How External Threats Affect Grain Markets

Chris Coore, Agfarm Advantage Manager

Monday 16th July 2018

Agfarm's monthly reports often focus on global weather, production, supply and demand and what that means for grain prices here in Australia. This month we are going to take a look at grain markets from a different far less fundamental angle. We will explore 'The Black Swan Theory' and external events, and how these don't directly relate to the supply and demand of grains or oilseeds, but influence price direction. We will also highlight the importance of understanding how external events can, at times, have a greater influence on price trends and outlooks than the fundamentals of grain markets and technical analysis.

Definitions.

The Black Swan Theory is what has been named from an event that is rare in nature and nearly impossible to predict but when an event does happen is creates turmoil in the markets.

Technical Analysis is the study and analysis of key signals and data points gathered from a price chart to identify key indicators and price trends which will generally determine if a market participant buys, holds or sells a certain commodity.

Outside factors refer to events which can directly influence price direction but are not directly correlated with grain production. This could include global or national politics and government, speculation and expectation of what may occur with no certainty, the state of global economic activity and how financial indicators are behaving.

Now, let's look at some examples of outside factors causing a ruckus.

Recent headlines have highlighted the continuing threats of a tariff war between China and the US causing agricultural futures to swing violently. While we won't comment on the political agendas, it's clear the US and Chinese governments have used the threat of tariffs to achieve a political outcome. This has led investors, traders and exporters around the world to speculate on the outcomes of such tariffs coming into effect. The result has been a sell down in soybean, corn and wheat futures whenever these tariffs hit the news.

The past has shown political tensions create uncertainty within markets. So, while the tariffs do not have a direct impact on the US crop conditions, grain and oilseed traders will take this as a threat to market access. In the long run, American producers will receive less for their products and Chinese consumers will be forced to pay more. Consequently, Australian producers can expect to see more demand for their exports as international trade flows are forced to re-route within the new paradigm.

Traditionally concern over destabilising global economic and political events will cause money to flow into the United States. Investors typically see the US as a safe place to store money in the event of a global economic contraction. When this does occur, traders around the world sell their investments driving prices lower then switch that currency exposure into USD, inflating the USD. This will naturally increase the cost of US soybeans, corn and wheat. The price of US commodities should then weaken to stay export competitive and maintain their customers. Again, not directly related to crop conditions, but causes commodity prices to fluctuate.

Publicly traded open markets are also at risk of short term divergence from fundamentals. As I am sure you have read and heard before, many publicly traded markets such as the Chicago Wheat Futures continue to see more money flow in from managed funds where the fund speculates on what price may do. Due to the quantity of money and the position size, it typically influences price when they come into the market place to either buy or sell.

You might be thinking, this is all very interesting, but what does it mean?

There are many factors that can, and do, influence the price of grain which sit outside the typically fundamental supply and demand landscape of grain markets. So, it is important we look at global demand trends and production forecasts, and remember to stay vigilant for 'The Black Swan Events'. This will place emphasis on sovereign risk, technical analysis of broader markets and other external factors that could indirectly affect commodity prices.

Unexpected events can be threats but they can also be marketing opportunities.