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MI Prospects

UK struggling to shrug-off imports

For the UK, 2014 has been a massive year of transition for the grain market. Largely led by wheat, where the year-on-year production increase is the greatest on record, the UK market has had to move from being a net-importer to a net-exporter. This amplified the downward movement in global prices in UK terms, as the UK has had to move from being at the top of the price complex (to attract imports) to the bottom (to stimulate exports).

2014/15 is arguably a challenging year to re-emerge as an exporter:

- Large global production means tough competition, although recent Russian issues may help.
- A big European grain crop further increases competition in our main export markets
- The sheer size and quality issues of the French wheat crop forces our main competitor to be competitive, although this has lent support to milling premiums.
- Sterling's strength against the Euro further reduces UK competitiveness into European markets, however, weakness against the Dollar is forcing UK exporters to operate more in the global market, particularly with feed barley as well as milling wheat.

After two seasons as a net-importer, the UK market was under no illusion that returning to exports was going to be easy. However, the import side of the equation may have come as a surprise. As can be seen by clicking here, UK grain imports in the first four months of 2014/15 were down year-on-year, but still at levels associated with net-import status i.e. 2012/13. As a result, **it took until October for the UK to export more wheat than it imported** – the first month since May 2012, read more in Grain Market Daily.

For wheat, the ongoing strength (relative to a big production year) is fairly logical and comes down to the two extremes of the quality spectrum. At the top end of the market, the low protein content of UK bread wheat is forcing premiums toward import price levels. At the other end, the sheer abundance of French feed wheat is another factor, principally earlier in the season.

The other dynamic is maize, where imports remained strong throughout July to October, despite the big domestic grain crop. Essentially though, it appears that the size of the European maize crop is the bigger fundamental in determining the competitiveness into the UK market. This could be evidence to support the notion that maize is gradually becoming a more competitive feed grain - is this the start of a long-term trend or just a one off?

The upshot for the UK is, yes UK prices can follow global prices higher as issues such as Russia emerge. However, **to maintain exports and avoid unmanageable stock levels we need to be competitive so can't afford to be at the top of the price spectrum** – as was seen in 2012.

Jack Watts

In this issue...

Rapid establishment of autumn sown crops in the EU

Autumn-sown crops in the EU have become well established due to relatively high temperatures and moist conditions in most countries. In some cases there are concerns about too much crop development prior to the winter ahead. Some concerns also exist with regard to pest damage in oilseed rape following the ban on neonicotinoid seed treatments this year.

Sarah Nightingale, External Contributor
11 December 2014

Introduction

The EU sowing campaign for winter cereals and oilseeds for the 2015 harvest is just about complete. **While weather was not a major issue affecting sowing decisions, EU farmers have new policy constraints to take into account for the 2015/16 crop.** These include the "greening" (notably crop diversification) requirements of the Basic Payment Scheme (BPS), which takes effect on 1st January 2015, as well as the temporary ban imposed by the EU Commission on neonicotinoids since the beginning of the year.

Predominantly favourable conditions for sowing and emergence

Generally favourable sowing conditions across the EU through October and up to 20 November have been reported by the EU Commission, by which time most of the winter wheat, barley and rapeseed were sown. However, some delays to durum wheat sowings following torrential rainfall in the main producing regions have been reported. The following reports on sowing progress in the four principal EU arable producing countries (accounting for around 63% of EU wheat production in 2014).

Figure 1 Early forecast of EU-28 crop areas (M ha) by Strategie Grains

	Commercial crop year				% change 15/16 vs 14/15
	12/13	13/14	14/15	15/16	
Cereals	57.16	57.32	57.58	57.45	-0.23
Oilseeds	11.4	12.14	11.97	11.8	-1.42
Protein crops	1.25	1.18	1.23	1.25	+1.63
Set-aside and fallow land	6.04	5.233	5.019	5.277	+5.14

Source: Strategie Grains, November report

France

The **total wheat area in France is expected to remain at a similar level to last year** at 5.01M ha, while a very slight decrease in winter barley sowings is forecast (Strategie Grains). The main **French winter cereals were more advanced by 24 November than last year, and a higher proportion of them are rated "good" or "very good"** (Figure 2). The only region where some concerns exist for wheat, with 10% of its common wheat rated "poor" or "very poor", is Rhone Alpes, where heavy rains, particularly in the south of the region delayed sowings.

Figure 2 Development and condition of French winter wheat and barley

	Common wheat		Durum wheat		Barley	
	2013	2014	2013	2014	2013	2014
% sown by 24/11	90	99	64	88	99	100
% emerged by 24/11	82	95	47	73	97	100
% tillering by 24/11	31	48	0	4	53	71
% "good" or "very good"	81	93	73	91	81	93

Source: FranceAgriMer

While the average sowing date for common wheat in 2014 matches that for the previous four years (FranceAgriMer), mild conditions experienced in recent weeks have resulted in tillering being ahead by an average of three days compared with the previous four year average. Durum wheat, for which Strategie Grains forecasts an increase in sowings of around 24% due to the attractive gross margins of this crop, has been sown on average 5 days ahead of the average for the previous four years. The average sowing date for barley was ahead of the 4-year average by 1 day but emergence was ahead by 4 days.

A **smaller area sown to rapeseed is forecast for France** due to low margins at sowing time. The French oilseeds institute, CETIOM, suggested that some of the oilseed rape area could be replaced by linseed, soyabeans and field peas. In early December, CETIOM reported that **development of oilseed rape was "very satisfactory"** in all regions. While emergence had been patchy in the north-west of the country, the crops in that region had caught up, and the vast majority of crops were entering winter in a healthy state having reached the target stage of 8 leaves. It warns however that good vegetative development is masking generally poor root development. Weeds and pests have been an issue throughout the establishment period but have been manageable.

Germany

Agrarmarkt Informations-Gesellschaft mbH (AMI) reports (in private communication) that the area sown to wheat and barley this winter is slightly higher than last year, while rye area is down. **Mild autumn weather led to strong vegetative growth, causing concerns about frost susceptibilty, particularly of the rape crops.** Famers in northern Germany have reportedly

Rapid establishment of autumn sown crops in the EU

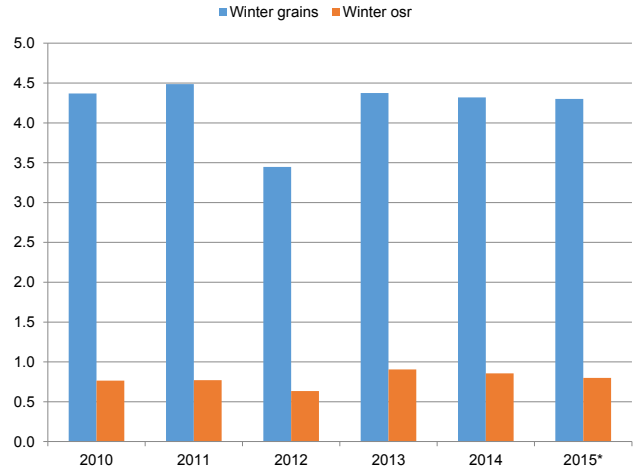
been cutting their barley crops and mulching because they are so overdeveloped. Many of the barley fields are also reported to be yellowish in colour following a very wet drilling period. The winter wheat looks generally better but is also overdeveloped.

With regard to oilseed rape, the Union for the Promotion of Oil and Protein Plants (UFOP) forecast a lower sown area this year, at 1.323M ha, which is down 5.2% on last year's winter-sown area. The largest decreases in areas sown were in the south of the country as well as the north-west. The principal reason for reducing oilseed rape area this year was reported to be long-term crop rotation planning (38% of respondents) while lower prices were reported to be the main reason for a decline in sowings in 11% of cases (read more on this here).

Poland

Sparks Poland forecasts **a similar, or slightly smaller area sown to winter cereals compared to last year** at 4.25-4.30M ha (4.32M ha); see Figure 3. In its October report, Overview of Grain, Feed and Oilseed Markets in Poland, Sparks suggests that while prices were not conducive to increasing the cereal area in Poland, the reduction in rapeseed prices and the lack of alternative crops for farmers mean that the change in area sown will be relatively limited. The north and north-west of the country has been suffering from a long-term water deficit, resulting in problems with autumn cultivations and sowing in these areas, with uneven emergence of seedlings reported. On the other hand, some regions in the south of the country have suffered from excess rainfall.

Figure 3 Areas sown to winter grains and winter oilseed rape in Poland (M ha)



** Forecast* *Source: Sparks Polska Sp.z O.O. (October report)*

The **Polish rapeseed area is also expected to be slightly lower** than last year at 800,000 ha. Sparks reports that the ratio of rapeseed to wheat prices at sowing time was about 1.9:1, which, while lower than last year, will not discourage sowings too much. The new CAP "greening" rules furthermore require the diversification of crops, and farmers may be limited with their other choices. **There is concern, however, about the ban on neonicotinoids** for the oilseed rape crop in Poland as the alternative, foliar spraying, is "less efficient and more expensive" with regard to crop protection.

UK

The Early Bird Survey showed initial expectations of a 5% decline in total wheat sowings for harvest 2015, a 12% increase in winter barley sowings, a 13% decrease in oat sown area, a 4% decrease in oilseed rape area and a 24% increase in the pulse sown area.

The latest ADAS report suggests that **crops were generally sown in good time in good conditions** and that vegetative growth is advanced at the start of winter. Weed control has been an issue, particularly for blackgrass, and foliar treatments have been necessary for oilseed rape seedlings following the ban on neonicotinoid seed treatments.

Concluding comments

Mild autumn temperatures and plentiful moisture have led to rapid establishment of autumn-sown crops in the EU. As temperatures fall to freezing in the UK, much of Europe remains relatively mild, and there are concerns in some regions about possible winterkill if temperatures drop very rapidly for the well-developed crops. It is difficult at this stage to assess the degree of any pest damage, particularly on rapeseed crops, which currently look healthy; the true effect of some pests on this crop may not be evident until the spring.

Key Points

- A mild and damp autumn across the EU resulted in good sowing conditions
- A reformed CAP imposes crop diversification requirements on large and medium-sized farms
- For oilseeds, lower prices are expected to lead to a reduced area for the 2015 harvest;

Price rally since planting supports a 'do nothing' approach to 2015 grain marketing, but a long way to go

The 2015 harvest pricing strategy demonstration has been live since 11 November, showing how different strategies can help to manage the risks of a volatile market. 'Post-Harvest Averager' is currently the top performing strategy (as at 8 December), just ahead of 'Cautiously Forward'.

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16 December 2014

Introduction

The five pricing strategies have been live and influenced by the market for several weeks, in which time grain markets have rallied, and also fallen. The upward trend was supported by bullish news including concerns over the 2015 crop prospects in Russia and Australia. With differing levels of unsold crop exposed to the market, each of the strategies has managed the price movement slightly differently.

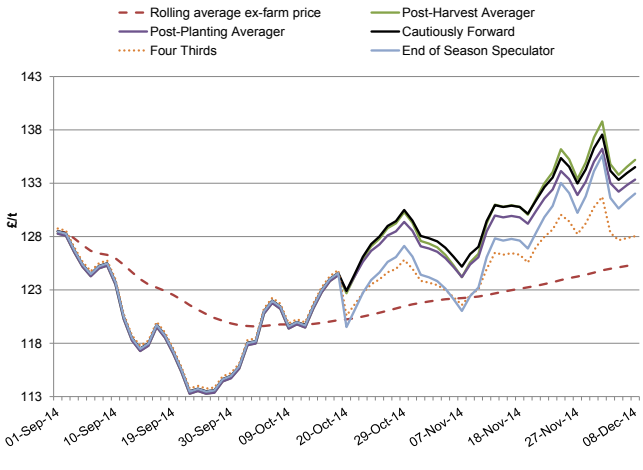
Please note: the pricing strategies have been designed as a price risk management demonstration. It is important to remember there is a limitation here in that it is a formulaic approach, and in reality pricing strategies should be designed to react to the evolving market. Keep up to date with the latest market conditions with Grain Market Daily.

Click here to read the 2015 pricing strategies launch article, as well as a concise description of each strategy.

Top Performers

From the launch of the 2015 pricing strategies (11 November) up until 8 December, May-15 UK feed wheat futures prices gained £10.25/t, peaking at £140.95/t on 2 December. Since the prices peaked, the market tracked back down by £4.70/t, and settled at £136.25/t on 8 December. The change in price direction has changed the general trend of the strategies, which had previously been increasing in value along with the market (Figure 1).

Figure 1 2015 Pricing strategies progress



Source: AHDB/HGCA

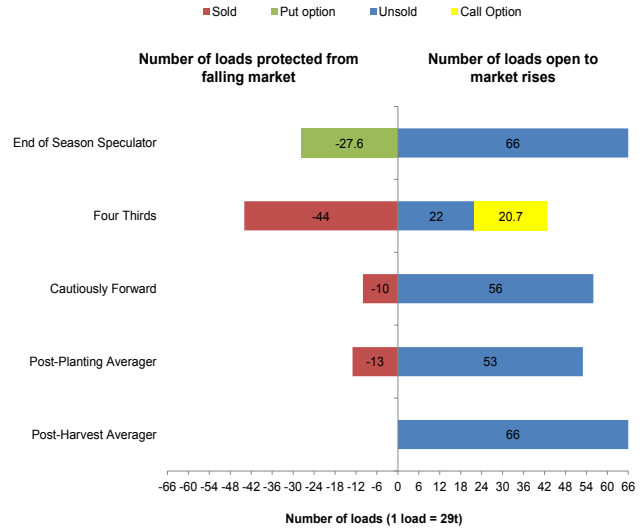
The **current top performing strategy is the 'Post-Harvest Averager'** (PHA) which (as at 8 December) is currently worth £135.19/t, just above the 'Cautiously Forward' (CF) strategy which is worth £134.51/t.

PHA and CF have been performing at a similar price since the beginning of October however, as at 30 October, 10 loads were sold under the CF strategy, lowering the level of market exposure which allowed PHA to pull slightly ahead with a larger volume, as the entire crop in this strategy is sold post-harvest. The recent market rally has been beneficial as the strategy, has been able to take advantage of the recent market strengthening, although PHA and 'End of Season Speculator' (ESS) hold the risk if the market falls.

Midfield Players

The 'Post-Planting Averager' (PPA) strategy has remained in the middle of the strategy rankings for the last month, sitting just ahead of ESS, and Four Thirds (FT). The value of ESS, as at 8 December, was £132.03/t. This level of market exposure does mean that although there is opportunity to gain value when the market rises, there is also a level of risk when the market falls (Figure 2). This was apparent when the market fell between 17-20 October as ESS dropped from being the third best performing strategy to the bottom of the ranks.

Figure 2 Market exposure



Source: AHDB/HGCA

It is important to take into account the level of exposure when strategies are being reviewed, however with ESS, the purpose of the strategy is to focus on prices at the end of the season. The falling value of ESS when the market prices dropped during the middle of October demonstrates that, although purchased at a premium, Put options can be highly beneficial for risk management when there is a high level of market exposure.

Price rally since planting supports a 'do nothing' approach to 2015 grain marketing, but a long way to go

Four Thirds

The 'Four Thirds' (FT) pricing strategy has made interesting progress and is now currently performing at the bottom of the ranks (Figure 1), despite being the top performing strategy up until 17 October.

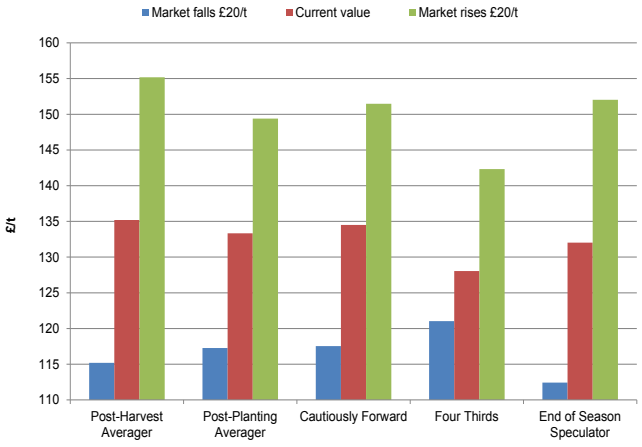
44 of the loads have already been sold; 22 loads on 20 October, and 22 loads on 20 November. In order to cover this forward selling approach, a Nov-15 UK feed wheat Call option for 600t was purchased on 17 October. The option premium was estimated to be £8.20/t with a strike price of £137/t. The strike price of the Call option was around £5/t 'out-the-money' to reduce the cost. Using an option here is ensuring that a minimum price is gained, although still allowing gains to be made if the market rises.

With the aggressive forward selling of this strategy, a lower volume of wheat is now exposed to any market movement. When the price fell in the middle of October, FT did not lose as much value as strategies with high volumes exposed, such as ESS. On the other hand, although the value of the strategy did not fall as aggressively, it has also taken longer to gain value in the recent rally (see below).

Resilience to market movements

Each of the strategies have been tested to review their resilience if the market was to fall by or gain £20/t (Figure 3).

Figure 3 Market strategy stress test



Source: AHDB/HGCA

The strategy with the most to gain from the increase is PHA, with a value of £135.19/t as at 8 December; a £20/t increase would directly increase the value of the strategy by £20/t as all of the loads are exposed to the rise in the market. However, it is important to remember that PHA could also directly lose £20/t. This is also the case for ESS, although with a Put option purchased for 800t of the crop, a certain level of security has been established.

The **strategy showing the most resilience is FT** which would fall by only £7/t from its value as at 8 December if the market were to drop by £20/t. With less tonnage exposed to the moving market and a Call option providing extra opportunity should the market rise, there is less risk of a loss for FT in times of market volatility.

Concluding Comments

Recent market volatility has reiterated the importance of planning a marketing strategy for the 2015 crop. The recent price rally demonstrated that pricing strategies with a less proactive approach i.e. do nothing until post-harvest (PHA), or until the end of the season (ESS), can be beneficial in the case of a rising market. However, stress tests confirm that this type of strategy also carries a substantial level of risk, with such a great amount of exposure to the market.

The next update will focus in more depth on another pricing strategy, as well as providing more analysis of the price components. If you have any particular questions or would like further detail on any of the strategies, please contact anna.lockwood@ahdb.org.uk.

Key Points

- The 'Post-Harvest Averager' is currently the top performing strategy
- Although exposed to an increasing market it is important to remember that 'do-nothing' strategies also carry substantial risk
- 'Four Thirds' is showing the most resilience to the moving market

Gross margins show stronger incentive to plant spring barley

Spring cropping may increase in popularity for harvest 2015 for a number of agronomic and policy reasons. Looking at gross margins alone, there is a stronger incentive to plant spring barley this year over other spring crops. Spring milling wheat may also be a popular choice, even if milling premiums next season are at a modest level.

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Introduction

While there can be greater risks with spring cropping compared with winter planting, **spring crops offer a number of benefits that may increase the popularity of spring planting in the UK this season**. With lower prices available during the winter planting window than in recent seasons, growers may take the opportunity to reduce weed and disease pressures through spring planting. Additionally, the new CAP 'greening' measures coming into force for harvest 2015 may encourage some growers to turn to spring crops, in order to satisfy the three-crop rule and/or plant spring pulses which can be included in Ecological Focus Areas (EFA).

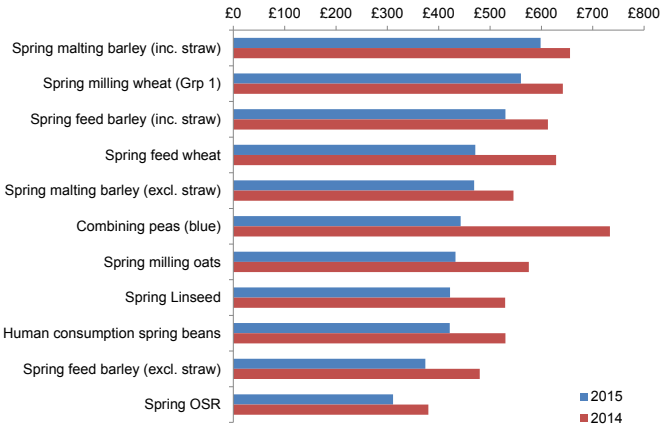
This analysis uses industry standard data on yields and costs, plus forward price assessments including estimated contract prices where applicable, in order to arrive at indicative gross margins for a range of spring crops in England.

The data is accurate as of early December 2014. Indicative gross margins are not equal to the gross margins for any individual farm, but instead are meant to be representative, at a national level, of the relative margins based on the options available to arable farmers this growing season. As such, gross margin analysis (Figure 1) can give an indication of the trends in the planted area for different spring crops that we may see this spring.

Straw as a risk management device for barley gross margins

Malting and feed barley, inclusive of straw values, have moved up to first and third in the rankings (from second and fifth respectively last year), with some of the smallest year-on-year declines in estimated average gross margins (Figure 2). These projections take into account an additional 40kg/ha K application for barley grown for grain alone and a £58/t straw value. Although the three-crop rule may also encourage the planting of spring barley, **gross margins are likely to incentivise an increase in spring barley area nonetheless**.

Figure 2 Projected 2015 gross margins against 2014 estimates (£/ha)



Sources: The Agricultural Budgeting and Costing Book, Trade, AHDB/HGCA, Defra

This also highlights the importance of straw as a risk management tool for barley crops. **With cereal prices at low levels, less variable straw prices can help to maintain some value at farm level**. Of course, this would also dampen the percentage gains in gross margins in a context of higher cereal prices. Note that, as a fixed cost, the cost of baling has not been included.

Figure 1 Projected 2015 gross margins

	Nov-15 price £/t	Yield t/ha	Gross Margin £/ha	Gross Margin Rank	Change in Gross Margin from last year
Spring milling wheat (Grp 1)	£155	6.00	**£560**	2	-13%
Spring feed wheat	£135	6.00	**£471**	4	-25%
Spring feed barley (inc. straw)*	£120	5.70	**£530**	3	-14%
Spring feed barley (excl. straw)	£120	5.70	**£374**	10	-22%
Spring malting barley (inc. straw)*	£144	5.25	**£598**	1	-9%
Spring malting barley (excl. straw)	£144	5.25	**£469**	5	-14%
Spring milling oats^	£125	5.50	**£433**	7	-25%
Spring OSR	£255	2.40	**£311**	11	-18%
Spring linseed^	£350	2.00	**£422**	8	-20%
Combining peas (blue)^	£200	3.80	**£443**	6	-40%
Human consumption spring beans^	£192	3.80	**£421**	9	-20%

**Straw valued at £58/t ^Assuming contract growing at this price*

Sources: The Agricultural Budgeting and Costing Book, Trade, AHDB/HGCA, Defra

Gross margins show stronger incentive to plant spring barley

Oats

Spring milling oats look to remain a relatively niche option based on the margin available, with estimated contract prices for milling oats trading lower relative to feed wheat than last year. This is perhaps unsurprising after another bumper oat crop for the UK has resulted in ample supplies on the open market.

Break crop options

The three-crop rule combined with EFA regulations in England are widely expected to lead to an increase in spring pulse area in 2015. However**, gross margins alone for blue peas and human consumption beans do not appear to offer an incentive to plant a larger national area** to these crops. For spring beans, output per hectare has actually increased relative to other crops, with very little price decline from last year. However, higher seed prices for spring beans have offset this. For blue peas, much lower forward prices than at this point last year have moved the crop lower in the rankings.

On the other hand, the alternative break crop **spring oilseed rape remains at the bottom of the rankings.** While linseed gross margins remain almost identical to spring beans as they were last year, the specialist skills needed (as with any crop) could significantly affect a farmer's potential gains from linseed. As such, **there will be far more technical and agronomic factors affecting farmers' decisions**, than if choosing between these crops on gross margins alone.

Uncertain top positions for malting barley and milling wheat

This season has especially demonstrated the **uncertainty of quality premiums until harvest quality is known**. The bread milling and malting premiums have been taken as £20/t and £24/t respectively, based on 5-year average premiums over ex-farm feed wheat and feed barley prices. However, the actual level will most likely be dependent on harvest quality, as well as closing stock levels of high quality grain (especially on the milling wheat side). Figure 3 demonstrates the effects various milling and malting premiums would have on average gross margins.

While a malting premium equal to that in four of the past five years would keep malting barley as the top ranked option, **gross margins on milling wheat this year will be particularly sensitive to the premium that can be achieved**. With much lower general price levels than in the past couple of seasons, achieving a moderate to strong premium for group 1milling wheat (assuming full bread specification is met) is particularly important to the projected gross margin.

Figure 3 Sensitivity of gross margins to different premiums

Group 1 bread milling wheat gross margin sensitivity						
	If milling premium is equal to:					
	2010/11	2011/12	2013/14	Model	2012/13	2014/15*
Premium (£/t)	2.9	13	19.6	**20**	26.4	38.1
Gross Margin (£/ha)	£457	£518	£558	**£560**	£598	£669
Gross Margin rank	5	3	2	**2**	1	1

**Season to date*

Premium malting barley (incl. straw) gross margin sensitivity						
	If malting premium is equal to:					
	2013/14	2014/15*	2010/11	Model	2012/13	2011/12
Premium	13	17.4	18.1	**24**	25.2	46.6
Gross Margin (£/ha)	£541	£564	£567	**£598**	£605	£717
Gross Margin rank	2	1	1	**1**	1	1

**Season to date*

Sources: The Agricultural Budgeting and Costing Book, Trade, AHDB/HGCA, Defra

Given the uncertainty over future premiums, however, some planting decisions may be based on current milling (read more here) and malting premiums. Looking at Figure 3, **if gross margins are modelled using 2014/15 premiums to date, milling wheat becomes substantially more attractive than malting barley**, in turn implying a greater shift into spring milling wheat. As such, farmers' expectations of premiums next season will be a key determinant of the relative areas.

Conclusions

Based on gross margins alone, **an increase in both spring feed and malting barley area in 2015 in England could be expected**, as well as spring milling wheat. The spring milling oat area may well fall due to lower incentives to plant the crop, while spring oilseed rape gross margins continue to appear relatively unattractive. The incentive to plant the pulses analysed here (spring blue peas and spring human consumption beans) appears to have declined, but there are many other reasons why pulses may be planted this season aside from gross margins alone.

Key Points

- Favourable gross margins for spring malting and feed barley may increase planted area in 2015
- Gross margins offer lower incentives to plant pulses than last year, although the new CAP reform may result in an expansion in pulse area
- The spring milling wheat area could increase, but will be especially dependent on farmers' expectations of premiums next season

Is it worth keeping an eye on markets over the festive period?

Grain markets are typically characterised by low trading volumes during the Christmas and New Year holiday period. This potentially exposes markets to enhanced volatility should any news break during this period on fundamental supply and demand or bigger picture issues such as geo-politics.

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23 December 2014

Historical grain price moves during the festive period

Figure 1 gives an overview of how futures prices for the UK feed wheat futures May contract have changed over the festive period in recent years.

Figure 1 Movement in May feed wheat futures price

**or nearest working day* *Source: AHDB/HGCA*

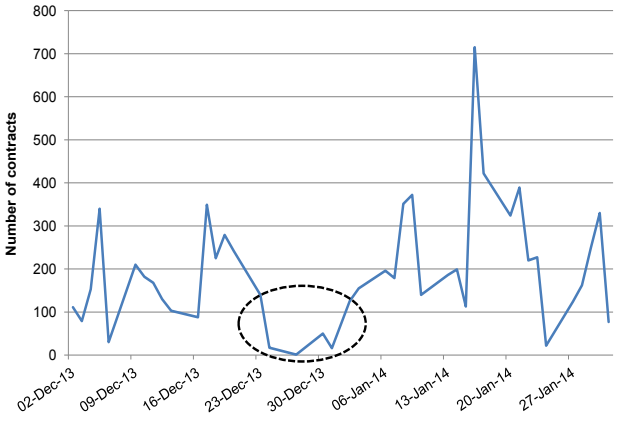
As is fairly logical, the last five years show the market doesn't show any particular price direction during Christmas and New Year. Although many might well be in 'holiday mode', Figure 1 suggests that markets remain volatile, with some years showing significant price moves. This underpins the need to perhaps have half an eye open to market activity this year, especially given the level of uncertainty recently experienced in markets.

Volume matter

Although futures markets remain open on working days through the holiday season, traded volumes are typically at their lowest. This often makes prices more 'jumpy', as lower activity in a market is likely to lead to wider bid and offer price levels. This means that if, say, a buyer needs to trade futures, they may have to increase their 'bid' price more than in a normal trading day to reach the 'offer' price. The reverse is true for a seller that needs to trade futures.

Figure 2 gives a summary of daily traded volumes a year ago for the May-14 contract. Heading into the Christmas period, traded volume quickly fell away but soon returned to previous levels once into January.

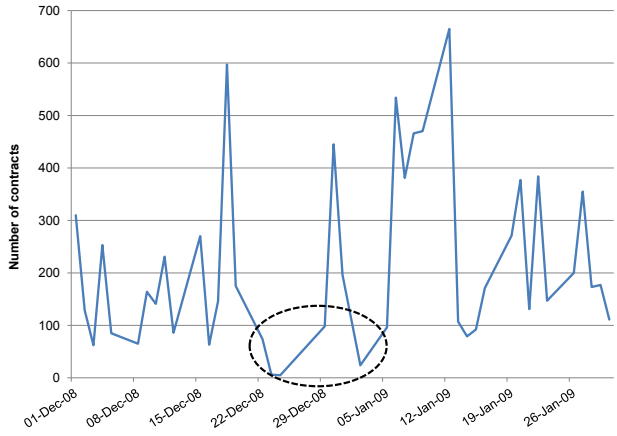
Figure 2 Number of contracts traded daily on May-14 feed wheat futures in Dec-13 and Jan-14



Source: Reuters

However, it would be too presumptuous to assume that the entire festive season will be lifeless in terms of market volume. Figure 3 looks at the same volume data, but for the May-09 futures contract during December and January 2008/09. On New Year's Eve 2008 there was a large spike in volume – probably as a result of the market reaching a three month high the day before.

Figure 3 Number of contracts traded daily on May-09 feed wheat futures in Dec-08 and Jan-09



Source: Reuters

Potential for volatility this festive season

It is arguable that the current market situation presents sufficient ingredients for a volatile holiday period. Firstly, with a large crop in the barn there is crop to trade – unlike the last couple of years. Secondly, it is likely that the current market sentiment surrounding Russia will likely fuel uncertainty – a driver of volatility at any time of year.

We will continue producing reports during the holiday period, so stay up to date at www.hgca.com/markets.

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