



Food, fuel and financial markets

The reliance on weather has always meant that agricultural markets are unpredictable and volatile. But the ever-increasing tangle between food, fuel and financial markets means the uncertainty and volatility within the agricultural markets has risen. Politicians muddy the waters even further.

Over the past three months each of these factors, at one point or another, has been behind the big moves in international grain markets. Since late May, US wheat prices (Chicago, 1st futures contract) have traded in a massive 264 cent range from 829 to 565 US cents per bushel. Current values¹, at ~USc707/bu, are somewhere near the middle of this range. The Q2 trading range was the ninth largest quarterly range in history.

Politicians in Russia unwittingly contributed to the 30% June price slide after they lifted their 2010/11 wheat export ban. Russian wheat is now the world's cheapest, and Russia is now expected to export 16 million tonnes of wheat this season, up from just 4 million tonnes last year.

Weather also contributed to the June price slide because of improving conditions in Europe. But as July prices attest, weather can also cause markets to rally. Excessive heat in the US Midwest though July resulted in a sharp downgrade to US corn production prospects, and a subsequent rally in corn prices. The bond between corn and wheat, which has tightened because of renewable fuel policies, has meant that rising corn prices pushed wheat prices higher. The US ethanol industry now consumes 40% of US corn supplies, leaving less for the livestock industry. Livestock producers are forced to use wheat instead.

But today, the biggest skeleton in the grains' closet is the influence of financial markets. The risk of a US and European recession has intensified, which is evident in the escalating European sovereign crisis, weakening economic data and S&P's credit downgrade to the United States. If global financial markets spiral out of control, agricultural commodities, no matter how tight their supplies are, will get caught in the storm.

Figure 1: Chicago wheat prices, first futures contract (USc/bu)



Source: Bloomberg and CBA

¹ At 18th August 2011



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