

Agricultural Services

Combinable Crop Outlook October 2015

USDA's August 2015 forecasts show that world grain stocks will reach 540million tonnes by the end of the 2015/16 marketing season. Down 2million tonnes on 2014/15 but up some 28million tonnes on 2013/14 -resulting in a stocks to use ratio of 21% - a relatively comfortable 76 days. This position is responsible for the price being paid for grains and the less than favourable price outlook for the coming season. Buyers are of the opinion that they will have little difficulty globally in securing both the quantity and quality of the grains they require.

Looking in more detail at wheat, the USDA forecast that production will increase marginally to 727million tonnes in 2015/16. Demand is forecast to increase by some 6million tonnes to 715million tonnes. The result stocks are forecast to increase by 12million tonnes to 221million tonnes, with a stock to use ratio of 30% or 110 days (28% in 2014/15), providing little encouragement for market prices to rise.

The coarse grain stocks of which maize (or corn) accounts for 75-77% are forecast to decrease from 233million tonnes to 227million tonnes with a stock to use ratio of 18% (65 days) back marginally on the year. As a result of slightly lower production and higher demand.

However, looking forward, volatility will remain a feature of the markets and growers should look at options to manage this volatility and the impact this has on their business. Additionally they should also review their cost control (as opposed to cost cutting) not just variable costs but overhead costs too, by controlling cost the business will be in a better position to weather the tough times yet benefit more in the good times.

China is forecast to hold approximately 40% of both wheat and coarse grain stocks increasing in proportion by the end of 2015/16 marketing season. These stocks are unlikely to be available to the market, resulting in a lower buffering capacity and, therefore, potentially increased exposure to volatility as fewer stocks are held by the countries that are major exporters.

Global oilseed supply in 2015/16 is forecast at 623million tonnes. Soya is the main crop, accounting for around 50% of all oilseed production at 320million tonnes. In comparison, oilseed rape accounts for typically 12- 13%. USDA forecasts for the 2015/16 season show flat production level for soya, following an uplift in production of some 30million tonnes in 2014/15, driven by increased production in Brazil and the United States.



Oilseeds demand is shown to grow by only 9million tonnes allowing year end stocks to increase marginally to 96million tonnes, with a stock to use ratio of 21%, with soya stocks at 28%.

The demand for food tends to be inelastic - consumption is not greatly influenced by rising or falling prices. Overall levels of consumption of cereals destined for the food sector tend not to be affected by the underlying performance of the economy. Demand tends to increase fairly steadily as the world population grows. This is compounded in the developing world, where economic growth should stimulate an increase in demand for meat and milk, which will also affect the demand for cereals as livestock feed.

Away from the food sector, the demand for cereals or oilseeds destined for industrial processes has shown no real sign of decline despite the market conditions being unfavourable – government policy remains a key influence on demand. However, since the summer of 2014 the crude oil price has fallen by some 45% to around US\$60 per barrel. There is a price link between crude oil and vegetable oils. The lower crude oil price is putting pressure on biodiesel manufacturers who have had to lower their prices to remain competitive with significantly lower margins being retained. Analysts F.O. Licht's data shows that EU biodiesel producer margins have been negative for most of the period from December 2013. Recently biodiesel prices have been relatively stable around €760 per tonne but vegetable oil prices have been volatile.

Biodiesel used in UK road transport fuel has been produced from various oils and fats. The proportion of biodiesel produced from virgin vegetable oils such as rapeseed, soya bean and palm, has declined, with more Used Cooking Oil (UCO) based biodiesel being consumed. This shift is mainly due to the Renewable Energy Directive (RED), implemented by the EU Commission which came into effect in the UK at the start of 2012. This allows 1 tonne of biodiesel produced from waste or recycled materials, such as UCO and tallow to count as two tonnes of biodiesel towards "the mandate", reducing the demand for vegetable oil for biodiesel. In the year to March 2015 around 64% of biodiesel was from UCO (319million litres), the volume from rapeseed oil was 9% or 43million litres of which a quarter came from UK crops. Despite the RED the amount of biodiesel from UK OSR increased some fourteen fold between 2014 and 2015.

The EU Energy Council has agreed to limit biofuels made from food crops to 7%. This is a cut from the 10% originally allowed, but higher than the initial proposal of 5%. This agreement still requires the ratification of the EU parliament and suggests that the use of rapeseed oil to produce biodiesel used in the UK roadfuel is limited. However, the outlook for edible vegetable oils is more promising and is being driven by the developing economies. Demand for vegetable oils for industrial use is also growing in these economies and these factors would be expected to provide some price support to the vegetable oil sector as a whole.

With increasingly volatile markets, managing risk has become even more important. Price risk can be managed in a number of ways. A pre-requisite to managing the risk is to know the cost of production (preferably in pounds per tonne produced), to allow informed decisions to be made on whether a potential sale will generate an acceptable margin.

A balanced sales pattern is suggested, using a mixture of sales mechanisms including spot, forward and pool marketing. A further refinement that can be considered is the use of grain options in the marketing of wheat. This guarantees a minimum price to the grower. The option is an insurance policy that allows the purchaser to trade on the futures market without being exposed to the risks of futures trading.

A further advantage of establishing costs of production is that it allows comparisons to be made between growers and to establish whether performance is in the average, bottom or top category. When costs are known, steps can then be taken to identify effective measures that could be put in place to improve performance. Many businesses have successfully addressed cost control of the direct costs associated with growing crops, though perhaps fewer have made a significant impact on their overhead costs. These traditionally have been viewed as fixed costs with limited scope for reduction. However, many forward thinking businesses have found ways of reducing these costs, changing cultivation practices, achieving economies of scale by entering into joint ventures with neighbours, which have shown that it is possible to significantly reduce machinery costs.

The longer-term outlook for the sector is still positive with the prospect of increasing demand and a tight supply. However, there will remain challenges concerning rising costs, and the impact of weather on global production all resulting in increased volatility in Farmgate prices, both in terms of frequency of price changes and the amplitude of these changes.

To see how we can help

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