

“Changing Grain Markets”

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PLEASE NOTE: These notes are provided some weeks prior to the Updates as guidance for the proceedings. Slide presentations available on the day will provide more current and detailed information – markets will remain volatile over 2009!

Key Message: World grain prices remain at historically high levels, despite the 30-40% drop from 2008. Growers will need to remain alert to grasping profitable returns when they present – don't wait for another 2008 spike.

This paper focuses on three main themes:

1. Why aren't prices higher? (or perhaps, why do they remain so high?)
2. Export wheat deregulation – what have we learnt?
3. What lies ahead in 2009?

1. Why aren't prices higher? – Or, why do prices remain so high?

The global position:

- After record prices in 2008 (over US\$10/bushel), 2009 still remains at historically high levels (over US\$6/bushel).
- the 2007-8 price run-up was building for several years starting with the US Govt decision in 2005 to support corn-ethanol plants (US wants less dependence on oil and corn converted to ethanol now accounts for 25-30% of the US corn crop). This was followed by a series of poor grain crops over 2006 and 2007. Australia had droughts in 2006 and 2007, US and EU suffered relatively poor crops in 2007 (esp eastern Europe).
- Apart from the new ethanol demand, traditional demand for grains remained strong (rising disposable incomes in Asia and India, changing diets to more poultry, pork, dairy, beef, etc).
- The end result in 2008 was world stocks of grains and oilseeds at record lows and an explosive price situation, further fuelled by hedge fund managers who poured money into soft commodities to drive futures markets even higher.
- Analysts spoke of competition between crops (wheat, corn, oilseeds) for the available land, where each commodity had to “buy” land away from the other.
- The rest is history. Price works! - A\$400 per tonne is too profitable!! Growers around the world responded by growing more grain. 2009 produced a record world wheat crop; the seasons generally were good (apart from parts of Australia and Argentina) and prices tumbled.
- The global financial crisis compounded the price corrections with fund managers having to liquidate their commodity positions to meet bankers' demands for security – futures markets also tumbled.
- BUT, despite the 33% drop from around US\$9/bushel in mid-2008 to US\$6/bushel in Jan 2009 (having touched US\$5/bushel in Dec 2008), these price levels remain high relative to the last decade average in the US\$3.50-5.00 per bushel range.
- There is the issue of higher production costs (esp fertiliser and chemicals) to produce each bushel, however these input costs appear to be undergoing a major downward price correction. Oil is now at approx US\$35-40/barrel c.f. US\$140/barrel in mid 2008. (We will provide an update to these costs at the time of the GRDC Adviser Updates in Feb 2009).
- Finally, stock levels remain sensitive to any interruption to normal crop yields in 2009, so the stage is set for continued volatility. The March-May period remains a key driver of where prices

will end up in late 2009. This is the northern hemisphere “spring”, and just as crops are made or broken in our southern hemisphere spring of Aug-Oct, we will see instant price reaction to how the northern hemisphere crops shape up after their “sleep under the snow” of December to February.

- A good northern hemisphere 2009 season, and the world could be awash with grain; or a below average yield with a major consumer or exporter, and 2009 prices may retrace back towards 2008 levels.

The Australian position:(as at early January 2008 – will be updated at the February 2009 meetings)

- Despite poor crops in 2008 in South-East Australia (sthn NSW, Vic and SA), there were good winter crops in Qld, Nthn NSW and WA. An average 20 million tonne wheat crop.
- The Australian feedgrain position is over-supplied, albeit it that the major stocks are in the north and with un-met demand in the south. The 2008 sorghum crop was an all-time record and carryover remains despite an active export program; the wheat and barley crops in NSW and Qld were, in part, weather-damaged which has added to feedgrain stocks, with much stored on farm. The incoming sorghum crop (Feb-Jun 2009) looks to be at least average on the back of excellent summer rains to date. There have also been large feed wheat crops in Eastern Europe (Ukraine, Russia) with these crops competing into Asia and Middle East.
- 2009 prices for the 2008-9 crop will be determined by export values, which will vary according to the global factors outlined above.
- The A\$ has now traded around US70cents for a few months and at these levels should translate into reasonable, but not fantastic, prices for Australian growers.
- Current prices for APW wheat reflect a range of A\$270-300 FOB around Australia, meaning farm gate returns of A\$220-250. East coast feed wheat returns have been trading around A\$150-180 ex farm.

2. Export Wheat Deregulation – what have we learnt?

- **Note: As at early January, a full picture of the lessons learnt from this first deregulated wheat harvest is still emerging. We will update this picture at the time of the February GRDC Adviser Updates.**
- The export deregulation debate will go on, but to date there have been no “disasters”. Around 20 exporters are accredited, with no one as yet emerging as dominant.
- Exporters generally displayed a cautious approach; many were concerned about the reliability of getting access to export supply chain services (storage, rail, ports, etc) when these were controlled by their competitors (CBH, ABB, GrainCorp and partly AWB).
- The rain-delayed harvest, both east and west coast, proved to be a challenge for those exporters who sold forward based on early shipment of new crop. At times, we saw these “shorts” having to pay up to get grain to meet their shipping commitments.
- Growers have also acted cautiously with significant volumes of grain being pooled or warehoused, as well as some growers taking cash where they saw it attractive.
- Export customers have acted in a hand-to-mouth fashion from late 2008 and into 2009 as they feel confident about supply of grain and are prepared to watch prices stabilise. Importantly, traditional human consumption demand throughout Asia and Middle East remains sound.
- Customers have also shown a preparedness to “shop around” with Australian suppliers, so that exporters have to be price competitive to win the business. If the price is not competitive from their traditional supplier, they will switch to another supplier.
- A new on-line marketing alternative, “Clear Commodities” was launched for the 2008 harvest. It provides the opportunity for growers and buyers to place on-line bids and offers 24 hours a day, with guaranteed payment to growers within five days. We will provide a post-harvest update of this service at the February updates.

3. What lies ahead in 2009?

- For reasons outlined above under “Why aren’t prices higher? – or why do they remain so high?”, we expect the price outlook to be volatile until we know the size and shape of the northern hemisphere crop. This places the March-May 2009 period as one to watch very closely.
- Industrial grain demand, including for ethanol, is likely to be curbed in line with the global slow-down and lower oil prices.
- Local ethanol demand may rise with the new sorghum-based facility at Dalby, Qld, now in production. Also, the NSW government mandate for 6% of all petrol sold to be ethanol by 2010 will likely see increased capacity installed in NSW.
- Australian feedgrain demand is expected to be strong in 2009. Beef feedlots are raising cattle numbers on the back of cheaper feedgrain supplies, a low A\$, and solid domestic and export markets for beef. Chicken, pork and dairy customers are expected to maintain or increase demand over 2009.
- Grower marketing will continue to rise up the ladder in terms of the matters they need to manage – the days of being “just producers” are over.
- Marketing channels will reflect either (a) a commodity-style return, where timing of pricing and supply chain costs will determine the final grower return from traders, or (b) a niche-style return, where growers establish a more direct line with the ultimate consumer, regular supply and consistency of return outweighs getting the “best price” every day, and the focus turns to building longer term sustainable relationships. The key for growers in this channel is to ensure they can capture an overall higher return (or perhaps lower risk) for the extra effort and cost of servicing this channel – this includes getting an appropriate return on any investment in on-farm storage.

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