AGFARM WORLD MARKET UPDATE AUGUST 2017

What does the recent USDA report really tell us?

The most recent United States Department of Agriculture (USDA) report was published on Friday 11th of August. Surprisingly, it increased global wheat and barley production when most thought it would do the exact opposite. Unsurprisingly, this left most market participants scratching their heads. The headline numbers were; global wheat production increased by 5.35MMT to 743.18MMT, global barley production increased by 1.531MMT to 140.06MMT, and global corn production decreased by 3.427MMT to 1,033.471MMT.

What does this unexpected increase mean for global market direction?

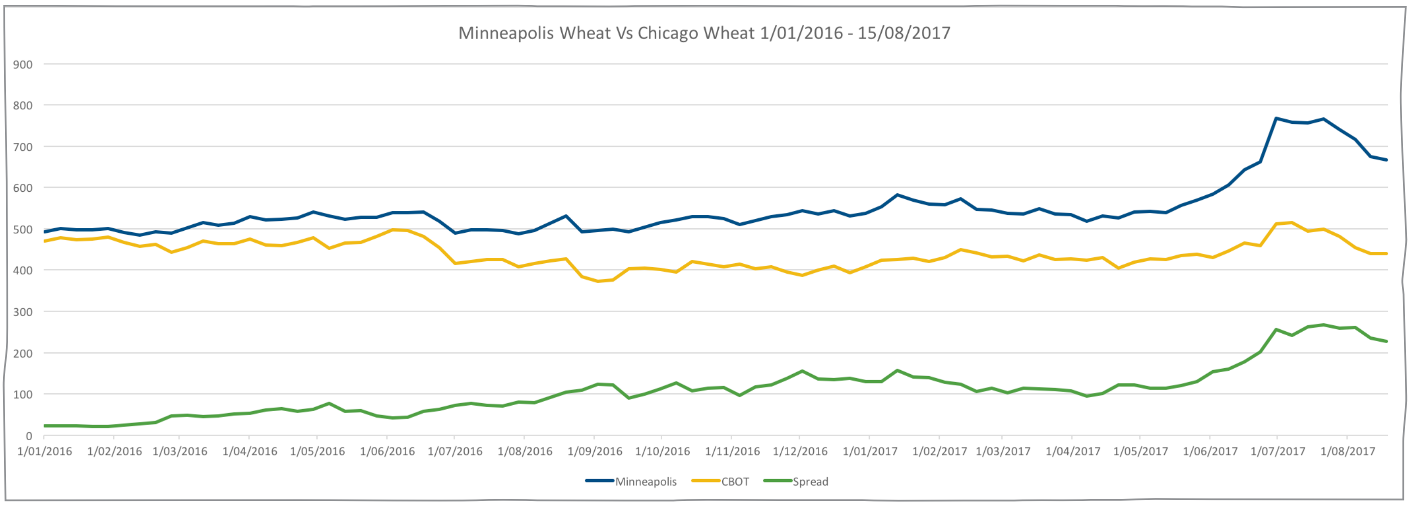
First, a little more depth on the numbers.

For wheat, US production was decreased by 0.56MMT to 47.33MMT, Canada by 1.85MMT to 26.5MMT and the EU by 0.44MMT to 149.56MT. On the flip side, some very strong increases were reported in the Black Sea, rising Russian production by 5.5MMT to 77.5MMT, Kazakhstan by 1MMT to 14MMT and Ukraine by 2.5MMT to 26.5MMT. For Barley, US production was decreased by 60KMT, Canada by 600KMT and EU by 510KMT. Just like wheat, the Black Sea showed increased production. The Ukraine by 1.5MMT, Kazakhstan by 0.2MMT and Russia by 1MMT. These strong production numbers coming from the Black Sea region were triggered by better than expected harvested yields, and essentially, has caused the unexpected increase in global production estimates.

So yes, the USDA report had an overall bearish tone for grain prices. However, let's take a look into what the report doesn't show you, such as the location and quality of these stocks.

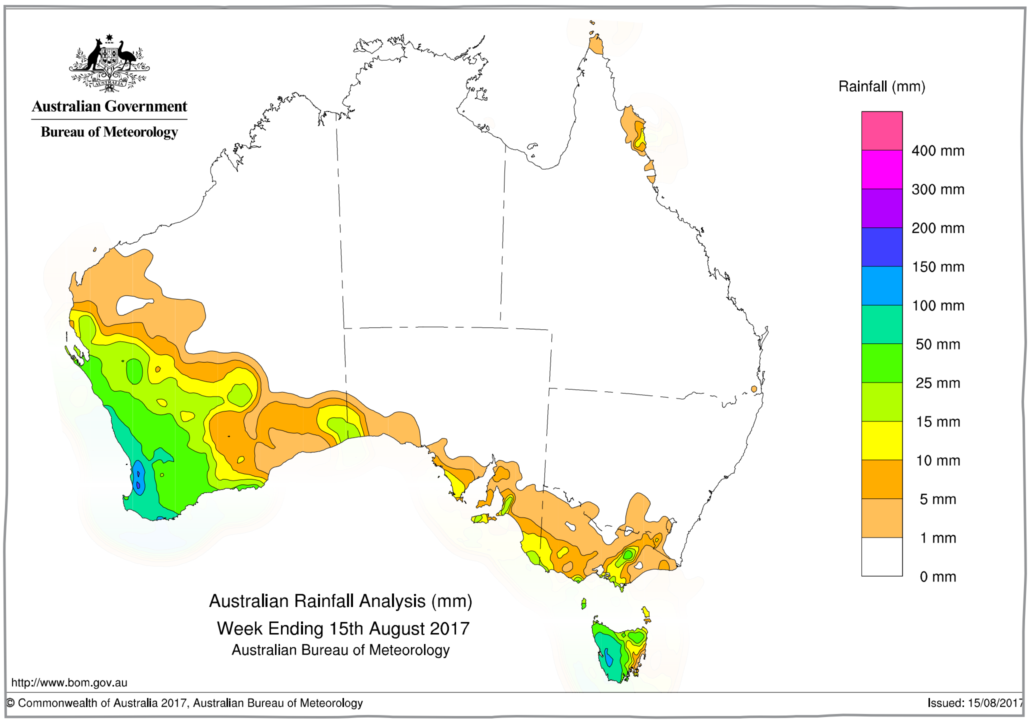
Global wheat ending stocks are pegged at 260.6MMT. Nearly 50% (or 127.59MMT) of this is in China. As mentioned in the past, China's role in the market place is to build large stock piles of grain to ensure local food security. Therefore, this grain will never be exported, it is destined to stay in China. This is an important point to remember, as the headline number of 260.6MMT overstates the 'useable' global wheat ending stocks. On top of this, the USDA report has 2017/18 Australian wheat production at 23.5MMT which many feel it is on the high side.

Another concern facing the global wheat complex is a lack of protein. The Minneapolis Wheat Futures contract, which is a higher protein spec than the Chicago Wheat Futures, is currently trading a large premium due to adverse weather resulting in low protein grain, and a drop in planted higher protein acres.



What does it mean for Australian prices?

Fortunately for the Aussie market, the higher protein wheat premium is likely to be reflected in new crop H2 and H1 prices. And although Australian wheat production looks to take a hit from last year's 35MMT to an expected 23.5MMT, we have finally seen some favourable weather conditions in the country over the past week (8th August – 15th August). Western Australia had fantastic rainfall causing struggling crops to rebound and the production potential for the state to lift. In South Australia, it has been patchy with the west missing a lot of the rain, however Adelaide through Victoria is looking fantastic in most parts. Moving through to NSW, western areas are still looking relatively dry but the remainder of the state is looking healthy. We can only hope the remainder of the season carries this favorable theme and we are able to cash-in on the expected premiums for high protein wheat.



Source: bom.gov.au

In terms of Australian grain exports, the onslaught of the sizeable Russian harvest and the need to clear ports and send wheat out the door has resulted in the Black Sea being more export competitive than Australia, and Aussie exports have slowed. Therefore, it looks as though we will have a reasonable carry over from last year's harvest which will need to be exported. To do this, either Aussie prices need to weaken, our currency needs to drop or prices around the world need to rally.

The short story

As the answer always is for 'what is going to happen to grain prices locally and globally?', the reality is no one knows. However, one would think, if the stocks sitting in China were discounted from the world ending stock numbers, and Australia was able to produce a high protein crop this season, we would be watching an entirely different market.