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Agricultural
Outlook
Forum
2013

Feb. 21-22, 2013

Risk Management and the New Dynamics of Ag Markets

Perspectives from an Exchange, Commercial Participant and Academia

Mike Adams, Moderator

Host, AgriTalk Radio

Bryan Durkin

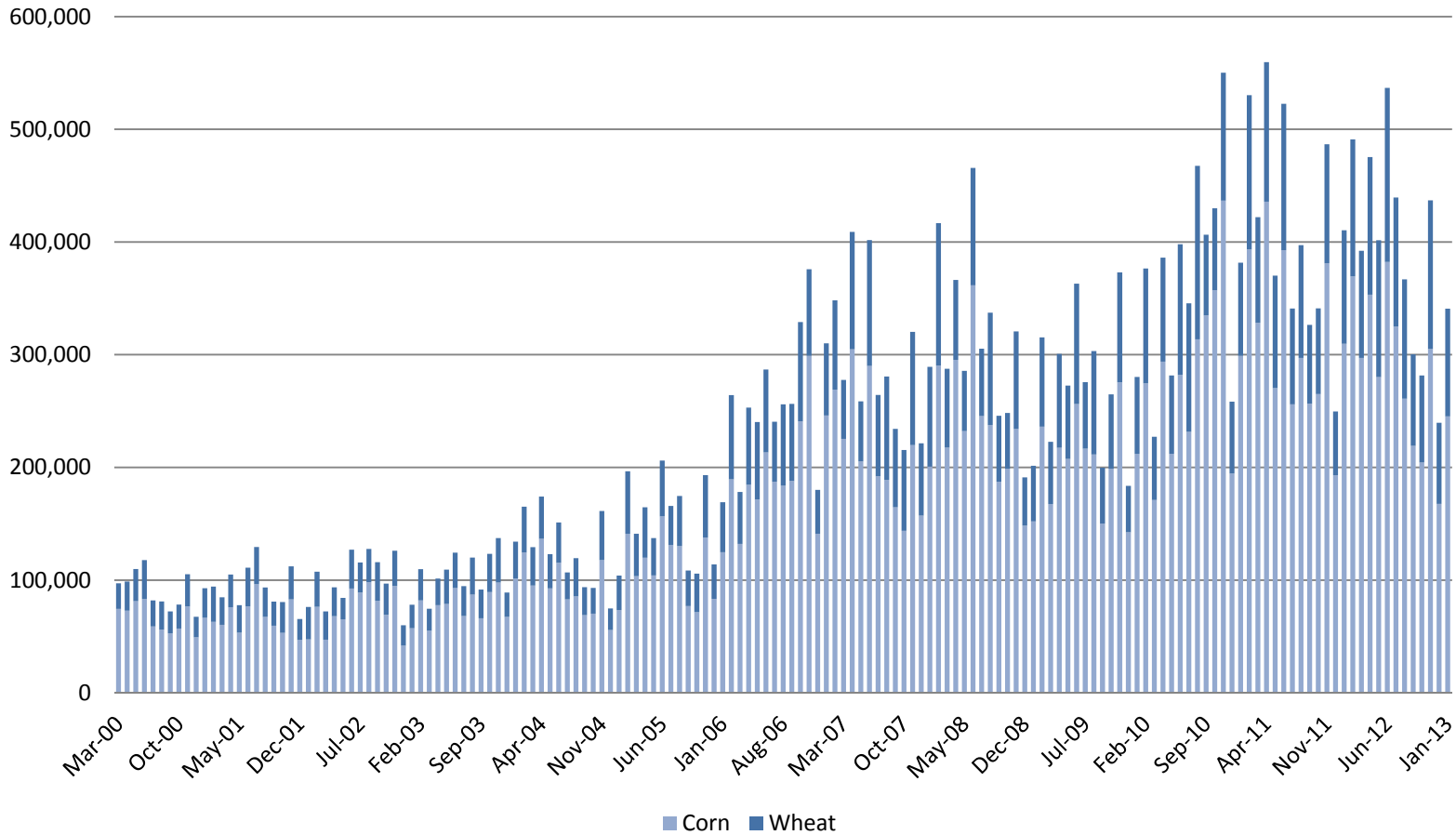
Senior Managing Director &
Chief Operating Officer
CME Group



CME Group

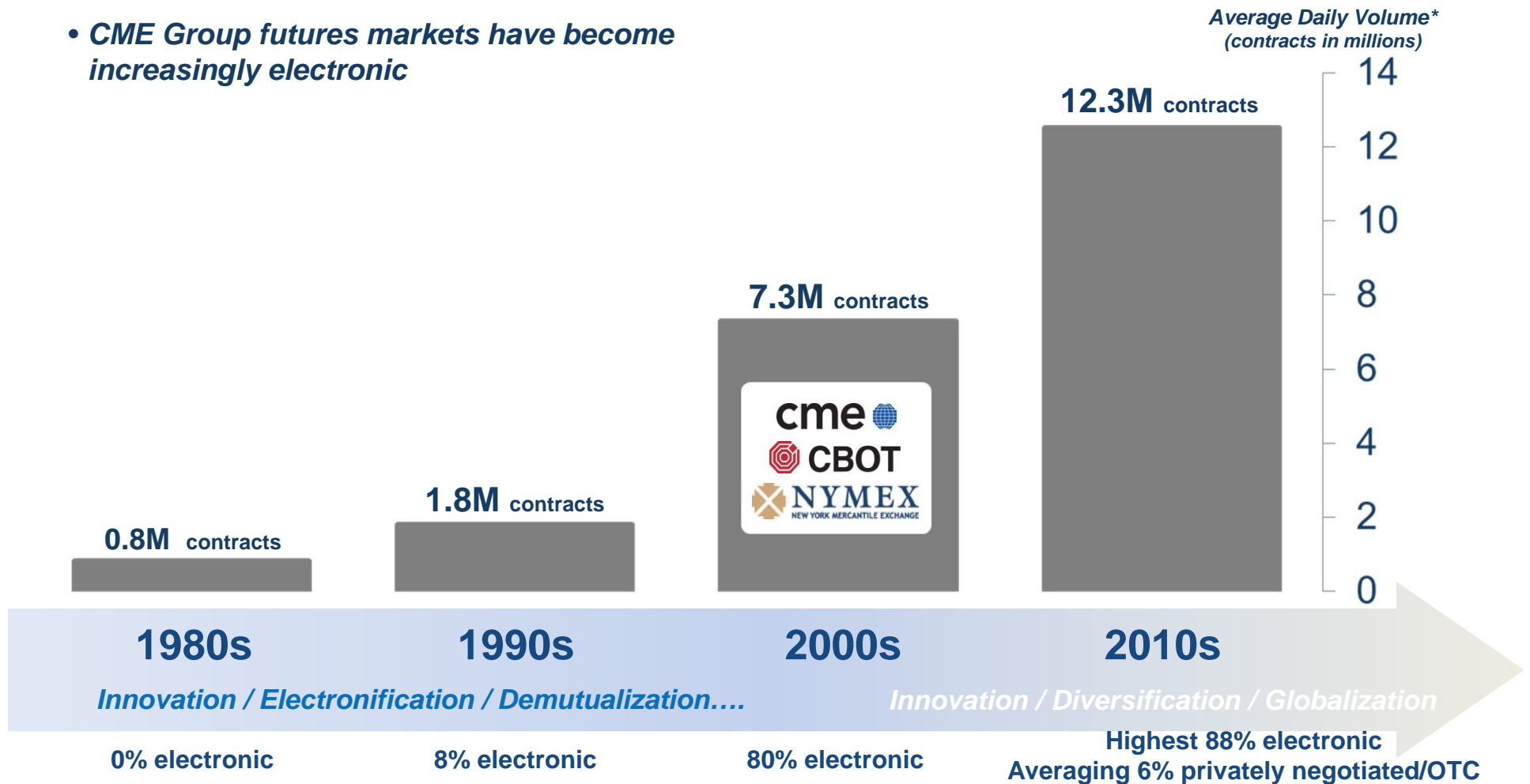
Market Evolution: Increased Use of Ag Commodities

Corn and Wheat Futures - Average Daily Volume
2000-2013



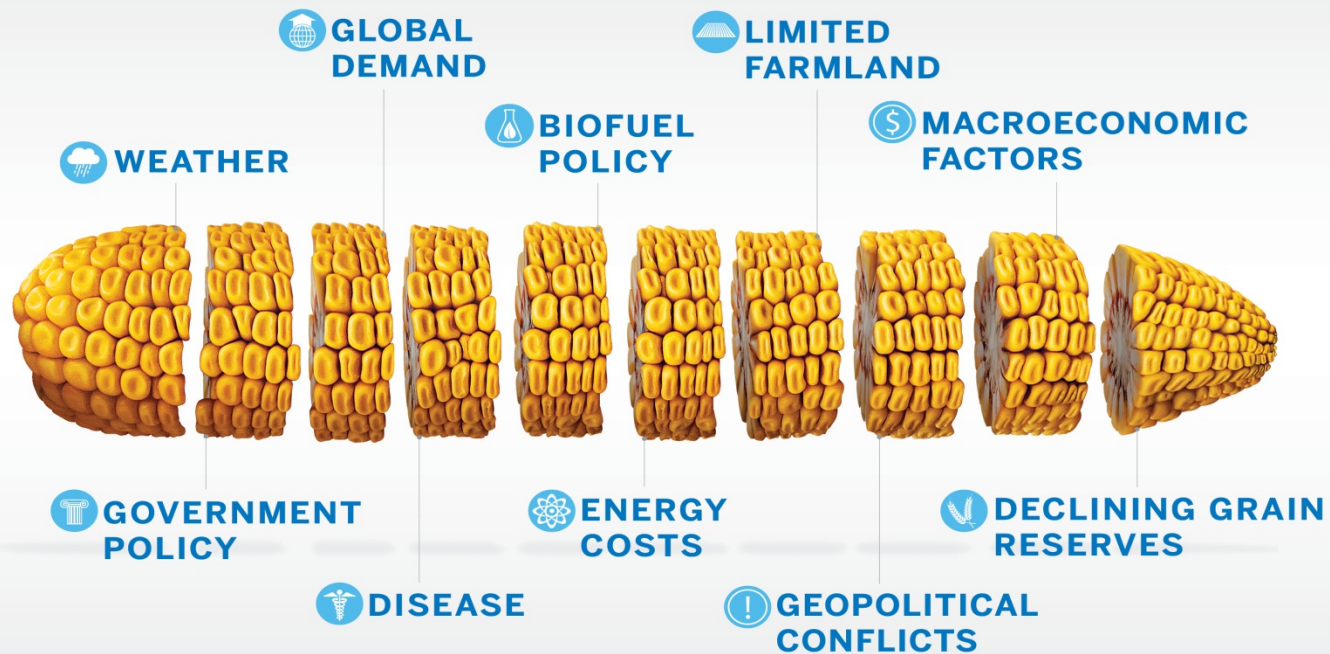
Market Evolution: State of Futures Markets

- *CME Group futures markets have become increasingly electronic*



Market Evolution: Factors Impacting Food Prices

THE FACTS BEHIND FOOD PRICES



Source: CME Group – cmegroup.com/effectivemarkets

www.cmegroup.com/effectivemarkets

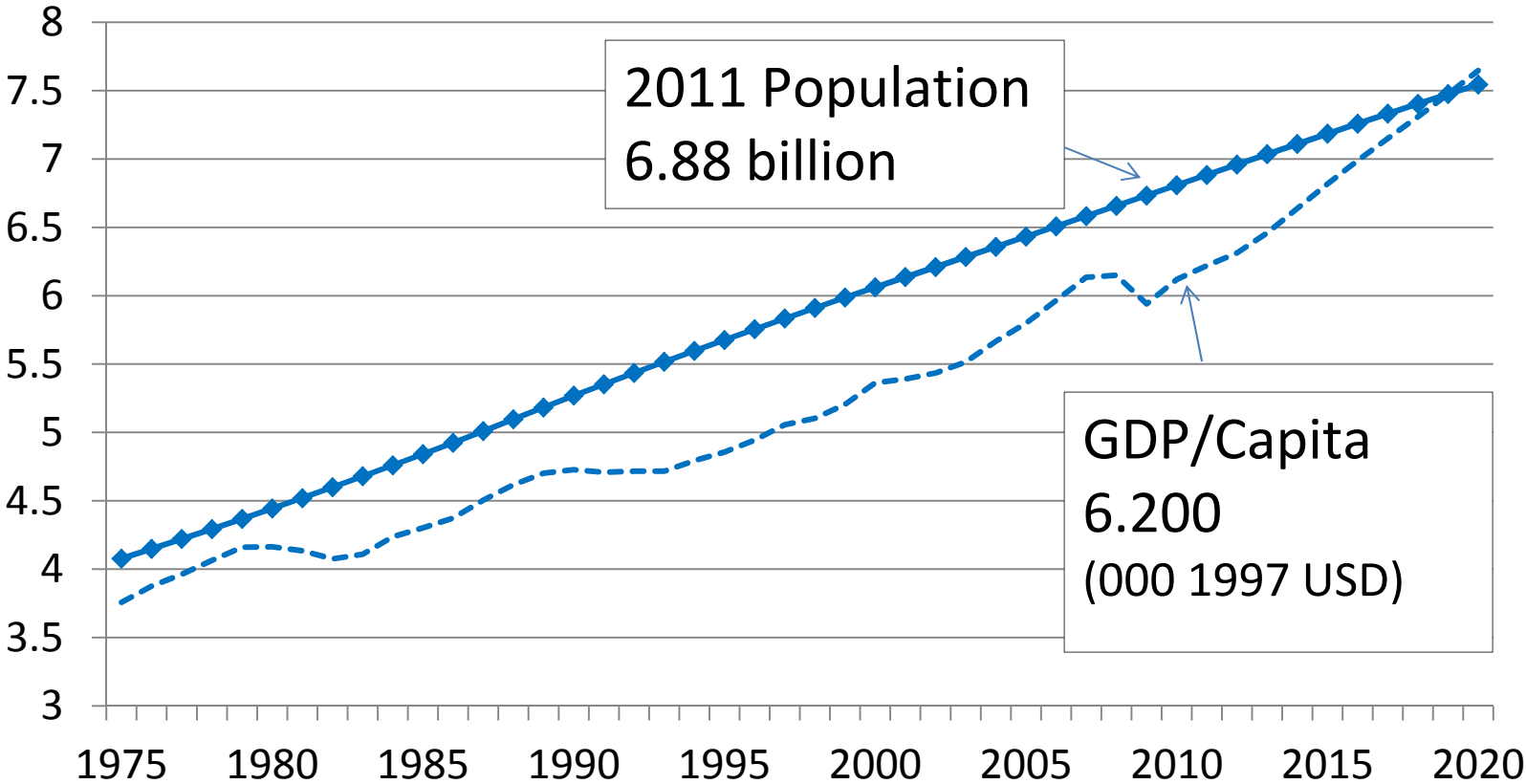
David Baudler

President, Cargill AgHorizons



Demand: Rising world population and standard of living

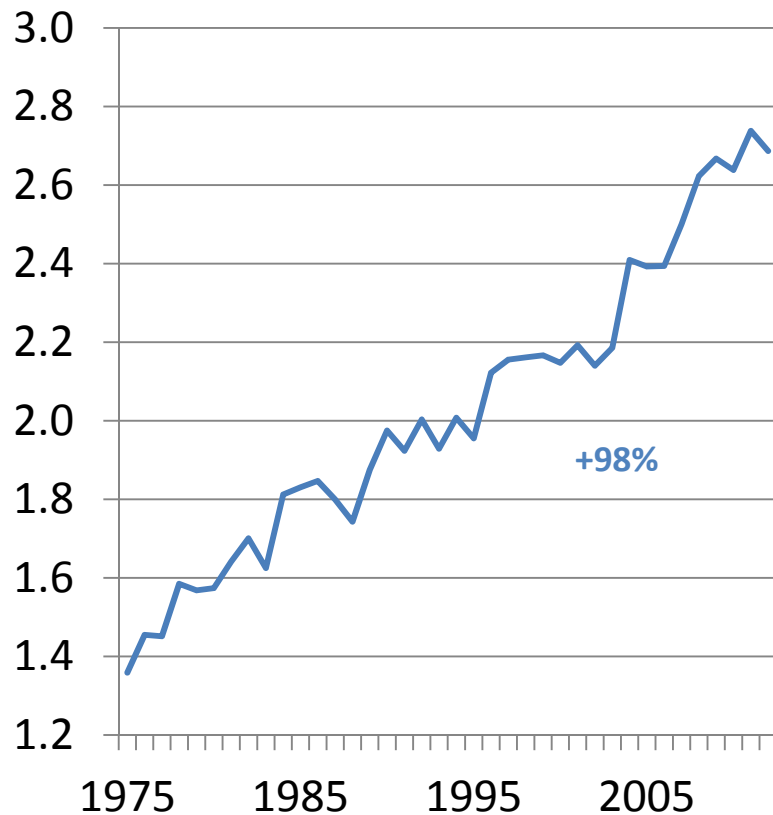
actual and projected



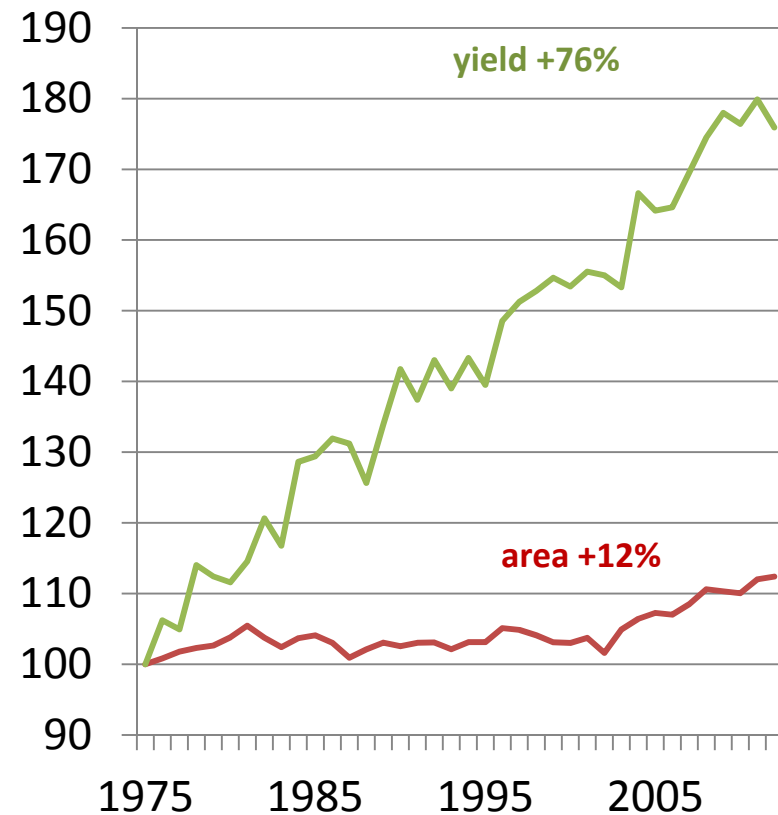
Supply: global food production, area and of yield

(grain, rice, major oilseeds)

production – bil mt

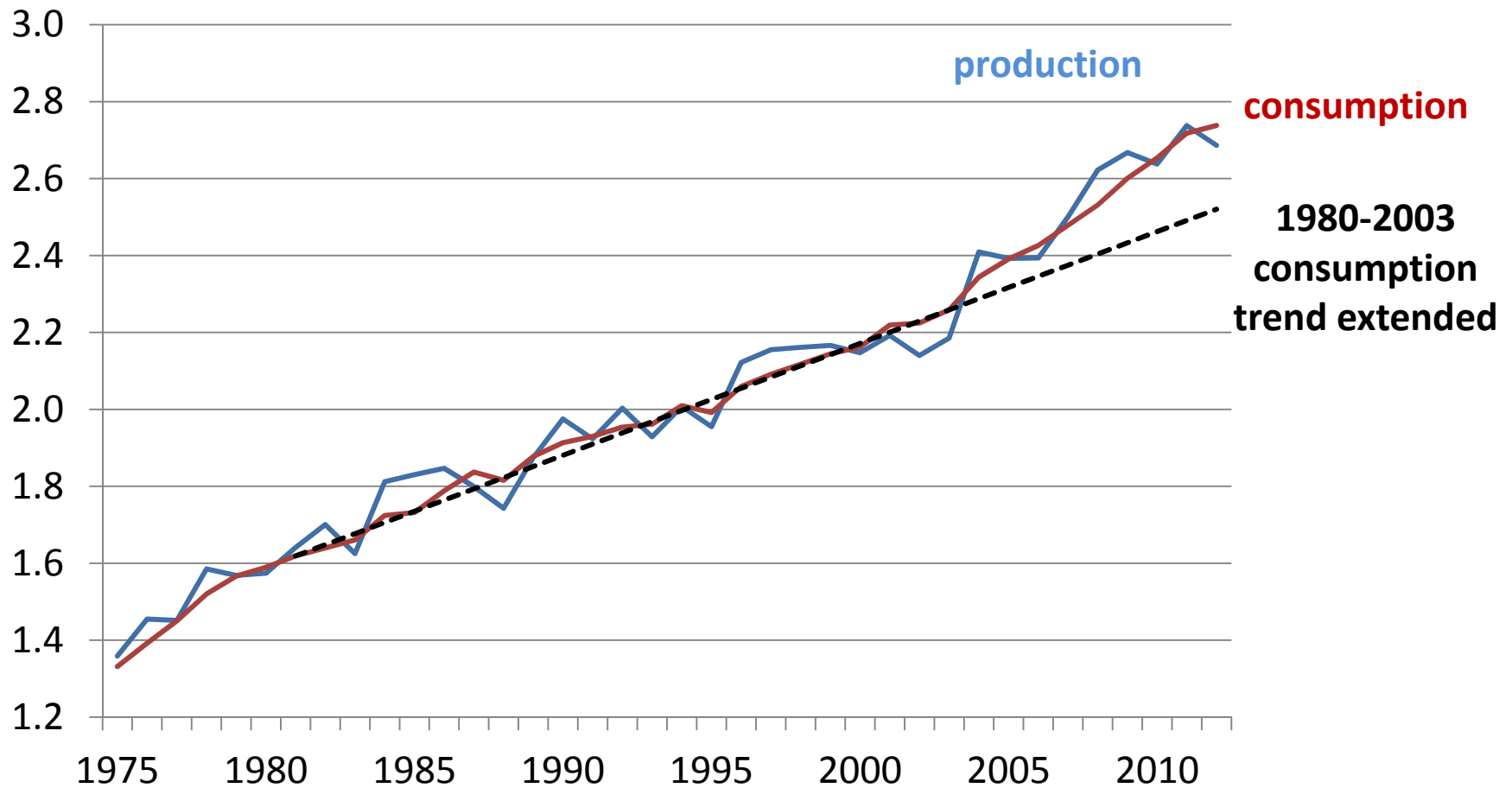


area and yield (1975=100)

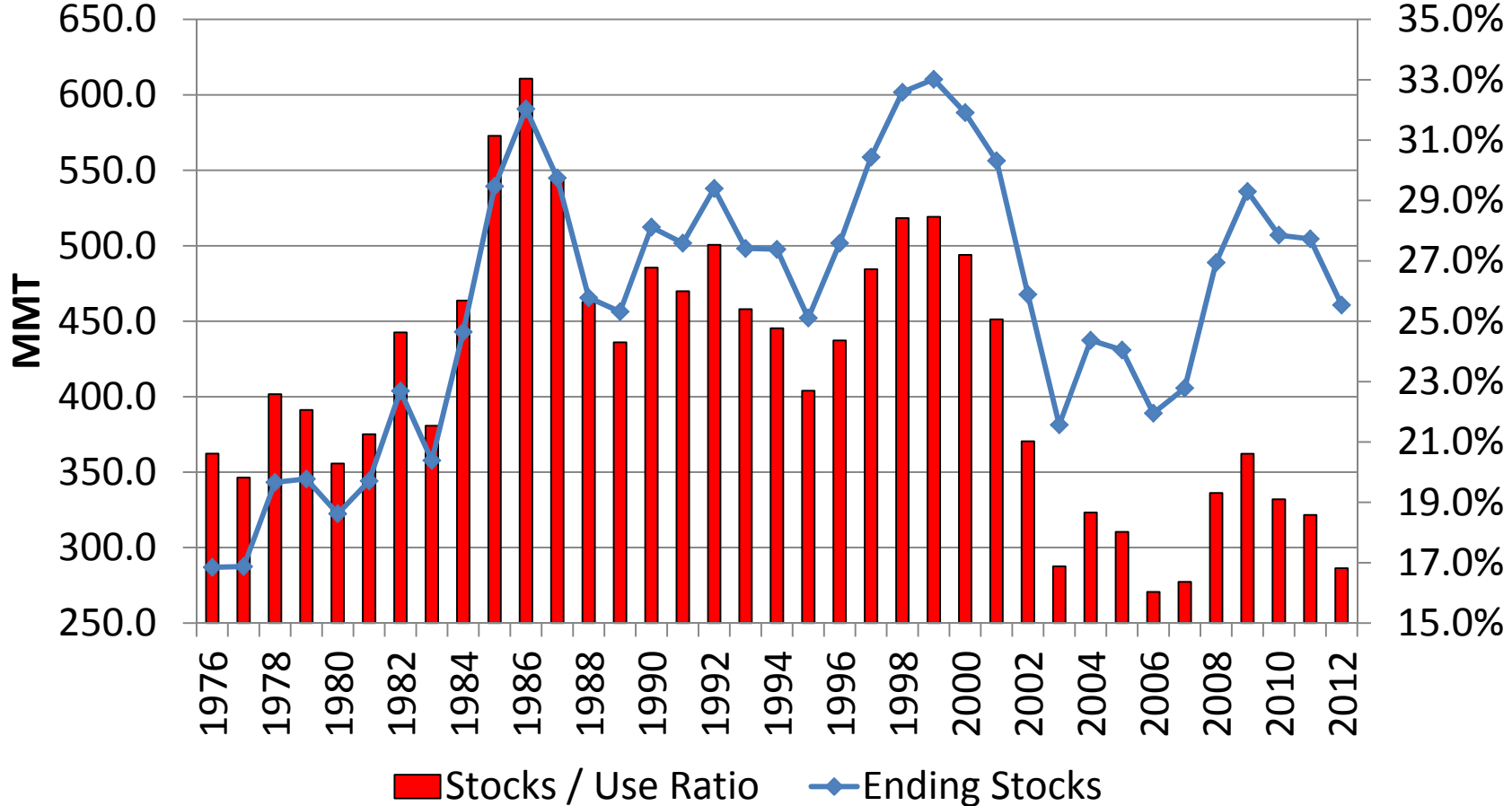


Global food commodity supply / demand

(grain, rice, major oilseeds – bil mt)



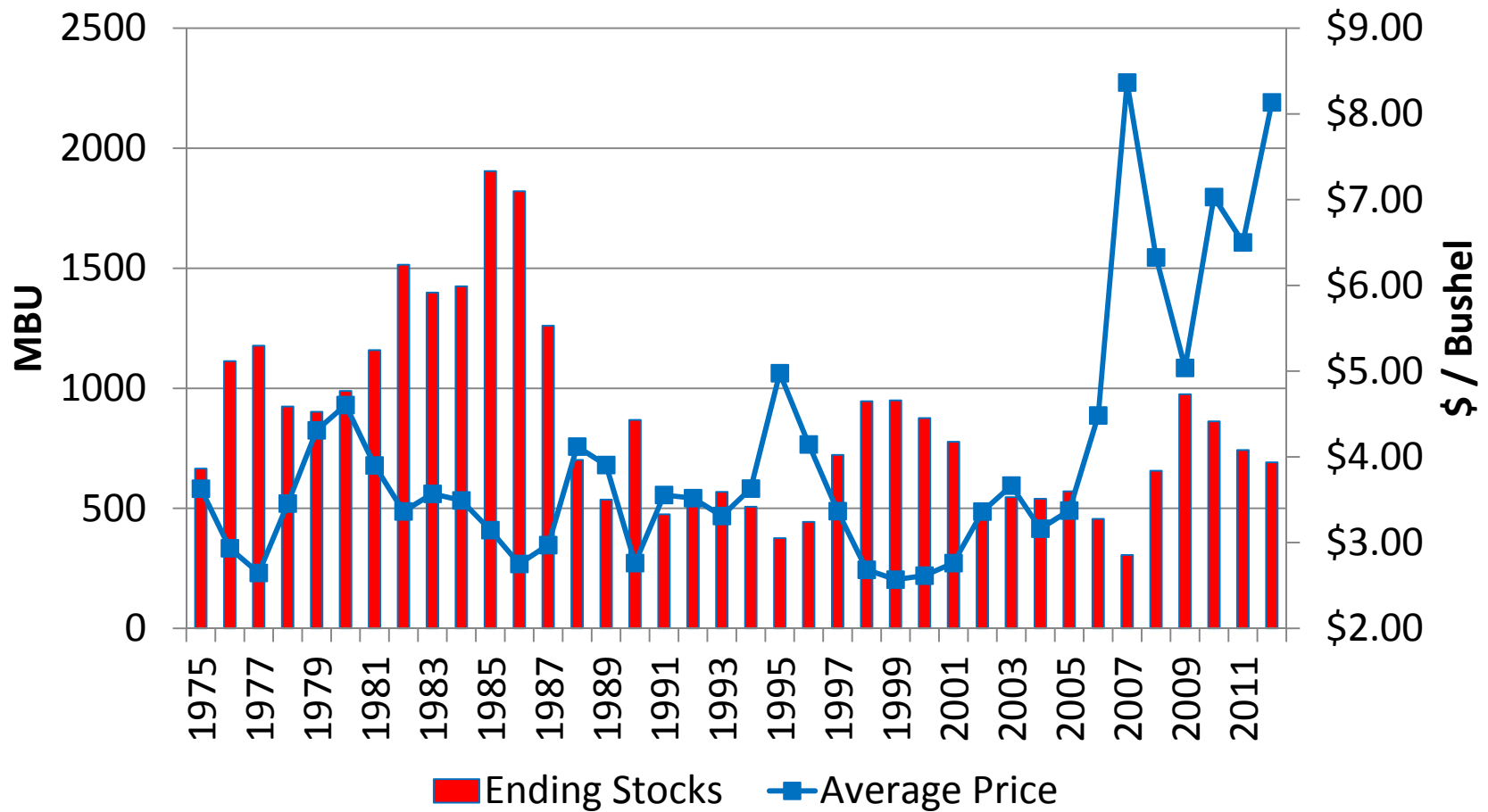
World Stocks



Source: USDA

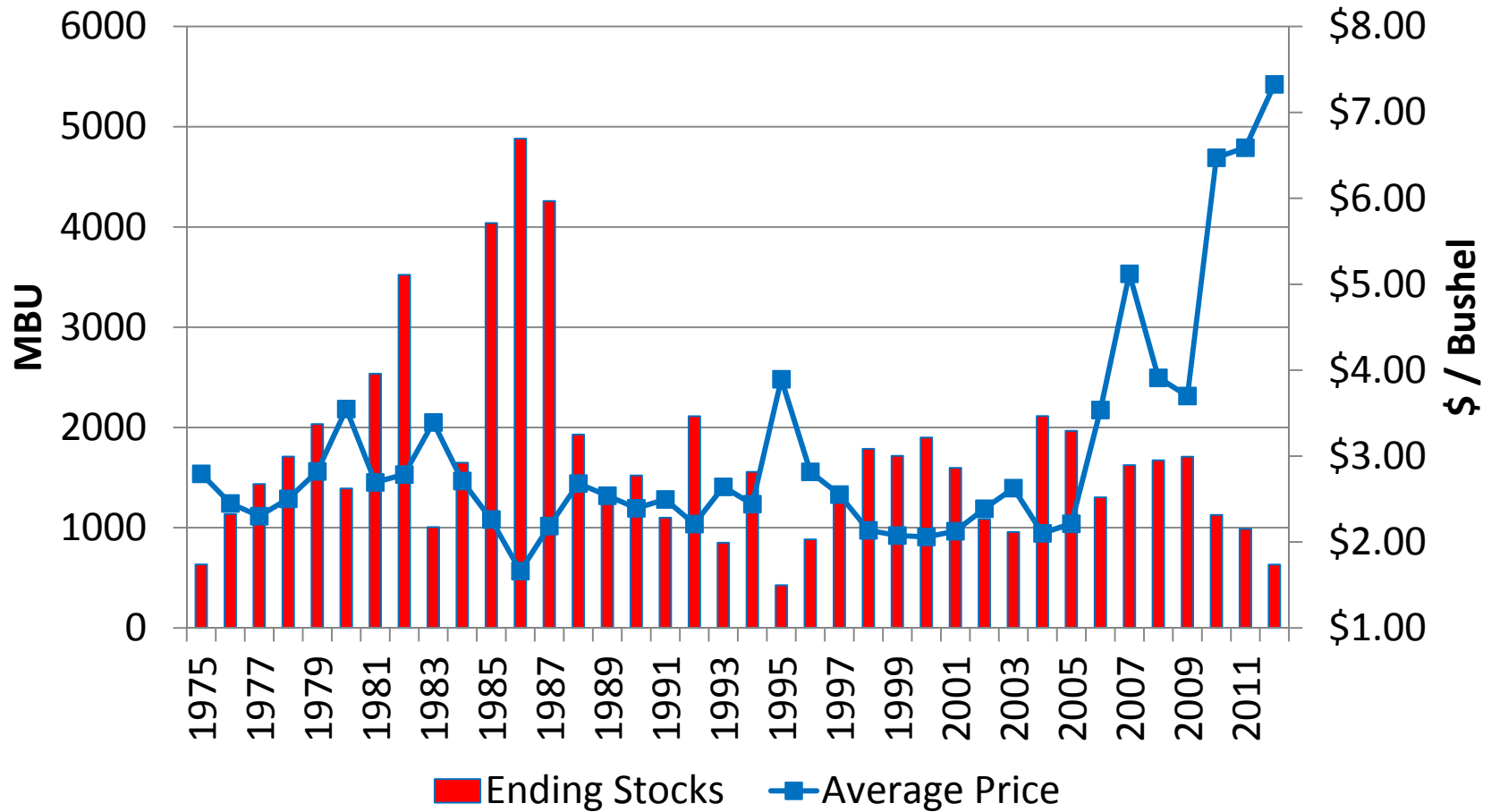
Includes: Coarse Grains, Wheat, Oil, Rice

US Wheat Stocks vs Price



Source: USDA

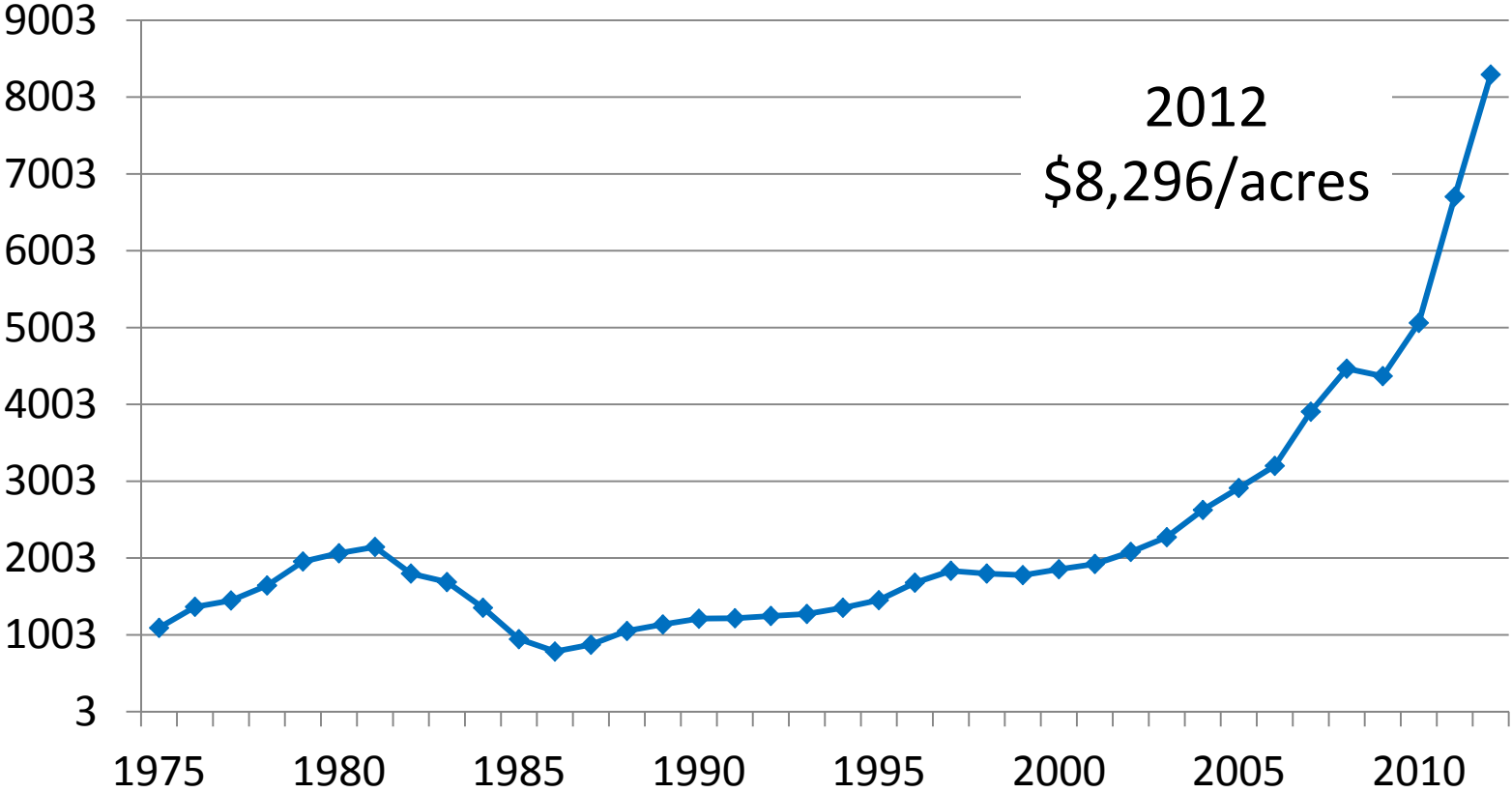
US Corn Stocks vs Price



Source: USDA

Iowa land values

\$ value per acre



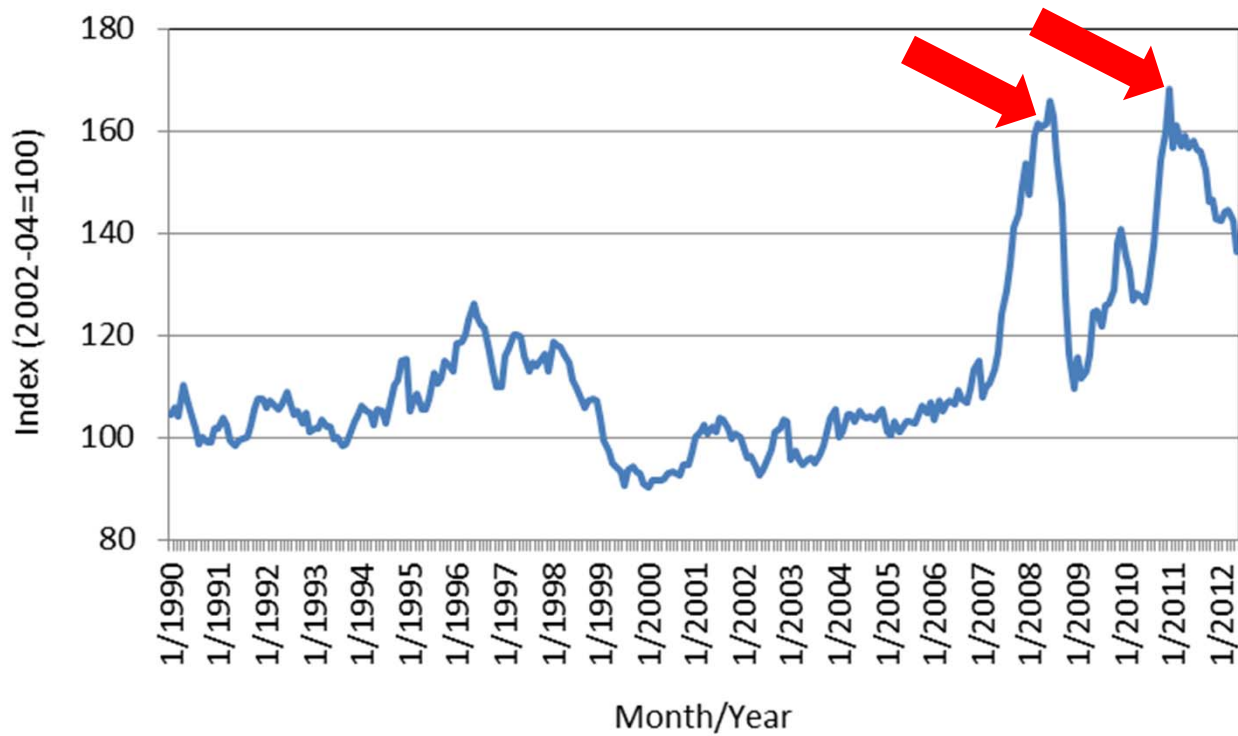
Source: Iowa State University

Scott Irwin

Laurence J. Norton Chair of
Agricultural Marketing
University of Illinois



FAO Index of Real Food Commodity Prices, January 1990-May 2012



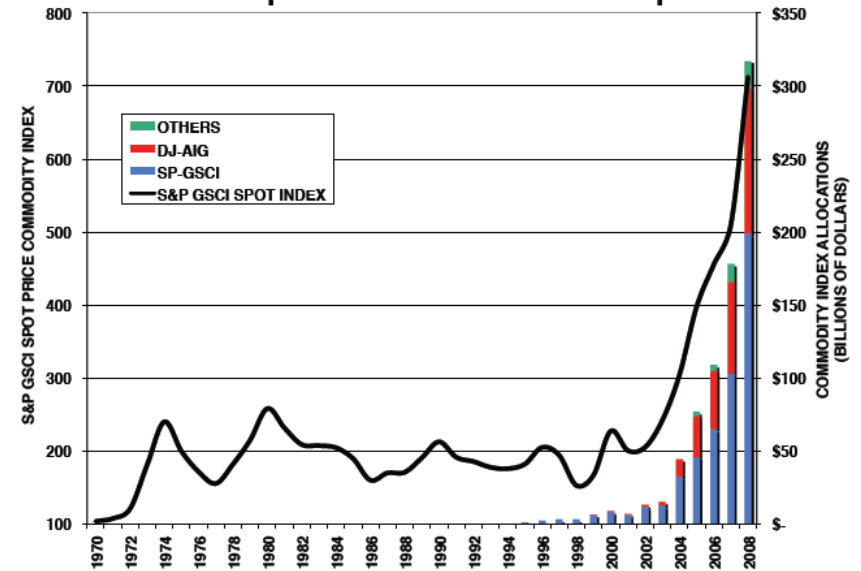


Mark Wilson

<http://www.nytimes.com/2008/09/11/washington/11speculate.html>

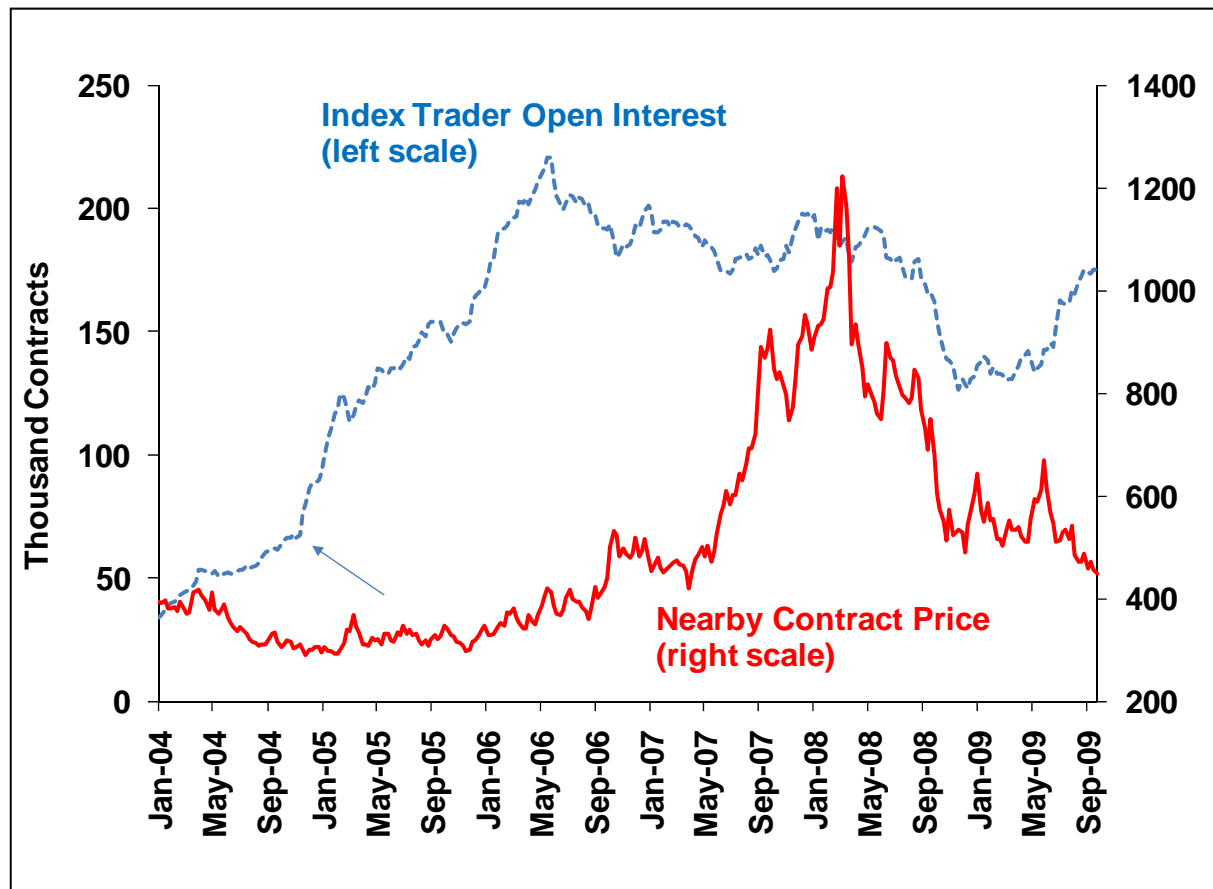
“The Masters Hypothesis”

Chart 1. S&P GSCI Spot Price Index vs. Index Speculator Assets

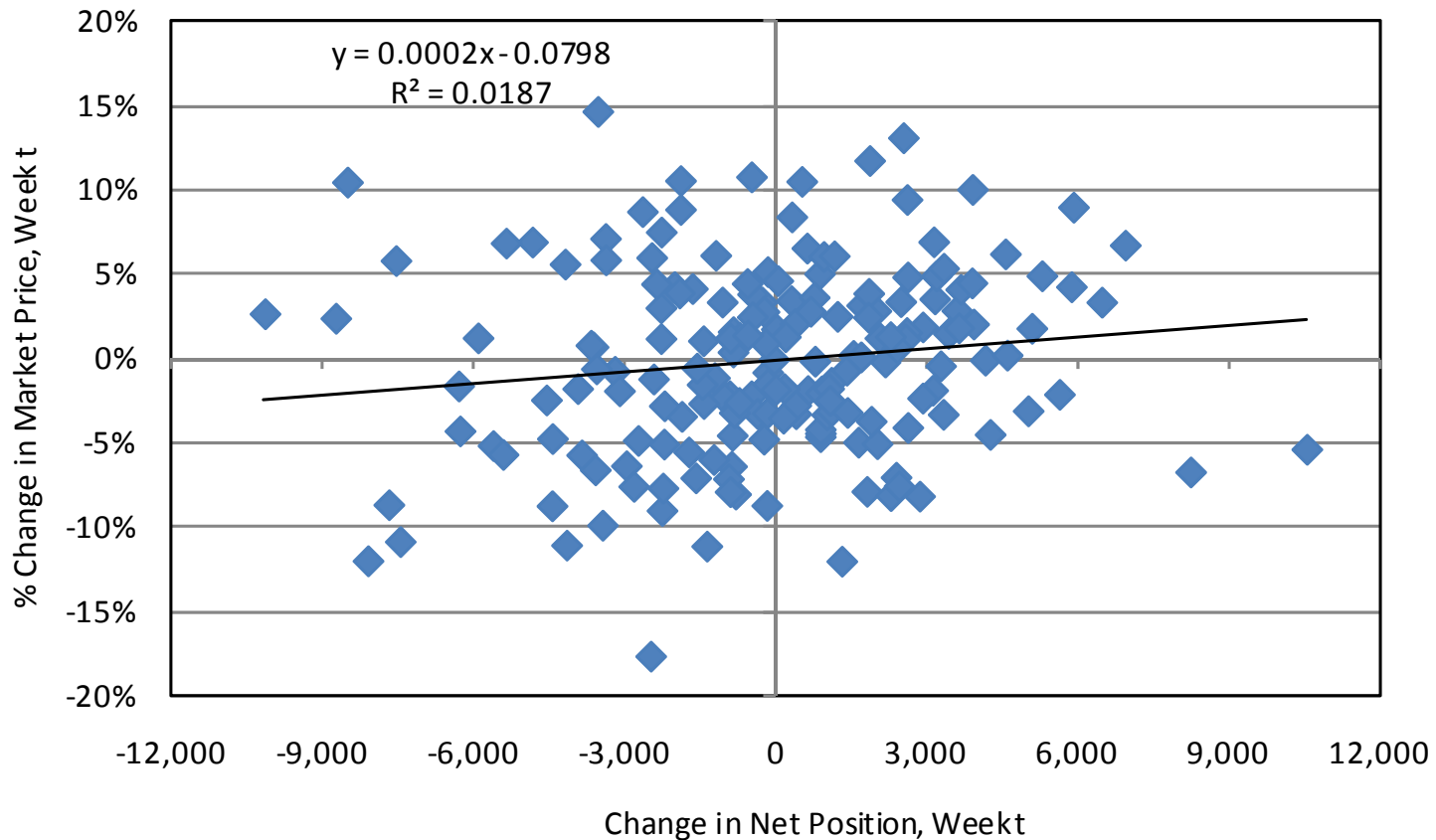


<http://www.loe.org/images/content/080919/Act1.pdf>

CBOT Wheat Futures Prices and Index Trader Net Long Positions, January 2004-September 2009



Relationship between CBOT Wheat Returns and Index Trader Net Long Positions, June 2006-December 2009



Alarm or rather false alarm? A literature review of empirical research studies into financial speculation with agricultural commodities

Thomas Glauben,
Ingo Pies,
Sören Prehn and
Matthias Georg Will

An evaluation of 35 research papers into the impact of financial speculation on agricultural commodities markets has revealed: The vast majority of studies did not confirm the concerns that prevail in public discourse. The current state of knowledge indicates only a few, and weak, findings that verify the assumption that the rise in financial speculation in recent years has increased (1) the level or (2) the volatility of agricultural commodity prices. Instead, those developments have rather been caused by fundamental factors in the real economy. This is why the majority of academic studies are not in favor but against (3) enacting regulatory barriers to market entry. Transaction taxes or position limits are described as involving high risks. Various studies explicitly warn against overregulation, which would impair rather than improve the functionality of agricultural markets. Seen in this light, the alarmism about financial speculation should be classified as a false alarm: Those who desire to effectively combat hunger in the world have to take real-economy precautions to ensure that food supplies will match the envisaged increasing demands.

New players have entered the futures markets for agricultural commodities over the last ten years. Commodity Index Traders (CITs) are heavily engaged in a business model that consists of permanently covering long positions that are continually rolled forward. Without building their own inventories, CITs contribute to hedge agricultural producers against marketdown risks.

This recent development has given rise to the suspicion that CITs could be causally responsible for the dramatic price events in 2007/8, 2010/11 and 2012. In view of global hunger revolts there was a great deal of conjecture among theoreticians and practitioners that CIT-conditioned financial speculation with agricultural commodities prompted rapid food price rises that notably affected people suffering from extreme poverty.

This suspicion has sparked an intense international discussion that has already entailed regulatory actions. The US, for instance, has introduced position limits, while Europe is updating the Markets in Financial Instruments Directive (MiFID). Various renowned civil society organizations (CSOs)

in Germany have mounted a joint public awareness campaign in this context. The CSOs demand the introduction of a transaction tax, the subjection of futures market speculators to severe position limits, and a full ban on financial speculations by CITs.

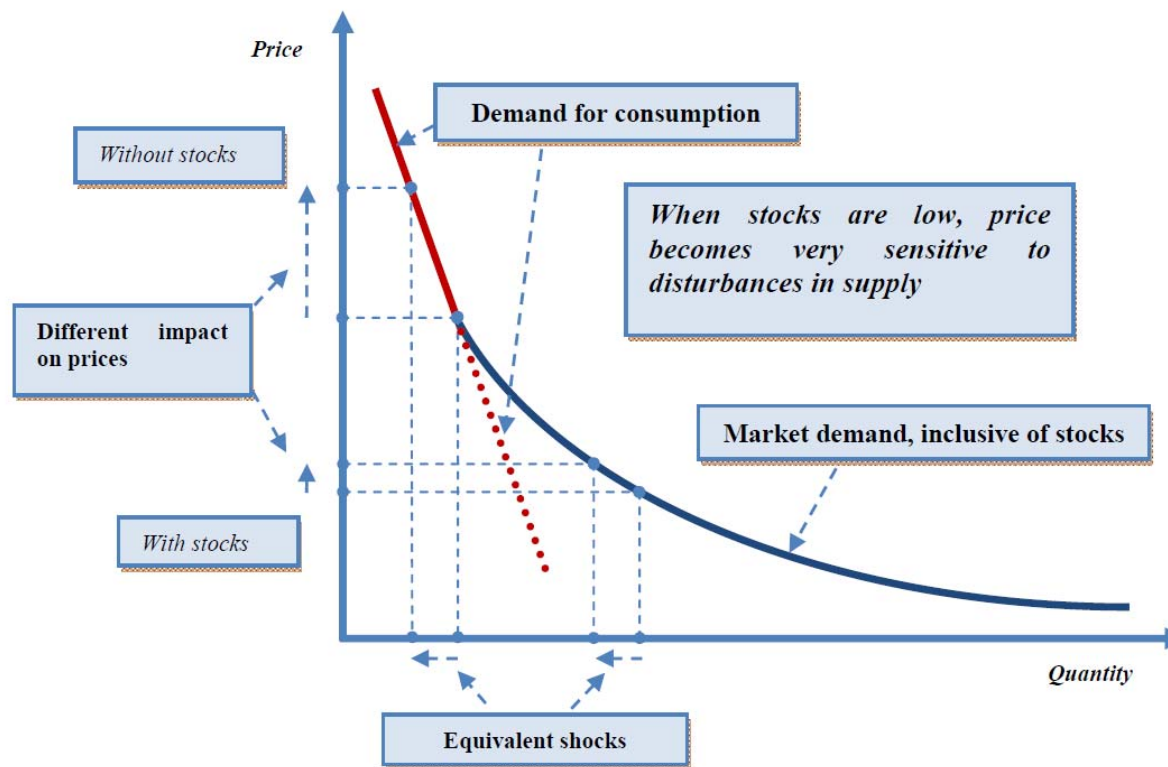
The CSOs commissioned their own studies (Pies 2012) to increase the efficiency of their demands. These groups assert that a "scientific evaluation" of available data provides "overwhelming evidence" that financial speculation causes and exacerbates hunger in the world.

Those statements have prompted strong responses. To give but one example: Thilo Bode, executive manager of foodwatch, asserts that banks, with their speculative futures market transactions, are "hungermakers". Within a few months, Bode attended no less than three publicly-documented debates where holders of economics chairs pointed out that his claims contradicted the state of the art in research (FAZ 2012, Handelsblatt 2012, Süddeutsche Zeitung 2012). The CSOs, however, maintain their view that scientific evidence is on their side (ettec 2012).

December 2012

“The current state of knowledge indicates only a few, and weak, findings that verify the assumption that the rise in financial speculation in recent years has increased (1) the level or (2) the volatility of agricultural commodity prices.....
Seen in this light, the alarmism about financial speculation should be classified as a false alarm: Those who desire to effectively combat hunger in the world have to take real-economy precautions to ensure that food supplies will match the envisaged increasing demands”

Pricing Function for Storable Commodities is Highly Non-Linear

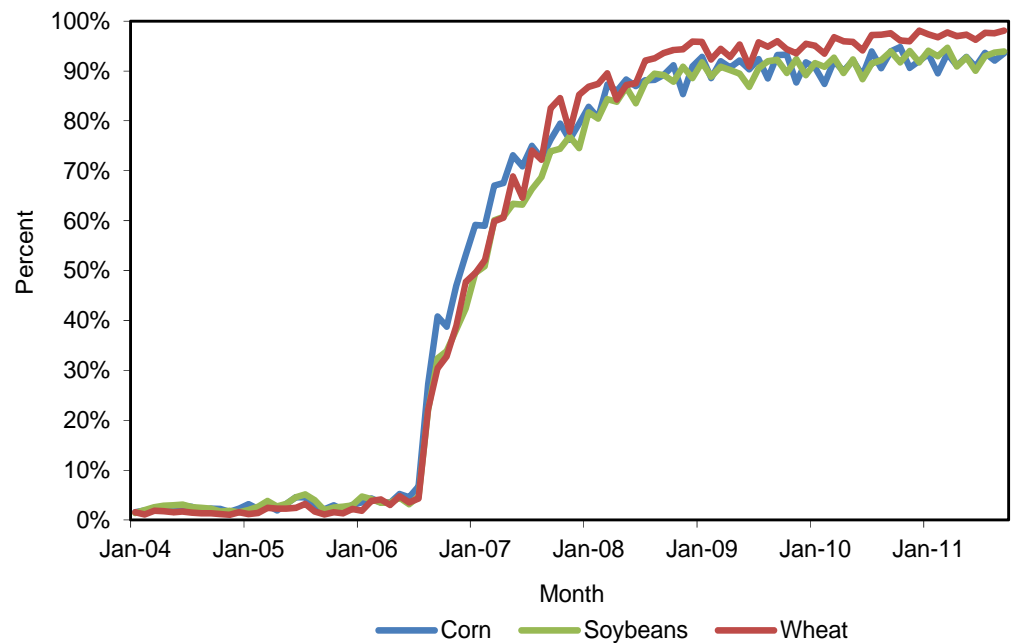


Source: Wright (2009)

Structural Changes in Commodity Markets in the Last Decade

- Electronic trading
- Online discount brokers
- Index investment
- Exchange-traded funds (ETFs)
- High frequency trading (HFTs)
- Real-time release of gov't reports

Percent of Futures Volume Transacted on Electronic Platform, 2004-2011





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