2nd Annual Canadian Agriculture Policy Conference

Growing Forward in a Volatile Environment

SESSION 2: AGRI-FOOD VOLATILITY AND RISK

A banker's perspectives on Scott Irwin's presentation and on agricultural market volatility in general

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- **Volatility of agricultural markets does not come first and certainly not that of futures market.**
- **The relative volatility of physical supply vs. physical demand is at the inception.**
- **This relative volatility is the convergence of the trends and shocks in both supply and demand.**
- **Demand shocks for agricultural commodities are nowadays quite rare and are mostly political in nature (**for instance **:** Soviet Union purchase in 1972, US embargo on grains to the USSR in 1980, US ethanol mandate in 2005 and 2007**).**
- **Supply shocks are more frequent as they often result from agro-ecological events (weather and pest mainly)**
- **Trends in demand are resilient and are possessing quite an inertia, originating from demography, income growth and consumption patterns.**
- **Trends in supply are not as resilient as they require continuous impulses from various stakeholders (government, R&D, investors, markets, etc.)**

➲ **Volatility in the agricultural markets will remain as long as there is not any adequate buffering capacity built within the global agrifood system, mostly at the supply level.**

As far as so-called speculators are concerned, the only real danger would be the emergence of markets players with the clout to command sufficient physical supply and/or demand to manipulate markets to their benefit.

For most agricultural commodities, it may happen locally but not on a regional nor global scale.

How may agricultural market volatility affect the ability of farms and agribusinesses to access credit ?

Access to credit

Borrower		Bank	
Risk of default	Risk of loss	Cost of capital	Exposure to risk

➢ Impact on debt servicing capacity

- the most direct impact is the volatility of cash prices. Yet, volatility of futures markets may affect decision-making and subsequently profitability.
- volatility of input cost vs. volatility of output price
- **incentive to hedge** : cost / reward of the different risk management options
- **capacity to hedge efficiently** : skills and financial structure
- the risk of the speculative mindset

➢ Impact on collaterization

- valuation of inventories in a volatile environment : fair market present value or cost or value of futures at harvest time ?
- collaterization of margin calls when crops are in the field
- valuation of inventories hedged by a future contract : present cash price OR value of the contract adjusted for carry-on costs ?