INTERNATIONAL MILLING DIRECTORY 2006

OVERVIEW

Supply challenges will continue

THE past season has demonstrated how quickly world grain and feed supplies can rise in response to the right price incentives - given favourable weather too. Whereas 2003/04 was a year of near record low stock/consumption ratios - and generally rising feedstuff costs - 2004/05 saw larger planted areas complemented by the highest world average cereal yields ever recorded.

Much of this was down to huge yields in the US where weather was particularly conducive to a long and fruitful growing season - and a relatively trouble-free harvest for coarse grains and oilseeds. Big crop recoveries were also seen across both west and east Europe and within the former Soviet Union, where droughts/heatwaves and frosts respectively had destroyed millions of tonnes of grain the previous year. There were also large supplies from the main southern hemisphere producers, Australia and Argentina. The only real problem area was wheat quality from North America which was affected by damp and difficult harvests of both winter and spring planted varieties, leading to a loss of milling grades and a much larger than normal supply of feedwheat, particularly from Canada.

World demand for cereals grew above the long term, mainly in the feed sector where input costs came down sharply from the 2003/04 highs. The great bulk of these increases was in countries where crops had seen substantial growth - the US, Europe and FSU, reducing the impact on world trade in feedgrains to a minimum. Demand also had a big boost from the 'green fuel' sector - especially ethanol production within the USA.

Despite this growth in demand, supply was large enough to replenish the historically low stocks with which the 2004/05 season began, raising these from 267m to 321m tonnes and, with them, lifting the stock use ratio from 17.4% to 20.3% - about 11 weeks supply cover. As this more comfortable balance developed, grain and oilseed prices fell rapidly from the (7 and 8-year) highs of early 2004, reducing raw material costs across the global feed sector.

The current 2005/06 season began with small cut in sowings, spread across both wheat and coarse grains, in contrast to relatively unchanged areas planted to oilseeds. Despite reasonable favourable weather in North America and several other regions, world average cereal yields also retreated from the 2004/05 record levels, particularly for coarse grains - which had seen the largest increase in that prior season. The result, at time of going to press is an estimated 84m tonne drop in world total cereal output, compared with 2004/05's 165m tonne gain. The important factor is that in both years, these, larger than usual changes, were mostly down to the shift in average yields rather than farmers planting intentions.

While this is still the second largest cereal crop ever, it will fall short of estimated annual demand, by about 33m tonnes, reducing world stocks by a like amount. This is despite the fact that world cereal consumption is only seen growing by an almost negligible 0.2% (versus almost 3% in 2004/05). Within that total, world feed demand for cereals actually declines by about 0.8%. This is a relatively rare occurrence for a sector that has seen more or less consistent growth in demand for at least the past thirty years.

The slowdown is spread over several regions, mainly those which witnessed an eruption in demand in 2004/05 on the back of cheap, abundant supplies.

In most cases, the slowdown affects demand for feedgrains, including lower grade wheat as well as coarse grains. The expansion in world demand for wheat-based foods also continues its long-term slowing trend as developing countries which fuelled the boom in demand in the seventies and eighties, upgrade their diets to include more livestock products.

Despite the latter trend, maize demand is currently forecast to contract slightly in 2005/06 - quite a change from the past season's 33m tonne increase. Only three real growth areas emerge: China (+2.5m), Brazil (1.9m) and Mexico (+0.5m) - outweighed by lower demand in the USA (-4m tonnes). Yet despite flattening world demand, 2005/06 ending stocks of maize will still be 16m tonnes lower and equal to little more than eight weeks supply. Lower barley production will also tighten the world coarse grain stocks/use ratio (World area planted to this grain has contracted by about a third in the last thirty years).

As we go to press in the autumn of 2005, markets are already anticipating next season's supply. Early pointers suggest US farmers may sow more wheat for 2006 in response to relatively larger incomes from this grain and possibly less maize, with its higher input and energy costs. Oilseeds, especially soya, also seem likely to maintain their advantage over cereals, provided treatment for crop diseases like Asian rust does not add too much to farmers' costs.

Although the coming year does not promise robust growth in demand for cereals and oilseeds, the pressures of world population and economic growth will eventually reassert its more dynamic long term trend. Over the last thirty years or so, demand for cereals in total has increased by roughly 50% - over 500m tonnes and, while the trend slowed in the late nineties, it has accelerated again in the first half-decade of the 21st Century. Apart from the underlying vigorous demand potential for feedstuffs, cereal and oilseed consumption trends could be radically boosted by the accelerating global market for bio-fuels made principally from maize, vegetable oils and sugarcane. Amid record high prices (in nominal if not in real terms) for fuel oil, economists have been frantically uprating their forecasts for tonnages required by alternative/renewable fuel resources. What effect will this competition for finite crops (still used mainly for food and feed) have on supply - and on cost - of grains and oilseeds in the future? Is there sufficient land to cater for larger crops. And will larger buffer stocks of cereals be required as security for both outlets?

Coarse grains - the mainly feedgrain - also face a challenge from supply concentration as countries like China exhaust the stocks used in past years to fund deficits created by their export policies and their own rising domestic demand. With world coarse grain supplies increasingly focused on the USA, will world prices become more sensitive to weather/supply shocks in one country?

Grain output clearly has huge potential to expand in some areas, like Brazil and Argentina (rainforests and Pampas especially) or in the Former Soviet Union. Yields, which are far below their potential in some of these countries, could also make an enormous contribution to future supply. However, this may require, not only the encouragement of higher market prices but investment of more of that return into transport and handling infrastructures.

Finally, among factors to watch in the next year or two, will be the involvement of 'outside' speculative forces in the grain and feed markets. For wheat, maize and soyabeans, the speculative influence on futures markets - and ultimately on consumer costs - is nothing new. However, the degree of participation by managed funds, hedge funds etc is reaching record levels. As inflation fears stir for the first time in many years, these operators - many of whom have no interest in the outcome of their actions on physical grain and oilseed markets - seem to be investing more and more of their huge resources in commodity markets. This opens the door to greater price volatility in the future and, with it, new uncertainties facing industries calculating their medium term grain and feedstuff costs. We may only have seen the tip of this iceberg so far.