



## There's more to wheat prices than inventories suggest.

Traditionally, world wheat stocks above 180 million tonnes would be viewed as exceedingly ample, and prices would be subsequently sluggish. But the relationship doesn't always hold.

Current world wheat stocks above 182 million tonnes easily exceed the 2007/08 position of 125 million tonnes. But prices don't reflect this comfortable headline inventory figure, with Chicago wheat currently quoted around US\$750/bu, roughly 1.6x the 10yr-average of US\$478/bu.

The mismatch in prices and stocks suggests there is more than meets the eye in the current wheat market, and indeed there is. The current strength in wheat prices is explained by three main factors; these are:

- *Wheat's not wheat.*

A key lesson from the past 12 months is that wheat is not wheat – different quality wheat has different end uses. Australian wheat producers learnt this lesson the hard way in 2010, with much of the record yielding east-coast crop downgraded to stock-feed grade because of excessive harvest rain.

Similar lessons have been learnt throughout the world, meaning that despite the large headline 'wheat' inventory figure of 182 million tonnes, quality high-protein milling supplies are in relative short supply. And while official grade statistics are hard to come by, wheat price spreads tell the story. Kansas wheat prices, representative of quality hard wheat, are currently valued ~145 cents over Chicago wheat prices, which represent lower quality soft wheat. Over the past decade this spread has averaged just 33 cents.

- *Poor production prospects.*

The world's farmers were expected to increase grain-crop plantings sharply in 2011, resulting in a sharp lift in global production. But despite farmers' best intentions, prevailing seasonal conditions will be the ultimate determinate of final output. And recent weather has been far from ideal with drought in Europe, drought in the US Great Plains and floods in the northern US wheat-belt hurting yield prospects. Current wheat prices suggest existing production forecasts are overstated will be revised lower in the coming months.

- *Feed grain supplies running on empty.*

Old-crop corn supplies in the US are at record low levels and the need for demand rationing in the corn pit has resulted in those prices recently traded to record high levels.. These high corn prices continue to provide a solid backstop for the wheat market as feed-grain consumers' switch from corn into wheat.

So despite the current large global supply of wheat, we believe that Chicago wheat prices will remain firm over the next 6-12 months because of the price-pull from high protein wheat prices and the price-push from feed-grain markets.

Figure 1: Global wheat inventories

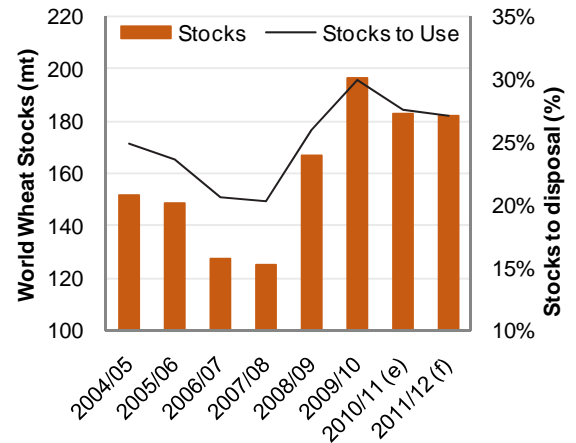


Figure 2: US winter wheat crop ratings

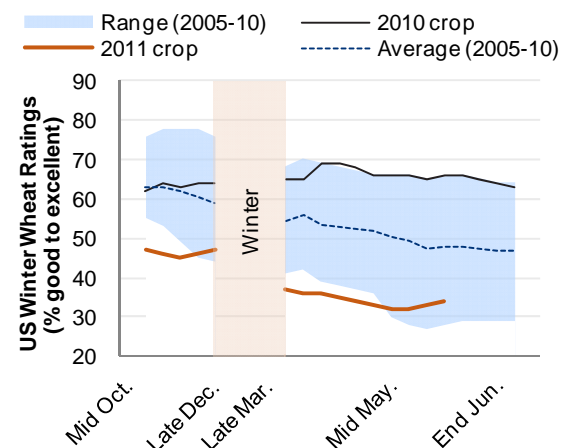
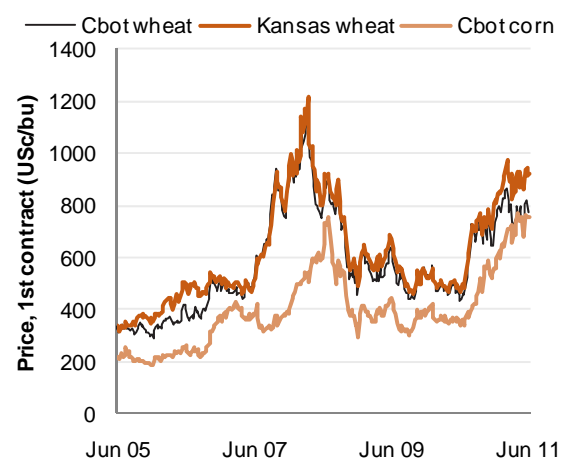


Figure 3: US grain prices



Source: USDA, Bloomberg, CBA



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