World wheat and barley outlook

White B.

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B. WHITE
DIRECTOR OF MARKET ANALYSIS
THE CANADIAN WHEAT BOARD

SUMMARY - The author begins describing the 1995-96 period in the world and the forecast for the 1996-97 period for barley and wheat. He explains the functions of the Canadian Wheat Board and the changes introduced in the production system in Canada. He also describes the activities of the United States and Canada in the world market of wheat, firstly, and barley, secondly, specially mentioning the exportations of these countries. Finally, he predicts the situation of the world market for the 1996-97 period.

Key words: Wheat, barley, world market, forecast, export.

RESUME - *"Perspective mondiale sur le blé et l'orge". L'auteur commence en décrivant la période 1995-96 dans le monde et les prévisions pour la période 1996-97 pour l'orge et le blé. Il explique les fonctions du Canadian Wheat Board et les changements introduits dans le système de production du Canada. Il décrit également le rôle des Etats-Unis et du Canada dans le marché mondial du blé, en premier lieu, et de l'orge, en deuxième lieu, en mentionnant spécialement les exportations de ces pays. Finalement, il présente les prédictions concernant la situation du marché mondial pour la période 1996-97.*

Mots-clés : *Blé, orge, marché mondial, prévision, exportations.*

Introduction

The 1995-96 crop year[1] marks a watershed year in world grain markets and for Canadian grain farmers. After ten difficult years of heavy wheat and barley export-subsidisation by the US and the European Union (EU) in the international wheat markets, the Canadian Wheat Board (CWB) as a grain marketer and Canadian wheat and barley farmers are finally living once again in the world in which they always want to live: a world in which prices are determined not by arbitrary foreign government intervention in the market but by the fundamental law of supply and demand.

Due to successive years of below-average wheat crops and strong demand, the burdensome wheat stocks built up in the late 1980's and early 1990's have now been eroded to critically low levels. For most of 1995-96 world wheat prices have been well above those of previous years. In this environment of short supply and high prices export subsidies have become indefensible as public policy in the current year in both the US and the EU, and so most wheat is trading at what we call "full commercial" (i.e., non-export-subsidised) price levels. Because of critically low carryin stocks for 1996-97 and projections for only a modest recovery in world wheat production, we are not expecting prices to drop off dramatically from current levels in 1996-97 -- if they drop at all. The 1996-97 year will be one in which global weather, much more than in recent history, will ultimately determine price levels. It will take more than an average wheat crop to rebuild wheat ending stocks to the point where prices would have to return to the low levels seen just a few years ago.

Many of the same factors hold true for the barley market. Barley prices are influenced overwhelmingly by coarse grain prices. Just as burdensome stocks in the wheat market have disappeared, so have those in the coarse grain market, and this has had a similar effect on prices. The drop in US corn production last year has acted to significantly buoy prices. This, in addition to low carryin stocks in the four major barley exporting countries (Australia, Canada, the EU, and the US), has led to a significant increase in barley prices.

[1]In discussing the world situation I will be using the international wheat crop year, i.e., July-June. In discussing Canada, I will be using our crop year, i.e., August-July.

The Canadian Wheat Board (CWB) - main function

The main job of the CWB is to maximise farmer returns. The CWB is the farmer's marketing partner, and as such, it works to maximise returns in two ways. The first way is single-desk selling, and the second is price pooling. By having only one seller of Canadian wheat and barley for export, the farmer has extended his market power. Working together as one, Canadian farmers are able to take the power of numbers out into the world market and get the best price for their grain, and at the same time, compete effectively with other large suppliers. This is the essence of single-desk selling.

The world market price fluctuates from day to day, even hour to hour. By taking the returns from all grain sales over the marketing year and pooling them together, Canadian farmers are able to reduce their risk. The CWB establishes an initial price for grain at the beginning of the year which is the same for all farmers for the same grade of grain. The initial price does not fluctuate throughout the year, but can go up if prices move higher. At the end of the year, the CWB pools the returns on the same grades of grain and returns all the monies, less operating expenses, to the farmer. All farmers delivering the same grade of wheat or barley receive the same final return.

The CWB's basic marketing strategy is to compare returns available in all markets, then plan sales to those markets that, over the long term, offer the best value. Naturally, this approach must take into consideration the development and maintenance of long-term relationships with customers. Subsidised competition from the US and the EU results in lower prices. Canadian farmers are not insulated from low market prices by large government support programs or taxpayer funded direct export subsidies. Western Canadian farmers, through the CWB pool accounts, bear the brunt of price discounting practices in the form of lower income. This can have important production-decreasing effects.

The Canadian situation: the change in incentives

An important change in transportation costs will significantly influence the movement of grain out of Western Canada, and this has special significance for the export of feedgrains. The Western Grain Transportation Act (WGTA) provided a subsidy to western grain farmers for the transportation of domestic or export grain from the Prairies to the ports of Thunder Bay, Vancouver, Prince Rupert and Churchill. Farmers paid about half of the freight rate while the federal government paid the railways for the other half. This helped to keep their transportation costs down and increased their income. This year, the farmer pays the full freight rate. For example, from the middle of Saskatchewan, the freight rate paid by farmers went from about $Cdn 15 dollars per tonne to about $Cdn 30 dollars per tonne. With the removal of the WGTA, Canada will be in full compliance with its GATT commitments ahead of schedule and in advance of any other country.

Impact

While the loss of the WGTA does not affect how the CWB prices grain to offshore markets, it will reduce farmers' income. Farmers are expected to respond by changing their production patterns to higher-valued grains and special crops and by increasing livestock production. This would allow farmers to maintain their income levels despite higher transportation costs. This will have a significant effect on barley production and exports, as feed barley has been affect more than wheat and malting barley. Most feed barley is expected, over time, to remain in Canada and be fed there.

1995-96 world wheat situation

The world wheat situation in 1995-96 is characterised by a few key factors which make 1995-96 stand out among other years in recent history. World wheat stocks are projected at their lowest level in twenty years. The projection for strong wheat consumption also implies the lowest world wheat stocks-to-use ratio on record. Export subsidies have not been a factor in the market since the US stopped awarding export subsidies on wheat in July 1995, while the EU actually began taxing wheat exports in December. Demand among the world's developing-country markets has remained reasonably strong despite the higher prices.

For the past five years, including the current year (1995-96), the world wheat market has basically been living on borrowed time. By that we mean that world wheat users have been relying on wheat stocks carried over from previous years in order to meet their needs. In four of the last five years world wheat use has significantly exceeded production. From a supply side perspective, this was in large part due to acreage and production shifts out of wheat and into other non-export-subsidised commodities in the major wheat-exporting countries where farmers were not insulated from low prices, especially Canada. In the last two years the difference between world wheat use and production has been dramatic, with demand exceeding production by 23 million metric tonnes (MMT) and 13 MMT respectively. In total, this reduction in wheat stocks has pulled projected 1995-96 wheat ending stocks down by 36 MMT since 1993-94 and a total of 53 MMT since 1992-93.

World wheat ending stocks in 1995-96 are projected at 90 MMT. This is the lowest level since 1975-76 and only the second time since then that ending stocks have fallen below 100 MMT. With world wheat use projected at 545 MMT this year, the ratio of ending stocks to current year's wheat consumption (commonly called the "stocks-to-use ratio") is projected at only 16.5%. This is the lowest in known history. To put the tightness of this situation into perspective, these forecasts imply that at current rates of consumption there will only be enough wheat in the world to satisfy 60 days' worth of consumption at the end of 1995-96. These extremely tight stock levels are making world buyers very nervous about the ability to cover future needs, which has led to substantially higher prices. Historically, there is a strong relationship between expected world wheat ending stocks and prices in any one year. Export subsidies also tend to be reduced when world wheat stocks are tight and prices therefore high, but even in 1988-89 US EEP subsidies never stopped completely as they have in 1995-96.

World wheat trade in 1995-96 is projected at 96 MMT, up only slightly from 95 MMT in 1994-95. Overall, world wheat trade has been relatively flat, averaging 97 MMT since first climbing over 90 MMT in 1980-81. However, underlying this period of apparent stability in world wheat imports has been a steep decline in imports by the Former Soviet Union (FSU), a decline which when looked at as an average over this period amounted to nearly 900,000 MT per year. This has special significance for feed wheat exports, as wheat feeding has decreased significantly in the FSU. Fortunately for Canada, the reduction in FSU imports has been offset by the early adoption by the CWB of a strategy of diversifying markets to capture the growth in wheat imports by other areas of the world, notably South East Asia and South America. While the break-up of the Soviet Union and consequent decline in FSU wheat imports has been bearish for world wheat prices over the first half of the 1990's, this phenomenon has been masking the fundamental growth in wheat demand which has been occurring in other parts of the world. Once FSU imports recover, or at least stabilise, the slow steady growth in wheat import demand from the rest of the world will begin to be fully reflected in world trade figures.

Probably the most positive development in the wheat market for Canadian farmers in 1995-96 has been the de facto suspension of wheat export subsidies by the US and the EU. In the past most of the wheat import markets which I just discussed were heavy recipients of EU and US Export Enhancement Program (EEP) subsidies, with the exception of Japan and Brazil. This meant that in years past, the CWB had to compete with these exporters' export subsidies in order to make wheat sales into these and other markets.

In 1994-95 EEP wheat subsidies averaged $23/MT on 18.1 MMT of world wheat trade (August-July basis). So far in 1995-96, the US has not used EEP on any export sales of wheat as grain, although there were some small awards of EEP export subsidies on wheat flour in August 1995.

The EU has also suspended its export subsidies. Beginning in September 1995, the EU suspended its weekly wheat export tender process, and it has since done something which would have been unthinkable a year ago: it has instituted a variable tax on wheat exports! EU wheat export taxes recently reached US$23/MT, as compared to wheat export subsidies of US$46/MT one year ago!

The reasons behind the EU's about-face in the wheat export game are successive smaller EU wheat crops and increased domestic use. These two factors together have substantially reduced EU grain stocks and forced the EU to take action to limit its wheat exports. EU 1995-96 wheat ending stocks are projected at just over 10 MMT, which would be the smallest since 1983-84, down from a peak of 24 MMT in 1991-92 and 1993-94. More dramatically, EU wheat intervention stocks are projected to fall to 2.0 MMT at the end of 1995-96, from a record 18.4 MMT at the end of 1992-93. The need to safeguard wheat supplies for the EU domestic market has forced the EU to limit its wheat exports, which are projected at about 14.5 MMT in 1995-96, down from 17.5 MMT last year and 23 MMT as recently as 1992-93.

In total, combined wheat ending stocks of the five major wheat exporters in 1995-96 are expected to fall below 30 MMT (35 MMT last year), which is the lowest level since 1973-74. Moreover, US wheat ending stocks - very important because of their influence on the US futures and cash markets -- are projected at a very tight 9.4 MMT, down from 13.8 MMT in 1994-95 and the lowest since 1973-74.

World wheat prices have shown a dramatic increase in 1995-96. Due to the reversal in EU export policy, the EU export price for soft wheat has increased from a monthly average of $121/MT FOB France in May 1995 to an average US$221/MT in January 1996. The reduction in EU wheat exports has pushed a lot of demand to the US, with the benchmark price of Hard Red Winter (HRW) Ordinary (ordinary means no guarantee on protein content) wheat at the US Gulf remaining above US$200/MT FOB since October 2, 1995, and currently trading at US$218/MT. Last year at this time, HRW Ordinary was trading at about US$156/MT at full commercial price levels, and some markets were receiving EEP export subsidies averaging about US$15/MT so the EEP price for HRW Ordinary was around US$140.

What will happen to wheat prices in the balance of the 1995-96 marketing year? With such tight projected world wheat ending stocks, the winter wheat crop in the US in such poor shape, and the North American spring wheat crop not yet in the ground, this is a tough call. US old-crop winter wheat prices (i.e., prices based off the March and May futures months) are going to be volatile because of the condition of the crop and the projected low US wheat ending stocks. HRW Ordinary FOB Gulf will likely trade in around US$215-225/MT through March. After that it may back off, particularly if the US winter wheat crop has not deteriorated any further, the North American spring wheat crop is off to a good start, and relatively good global crop conditions elsewhere remain so. French soft wheat will likely trade in a range of US$210-$220/MT through March, then also back off thereafter. There's still some potential upward movement in new-crop US and European winter wheat prices between now and July, however, depending on what happens with the North American wheat crops.

Canadian wheat production

Canadian wheat production has been on an upward trend since the 1970's. Since 1991, as a result of low world prices made even lower by subsidies, there has been a significant downward shift in Canadian production. The low price of wheat has forced farmers to shift into the production of higher valued crops such as canola.

Poor weather determines whether Canada has feed wheat to export. The Canadian system of varietal and quality control is one which promotes the production of high quality milling wheat for human consumption. In 1992, Western Canada produced approximately 28.4 million tonnes of wheat, 39% of which fell into the feed category. This was unprecedented, as during the previous five years, feed only accounted for an average of 5% of production. In 1993, cold growing conditions resulted in yet another lower quality crop, but only 23% of production that year fell into the feed category. By 1994, Western Canadian production had returned to its normal quality parameters, with only 6% of production classified as feed. In a normal year, Canada has very little feed wheat to export.

1995-96 Canadian total wheat situation

Wheat prices started to rise significantly in July 1994. As a result, Canadian farmers had planned to plant more wheat last spring. Unfortunately, due to a rainy planting season, many farmers were unable to get out into their fields in time to seed as much as they intended to. During the summer, a lack of rain forced many farmers to plow under their wheat crop, further depressing production. As a result, Canadian wheat production in 1995 was 25.4 MMT, up 10% from 1994. However, due to relatively low carryin stocks for 1995-96, overall wheat supplies are down by 9% to 31.1 MMT. This is the lowest level of Canadian wheat supplies since 1989-90. Domestic use is projected at 8.2 MMT based Statistics Canada's December 31, 1995 stocks estimate, which suggests that domestic use in the first five months of 1995-96 was 10% higher than in 1994-95. Subtracting the domestic consumption leaves just under 23 MMT of wheat available either to export or to carry over into 1996-97. At this point, we are forecasting Canadian wheat exports will end up at 17.3 MMT (also the smallest since 1989-90), which is off 17% from 1994-95. Canadian wheat ending stocks on July 31, 1996, are projected at 5.6 MMT, which is down slightly from 5.7 MMT in 94/95 and the lowest since 5.1 MMT in 1988-89. Only 8% of production qualified as feed in 1995.

Canadian exports

From the late 1960's until the mid-1980's, Canadian wheat exports showed a steady, upward trend. Over the past five years, Canada has exported an average of about 21 million tonnes. Large, but steadily dwindling Canadian carry-over stocks, have allowed Canada's export program to stay at average levels, even with steadily decreasing production. The CWB achieved exports last year of 21 million tonnes. This was possible with production at only 23.4 million tonnes at the cost of a 50% draw-down in carry-out stocks. Carry-out went from 11 million tonnes in 1993/94, to only 6 million tonnes last year. Western Canada is close to what is considered a minimum carry-out level. This will permit exports of no more than 17.5 million tonnes in 1995/96. Carry-out levels will likely remain precariously low this year as well.

Total Canadian wheat exports between August 1995 and January 1996, are at 6.7 MMT down about 2.8 MMT from the same period last year. So far this year Canada has shipped wheat to 42 different countries, with the top five destinations being China, Japan, Brazil, the United States, and Algeria. Our major export markets are now in the Far East and the changes in transportation costs have shifted the supply of exportable wheat and barley west.

Canadian barley production

Canada produced 13 MMT of barley in 1995, up from 12.7 MMT the previous year, but this increase was offset by very tight carryin stocks. Canadian barley exports are forecast to fall by 700,000 MT, to 2.8 MMT, in the current year due to the low level of stocks and continued high domestic use. At the same time, good crop conditions and strong demand have resulted in a very high malting selection rate, estimated at about 28%. Canada's bulk malting barley exports are forecast at a record 1.5 MMT this year, putting further supply pressure on feed barley supplies.

Canola

Canola is the name used to describe cultivars of rapeseed that have low levels of erucic acid and aliphatic glucosinolates. It was first released in Canada in 1974. Canola meal is widely accepted in the livestock and poultry feeding industries. Canola is known as the Cinderella crop in Canada, as it allowed Canadian farmers to survive the period of devastatingly low wheat and barley prices of the early 1990's. Area seeded to canola in Canada rose from 2.6 million hectares in 1986 to 5.8 million hectares in 1994. Area seeded to Canola dropped off in 1995, to 5.3 million hectares, primarily in response to high wheat prices. Acreage seeded to canola will likely drop again this year, as wheat prices are expected to remain high.

The average canola price received by farmers in Western Canada grew from Cdn$ 199/MT in 1986/87 to Cdn$ 359/MT in 1994/95. The average nearby canola futures price at the Winnipeg Commodity Exchange has ranged between Cdn$ 406.90/MT to Cdn$ 427.00/MT since August 1995. Even though the market is sending out strong price signals to canola producers, production will likely fall due to the high price of wheat and other agronomic concerns specific to canola production.

1996-97 world wheat outlook

There is an old saying in the grain industry: "Nothing cures high prices like high prices." The record international wheat prices seen in 1995-96 will encourage an increase in wheat acreage and inputs, which at this stage has to be expected to lead to increased wheat production in 1996-97. However, wheat will likely face some tough competition for acreage and inputs in Canada and elsewhere from other grains and oilseeds. World coarse grain stocks are also projected at their lowest levels in twenty years, while any significant anticipated reduction in oilseeds or special crops area in Western Canada will lead to higher forward prices for these crops given the strong demand base which has built up for them in the past few years.

The first indication of the response in wheat area to these higher prices was revealed in the EU and US winter wheat plantings for the 1996 crop. EU and US winter wheat acreage are each estimated about 7% higher than for the 1995 crop. However, early in its development the US winter wheat crop is in very poor condition and has undoubtedly suffered from some winterkill damage. We will not know the full extent of that damage until the crop emerges from dormancy in March. Potential problems with the US HRW wheat crop have pushed the July Kansas City wheat futures to prices approaching US$5.00/bu and made buyers very nervous about the availability of HRW wheat supplies in 1996-97.

Given the tight world wheat stocks, we are facing at this moment an even more acute "weather market" than the one we faced at this time last year, in that any significant production problem in a key wheat-growing area of the world would lead to a further reduction in expected wheat ending stocks for 1996-97, and this could well touch off an explosion in wheat prices. This is particularly true for milling (i.e., non-durum) wheat prices. Even with a normal crop, world wheat ending stocks are not expected to recover enough to give world wheat users a buffer of stocks that could make them again feel comfortable about supply.

The tight world wheat supply situation leaves no reason whatsoever for the US or the EU to resume export subsidies in 1996-97 -- not that there is ever a reason to have export subsidies. Strong world wheat import demand in 1995-96, despite the higher world prices and an absence of export subsidies, has to be taken by the US and EU as a clear signal that export subsidies are not necessary to maintain wheat exports, and instead simply depress on-farm returns in the rest of the world and create wheat production and trade distortions. The principal reason wheat farmers outside of the EU and the US have reduced their acreage of wheat by nearly 10% over the last fifteen years is the depressing impact which wheat export subsidies have had on their farmgate returns.

With ending stocks in 1996-97 expected to remain nearly as tight as in 1995-96, we are projecting somewhat lower but still good returns for milling wheat for Canadian farmers again in 1996-97.

World wheat production in 1996-97 is currently projected at 553 MMT, up from 529 MMT in 1995-96. Based on this level of production supplies would only increase to 643 M MT, only 11 MMT higher than in 1995-96 and 9 MMT below supplies in 1994-95. With this level of supply, wheat demand would have to be rationed (with limited wheat feeding) to about 545 MMT, leaving wheat stocks at the end of June 1997 of 98 MMT, up only 8 MMT from 1995-96. Despite the increase in ending stocks, 1996-97's would still be the second lowest level of ending stocks since 1975-76.

What about international wheat prices in 1996-97? I have already indicated we expect higher world wheat production in 1996-97 -- though not dramatically higher -- which under normal stocks circumstances would indicate at least somewhat lower prices. However, total world wheat supply in 1996-97 at 643 MMT is still going to be very low relative to the past few years, and there's a very strong probability there will be either no US and EU wheat export subsidies, or at best they may only reappear in the last quarter of the crop year. The continued suspension of export subsidies is good news just by itself for wheat farmers in Canada and other non-export-subsidising wheat exporters such as Australia and Argentina. What this all means is that milling wheat prices are going to be quite high in 1996-97, although at this stage of the year we would have to expect them to be somewhat lower than in the current year, which is a banner year in terms of wheat prices. On an annual average basis, however, international milling wheat prices in 1996-97 might be off as little as just a few dollars per tonne from levels in the current year, partly due to much lower price levels at the beginning of the current crop year. If any serious wheat production problems emerge, prices could explode. Another 530 MMT world wheat crop in 1996-97 and we will be into uncharted territory, in which an average HRW Ordinary FOB Gulf price US$10-$25/MT above current levels may not be out of the question.

1996-97 outlook for Canadian wheat

Given the record-high returns for wheat for Canadian farmers in 1995-96, the area sown to wheat in Canada is expected to increase by 10% and recover to 31 million acres in 1996. Wheat acreage in Canada dropped by about 23% from 1991 to 1994, because farmers shifted into other crops mainly in response to low wheat prices caused by the US-EU wheat export subsidy war, and to a lesser extent to two successive years of bad weather and lower grades of wheat on the Prairies. Now that US and EU subsidies are gone and the weather has returned to normal, wheat is once again attractive to many Prairie farmers and acreage is on the rise. The availability of feed wheat and barley for export, however, is expected to be limited.

Based on trend yields of 31 bushels per acre, Canadian wheat production in 1996 is projected at 26.2 million tonnes up about 800,000 MT from 1995-96. Total Canadian wheat supplies would be about 32 MMT, up from 31 MMT in 1994-95, but the second lowest since 1989-90. We are expecting Canadian domestic wheat use to run around 8.0 MMT, slightly down from the current year due to less wheat feeding. At this point, we think Canadian wheat exports could reach 18 MMT in 1996-97. This would put ending stocks at 5.8 MMT, which is up marginally from the projected ending-stock level of the current season but still well below the average Canadian wheat ending-stock level of 11 MMT in the period 1990-94. A level of 5.8 MMT for Canadian wheat ending stocks would be the fourth-lowest in the past twenty-five years; the lowest in this period was the 5-MMT wheat carryout at the end of the disastrous drought year of 1988-89. Five million tonnes is a very low carry-out level in Canada, and history foretells that Canada may be due for another drought year on the Prairies soon, so contemplating a projected carryout of only 5.8 MMT on July 31, 1997, should serve to remind us that the supply of Canadian wheat could potentially still be very tight for the next couple of years at least.

Conclusion

For the 1996-97 world wheat outlook overall, we are forecasting record low carryin stocks, but at this stage of the year we have to expect higher world wheat production and therefore supply than in 1995-96. The stocks situation will remain quite tight at the end of 1996-97 and likely through 1997-98, barring a record world wheat crop. The wheat trade outlook is as unclear as it always is this far ahead of the crop year, so we are pegging it for now at about the same level as in the current year. The somewhat higher world wheat supply, somewhat counter-balanced by the very tight stocks, are what lead us at this time to forecast only slightly lower world wheat prices and pool returns in 1996-97. Two things that could change this scenario and cause wheat prices to explode in the other direction: wheat production problems in one or more of the big producers, and/or the materialisation of unforeseen substantial wheat import demand from an unexpected quarter. The FSU naturally springs to mind here but we should never forget China in this context either.