GRDC ADVISOR UPDATES – FEBRUARY 2011

"National and Global Grain Market Trends"

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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 2011!

Key Message: **World grain markets are poised in early 2011 for some rapid run-ups in price if weather problems emerge in first-half 2011, OR for a more gradual but significant price fall through mid-2011 if northern hemisphere weather is normal and crops can achieve their potential. If you have unsold 2010-11 grain or are confident of production in 2011-12, it is NOT A TIME TO BE WAITING FOR HIGHER AND HIGHER PRICES, IT IS A TIME TO LOCK IN GOOD PROFITS. Current prices are encouraging growers around the world to grow more – and given average weather, they will. If that happens, the current prices will have done their job of bringing more grain into the market and prices will retreat to more sustainable levels. If further weather problems persist into 2011, then it's off to the races with even higher prices; but that will also bring political intervention as governments seek to protect their populations from unaffordable food prices.**

This paper focuses on three main themes:

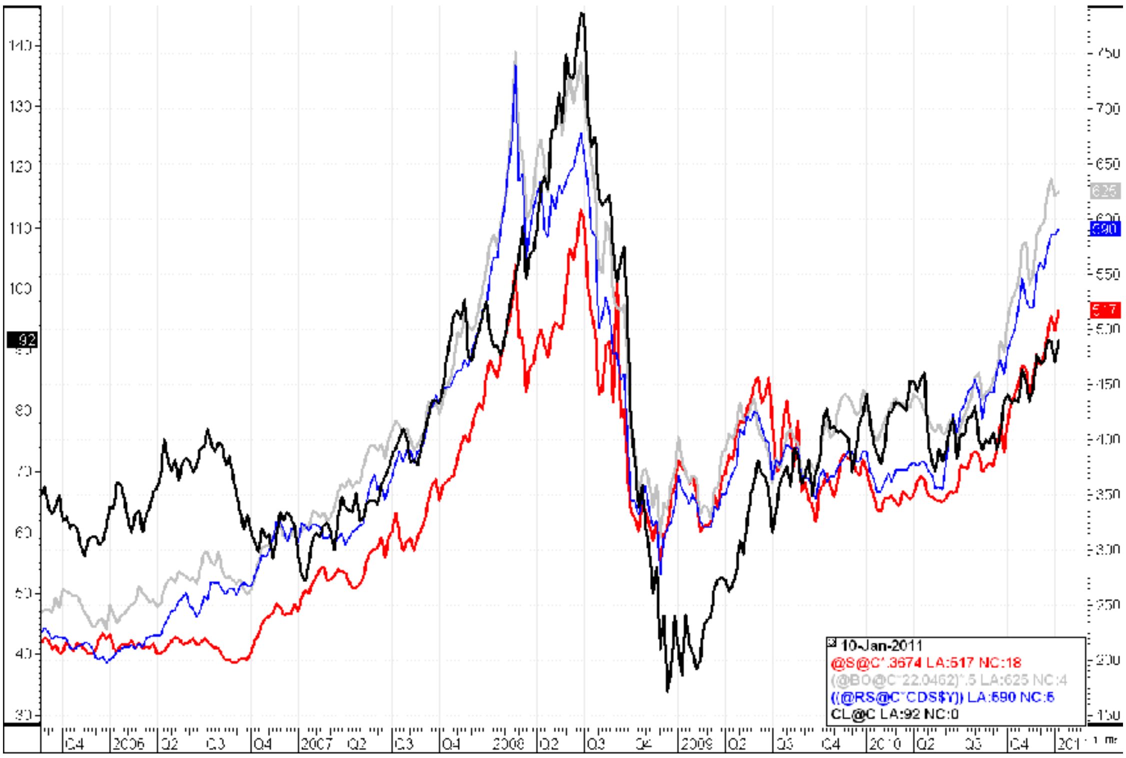
1. Is there a shift in grain market dynamics?
2. Key trends in grain markets for 2011?
3. In the grower's shoes: what is their attitude and behaviour in grain marketing?

1.Is there a shift in grain market dynamics?

- The fundamentals of grain supply and demand continue to underpin the longer term direction of prices in grain markets (See section 2 of this paper for 2010-11 outlook)
- These fundamentals are basically bullish for agriculture and soft commodities (Demand is strong: rising populations, increasing disposable income, diet shifts to animal protein, supportive policies for biodiesel and ethanol. Supply is challenged: urban land creep, water supplies, yield curves flattening out, soil fertility decline, climate change.)
- This implies a continued dependence on cyclical seasonal responses around the world to the vagaries of weather – what is typically known as the boom and bust cycle of agricultural commodities.
- Over the past two decades, consumers (governments) have not responded by building strategic reserves of these food commodities to smooth out prices for their consumers. They have learned to live with the volatility of seeing stock

surpluses and very tight stocks. Will this continue? We have seen governments intervene with export bans and other measures (several countries did in 2008 and Russia has for 2010-11)) to protect their populations from wildly rising food prices. FAO and the UN speak of the impact on under-developed nations.

- One of the more significant shifts that we need to acknowledge in agribusiness is the impact of what is referred to as the MACRO factors; the inter-connection of agriculture with other global markets – financial, energy, resources.
- Oil peaked at US$140/barrel in 2008 when wheat also hit US$10/bushel; oil dropped to US$35-40/barrel in 2009 but is now back at US$90/barrel with grain and oilseeds surging as well. Grain and energy markets show strong correlation.



- Money moves around the globe at the click of a “mouse” and fund managers are agile in shifting between different asset classes to maximise returns to their shareholders. Decisions to “go long or short” soft commodities can mean grain markets swing further on the up and downside than they otherwise might without those funds driving them.
- **The net impact of these macro influences is that grain and oilseed markets are open to additional volatility factors, quite apart from the normal fundamentals of weather-induced supply and demand in agriculture.**

- **Locally in Australia, there has been a transformation of the playing field** in terms of who buys and exports our grain. Rather than being a shift in market dynamics, the opportunities opened up by privatisation of major grower marketing bodies in the early noughties (2000-2002) and export deregulation of both wheat and barley, have brought the underlying globalised marketplace to the Australian market.

- What growers knew as the "big four" (AWB, ABB, CBH and Graincorp) have been replaced or joined by global names such as Viterra, Cargill, Glencore, Gavilon, Sumitomo-Emerald, Nidera-Pentag, Elders-Toepfer, etc.
- Until 2008, the former Australian "giants" accounted for 80-90% of Australian exports. In 2011, it is estimated that 80% of exports will be shared across the top eight exporters, mostly foreign owned, with the largest single share being 20-25%.
- We should expect these companies to invest further in our infrastructure, as they establish a broader agri-presence in Australia (many of them have broader interests including sugar, cotton, fertiliser, livestock, etc).
- There are 27 accredited wheat exporters with Wheat Exports Australia (Sept 2010), 18 of them being active over 2010. There is very active growth in the second tier level of traders, both from local and overseas companies.

2. Key trends in grain markets for 2011?

Note: These notes made as at mid-January; an up to date report will be provided at the February GRDC Advisor Updates.

The global position:

- After record prices in 2008 (over US$10/bushel), prices retreated to more normal levels over 2009-10 (US$5/bushel), but 2010-11 has rebounded to historically high levels (US$7-8/bushel)
- The 2010-11 recovery in prices started mid 2010 with a succession of weather related problems which have run for the last six months, viz:
- *Russian drought July 2010, followed by ban on Russian exports*
- *Lower than expected US corn crop*
- *Canadian wet harvest shrinking supplies of quality wheat*
- *Continued strong demand from China for both soybeans and corn*
- *Poor growing conditions in South America due to La Nina*
- *Rain ravaged Australian harvest further shrinks the supply of milling wheat*

- This combination of events has reduced world grain stocks to levels where consumers are concerned about supply security into 2011 if there are further production shortfalls
- Traditional demand for grains remains strong (rising disposable incomes in Asia and India, changing diets to more poultry, pork, dairy, beef, etc) and ethanol demand retains the benefit of both continued subsidies in a number of countries and strong oil prices.
- Analysts are again speaking of competition between crops (wheat, corn, oilseeds) for the available land, where each commodity has to "buy" land away from the other – this occurs through price signals to farmers.
- Price does work! - A$350-400 per tonne is very profitable!! In 2009, growers around the world responded by growing a record world wheat crop; the seasons generally were good and prices tumbled.

- For 2011, prices to grow grain and oilseeds need to remain attractive through Jan-Apr at least to encourage farmers to plant as many hectares to crops as possible for 2011, as well as ration demand back in first-half 2011 to conserve stocks till the new crop supplies arrive in the second half of 2011.
- Even a 25% drop to around US$6/bushel (we touched US$5/bushel in Dec 2008), is still high relative to the 1990's average in the US$3.50-5.00 per bushel range.
- Demand for nutrients and chemicals will push input prices up so farmers will need to manage their margins well, even though the headline prices for grains look strong.
- The markets remain sensitive to any interruption to normal crop yields in 2011, so the stage is set for continued volatility. The Feb-May period remains a key driver of where prices will end up in late 2011. This is the northern hemisphere "spring", and we will see instant price reaction to how the northern hemisphere crops shape up.
- Current prices reflect the premium for this uncertainty and are likely to stay in place till this risk period passes.
- A good northern and southern hemisphere 2011 season, and the world could be awash with grain; or below average yields with a major consumer or exporter, and 2011 prices may retrace back towards 2008 levels.
- **Message? Don't sit on unpriced grain thinking the market will go higher and higher. Have price targets which allow you to take the opportunities during this period of volatility, and look for opportunities to price 2011-12 grain if you are a forward seller with confidence about your 2011-12 production.**
- **Signposts to watch?**
- *Jan-Mar in Argentina and Brazil for their corn and soybean crops under La Nina (drier) conditions*
- *Apr-May in Russia and eastern Europe for emergence of their winter crop and planting of spring crop – they need a good one*
- *Apr-May in US and Canada for emergence of HRW crop (dry so far) and planting of corn, soybeans and spring wheat. Floods expected in northern US states and Canada after soaking in late 2010 and record snow cover – could impact high-protein wheat supplies.*
- *Apr-June for southern hemisphere plantings*
- *Import action from China to guage how they see their corn and soybean supplies.*

<u>The Australian position:</u>(as at mid January 2011 – will be updated at the February 2011 meetings)

- All-time record yields for 2010-11 in most of Queensland, NSW, Vic and SA, and a very poor season in WA.
- The "cream" was taken off the crop with up to 10 million tonnes of weather damaged wheat down the east coast, but fortunately the global feedgrain markets are strong (see comments above), so prices have been good.
- While our local feedgrain market will be well over-supplied, there is an active export program and prices reflect export parity.
- There will be a large carryover of grain in Australia at end 2011, even with good exports.
- The container trade looks like a permanent feature of the local/export market for now. **Wheat exports in containers have now averaged 2-2.5 million tonnes**

for the last 4 years and look set to continue. Growers in the container packer catchment areas have the opportunity to make some savings on supply chain costs with direct delivery to packers, and also need to watch the price opportunities when packers/exporters move to cover a short term requirement. Logistics is a major determinant of container trade profitability.

- At around parity with the US$, the A$ is taking the edge off our export values, but the resources boom looks set to keep the A$ strong into 2011.
- On current pricing and the A$ at parity with the US$, APW is at A$300-330, meaning farm gate returns of A$250-280. East coast feed wheat returns have been trading around A$200 ex farm.
- Quality specs on feed wheat will become increasingly important through 2011. Test weights will be critical for the most rain-affected crops. SFW1 at 68kg/hl minimum is the most sought after grain for both domestic and export markets. Fed 1 at 62kg.hl minimum will attract a discount.
- The Queensland and NSW sorghum plantings are expected to be reduced for 2011 due to the floods and many farmers may choose to wait for a winter crop on full moisture profiles.
- If sorghum production is down, expect a major shift to wheat feeding for 2011.

3. <u>In the grower's shoes: their attitude and behaviour in marketing?</u>

- Grain marketing has rapidly risen up the priority ladder in terms of matters to be managed by growers – the days of being "just producers" are over.
- The changes to be managed by growers since deregulation of the export wheat market in 2008, can be summarised into: selling patterns, price volatility, on-farm storage, contract management,
- **Selling patterns:** There has been a major shift to warehousing of grain at delivery, rather than sales on the weighbridge. This is a good thing. Evidence shows that "cash-at-silo" prices offered by traders are typically lower than what is available by direct negotiation with grain buyers. It also means that growers manage their sales program over the course of the year rather than just at harvest – this can be through periodic cash sales, delivery to pools or deferred delivery contracts.
- **Price volatility:** Growers are now directly exposed to the daily shifts in grain prices (meaning they see the variations in all the factors which drive their A$ price, i.e., the underlying global commodity futures price, the exchange rate, and the local "basis"). This volatility can be confusing as **<u>no-one can reliably predict grain prices</u>**. It becomes more and more important for growers to set target prices they seek to achieve and not try to pick the top of the market. Having daily access to trusted advisors/brokers or using on-line selling services such as Clear Grain Exchange are alternatives that are expected to grow.
- **On-farm storage:** Investment in on-farm storage continues to grow, but farmers are becoming more alert to the risks that have to be managed through this marketing channel. Quality risk remains entirely with the farmer right through to final delivery of the grain – this risk will be of greater significance in 2011 due to the huge volumes of rain-damaged grain with the associated potential for moulds, toxins, etc. Comparing this on-farm risk with the alternative of passing the risk to a professional bulk handler, will become a topic of greater importance. Associated with this discussion is the linkage to accessing price opportunities

under the selling pattern and price volatility issues discussed above. Grain typically needs to be in the bulk handling system, with guaranteed quality certificates and title documentation, to allow growers to access the short term price spikes as they occur. Buyers who want prompt coverage prefer not to be exposed to the potential vagaries of on-farm stored grain, ex-farm logistics and the lack of quality assurance.

- **Contract management:** Growers are now more directly involved with the nitty-gritty of the "T's and C's" of grain contracts (Terms and Conditions). This is a major shift from the days of pools where the pool manager looked after any issues of quality claims, delivery periods, payment arrangements, etc etc. Knowing the fine print, so that growers are not disadvantaged during the process of contract execution matters, has led to a significant growth in growers using agents or brokers to assist them in these areas. In 2010-11, the delayed harvest and issues surrounding multi-grade contracts has been a case in point. The role of Grain Trade Australia (GTA) acting as the industry's independent governing body for standard contract terms, grain standards, dispute resolution, etc has become a critical component of the grain supply chain.

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