Short crops have long tails

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Markets

Recent weeks have seen record prices for wheat and huge market volatility as traders react to forecasts, events and rumours. For farmers watching the market there’s very little certainty about when’s likely to be best to play their hand. *CPM* digs into the key factors influencing the grain trade.

By Lucy de la Pasture

While the war in Ukraine has had an undisputed effect on grain markets, it’s not the only factor. Weather events, politics, increasing demand and tightening supplies have all been causing markets to rise — even before Russian soldiers set foot in foreign territory.

Presenting at the Suffolk Farming Conference in early March, ADM’s head of grain trading Jonathan Lane gave the back story to rising market prices, examining supply and demand factors in the various different sectors around the world.

“We always look at corn as the key driver of all commodities, so what happens to world production will determine what happens to soybeans and ultimately to wheat. In the past five years we’ve seen a sharp decline in the availability of corn and its stocks to use ratio for the world.”

Global influences

“If you want to have one sole reason why prices of all commodities, not just corn, have moved higher in the past two to three years, it’s the increase in purchasing from China. The Trump administration started a trade war with China. Spooked by the potential impact on them, China began prioritising its own food security and being able to maximise their industrial output. So we saw a big jump in Chinese corn imports as they tried to build strategic stocks.”

Weather events around the world are also having a big effect on production, says Jonathan. “There are impacts on wheat from drought, which was widespread through Canada and the US last year, and we haven’t had replenishing rains through the winter.

“Brazil also has had issues with drought. Although rain came, one would argue that it was probably already too late as harvest was beginning. So we’re going to see declines in the Brazilian soybean and corn crops, building more issues when it comes to stocks to use ratios, and the availability of alternative corn and soybean sources.

“And it’s the same situation in Argentina. Although the rain over there may have come in time for crops, they’re just that little bit later than Brazil but, nevertheless, it’s still a perilous situation for the world.”

The Brazilian corn crop estimate by USDA has been posted at 113M tonnes, and a big bulk of that comes in what’s known as the Safrinha crop, which is the second corn crop. ADM analysts believes that number is way too high, says Jonathan. ▸

Maize is the staple food in many countries and its global supply sets the trend in other grain markets.

Jonathan Lane explains that grain prices were already rising because global stocks and production are tight due to weather events as demand soars, particularly from China.

"This indicates that one of the major global producers is unlikely to have a bumper crop at a time when the world needs it," he says.

"So that's the background to the current situation — we've got a tight supply and demand and China's still importing big tonnages which means those stocks aren't available to the rest of the world. We desperately need record crops and that seems unlikely, so it makes the markets nervous."

AHDB's arable market specialist Vikki Campbell adds to the story as the US quarterly stock reports and prospective plantings for harvest 2022 were released in early April. The report shows that although the overall planted area looks to be unchanged, some growers plan to take land out of corn and into soybeans, with rising input costs cited as the driver, she explains.

"This could affect the corn availability in 2022/23, further tightening supply," she says. "The USDA figures also reveal that wheat plantings are up 1% but the current crop condition report (in April) has dampened prospects of increased output."

Just 30% of the US winter wheat crop was rated in good-excellent condition (in April), compared with 53% at the same time last year. "We have to go back to 1996 to see crop condition ratings this low," adds Vikki.

Prospects for the US wheat crop will very much depend on weather patterns and whether the drought covering some key grain producing states, in the Plains in particular, eases. And that very much depends on the duration of La Niña, which has had a grip on the weather for the past couple of seasons, affecting South America particularly badly.

Jonathan says the company is starting to see some flags around La Niña and what it might mean for the upcoming growing season. "The La Niña weather pattern means the key growing season in the US looks like it's going to be dry. It also doesn't really help parts of Southern Russia, which is a key growing region, and also South America.

"It creates more uncertainty for those key growing regions and we can't afford to have any crop failures throughout the US or in South America."

It's not just about crop production in South America, domestic issues may also influence the markets, says Vikki. "In Argentina, inflation is through the roof and the grain transport unions have recently taken brief strike action, just as the country goes into its busiest quarter for corn supply."

Closer to home, there's been a steady decline in EU wheat production and stocks to use ratio, though exports have remained static and seen a recent uptick since the war broke out in Ukraine. Vikki adds that in the EU and UK, the condition of the wheat crop looks positive after a benign winter but warns that any adverse weather, such as a dry period, is likely to get market sentiment going.

One thing to be mindful of is the effect of high grain prices on the animal feed sector, highlights Jonathan. "Chicken appears to be fairly static, but pigs on a pan-European basis will come under pressure. And I would say that has the potential to undermine animal feed demand."

However, any decrease in animal feed demand could well be offset by increases in ethanol production, he says. "I think that's probably the biggest swing factor that we've got in our balance sheet coming forward. From a demand perspective, there's a new ethanol plant in Hull that's now up and running and it has the potential to use up to 80,000 tonnes a month. That could bring in upwards of a million tonnes of demand from the ethanol sector.

"There's also a plant in Teeside and its technology is different — it uses maize as a blend with wheat. It all depends on the price relationships, particularly if corn supply is an ongoing problem, but we could see more wheat finding its way into Teeside as well, which gives us another tight balance sheet for next year. So it's a very interesting marketplace that we're in from both a global, European and UK perspective."

It's clear that the global balance sheet for corn, wheat and soy were already tightening before the Russian invasion of Ukraine. But since Russia and Ukraine make up over 30% of the global wheat exports and around 18% of the global corn trade, the conflict is going to be an ongoing influencer.

Interruption to exports, particularly via the ports in the Black Sea and Sea of Asov, and uncertainty about the availability of Ukraine's old crop are helping to fuel market volatility — particularly as between 20-25M tonnes of grain was expected to come from the region between now and harvest.

"Some grain is now trickling out of Ukraine via truck and train, but we believe a best-case scenario is that about 10% of the old crop will exported. There are also reports of severe backlogs via rail due to bottlenecks," says Vikki.

"In addition, Russia is now only exporting to 'more friendly' countries and supplies are under export restrictions to sure up its own food security, and the country is also dealing with sanctions and logistical problems."

Even if peace is negotiated

Grain is finding its way out of Ukraine via train but there's considerabledislocation of supply chains. Photo credit: Zahnoi Alex/Shutterstock.com

The grain terminal at Odesa is normally busy loading ships, with Ukraine and Russia usually responsible for 30% of global exports.

Managing cash flow is as much of an issue as managing the marketing risk at the moment, especially with BPS cutting back again this year, says Richard Jenner.

▸ quickly, market analysts all agree that price volatility isn't going to go away in the short-medium term, she says. "There's a lot of dislocation in supply chains that have got to be repaired, and how that pans out remains to be seen."

Vikki adds that shipping is likely to be an issue because of damage to the Ukrainian port infrastructure and also reports that Russian mines have been found in the Black Sea, which would provide further disruption to shipping.

"As a net importer of wheat, the UK is a price-taker on the global market so it's important to understand what's driving it," she says.

And Jonathan believes that there's opportunity amidst all the uncertainty. "I think from a fundamental standpoint, balance sheets globally on grains are tight. Long-term demand continues to grow as the world population isn't getting any smaller and with markets looking for alternative sources of energy, the biofuels sector has grown significantly and stabilised.

"The one thing that markets are is cyclical and agricultural markets in particular have proven over the years to be very elastic to price. So, yes, today we have concerns around supply that have driven prices higher, but farmers globally are very good at reacting to high prices and producing plenty of crops.

"At a time when agricultural policy has the potential to significantly change the dynamics of the UK arable sector, I think this is a good opportunity while the sun is shining to perhaps mend the roof."

A watching brief on futures

The grain markets are full of uncertainty at the moment and the most obvious current influence being the situation in Ukraine. While that's the current focus of the market, there's always uncertainty at this time of year, says Richard Jenner of Openfield.

"The influence of the weather is something that hasn't really kicked in yet, nor has the impact of high fertiliser prices and whether that's going to impact yields for this harvest — or whether it will be more of an issue for harvest 2023," he says.

So what can growers do to help manage their exposure to risk? "Several have already sold some wheat forward as prices were already stronger for harvest 2022 than they were for 2021 at the same stage. And certainly since the events that happened on 24 February, we're seeing more people selling, which is the right thing to do because you're locking in at some good values. But I think the concern for everyone is the unknown."

In futures terms, wheat prices for harvest 2021 have reached £300 plus a tonne. Could 2022 see a repeat of the same thing? "Well, yes, it could quite feasibly. At some point, old crop and new crop have got to converge and as I said, there's a lot of uncertainty around weather, fertiliser and all the other things that are going on in the world at the moment," says Richard.

And we've all seen the situation in Ukraine is feeding volatility, he adds. "Sanctions are changing trade flows and we don't know how that's going to pan out. So perhaps rather than selling too much flat, if you're minded to stay in the market, then participating in a tracker or a pool — so you're not just fixing a price today — is another way of managing grain sales.

"Managing cash flow is as much of an issue as managing the marketing risk at the moment, especially with BPS cutting back again this year. Openfield has a crop fund that farmers can borrow money from against the commitment they've got to the business, and other organisations have similar schemes.

"The reason it was put in place 20 plus years ago was so that farmers don't have to sell grain just to release cash, we want them to sell for the right marketing reasons. And that might be moving at harvest into store, so you're still in the market but are able to take an advanced payment against it," he says.

The higher prices give people a bit more oxygen to survive some of these cash flow issues, he adds. "Look at where oilseed rape has been, even for new crop. Now you're looking at probable values in the £670s ex farm for October, which is twice what it was this time last year. So all being well and a reasonable yield, then it's going to generate a lot more cash in itself.

"You can stay in the market

The conflict in Ukraine has effectively halted grain movements via the Black Sea and Sea of Asov.

Selling forward for harvest 2023 isn't something Openfield are encouraging people to do at the moment. It's more a watching brief and see how things unfold.

by taking advantage against what you've already committed to be marketed or even sell it for further forward and take the benefit of the carry and draw some of the cash against it. That's one of the things that we certainly do to try and help members."

And the bigger challenge really is not necessarily marketing for 2022, because that looks quite good, he says. "The challenge will be what you do for 2023, because forward values are quite good. But input costs, not just for fertiliser but for absolutely everything, are all going to be higher. So selling forward for 2023 at the current prices on the board would mean you'll end up earning less money than for 2022. And with the reducing BPS payment to boot, that's quite a conundrum for everybody."

Fertiliser purchasing will be important because fertiliser values may start to come down again, he says. "They've dropped a bit certainly recently, but whether that continues is completely unknown at the moment. It's not going to collapse, but maybe we'll still see some reduction in values in due course. So the timing of 2023 sales is going to be quite critical for growers."

So what are most growers doing at the moment? "I think everybody's watching the current market situation. There are so many unknowns or uncertainties around harvest 2022 and that's clearly the focus for most people.

"Historically, growers would have looked forward at 2023 and thought, actually, that looks quite a good forward value (when fertiliser was £300/t), and they may have done a little bit of selling. But that's not something we've been encouraging people to do for now. It's more a watching brief and see how things unfold," says Richard.

"And when we do know what fertiliser prices are and what the market is at that stage, maybe the two will converge, but we'll have to wait and see. And just because fertiliser prices are higher, there's no guarantee that the cereal price, or rapeseed price, will stay high.

"Clearly fertiliser prices will have an influence on the overall market, as we've already seen in the US for the current season where there's a lower-than-expected intention for corn plantings because growers are favouring lower input soybeans due to the high nitrogen prices. So those sorts of consequences will play out around the world. Although we don't really have that option here, we might well see more spring cropping," he concludes. ■

Openfield growers can take advantage its Crop Fund by moving grain at harvest into store but taking an advance payment against it, so they're still in the market.