MI Prospects

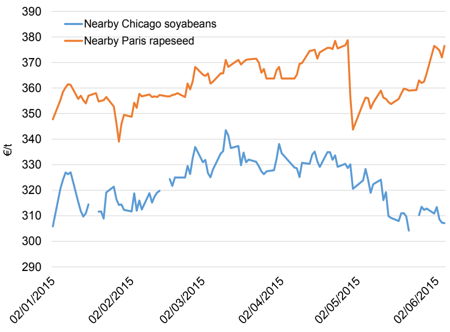
10 June 2015 / Vol 17 Issue 25

CEREALS & OILSEEDS

Analyst's Insight: Out of sync oilseeds

Due to their dominance of the global oilseed market, we can usually look at soyabean price movements to explain the direction being taken by European, and indeed, UK rapeseed values. Recently, however, this has not been the case. As Figure 1 shows, **Chicago soyabeans and Paris rapeseed futures have been moving in opposite directions**.

Figure 1 Soyabean / rapeseed price divergence



Source: AHDB Cereals & Oilseeds

This isn't something unheard of, as there are instances during a season when local dynamics exert a greater influence on prices than global forces. So, while the world seems to feel awash with soyabeans thanks to record output by the top three producers (US, Brazil and Argentina), **in Europe, rapeseed supplies have been feeling tight**. This has led to the market questioning if the EU rapeseed supply and demand estimates are correct; has the production number for 2014 been overstated? Has demand been higher than expected?

Canadian canola futures are also helping to provide support for EU rapeseed prices. Concerns over the effects of dryness and frost on the growing canola crop have seen nearby prices rally by over CAD55/tonne (about 13%) since mid-April to reach levels not seen since May 2014.

Nevertheless, **this divergence between soyabeans and rapeseed prices is likely to be short-lived** as the new rapeseed crop will soon become available in Europe. The latest forecast from Strategie Grains (4 June) estimates the 2015/16 EU rapeseed crop at 22.3Mt. While this is 8% lower year-on-year, it is still above the three-year average. Furthermore, growing conditions are generally favourable and the overall crop is looking to be in a good state. As we move into the next season, there might still be price support from Canadian canola if concerns persist, but replenished EU supplies should have an overbearing effect.

On a global scale, though, we're looking at a hangover of soyabean stocks from 2014/15 plus projected further, albeit slight, increases for US and Brazilian soyabean planted areas. Unless yields reach the dizzy heights of 2014/15, we might not see a third consecutive record crop, but if weather conditions remain favourable, another large soyabean harvest in 2015 can't be ruled out. This is likely to weigh down on prices for all oilseeds. A bullish glimmer that remains on the horizon, however, is **the potential impact of El Niño** on palm oil production in Malaysia and Indonesia. This **could see vegetable oil prices rise, and rapeseed would be a bigger beneficiary than soyabeans** due to its higher oil content.

Amandeep Kaur Purewal

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Uncertainty for wheat and maize but possible risk ahead for barley

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UK feed grain mix: How yellow's your yolk?

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Oat exports helping to clear UK stock hangover

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Uncertainty for wheat and maize but possible risk ahead for barley

New crop feed wheat futures found some support from the middle of May with the market losing some of its purely 'big old crop stocks' sentiment and possibly appreciating that the new crop is far from secure. Very early forecasts suggest the world will see another barley deficit in 2015/16, however, demand is at risk especially with the abundance of other feed grains.

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Recent market activity

With the demise of global May futures contracts, price focus has shifted to the new crop. However, this doesn't mean we should forget about large old crop end season stocks, which are acting as a weight on global prices. Some key end season stock estimates from the USDA are provided below:

Wheat

- US: up 20% at 19.3Mt
- EU: up 46% at 14.7Mt, although from a low base
- Canada: down 49% to a more normal level of 5.3Mt
- North Africa: down 13% to 11.9Mt, although production is expected to be higher this year

Maize

- US: up 50% at 47Mt
- EU: up 17% at 8Mt
- Brazil: down 9% at 17.3Mt

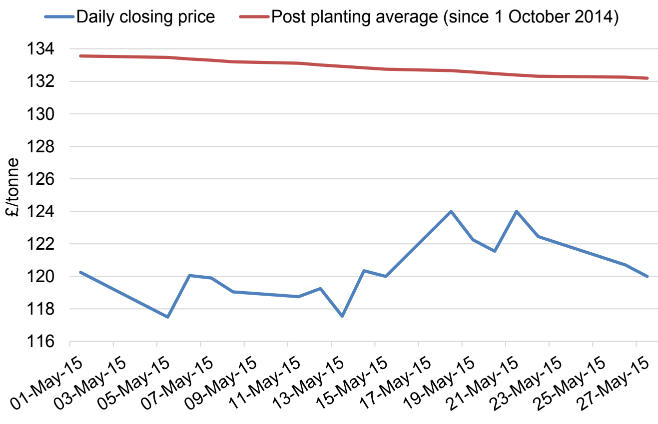
From a UK perspective, the positive price carry from the spot market through to the new marketing season has been **a clear indicator that stocks were going increase this season**. Essentially, there has been and still is, an evident commercial incentive to carry feed wheat at least into 2015/16. It's not surprising then that the latest Defra stock survey showed a 49% year-on-year increase in UK wheat stocks at the end of February 2015 (excluding farm stocks in Scotland and Northern Ireland).

Despite the talk of high stocks, prices rose slightly in the second half of May

Although very modest in the grand scheme of things, Nov-15 feed wheat futures have seen some support, breaking back over the £120/t level, but remaining relatively low against the rolling average since planting. Recently, however, prices have started to edge back towards £120/t.

The recent price increases can be attributed to new crop news events. The USDA have now set out their first forecasts of global supply and demand for 2015/16, a summary of which can be found on here the AHDB Cereals and Oilseeds website. Given the sheer level of variation that can occur in production forecasts between now and the post-harvest period (read more here), both global wheat and maize supply and demand are difficult to call. At this point a year ago, the first forecasts for global maize supply and demand pointed to a clear surplus.

Figure 1 New crop (Nov-15) UK feed wheat futures prices in May 2015



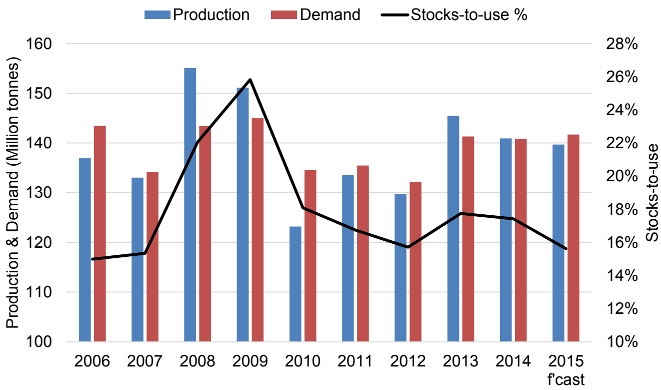
Source: AHDB

In contrast to the broader grain market, global barley supply looks tight in 2015/16

Although barley prices have to follow the broad movements of the wider grain market to maintain feed demand, barley's global supply and demand situation looks tight again.

Figure 2 looks at headline supply and demand, with the early 2015/16 USDA projections indicating a deficit, and thus falling stocks. However, **global barley demand is a risk factor because the commodity could easily lose some of its mainstay feed demand to other feed grains** in more plentiful supply, such as maize and even sorghum.

Figure 2 World barley supply and demand

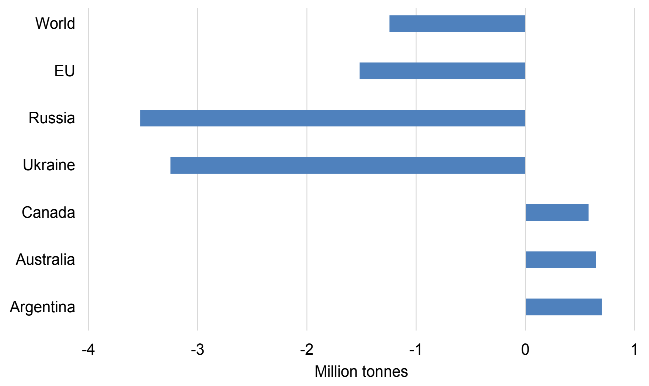


Source: USDA

The projected changes in barley production for the main producer-exporters, reveal lower production forecasts for the EU, Russia and Ukraine. This may in fact reduce supply pressure at the beginning of the marketing season when these harvests begin to arrive.

Uncertainty for wheat and maize but possible risk ahead for barley

Figure 3 Year-on-year changes in barley production

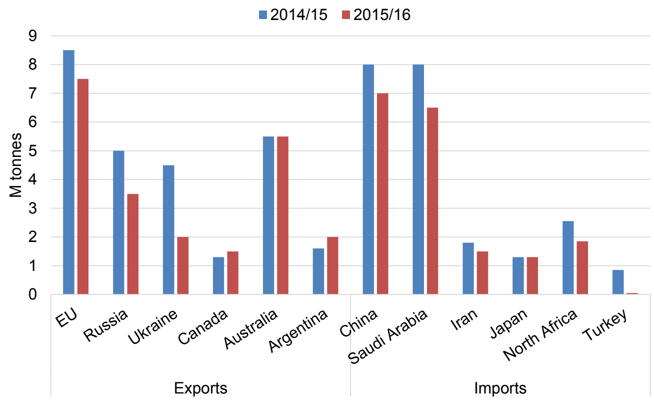


Source: USDA

Risk of global barley trade falling in 2015/16 – could this reduce the opportunity to export?

Saudi Arabia for some time now has been established as the world's largest barley importer. According to a recent USDA 'GAIN' report, 80% of imported barley is fed to camels, sheep and goats. **The feeding of raw barley is reportedly wasting more than 30% of the commodity**. To combat this, the government is subsidising the import of various feed ingredients to encourage use of compound feed and improve feed use efficiency. This is likely to reduce Saudi's barley import requirements in favour of more competitively priced feed ingredients.

Figure 4 World barley trade



Source: USDA

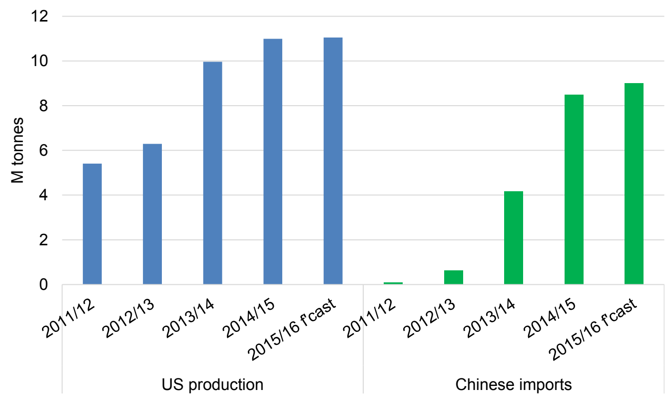
With Saudi Arabia's import demand falling, **China, by default, is set to become the world's largest barley importer**. Part of the reason behind China's barley consumption is the demand for non-maize feed grains. In order to encourage domestic maize production, domestic maize prices are high and imports are regulated, which means that alternative feed grains, such as barley, offer feed producers a substitute for relatively expensive maize.

Given the size of the global barley market in comparison to maize (production of 140Mt vs. 990Mt), there is extremely little risk of barley 'flooding' the Chinese market to the same extent as maize could.

Gaining access to the Chinese market is not easy – **HGCA have been working with industry for a number of years to obtain the necessary trade protocol to enable barley trade**. The next step in the process is an inspection by the Chinese government. This has been organised and funded by HGCA and will take place in June, after which a protocol will be agreed so trade can commence.

However, barley does face competition into China from another 'alternative' feed grain – sorghum. Global production is set to hit 65.4Mt in 2015/16, the highest since 2007, with US production the highest since 2008. Figure 5 clearly shows China's growing appetite for sorghum in recent years.

Figure 5 Sorghum: US production & Chinese imports



Source: USDA

Concluding comments

Grain markets remain subdued by high ending stock forecasts for the current marketing season. However, the new crop is now in focus and it is far from certain if production surpluses will be seen in 2015/16 or if the stocks of this season will be needed to fill a deficit.

On the barley side of things, relatively tight supplies are putting demand and trade at risk in favour of other more abundant feed grains. The leading global importer, Saudi Arabia looks set to reduce its reliance on imported barley, pushing China to the top spot. This dynamic may well mean that sorghum, has a growing influence on global barley prices.

Key Points

- High old crop stocks remain a weight upon global grain prices, although the new crop is uncertain
- Global barley supply and demand remains tight, but to maintain demand must follow the broader grain market
- Global barley trade looks set to re-shape as China is expected to become the leading barley importer

From grain markets to grain marketing

UK wheat futures began to rally during May, highlighting the importance of taking advantage of gains in the market where possible, while protecting from downward threats. There are various strategies that can help to achieve this. Interestingly the forward price carry into the new crop season extends into the 2016 crop – can this be capitalised upon.

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Introduction

As the new season rapidly approaches, the fundamental situation for the new crop is gradually developing. With this in mind, it is important to keep price movements in context and take advantage of opportunities available with grain marketing.

New crop UK wheat futures prices are currently below the post-planting average level, while Paris rapeseed is hovering slightly closer to the post-planting average. However, our example pricing strategies demonstrate how some of this weakness can potentially be avoided.

From markets to marketing

When considering marketing strategies, it is essential to simultaneously consider the current market drivers. Keep up to date through our Grain Market Daily, published Tuesday- Friday at 12.30pm (click here to subscribe) and our weekly Market Reports, see previous issues here. Grain markets gathered some upward momentum in mid-May, as detailed in our latest market outlook, while oilseed markets remain flat in the UK.

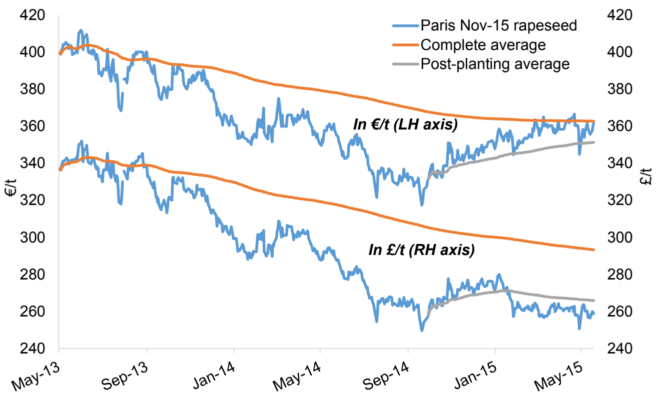
Price context

The next step is to remember where recent prices and price movements sit in the wider context of the season. Considering futures market contract averages is useful for benchmarking your marketing performance, as they indicate what could be achieved through simply selling at a steady rate. Following from this, they may help indicate a *potentially* good time to sell (i.e. if prices are above the contract average).

After almost touching the post-planting average on 23 March, UK Nov-15 wheat futures have remained below this level since. As of 28 May, the Nov-15 contract settled at £120.25/t, with the post-planting average at £131.81/t.

The **situation is a little more complex for rapeseed**, with the Paris Nov-15 futures contract strong in euro terms but flat in sterling terms (Figure 1). If you are benchmarking the performance of your marketing strategy, the average value in sterling is relevant. However, it is worth keeping the euro context in mind, where values are currently performing relatively strongly against the post-planting average. Together with the overall average, this is forming a narrowing channel which the Nov-15 contract seems to be bound within.

Figure 1 Paris rapeseed futures benchmarked against averages



Source: AHDB Cereals & Oilseeds

Pricing strategies

Unsurprisingly, all of AHDB/HGCA's example pricing strategies for the 2015 crop suffered from April's fall in UK wheat futures but gained from the mid-May mini rally. The strategy that provided the most protection from the falling market was 'Four Thirds'. This strategy has taken advantage of early sales (67% sold by November 2014), as well as the use of a call option, which allows a minimum price to be gained while also adding the opportunity to obtain a higher price if the market rises.

Looking forward, if May's mini-rally is repeated in June, then the strategies with larger volumes exposed to the market will gain the most. However, many of our examples have a long time yet to run so there is plenty of time for things to change.

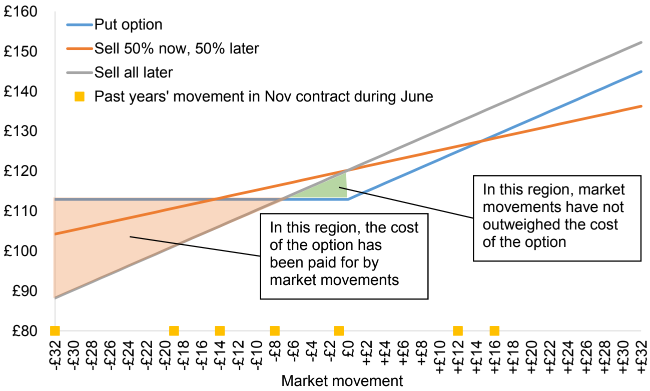
Are options worth the cost?

Unlike earlier in the season, sufficient interest is building in Nov-15 options to make them feasible for use in hedging the 2015 crop. As at 28 May's close, a put option on UK Nov-15 wheat futures could be bought at £7.05/t for a strike price of £120/t. This essentially guarantees a futures equivalent minimum sale price of £112.95/t (£120/t - £7.05/t). Every £1/t gain in UK Nov-15 wheat futures above £120/t would in this example give a £1/t gain for the potential sale price.

Options provide an alternative to simply selling or holding a crop. However, **the 'cost' of an option, compared to selling or holding crop, effectively occurs when the market moves by less than the premium for buying the option**. Figure 2 compares the potential gain from buying an option for the desired tonnage, holding onto your crop, or selling 50%.

From grain markets to grain marketing

Figure 2 Effective selling price from taking out a Nov-15 option compared to alternatives



Source: AHDB Cereals & Oilseeds

UK wheat futures' November contract prices changed by more than £7.05/t in the month of June in seven out of the past eight seasons since 2008. A downward price movement of this magnitude essentially pays for the option. In the event of the market rising**, the default hindsight view might be: 'that put option was a waste of money'**. However without the put option, to take out some of the price risk the temptation may have been to sell some at a fixed price, which would remove the capability of that tonnage of grain to benefit from the rise in price. So another way of looking at options is to treat them as confidence boosters to enable the owner to do things they wouldn't otherwise do.

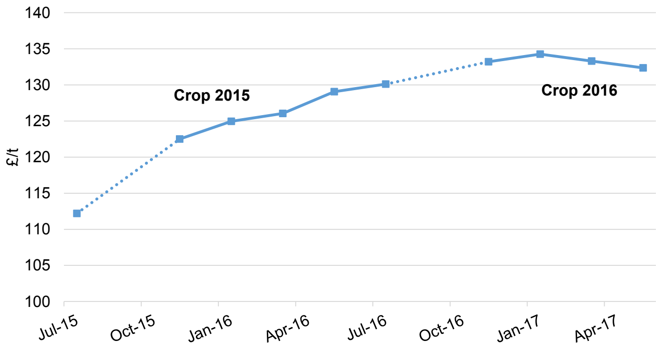
- For a put option, the confidence to sell nothing is bought: the option protects downside whilst the unsold grain maintains market opportunity should the market rise.
- For a call option, the confidence to sell a high proportion of the crop is bought: the sales of grain protect from a falling market whilst the option pays out if the market rises. The option also protects against default charges in the event of crop yields disappointing.

Forward carries continue into 2016, why?

As we have frequently mentioned this season, there has been a clear price carry in UK feed wheat futures from this season through to next. This has created an incentive to store feed wheat into next season as an alternative to releasing into the near-term market. See our original article on this from last August.

Whilst the carry from the old crop to the new is fairly logical, the fact that the carry continues from the 2015 crop into the 2016 is more intriguing.

Figure 3 Fwd price profile of UK feed wheat futures as at 1 June 2015



Source: AHDB Cereals & Oilseeds

The answers might be down to much lower levels of liquidity in the further forward contracts – although trade has occurred. Essentially the market is maintaining an element of incentive not just to store the 2014 crop into the next marketing season, but also the 2015 crop into the 2016/17 period. Any issues impacting the 2015 crop would mean that the market will need to remove the carry into 2016/17 to encourage grain out of store. This raises the question: Can Nov-16 futures be used to hedge the price of the 2015 crop and take advantage of any reversal in the carry? More on this in a future Prospects article.

Closing comments

Translating market movements and market drivers into an effective marketing strategy allows you to weigh up managing your risk with taking advantage of price opportunities exactly as you would like. AHDB/HGCA's publications and regular strategy updates can help you in doing. For the 2015 crop, pricing strategies that include some downward price protection have shown their worth recently. Looking further ahead, the carry from the 2015 crop into 2016 could provide some interesting opportunities.

Key Points

- Keeping price movements and market drivers in the context of how the market has performed can help you go from markets to marketing
- Strategies that have provided some downward price protection have performed well into May
- For a second season running, there is currently a carry in UK wheat futures (from 2015/16 into 2016/17) – does this provide a unique hedging opportunity?

UK feed grain mix: How yellow's your yolk?

In the last couple of years in particular, the vulnerability of wheat in feed rations has been highlighted, mainly due to the increased attractiveness of maize. The demand of barley for animal feed production can be heavily influenced by regional conditions and recent years have seen higher utilisation of oats in diets.

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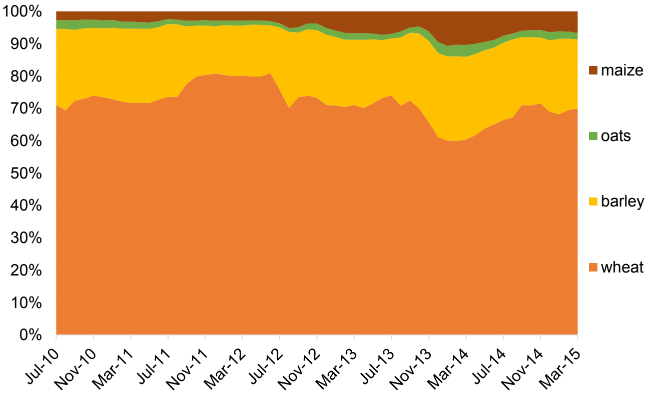
Introduction

The UK cereals industry has encountered a few particularly interesting seasons recently, which has impacted on the pattern of availability and demand for particular feed grains. 2012/13 saw adverse weather cutting supplies of key feed grains, whilst at the same time boosting demand for compound animal feed. In contrast is the bumper supply of home-grown feed grain in the UK this season. **Whatever the supply dynamics of the market, the animal feed sector has to adapt to these changes to remain competitive by finding the optimum balance between raw material costs and nutritional performance**.

Typical structure of UK feed grain mix

The UK feed grain structure is typically reliant on wheat as the main cereal used in the production of compound animal feed (including integrated poultry units or IPUs). However **the proportion of wheat used can vary, because it's substitutable with other feed grains** (Figure 1). So when there are times of higher wheat prices due primarily to lower availability, wheat can quickly lose share in feed rations.

Figure 1 Proportion of grains as % of total cereals used in animal feed production



Source: Defra

The adjustments to the mix of grains is apparent throughout the last couple of years, particularly in relation to more maize coming into the mix. The trends witnessed in the 2013/14 season show how vulnerable wheat is in terms of the risk of losing market share in animal feed demand to barley, maize, and to a much lower extent, oats. During 2013/14 an unprecedented 2.4Mt of maize was imported into the UK, plugging the gap caused by relatively low availability of wheat. As a result, maize used in animal feeds increased by 22% year-on-year, at the same time as reductions for wheat of 10%.

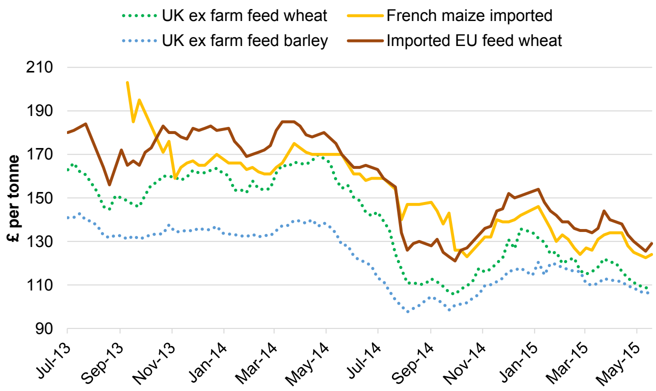
Current trends

According to the UK cereals balance sheet, **wheat has now bought back a large amount of its share in animal feed demand**, with usage forecast to be up by 8% year-on-year in 2014/15. At the same time, maize usage has been phased out by 13% year-on-year. However, the proportion of maize in animal feed has not reduced as quickly as earlier predicted earlier in the season. **Demand has been maintained by Northern Ireland compounders, which also helps to explain to an extent the continued influx of maize into the UK, which during July to March equated to 1.5Mt.**

Data from the Department for Agriculture and Rural Development Northern Ireland (DARDNI) revealed that during Q1 of 2015, 8% more maize was used as a raw material in animal feed production than in the same period last year – so look out for a 'yellower' yolk in your Ulster fry!

At the moment, the price for imported French maize is at a premium to the key UK ex-farm feed grains, making maize less attractive as a feed ingredient. However, when considering the price of grains imported into the east coast of England – which gives an indication of imported grain prices into N Ireland – the price differential between EU feed wheat and maize currently favours maize.

Figure 2 Prices of key UK feed grains

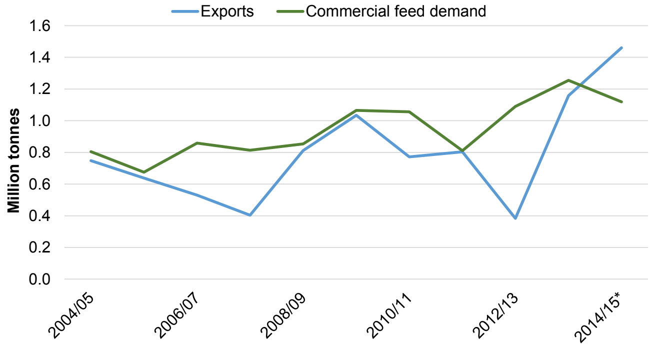


Source: AHDB Cereals & Oilseeds

Looking again at Figure 1, we can see that barley has continued to bob along in the middle of the scale of consumption for feed grains used in compound production. The domestic UK feed demand for barley is heavily influenced by the price relationship with other grains, which can vary noticeably by region. With generally lower wheat prices relative to barley this year, barley usage in UK animal feed is forecast to decline by 4% year-on-year. However, this hasn't been an issue for balancing the big 6.9Mt barley crop of 2014. **As Figure 3**

shows, although commercial feed demand has struggled, forecast exports at a 15 year high is preventing stock build up.

Figure 3 Full season barley exports and commercial feed demand



N.B. Commercial feed demand: GB compounder, NI compounder and IPU
*2014/15 = full season forecasts

Source: Defra

With barley having been pushed out of favour by wheat for commercial feed producers this year, the hike in exports looks to have saved the day for the barley market. While the price differential has at times acted against barley's competitiveness for domestic feed demand, barley markets could afford this sacrifice in favour of a 'better deal' on export markets. However, it would be foolish to assume that barley exports will continue to impress, as global barley demand and indeed trade faces risks posed by the abundance of other feed grains, read more here in our recent Prospects article.

Oats have secured a bigger share in UK feed demand in the last two years, driven mainly by availability, following two bumper production years. Anecdotal evidence suggests that some compound producers liked the results that oat-fed animals achieved – at the price they were able to procure the raw material relative to other grains. So, oats could have bought themselves some continued favour with feed producers. However, with the oat balance sheet looking to be tightening, it may be harder for processors to source oats towards the end of this season.

Closing comments

A review of the differing shares of different grains in animal feed consumption highlights the complexities of the feed grain market. The current mix is heavily influenced by the availability and price differentials of lower priced grains, especially maize.

In the longer term, wheat looks to be at a strategic cross-roads when it comes to feed demand with imported maize a relatively small but increasingly important feature. Whilst high maize imports in 2012/13 and 2013/14 are logical, the historical strength of imports in 2014/15, on the back of big European crops, flies in the face of the large supplies of wheat and barley at the same time in the UK. Whether this is a quirk of the 2014/15 season or the beginning of a long term trend remains to be seen. The risk though for UK wheat demand is that maize is beginning to have a direct impact on the domestic market – we've been used to an indirect impact for some time with UK feed wheat exports having to compete with maize on the global market.

As highlighted above, barley faces a particular vulnerability in terms of feed demand, depending on whether or not the price differential against wheat is working in its favour. This season, the risk of a large build -up of stocks caused by the decline in barley use as a feed ingredient has been mitigated to an extent by the strength of the UK export campaign.

Key Points

- Wheat has now bought back a large amount of its share in animal feed demand, driven by lower prices
- Despite reducing in competitiveness for use as a feed grain in GB, increased demand from N. Ireland compounders has maintained maize import flows
- Barley demand for animal feed has declined, as the price differential against wheat has worked against its competitiveness

Oat exports helping to clear UK stock hangover

Strong exports are helping the UK oat market to rebalance after large crops in 2013 and 2014. Production potential in 2015 remains unclear, and there are areas of concern for several key EU producers.

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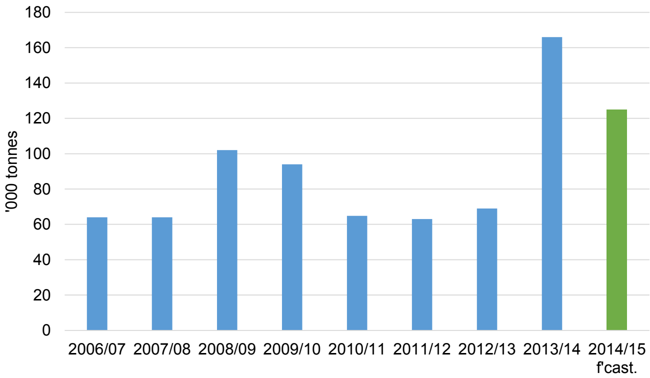
UK stocks declining

In the UK, a total of 125Kt of oats are forecast to be carried over into the 2015/16 marketing season according to the latest forecasts by Defra – read more here. While this would still be a historically high stock level, it does represent a drawdown of 41Kt year-on-year, and is also lower than the 138Kt forecast earlier in the season (Figure 1).

Figure 1 UK commerical closing stocks of oats



Source: Defra

The projected drawdown in stocks is due to both a smaller crop (down 15% between 2013 and 2014 to 0.82Mt) but also a stronger trade position; imports are lower, while exports are far higher.

Between July 2014 and March 2015, a total of 70Kt of oats was exported from the UK. Defra forecasts 2014/15 total exports at 85Kt, sharply higher than both the 50Kt forecast in November and last season's total of 36Kt. If realised, this would represent the largest level of UK oat exports since 2008/09 (86Kt).

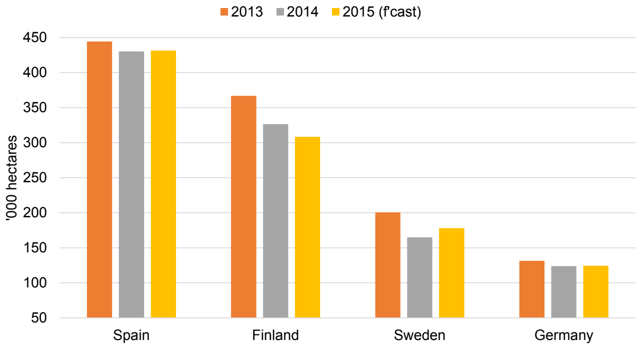
Uncertain UK area but crops generally OK

While a lower carry-over reduces the potential drag on the 2015/16 season, total supplies are far from clear. The latest ADAS crop report showed winter oat crops in generally favourable conditions, with spring planting nearly complete by end-May. The AHDB/HGCA Planting and Variety survey will give the first statistical indication of the total oat area planted for harvest 2015 in early July.

European 2015 crop outlook

Across the bloc as a whole, the International Grains Council (IGC) currently forecast EU oat production at 7.93Mt, below last season's 8.24Mt, based on the assumption of a return to average yields. However, there are contrasting pictures amongst some of the EU's key oat producers (Figure 2).

Figure 2 Planted area forecasts for key EU oat producers



Source: Agricultural Ministries
Except for 2015 Swedish figure, which is from Coceral

Preliminary data from the Natural Resource Institute of Finland reveals that **for top exporter Finland, the area planted to oats for harvest 2015 may fall 6%** year-on-year. At 308.4Kha, this would be the second smallest Finnish oat area on records back to 1910. Furthermore, **planting is around two weeks behind normal** after heavy rain. As much as 50% of the arable area remained unplanted in some regions as at 6 June, and there are concerns that oats may lose out further as the optimum planting window has now passed.

Rain has also protracted the planting season in major exporter Sweden, although anecdotal reports suggest much less impact than in Finland. Early forecasts from Coceral in March pointed to increased plantings for harvest 2015, but more clarity will be gained when Statistics Sweden release preliminary area statistics on 11 June.

The **area of oats in Germany is estimated just 0.5% higher than last season's low** in initial statistics from Destatis. Last year, strong yields maintained production at 627Kt despite a 6% fall in the area. Unless similarly favourable conditions are repeated in 2015, German oat production could well decline this season.

While a **similar area to 2014 was planted in Spain**, an important destination for UK oats, production is under threat from hot and dry weather conditions. Rainfall levels over the next couple of weeks will be key to production levels and so import demand.

Concluding comments

The hangover on the UK oat market from the exceptional crop of 2013 and large 2014 crop, looks to be clearing. While current projections still show historically large stocks, the size of the 2015 crop will be key to availability in the season ahead. From a European perspective, there are areas of concern for crops in key producers Finland and Spain. Keep an eye on Grain Market Daily (subscribe here) for regular market and crop updates. The next few months will be key for determining output levels next season.

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