

Analyst's Insight: The ugly side of the commodity cycle

It is often said that commodity markets go in cycles, following the principles of supply and demand. While the theory is correct, there is no set time frame for the 'cycle'. Weather can often act as a trigger point to move the market from one phase to another. However, the theory should not be ignored as understanding what phase of the cycle the market is in can help inform what is driving the price and any associated risks.

Figure 1 illustrates the commodity cycle via wheat and crude oil prices over the last 20 years. Crude oil was chosen because it's a good indicator for the state of/confidence in the global economy, rather than the link to biofuels. **A growing economy needs energy. Sentiment towards the economy drives confidence in food demand and so a population in a growing economy consumes more food commodities.**

Period 'A' - the 'lost decade' for grain commodities: low prices = stagnant production = stock depletion. China's accession to the WTO in 2001 took commodities gradually into a new era.

Period 'B' – the 2007/08 spike: tight stocks + poor growing weather = very tight supplies of exportable wheat.

Period 'C' – the supply response and global recession: strong prices and ideal weather gave rise to a step change in global grain production. Economic

meltdown shatters confidence in global demand.

Period 'D' – the weather years: despite strong prices, weather delays the arrival of the supply response.

We now find ourselves in Period 'E' – strategizing around the commodity cycle: strong production in recent years with a whiff of economic uncertainty.

High prices are generally created by supply (weather) issues – **NOT** by the '9Bn people by 2050' argument – this is a longer term driver. When strong forward prices and favourable weather coincide, a supply response is inevitable. This brings us to the much loved: **"The best cure for high prices, is high prices"**.

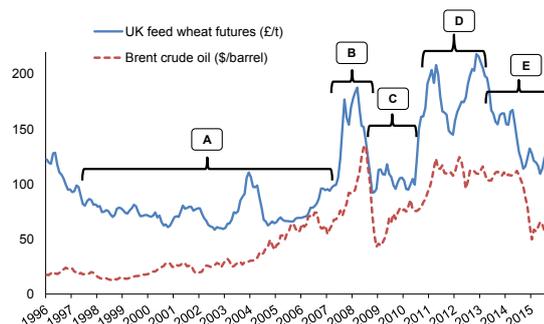
Strategizing around low prices is more challenging. This is where the audience is divided to:

1. Rationalise production in response to poor margins *Or*
2. Expand in the hope that costs can be diluted over a greater tonnage

I can't help but think that the second is flawed as producing more goes against the price signal, which is saying 'produce less'. Nonetheless, any commercial farm business needs an effective strategy for dealing with periods of low prices – what's yours?

Jack Watts

Figure 1 Nearby UK feed wheat and crude oil futures



Source: AHDB

In this issue...

Wheat stocks – beyond the headlines

Despite reports revealing record global wheat stock estimates this season, they don't show the full picture. With a decreasing proportion of stocks held by the major exporting nations, the wheat market may be more vulnerable to production challenges than the headline figures indicate.

Harvest 2015 – what yields will wheat bring?

Harvest of winter barley and winter oilseed rape started in mid-July, with the earliest wheat expected to be harvested towards the end of July.

Could maize malaise set up a win for wheat?

Compared with initial forecasts, global maize supply and demand is looking tighter than for wheat.

Adding reactivity to strategies - update on 2015 pricing strategies

The 2015 price strategy rankings have remained the same as in June and all have moved lower in line with futures prices.

Wheat stocks – beyond the headlines

Despite reports revealing record global wheat stock estimates this season, they don't show the full picture. With a decreasing proportion of stocks held by the major exporting nations, the wheat market may be more vulnerable to production challenges than the headline figures indicate.

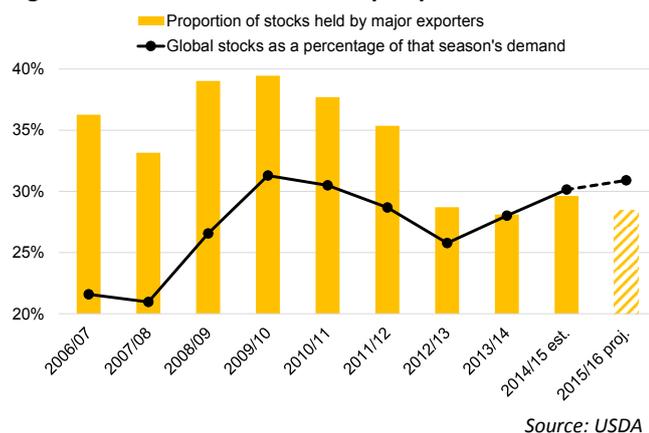
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 23 July 2015

Introduction

The July global supply and demand estimates from the USDA contained some considerable revisions to global wheat demand – [read more here](#). These revisions lifted the global wheat carry-over into this season by 12Mt compared with the previous estimates.

At the headline level, the global stocks are estimated to be the highest on record and represent more than 30% of annual demand (Figure 1) - a particularly weighty level. However, it's important to look beyond the headline level as much of these stocks may not be accessible to the market.

Figure 1 Global wheat stocks in perspective



Source: USDA

Major exporters account for lower proportion...

Together, the major wheat exporting nations are estimated to account for less than a third of global wheat stocks. In comparison, between 2008/09 and 2010/11 – they accounted for nearly 40% (Figure 1). Much of this shift has come from a build-up of stocks in China and a decrease in stocks for Russia and the US.

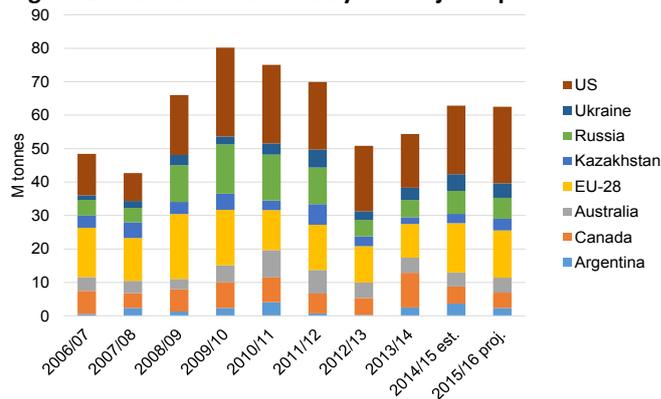
The key point here is that with less of the world's stocks held by major exporting countries, the headline stocks level is less of an indicator of the sensitivity of the market.

...and hold less volume

In volume terms, total stocks carried into 2015/16 by the major exporting nations are well below the 2008/09 – 2011/12 highs and only slightly higher year-on-year (Figure 2).

This points to the global wheat market being less well stocked and so potentially more vulnerable to production shocks than the headline levels suggest.

Figure 2 Wheat stocks held by the major exporters



Source: USDA

The relatively low level of stocks held by major exporters may help to explain the strength of the rallies seen in wheat markets over recent weeks.

It's also worth highlighting that projections show stocks held by the major exporters declining slightly between 2014/15 and 2015/16. The fall isn't too large mainly due to a build-up of winter wheat stocks in the US, a crop for which there are quality concerns. It's still early days but this will be an important area to monitor.

US stocks 'cushion' weighing down?

It is important to remember that not all stocks are viewed equally by the market. The US in particular, is regarded as a particularly 'safe' origin and a build-up of US wheat stocks tends to weigh more on market sentiment than a build-up for other major exporters.

Challenges exporting US wheat last season have led to a partial stocks rebuild. Exports are projected to remain lacklustre in 2015/16, given the current weakness of the euro against the US dollar and quality concerns for winter wheat crops. Consequently, US wheat stocks could return to the high levels seen in 2010/11 or even 2009/10.

Based on these factors alone, it seems that the pace of US wheat exports could once again be a bearish driver in 2015/16 – offsetting the lower stock cushion held by other major exporters.

However, there is a twist. For US stocks to be exported, they need to be price competitive – currently not the case. Wheat prices for other major exporters need to rise relative to US values to enable US stocks to reach the market.

Concluding comments

While the headline figures show a very heavy supply and demand balance, they do not show the full story and it's important not to get complacent towards global wheat supplies.

The stocks held by major exporting nations are not large in historical terms and are forecast to decline once more over the season ahead. Caution is needed though, as US stocks tend to have a bigger 'drag' on market sentiment than the numbers suggest. US stocks are projected to rise but a lack of competitiveness is currently keeping them off the market. Both these areas will be important to monitor going forward.

Harvest 2015 – what yields will wheat bring?

Harvest of winter barley and winter oilseed rape started in mid-July, with the earliest wheat expected to be harvested towards the end of July. The current crop status suggests average to good wheat yields for GB, although weather conditions in the run up to harvest can still change the final outcome.

Rebecca Carter, External contributor
28 July 2015

Introduction

This article is the first instalment in a series of harvest reports that will be produced by ADAS this season. All harvest reports will be published on the [Market News](#) page of the AHDB Cereals and Oilseeds website, so keep an eye out for future updates, or email Brenda.Mullan@ahdb.org.uk for more information.

GB wheat crop overview

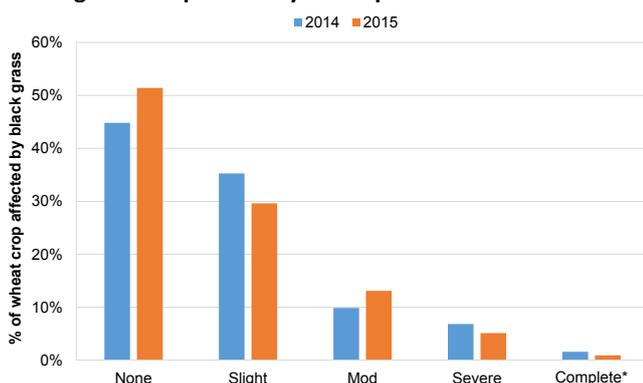
During the growing season this year, there were no serious or widespread pest or disease issues in wheat or other cereals. Furthermore, crop inputs have been well timed and lodging levels are currently low.

During May, the weather was generally favourable with sufficient moisture, although cool temperatures slightly delayed winter wheat flowering compared with 2014. It was largely dry from mid-June, particularly in the south and east, and soil moisture deficit levels rose which caused crop stress in some areas, although this was dependant on soil type. The dry weather in June and early July was accompanied by good sunshine levels, which is good for grain fill. However, some very high temperatures in early July may affect grain development.

Low disease pressure but black-grass a continuing problem

The 2015 [AHDB Cereals and Oilseeds Planting and Variety Survey](#) estimates that the total GB wheat area to be harvested in 2015 will be around 1.87Mha, down 3% compared with 2014. The survey also indicates the area of nabim Group 4 wheat has increased by 5% compared with 2014 to 1.18Mha and makes up the majority (63%) of the GB wheat area.

Figure 1 Estimated percentage of wheat crops affected by black-grass and potential yield implications



*black-grass pressure has been so severe that patches or the entire crop has been sprayed off

Source: ADAS

Overall, the GB wheat area was drilled within the optimum window and established well. Weed control has generally been good for the wheat area, although an ADAS snapshot assessment of black-grass infestation levels indicates that an estimated 48% of the crop area was affected by black-grass (Figure 1). Furthermore, 18% of the infested area was moderate to severe and is expected to have some impact on yield.

Yellow rust, mildew and septoria tritici were well controlled with standard fungicide programmes. Take-all incidence is low, but where symptoms are present they are often severe, with the potential to reduce yields in the affected parts of fields by up to 20%.

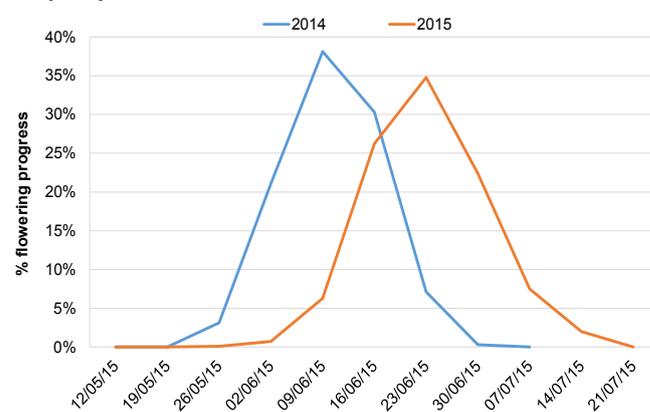
Low rainfall during flowering means an estimated 76% of the GB winter wheat area is at low risk of fusarium infection. Only 23% of crops, mainly in the East Midlands and Scotland, are at moderate risk and 1% of crops at high risk.

Flowering of wheat crops was later than in 2014

In mid-July, typical wheat crops ranged in growth stage from early to medium milk development. On the whole, the GB wheat area flowered later than in 2014 (Figure 2), (although note that 2014 was an early flowering year) which is expected to result in a later start to harvest.

The more forward crop areas in southern and eastern regions are expected to be ready for harvest in late July to early August.

Figure 2 Flowering progress of GB wheat area between May-July



Source: ADAS

May delivers favourable weather for wheat ear formation

Wheat yield is driven by grain number per ear and final grain weight. Cool, dull conditions a fortnight before flowering can enhance the ear-formation period and increase grain number per ear. Conditions during May were generally conducive to ear formation, with an average weekly temperature of 10 degrees Celsius and a weekly average of 38 sunshine hours.

The optimal conditions for grain fill are cool and bright, with temperatures of 25 degrees Celsius or more potentially negatively affecting grain fill.

Harvest 2015 – what yields will wheat bring?

For those crops starting grain fill during June, conditions were generally positive. However, conditions changed in July, with day time temperatures reaching over 25 degrees Celsius in many places and over 30 degrees Celsius in southern and eastern regions.

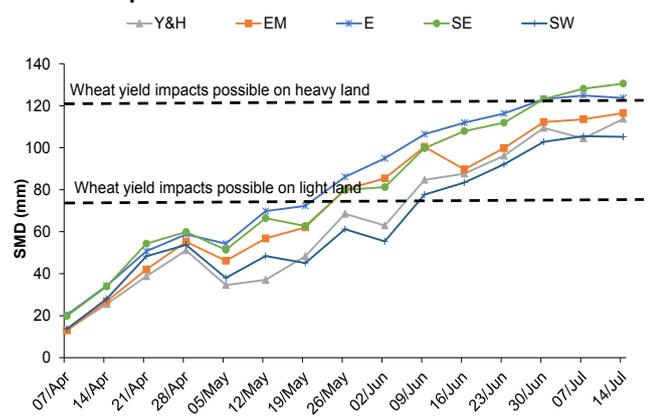
Sunshine hours were just above normal during June and July with a weekly average of 45 hours.

Moisture stress for some crops

There was a prolonged dry period during June and July in many parts of the country. It was especially noted in southern and eastern areas, resulting in some crops showing signs of moisture stress as soil moisture deficits built (Figure 3a and 3b).

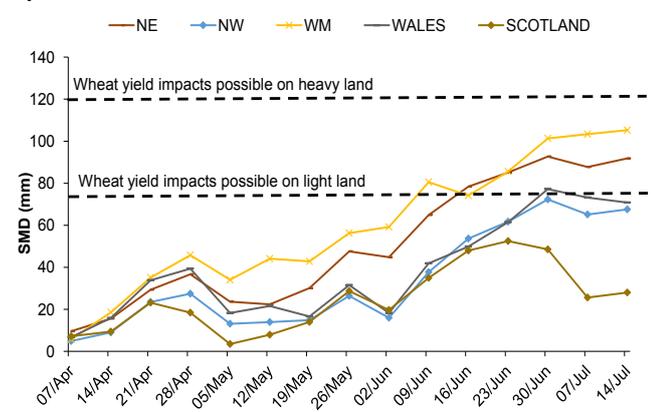
This was particularly apparent when air temperatures were also high and may have an effect on yield. Although, it should be noted that the effects of mild drought can be counteracted by higher radiation levels.

Figure 3a Soil moisture deficits* (SMD) in each region between Apr-Jul 2015



* of wheat crops on medium soil Source: ADAS

Figure 3b Soil moisture deficits* in each region between Apr-Jul 2015



* of wheat crops on medium soil Source: ADAS

Crops at risk of lodging if rain continues

Lodging can have a serious effect on yield and quality, particularly when it occurs early. At the moment there is very little lodging, but crops remain at risk in the lead up to harvest, particularly if the weather is stormy with heavy rain and winds.

Oilseed rape

The 2015 oilseed rape area is estimated to be 627Kha; a 7% decline on 2014, [read more here](#).

As at mid-July, crop development for the GB oilseed rape area was similar to recent years, with typical crops in the latter stages of seed development.

Desiccation of oilseed rape began in early July, with the first crops harvested in mid-July, predominantly in the south and east of England where crop development is generally further along than the rest of the country.

There have been few weed, pest or disease issues this season for the GB oilseed rape crop. Black-grass control appears to be better than in previous years and pest levels have also been low. There were some crop losses to adult cabbage stem flea beetle at emergence, but once established there were few other problems.

Disease pressure has also been fairly low; phoma and light leaf spot were well controlled by fungicide treatment and the largely dry weather during flowering also meant that the risk of sclerotinia infection was low.

Concluding comments

Overall, the prospects for the GB wheat crop are good with good conditions for grain set and grain fill. However, it should be noted that with some areas potentially affected by moisture stress and high temperatures, final grain size could be variable. Lodging is currently low, but poor weather conditions in the run up to harvest could increase lodging.

Oilseed rape prospects are generally good, however, with crops now desiccated any delays in harvest due to poor weather could lead to crop losses.

Key Points

- Harvest of winter wheat is likely to begin in mid-July – slightly behind last year
- Wheat yield prospects are currently good to average
- Oilseed rape prospects remain good, assuming lodging does not occur

Could maize malaise set up a win for wheat?

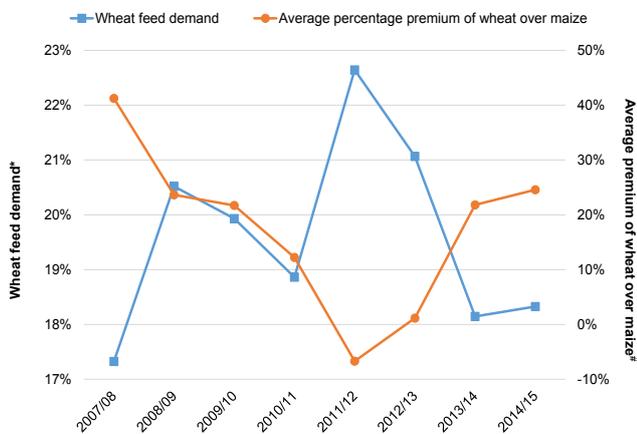
Compared with initial forecasts, global maize supply and demand is looking tighter than for wheat. Wheat and maize prices converged recently favouring increased demand for feed wheat, especially in Europe. As a result, EU and UK wheat prices could see some support.

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 30 July 2015

In this month's outlook article, we take a close look at the recent developments in the maize market. While maize is not grown in substantial amounts in the UK, its status as not only the world's largest grain, but also the world's largest feed grain, means that the maize market can exert a considerable influence on the feed wheat market.

Figure 1 illustrates the relationship between the average percentage price premium of Chicago wheat futures over Chicago maize futures against the proportion of wheat used in global animal feed demand (based on just wheat and maize consumption). It's clear to see that wheat loses its share of feed demand to maize as its price premium increases.

Figure 1 Relationship between wheat feed demand and wheat price premium over maize



* Based on global feed demand for just wheat and maize
 # Based on Chicago futures prices

Source: USDA, AHDB

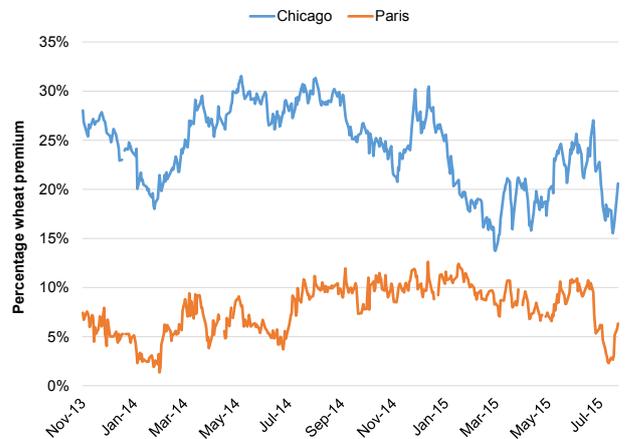
It's early days in the 2015/16 season but we're beginning to get a better picture of the Northern Hemisphere wheat harvest and some indication of the state of the maize crop. So, based on this initial outlook, how might we expect the wheat/maize relationship to evolve in 2015/16?

Wheat/maize price spread narrows but has recovered recently

The premium of Chicago wheat futures (Dec-15) over Chicago maize futures (Dec-15) fell to 15.5% as at 22 July, the lowest since March 2015. Likewise, the premium of Paris wheat futures (Dec-15) over Paris maize (Nov-15) fell to 2.3% as at 17 July - the lowest

since early February 2014. Recently though there has been some recovery for both of these price spread due to improving crop prospects for maize in the US (Figure 2).

Figure 2 Percentage wheat premium over maize (Nov/Dec-15)



Source: AHDB

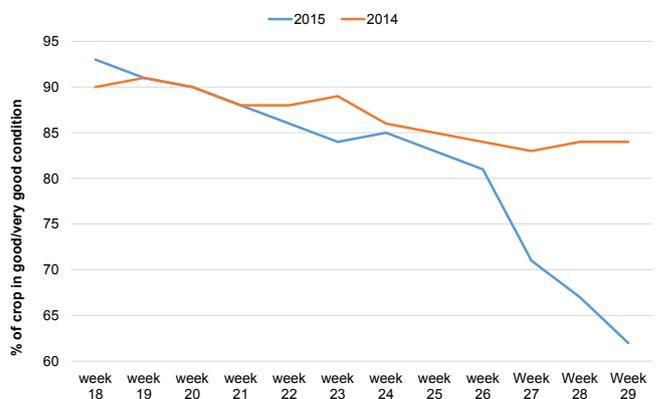
Compared with this time last year, the wheat/maize price spreads for both Chicago and Paris November/December contracts, are narrower, which could mean higher demand for feed wheat in animal feed instead of maize.

Deteriorating maize crop conditions

The recent dry weather in the EU has raised concerns for crops. In France, the wheat crop is likely to have escaped from any ill effects as the dry weather came too late to have a considerable impact on yields. For maize, however, the story could be different.

Figure 3 shows the crop condition scores for the French maize crop provided by FranceAgriMer. Over the past few weeks, crop conditions have deteriorated considerably relative to last year.

Figure 3 Proportion of French maize crop in good/very good condition



Week 18: start of May; Week 29: mid-July

Source: FranceAgriMer

Just over half of the French maize crop had entered the "silking" stage, the first reproductive stage by 20 July. Soil moisture is critical during this phase and any stress to the crop can lead to the largest reduction in yield compared with other crop development stages. If

Could maize malaise set up a win for wheat?

dryness in Europe persists, maize production could be lower than originally anticipated. Strategie Grains recently cut their estimate for EU maize production to 66.74 Mt, 0.74Mt lower than their previous forecast in June and warned that further reductions were possible.

Unlike French wheat, the later developing German wheat crop is more susceptible to suffer from lower yields caused by dry weather and estimated output in 2015/16 has been revised lower ([read more here](#)). As a result, Strategie Grains also downgraded their overall EU wheat production forecast compared with their previous estimates, but not as much as for maize.

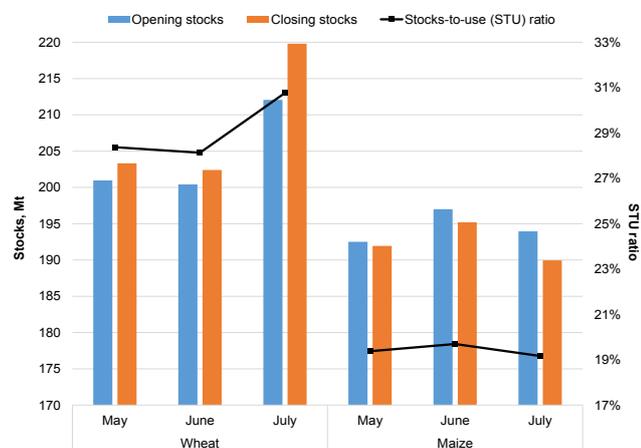
US maize crop conditions also deteriorated from the latter half of June, but have since stabilised. While the proportion of the US maize crop in good/excellent condition is below last year's level, it remains above the five-year average. Almost 80% of the US crop had reached "silking" by 26 July, so again adequate soil moisture levels in the coming weeks will be crucial for yields. Recently, though, the weather in the corn-belt has been described as "ideal" which has led to the Chicago wheat and maize spread to diverge again (see above).

Despite earlier fears for the US wheat crop, it appears that the recent unfavourable weather is not considered to be detrimental to output. The USDA has steadily increased its 2015/16 US wheat production forecast from 56.81Mt in May to 58.46Mt in July. However, quality issues may have led to a higher proportion of feed wheat.

Maize supply/demand balance in 2015/16 looking less comfortable

When the first USDA forecasts for 2015/16 were published in May, the global wheat and maize supply balance was best described as "finely balanced" ([read more here](#)).

Figure 4 USDA 2015/16 global stock estimates



Source: USDA

A few months on, these initial projections have evolved to show more comfortable global wheat supplies, but a tighter position for global maize

(Figure 4). Compared with 2014/15, the latest USDA forecast of this season's global wheat stocks-to-use (STU) ratio is 30.8%, up 0.8 percentage points (pp). For maize, the global STU ratio in 2015/16 is forecast at 19.2%, down 0.5pp from 2014/15.

Closing comments

The maize price discount to wheat shrunk at both a global and EU level due to emerging concerns over the size of this year's maize crop. However, as Figure 2 shows, this was more severe in the EU. European feed grain supplies are expected to be considerably lower year-on-year in 2015/16 compared with a year earlier. It's looking unlikely that there will be a repeat of last year's quality issues for French wheat plus the overall size of the wheat crop is forecast lower year-on-year. While EU maize production was expected lower than 2014/15's record, unfavourable weather conditions are leading to further cuts to 2015/16 forecasts and it is uncertain how much lower actual production will be.

We're potentially looking at a more bullish feed grain situation in the EU than in the US. From a UK perspective, a lower premium of wheat over maize should see higher demand in animal feed and help digest some of this year's wheat surplus plus the large carry from 2015/16.

In terms of UK wheat exports, though, the outlook is mixed. Lower feed grain supplies in Europe should provide improve UK wheat exports to the continent compared with last year, however, the continuing weakness of the euro relative to the sterling may remain an obstacle.

Key Points

- Global maize supply/demand balance in 2015/16 is looking less comfortable compared with wheat
- A narrower wheat/maize price spread should lead to increased feed demand for wheat
- EU feed grain supply looks considerably tighter, which could be beneficial for UK, in terms of prices and exports, currency permitting.

Adding reactivity to strategies - update on 2015 pricing strategies

The 2015 price strategy rankings have remained the same as in June and all have moved lower in line with futures prices. The limitation with the current strategies is the inflexibility to respond to market information. Trigger pricing and benchmarking can add reactivity to strategizing in the real world.

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4 August 2015

Introduction

Downward trending wheat futures in July have now offset the gains of the rally in June. As at 29 July, Nov-15 UK feed wheat futures closed at £122.00/t, bringing the market back to the levels seen in mid-June and £13/t lower than the peak of the rally on 2 July.

The USDA's supply and demand update in July pointed to a [weightier wheat balance globally](#), with the forecast stocks to use ratio increasing by three percentage points compared with the previous estimates in June. While concerns still remain about the likely quality of the US winter wheat crop, it appears that markets have become more relaxed about the weather issues. In Europe, prolonged hot and dry weather has raised questions regarding yield expectations, but the focus has been on [potential maize production cuts](#) rather than for wheat.

Looking ahead, clarification on yields and quality will come into focus as cereal harvesting takes up speed over the next month or so. To find out how the UK harvest is progressing, keep an eye on the [AHDB Cereals and Oilseeds Markets](#) website each Thursday for the ADAS harvest updates.

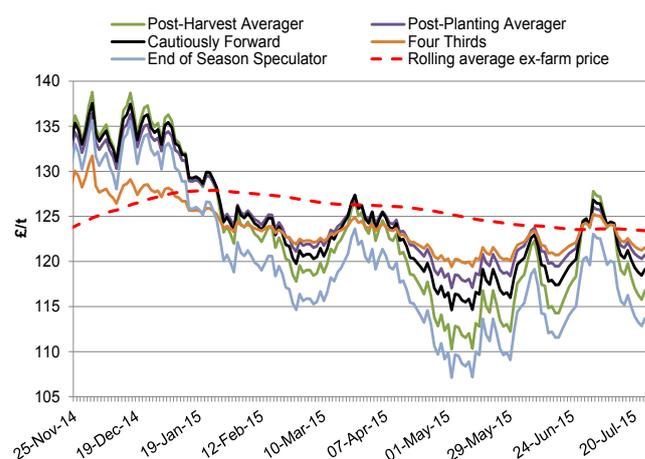
How the strategies are faring

We have been tracking our risk management demonstrations for the 2015 wheat harvest now for eight months ([click here to read a concise description of each strategy](#)). When viewing the performance of the strategies, it's important to remember this includes the value of sales made to date, and the value of any unsold wheat at current prices.

Four Thirds (FT), the strategy which has sold the most loads up to this point, continues to stay on top of the rankings. Having sold the most loads up to now (44 loads – 1.3Kt), this strategy has protected itself the most from the market drifting further.

With the recent downward price trend in mind, **the strategy which still has some of the highest volume of wheat exposed to the downside risk, the End of Season Spectacular (ESS), remains at the bottom of the rankings.**

Figure 1 2015 Pricing Strategies Progress*



* as at 28 July

Source: AHDB

While the ranking of strategies has remained the same since the previous update, they did alter somewhat during the price rally towards the end of June and early July. Only one strategy sold any loads since the last update – the Post Planting Averager (PPA) – the implications of this sale will be touched upon later. In the last month, we also saw prices coming above the rolling average ex-farm price for the first time in this series.

Limitations to a formulaic approach

All strategies have moved up and down with each other in line with wider price trends. With decisions on when and how much to sell 'locked in' at the beginning of the marketing period, the synchronised trends for all strategies highlights the limitations of a formulaic approach. Essentially because of this formulaic approach, the strategies performed poorly at taking advantage of the rally. This underpins the importance of using market information to inform pricing strategies.

Building flexibility into strategies

This begs the question as to whether a strategy can be prescribed that is able to respond to every-day market information?

In order to allow for a degree of flexibility to respond to market information, but still work as a strategy, **trigger price levels can be applied.** This allows sellers to activate a strategy based on prices hitting a pre-specified level and as such, seeks to benefit from rising markets, while protecting profit margins when prices fall.

For example, a trigger price may be developed in order to sell at the minimum price level which would generate a sufficient revenue. The owner of this strategy would sell 'X' number of loads when the price moves above £'X'/t. The fact that decisions are made on a reactive basis and the volumes of grain sold are also variable means that this strategy cannot be fully described right from the offset of the marketing period.

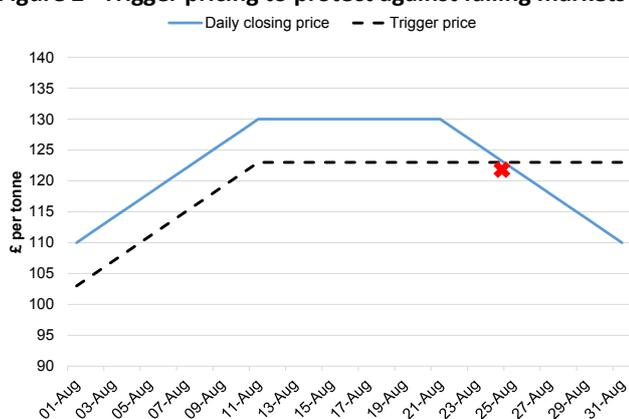
Adding reactivity to strategies - update on 2015 pricing strategies

Thinking about strategizing in this way taps into the **underlying psychology of grain marketing**, for example:

- If grain prices are going up, the assumption is that they will continue to appreciate so there is the incentive to hold on to grain to get a higher price;
- If grain prices are going sideways then there is neither an incentive nor a disincentive to sell, so there's an inclination to hold on to grain waiting for markets to rise; and
- If grain prices are going down, there is a disincentive to sell at a lower price, so there's a tendency to hold on to grain with the assumption that the price will have to come up again.

Alternatively, a price level could be set against daily futures closing prices. If daily closing prices break below this level, that would be the indicator to cash out, as illustrated in Figure 2. With continuing sideways or rising prices, you would never be worse off, as you would always have a higher price than your benchmark level to sell against. However, this strategy would need to be revisited and reviewed on a regular basis, depending on the trends in the market, in order to operate as efficiently as possible.

Figure 2 Trigger pricing to protect against falling markets



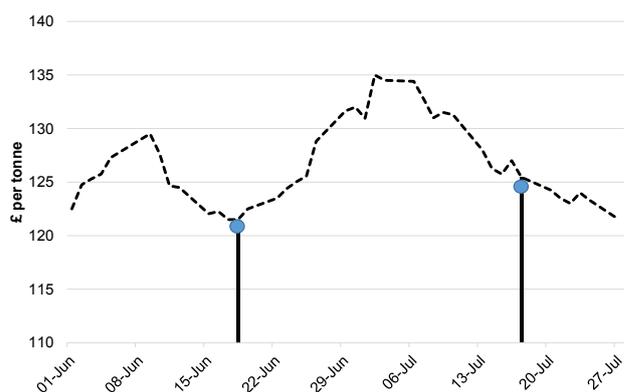
Source: AHDB

Trigger prices make strategizing more reactive, putting selling decisions in context with costs of production or desired revenue levels. [Read more about other examples of benchmarking futures here.](#)

Which average is best for your business?

When incorporating pricing strategies into your grain marketing, it's important to consider when averages can be set for your business. See the [previous 2015 pricing strategies update for more.](#)

Figure 3 Recent selling averages in context with Nov-15 daily closing price



Source: AHDB

The averages for our current strategies are calculated on the 18th of each month. Considering this in line with the recent rally in June, the **PPA missed the opportunity to benefit**. The loads sold on 18 June and 18 July were sold on either side of the rally, so the PPA failed to capitalise when prices were at their peak.

So, ask yourself when is best for your business to set your averages to make sure cash flow is intact? Do you have the option to be flexible with your averages?

Concluding comments

This article highlighted the limitations that can be associated with price strategies. **In the real world, flexibility needs to be built in to grain marketing.** It's also important to keep in touch with market information and understand it in the context of your own business. [Subscribe to the Grain Market Daily](#) for a daily snapshot of what's happening in the cereals and oilseeds markets and how this could impact you.

Now that the growing season for the 2016 harvest is almost upon us, it's time to start thinking about strategies for 2016. How would you like us to test the market with the 2016 strategies? If you have any ideas about possible strategies for next year's crop, please e-mail Anna Lockwood (anna.lockwood@ahdb.org.uk).

Key Points

- The ranking of the 2015 pricing strategies is unchanged since the last update, with 'Four Thirds' still leading the pack
- There are limitations to formulaic approaches and in reality pricing strategies should be designed to react to an evolving market
- Set your averages according to what suits your business needs best