Wheat Market Outlook and Price Report: December 17, 2018

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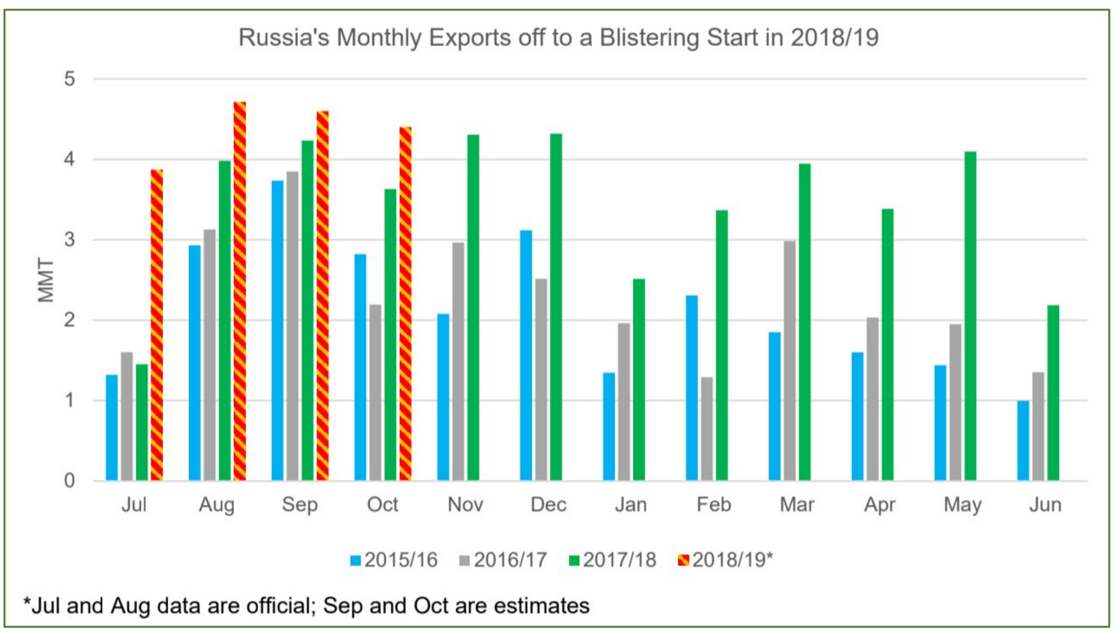
i) Background and Rationale for the Report

The following wheat market outlook and price report will be published on a weekly basis on the Sask Wheat Website. The report provides producers with an overview of world wheat markets, a market forecast, and benchmark prices at both the primary elevator and export positions (FOB Vancouver or elsewhere).

The report is made up of several sections. Following this section, a World Wheat overview is provided, which includes a summary of wheat market fundamentals, world production and trade, and a wheat market outlook. This is followed by several price tables, which include primary elevator bids at various Saskatchewan locations (Table 1), grain spreads (Table 2), and FOB port prices and basis (as measured by subtracting the primary elevator price (Rosetown) from the relevant port location price for individual crops) (Table 3). Table 3 is preceded by a description of the various assumptions, definitions and methodology used in arriving at the FOB port prices and in the export basis calculation.

ii) Wheat Market Outlook Dec. 17, 2018

December USDA-WASDE Report: Russian Wheat Export Pace



- **Russian wheat exports** are projected down from last year's record, based on smaller exportable supplies.
- However, its **export pace** currently is actually stronger than last year.
- With massive supplies and a price advantage, Russian wheat has dominated the global wheat market for several months. The forecast for Russia's exports was increased this month by USDA to 36.5 million mt, but monthly shipments are still expected to slow as winter arrives

and supplies become tighter.

- *As Russian exports slow, the U.S. export/ North American pace will likely pick up as North American wheat pricing becomes more competitive.*
- Because large carry-in stocks were a significant reason for the robust early pace of Russian wheat shipments, Russia's 2017/18 feed and residual has been trimmed by 1.0 million mt to 20.0 million and 2018/19 beginning stocks are boosted by the same amount.
- Note the ability by Russia to increase monthly shipping volumes very significantly over the past 4 years (both rail capacity and port fobbing capacity); something we seem unable to accomplish in Canada.

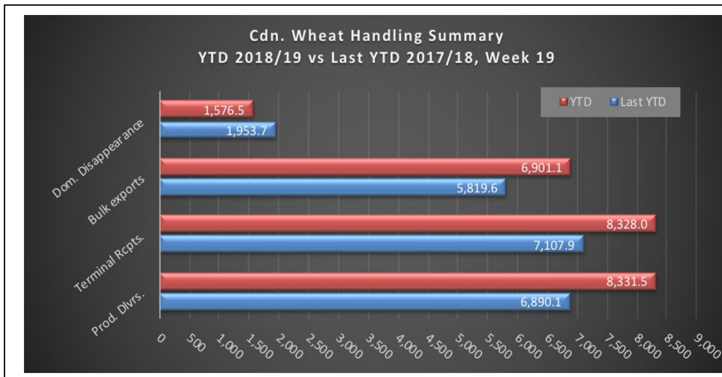
➢ **Global wheat production and trade:**

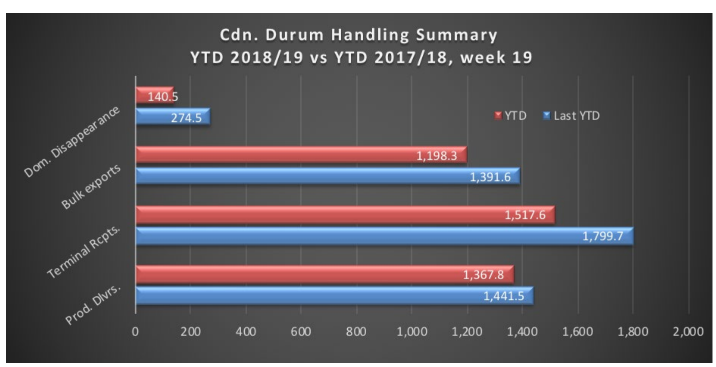
There is a lot of competition in the wheat markets as wheat is produced around the world. Below is a brief synopsis on last week's market events in the major wheat origins.

- **Futures:** Mar '19 contract Chicago winter wheat closed at 530-0, down 6-0 cents in Friday's trade. Mar '19 contract Kansas hard red winter wheat closed down 1-6 cents at 518-2. In Minneapolis, Mar '19 contract hard red spring wheat closed at 584-0, down 4-2 cents for the day, while May '19 hard red spring wheat closed at 589-0, down 2-6 cents for the day. For the week, wheat was from 5 cents lower to 26 cents higher.
- **Funds:** Index Funds have increased their longs and the Specs have reduced their overall short dramatically form where they were 5 weeks ago.
  Friday's COT report showed that spec funds in CBOT wheat futures & options shaved 6,005 Ct's from their net short position to -22,402 Ct's; in KC wheat futures & options, specs reversed 4,874 contracts as of Wed. to get back to a CFTC net long position of 2,429 Ct's.
- **Matif:** Matif wheat rose by €3/mt as Argentine wheat priced itself out of Algeria because of adverse weather causing quality problems.

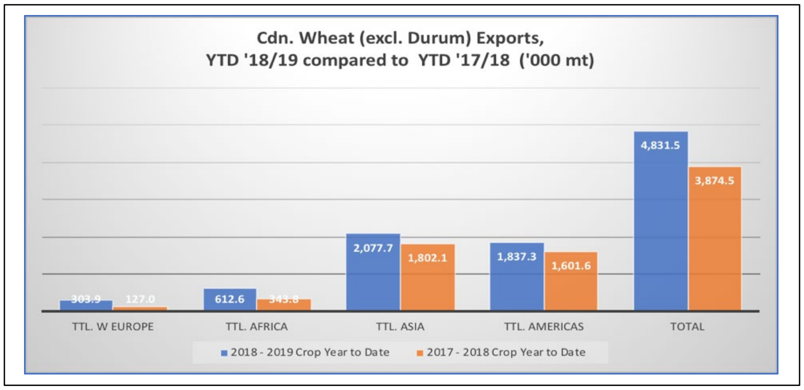
  - **Canadian wheat:**

- According to the CGC, Cdn. wheat growers delivered 532,400 mt of wheat (excl. durum) during week 19, domestic disappearance was said to be 165,100 mt, and exports 366,800 mt. Commercial wheat stocks amount to 2.74 mln mt. The CGC is not posting in-transit numbers.
- Cumulatively, YTD wheat deliveries at 8.3 mln mt are 21% ahead of last year's pace (+1.4 mln mt). Terminal receipts at 8.3 mln mt are 17% ahead of last year's pace (+1.2 mln mt). ***Exports** at 6.9 mln mt are 19% ahead of last year's pace (+1.1 mln mt).* And domestic use at 1.6 mln mt is 19% below of last year's pace (-377k mt, though we think there was a mistake in last year's domestic CGC numbers).
- **Wheat export destinations**: Canada has been able to increase wheat exports to all market areas this year over last year, but with the biggest volume gains into **Asia**

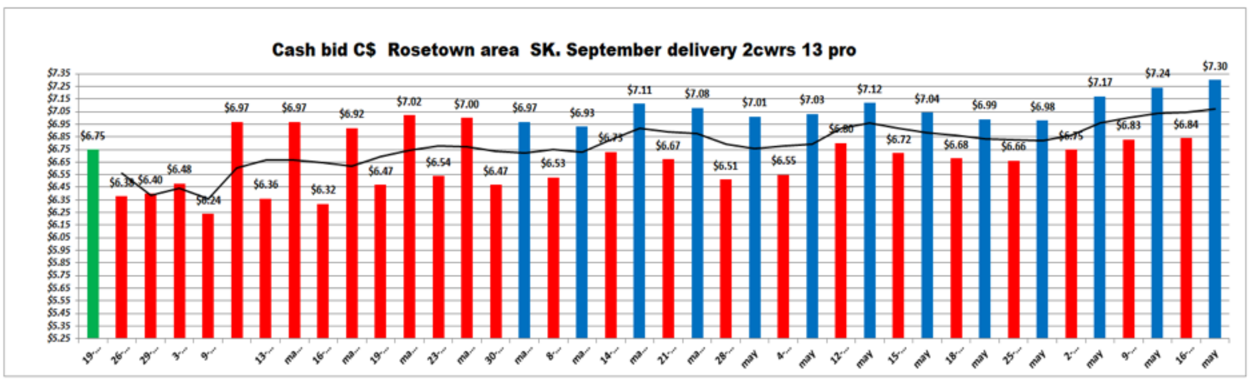




(+276k mt), followed by **Africa** (+269k mt), then the Americas (+236k mt). Exports into W Europe were increased by 177k mt, with most of the gains into Spain. Total YTD Cdn. wheat exports to the end of October were up by almost 1 mln mt, a 25% increase over last year.



- **China:** To the end of Oct. (latest destination data), China bought 435k mt of Cdn. wheat, compared to 207k mt last year. There is room to ship more wheat and barley, let's just hope the Chinese Gvmt. is not going to retaliate against Canada due to the arrest of the Huawei CFO.
- Unfortunately, **durum exports** are dismal. They lag last year's exports by 14% (-193k mt). YTD exports to Italy at 97k mt are only 34% of last year's exports. -We do not see a resolution to this problem.
- It was a slow week in export sales, which we expect will continue until we get through the holiday season. *Canadian bids are a little higher and in this thin market, we could see futures and cash markets trade higher*.



- **US wheat:**

- There were no major changes in the USDA-WASDE report last week. USDA adjusted Canadian and Australian production in line with the recent StatsCan and ABARES' updates. World demand was lowered 500k mt but raised 800k mt in Australia and Canada. Exports for Australia and the EU were both taken down 1 mln mt, the US was lowered 25 mln bu, but this was essentially offset by a 1.5 mln mt increase in Russia to 36.5 mln mt.
- The weekly US export sales at 754k mt were on the high side of estimates last week. US sales increased by 5.9% from last week and were 28.1% higher than last yr.
- US HRS wheat exports are 4% higher than last year at this time, with 3.27 mln mt shipped YTD.
- A positive U.S.-China trade relationship is primarily seen as supportive to soybean prices, but it might also be supportive to U.S. spring wheat; China has developed into the 4th largest buyer of U.S. spring wheat, just behind the Philippines.

- **Australian wheat:**

- USDA lowered Australian wheat production by 500k mt to 17 mln mt.
- USDA lowered exports for Australia by 1 mln mt.
- Harvest is about 75% complete nationwide.
- Australian wheat futures rose A$13/mt while Fob values increased ~US$10/mt as the rain caused fresh problems.

- **Argentine wheat:**

- The Argentine wheat harvest is 57.4% completed, with BAGE trimming production to 19.0 mln mt from 19.2 mln mt, widening the opportunities for N American wheat due to reduced S Hemisphere crops.
- Heavy rains started in Argentina's northern wheat growing region last Tuesday, temporary halting harvest progress and causing some traders starting to question the quality and condition of the unharvested crop. Cash prices have spiked at a time when they should typically be under harvest pressure. Only 35.8% are rated at Gd/Exc. vs. 63.9% Gd/Exc. last yr.
- Argentine Fob values went up US$15/mt on the week with the January 12% protein wheat bid-offer closing at US$233- 237/mt.

- **EU wheat:**

- USDA lowered exports for the EU by 1 mln mt last week to 22 mln mt.
- Matif rose €3/mt.

- **Black Sea wheat:**

- Russia's latest estimate of their '18/19 wheat crop is at 70 mln mt (acc. to Russia's Ag. Ministry; same # as USDA).
- In Russia rumours re-emerged that the government could step in to limit the pace of exports to prevent domestic food price inflation. And even though the trade has downplayed the risk of a Russian export ban, domestic prices in Russia keep getting firmer as farmers become increasingly reluctant to sell, which is translating into higher export prices. The GASC (Egypt) tender last Wednesday ended with Egypt paying ~US$6/mt more than in the previous tender, which seems to confirm an increasing scarcity of wheat from Russia.
- Black Sea wheat continued to rally with January 12.5% protein wheat at a bid-offer spread at US$235-240/mt. 11.5% protein wheat is worth $5/mt less. Feed wheat value drops another $8-9/mt.
- CME Black Sea futures rose $8/mt, and Egypt paid ~$6/mt more than at the previous tender just one week earlier.

➢ **Significant purchases/ trades:**

The market is becoming quiet ahead of the holidays:

- **Japan** bought 138k mt of wheat in their weekly tender, with 60k mt from the US and the balance from Australia and Canada.
- **Egyp**t (GASC) bought 180k mt Russian/ Romanian wheat at US$256.40-259.15. 120k mt were bought from Russia $6 above last week's Fob value, and 60k mt of Romanian for $3 higher than the previous tender.
- US wheat inspections were 418k mt (season total 404 mln bu, down 16%), sales were 754k mt (season total 601 mln bu down 10% on last year) against the USDA's revised 11% increase.

➢ **Wheat Market Outlook:**

Significant events:

- The USDA-WASDE report brought little for the US market, with the only change being a 25 mln bu hike in stocks on the back of lower exports. World numbers were also mostly as expected.
- But prices steadied on the highest price paid by Egypt in almost 4 years, solid US export sales, concern over Argentine wheat quality (only 35.8% are rated at Gd/Exc. vs. 63.9% Gd/Exc. last yr.).
- There is again uncertainty ahead of next week's meeting between Russian exporters and Govt officials: The rumours re-emerged that the Russian government could step in to limit the pace of exports to prevent domestic food price inflation.

- There is still hope of Chinese buying, though so far, buying has not materialised.

- ***Outlook:***

Cash markets are improving and consumers do not seem to be covered for the New Year. At the same time, Argentina's exportable milling surplus is declining (reports of 40% of the crop may be feed), Australian export wheat prices do not work anywhere, HRW high-pro premiums spreads widened this week, and the EU Supply and Demand seems to be tightening. - This could be quite bullish, if the Chinese buy an amount of US wheat. However, politics make these predictions difficult to make with any certainty.

In our opinion, we would hold selling until the New Year.

iii) Primary Elevator Price Tables and Grade Spreads

Table 1: Canadian Primary Elevator Bids, in Canadian Dollars per Bu and per MT

NW Sask	Spot		NW Sask	Deferred	
	(bu.)	(mt)		May.'19 (bu.)	May '19 (mt.)
1 CWRS 13.5	$7.21	$264.92	1 CWRS 13.5	$7.49	$275.21
1 CWAD 13.0	$5.82	$213.85	1 CWAD 13.0	$6.11	$224.51
1 CPSR 11.5	$6.47	$237.73	1 CPSR 11.5	$6.75	$248.02
SW Sask			SW Sask		
1 CWRS 13.5	$7.07	$259.78	1 CWRS 13.5	$7.37	$270.80
1 CWAD 13.0	$5.85	$214.95	1 CWAD 13.0	$6.13	$225.24
1 CPSR 11.5	$6.23	$228.92	1 CPSR 11.5	$6.64	$243.98
NE Sask			NE Sask		
1 CWRS 13.5	$6.98	$256.47	1 CWRS 13.5	$7.24	$266.03
1 CWAD 13.0	$6.00	$220.46	1 CWAD 13.0	$6.15	$225.98
1 CPSR 11.5	$6.19	$227.45	1 CPSR 11.5	$6.47	$237.73
SE Sask			SE Sask		
1 CWRS 13.5	$6.93	$254.64	1 CWRS 13.5	$7.18	$263.82
1 CWAD 13.0	$6.06	$222.67	1 CWAD 13.0	$6.26	$230.02
1 CPSR 11.5	$6.14	$225.61	1 CPSR 11.5	$6.43	$236.26

Table 2: Grade Spreads, in Canadian Dollars per Bu and per MT

Avg. Grade Spread/ Pro Discounts	Cdn$/bu.	Cdn.$/mt
1 CWRS 13.5	Base Grade	Base Grade
2 CWRS 13.5	(0.01)	(0.37)
1 CWRS 12.5	(0.15)	(5.51)
1 CWAD 13.0	Base Grade	Base Grade
1 CWAD 13.5	0.00	0.00
2 CWAD 13.0	(0.10)	(3.67)
2 CWAD 12.5	(0.20)	(7.35)

iv) FOB Wheat Prices and Export Basis Calculation

Background and Rationale:
Reporting FOB prices at port position and primary elevator prices allows the reader to gain an understanding of both local and international wheat prices and to understand the relationship between the two, as measured by the export basis. Export basis can be defined as FOB port position prices minus the primary elevator prices at any given prairie delivery location, and is therefore reflective of transportation costs plus any premiums being captured by terminal grain elevator companies or the railway companies, at any given time.

In general, a widening basis is indicative of decreasing system performance in terms of either reduced port capacity or rail service, or both. A narrowing basis is indicative of increased available port capacity and/or better ability of the railways to provide ample service to grain shippers. In this regard, tracking these prices over time has value both in terms of producers being able to time the selling of their grain but also in terms of evaluating and setting policy related to various transportation and capacity issues.

Gray (2015) has calculated a normal basis to be in the range of C$72/tonne. During the 2013/14 crop year the export basis for wheat widened to approximately C$250/tonne, which indicated an inability of the grain handling and transportation system to adequately handle the record crop produced that year. This occurrence has highlighted the need to improve the level of rail service and take measures to expand port capacity where possible. It has also underscored the need for better price transparency and market information within the grain sector.

Assumptions, Definitions, and Methodology
The following background information should assist in understanding and interpreting international market signals and to relate them to the 'local' Saskatchewan wheat market:

- The price information generated for the weekly report is designed to show farmers at what price levels several wheat classes are trading at local primary elevators (Table 1) and in nearby international markets (Table 3). To express the Export Basis[1] (see *Export Basis* in Table 3) defined as Cdn. FOB Prices minus primary elevator bids, the FOB prices are translated into Cdn. dollars from US dollars and compared to current actual primary elevator Street prices at Rosetown, Saskatchewan (see *Street Prices* in Table 3). Rosetown is used as a proxy for all primary elevators in the basis calculation. The actual handling and transportation costs from the West Coast to delivered elevator (Rosetown area) range from ~C$58.00-C$74.72/mt, depending on number of cars moved and elevator used.

- Approximate relationship between U.S. wheat classes and Canadian wheat classes:
    - DNS 14% in the Pacific North West (PNW) ≈ 1 CWRS 13.5% in Vancouver
    - HRS in the Pacific North West (PNW) ≈ 2 CWRS 13.0% in Vancouver
    - HRW in the Pacific North West (PNW) ≈ 3 CWRS in Vancouver
    - SW (lowest price wheat) ≈ CPS red (mostly fed domestically)
    - HAD (Lakes) ≈ CWAD (Thunder Bay/ Lawrence)

[1] Gray, R.S. (2015). The Economic Impacts of Elevated Export Basis Levels on Western Canadian Grain Producers 2012/13, 2013/14 and 2014/15.
"The difference between FOB Vancouver prices and the Saskatchewan elevator cash bids to producers is referred to as export basis: Basis can refer to the difference between any two prices. As the largest volume port, Vancouver FOB, minus the elevator bid prices representative measure of the "export" basis for grains in Western Canada."

- Abbreviations: DNS (Dark Northern Spring Wheat); HRS (Hard Red Spring Wheat); HRW (Hard Red Winter Wheat); SW (Soft Wheat); HAD (Hard Amber Durum Wheat); CWRS (Canadian Western Red Spring Wheat); CPS (Canada Prairie Spring Wheat); CWAD (Canadian Western Amber Durum Wheat)

- <u>Hard wheat price calculations:</u>
  Exporters in Western Canada generally derive their primary elevator wheat prices from HRS values at the West Coast (Pacific Northwest - PNW).
  Similarly, HRW values are used for lower grade (3) CWRS.
  - West Coast HRS and HRW values essentially dominate the international hard wheat trade and determine its basic value.
  - If premiums are paid for 1 CWRS 13.5, elevator companies are often able to retain the premium

- Durum wheat price calculations:
  The primary export route for Canadian durum wheat is still through Thunder Bay, not the West Coast of Canada.
  - Nevertheless, the Pacific Coast has increased in importance for durum over time with 38% of total export volume crop year to date.
  - Italy is the single biggest buyer of Canadian durum wheat with 27% of total Canadian durum exports YTD (East Coast shipments).

- <u>Optional origin grain sales</u>:
  Most major international grain companies sell ‘optional origin’ wheat to their customers and often cover their sales ‘at best’ closer to the shipment position. The Canadian grain system is not conducive to servicing optional origin sales because the volume of wheat kept in storage in port today is much smaller than prior to deregulation of the Canadian wheat market.

Table 3: Relevant FOB Prices and calculated Basis, US & Canadian Dollars per MT

Releveant FOB Prices and Export Basis				December 17, 2018
	FOB Prices CDA[1] (calculated)		Street Prices	Export Basis[2]
Type of Wheat	West Coast (Cdn./mt$)	Great Lakes (Cdn.$/mt)	Rosetown (Cdn.$/mt)	Basis: West Coast-Centr. SK (Cdn$/mt)
DNS 14.0	$351.42	$317.01		
HRS	$344.04			
HRW 11.5	$336.67			
SWW 12.0	$315.54			
1 CWRS 13.5[3]	$351.42		$266.39	$85.02
2 CWRS 13.0[3]	$344.04		$257.21	$86.84
3 CWRS[3]	$336.67		$235.16	$101.51
CPS[3]	$308.66		$233.32	$75.33
1 CWAD[4]		$307.18	$201.72	$105.46
Competing wheat:	US$/mt			
Russia 12.5 (Black Sea, 25k mt)	$238.00			
French 11.5 (Rouen)	$238.87			
APW 10.5 (W Coast)	$272.00			
Argentine 12.0	$235.00			

[1] FOB Prices CDA = FOB US$ converted into Canadian Currency

[2] Export Basis = FOB Prices CDA minus Cdn. Street Price

[3] DNS 14% ≈ 1 CRWS 13.5%; HRS ≈ 2 CWRS 13.0%; HRW ≈ 3CWRS; SWW ≈ CPS

[4] Values derived to Lakehead FOB

Sask Wheat Development Commission

ADDENDUM

Futures Driven Basis Calculation, Canadian Dollars per MT

Canadian Wheat - World Price Parities					December 17, 2018
Canadian Funds			**Grade**		
PNW value/Vancouver	**1CWRS13.5**	**2CWRS**	**3CWRS**	**Winter wht.**	**CPS**
May/June delivery	$9.38	$9.18	$8.98	$8.40	$8.40
Parity Track Rosetown	$7.88	$7.68	$7.48	$6.90	$6.90
Track Bid Rosetown Area	$7.25	$7.00	$6.40	$6.35	$6.35
Gross Margin at Elevator ($/bu)*	**$0.63**	**$0.68**	**$1.08**	**$0.55**	**$0.55**
Gross Margin at Elevator ($/mt)*	**$23.16**	**$24.97**	**$39.65**	**$20.35**	**$20.35**

* to cover elevation, elevator market risk, margin