

Agri Grains Insights

Volatile grains prices on trade conflict and weather

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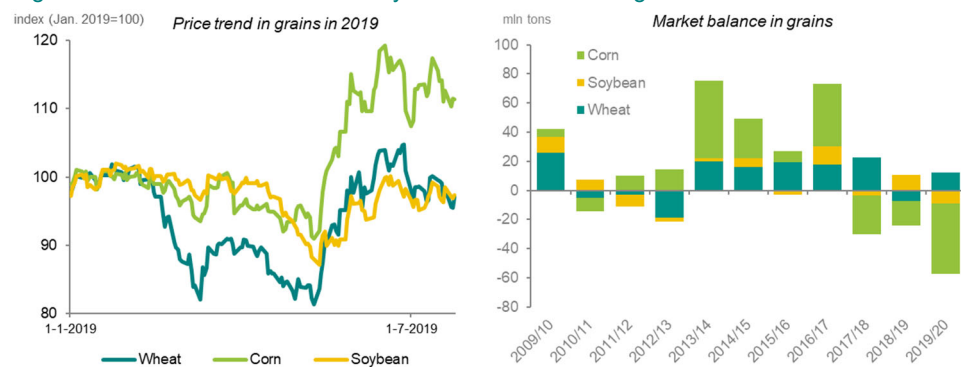
Agricultural Commodities

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	Price	% price Δ since 1 Jan.	forecast eop 2019 to spot
24-7-2019			
Wheat	506.75	-1%	4%
(CBT-Composite TRC2, USDc/Bu)			
Corn	430.75	12%	4%
(CBT-Composite TRC2, USDc/Bu)			
Soybean	896.25	0%	0%
(CBT-Composite TRC2, USDc/Bu)			
	FX rate	Forecast	Forecast
24-7-2019 end 2019 end 2020			
EUR/USD	1.11	1.12	1.20
USD/BRL	3.76	4.00	3.60
USD/CNY	6.87	6.90	6.70
EUR/GBP	0.90	0.90	0.86
GBP/USD	1.25	1.24	1.40

- **Soybeans:** shortages will result in soybean price increases in 2019/20
- **Corn:** less favourable harvesting conditions lead to lower availability
- **Wheat:** inventories will peak in 2019/20 alongside stronger demand growth

Figure 1: Price trend since 1 January 2019 and balance in grains markets



Source: IGC, Refinitiv (former: Thomson Reuters Datastream)

So far this year, the difference between the highest and the lowest corn price is 24%. For the wheat price this is 22% while for soybeans the gap is 15%. This indicates that the grain markets have witnessed a turbulent first half of 2019. Most striking in the price trends of the three grain markets is the nearly simultaneous peaks and troughs in the prices. The common denominator here is the continuing **trade conflict** and the ongoing trade talks between the US and China. The progress of and sentiment about the trade talks has a significant influence on the grain markets. That is because the result of the trade talks has a direct effect on the future demand for grain. And that is why also sentiment about the progress of the talks has a major impact on prices. A negative sentiment usually leads to falling prices (less demand), and vice versa.

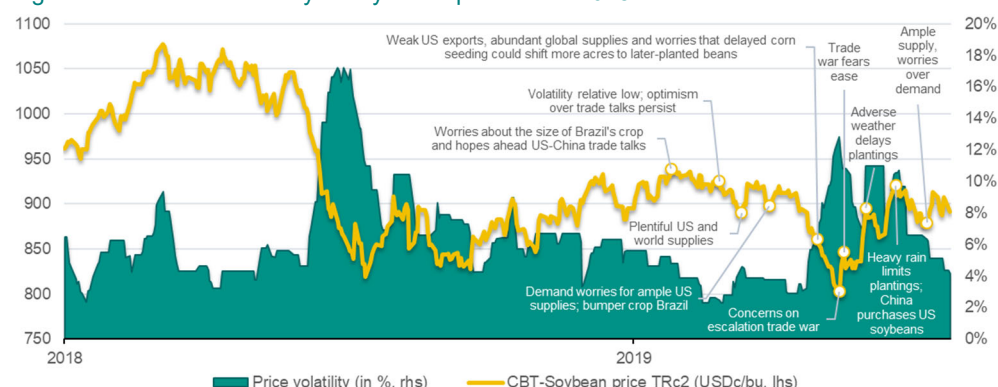
Higher price volatility is also caused by supply side issues. In addition to crop-threatening diseases (such as fungi) and insects (such as the invasion of the fall armyworm in Asia), **weather conditions** have a particularly significant influence on prices. So far in 2019, conditions that are too wet or too dry have proven to be unfavourable for crops. In the US, heavy rainfalls and flooding have had a negative effect on crop conditions and plantings were also delayed. Ultimately, this comes at the expense of crop quality. Meanwhile, farmers in Russia, Ukraine, the EU and Australia were faced with little rainfall and high temperatures, which damaged crop fields. Indeed, the US Department of Agriculture (USDA) had to adjust its production forecasts more than once this year because of the less favourable global weather conditions.

Investors translate these circumstances into future supply and demand scenarios for grain markets. This causes a lot of price volatility in the short term. When sentiment is negative, investors expand their short positions and expect a fall in prices. When sentiment is more favourable, investors extend their long positions as they expect prices to rise. Currently, investors must digest the news about heat in the US, the good wheat harvest in Germany and soybean sales from Russia to China.

Soybeans: shortages will result in soybean price increases in 2019/20

The trade conflict continues to influence soybean prices in the short term. Uncertainty about Chinese demand for soybeans going forward remains high. Meanwhile, the outbreak of African swine fever means pig farmers in China are purchasing fewer soybeans. This mainly affects soybean exports from Latin America to China. In the coming season (2019/20), global demand for soybeans will grow by 2% according to the International Grains Council (IGC). However, total production will decrease by almost 4%. As a result, inventories are expected to fall to 13% of total consumption, or 6-7 weeks of available consumption. In this scenario, **soybean prices will recover during the 2019/20 season.**

Figure 2: Trend and volatility in soybeans price since 2018



Source: Refinitiv (former: Thomson Reuters), ABN AMRO Group Economics

Volatility in the price of soybeans from January to the end of April 2019 was below the long-term average. Turbulence in prices was limited during this period due to the uncertainty about the harvest in Brazil, the relatively high supply in the US and the progress of trade talks. However, that changed from early May when turmoil increased on both the supply and demand side.

New data from early May showed that there was no shortage of soybeans. Moreover, there was a good chance of an increase in the number of soybean plantings in the US. Prices fell as a result. In addition, concerns about the trade conflict escalated and price pressure mounted. Since the trough of mid-May, however, prices have returned to an upward trend, with the associated peaks and troughs along the way.

Changing relations

Trade flows in the global soybean market are changing. At the beginning of July the very first bulk vessel with more than 4,000 tonnes of soybeans on board left Russia bound for China. Although this amount is only a fraction of China's total monthly import of soybeans, there is a real chance that this trade relationship will further intensify in the coming years. For the time being, Brazil remains the largest exporter for this and next season, with China as the most important final destination. The US now mainly exports its soybeans to Mexico, Japan, Indonesia, Egypt and the EU. Until May 2019, the US export volume to these countries increased by 24% on an annual basis. The loss of the Chinese export market in the wake of the trade conflict was largely compensated by strong exports to other countries.

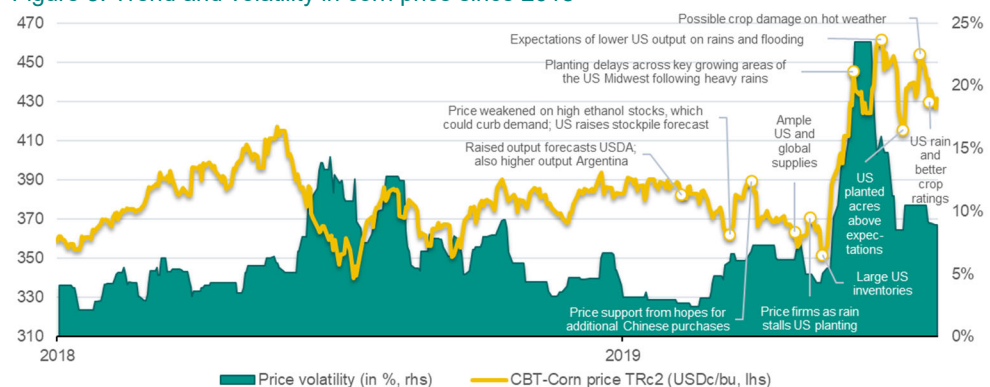
Decrease in output

Next season, global soybean output will decrease by 4%. Excessive wet conditions in North America resulted in significant planting delays, which means that the harvest in the 2019/20 season will decrease sharply by 14%. Production in South America (Brazil/ Argentina/Paraguay) will increase by almost 2% in the 2019/20 season. In China, production will increase by around 8%, but the country will remain dependent on external deliveries. In Russia, the output of soybeans will grow by almost 11%. Nevertheless, this country currently remains a marginal player in the global soybean market.

Corn: less favourable harvesting conditions lead to lower availability

According to the International Grains Council (IGC), both production and demand for corn will fall globally in 2019/20. On balance, the corn market will experience a shortage next season. That is mainly because production will decline faster than demand. As a result, stocks will decline further, falling from a level of 28% of total consumption to 24%, or approximately 12 weeks of consumption. Due to the extremely wet weather in the US over the past few months, the plantings have been delayed. This ultimately influences both the quality and the quantity of corn. The US Department of Agriculture (USDA) indicated that in mid-July, 58% of the corn harvest was in good to excellent condition compared to 72% a year ago. This creates uncertainty about the US harvest and will determine price volatility over the coming months. It also increases the chance that the market will have a deficit next season. On balance, this will have an upward price effect and **ABN AMRO expects a higher corn price in 2019/20.**

Figure 3: Trend and volatility in corn price since 2018



Source: Refinitiv (former: Thomson Reuters), ABN AMRO Group Economics

Corn prices fluctuated from January to May this year within a bandwidth of 390 and 350 US dollar cents per bushel. Prices were mainly in a downward trend during this period due to good availability of corn. But since May, prices have recovered swiftly. Very wet conditions in the US caused severe delays in planting. This will have a negative effect on total output and as a result, production expectations were lowered. That caused a peak in the price on 17 June. But soon after, the price dropped again on the news that the area of planted hectares in the US was above expectations.

Demand growth

This season, demand for corn is expected to rise to a record level. The IGC expects that demand will grow by 3% in the 2018/19 season, bringing demand to a level of 1,147 tons. The growth is mainly due to demand from the animal feed industry (particularly in China, the EU and Turkey). This sector accounts for almost 60% of total demand for corn. More than 25% of the total corn finds its way to industrial processing (such as ethanol production). And about 10% is destined for human consumption.

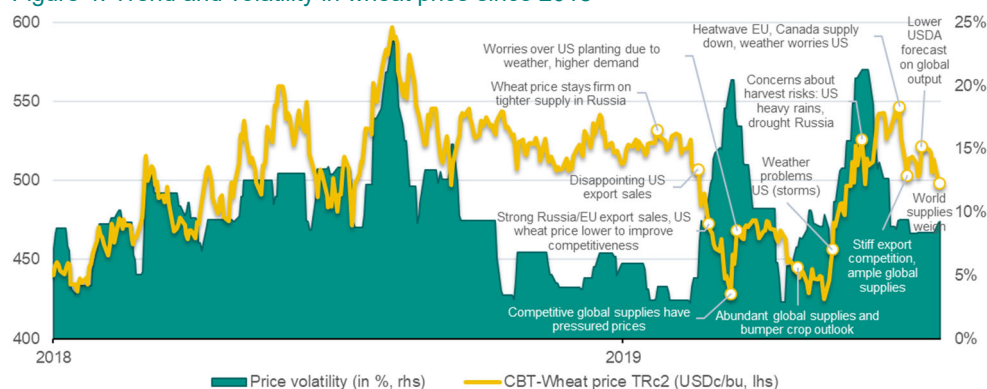
Decrease in output

Due to the challenging weather conditions - especially in the US - the number of long positions has increased. Investors expect that prices will rise further. This optimism is fuelled by the delay in plantings and the unexpected sharp downward adjustments in the USDA's crop expectations. Production is also under pressure in China. Besides the high temperatures and drought conditions in some harvesting areas in China, the so-called fall armyworm also caused a lot of damage to the harvest. Expectations are that Chinese production of corn will reach 230 million tonnes this season. That is about 11% less than last season. Demand for corn in China continues to grow, increasing by more than 2% in 2018/19. Demand is growing fastest in the industrial sector, especially for the corn-based production of biofuels.

Wheat: inventories will peak in 2019/20 alongside stronger demand growth

In the 2018/19 season, total wheat production will decrease by almost 4%, mainly due to challenging weather conditions globally. Consumption remains stable. As a result, stocks are declining, and this means that the price of wheat may recover towards the end of 2019. However, market dynamics will change in the 2019/20 season. The International Grains Council (IGC) expects production to grow by almost 5% in the new season. Wheat production in the US is expected to drop, mainly due to delays in harvesting due to wet conditions and less plantings. However, production will increase strongly in Australia, Ukraine and Russia where yields will rise. Global demand will ultimately grow by just over 2% in 2019/20. Demand from the animal feed industry in particular will increase sharply. This means that compared to three seasons ago, growth in demand has once again exceeded the long-term average. On balance, inventories are rising and will reach a peak level. The available inventories compared to total consumption will increase to 36.3%. This will put some pressure on the wheat price. The strengthening growth in demand will provide a cushion. On balance, **ABN AMRO expects a stable price trend for 2020.**

Figure 4: Trend and volatility in wheat price since 2018



Source: Refinitiv (former: Thomson Reuters), ABN AMRO Group Economics

The average long-term price volatility of wheat is highest relative to the corn and soybean markets. This is because wheat is produced in many different countries, while the bulk of corn and soybean production is concentrated in just a few countries. Therefore, more countries are active on the wheat export market, which makes it more competitive. This considerably increases price competition and results in higher price volatility.

Challenging weather conditions

During the first half year of 2019, there was a lot of focus on weather-related risks. Many wheat exporting countries faced difficult weather conditions. The US was mainly affected by wet weather. Meanwhile, drought and high temperatures caused considerable damage to production in Canada, Australia, the EU, Ukraine and Russia. On balance, the competitiveness of the US increased compared to the other exporting countries. Until May 2019, wheat exports from the US increased by 28% on an annual basis. Exports from Russia and Australia fell by 19% and 10%, respectively.

Crop progress

So far, the wheat harvest in Europe is progressing well, especially in Germany. The heat in June throughout Europe caused less damage than initially expected. The number of tons of wheat per hectare is increasing, keeps availability high. This will cause some price pressure. On 21 July, approximately 69% of the winter wheat was harvested in the US, 10 percentage points lower compared to the level of a year ago, but also 10 percentage points below the five-year average. The harvest in Russia is on track. Due to the drought and high temperatures earlier this year, overall wheat production in Russia will decrease. The yield in Russia is currently relatively low, but the quality of the harvest is good.

Sources:

For this publication, various sources have been used, of which International Grains Council, OECD, FAO, USDA were the most important.

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