricultural markets are developed separately by OECD for its member states and some non-member countries and by FAO for all remaining countries.

- On the OECD side, an annual questionnaire is circulated in the fall to national administrations. Through these questionnaires, the OECD Secretariat obtains information on how countries expect their agricultural sector to develop for the various commodities covered in the *Outlook*, as well as on the evolution of agricultural policies.
- On the FAO side, the starting projections for the country modules are developed through model-based projections and consultations with FAO commodity specialists.

External sources, such as the IMF, the World Bank and the UN, are also used to complete the view of the main economic forces determining market developments.

This part of the process is aimed at creating a first insight into possible market developments and at establishing the key assumptions which condition the *Outlook*. The main economic and policy assumptions are summarised in the Overview chapter and in

specific commodity tables. The sources for the assumptions are discussed in more detail further below.

As a next step, the OECD-FAO Aglink-Cosimo modelling framework is used to facilitate a consistent integration of the initial data and to derive an initial baseline of global market projections. The modelling framework ensures that at a global level, projected levels of consumption match with projected levels of production for the different commodities. The model is discussed in section three below.

In addition to quantities produced, consumed and traded, the baseline also includes projections for nominal prices (in local currency units) for the commodities concerned.¹

The initial baseline results are then reviewed:

- For the countries under the OECD Secretariat's responsibility, the initial baseline results are compared with the questionnaire replies. Any issues are discussed in bilateral exchanges with country experts.
- For country and regional modules developed by the FAO Secretariat, initial baseline results are reviewed by a wider circle of in-house and international experts.

Final baseline

At this stage, the global projection picture starts to emerge, and refinements are made according to a consensus view of both Secretariats and external advisors. On the basis of these discussions and updated information, a second baseline is produced. The information generated is used to prepare market assessments for biofuels, cereals, oilseeds, sugar, meats, fish and sea food, dairy products and cotton over the course of the *Outlook* period.

These results are then discussed at the annual meetings of the Group on Commodity Markets of the OECD Committee for Agriculture, which brings together experts from national administrations of OECD countries as well as experts from commodity organisations. Following comments by this group, and data revisions, the baseline projections are finalised.

The *Outlook* process implies that the baseline projections presented in this report are a combination of projections and expert knowledge. The use of a formal modelling framework reconciles inconsistencies between individual country projections and forms a global equilibrium for all commodity markets. The review process ensures that judgement of country experts is brought to bear on the projections and related analyses. However, the final responsibility for the projections and their interpretation rests with the OECD and FAO Secretariats.

The revised projections form the basis for the writing of the *Agricultural Outlook*, which is discussed by the Senior Management Committee of FAO's Department of Economic and Social Development and the OECD's Working Party on Agricultural Policies and Markets of the Committee for Agriculture in May, prior to publication. In addition, the *Outlook* will be used as a basis for analyses presented to the FAO's Committee on Commodity Problems and its various Intergovernmental Commodity Groups.

2 Sources and assumptions for the macroeconomic projections

Population estimates from the 2017 Revision of the United Nations Population Prospects database provide the population data used for all countries and regional aggregates in the *Outlook*. For the projection period, the medium variant set of estimates was selected for use from the four alternative projection variants (low, medium, high and constant fertility). The UN Population Prospects database was chosen because it represents a comprehensive source of reliable estimates which includes data for non-OECD developing countries. For consistency reasons, the same source is used for both the historical population estimates and the projection data.

The other macroeconomic series used in the Aglink-Cosimo model are real GDP, the GDP deflator, the private consumption expenditure (PCE) deflator, the Brent crude oil price (in US dollars per barrel) and exchange rates expressed as the local currency value of USD 1. Historical data for these series in OECD countries as well as Brazil, Argentina, the People's Republic of China and the Russian Federation are consistent with those published in the *OECD Economic Outlook* No. 102 (November 2017). For other economies, historical macroeconomic data were obtained from the IMF, *World Economic Outlook* (October 2017). Assumptions for 2018-2027 are based on the recent medium term macroeconomic projections of the OECD Economics Department, projections of the *OECD Economic Outlook* No. 102 and projections of the IMF.

The model uses indices for real GDP, consumer prices (PCE deflator) and producer prices (GDP deflator) which are constructed with the base year 2010 value being equal to 1. The assumption of constant real exchange rates implies that a country with higher (lower) inflation relative to the United States (as measured by the US GDP deflator) will have a depreciating (appreciating) currency and therefore an increasing (decreasing) exchange rate over the projection period, since the exchange rate is measured as the local currency value of USD 1. The calculation of the nominal exchange rate uses the percentage growth of the ratio "country-GDP deflator/US GDP deflator".

The oil price used to generate the Outlook until 2016 is taken from the short term update of the *OECD Economic Outlook* No. 102 (November 2017). For 2017, the annual average monthly spot price is used, while the average daily spot price for December 2017 is used as the oil price value for the year 2018. Brent crude oil prices from 2019 are projected to grow at the same rate as projected by the World Bank Commodities Price forecasts (October 2017).

3 The underlying Aglink-Cosimo model

Aglink-Cosimo is an economic model that analyses supply and demand of world agriculture. It is managed by the Secretariats of the OECD and Food and Agriculture Organization of the United Nations (FAO), and used to generate the *OECD-FAO Agricultural Outlook* and policy scenario analysis.

Aglink-Cosimo is a recursive-dynamic, partial equilibrium model used to simulate developments of annual market balances and prices for the main agricultural commodities produced, consumed and traded worldwide. The Aglink-Cosimo country and regional modules covering the whole world, and projections are developed and maintained by the OECD and FAO Secretariats in conjunction with country experts and national administrations. Several key characteristics are as follows:

- Aglink-Cosimo is a “partial equilibrium” model for the main agricultural commodities. Non-agricultural markets are not modelled and are treated exogenously to the model. As non-agricultural markets are exogenous, hypotheses concerning the paths of key macroeconomic variables are predetermined with no accounting of feedback from developments in agricultural markets to the economy as a whole.
- World markets for agricultural commodities are assumed to be competitive, with buyers and sellers acting as price takers. Market prices are determined through a global or regional equilibrium in supply and demand.
- Domestically produced and traded commodities are viewed to be homogeneous and thus perfect substitutes by buyers and sellers. In particular, importers do not distinguish commodities by country of origin as Aglink-Cosimo is not a spatial model. Imports and exports are nevertheless determined separately. This assumption will affect the results of analysis in which trade is a major driver.
- Aglink-Cosimo is recursive-dynamic, and outcomes for one year influence those for the next years (e.g. through herd sizes). Aglink-Cosimo models ten years into the future.

A detailed documentation of Aglink-Cosimo has been produced in 2015 and is available on www.agri-outlook.org.

The model used to generate the fish projections is operated as a satellite model to Aglink Cosimo. Exogenous assumptions are shared and interacting variables (e.g. prices for cross-price reactions) are exchanged. The fish model went through substantial revision in 2016. The aggregated aquaculture supply functions of 32 components of the model were replaced by 117 species-specific supply functions with specific elasticity, feed ration and time lag. The main species covered are salmon and trout, shrimp, tilapia, carp, catfish (including Pangasius), seabream and seabass, and molluscs. A few other minor productions such as milkfish were also included. The model was constructed so as to ensure consistency between the feed rations and the fishmeal and fish oil markets. Depending on the species, the feed rations can contain a maximum of five types of feed; fishmeal, fish oil, oilseed meals (or substitutes), vegetable oil and low protein feeds like cereals and brans.

The methodology of stochastic simulations with Aglink-Cosimo

The partial stochastic analysis highlights how alternative scenarios diverge from the baseline by treating a number of variables stochastically. The selection of variables treated stochastically aims at identifying the major sources of uncertainty for EU agricultural markets. In total, 42 country specific macroeconomic variables, the crude oil price, and 85 country- and product-specific yields are treated as uncertain within this partial stochastic framework. Apart from the international oil price, four macroeconomic variables are considered in major countries: consumer price index (CPI), gross domestic product index (GDPI), gross domestic product deflator (GDPD) and exchange rate (XR).² The yield variables are key crop and milk yields in important world markets. Among the key crops, we include wheat, barley, maize, oats, rye, rice, soybeans, rapeseeds, sunflower, palm oil, and sugar beet and cane.³

The methodology is thoroughly explained in Araujo-Enciso, Pieralli and Pérez-Domínguez (2017).⁴ The three main steps are briefly explained below.

(i) The quantification of the past variability around the trend for each macroeconomic and yield variable separately

For macroeconomic variables, the estimation is based on econometric estimation of vector autoregressive systems of equations for the period 2000-2016. The unexplained portion of uncertainty in each year for the different variables is considered. For yields, the uncertainty is based on the deviation between historical yields and a fitted cubic time trend for the period 2000-2016. Correlation between empirical distributions of yield errors for a given commodity is calculated by regional block, but is assumed to be zero among regional blocks. Both in macroeconomic and yield variables, the empirical distributions of the errors are used as input for step (ii) into hierarchical Archimedean copulas without further assumptions on the shape of the marginal distributions of uncertainty.

(ii) The generation of 1 000 sets of possible values for the stochastic variables

The second step involves generating 1 000 sets of possible values for the stochastic variables, thus reproducing the variability determined in step (i) for each year of the projection period 2018-2027. Macroeconomic and yield errors are separately included in a hierarchical Archimedean copula framework to flexibly simulate the correlation of the variables inside countries and regional blocks, respectively.

(iii) The execution of the Aglink-Cosimo model for each of these 1 000 possible alternative sets of values (uncertainty scenarios)

The third step involves running the AGLINK-COSIMO model for each of the 1 000 alternative “uncertainty” scenarios generated in step (ii). When including both macroeconomic and yield uncertainty, this procedure yielded 994 successful simulations. In the remaining six cases, the model did not solve. This can occur as the model is a complex system of equations and policies that may lead to infeasibilities when exposed to extreme shocks in one or several stochastic variables.

Notes

1. Trade data for regions, e.g. the European Union or regional aggregates of developing countries, refer only to extra-regional trade. This approach results in a smaller overall trade figure than cumulated national statistics. For further details on particular series, enquiries should be directed to the OECD and FAO Secretariats.
2. The countries considered are Australia, Brazil, Canada, China, Europe (E15 and New Member States, with a unique exchange rate), India, Japan, New Zealand, Russian Federation, and United States.
3. Among the key markets, we include Europe (E15 and New Member States), Kazakhstan, Ukraine, Russian Federation, Argentina, Brazil, Paraguay, Uruguay, Canada, Mexico, United States, Indonesia, Malaysia, Thailand, Viet Nam, Australia, China, India, and New Zealand.
4. Araujo Enciso, S., Pieralli, S. and I. Perez Dominguez (2017), “Partial Stochastic Analysis with the Aglink-Cosimo Model: A Methodological Overview”, EUR 28863 EN, Publications Office of the European Union, Luxembourg, 2017, doi: 10.2760/680976, JRC108837.