

## INTERNATIONAL MILLING DIRECTORY 2006 - WHEAT

### *OVERVIEW - Supply & demand*

#### *Another big crop but quality premiums stay high*

Relatively high wheat prices in second half-2004 helped support world planted acreage at a higher level for the second year running for harvest 2005. Although world average yields have dipped a little from the record (2.87 tonnes/ha) high of the past season, they have come close enough to produce the second biggest crop ever at some 613m tonnes. Last year's mammoth 625m tonne harvest meanwhile left large stocks to carry into 2005/06 - an extra 19m tonnes in all and enough to put total world wheat supplies ahead of the previous season's.

Within the total, major producers have had mixed fortunes. The biggest change this year has been the decline in EU soft and durum wheat production, from 137m to 128m tonnes, partly down to slightly lower planted area but mainly caused by a series of droughts and heatwaves from Spain and other southern Europe up to North/Central France.

It is not clear yet to what extent this has affected grain quality. Though early reports indicate proteins are up and Hagbergs adequate - good news for millers - the heat may have resulted in some shrivelled grain and lighter bushel weights. On the other hand some wet harvest conditions in North Europe in early August might also compromise quality of some ripe crops that experienced delayed harvests in this time. Overall, EU supplies are more than adequate to meet consumption of 115m tonnes and, with an extra 16m tonnes of stocks carried in from 2004/05, ample to maintain a competitive export campaign. The adequacy of this year's wheat supply has been underlined by downward pressure on soft wheat prices, resulting in huge volumes of grain offered and accepted into intervention support stores and an artificially tighter market as we go to press ahead of new crop arrivals.

#### *Uncertain North American proteins*

US farmers sowed a slightly larger wheat acreage this year, boosted by a late surge in spring wheat, encouraged by the past season's higher prices for hard milling varieties and by less certain prospects and possible higher energy and herbicide costs for maize and soya respectively. The resulting crop of over 60m tonnes is up from last year's and export supplies are again adequate to maintain the USA's role as top world supplier. However, it is possible proteins for soft and hard red winter wheats have suffered some decline from damp harvest in many areas.

Canada's wheat sowings were down a little and with yields estimated lower too, the crop may decline by about 2m tonnes. However, at time of going to press, the key issue for Canadian farmers was the need for better harvest weather than last year when so much of the milling wheat crop was downgraded to feed. Good harvest conditions could result in millions of tonnes more of Canada's traditionally high protein hard breadwheats, far outweighing less than stellar quality performance for US and some EU countries' milling wheat crops.

Last year, Canada's unusual lack of quality wheat supplies - along with some quality problems in the US too, was a major factor behind firmer prices of the better quality milling wheats.

Australia was a big worry for millers in the early summer as a severe drought in south and eastern states threatened to slash wheat output there to as little as 15/16m tonnes from the 20m plus norm of recent years. Fortunately for Australia's farmers, and their customers, rains seem to have come in time to rescue these crops, which make such an important contribution to the global supply of higher quality milling wheats.

### ***Argentina, FSU set cheap price pace***

Argentina had a particular good wheat crop earlier in the past season and has been an aggressive exporter, almost doubling sales and strengthening its position in a number of non-traditional milling wheat markets. The discounts offered on Argentine wheat have been a key factor setting the world price for middling/good quality wheats and have helped keep other exporters on their toes. In the coming year, Argentina's role is less certain as credit squeezes, currency problems and farmers' rising costs threaten to trim plantings somewhat. Even so, with normal weather, Argentina should be able to produce another reasonably large crop and maintain an active supplier to some of its newer as well as its traditional customers.

Another important factor keeping world bread and feedwheat prices in check this past season has been the good supply from the Former Soviet Union, where wheat production rose by over 7m tonnes in 2004. Exports from the region rose sharply (Russia to 7m, Ukraine to 4.2m), providing stiff competition for EU, US and other wheat suppliers, particularly in the Near East. Top world importer Egypt alone took 1.35m tonnes from Russia last season, making the latter its largest supplier. Ukraine, in turn has expanded sales to over 40 countries in the past season, including 1.6m tonnes sold to the EU to date. Currently production within the FSU in total is expected to rise by another 3m to 4m tonnes in 2005/06, with all of the extra grain going to export channels.

### ***Strong feedwheat demand to continue in Europe, FSU***

On the demand side of the ledger, world wheat consumption grew by 18m tonnes last season to a new record 624.5m tonnes. Here too, the FSU was an important factor as its demand grew by 7.3m tonnes in response to good supplies and lower prices, mainly in the feed sector. A further increase in FSU wheat demand of some 2.5m tonnes is currently expected to flow from the large 2005 crop, again growing mainly in the feed sector.

A particularly strong 7m tonnes gain was also seen in EU demand, boosted by rising feedwheat offtake. Despite the decline in this year's crop, feedwheat demand is expected to leap by a further 4.5m tonnes in 2005/06 due to tighter supplies of competing maize and barley for the feed industry.

India's consumption leapt by an above-trend 4.6m tonnes in 2004/05 as domestic prices fell following a bumper harvest and earlier stock buildup. However, as demand began to exceed supply India's exports fell sharply and, with a smaller crop expected this year, it could even return to net import status.

Canada boosted wheat feeding to livestock by 1.5m tonnes in 2004/05 to dispose of some of its unusually large weather-damaged milling wheat harvest. Gains in demand were also seen for developing countries including Brazil, Egypt, Pakistan and Algeria.

Against the grain, Chinese consumption continued a long term decline borne of its gradual shift from cereal to meat-based diets, shedding 2.5m tonnes. Chinese demand in the coming year is forecast at just 101m tonnes - almost 8m less than four years ago.

### ***Consumption growth slows, trade flattens***

As so much of last year's huge crop increase was used within countries of origin, world wheat trade only increased by about 5m tonnes in 2004/05 and at 110m, was still below the peaks (113m) reached at the start of the new millenium.

The main growth area for imports in 2004/05 was China, whose own crop fell 11m tonnes behind consumption, boosting trade to a multi-year high of 7m tonnes - the highest since 1995/96, when it took 12.5m tonnes. This was warmly welcomed by major wheat exporters including Canada,

Australia and the USA, who supplied 2.3m, 1.9m and 1.8m tonnes respectively. For the new season, however, China looks a much quieter market with USDA predicting exports will drop back to 4m tonnes, partly enabled by a slightly larger domestic harvest and partly by drawing on stocks.

Another bonanza for exporters was provided by Pakistan emerging from several years of near self-sufficiency to import 1.6m tonnes of wheat to rebuild its low stocks. Egypt, Iraq and other Near East markets also raised imports for food use and S Korea for feed.

Prospects for wheat trade in 2005/06 are fairly stable overall. Smaller Chinese needs will be only partially offset by larger requirements from the Maghreb countries of North Africa, where drought has reduced local crops this year.

Overall, world value for good/middle grade breadwheats have been cheaper this season than last, thanks in no small part to last year's huge EU and FSU wheat crops. As the charts show, the hard milling wheats have been firmer and as recently as July 2005, were still running at premiums of 20-25% over the same time last year, mainly in reflection of disappointing quality from the 2004 North American crops.

### ***A fairly stable price outlook?***

The Chicago (soft red winter) wheat futures market currently suggests wheat prices may be about 12% dearer this time next year - i.e. in the early months of the 200/07 season at some \$3.70/bushel (about \$136/tonne). This time last year, the forecast was close to \$3.50/bu, which was just a little on the high side.

Given the relatively comfortable wheat supply for 2005/06, much slower growth in consumption and no prospective growth in world trade, there seems little reason at this stage for much upward pressure on prices. But there are one or two caveats. In the feed sector, wheat use is rising quite sharply as a replacement for smaller maize and barley crops. Until the US maize harvest is safely gathered and counted, the possibility remains that more demand could shift toward feedwheat, supporting prices at higher levels. Milling wheat quality is also an unknown at this stage with millers hoping that countries like Canada will turn around last year's poor performance and take the upward pressure out of hard wheat and protein premiums. There is also a possibility that countries like China or India could surprise the market with larger purchases than those signalled above. Also, events in the 2005/06 season will begin to be influenced in a few months time by the autumn sowing progress in the Northern Hemisphere. Will the weather be favourable and will farmers see an incentive to maintain or increase area for harvest 2006? With world wheat stock/use ratios at their second lowest level on record - any further increase in demand (which has trended up most of the past thirty years) will require a larger crop in 2006/07 to avoid pushing wheat prices sharply higher.