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## **Uncertainty in world wheat markets: The impact of Russia's ban on exports will be minimal**

The world is not on the verge of a new crisis in food prices following Russia's decision to temporarily suspend its wheat exports because of the drought, and the floods in Pakistan, China, and India, although some analysts have predicted otherwise. However, the events of recent weeks have again highlighted the volatility of prices and the growing impact of climatic factors on agriculture and food security.

There are strong technical reasons for thinking that the current nervousness in the markets will lead to an increase in short-term prices, mainly due to panic buying and the decision of some countries to restrict exports. The higher international prices will not be passed on to local markets, however.

At moments like this, it is essential that the agents involved take note of long-term market signals, so that things return to normal.

**The reason for the market's nervousness.** The drought in Russia, which has destroyed 20-30 percent of the country's wheat crop, led the government to announce nearly two weeks ago that it was suspending exports of the grain temporarily. Production in Ukraine and Kazakhstan is also down considerably as a consequence of droughts (in Kazakhstan and parts of Ukraine) and heavy rains (in parts of Ukraine), forcing the governments of both countries also to consider imposing restrictions on grain exports. That clearly unnerved global markets, especially since the decline in world grain stocks was one of the reasons for the food crisis in 2008. That fear has triggered a spike in international wheat prices, mainly in the prices of futures contracts closest to maturity, highly correlated with spot prices.

The fall in Russian production and the decision to restrict exports temporarily - coupled with the spike in international prices and the flooding in Pakistan, China and India, which may affect the production of other grains - have raised concerns about a possible second food crisis.

There are a number of reasons for thinking otherwise, including the following:

**Russia's wheat losses are not significant in global terms:** According to FAO data,<sup>1</sup> in 2009 Russia accounted for nearly 8 percent of the world's wheat production (692 million tons). That means that, even in the worst scenario, the loss of 30 percent of Russia's wheat production would lead to a maximum decline in global production of 2.4 percent, or the equivalent of all of Russia's exports in 2007 (14 million MT), which accounted for 11 percent of all world exports.

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<sup>1</sup> FAO. 2010. Food Outlook: Global Market Analysis. June 2010

These figures are not very alarming and the losses could be offset (albeit to a lesser degree) by good weather and increases in the acreage planted by some of the biggest wheat exporters, such as Argentina, Australia, and Canada.

**Price volatility in the wheat market is within the normal range:** As is the case with most grains, the wheat market deals primarily in surpluses. This means that any situation that has a positive or negative impact on the supply of the main producers and exporters (such as frosts, droughts, variations in acreage, changes in yields or pests and diseases) will rapidly be reflected in international prices. However, so far the week-to-week changes in prices since the drought in Russia began have not been greater than the changes in prices in the weeks prior to the drought. Furthermore, the highest price reached in the last few weeks was 300.19 US\$/MT, which is 31.7 percent less than the highest price during the 2008 crisis, when wheat prices peaked at 439.72 US/MT.

**The world wheat market is in better shape than it was at the time of the food crisis:** Around the time of the 2007/2008 harvest, when the food crisis was declared, wheat production and stocks were put at 768 million tons.<sup>2</sup> Today - even discounting the 14 million tons that could be lost as a consequence of the drought in Russia - the figure is about 870 million tons, or 13 percent more than at the time of the crisis. In other words, the losses in Russian wheat production do not pose a threat to the bigger world reserves that have accumulated since the food crisis began.

The stock-to-use ratio for 2010 is set to fluctuate between 26 and 28 percent, indicating a balance between supply and demand and suggesting there will be no negative effects in the markets or long-term prices for this product. It should be remembered that during the food crisis in 2008, this ratio was less than 20% (USDA).

It is estimated that at the end of 2010 wheat stocks will be 7 million tons higher than in 2008-2009 and nearly 50 million tons higher than in 2007-2001. Russia is in a curious position, because it is estimated that, following the ban on wheat exports, the country will have ending stocks of more than 1.5 million tons at the end of this year (USDA).

**Although wheat prices have risen sharply, the initial comparison price was very depressed:** Until June 2010,<sup>3</sup> forecasts for the wheat market were predicting higher than average production, large stocks, weak demand as a consequence of the economic crisis and an increase in exportable supplies. Accordingly, spot prices and futures prices for wheat (for September this year) had weakened very sharply. For example, although at the end of July 2010 some wheat prices were more than 30 percent higher than in June 2010 (Chicago Board of Trade), in June 2010 they stood at their lowest level since September 2009.<sup>4</sup> In its Food Outlook document for June 2010, FAO also emphasized the decline in international wheat prices during those months, noting that in May 2010 both the price of United States No.2 Hard Red Winter, FOB Gulf, and the price of wheat futures for September delivery (Chicago exchange) were approximately 60% below their March 2008 peak.<sup>5</sup>

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<sup>2</sup> FAO. 2010. Food Outlook: Global Market Analysis. December 2009

<sup>3</sup> FAO. 2010. Food Outlook: Global Market Analysis. June 2010

<sup>4</sup> Reuters

<sup>5</sup> Idem

**Experts recommend focusing on futures prices:** Fears of a possible new food crisis have been raised by the spike in the price of wheat in spot markets and futures closest to delivery. However, as IFPRI rightly says,<sup>6</sup> it is possible to argue that the prices of futures of longer maturity should be analyzed at this moment, given their greater price-transmission effects within economies. In the specific case of wheat, while the prices of futures contracts close to delivery have risen sharply, the increase in futures of longer maturity has remained stable, showing that long-term expectations have not varied significantly.

**Price volatility is likely to have knock-on effects:** The rise in wheat prices could have two possible impacts. First, because of the links between the prices of wheat and other grains. For example, barley prices have more than doubled in recent weeks, which could impact the meat chain, due to the fears this has created in the market. Second, the decision to restrict exports could drive prices upwards and make them more volatile; however, it is to be expected that in the medium term such policies will increase the surplus in those net wheat-exporting countries where they are implemented, and eventually that will cause prices to fall again.

**An opportunity for the Americas:** A final point worth mentioning is that the cancellation of contracts and exports by Russia, and possibly by other countries, creates greater opportunities for the wheat-producing nations of the Americas - particularly the United States, Canada, Brazil, Argentina and Uruguay - to sell their wheat, and sell it for a higher price.

*For more information, visit IICA's website - [www.iica.int](http://www.iica.int)  
(Arias, Chavarría and García-Winder) *Incertidumbre en los mercados mundiales de trigo.*  
August 2010.*

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<sup>6</sup> IFPRI. 2010. Fires in Russia, Wheat Production, and Volatile Markets: Reasons to Panic?