Speculators under the spotlight

By Peter Guest and Eleanor Whitehead | Published: 12 October, 2010

High prices for grain this summer have prompted fears of a fresh food crisis, but the conditions do not appear right for a repeat of 2008.

The portents have not been good. Russia saw extremely high temperatures throughout the summer, which led to huge forest fires and a dramatic fall in wheat production. Food prices in the country rose, and in response, the president, Dmitry Medvedev, announced an export ban. Neighbouring Ukraine, also a major exporter of grains, faced similar shortfalls and introduced an export cap. Globally, wheat prices jumped upwards in reaction.

Shortly afterwards, riots broke out in Mozambique over rising bread prices. 13 were killed and hundreds injured. This recalled the food crisis of 2008, when shortages prompted unrest across low- and middle-income countries, leading some commentators to forecast a repeat of the crisis.

This seems unlikely, at least in the short term. The crisis of 2008 was, analysts say, due to a combination of factors that have not been replicated in 2010. Food stocks are far higher today than two years ago and the fall in outputs has not been anywhere near as widespread.

Furthermore, in 2008, there was a far broader commodity bubble – notably in oil, which was high and rising. That July, it hit a peak of $145 per barrel – around double what it is today. This fed through into higher input prices for agriculture. The prevailing sentiment was that oil prices would remain above $100 per barrel indefinitely and may continue to rise past $200. The climate change debate was raging and the focus on alternative energy supplies was tightening. Under a high oil price regime, fuels which were previously too expensive to produce or too capital intensive to develop became economically viable.

A subsequent interest in biofuels meant a renewed interest in agricultural land, and analysts foresaw competition with food production. Once again, this put upward pressure on most soft commodities, even though the actual amount of land and produce being diverted for biofuels was near-impossible to quantify. It remains difficult to disaggregate this effect.

Regardless, grain prices increased significantly – although not to 2008 levels – after the announcement, and remain high. This is driven, a number of analysts now say, more by speculation than by fundamental factors.

“We see this as a reaction to headlines from Russia, and the market’s going to moderate going forward… There should be significant amounts of spring wheat coming in from the US, so we don’t really see that as being hugely bullish,” says Abah Ofon, soft commodities analyst at Standard Chartered.

 “[Russia’s announcement] has basically triggered concerns from the investor side and you might get investors who were prior to this very relaxed and comfortable with the fact that there were global stocks, now they might want to take up longer positions, and I think that’s one of the reasons why prices have been amplified as they have. It’s not really a fundamental issue; it’s more of an investor issue.”

The role – real or perceived – of speculators in the food markets remains a controversial one. A September 2010 report by Olivier De Schutter, the UN’s special rapporteur on the right to food, notes that deregulation in commodity derivatives markets, beginning in 2000, permitted the entry of institutional investors who are “generally unconcerned with agricultural market fundamentals”.

These speculative investors are capable of creating pricing dynamics that are divorced from basic supply-demand relationships. Their presence also fuels market volatility, which can have more serious knock-on effects for producers and consumers than stable high prices. Mr De Schutter called for trading in food commodity derivatives to be restricted to “qualified and knowledgeable investors”.

The 2008 food crisis also prompted another – possibly speculative – bubble in land. Investors, both sovereign and institutional, began acquiring large areas of agricultural land in the developing world. In some instances it appeared to be fuelled by a long-term desire to secure food supplies and mitigate volatility by the governments of countries facing population or water stress. This was probably true in the case of Middle Eastern sovereign wealth funds, which bought into Africa and Eastern Europe, and in the case of Daewoo Logistics, a South Korean company that briefly held the rights to large areas of Madagascar. The latter deal was partially responsible for bringing down the government of then-president Marc Ravalomanana.

The World Bank released a major report on land acquisitions this September. According to the Bank’s research, 45m hectares of land were acquired in large-scale deals during 2009 – compared with an average expansion rate of 4m hectares per year in the preceding decade. These land deals can pose serious environmental and social risks if not properly managed, the report warns.
Much of this investment can be seen as speculative, according to Juergen Voegele, sector director for agriculture and rural development at the World Bank. Many investors seem more interested in the appreciating value of the underlying land than on actually producing crops. In food security terms, increasing the productivity of existing cultivated land would be a more viable option, he explains.

“I think with the wheat prices going up, people once again are going into long positions on this. Over the medium- to long-term, given that we need 50-70 percent more food in the world, land that has access to water, etc, will be at a very high premium,” he says.

“Is this justified? Not really. The fundamentals don’t really justify this thinking, certainly not in the medium term, because there is so much land that is producing below potential in Africa. The first priority should be to get local communities up to reasonable yield levels before expanding into other areas.”

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