

Grain Futures Unshaken By OECD Projections On Commodity Prices

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Corn In a report released in mid-June, the Organisation for Economic Co-operation and Development (OECD) and the Food and Agriculture Organization (FAO) projected that corn prices will be almost 20% higher this decade on average, and rice more than 15% higher.

The price outlook for the short term, however, is proving to be sluggish for grain commodities traded on stock exchanges.

Developing economies will push up cereal prices

According to the OECD-FAO Agricultural Outlook, wheat prices are projected to remain stable, but cereal prices could generally be 20% higher and meat prices 30% higher over the coming decade. Food consumption will expand "most rapidly" in Eastern Europe, Asia and Latin America, especially the consumption of meat, dairy, vegetable oils and sugar.

Corn and wheat futures prices rose by 110% and 60%, respectively, over the 31 July-1 June period. Prices of another key food staple commodity, rice, increased by 50% over the same period. While sustained demand for processed food in emerging economies in Asia and Latin America accounted for part of this growth, prices were underpinned by external forces such as high energy prices and the low cost of speculative funding.

Commodity overview: 1-30 June review period

Despite the OECD's projections, grain prices have seen a slowdown in recent weeks. According to Euromonitor International's analysis, this slowdown is partially being driven by weak recovery prospects in the US economy, uncertainty surrounding the Greek debt crisis and better weather prospects in key grain planting areas.

A stronger dollar environment was regarded as a negative force on nominal prices. The US Dollar Index increased by 2% between 7-28 June, increasing the cost of short trading for investors based outside the US.

Wheat

LIFFE wheat futures prices declined by 15% over the 1-30 June review period to close at US\$6.5 per 60lb bushel. Wheat futures remained relatively stable over the 1-9 June period. On the one hand, prices were pushed up by rumours that Russia may not have as much high-quality wheat for export as expected.

On the other hand, external forces in the form of weak economic data in the US suggested sluggish wheat demand for Q3 2011, offsetting upward price pressure from market fundamentals.

LIFFE futures declined by 11% between 10-17 June, a fall linked to strong market fundamentals. The mood turned bearish (ready to accept price losses) among traders as news about better weather in Europe, and especially the Black Sea region, reached the stock exchange on both sides of the Atlantic.

Wheat futures prices were weakened further by concerns about stronger exports from Russia and Ukraine during the second half of 2011. In addition, wetter weather conditions in Southern Europe improved wheat output projections for the region, putting additional downward pressure on wheat prices.

Trading in wheat over the 20-27 June review period was heavily influenced by external market forces. US dollar depreciation and concern about the potential effects of Greek debt default on global economic growth dampened the appetite for risk among traders. This resulted in soft commodity short-term selling across trading rooms.

It was against this backdrop that wheat futures sustained further losses on the previous weeks, with prices declining by 4% between 20-27 June. Conversely, no expectations on immediate default after the favourable confidence vote for President Papandreou (29 June) prompted a partial recovery of earlier losses.

Wheat futures rose by 4% between 28-30 June on the back of a weaker dollar environment and stronger confidence on economic growth in the EU zone.

Corn

LIFFE corn futures declined by 8% over the 1-30 June review period to close at US\$7.0 per 60lb bushel. Corn futures increased by 4% between 1-10 June, an increase driven by strong demand for ethanol in the US and concerns about existing stock levels. Interestingly, external forces in the form of weak oil prices and concerns about the impact of the Greek debt crisis reversed previous gains. LIFFE corn futures declined by 15% between 10-27 June, closing at US\$6.60 per 60lb bushel.

Corn futures dropped by 4% in just one single day (24 June), a decline underpinned by news about poor economic

manufacturing output in China and weak employment data in the US. In addition, the IEA's (International Energy Agency) decision on 23 June to release a total of 60 million barrels of crude oil from strategic reserves prompted a tumble in energy prices, dragging along soft commodities like corn, widely used in bio-fuel manufacturing.

Conversely, corn prices increased by 5% between 28-30 June as a result of the positive impact that the favourable confidence vote for the current Greek administration (29 June) had on grain trading.

Cocoa

Cocoa's value fluctuations returned to negative levels over the 1-30 June period, with futures prices rising by 7% to close at Â£1,950 per tonne. The mood among traders turned bearish as news about strong output projections from West African countries reached stock exchanges on both sides of the Atlantic. The Ghana Cocoa Board (Cocobod) declared on 1 June that 903,646 metric tonnes of cocoa were purchased during the 2010/2011 main season. Cocobod said it was on course to achieve its target of one million tonnes for the 2012/2013 crop year. The board mentioned the development of hybrid cocoa seedlings, the application of fertilizers and control of disease and pests as factors pushing strong production in the country. As a result of strong market fundamentals, LIFFE cocoa futures prices remained stagnant between 1-16 June.

Interestingly, supply and demand market fundamentals reversed the traders' mood between 17-30 June, with LIFFE cocoa futures rising by 7% in value. This increase came as a result of concern about news suggesting that cocoa bean marketing in Southwest Nigeria was coming to a standstill after foreign buyers rejected beans failing to meet industry standards.

On the demand side, investment bank Macquarie predicted an increase in cocoa sales of 2.6% over the 2011/2012 season, a performance underpinned by strong economic and demographic growth in emerging economies.

Sugar

LIFFE sugar futures increased by around 30% over the 1-30 June period to close at US\$0.29 per pound. Futures growth was underpinned by news on 2 June that China's sugar production in the 2010/2011 marketing year reached just 10.45 million metric tonnes, down 3% from 10.74 million tonnes in 2009/2010.

The source was industry website Yunnan Sugar Network, citing industry association data. In addition, sugar prices have been underpinned further by concerns about lower output in Brazil in the early part of the year as well as an early monsoon season that could weaken 2010/2011's sugar output potential in India.

Rice

CBOT rough rice futures declined by 8% over the 1-30 June review period to close at US\$0.13 per hundredweight (CWT). This moderate decline was driven by optimism that with the prediction of a normal rainy season in the coming months, India is on its way to attain its desired rice production of above the 100 million tonne mark in the 2011/2012 season.

In addition, strong market fundamentals were further underpinned by news in early June that rice farmers in Southern China had managed to finish rice transplantation in the fields despite suffering a drought for months.

July-August outlook

Strong market fundamentals in the form of wetter weather conditions in the US and Southern Europe in June have resulted in better wheat and corn global supply prospects. The latest data released by the International Grains Council (IGC) on 26 May points to an increase of 4% and 4.4%, respectively, in wheat and corn output over the 2011/2012 season.

Global corn stocks are projected to remain close to the 2009/2010 mark, despite a forecast 1.3% increase in consumption. Unless unexpected changes in weather patterns occur in July/August, market fundamentals will continue to hamper growth of grain prices in the short term. Conversely, concerns about Nigeria's mid-crop output and robust demand for cocoa in emerging economies make a steep drop in prices for this commodity unlikely in the coming weeks.

Similarly, concerns about sugar production in Brazil might contribute to maintaining the existing pressure on sugar prices during July and August. Nominal prices of this commodity, however, might be slowed by a stronger dollar environment linked to the Greek debt crisis.

Regardless of short and medium-term market fundamentals, there is agreement among traders that negative external forces will continue to have an adverse impact on the rise of nominal grain prices in the short term. Weak employment data in the US and strong risk aversion on the back of the Greek debt crisis are dampening the appetite for bullish trading in grain commodities.

The International Energy Agency's decision to release part of its strategic oil reserves on 23 June caused surprise among most traders. Crucially, weaker energy prices prompted short selling across most grain commodities.

This, alongside a contraction in liquidity linked to the end of the second round of quantitative easing in the US (QE2), is spreading concerns across trading rooms that the agricultural commodity bubble seen in late 2010 and early 2011 is not sustainable in the medium term.

Conversely, the prevailing view in trading rooms is that cocoa and sugar will be shielded from short-term dips by current concerns about output projections – a trend which will allow the maintenance of some stability in the price level of both commodities.

You also might be interested in our recent podcast, "The Implications on Commodity Prices after the OPEC Meeting ."

Analyst Insight by Francisco Redruello.

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