World Development Movement
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Speculation in Food Commodity Markets

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Food price changes 2006-08

Changes in world prices (%)

	Dec '05 - Jun '08	Jun - Dec '08
Food commodities (overall)	+160	-39
Wheat	+112	-37
Maize	+181	-45
Rice	+170	-30
Soya beans	+146	-44
Coffee (arabica)	+38	-19

Food prices in developing countries

'Major' staple foods are imported in many countries
- Sub-Saharan Africa's net imports, 2005:
  - 11.4 million tons of paddy rice
  - 14.5 million tons of wheat

The staple foods consumed are very varied
e.g. maize, rice, cassava, sorghum, millet, teff, yams, bananas
…and most of them are little traded internationally

Agricultural exports tend to be of non-staple foods (e.g. coffee, cocoa) and raw materials (e.g. cotton)

The wider Commodities Boom

Changes in world prices (%)

	Dec '05 - Jun '08	Jun - Dec '08
Oil	+125	-69
Copper	+80	-63
Gold	+74	-8
Cotton	+36	-28
Fertilisers	+384	-31

New influences on markets

Financial deregulation

Diversification of investments

Financial deregulation

Financial engineering:
- 'Derivatives' revolution
  - Forms of commodity trading spread to other markets
  - Over-the-counter (OTC) trading expands
- New commodity instruments
  - e.g. commodity swaps, collateralised commodity obligations, index funds, exchange-traded funds (ETFs)

Functional barriers break down:
- Banks take centre-stage
  - Goldman Sachs, Morgan Stanley, J.P.Morgan Chase, Barclays Capital and Deutsche Bank now dominate commodities trade
- ➢ Conflicts of interest, 'internalisation' of transactions

Diversification of investments

Fears of loss after 'dot.com' crash in 2000

Commodity prices thought to follow different cycles from other 'asset classes'

- 'Commodities supercycle' doctrine
  - Good, countercyclical long-term returns thought to be available from 'buying and holding' commodities
- Trading in commodity *indices* ('index funds')
  - Became available relatively cheaply as 'exchange-traded funds'

How index investment works

The aim: match the *average* returns available in a market

- On stock markets, buy each share in a representative index, e.g. FTSE-100
- Or in commodities, each commodity in a general index or a partial one (e.g. energy or agricultural commodities)
- Trading is generally 'passive' and 'long-only'

This is a source of ***extra demand***

- Unrelated to physical supply and demand factors

(In an ETF, the units are themselves traded on stock exchanges)

Problems caused by index trading

Volumes can overwhelm markets

- In 2007, recommendations implied increasing pension fund investments in commodities from \$80bn to \$930bn
- 85% of London Metal Exchange (LME) activity was estimated to derive from index and hedge funds
- \$60bn estimated in copper on one index alone (GSCI) – more than 2x the copper in LME warehouses
- Non-commercial share of open New York coffee contracts rose from 25% in late 1980s to >60% in 2006

Market disruption

- 'Roll-over' problem when futures contracts expire
- Lack of transparency, 'passing the parcel' with risks when OTC commodity swaps used instead

Close tracking of index outcomes is *not* achieved