4 March 2015 / Vol 17 Issue 18

MI Prospects

Analyst's Insight: Non-EU markets key this season, and beyond?

UK grain exports to non-EU destinations are performing well so far this season. Relatively large volumes of both wheat and barley have been shipped (July-December), an opportunity gained from the depreciation of sterling against the US dollar.

This success outside the EU has been particularly important this season given the large crops harvested in 2014, and the challenges in exporting to the eurozone – read more here. Difficulties have stemmed from the high supply of feed grains as well as increased availability of lower protein wheat in mainland Europe, both unique factors to this season. Nonetheless, the situation is undoubtedly compounded by the weakening of the euro against sterling (Figure 1).

And as thoughts increasingly turn to the new crop situation, **it seems more likely than not that these non-EU destinations will again be important for the UK in 2015/16**. Based on the current economic outlooks, it is projected that the weakness in the euro will persist, at least in the medium term – read more here.

As a result, it is difficult to imagine exchange rates boosting the competiveness of UK grain into the eurozone any time soon.

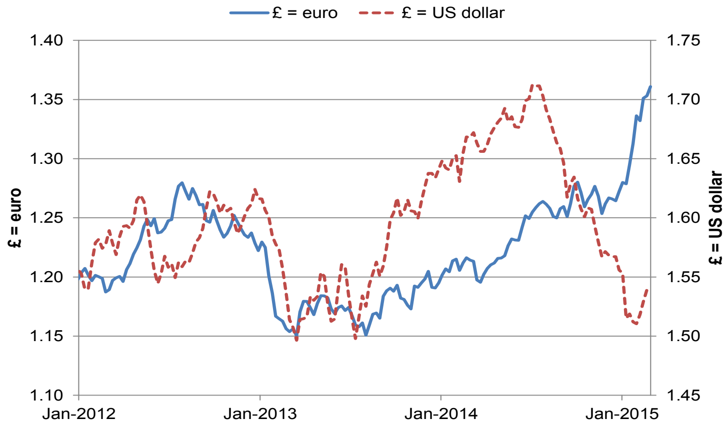
The AHDB/ HGCA Winter Planting survey points to a drop in winter wheat plantings, but the winter barley area remaining historically strong for harvest 2015 in England and Wales. Equivalent results in Scotland will add to the picture on 17 March, but the final UK area is far from certain and spring planting is looking to be of increased importance this year.

Production will depend on both the final area and yield levels, so there is still all to play for in terms of UK output in 2015. However, there is no reason yet why the UK wouldn't again be looking to export grain in the upcoming marketing season.

The outlook for the eurozone points to export destinations outside the EU being at least as important as this season. Consequently, the **UK will need to remain competitive against world markets in the year ahead and monitoring the £/US$ rate retains its increased importance.**

Helen Plant

Figure 1 Sterling vs euro and US dollar



Source: European Central Bank

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USDA Agricultural Projections to 2024

The latest USDA long-term projections for agricultural commodities are positive for demand and trade in all agricultural products as world population and GDP are forecast to increase steadily in the years ahead.

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Resilience to falling prices key in current market conditions – 2015 marketing pricing

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19 February 2015

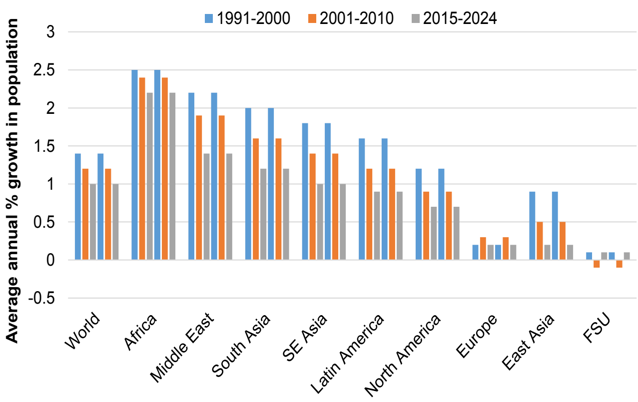
Introduction

The USDA published its annual long-term projections for the agricultural sector on 11th February. These cover agricultural commodities and trade as well as US farm profitability and trade value projections over the next 10 years. They are useful indicators of possible trade developments over the next decade, which will have direct or indirect impacts on the UK agricultural sector.

Population and economic growth drive demand for agricultural products

One of the key assumptions in these projections is an average world **population growth rate** of 1.0% per year between 2015 and 2024. This is a reduction from the 1.2% annual rate seen between 2001 and 2010 (Figure 1). While the annual average population growth rate in developed countries is estimated at 0.4%, it is forecast much higher in developing countries, although it is lower than in previous decades in these regions. Sub-Saharan Africa, for example, is projected to have the largest average growth rate of 2.3% per year over the next 10 years.

Figure 1 Population growth slowing



Source: USDA

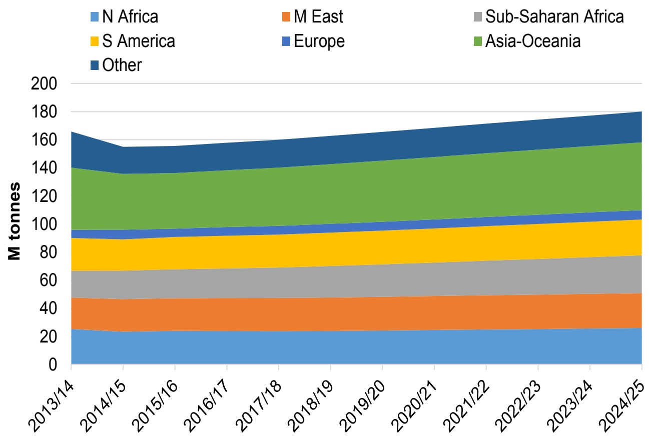
Global gross domestic product (GDP) is projected to grow at an average annual rate of around 3.5%. The **strongest growth is anticipated in developing countries** where GDP is projected to increase by an average rate of 5.5% per year. Developed economies are expected to grow by an average of 2.1% annually in 2015-24, with particularly slow growth anticipated in Europe (1.9%) and Japan (0.9%).

The **combination of population growth and strong economic growth in developing countries will affect both food and feed demand**. As incomes grow in developing countries, demand tends to shift towards more meat and dairy products in these countries as well as processed and higher value foods. While imports of livestock products are seen to increase, a significant increase in imports of feed materials to developing countries is also projected.

Global wheat trade projected 16% higher by 2024/25

Population growth is seen as the main driver for global trade in wheat, which is projected to increase by just over 25Mt (16%) between 2014/15 and 2024/25 to 180Mt (Figure 2). Per capita consumption is not expected to increase in many developing countries, though rising incomes in Indonesia, Vietnam and other Asian countries are expected to lead to a shift in consumption towards noodles and bakery products. Imports by Indonesia are seen to increase by 2.8Mt (36%) over the 10-year period to 10.5Mt, making Indonesia and Egypt the joint largest wheat importers by 2024/25. Brazil is seen as the third largest importer with imports of 7.7Mt by 2024/25.

Figure 2 Projected global wheat imports



Source: USDA

An important region for wheat trade over the next 10 years is sub-Saharan Africa, which is projected to increase its wheat imports by 6.6Mt (32%) to 26.8Mt. This forecast is considerably higher than the USDA's previous long-term outlook published in February 2014, and is likely to be due to an upward adjustment in the forecast for economic growth in sub-Saharan Africa. More steady, but consistent, growth in wheat imports is anticipated for the Asian countries of China, Vietnam, Thailand, Bangladesh and Philippines as well as most Middle Eastern countries.

With regard to wheat exporters, **the USDA projections suggest that the market share held by Russia, Ukraine and Kazakhstan will continue to grow**, and together they will account for nearly half of the projected increase in world wheat trade between 2014/15 and 2024/25. However, it is noted that this region's **highly variable weather is likely to continue to significantly affect yields and export availabilities from year to year, suggesting price volatility.** Canada's wheat exports are seen lower as farmers are expected to switch to more profitable canola production over the 10 years. EU wheat exports are seen to increase by 7.7Mt (27.5%) over the 10-year period to 35.7Mt. Increased export availability of EU wheat is expected due to lower anticipated prices for feed grains over this period, which will replace wheat in livestock rations.

International trade in barley seen relatively flat

Global trade in barley is projected to fall in the near term from the 23.5Mt forecast for 2014/15, then steadily increase to 23.6Mt in 2024/25. **The world's largest barley importer, Saudi Arabia, is expected to reduce its barley import requirements over the decade** from 7.5Mt to 7.1Mt as the country moves towards more balanced feed rations and increases imports of other feed materials. North Africa and the Middle East are seen to increase barley imports steadily, while China's imports are projected to grow from 4.5Mt to 5.1Mt. **Higher demand for both feed and malting barley varieties is expected in China**, whose barley import projections have been increased significantly from the USDA's previous forecasts. Strong growth in beer consumption in China and other developing countries is expected to continue to drive demand for malting barley.

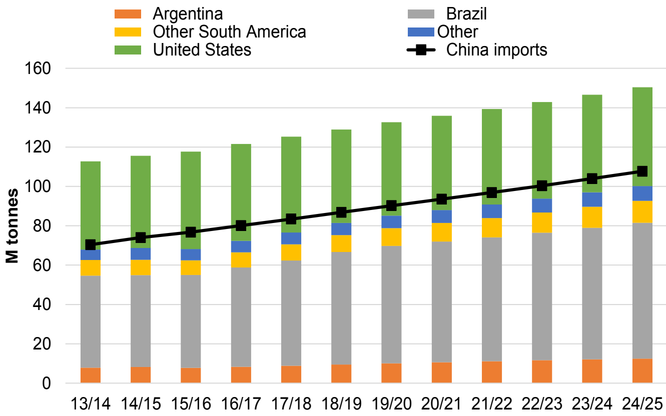
The main barley exporters over the next decade are expected to be the EU, Australia, Russia, Ukraine and Argentina. EU barley exports are seen to decline slightly, due to lower demand by Saudi Arabia and **Australia is expected to replace the EU as the world's principal barley exporter by 2024/25**. Australian barley exports are forecast to increase by 1.8Mt (42%) to 6.1Mt by 2024/25. Canada and Argentina are also expected to increase production and exports over this period.

Soyabean trade projected to increase by 30% over next decade

The USDA projections suggest that global soyabean trade will rise rapidly over the next decade, increasing by 34.9Mt (30%) to 150.4Mt in 2024/25. China is seen to continue its rapid growth in soyabean imports, which are projected at 107.7Mt in 2024/25, up from 74.0Mt in 2014/15. However, this estimate is a little lower than the USDA's previous long-term forecast when soybean imports were projected to reach 112.3Mt by 2023/24. Other countries expected to increase imports over the decade include Indonesia, Mexico and countries in North Africa and the Middle East, where feed demand is seen to increase but constraints exist with regard to domestic oilseed production.

As Figure 3 shows, **Brazil's soyabean exports are projected to increase the most in forthcoming years**; they are predicted to rise by 22.3Mt (48%) to 69.0Mt in 2024/25, as area and yield increases lead to production gains in the country. While US exports will rise over the period, the **US share of global soyabean trade is seen to decrease** from around 41% in 2014/15 to 33% in 2024/25 as a result of larger exports from Brazil, Argentina and other South American countries.

Figure 3 Global soyabean exports and China's soyabean imports



Source: USDA

Concluding comments

The latest USDA long-term projections are positive for consumption and trade in agricultural products. Global economic growth and population gains, along with steady growth in demand for raw materials for biofuels, are seen to raise overall demand and increase prices and export values after 2016. As the year ahead progresses, it will be possible to assess developments against many of the assumptions used by the USDA, including factors such as economic growth, oil prices and exchange rates, and take a view on how actual developments may affect the long-term projections presented in this report.

Key Points

- Near-term adjustments to production are expected due to low prices
- Long term increases in production, consumption and trade are foreseen
- Global economic growth, oil prices, exchange rates, weather and political developments are some factors which will affect actual outcomes

Clock's ticking for UK wheat

UK Trade data for the first half of 2014/15 shows that wheat has the most work to do if a large carry-over into next year is to be avoided.

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24 February 2015

Wheat's export woes

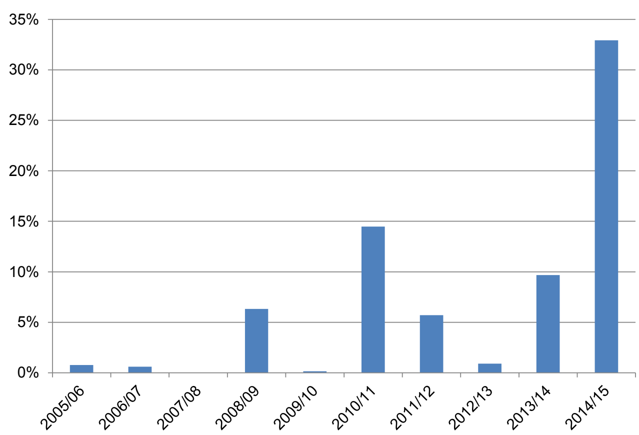
It is no secret that the UK wheat export pace in the first half of this season has been disappointing. Increased competition and currency movements have created a greater challenge in shifting the bumper wheat crop produced in 2014/15.

This season, by end-December, only 938.2Kt of UK wheat had been exported, just 5.6% of total domestic production. This is **the lowest proportion of production that has been exported in the first half of a season, where the UK is expected to be a net-exporter**, on records dating back to 1992/93. Furthermore, cumulative imports until end-December are still higher than cumulative exports during the same period- meaning that on this basis, **the UK has overall been a net importer for the first half of 2014/15**. With strong UK bread wheat prices, due to lower protein levels in UK bread wheat, there have been relatively higher imports so far this season.

The glut of feed grains swamping the EU this year could not have come at a worse time; nabim group 4 varieties (often labelled as "feed") accounted for nearly 60% of the UK area and most feed exports are usually shipped to the EU. On top of this, the weakening of the euro relative to sterling has made UK wheat less price competitive into the eurozone.

However, the strengthening of the US dollar against the sterling has provided opportunities, with a larger share of UK wheat exports heading for non-EU destinations (Figure 1). As the world market trades in dollars, UK wheat has been relatively more price competitive in this market compared with the EU market.

Figure 1 Proportion of UK wheat exports to non-EU destinations (July-December)



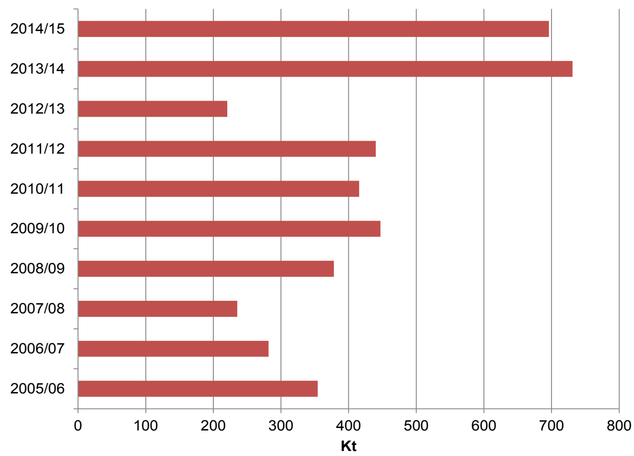
Source: HMR&C

It's important to keep in mind that when the UK trades outside of the EU, much larger consignments are being used – so a small number of export transactions can have a noticeable impact. On this basis, the situation could change if the UK has a sustained period of competitiveness on the world market. It is therefore important not to get complacent about the slow pace of exports to date in official data.

Things look better for barley

In contrast to wheat, **UK barley exports have been more promising** as the momentum from 2013/14 has continued. Although cumulative exports until end-December are slightly below last year's pace (742.7Kt vs 776.8Kt), the proportion of barley exported relative to production is the same (11%). The good quality of the UK barley crop this season has also meant that import requirements have been low. Consequently, net-exports (exports less imports) between July and December 2014 were close to the high levels seen last season - Figure 2.

Figure 2 Net UK barley exports (July-December)



Source: HMR&C

The latest USDA forecasts point to lower barley exports in 2014/15 from key global players such as Canada and Australia. EU exports, however, are forecast 17% higher.

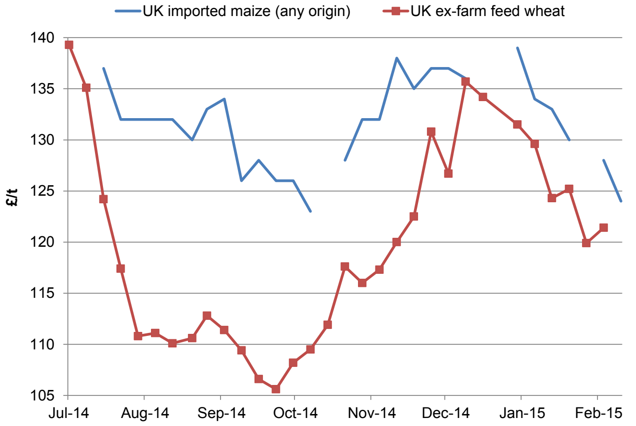
At 63%, the proportion of UK barley export shipped to the EU between July and December was higher year-on-year (51% in 2013/14); whereas exports to non-EU destinations were lower (37% compared with 49%). Hence, unlike wheat, UK barley appears to have overcome the challenge of currency movements and competition with other EU producers.

Incoming maize mounts up

With the amount of wheat and barley produced in the UK this year, it seemed likely that there'd be less maize arriving upon these shores. Apparently, not. **By end-December, UK maize imports reached 938.3Kt**, not far behind last year's record mid-season figure of 1.13Mt. Similar to July-December 2013, around 72% of these imports have come from within the EU.

As usual, price has been the main influencing factor. The narrowing of the price spread between imported maize and ex-farm UK feed wheat led to maize becoming more competitive (Figure 3). This has been more pronounced in Scotland and Northern Ireland, favouring high imports of maize.

Figure 3 Imported maize and UK feed wheat prices



Source: AHDB/HGCA

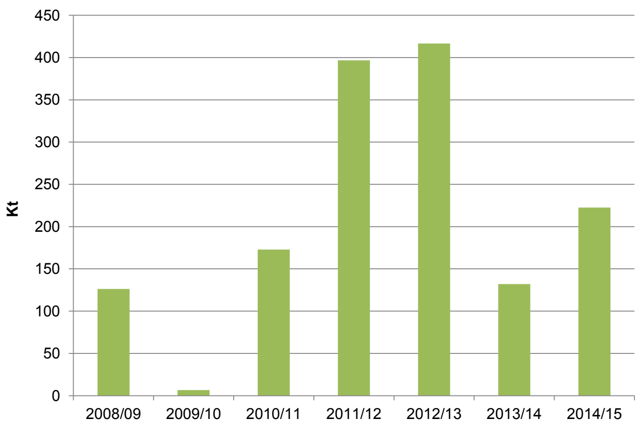
Competition for animal feed demand between wheat and maize is, therefore, higher than what might have been expected at the start of the season. Combined with the slow pace of wheat exports, this has the potential to further exacerbate the current challenge of shifting this year's domestic wheat surplus.

Challenges for rapeseed exports but moving in the right direction

Along with the main UK cereals crops, domestic rapeseed production also obtained a boost in harvest 2014, increasing 16% year-on-year to 2.46Mt. This season's **cumulative exports by end-December are ahead of last year's pace** (222.5Kt vs 131.9Kt), see Figure 4. Although, compared with 2012/13 when the crop size was similar, rapeseed exports by end December 2012 were almost double those achieved in the same period this season.

This season, however, the EU harvested a record rapeseed crop and given that most of UK rapeseed exports are shipped to the EU, the challenge faced becomes more apparent. Again, the depreciation of the euro against the sterling makes things more difficult.

Figure 4 Cumulative rapeseed exports until end-December



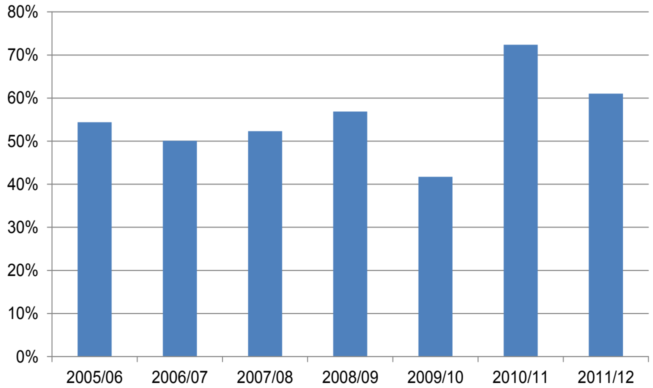
Source: HMR&C

Closing Comments

Of the main UK cereals and oilseeds crops, **wheat has the most work to do if a large carry-over into 2015/16 is to be avoided**. With increased competition in the EU wheat export market and currency working against the UK, the level of exports have fallen short of what is required. The relatively high level of wheat and maize imports during the first half of the season have not helped matters either.

Between 2005/06 and 2011/12, 56% of full season wheat exports were shipped out of the UK in the first six months of the season, on average (Figure 5).

Figure 5 Cumulative UK wheat exports by end December as percentage of full season total in net-exporter seasons



Source: HMR&C

This trend would suggest full season exports in 2014/15 of around 1.7Mt, which is hardly encouraging given that the amount of imports until end-December are already more than half this amount. However, although, most of UK wheat exports are shipped out in the first half of the season, there are exceptions, such as 2009/10.

In order to boost the UK wheat export program, domestic prices will need to remain competitive; otherwise a larger carry-over into 2015/16 is looking likely. UK feed wheat prices have moved lower since the start of 2015, but so have global prices and the euro has weakened further against the sterling. It's uncertain exactly how things will develop in the remainder of the season, but one thing's for sure- time is running out to avoid a large wheat carry-over.

Key Points

- UK wheat exports in the first half of 2014/15 have been disappointing
- Combined with relatively high wheat and maize imports, this suggests higher closing stocks
- UK barley exports have got off to a much better start

Deflation, low growth and political uncertainty: trouble in the EU

The bearish sentiment in grain and oilseed markets has put pressure on prices, and currency movements have exacerbated issues for UK prices. The fall in value of the euro has impacted on the export competitiveness of UK crops.

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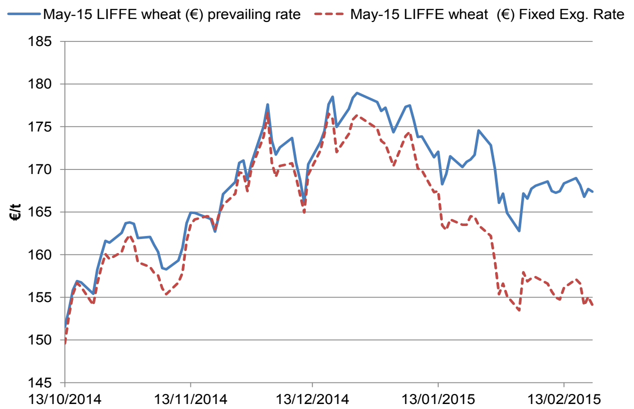
Introduction

With the eurozone once more on the brink of recession and recent uncertainty on the future of Greece, the euro has fallen against all major currencies. By 26 February, the single currency was at a seven-year low against the pound at €1=£0.73 and just up from an 11-year low against the US dollar at €1=$1.13.

It seems unlikely that the UK will be inundated with EU exports since euro weakness against the dollar opens up a range of global exports markets for EU cereals. However, UK exports to the EU are likely to suffer as currency movements have eaten into the recent decrease in UK feed wheat prices (Figure 1).

UK wheat exports for the current season up until December 2014 have been sluggish (read more here). With the further weakening of the euro since then, it will be interesting to see how much of an impact this has had on the export pace to the eurozone in the New Year.

Figure 1 UK feed wheat price with fixed 6 month May-Oct 2014 average euro exchange rate

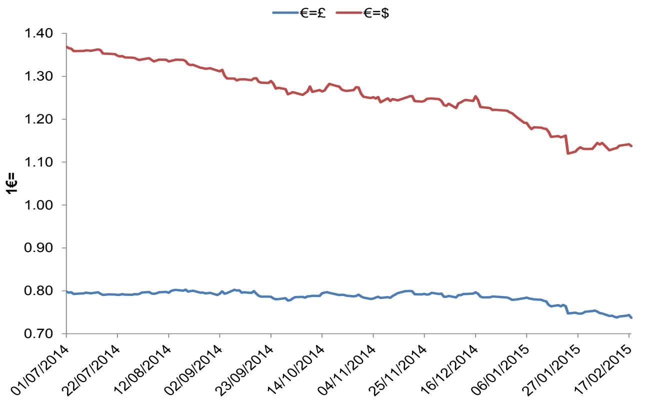


Source: AHDB/HGCA

Downward pressure on the Euro

With GDP for the third quarter expanding by a marginal 0.2%, the eurozone managed to keep clear of recession, though the economy remains fragile. Unemployment is only very slowly coming down and even in key economies such as Germany, business confidence remains low. Moreover, inflation just turned negative, tipped over by falling oil prices, prompting further moves by the European Central Bank (ECB) to try and stimulate growth. The ECB's decision to try and stimulate growth through quantitative easing, coupled with the decision from the Swiss National Bank to break the link between the Swiss franc and the euro, resulted in sharp falls in the value of the euro against all major currencies (Figure 2). However, the most recent factor putting downward pressure on the single currency has been the renegotiation of Greece's debt deal and fears of a possible exit of Greece from the single market. It now looks as though an extension of financial help will be made available, which should provide some confidence to investors, but it seems likely that the euro will remain volatile in the short term.

Figure 2 EUR exchange rate



Source: AHDB/HGCA

Better prospects in the UK

In contrast with the EU, the UK economy has continued to strengthen, with growth hitting 2.6% for 2014, the fastest pace since 2007. There are, of course, still weaknesses in the economy and inflation figures, at just 0.3%, are low. Like deflation, low inflation is typically associated with raising the burden of private debt as incomes grow more slowly than loan repayments. However, the latest inflation figures have been primarily driven by the fall in oil prices, with a number of economists - including the Bank of England Governor Mark Carney - commenting on the positive impact this could have on the UK economy.

Oil prices have more than halved over the last six months and have been a significant driver in allowing nominal wages to overtake inflation rates. Until late last year, real wages had been consistently dropping since 2010, the longest period of falls since at least 1964. It was only towards the end of last year that growth in real wages finally turned positive again.

Concluding comments

The weakness in the euro looks set to stay for the medium term and volatility will remain as the economies of individual member nations recover at different rates. Due to the large production of the UK's key crops, strong exports are needed if a large carryover is to be avoided. UK wheat futures have dropped in price since January and this may have strengthened exports but data has yet to be released. The likelihood of the UK market being flooded with imports from the EU is not huge as the weakness of the euro against the dollar provides opportunities in global markets.

Resilience to falling prices key in current market conditions – 2015 marketing pricing strategies

After geopolitics supported an upward market trend throughout December, the New Year has brought the focus of the market back to supply and demand fundamentals. The change in market direction has shifted the desired requirement of the pricing strategies to resilience against falling prices rather than opportunity to gain from increasing prices. However, things could change come spring/summer.

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3 March 2015

Introduction

The five pricing strategies for the 2015 harvest have been live since November-14 (read the launch article here) and are reacting to the market movements. Throughout December, UK feed wheat prices gained a lot of support from uncertainty emanating about Russian exports, as well as concerns surrounding winterkill in the US.

During December when the market was supported by bullish sentiment, a 'do nothing' strategy topped the ranks and gained the most value from the price increase. As the focus of the market has now returned to the large supply fundamentals, spot prices have taken a downturn and new crop prices have followed – although remaining at a premium to near-term values.

2015 crop prices have yet to be massively influenced by 2015 supply fundamentals essentially as very little is known about new crop production. This is a large source of uncertainty so more volatility should be expected as more information becomes available.

The risk involved with a 'do nothing' strategy is starting to show. It is becoming increasingly clear that during a period of declining prices, a strategy with resilience to the falling market is important.

Click here to read a concise description of each strategy.

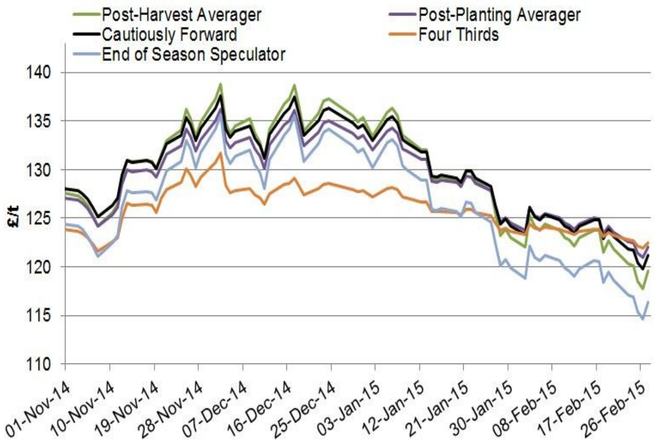
Please note: the pricing strategies have been designed as a price risk management demonstration. It is important to remember there is a limitation here in that it is a formulaic approach, and in reality pricing strategies should be designed to react to the evolving market. Keep up to date with the latest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

Changing Players

Nov-15 UK feed wheat futures closed at £126.75/t on 27 February, down £19.25/t since 2 December, when prices peaked at the highest point since June-14, at £146/t.

The falling market has been pushing down the value of each of the strategies, and in particular is demonstrating the high level of risk associated with the 'Post-Harvest Averager' (PHA) marketing strategy. The value of the PHA has fallen £19.25/t since the beginning of December, and is currently valued at £119.54/t (as at 27 February, see Figure 1).

Figure 1 2015 Pricing Strategies Progress



Source: AHDB/HGCA

The PHA strategy currently has the largest volume of wheat exposed to the market, and along with the opportunity here for maximum gain, there is also the risk of maximum loss. This is currently being demonstrated as the value of the PHA strategy is falling at the same rate as the market.

The 'Four Thirds' (FT) strategy has shown the most resistance to the recent downward price trend. The value of the strategy has risen from the lowest in the rankings to the top as the values of the other strategies have fallen at a faster rate.

The current value of the FT strategy is £122.49/t, dropping only £9.24/t since the beginning of December (Figure 2). The resilience of the FT strategy against falling prices comes about due to the high level of early forward selling. The use of the options within this strategy essentially protects the decision to aggressively forward sell.

Figure 2 Changing value of pricing strategies

Strategy	Value of unsold loads		Change in value
	as at 2 December	as at 27 February	
Post-Harvest Averager	£138.79	£119.54	**-£19.25**
Post- Planting Averager	£136.23	£122.08	**-£14.15**
Four Thirds	£131.73	£122.49	**-£9.24**
Cautiously Forward	£137.56	£121.23	**-£16.33**
End of Season Speculator	£135.63	£116.38	**-£19.25**

Source: AHDB/HGCA

With 44 loads sold in total, the level of protection from the falling market is the greatest for the FT strategy out

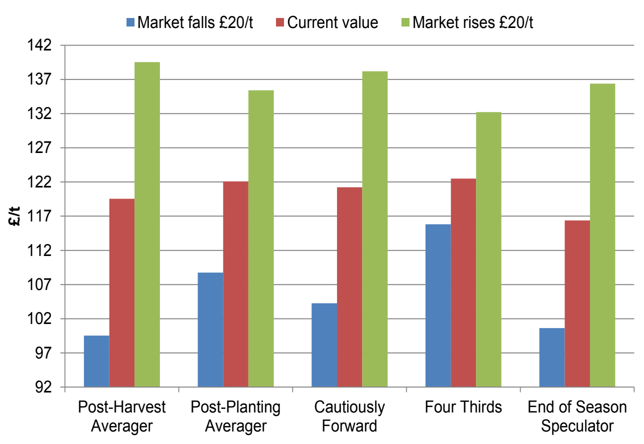
Resilience to falling prices key in current market conditions – 2015 marketing pricing strategies

of all of the strategies, with the further added benefit of a call option purchased on 600t of the wheat. The use of the call option here allows a minimum price to be gained, while still allowing the opportunity to obtain a higher price if the market increases.

Stress tests show that if the market were to fall £20/t, FT would be the strategy worth the most at £115.82/t, £7.08/t higher than the Post-Harvest Averager (PHA) which would be in second place and valued at £108.74/t (Figure 3).

On the flip side though, if the market was to rally by £20/t, FT would fall to the bottom of the rankings, but only marginally. A £20/t rally would not quite take the market through the £137/t call option strike price, although the call option on the 600t would come into play if a price rally went beyond the simulated £20/t.

Figure 3 Market strategy stress test



Source: AHDB/HGCA

Post-Planting Averager (PPA)

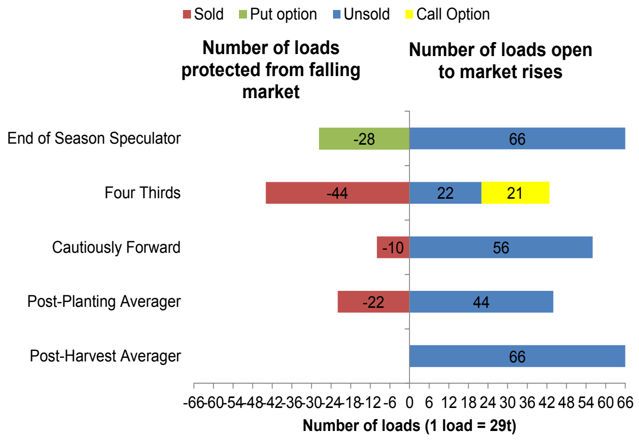
The PPA strategy is currently valued at £122.08/t (as at 27 February) and is ranked second out of the various strategies.

There have been nine loads sold since the last pricing strategies update in December; three on the 18 December, three on 18 January, and three on 18 February. Although small, the sales have resulted in a decreasing level of volume exposed to the market, adding more protection against the downward trend.

The remaining loads will be sold equally each month (2/3 loads per month) until the end of the marketing season.

If the price continues to decline, monthly sales will allow an average price to be gained, although there is still a considerable volume exposed to potential loss. 44 loads are currently open to market (Figure 4), although the level of volume exposure for the PPA strategy is not as great as the exposed loads for the End of Season Speculator (ESS), Cautiously Forward (CF) and PHA strategies.

Figure 4 Market exposure



Source: AHDB/HGCA

Concluding comments

With a change in market direction since the last update, the strategies have each managed the market downturn in different ways. FT is currently showing the most resilience to falling prices; the strategy had the lowest change in value since the Nov-15 futures peaked on 2 December, helping to maintain the value of the strategy. Resilience to downward market movements is crucial during periods of declining prices and finding the balance between market opportunity and security is crucial.

To read the previous articles in this series, please click on the links for the 2015 pricing strategies launch article, and 2015 pricing strategies update part 1. 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 details on any of the strategies, please contact anna.lockwood@ahdb.org.uk.

Key Points

- A 'do nothing' strategy carries a large amount of risk and should be exercised with caution
- Market resilience is key during periods of declining prices
- Options can be beneficial in order to secure a minimum price while still allowing the opportunity to gain if the market increases

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