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HGCA

MI Prospects

AHDB Agriculture & Horticulture DEVELOPMENT BOARD

Can the recent price stability last?

Despite the fact that the 2012 UK wheat harvest is now more than 90% complete, **uncertainty over production is widespread**.

At this point in previous seasons the industry would normally be closing in on a reasonable consensus but huge variability in yields, even between neighbouring farms, is making this a difficult task. The added complication of generally lower specific weights only compounds the issue. With trade and industry holding a broad range of views, clarity is needed.

One side of the production equation - area - will be finalised this week, with **Defra's final England cereal and oilseed area statistics** due on Thursday. Scottish data will follow on 28 September.

In addition, the second release of the **AHDB/HGCA Cereal Quality Survey** has been brought forward to the end of this week. This will give further information on average specific weights, Hagberg Falling Numbers and protein content from wheat and barley samples received up to 17 September.

Globally, anticipated lower supplies of wheat and coarse grain in 2012/13 are **forcing an end to the long term demand growth trend**. Recently grain prices have traded in a relatively tight range but this stability will likely be challenged in the next few weeks as the USDA release quarterly stocks information and post harvest maize yield estimates.

Investment funds are a further potential source of volatility. The **'Funds' have been net-long** of CBOT maize and soyabeans for some time but are now also long of CBOT wheat. This reflects the tight global grain supply and demand situation but **increases the risk of a sell-off** should price change direction.

A hint of this was seen at the beginning of this week when news of better than expected US maize yields and rains in Australia anecdotally saw Funds selling off some of their positions.

Currency also has its role to play with the weaker dollar, following the announcement of QE3, closing the price gap between EU and US exports. The euro has shown gentle recovery against Sterling over the summer but is still considerably weaker than last year. For the UK farmer this means a lower Single Farm Payment in Sterling terms which, for some, will add to the impact of lower than budgeted yields.

Charlotte Garbutt

Grain Outlook Conference 16 October

AHDB's Jack Watts will be joined by international Eurozone economics expert Megan Greene, Mike O'Dea from risk management consultants FC Stone and Matthew Collins, Professor in Climate Change, University of Exeter. See www.hgca.com/events for more.

In this issue...

Global Grain Supply and Demand

Wheat and coarse grain availability is estimated to be lower in 2012/13, forcing an end to the long term demand growth trend. China's appetite for soyabeans continues to grow, but will be heavily dependent on supplies from South America.

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Introduction

Despite high prices, global grain markets experienced **relative stability in early September**. In the ten working days to 12 September, the Nov-12 UK feed wheat futures contract saw a daily closing range of less than £3/t versus £7.50/t for the same period in August, and almost £15/t in July.

However, this stability is unlikely to last. On 28 September the USDA release estimates of **quarterly grain stocks** in the US, which will give a measure of 2011/12 end season maize stocks. Also, on 11 October, the USDA will release further **supply and demand estimates** which following significant harvest progress, will give the first indication of US maize yields.

Current wheat prospects

As shown in Figure 1, the **UN's Food and Agriculture Organisation (FAO)** currently estimate the 2012/13 **global wheat crop** at 663Mt. 36Mt down on the record 2011 crop. It is more akin to the crop of 2010 and the fourth largest crop on record. As a result, FAO estimate **wheat demand** to be lower season-on-season by 4.6Mt at 687Mt. Although, according to FAO, this is the first season-on-season decline in global wheat demand since 2003/04m, making 2012/13 second only to 2011/12 for demand.

FAO estimate **wheat stocks** at the end of 2012/13 at 174Mt, 19Mt lower than the previous season and lowest since 2008/09. Usefully, FAO analyse **stocks-to-use** (STU) ratios for both the world, but also in respect of the main exporters. This is critical to the wheat market given the vast amount of stock held by non-exporting countries. For the end of 2012/13, FAO put the global STU ratio at 25.1%, 3% points below the previous season and the lowest since 2007/08. For the main exporters, the STU for 2012/13 is put at 15.5%, 3.6% points down on last season and also the lowest since 2007/08.

Figure 1 FAO Estimates of World Wheat Supply & Demand

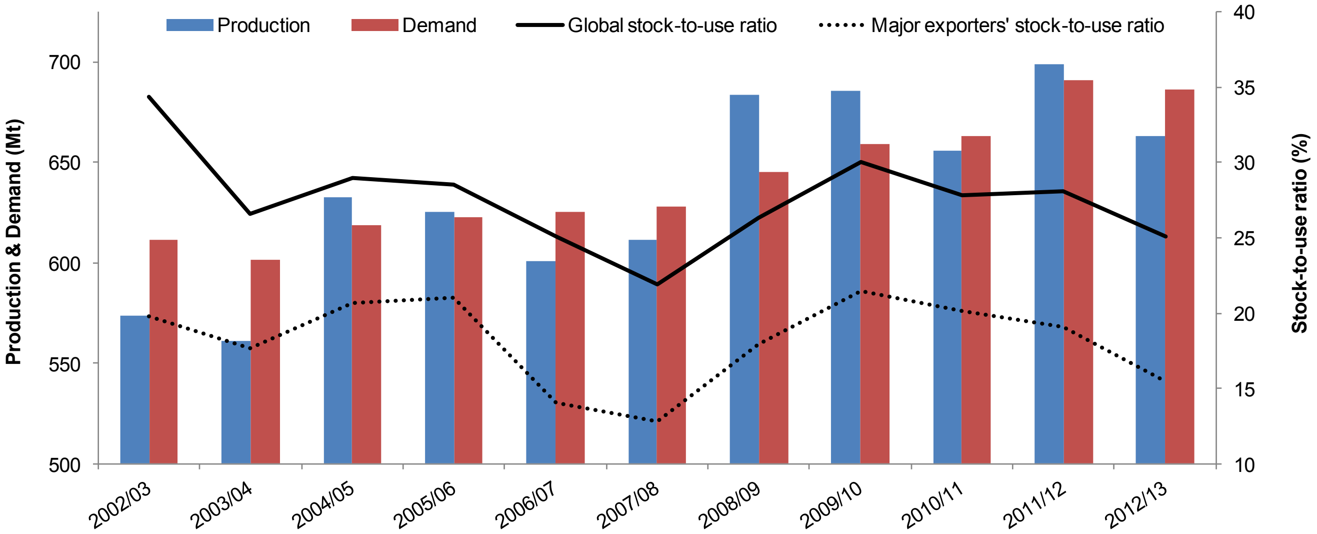
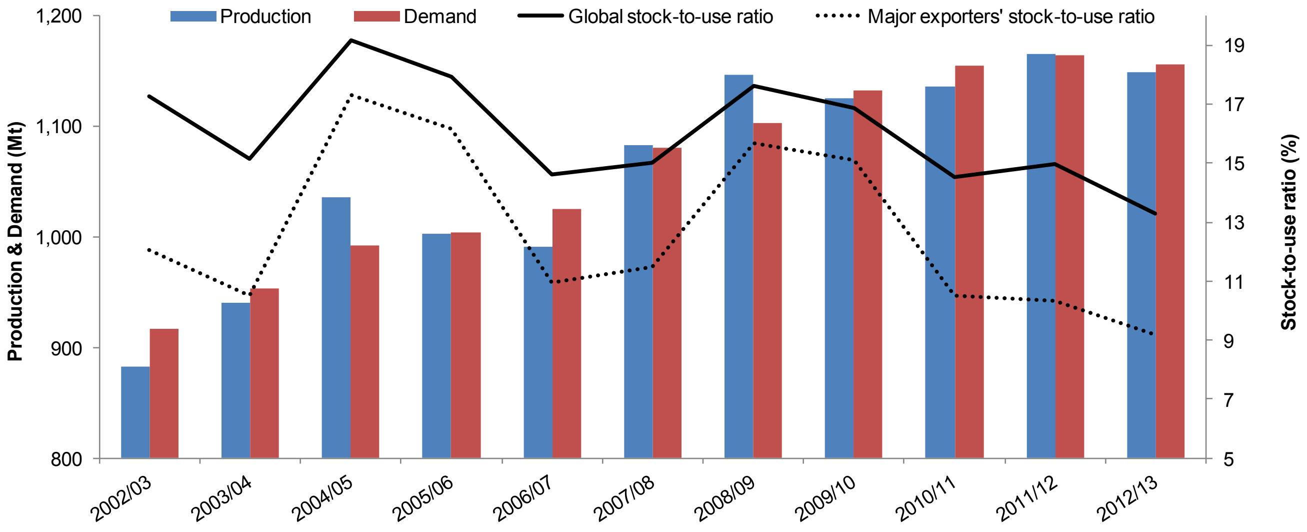


Figure 2 FAO Estimates of World Coarse Grain Supply & Demand



Global Grain Supply and Demand

Conclusion on wheat

2012/13 is likely to cause further erosion of wheat stocks as production stalls and demand remains relatively strong. In 2011/12 due to abundance of supply, wheat was largely a passenger of the maize market. However this season, the wheat market may need to be **more assertive with its price relationship with maize** to prevent too much feed demand transferring to the wheat market. The market is also likely to be more reliant on developing Australian and Argentine wheat crops - see the last Prospects for more.

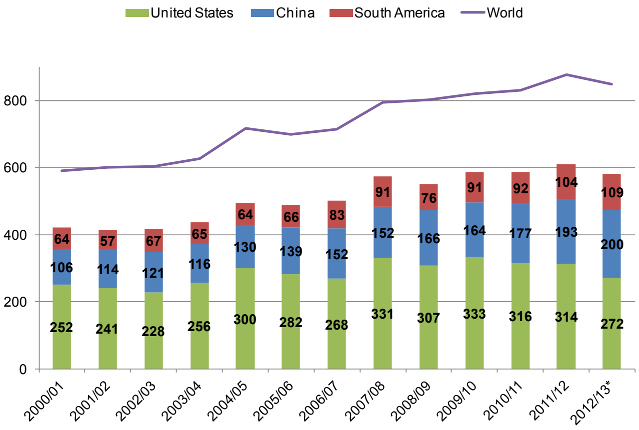
Current coarse grain prospects

The coarse grain market is dominated by maize (over 75% of production in 2011/12), but includes other grains such as barley, oats and sorghum. As Figure 2 shows, the world has become accustomed to generally progressive increases in production – setting new records year after year. However, **production in 2012/13 is expected to fall**, partly due to the severe US drought.

Historically, season-on-season growth in coarse grain demand has been consistent – until now, **breaking the long term trend**. Demonstrating the supply issues that the global feed grain market faces, and the importance of high prices in regulating demand. STU's at both the world level and for main exporters remain very delicate, much more so than for wheat.

Figure 3 shows the make-up of **global maize production**. The US drought is the critical issue here, reducing the domestic crop to its lowest since 2006. The anticipated record **Chinese production**, combined with high global prices looks set to regulate China's maize imports. The USDA peg China's 2012/13 maize imports at just 2Mt, down from 5.3Mt in 2011/12. However, this is heavily influenced by the global maize price so any noticeable fall in price could be supportive of Chinese buying.

Figure 3 Global Maize Production Estimates



**September 2012 forecast* *Source: USDA*

Ahead of the respective crop even being planted, the USDA are forecasting record **South American** maize production, as farmers respond to strong prices. However, the market is likely wanting to see the crop before it takes too much comfort from these estimates.

What's more, the global feed grain market in 2012/13 is likely to be more reliant on South America than ever before. Any weather issues, either negative or positive, emerging in the region over the coming months will have implications for global pricing.

Conclusion on coarse grains

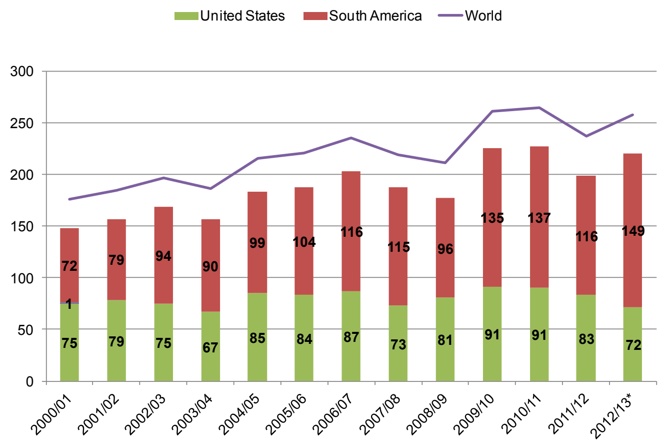
The course grain markets have now entered into a new era with an end to the long standing trend of ever increasing growth in production and demand. As a consequence, prices may need to remain historically strong to regulate demand and also encourage farmers to produce more.

Soyabean prospects

As Figure 4 depicts, the USDA currently expect the lowest **US** crop since 2003/04. However, just as with maize, increasing reliance is placed upon **South American** crops. These are yet to be planted, so as a result global oilseed price remains heavily dependant on weather.

South America will be key in supplying Chinese imports, which the USDA for 2012/13 put at 59.5Mt, up 1.5Mt on last season. Although this is a season-on-season increase, the rate of growth is slowing. The annual average rate since 2002/03 has been almost 4Mt.

Figure 4 Global Soyabean Production Estimates



**September 2012 forecast* *Source: USDA*

Conclusion on soyabeans

Much more than for maize, there is high dependence on South American crops, which have yet to be planted. With such high oilseed prices, it is important to monitor the palm oil market which may see additional demand at the expense of soy oil. As part of the global oilseeds complex, this is a key driver of UK oilseed rape prices.

Key Points

- Relatively calm markets in early September, but key information arriving soon.
- Global wheat supply and demand tightening in 2012/13 meaning it must be less of a 'passenger' of the maize market.
- The long term trend of coarse grain production / demand growth is now broken, propelling feed grain markets into a new era.
- Attention switching to South America, which will need to be a key supplier of soyabeans to China.

Funds Update

Investment Funds currently hold substantial net-long positions in two of the largest US cereal and oilseed markets, CBOT maize and CBOT soybeans, echoing the tight global supply and demand situations for the underlying commodities. They also now hold the largest net-long position in CBOT wheat since May 2004.

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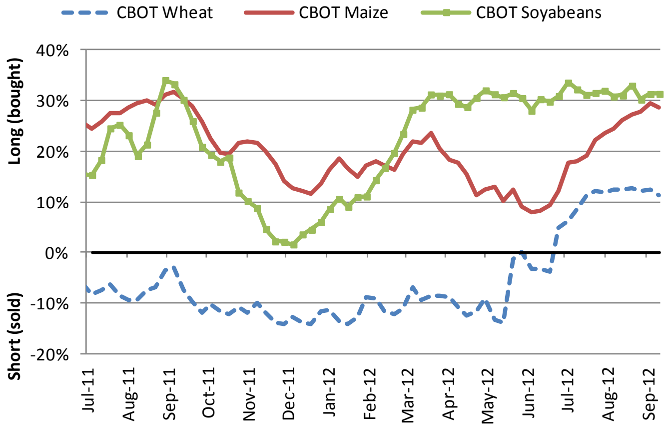
Introduction

Each week, the US Commodity Futures Trading Commission (CFTC) produces reports showing the positions held by different types of trader in futures markets. The 'non-commercial' category of traders includes professional money managers (e.g. hedge funds) and a wide array of other speculative traders who are collectively known as the **'funds'**.

When a trader chooses to be the 'seller' in more futures contracts than they are the 'buyer' they hold a **'net-short'** position. Conversely, when a trader chooses to be the 'buyer' in more futures contracts than they are the 'seller' they hold a **'net-long'** position. Typically, holding a net-short position would indicate a bearish view of a market, whereas a net-long position would suggest a bullish outlook. For more explanation, see Prospects Vol 12, Issue 17.

Figure 1 Non-commercial net positions as a percentage of open interest



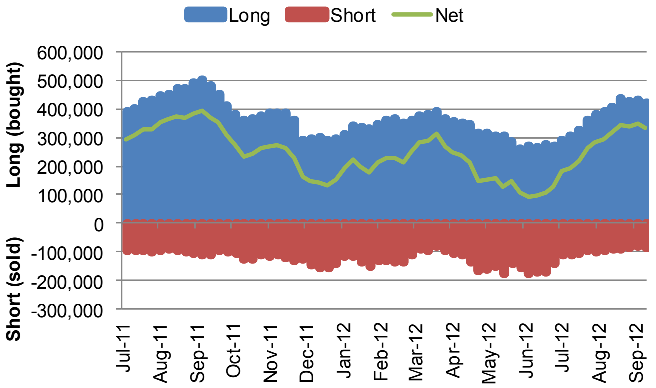
Source: CFTC

CBOT Maize

Since late June the 'funds' have built up an increasingly large number of long positions in CBOT maize, shown in Figure 2, while the number of shorts has remained relatively stable. Comparing the net-position in terms of contracts to the size of market, known as open interest, indicates the relative size of the net-position. The funds currently hold a net-long position equivalent to **nearly 30% of open interest.** The relative positions for the contracts discussed in this article are shown in Figure 1. Using this measure allows market positions to be compared across different commodity contracts despite the large variation in their open interest.

Taking a net-long position is a strategy often used by investors when they anticipate price rises. This reflects the increasingly tight global supply and demand situation as the extent of the US drought and also dry conditions in the Ukraine and Eastern Europe have become apparent.

Figure 2 Positions held by Non-commercial traders in CBOT Maize



Source: CFTC

CBOT Wheat

For wheat, the CFTC report for 26 June 2012 was the first to show the Funds taking a net-long position in CBOT since June 2011. Over the previous 12 months reports, they had held net-short positions, reflecting the heavy wheat stocks in US, particularly soft red winter (SRW) wheat. The CBOT wheat futures contract is based upon a specification for SRW wheat and closing stocks of SRW in the US for the 2011/12 season were equivalent to 39% of demand. However, end-season SRW wheat stocks are forecast to decline to 32% of demand during 2012/13 due to stronger export demand and a smaller crop.

US exports for nearly all classes of wheat are forecast to increase this season due to reduced availability in other major exporters such as Russia. Reflecting this, the Funds have held a net-long position of at least 11% of open interest since the middle of July - **the largest net-long positions in CBOT wheat since May 2004.**

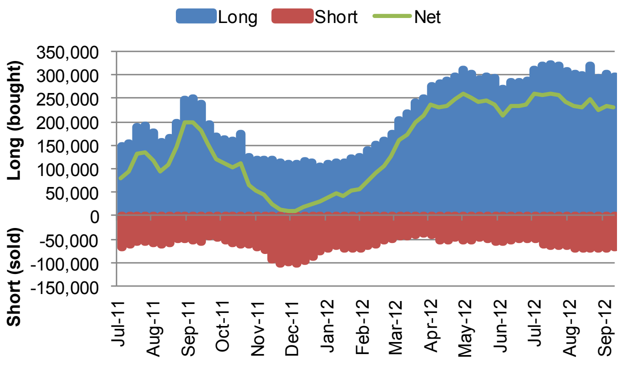
CBOT Soyabeans

Between December 2011 and March 2012, the funds moved from holding a nearly neutral position in CBOT soyabeans to a substantial net-long position equivalent to nearly 30% of the open interest (Figure 1). The increase in net-long reflects the changing supply and demand picture as dry weather affected yields in South America and supplies were less than initially predicted.

A net-long position of this size has now been maintained for nearly 6 months as prices have been supported by the lower planted area in the US and then by growing concerns over the impact of drought on US yield potential. During the same period, the size of the market reached new highs with over 800,000 open contracts, shown in figure 3. This increase in open interest has been facilitated or potentially led by the Funds who since March 2012 have accounted for between 37% and 39% of open interest compared with 30-36% in late 2011.

Funds Update

Figure 3 Positions held by Non-commercial traders in CBOT Soyabeans



Source: CFTC

Figure 4 Open Interest in CBOT Soyabeans

Source: CFTC

Where next?

The funds typically follow the market direction which is usually led by the supply and demand situation. However, activity by the Funds can amplify market movements both on the upside and the downside. As a result, large positions held by the Funds can present an additional 'risk' factor if the market direction changes. With the funds holding large net-long positions in CBOT wheat, maize and soybeans, **if the market begins to change direction** and 'stop-losses' are triggered the speed of movement is likely to be amplified. A stop-loss is a mechanism used by investors to minimise their losses if the market moves more than a set proportion or amount contrary to their position, thus there is a 'sell off' risk.

A small example of this was seen at the start of this week when bearish fundamental news caused a decline in prices and stimulated funds to sell-off some of their positions. This potentially added to the decline in prices in Chicago, particularly for soyabeans. However, prices stabilised somewhat on Tuesday (18 September).

Influence of External Factors

While the funds often follow fundamental factors (supply and demand) they can also be influenced by other factors external to commodities markets.

As result of the current global economic situation the US Federal Reserve announced on 13 September that they will be implementing a third round of economic stimulus known as quantitative easing (QE3). In the previous rounds of the policy, QE1 and QE2, the increased supply of money contributed to a weaker US dollar.

QE3 could also potentially encourage investors to maintain or even increase involvement in the commodity markets such as CBOT maize. The ongoing global economic situation can directly affect the potential returns from other markets such as equities and in this light commodities can look attractive.

Concluding Comments

Commodities continue to represent an investment opportunity for speculative traders and with the global economic situation affecting returns from other markets, this is likely to continue or even increase. This involvement facilitates hedging activity by processors, farmers, merchants and others directly involved with the physical commodities as they can be willing to trade when others are not. However, it is important to be aware of the positions held by the Funds as their involvement can amplify market movements and thus represent additional risks.

Key Points

- Fund involvement in commodities likely to continue
- Sell-off risk if prices begin to decline
- Funds generally follow supply and demand
- QE3 could influence future investment levels

End of Season Stocks

End of season on-farm wheat stocks in England and Wales fell in 2011/12 for the third consecutive season to 403Kt – the lowest level since 1999/00. These relatively low stock levels coincided with a delayed 2012 harvest giving support to spot prices through July and into August.

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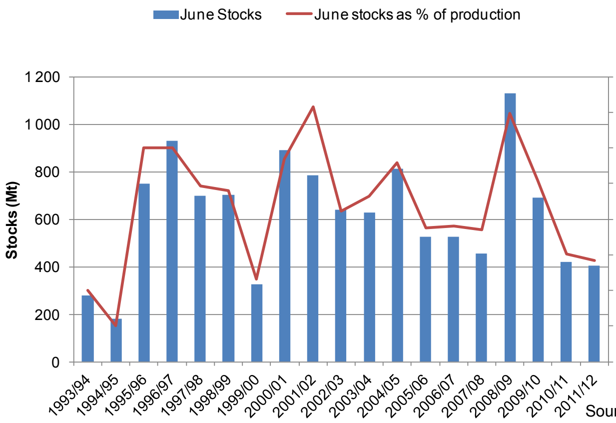
Introduction

Defra have recently published information on June grain stock levels, which is important information in formulating estimates for end season stocks. At the farm level, Defra publish results of the Cereals Stocks Survey for England and Wales. Stocks of both home-grown and imported grain are reported for merchants, co-operatives and ports UK wide. Via monthly usage data reports, Defra also publishes information on stocks held by UK millers and maltsters.

Wheat

End-June on-farm stock (for England and Wales) was at the lowest level since 1999/00 and 35% below the 10 year average. The data shows the third successive decline in on-farm stocks, representing a finely balanced domestic situation which is likely to be exacerbated by this year's late, lower than average yielding harvest.

Figure 1 On-Farm Wheat Stocks (England and Wales)

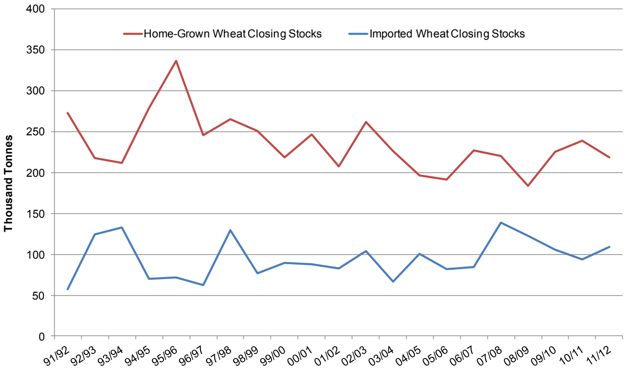


Source: Defra

Figure 2 shows the regional breakdown of on-farm wheat stocks and even though there is a noticeable decline in England and Wales, this is not the case for all of the regions. The most noticeable region is Yorkshire and the Humber, which saw an increase in wheat stocks of 15Kt to 77Kt – although this is still around half the stock level of 2010. A possible explanation of this may be attributed to the anticipated arrival of ethanol demand in the region.

Stocks held at UK merchants, co-ops and ports were 5.4% lower than at the same point last year, with a fall in home-grown stocks more than offsetting an increase in imported wheat.

Figure 3 Home-Grown and Imported Wheat Stocks held in June by UK Merchants, Co-ops and Ports



Source: Defra

With July usage data now available, UK millers (including starch and ethanol) held just 190.9Kt of wheat at the end of July. This is the **lowest since July 2009** and similar to July 2008. In contrast, stocks of imported wheat were 115.4Kt, the **highest since July 2008**. This is likely to have been driven by the delayed UK 2012 harvest as well as quality fears, which may have increased millers' reliance on imported wheat.

Barley

End-June on-farm barley stock (for England and Wales) was 13% higher than 2011 at 63Kt, but 31% lower than the 10 year average. However, large regional variation is seen with both the South East and Eastern regions holding less stock than at the same point in 2011. This reflects the lower barley production in these regions for the 2011 harvest. All other regions held larger stocks. Figure 4 shows a breakdown of regional farm stocks for the last five years.

Figure 2 Regional On Farm Wheat Stocks

Thousand Tonnes	June 2008	June 2009	June 2010	June 2011	June 2012	Change 2011 - 2012
North West	7	19	17	3	4	1
Yorkshire & The Humber	99	247	146	62	77	15
East Midlands	76	185	167	125	100	- 26
West Midlands	42	143	70	46	31	- 15
East of England	149	347	109	78	68	- 10
South East & London	32	41	53	45	54	9
South West & Wales	30	93	92	56	63	7
England & Wales	457	1 129	689	420	403	- 17

Source: Defra

End of Season Stocks

Figure 4 Regional On Farm Barley Stocks

Thousand Tonnes	June 2008	June 2009	June 2010	June 2011	June 2012	Change 2011 - 2012
North West	11	14	11	5	7	2
Yorkshire & The Humber	16	31	36	11	14	3
East Midlands	12	21	85	9	10	1
West Midlands	9	22	10	6	6	0
East of England	8	24	21	6	2	-4
South East & London	3	6	5	4	0	-4
South West & Wales	11	14	35	12	19	7
England & Wales	73	150	208	56	63	7

Source: Defra

Barley stocks held by UK merchants, co-ops and ports, were up 24% on the year from 250Kt in 2011 to 310Kt at end-June 2012. Imported barley and oat stocks (reported together) at 15.9Kt were the highest since reporting began in 2007.

Maltsters, distillers and brewers stocks were 4% up on the year before at end-June, likely reflecting the need to secure greater supplies to maintain the higher levels of usage seen in the last 12 months.
At the end of July stock had reduced to 445.8Kt, 1% below 2011 and reflecting the late arrival of harvest.

Oats

End-June on-farm oat stock was 10% down on the same point in 2011 at 14Kt, against a five-year average of 21Kt. No bought in oats were found in the survey (oats held on farm for feed use, but not grown on the same holding) against 2.5Kt in 2011. This mirrors the trend seen in the March stock survey and is supported by the uncompetitive pricing of oats to buy-in food feed relative to other cereals in 2011/12.

UK merchants, co-ops and ports held 17Kt of home grown oats at the end of June, the lowest in recent years. Although there is no split between imported barley and oats, it is likely that more imported oats were in stock at end-June 2012 than at the end of last season given the large increase in oat imports in 2011/12. HMRC trade data shows that the UK imported 57Kt of oats in 2011/12, over three times that of the year before to make up for a shortage in domestic supply. While this looks dramatic it should be noted that oat imports can vary significantly depending on the season.

Maize

Imported maize stocks held by merchants, co-ops and ports at end-June 2012 were the highest since the start of the dataset in 2007, at 105.7Kt. Home-grown maize stocks were also at a record high of 2.7Kt. This suggests that feed producers may be intending to use more maize in compound at the beginning of the 2012/13 season, although with imported maize prices currently higher than those of domestic feed wheat this is not a given.

July usage data shows that 12.1Kt of maize were used in feed rations in July, up 78% from July 2011 and 19% up on the previous month, against a year-on-year increase in total feed production of 7%. UK imports of maize were less than 1Mt last year, only the third time since 1995/96 that imports have been below this level.

Conclusion

End-June wheat stocks on-farm and held by merchants, co-ops and ports indicated a finely balanced supply situation ahead of the delayed 2012 harvest. Usage and trade figures for August (released in October) will be key to revealing the level of demand and the amount of wheat imported to compensate for lower stocks and late harvest.

Barley stocks are healthier than previous seasons, but remain below average. A respectable harvest this year, both in the UK and abroad, should ensure reasonable supplies of feed and malting barley. However, the price relationship between wheat and barley will determine how much barley is used in feed rations; in 2011/12 the proportion was low compared with previous seasons.

The increase in maize stocks and low imports follows two years of relatively low use in feed compounds. Historic records suggest that in years when UK wheat quality is low more maize is used in feed rations, and usage data over the next few months will demonstrate if this trend extends beyond July.

Key Points

- Domestic wheat stocks are down for the third year in a row.
- Barley stocks are variable by region
- Maize stocks are higher and more maize has been used in feed rations in July.

Single Farm Payments and the Euro

With the exchange rate used for calculating Single Farm Payments fixed on 30 September, the decline in the value of the Euro against UK Sterling over the last year indicates lower payments for UK farmers.

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The last year has seen a continued deterioration in the value of the Euro against all major currencies as the region continues to be plagued by instability. The last three months of 2011 saw the single currency fall almost 4% against Sterling, as investors fled the Euro in response to a flare-up of the **Greek debt crisis.** This created doubts about the EU's financial strength, and even the future viability of the currency itself.

The November 2011 crisis meeting of EU leaders briefly held the Euro just short of €1=£0.86 but by the end of 2011 it had fallen to a 12 month low of €1=£0.835. (Figure 1)

Figure 1 Euro exchange rate against UK Sterling

The Eurozone narrowly avoided a slide back into recession at the start of 2012. In December 2011 and February 2011, the European Central Bank injected €1,019bn into European Banks and giving them an unprecedented refinancing opportunity. This eased the stress on sovereign-debt and bank-funding, helping to reduce prospects of another credit crunch. However, renewed uncertainty about the financial sustainability of some Member States, a worsening growth outlook and still fragile banks, again caused investors to flee. As a result the Euro deteriorated against other major currencies.

The debt crisis continued to cast a cloud over growth prospects, though a series of EU summit meetings and negotiations with Greece made tentative progress towards stabilising the situation. By the end of July, the Euro had fallen to a four-year low at €1=£0.78.

Since July the Euro has seen some **gentle strengthening** amid renewed optimism in the region. The latest rescue package aimed at cutting Greek debts and G20 leaders pledging to safeguard the integrity and stability of the Euro area have both supported this trend. However, the single currency is expected to remain fragile for the foreseeable future.

Implications to the Single Farm Payments

The deterioration in the value of the Euro against Sterling over the last year has enormous implications for the UK's agricultural sector. Not only does it make UK exports relatively less competitive in the EU – and, by extension, imports to the UK relatively more competitive – but it has a direct impact on the value in Sterling of **UK Single Farm Payments.** These are set in Euros based on the exchange rate on **30 September** so a weak Euro relative to Sterling on that date results in a lower payment to the UK farmer.

When the 2011 rate was set last September it was at 86.665 pence for every Euro of support. Assuming the exchange rate does not change between now and 30 September, the Euro would be approximately **9% weaker against the Sterling** than at the same time last year.

Based on a payment of Eur250/ha, the UK farmer can expect to receive approximately £19/ha less in 2012 than 2011. Across an 100ha farm, this is £1,900 less income purely as a result of changes in the exchange rate.

There are tools available for farmers to hedge currency in relation to their Single Farm Payment and hence manage the risk. However, for those who accept the rate as at 30 September, Figure 2 shows that in 2012 they will likely receive their lowest Sterling payment since 2008.

Figure 2 The Impact of the Euro on Single Farm Payments

	€1=£	Value of €250 payment
2005	0.68195	£170
2006	0.6777	£169
2007	0.6989	£175
2008	0.7903	£198
2009	0.9093	£227
2010	0.85995	£215
2011	0.86665	£217
2012*	0.79	£198

* Based on weekly average as of 10/09/12

Source: AHDB

Closing Comment

Lower Single Farm Payments in 2012 for many will come on top of lower than budgeted wheat yields. These issues combined could have implications for whole farm profitability in the UK.

Megan Greene, Director of European Economics at Roubini Global Economics, will put current European economic issues into a wider global perspective at the AHDB/HGCA Grain Market Outlook Conference on 16 October.

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