◆ MARKETING ◆

What's driving the current grain market and what to do in 2008?

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We need to be aware of the main features of the current global and domestic grain markets to help make the best marketing decisions for the coming crop.

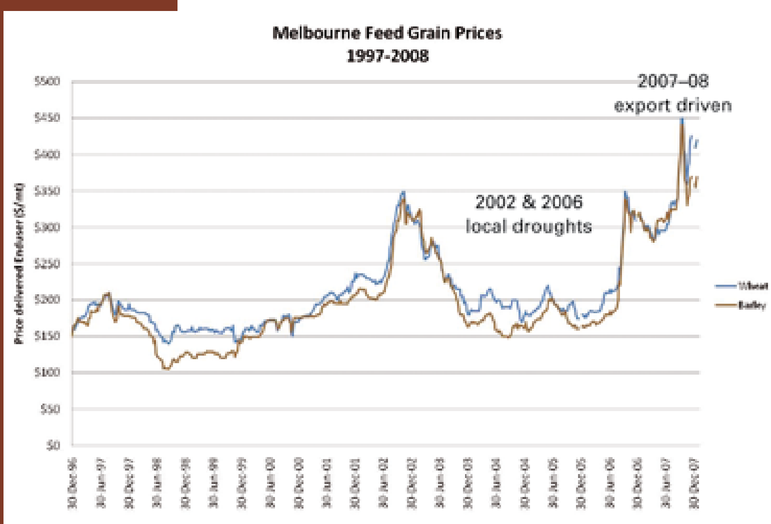
The global position

- First quarter 2008 represents all time highs for grain prices;
- The figure below shows that 2007–08 prices have punched through previous price spikes;
- The 2003 and 2006 price spikes were related to our local droughts;
- The 2007–08 price run-up is driven by world markets, with stocks at record low levels;
- This is not a one year story; it has been building for several years starting with the US government decision around 2005 to support corn-ethanol plants and biodiesel for US fuel and energy needs (the US wants to be less dependent on Middle East oil);
- Corn converted to ethanol now accounts for 25–30 per cent of the US corn crop – the world has a new 'mouth' to feed, which competes for grain against food and feed users;
- This demand shift in world grain markets was then followed by a series of poor crops over 2006 and 2007. Australia had a drought in 2006, the US and the EU suffered relatively poor crops in 2007 (especially eastern Europe), then Australia followed up with another drought in 2007; and,
- Apart from the new ethanol demand, traditional demand for grains from rising disposable incomes in Asia and India (changing diets to more poultry, pork, dairy, beef and so on) has continued to grow strongly.

The end result is that world stocks of grains and oilseeds are now very low and the world markets need a series of at least average seasons to restore stocks to more acceptable levels. There is competition between crops (wheat, corn, oilseeds) for the available land and this is tending to create a price war where each commodity is having to 'buy' land away from the other.

There is also an emerging food versus fuel debate, where food consumers are having to buy grain away from fuel consumers.

Don't throw the baby out with the bath water. There are still sensible opportunities to reduce market and price risk in 2008 despite some bad experiences in 2007.



The Australian market position

- Feedgrain prices across Australia have traded through a range of around $100 per tonne since October 1, 2007! This has been driven by the expectations of a large sorghum crop in the northern region (harvested February through to June 2008) and the competing demand for local milling wheat and from exporters of wheat in containers (this is now an active and continuing trade).
- Barley is much cheaper than wheat and may remain so for most of 2008.
- It is highly likely nearly all wheat in Australia will be committed by mid-2008. The reason for this is that no grower or trader is likely to take the risk of holding grain into the last half of 2008 when they can sell either domestically or to export right now at current price levels.
- If the northern hemisphere crop progresses well between now and mid-year, then we may well see lower global prices in the second half of 2008, but this will be of little relief to local users if there are relatively minor stocks left in Australia. The east coast supply and demand position for 2008 indicates that we need every grain of sorghum, especially if we see the beef feedlots start to increase numbers through the year.
- We need to keep an eye on the global oilseeds situation for 2008. Just as wheat was the major runaway price leader in 2007, soybeans/canola/oilseeds look set to take that role in 2008. Canola prices for 2008 have traded well above A$700 per tonne so far.

GRAIN MARKETS IN 2008–09

Could we see good to average crops in all major grain regions around the world in 2008–09, with a consequent drop in prices of A$150–200 – that is, back to A$200 on-farm? The short answer is we certainly could!

Could we see a hiccup in one of the grain region crops in 2008–09 with a rise in prices to A$450 on-farm? Another short answer – we certainly could!

The facts are that the world stocks are so low that prices will not reduce significantly until some grain stocks are literally in the bin – this means continued volatility for at least the first half of 2008.

The price of the dollar (exchange rate) has a huge impact on export grain prices. At a price of around $350, each one cent move in the value of the Australian dollar against the US dollar shifts the grain price by $A4 per tonne.

New wheat marketing arrangements

After July 1, 2008, Australian growers can expect to have a multi-exporter licensee system. There will be a greater range of choice for farmers, but the basics of selling for cash or delivering to pools will remain. After all, almost two thirds of Australia's grain crops have been sold under deregulated arrangements for the past five years or so – this will not be entirely new territory for farmers.

But there will be greater price volatility as the domestic wheat market will more closely reflect global prices, whereas before, the national pool had a smoothing impact on local prices.

What marketing options to consider this year

- There is no right or wrong answer to how to market your grain.
- Every farm risk situation is different, and there is not one size fits all.
- Farms in more marginal areas (land prices of around A$1000 per hectare) with less reliable rainfall, face much greater production risk and have less invested per hectare than very reliable rainfall areas (A$4000 to $5000 per hectare). These risk profiles require a different approach to managing marketing risk.
- Some forward selling experiences of 2007 were very costly to growers because of failed crops, and rapidly rising markets in the last half of 2007. But there is an opportunity to learn from those experiences rather than discard forward selling as a tool for grain marketing.
- Many people equate risk management with price risk only. But there are many other components to marketing risk such as growing the quality you have forward sold, the contracted party being able to perform when it comes time for delivery and payment and being able to deliver within the contract period.

The two big questions to ask when looking at your grain marketing plan

- **Am I producing for the general commodity market or am I targeting a niche or position for a particular market segment?**

  A focus on the niche or specialist customer will mean greater attention on which variety to plant, the need for on-farm storage, traceability records, finance to carry the grain for extended delivery, and meeting customer specifications and delivery schedules. There is less focus on achieving the highest price on the day – a longer term relationship and price stability is more important. The focus in the commodity segment is on price, yield, low cost and making the most of the opportunity.
- **In pricing your grain, do you need a floating price (roll the dice) strategy or a fixed price (sleep at night) strategy?**

  With a floating position the price remains unfixed and you accept the results over a period of time. This price can be outsourced by delivering the grain to a pool or in-sourced by growers running their own mini-pool by progressively delivering grain to a market and taking the spot price on the day. With a fixed price you lock in a margin for your enterprise.

Fixed price tools

Forward cash sale – a known sale price for a future delivery period.

Forward sale using basis/futures/swaps – with this approach the final price comprises three elements:

Basis + Futures + Exchange rate = Cash Price.

The final return is not known until all three elements are locked in when the product is sold. However, the outcome can be estimated based on historical relationships.

Options – similar to insurance. The right to buy/sell grain of specified grade, for a specified delivery month, at a defined price ('strike price'), for a specific cost. For example: Buy a 'put' (the right to sell) at A$300 for December 2008 for a cost of $25. This means a farmer can lock in a minimum return of $275 and be protected against any drop below $300, but enjoy all the upside from $300 if the market rises.

Options require money up front and costs vary. They are cheapest when no-one is worried about price movements and become expensive when everyone wants to protect themselves against market volatility.

Some notes on forward selling

Remember that forward selling is not a strategy to maximise price, it is a tool to reduce price risk from the time you choose to take it out (any time from pre-planting, through the growing season until harvest). You transfer price risk from the farm to the buyer of the grain.

But the farmer-seller retains the production risk and the obligation to deliver if it is a physical forward contract.

Marketing can become overly complicated and gains can be made by going back to more simple strategies.

Forward selling is less attractive in areas where production is very uncertain.

On-farm storage can be used to manage price risk by storing the crop for sale and contracting to supply stored grain to a local market at the spot price or a price based on the spot price when deliveries are made.

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