Rob Rees Feb 23 rd Grain Market Commentary Presented at the YP ASG 2009 Update.

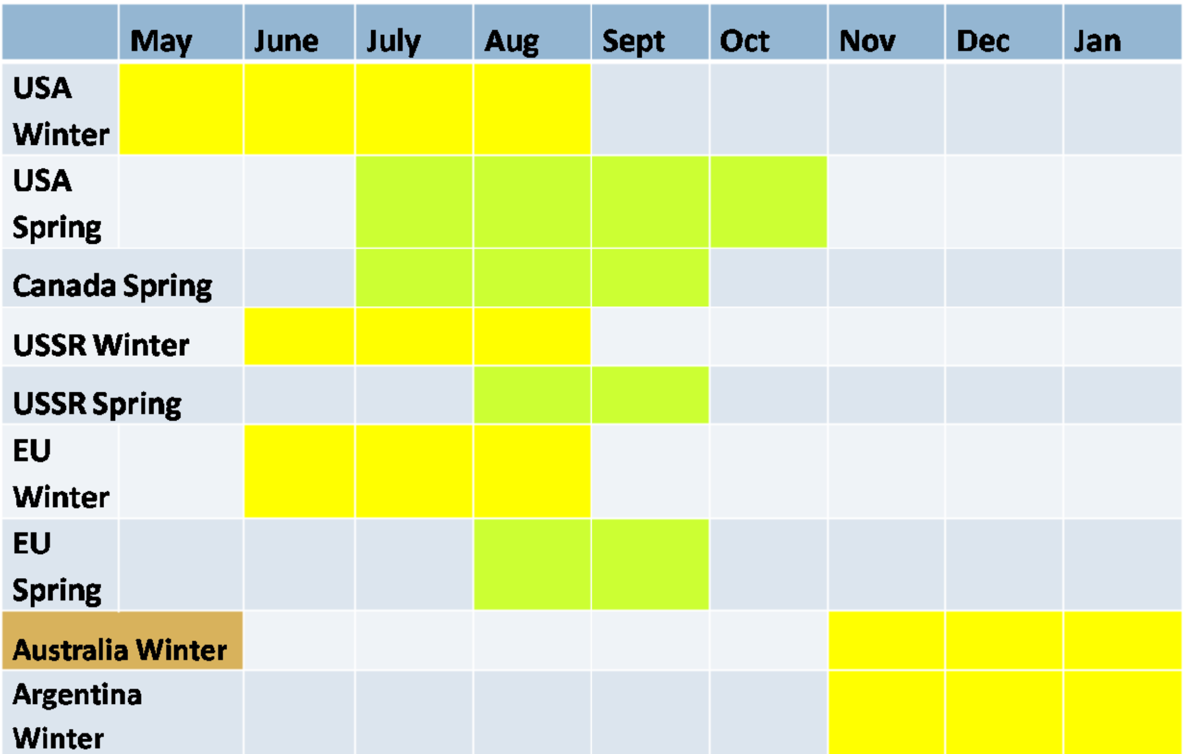
- For most South Australian farmers 2009 has begun with a great deal of apprehension about the year ahead.
- Individual farm financial positions have been threatened by
  - a number of poor seasons
  - falling prices
  - impact of the current global financial and economic crisis.
- Review of 2008 Grain Price Changes.
- Why aren't wheat prices higher?
- On 18 March 2008 South Australian growers would have been licking their lips in anticipation of a good price for their 2008/09 wheat crop. On that day the wheat price for soft red winter wheat on the Chicago Board of Trade rocketed to the equivalent of $A450/tonne. Take off around $A50 for a basis difference and growers were looking at a port price of around A400/tonne.
- To understand why this did not happen we need to examine the global price determinants for wheat corn and soybeans.
- prices of wheat, corn and soybean are correlated strongly to the development of crude oil prices
- the size of the crops and the amount in stock determines the price of all three grain products

This scenario has been played out in graphic fashion over the last two years. Clearly global weather shocks in 2007/08 have shaped prices, political panics and grower responses ever since.

- 2007-08 Supply Issues
- Started with exporters opening stocks down 38%
- With world production of food grains unable to keep pace with consumption many countries panicked in 2007/08 and began to hoard grains and rice in particular and imposed export bans
- 5 of the 8 major exporters had failed crops
- But ironically 2007/08 was a very good year, in fact a record year. Production estimates by the USDA and others reached 2119Mt (wheat, coarse grains and rice) mainly because of a 79 million tonne increase in US corn production. However wheat, barley and rye were all below expectations
- There were record oilseed prices because of smaller soybean crops in the US and poor EU rapeseed and sunflower crops in Europe.
- More importantly from a trade perspective the eight major exporters wheat stocks (USA, the EU27, Canada, Australia, Argentina, Kazakhstan, Ukraine and Russia, fell from 42 million tonnes in 2006/07 to 34 million tonnes in 2007/08.
- 2007-08 Demand Issues
- The move to alternative fuels with government mandates in many countries shifting supply demand balances
- Demand for ethanol made from corn escalated and demand for biodiesel made from palm oil, canola oil and soybean oil grew dramatically
- The global price of oil led to grain prices moving to a higher base threshold than in previous years

- The huge surge in growth by China and India led to significant changes in grain demand patterns, in particular for feed grains, edible oil and protein meals to meet income led demand for meat products
- 2007-08 Price Drivers
- Another major factor which influenced price increases were the hedge funds, index funds and other investors which drove prices higher than the fundamentals (in 2008/09 they have done the opposite)
- This scenario left the USA, with ample wheat supplies, to capitalise on the world shortage in early 2008 with exporters such as Australia dealing with drought and marketing issues, Canada with a smaller crop whilst there were wheat export bans by other major exporters
- High freight rates have become an additional cost factor for poor countries and for aid donors.
- All of these events led to wheat prices rising to a record level at CBOT of US$1280 cents bushel, at an Australian dollar exchange rate of .9181 to the US dollar or equivalent to A$450/tonne in March 2008.

Wheat Cropping Calendar



Note Australia is at the end of the line of the recovery in 2008/09.

- Global Response in 2008-09 to Wheat Crisis
- As expected the world responded in spades. Every major northern hemisphere exporter increased production significantly- no sign of global warming here. Whilst Australia did increase its wheat production to around 20 Mt it was lower than expected and Argentina's wheat crop has been reduced to 8.3Mt due to drought.
- The USDA is forecasting world wheat production to rise by 72Mt to 683 million tonnes (as at February 10 2009)
- Consumption, mainly for feed, is expected to rise by 34 million tonnes (mainly in the USA and the European Union).

- The 8 major exporters stocks have risen by 25 Mt to 59 Mt with a high percentage of feed wheat
- Competition for land space in the USA between corn, wheat and soybean was won by wheat
- Export bans removed except in Argentina
- Recovery of soybean crops in the US, rapeseed in Canada and EU Ukraine and Russian oilseed crops
- Demand growth for ethanol has fallen in line with the dramatic fall in oil prices
- The global recession has seen the exit of many hedge fund players as they moved funds out of soft commodities to meet margin calls and other financial activities . the reverse of 2007/08
- World wheat production, consumption and stocks
- In 2008/09 as we all know the major exporters responded strongly which led to record wheat crops and replenishment of stocks, although a large percentage of stocks are of a feed quality due to rain affected harvests in a number of countries.
- Note the volume changes and the percentage changes in stocks by the major exporters and the USA
- China gradually increasing stocks to around 46Mt in 2008/09. On the other hand India stocks are only 7 Mt at the end of 2008/09
- Wheat prices for March 2009 delivery (as at 13 February)
- The ABB cash price delivered Port Adelaide for ASW flat on 13 February was A$300/tonne
- The ASX milling price for wheat as at 13 February was A$295/tonne for March delivery
- The US dollar exchange rate is A$0.65 cents
- The US hrw –Gulf price on 13 February was US$242/ton
- The EU (France standard) – Rouen was US$194/ton on the same day

Wheat price and exchange rates –impact on grower returns

- The financial crisis and subsequent fall in the Australian dollar against the US dollar cushioned the price fall by A$88/tonne –a net loss of A$148/tonne
- On 18 March 2008 the Chicago price was 1124 cents /bushel or A$450/tonne
- On 13 February 2009 the Chicago price was 535 cents /bushel or A$302/tonne
- If the A$ had remained where it was in March 2008 the Australian price would have been A$214/tonne –a loss of A$236/tonne
- Barley Outlook 2008/09
- There have been major recoveries in world barley production. Ukraine, Russia and the EU have all increased production significantly, especially Ukraine with exports from that country expected to rise to 5 Mt compared to 3.8 Mt last year.
- Despite higher production in Australia and Canada their exports are expected to fall because of cheaper prices in European countries and earlier shipments. Canada is not expected to be a major feed barley exporter as international prices are lower than domestic options
- Whilst Australian feed barley production is expected to rise to around 6.5 million tonnes, The ASX price for Australian feed barley on 13 February was $202.50/tonne
- The EU (France) – Rouen price was US$157/ton on 13 February (US $309/t a year ago)

Oilseeds Outlook 2008-2009

- Demand for oilseeds has been slowing in recent months. Demand from the biodiesel sector has been weak on the back of rapidly falling crude oil prices. The financial crisis and the current economic uncertainty is generally keeping demand hand to mouth
- Strength in Canadian dollar not helping
- ABB's fixed grade canola price on 13 February was $565/tonne delivered Port Adelaide
- The ASX price on 13 February for March canola was $555/tonne
- The average price for canola in 2007/2008 del Melb was A$696/tonne
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Price outlook positive for 2009/10

- Lower prices and high input costs are affecting wheat plantings by major producers in 2009-10, with the global area set to fall by 1% according to the International Grains Council. Production is likely to fall sharply, down 37Mt from the 2008 record but still well above average. The largest declines are expected in the EU, Russia, Ukraine, the USA, Canada China and possibly India. (five exporters)
- Ukraine first estimate is for 2009 grain harvest of 45 Mt compared to 53.3Mt for 2008
- Winter wheat plantings are expected to be 4 million acres lower in the USA-leaves open the battle for acres between soybean and corn. The brunt of the fall will be borne by SRW, down 26% and HRW down 4%.
- Still considerable uncertainty about planted acreage of corn and soybeans in the US. The size of the biofuels market will be one of the more important factors, particularly for corn. USDA outllok forum 26-27 February for prelim numbers on soy and corn plantingsWatch 31 March plantings survey-probably soybeans will get the nod
- For the EU continuation of the 'No set aside ' program for 2009 is likely to lead to a large supply of grains which will limit the upward potential of prices unless there are major crop losses in other important exporting countries.
- Import duties another issue being considred by the EU. First EU estimate for wheat down 10Mt to 130 Mt
- US key winter wheat growing areas affected by drought. Texas 35% very poor, 11% Oklahoma, 8% excellent in Kansas in odds favouring below average rainfall in south west corner WA. Rest is 50-50
- Forecasts of moderate heavy rain in dry areas of Argentina, Uruguay and southern Brazil a negative
- Indian wheat stocks ample. Indian Ag Minister to purchase 22.6 Mt this year subject to weather problems
- Moderate shift
- 2007 Sheep and lamb numbers 11.6 million – 46% in South East(3.3) and Northern (2.1)
- Pig numbers 360kt – 43% in Murraylands and 23% Outer Adelaide
- The credit crisis and deteriorating economic outlook has disrupted trade with the USA causing some importers to cancel contracts or seek renegotiated prices. Many importers and end users have also moved to hand to mouth buying until stocks are cleared. The future of the Australian dollar will determine demand for Australian lamb and beef throughout 2009.
- MLA more confident because of lower dollar and tighter New Zealand supplies. Other issue for stock build up is the ongoing dry weather.
- Feed lot cattle are up 5% in South Australia according to the Australian Lot Feeders Association-outlook tempered by the global financial crisis

Global weather conditions
18 February 2009

- ☐ Canada-soil moisture levels very low in Alberta and western Saskatchewan
- ☐ USA –above normal temperatures across Northern Plains. Dry conditions prevailed across most of the Plains region
- ☐ Argentina-moderate to heavy rain fell in most regions helping to lower stress levels in corn and soybean crops
- ☐ EU. Moderate to heavy rain in S.E. France, light rain in rest of France and UK –dry in northern Europe . Southern Spain and northern Italy received heavy rain. Soil moisture supplies above normal in most of southern Europe
- ☐ Russia and Ukraine. Winter crops benefit from mild weather during winter with warmer temperatures and appropriate snow cover
- ☐ China –below normal rainfall in the North China Plain over the past two months have raised concerns about poor soil moisture levels in areas for the winter wheat crop
- ☐ Severe drought has hit almost 43% of the country's wheat crop. Low rainfall since October has affected more than 9.3 m ha of land across six major grain producing provinces
- ☐ Turkey - Soil moisture poor in most parts of Iran, more moisture needed in northeast Syria. Mild conditions and adequate moisture continues to benefit the winter grains across Turkey
- ☐ India-temperatures above normal across main growing areas-light rains fell in northern Rajasthan and Punjab
- ☐ Australia has had sustained positive values of the SOI since November 2008. It was + 14 in the 30 days ended 16 February. These values are often associated with above average rainfall in eastern Australia.
- ☐ The Indian Ocean Dipole is neutral and is expected to remain neutral through summer. A positive mode for the IOD is an effect that often hinders the formation of the northwest cloud bands that are an important source of winter/spring rainfall in south east Australia

Marketing SA Grains

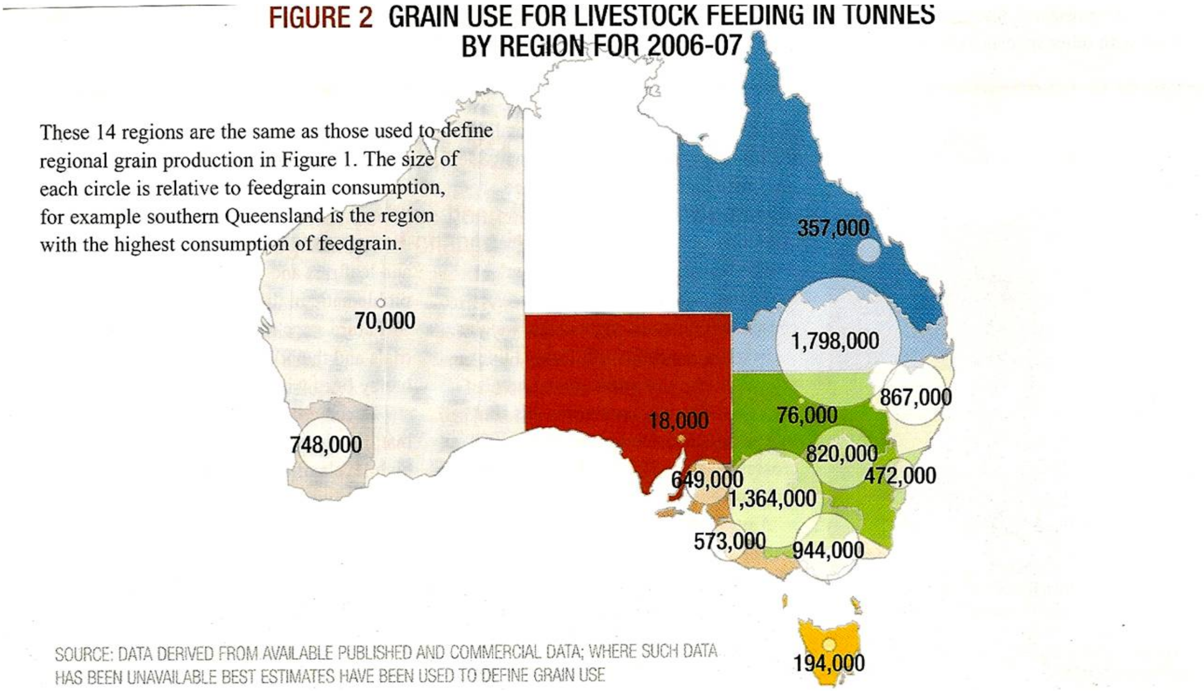
- ➢ Marketing is about managing risk! Let us face it the earlier slide depicting price falls and exchange devaluation and the impact they had on grower returns would surely have given growers and bankers grey hairs if they had no protection from the moment they secured finance to plant crops for 2008/09

<u>Price Risk Instruments</u>

- ➢ This is simply an alert to let you know that protection is available using the (listed) Price risk instruments.
- ➢ There is a need for you to at least monitor what is happening globally so that you are in a position to act sooner rather than later. I understand many growers have done so . Luckily some growers warehoused grain and received the benefit of the ride up in prices during December
  Wheat price insurance (illustration)
- ➢ If you take a December 2009 CBOT contract at say 500 cents bushel which is probably your bottom line, less 50 cents basis, at 65 cents in the dollar that is equivalent to A$258 /tonne. The insurance cost would be A$18.65/tonne to protect yourself for any fall below this level. If the price finishes above this level your premium cost is reduced by the difference in the price gained less the premium.

- I noted that Upper North farmers were using A$270/tonne when calculating their base gross margin so this example gets pretty close to a reasonable protection level. However, there is no exchange rate protection at this price.
- Australian dollar to rise again
- G. Mumford Australian Financial Review
- Three major reasons why the Australian currency fell from $US 97c since July 2008
- 1. The closing of the dramatic 5.25% points that had opened up between US and Australian official interest rates
- 2. The Australian dollar was strongly underpinned by our metals, energy and bulk pricing that fuelled unprecedented buying of the local dollar
- 3. As global growth ground to a halt, the US was the beneficiary of a spectacular flight to safety. US treasury bill yields fell to zero.
- All three of these influences have run their course.
- The US Federal Reserve has anchored their interest rates to zero for some time to come. The Australian Reserve Bank is moving toward a 2% interest rate.
- The outlook for commodities has shifted. A base looks to have been established in most energy and metals markets, though a meaningful recovery must await clearer signs of global economic recovery. But there are already signs out of China that their aggressive stimulus measures are gaining traction. This bodes well for demand for Australian minerals and energy products.
- There is a partial recovery happening in world trade as evidenced by the recent strength in global freight rates. The Baltic Dry Freight index is up 200% from its recent lows. In the US with Treasury supply of money surging and demand petering out, the relative appeal of the $US has diminished. And with global stimulus efforts accelerating, the prospect of a complete system collapse has receded. These factors are combining to reverse $US buying support, with a sell off looking more likely. Where to for the Australian dollar? A test of US 75cents as the three elements unravel possibly in late2009.

Look out wheat prices!
What lies ahead?



Demand for food and feedstuffs

Forecast global grain usage

- What about the medium term? Over the next 8 years global grain usage (wheat, coarse grains and rice) is forecast to rise from 2 billion tonnes to 2.3 billion tonnes i.e. 300 million tonnes or by 15% or a 1.8% a year increase in grain production is needed to meet demand
- I Challenge the feed growth assumptions!
- For oilseeds an additional 70 Mt is required or 18%.
- USDA Projections
- The USDA released its long term projections in February 2008. Despite the global downturn impact which is not included in the report there are some issues which may still hold.
- The USDA assumes the US dollar will depreciate through to 2012, with a drop in value of about 14% from 2002
- Oil prices in the future will depend almost entirely on demand for crude oil resulting from world economic recovery and a return to rapid manufacturing growth in China and India
- In 2008 there was shift in the cropping mix toward wheat and soybeans away from corn due to the short term global supply reductions for these crops. However, longer term shifts move acreage back to corn, reflecting the growth in domestic corn-based ethanol production that raises corn prices and producer returns.
- Wheat area expected to fall because of competition from corn and soybean
- Key points of EU climate change package:
- Total share of renewable energy will increase to 20% of total energy consumption by 2020
- The Renewable Fuel Standard (RFS) from the 2007 Energy Act calls for total renewable fuel "sold or introduced into commerce in the United States" to reach 36 billion gallons by 2022. Within this standard, ethanol derived from corn starch is to reach 15 billion gallons.
- Under current conditions of relatively low energy prices and tight margins for ethanol producers, it is believed the that the Renewable Fuels Standards (RFS) will determine the level of biofuels production and therefore, the demand for corn and ethanol. The USDA expects a 10% increase in the use of corn for ethanol in 2009/10

Economic Nationalism

- Economic nationalism – the urge to keep jobs and capital at home – is both turning the economic crisis into a political one and threatening the world with depression.
- Trade encourages specialisation, which brings prosperity; global capital markets, for all their problems, allocate money more efficiently than local ones; economic cooperation encourages confidence and enhances security. Yet despite its obvious benefits, the globalised economy is under threat.
- Witness the EU restarting its export subsidy program for butter, cheese and milk powder –will hurt Australian fed grain demand
- and the US stimulus package emphasising buy American.
- How many other countries will follow?
- Indonesia is applying a 10% tax on imports of wheat flour

Market deregulation

- What have we learned?

- The first season for the deregulated wheat market has been fraught with quality problems in all states due to untimely rainfall at harvest.
- Industry suggests that that there has been little noise regarding deregulation and that financing has been available to farmer sellers
- Whilst the fall in world grain prices has been dramatic this is not the fault of deregulation
- Industry says the major issue is the inability to match logistics capacity with sales. The supply chain and large shippers need to employ a common user facility. There is a need to have stocks in place and be able to block out shipping capacity. This is a major work in progress!
- Net Cash prices offered by the newly accredited exporters have invariably been higher than net export pools, particularly earlier in the season when prices were much higher,
- All cash operators were prepared to offer higher cash prices
- earlier in the season with price and exchange rates locked in.
- Pools, particularly in WA, did well. As prices kept falling through to December, growers let go cash in the hope of an upside through pools. Farmers also chose to go with major pool providers
- At the same time there was a certain amount of inertia on the growers part by doing what they have always done and that is to support pools
- Industry failure to recognise the information needs of the deregulated market. Industry is obviously reluctant to give away proprietary information. Cash prices were not available at silos on some days and growers needed to revert to individual web sites for information. Industry was reluctant to post prices today because of price volatility and then find out tomorrow what they have bought.
- The trade did oversell the container packing capacity by around 50% as they did last year.
- The CLEAR web site was ignored by many with too few growers depositing grain

Take home messages

- Wheat prices have risen to a new plateau with the advent of ethanol, biodiesel, and growth in China and India
- Shift to feed demand versus food – Rising incomes in South East Asia principally and in Eastern Europe. This is leading to greater consumption of meats, and thus the demand for feed
- 2007-2008 year was a ”one-off” and unlikely to be repeated. Most major exporters are unlikely to collectively have such a significant crop failure. Income growth is likely to be much slower in the near future.
- Global warming was not an apparent factor in the 2008-2009 northern hemisphere despite ongoing droughts in Australia and Argentina
- Major competition for Australian Barley producers in the future –major investments in Ukraine and Russian grains supply chain
- Growth in edible oil and biodiesel use –higher prices
- Revaluation of the Aus $ will reduce the competitiveness of our export commodities
- Forecast APW price for 2009 -2010 is US$214/tonne at A$.75 equals A$285/tonne. That is based on March 2010 CBOT US$6.22/bushel minus 40 cents a bushel basis (a 16% premium on March 2009).
- Swap price on 16 February for March 2010 was A$341/tonne

- Bankers are seeking more crop insurance options by growers. On Monday growers could have locked in next year's March 2010 price at $341 through a Swap. If they don't do anything then they take home my forecast A$285/tonne and their opportunity cost is $56/tonne.
- Options for growers to cover themselves around A$250/ tonne would cost them an option contract deposit of A$18.65 /tonne (500 US cents/ bushel) as mentioned earlier.
- For the longer term the pressure will remain for major exporters to meet the expected projections. A hint of what is to come is the current land grab by a number of countries in South America and Africa to improve their food security.