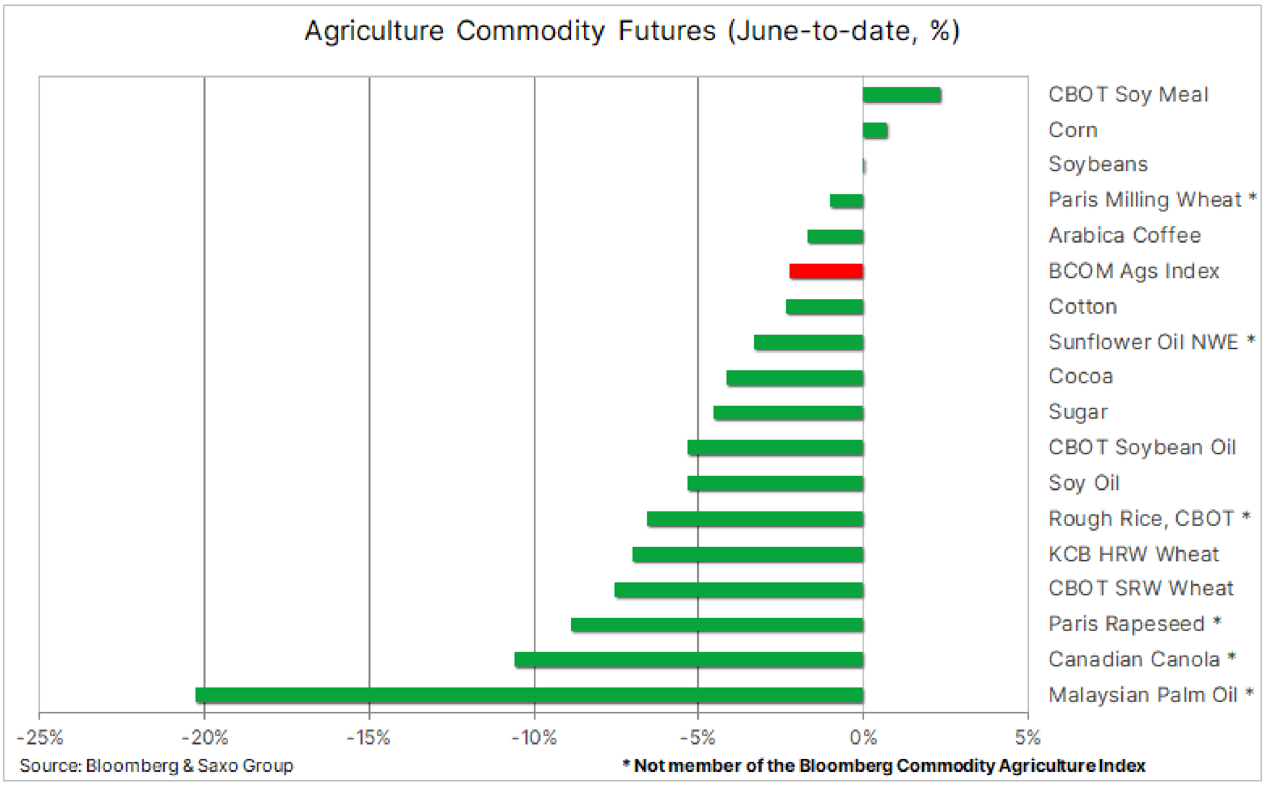
Finally, some good news as food prices ease

By Ole S. Hansen // June 21, 2022

Global food price inflation, currently running at a near 23% on an annual basis according to the FAO, has since peaking in March showed signs of easing. The Global Food Price index compiled monthly by the UN organisation reached a record peak in March after Russia's attack on Ukraine, a key global supplier of high-quality wheat and the biggest exporter of sunflower oil, helped turbocharge prices to levels raising concerns of a global food crisis.

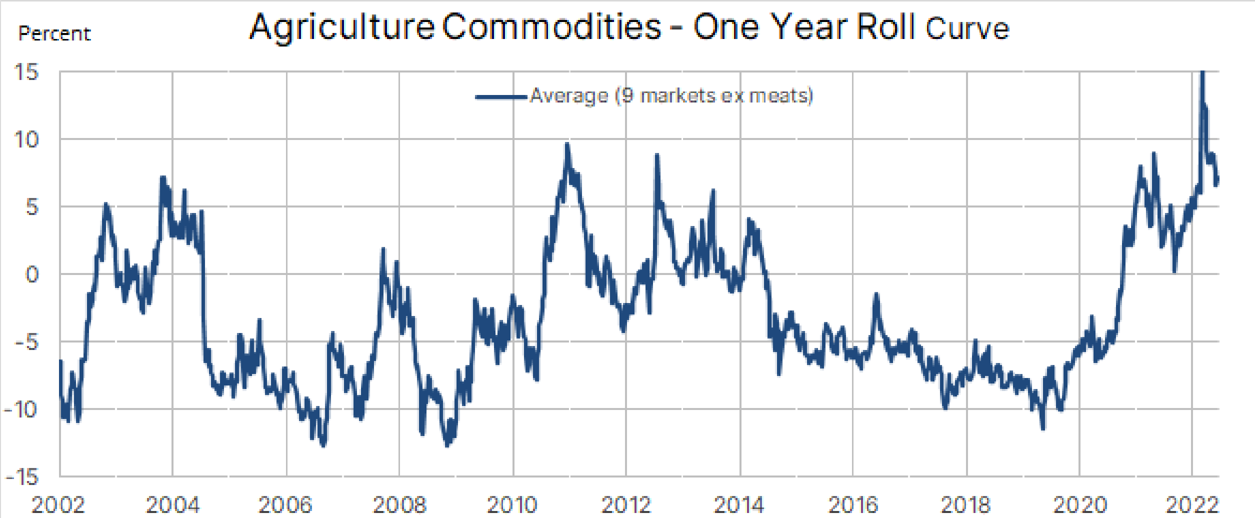
Since then, however, some of the worries have started to ease with palm oil prices suffering a steep decline on the prospect for increased supplies from Indonesia, a major producer who temporarily implemented export restrictions back in March. Winter wheat harvesting in Europe and North America meanwhile have eased some of the supply concerns triggered by lack of Black Sea shipments from Ukraine.

The prospect of sharply lower prices, however, remains doubtful with weather worries still a key focus in countries like India and key growing regions in France. In addition, and important from a food security perspective next winter, negotiations to export Ukrainian grain through a protected corridor in the Black Sea has made little progress, and unless Ukraine can empty its silos before the next albeit much reduced harvest arrives, the prospect of lower-than-expected available supply will linger on.

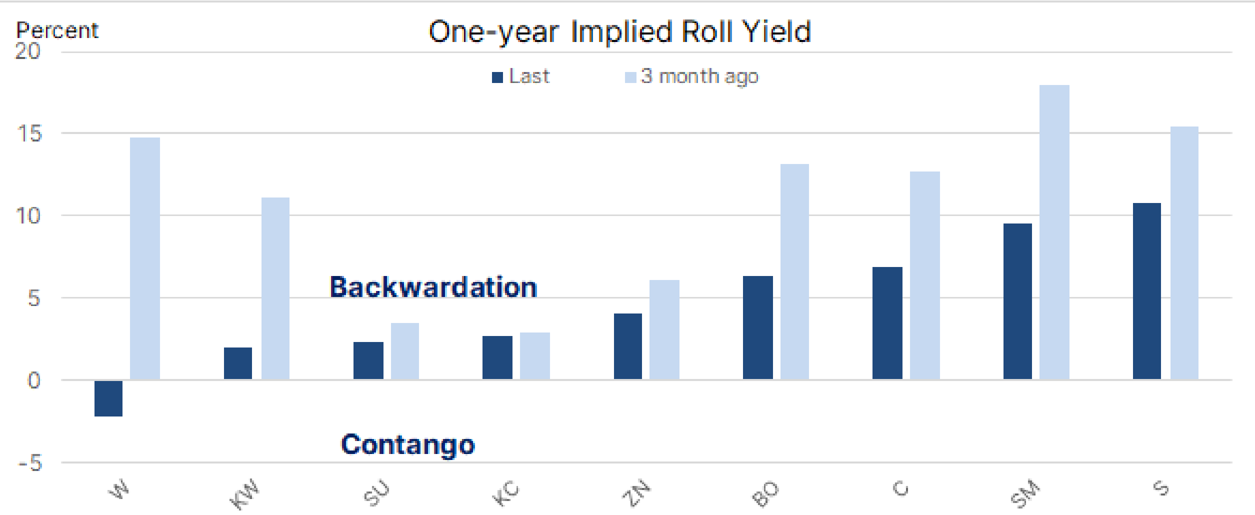


In order to gauge the level of tightness in each market, we often look at the 12-month spread between the spot futures contract and the one expiring one year into the future. The chart below shows very clearly how the agricultural market has changed during the past couple of years. During a six-year period from 2014 the agriculture market witnessed a period of ample supply driven by crop friendly weather and low input costs. During this time, the market was trading in contango meaning spot prices commanded the lowest price relative to deferred.

This benign and calm period was suddenly disrupted in early 2020 when the pandemic led to a temporary breakdown in supply channels. In addition, the weather phenomena of colder than normal temperatures in the region of the equatorial Pacific Ocean, called La Ninã started to create challenging growing conditions, especially in South America, but also the USA and Australia. These price supportive developments were then turbocharged in early 2022 by surging cost of diesel and fertilizers and by Russia's attack on Ukraine, a major global supplier of key food items from wheat and corn to sunflower oil.



Source: Bloomberg, Saxo Group



Source: Bloomberg, Saxo Group

However, the easing conditions since the March peak has seen the CBOT wheat one-year spread from a near 15% backwardation to a small contango. In Europe however, the one year spread in Paris Milling wheat remains elevated at a near 15% backwardation, highlighting current challenges to the European crop outlook and uncertainties about the outlook for new crop supplies from Ukraine this coming autumn.

Managed money accounts, also known as speculators, given how they leverage their positions using futures markets, have been net sellers of the nine food commodity futures tracked in this update since late April, almost one month before prices started to turn lower. Whether it was overbought markets or the temptation to book some profit following a strong run up in prices remains unclear, but from a record 1,112,000 lots representing a nominal value of $51.6 billion on April 22, that figure had dropped to 750,000 lots and $35 billion during the latest reporting week to June 14.

Since April, head and shoulder formations have emerged on CBOT wheat charts, both the current front month of September and the December contract, which best reflects the final availability following this season's harvest. For the recent weakness to stick and extend, the break below necklines at $10.37 in September (last at $10.36) and around $10.48 in December (last at $10.52) needs to be decisively broken.

Source: Saxo Group

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