



Fires in Russia, Wheat Production, and Volatile Markets: Reasons to Panic?[†]

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Recent events in Russia, one of the largest suppliers of wheat in the world, have raised concern about the current and future price of wheat and wheat-based products. This article briefly examines the issue and determines if there is in fact cause for serious alarm.

Summary of Facts

- In Russia, one of the worst droughts in decades has already destroyed 20 percent of the country's wheat crop, and there are fears that more fields will be lost due to recent wildfires in the western part of the country. Considering that Russia accounts for roughly 8 percent of the world's wheat production, the current loss is equivalent to a 1.6-percent decrease in the global wheat supply.
- Because of the drought, some specialists and grain unions expect Russia's wheat exports to decrease between 30 and 40 percent this year, relative to 2009. Since Russia exported 21 million metric tons (mt) of wheat last year, this decrease is equivalent to 6–8 million mt.
- On August 3, 2010, *The Financial Times* reported that traders at Glencore, the world's largest commodity trader, asked Moscow to impose an export ban on grain to allow companies to renegotiate their contracts (Blas and Gorst 2010). Press reports indicate that the temporary ban on Russian grain exports will take effect from August 15 until December 31.
- Recent reports also point toward a powerful rally in wheat prices, which began during the second week of June. Some specialists maintain that the fastest wheat-price increase in decades is currently taking place. According to official statistics from the Food and Agriculture Organization of the United Nations (FAOSTAT), spot prices for wheat increased by more than 24 percent in July. On August 2, 2010, September Chicago Board of Trade (CBOT) wheat contracts rose for the fifth straight trading session—by 5.6 percent; on August 4, they rose by 6.6 percent, which is the highest increase since September 2008. Current futures prices are above \$US 7 per bushel, also for the first time since September 2008.

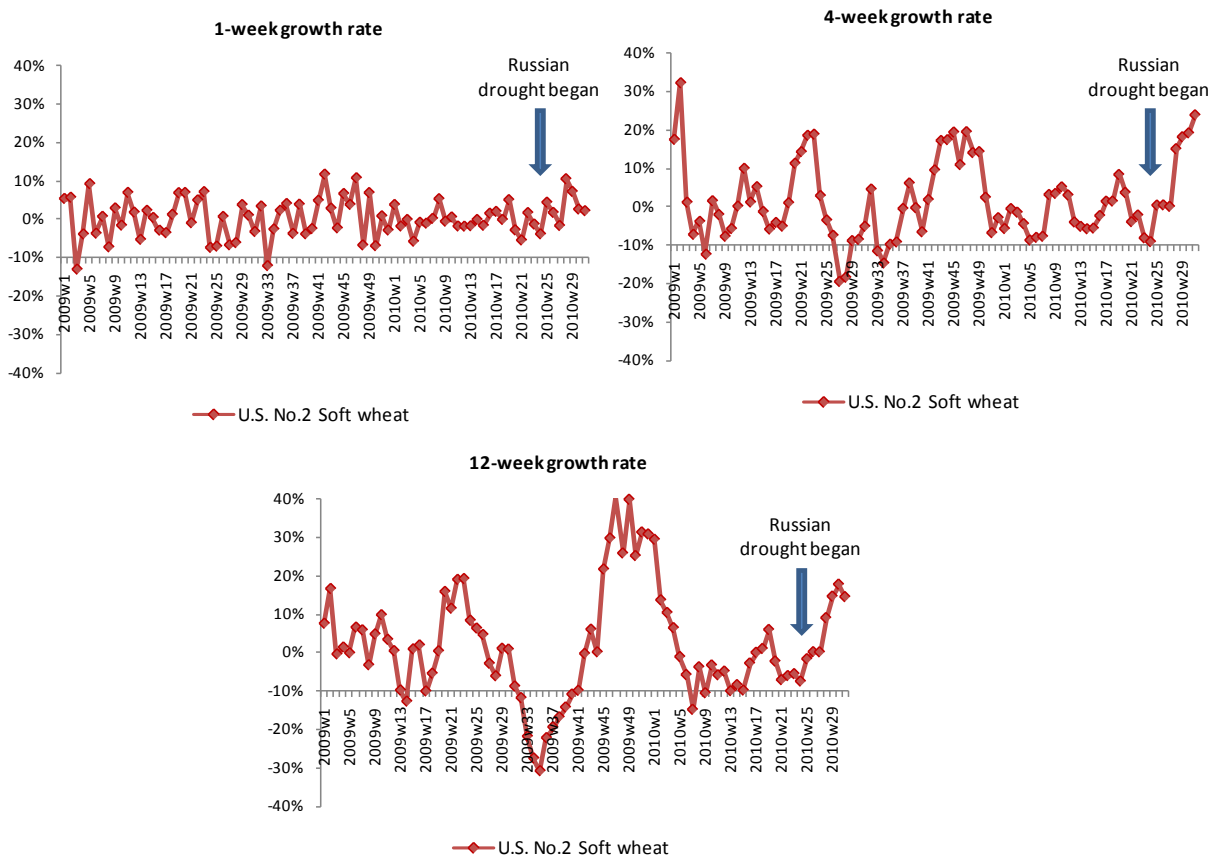
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Is there a reason to panic?

1. Price Volatility is within the Normal Range

A close look at soft and hard wheat prices confirms that spot prices have shown an important increase in recent weeks. However, markets also experienced similar price increments at other points during the post food-price crisis period (see Figure 1), but people were not as concerned then as they are today. For example, during most of July 2010, weekly spot prices for soft wheat increased between 15–24 percent with respect to the previous four weeks; however, between October and November 2009, there were similar increases in spot prices for eight weeks in a row (and in May 2009, there was also an important increase for four weeks). Furthermore, when compared to prices during the previous week, the price increments in October and November 2009 were higher than in July 2010. The differences are even clearer when analyzing price variations with respect to the previous 12 weeks. A similar story applies for hard wheat prices. Therefore, while prices have increased significantly in recent weeks, the price volatility is within the normal range.

Figure 1—Growth rates of weekly wheat prices, January 2009–July 2010



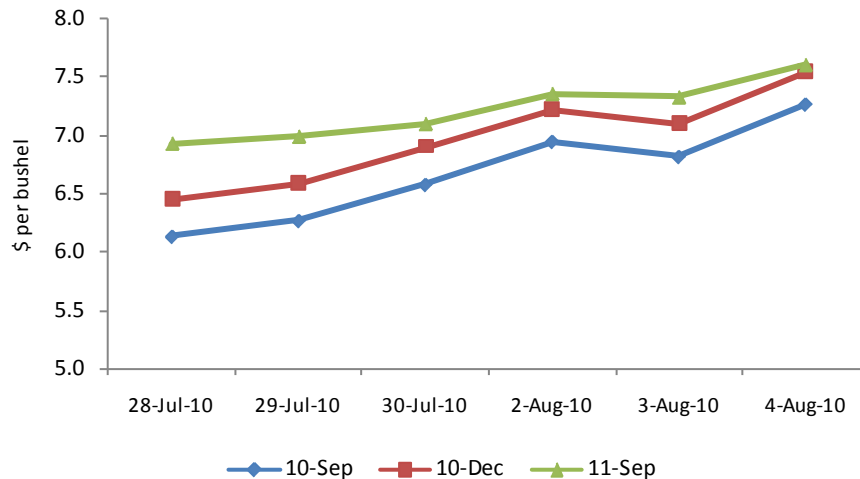
Source: FAOSTAT.

2. Future Prices Indicate Normal Market Adjustments

It is possible to argue that futures prices are the relevant prices that should be analyzed, given their risk-transfer role and, in particular, their informational role. A quick examination of CBOT wheat futures prices (see Figure 2) indicates that futures prices did in fact increase from July 31, 2010 to August 5, 2010, but the rates that have been cited (of above 5 percent) correspond to the futures of closest delivery (September and December 2010). This is reasonable, considering the temporary shock that traders are experiencing. Futures of longer maturity are naturally also adjusting, but at a much lower rate, contrary to what happened in grain markets three years ago when there was a recurrent uniform increase in futures prices of distinct maturities. This implies that long-run expectations are not as negative as some people are suggesting. It is also important to note that only the volume of futures closest to maturity has shown an important variation, with a considerable spike on August 2, 2010 and August 4, 2010—precisely the days that prices peaked.

Observers are also worried because wheat futures prices in the United States are more than US\$1 above spot prices, even though spot prices are usually higher than futures prices. But this is part of the market adjustment and should not be grounds for concern, seeing as not everyone is purchasing wheat for the entire year right now, according to Hackett Financial Advisors, a firm with a specialized focus on agricultural commodities (Rohrlich 2010).

Figure 2—CBOT wheat futures prices and traded volume, July 28-August 4, 2010



Volume traded			
Date	Sep 2010	Dec 2010	Sep 2011
28-Jul-10	61,623	43,088	729
29-Jul-10	57,511	42,085	371
30-Jul-10	79,103	55,563	899
2-Aug-10	116,092	83,820	918
3-Aug-10	66,316	50,185	1,042
4-Aug-10	92,185	62,091	1,515

Source: CME Group.

3. Global Supplies are Secure

It is true that Russia is one of the largest suppliers of wheat in the world, and thus, the situation there could cause concern, but Russia is not the only supplier. As mentioned above, Russia accounts for 8 percent of the world wheat production. It exports around 30 percent of its production, which represents roughly 11 percent of total world exports (see Table 1). It is tempting to think that a 6-8 million mt-reduction in Russian exports will create supply shortages in regions such as the Middle East and North Africa, which is the main buyer of Russian wheat, but excess wheat supplies around the world could easily fill the gap. For example, the United States alone stores more than 26 million mt. This quantity is three times larger than the expected decrease in Russian wheat exports and is greater than total Russian exports last year (around 21 million mt). Other major suppliers of wheat (Canada, Australia, and Argentina) may not expect as healthy harvests this year as the United States, but their situation does not appear to be as dire as some have predicted. Australia, for example, actually expects to increase its wheat exports this year by 1 million mt (reaching a total of 15 million mt). Furthermore, a recent report from the United States Department of Agriculture estimates the global production of wheat for 2010-2011 to be 661 million mt—only 3 percent lower than production in 2009-2010 (USDA 2010). On August 4, 2010, the Food and Agriculture Organization of the United Nations, in turn, cut its 2010 global wheat production forecast to 651 million, just 3.8 percent less than its previous prediction (*Wall Street Journal* 2010).

Table 1—World top wheat producers and exporters, 2007

Top producers		Top exporters	
Country	World share (%)	Country	World share (%)
China	17.9	United States	24.8
India	12.4	Canada	13.2
United States	9.1	Australia	11.1
Russia	8.1	Russia	10.9
France	5.4	France	10.8
Total (million MT)	611.10	Total (million MT)	132.83

Source: FAOSTAT.

It seems, then, that some market participants are overreacting to the events in Russia. The fact is that a supply shock of less than 2 percent of the world's production has occurred and the price of wheat has shown an upward trend in recent weeks. This is an expected temporary market adjustment to a negative shock. Russia's temporary ban on wheat exports may now lead to further price increments.

A sober analysis of market fundamentals indicates there is no reason to worry about major increases in wheat-related products such as bread or cereals. U.S. wheat producers are probably going to take advantage of the present situation, and there are going to be some further price adjustments, particularly in the Middle East, North Africa, parts of Asia, and possibly Latin America, but skyrocketing global food prices are unlikely. Recent studies of price transmission effects by the International Food

Policy Research Institute (IFPRI) indicate that a 1-percent increase in the international price of wheat translates into an increase of 0.20 percent points in the growth rate of the domestic price of bread; for certain countries in Asia, these transmission effects fluctuate between 0.11 and 0.74, while in Africa there is not much transmission.

Finally, it is important to remember that there are sufficient supplies of wheat around the world—the 2010 forecast for global wheat production is only 3–4 percent lower than 2009 production and sufficient inventories of wheat are available. While Russia, Canada, and India and other producers may see a drop in wheat production, other countries like the United States and China will see an increase in production.

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