MGEX Spring Wheat 2013

The Minneapolis Grain Exchange, Inc. (MGEX) has been the principal market for hard red spring (HRS) wheat since 1881, offering futures and options contracts based on this unique commodity. Hard red spring wheat dominates North American wheat production and trade which makes it one of the most important crops on the continent. Hard red spring wheat's unique growing season and quality characteristics generate price movement that is often quite different from other classes of wheat. Price spreads across futures contracts on alternative classes of wheat—such as Hard Red Spring and Hard Red Winter—provide opportunities for traders. At the same time, MGEX HRS wheat futures provide a stable and predictable basis for hedgers and merchants.

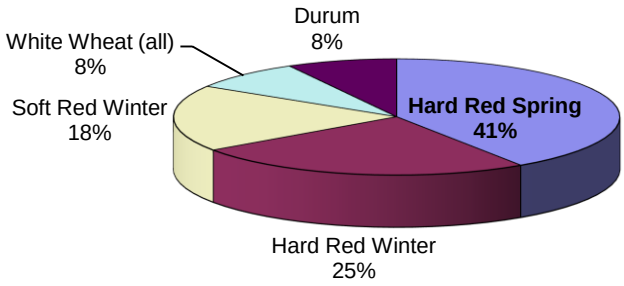
HRS Wheat Production

Hard red spring wheat is grown in the U.S. Northern Plains (e.g., North Dakota) and the Canadian prairies (e.g., Saskatchewan). As its name indicates, HRS wheat is planted in the spring and harvested in late summer with the September contract representing new crop delivery. In contrast, winter wheat is fall-planted and spring-harvested, with a July new crop contract.

Hard red spring wheat is premium milling quality wheat. The commercial standard HRS wheat specification is 13%-14% protein; whereas the hard red winter (HRW) is often 11% protein. Generally, the higher the protein content, the better the baking quality of the flour.

North American wheat production is dominated by HRS varieties. Figure 1 and Table 1 present U.S. and Canadian wheat production by class.

Figure 1. U.S. and Canadian Wheat Production by Class, 2013.



Source: United States Department of Agriculture, Statistics Canada.

Table 1. U.S. and Canadian Wheat Production, 2013.

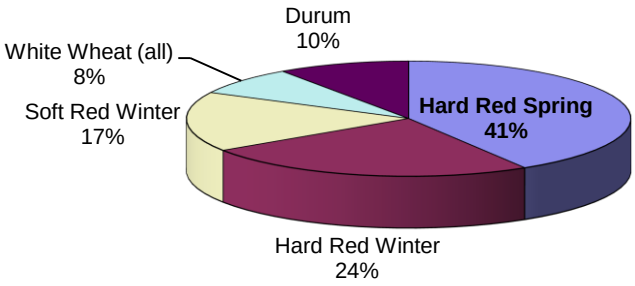
	Production (millions of bushels)			Quantity	US $/bu.	$ Millions	Value
Wheat Class	U.S.	Canada	Total	Percent	Farm Price	Value	Percent
Hard Red Spring	489	869	1358	41%	7.35	9,981	42%
Hard Red Winter	744	80	824	25%	7.00	5,768	24%
Soft Red Winter	565	53	618	18%	6.65	4,110	17%
White Wheat (all)	269	6	275	8%	6.80	1,867	8%
Durum	62	205	267	8%	7.75	2,069	9%
Total	2129	1213	3342	100%		23,795	100%

Note: Figure 1 and Table 1 are based on the September, 2013 USDA and Stats Canada production estimates.

At 41% of total production, HRS is the largest wheat crop in North America. Likewise, when considering the price premium for HRS wheat, it is 42% of the market in terms of value.

Because of the world demand for premium milling wheat, HRS wheat tends to dominate North American exports and trade. Figure 2 and Table 2 show the relative proportion of U.S. and Canadian exports for each class of wheat. Forty-one percent of combined U.S. and Canadian wheat exports are HRS, while the next closest class of wheat, HRW, represents 24% of the North American export market.

Figure 2. U.S. and Canadian Wheat Exports by Class, 2013.



Source: United States Department of Agriculture, Statistics Canada.

Table 2. U.S. and Canadian Wheat Exports, 2013.

	Exports (millions of bushels)			Quantity
Wheat Class	U.S.	Canada	Total	Percent
Hard Red Spring	225	568	793	41%
Hard Red Winter	415	54	469	24%
Soft Red Winter	285	37	322	17%
White Wheat (all)	150	2	152	8%
Durum	25	160	185	10%
Total	1,100	821	1,921	100%

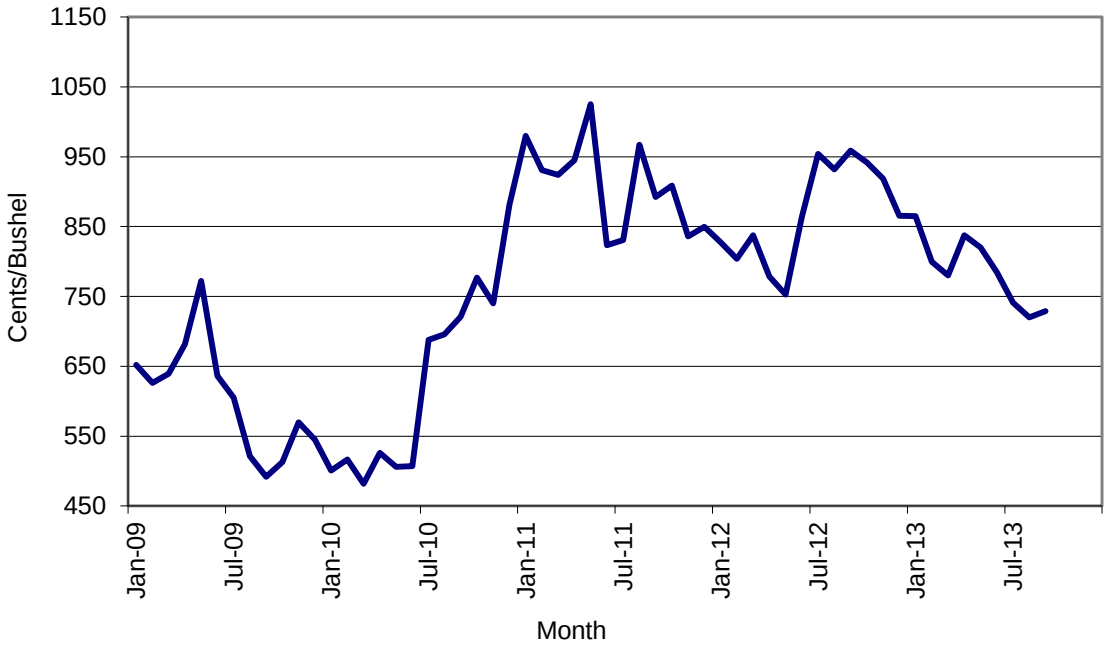
Note: Figure 2 and Table 2 are based on the September, 2013 USDA and Stats Canada production estimates.

Clearly, HRS wheat is the most important wheat crop in North America in terms of production, value, and trade. Because of this, HRS wheat prices are important to the overall wheat industry.

MGEX Spring Wheat Prices and Trade

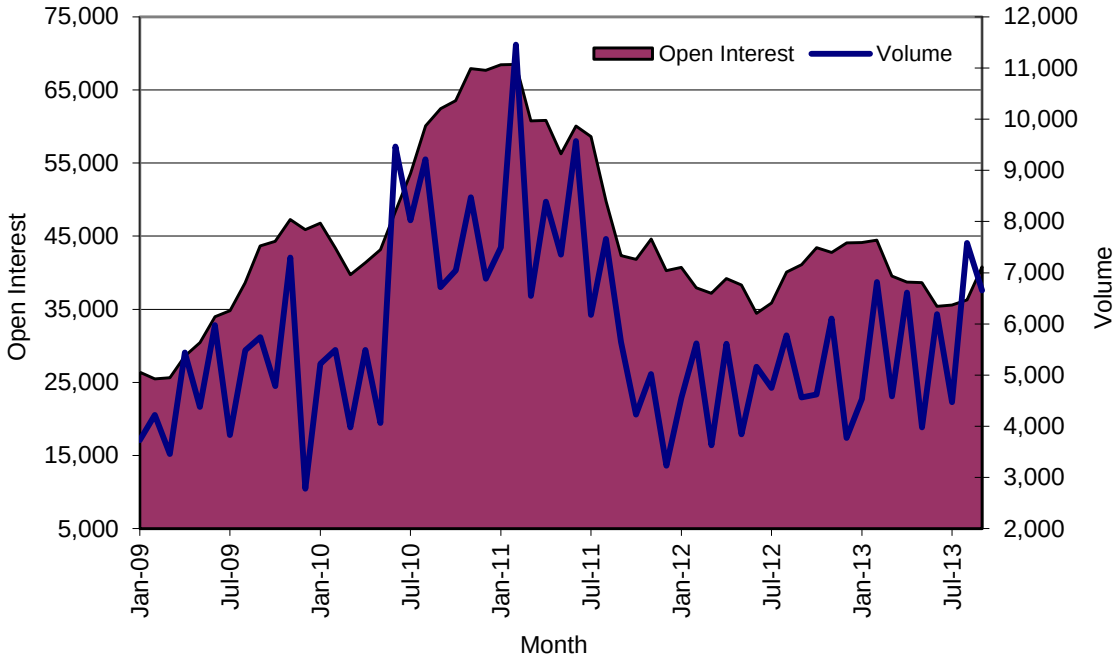
Hard red spring wheat prices are susceptible to numerous supply and demand factors. Demand shocks often arise from an active export market, while summer weather in the Northern plains and Canadian prairies can create volatile swings in supply. Additionally, because of the milling quality of HRS wheat, relative supplies of high quality wheat can drive price trends even when the overall wheat market is quiet. Collectively, these factors result in unique price moves in the spring wheat futures market. The price action over the last four years is shown in Figure 3.

Figure 3. Nearby Minneapolis HRS Wheat Futures, 2009-2013.



Due in part to its' unique price action and the importance of HRS wheat in the international wheat markets, MGEX HRS wheat futures experience consistently good trade volume. For 2013 (through September), daily volume has averaged over 5,700 futures contracts with open interest near 40,000 contracts.

Figure 4. MGEX Wheat Futures Average Daily Volume and Open Interest, 2009-2013.



Wheat Spreading Opportunities

The MGEX HRS futures contract is one of three active wheat futures traded in the U.S. HRW wheat is traded at the Kansas City Board of Trade (KCBT) and soft red winter (SRW) wheat is traded on the Chicago Board of Trade (CBOT), both are divisions of the CME Group. From a trading perspective, it is important to understand how these three wheat contracts relate to each other as price movements across the wheat contracts can provide opportunities to traders and merchandisers.

Figure 5 shows the price spread between nearby MGEX HRS wheat and nearby futures prices for KCBT HRW wheat prices. The spread has ranged from a high of over 180 cents per bushel to a low of negative 10 cents per bushel. An astute trader or merchandiser can utilize their understanding of quality and class spreads to take advantage of this variability.

Figure 6 shows the price spread for nearby futures on MGEX HRS wheat and CBOT SRW wheat futures. This spread relationship is also volatile—with a range of over 250 cents per bushel over the last 3 crop years—which provides ample spreading opportunities across contracts.

Figure 5. MGEX HRS Wheat – KCBT HRW Wheat Spread, 2009-2013.

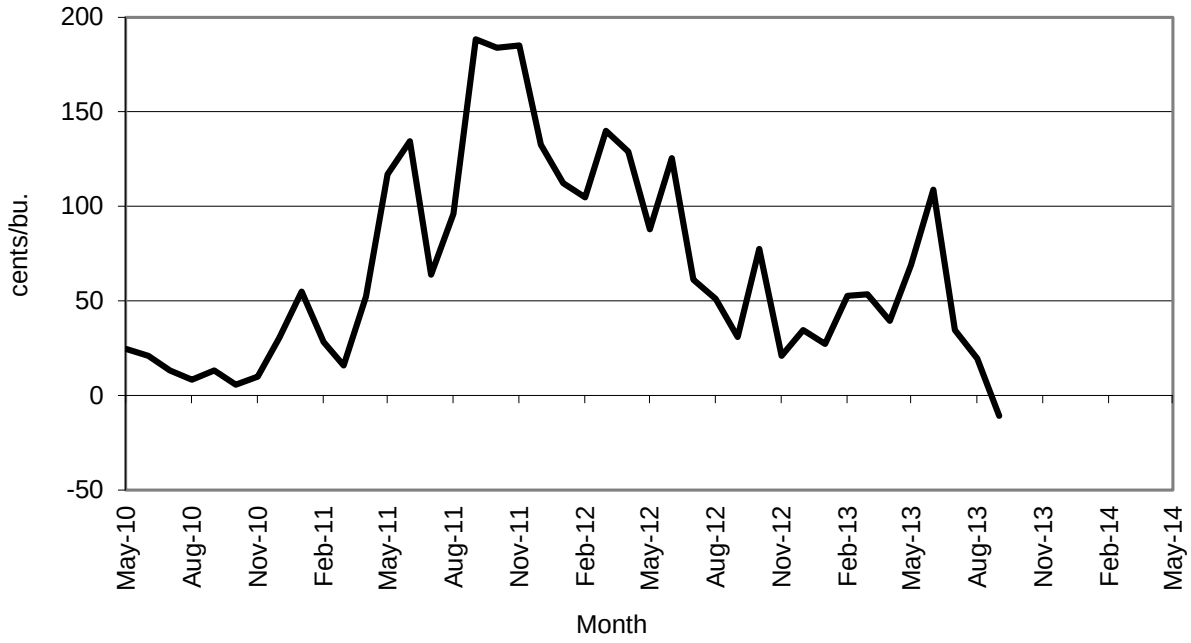


Figure 6. MGEX HRS Wheat –CBOT SRW Wheat Spread, 2009-2013.

Spring Wheat Hedging Opportunities

Hedgers and merchandisers rely on stable and predictable basis patterns to manage risk and profitably merchandise wheat. The MGEX spring wheat contract provides a predictable cash-futures basis at both country elevator locations and terminal markets.

Figures 7 and 8 show the cash-futures basis for Northeast Montana elevators (as reported by the USDA). As shown in Figure 7 the country basis can have a large range. However, the movements within the range are generally predictable. As shown in Figure 8, the weakest basis in NE Montana occurs during the late summer harvest and the basis strengthens through the follow spring. The 2012 crop year followed this predictable pattern.

Figure 7. NE Montana - MGEX HRS Wheat Basis, 2010-2013.

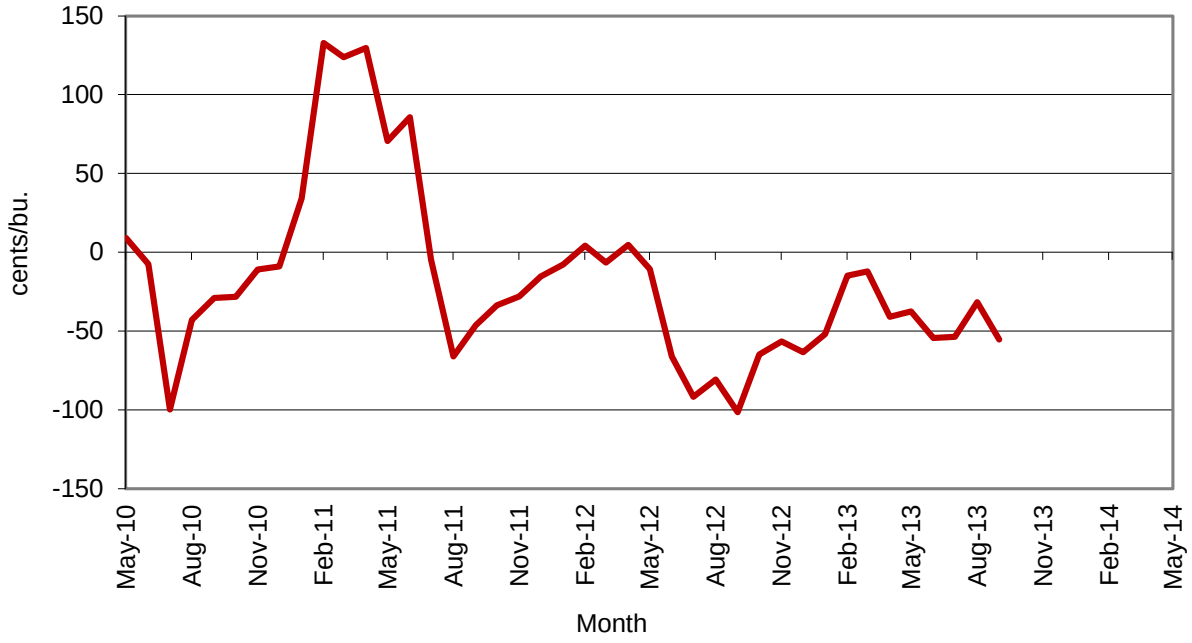
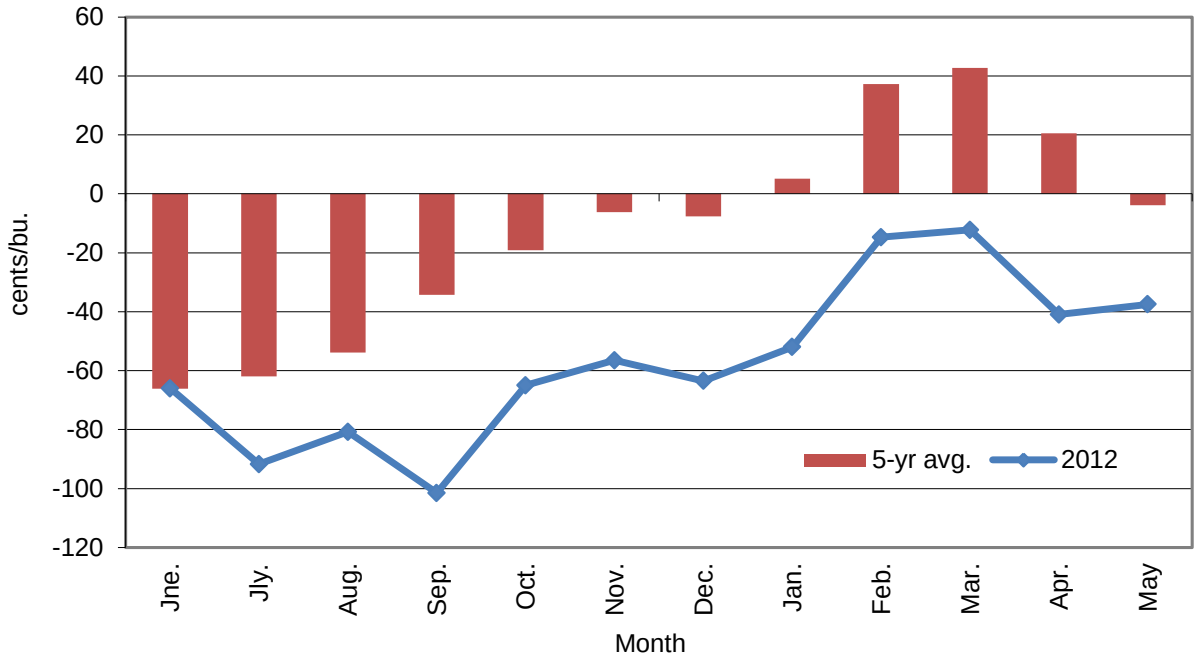


Figure 8. NE Montana - MGEX HRS Wheat Basis, Seasonal Trend, 2010-2013 Crop Years



The analogous graphs are shown for the Portland export market in Figures 9 and 10. Again, while the basis is positive and has a fairly large range in Figure 9 (reflecting transportation costs to the Portland market), the seasonal variation provides a very predictable pattern for merchandisers as shown in Figure 10 where a weak harvest-time basis gives way to basis strength throughout the winter and into the early spring. The 2012 data are indicative of a year that follows this pattern.

Figure 9. Portland - MGEX HRS Wheat Basis, 2010-2013

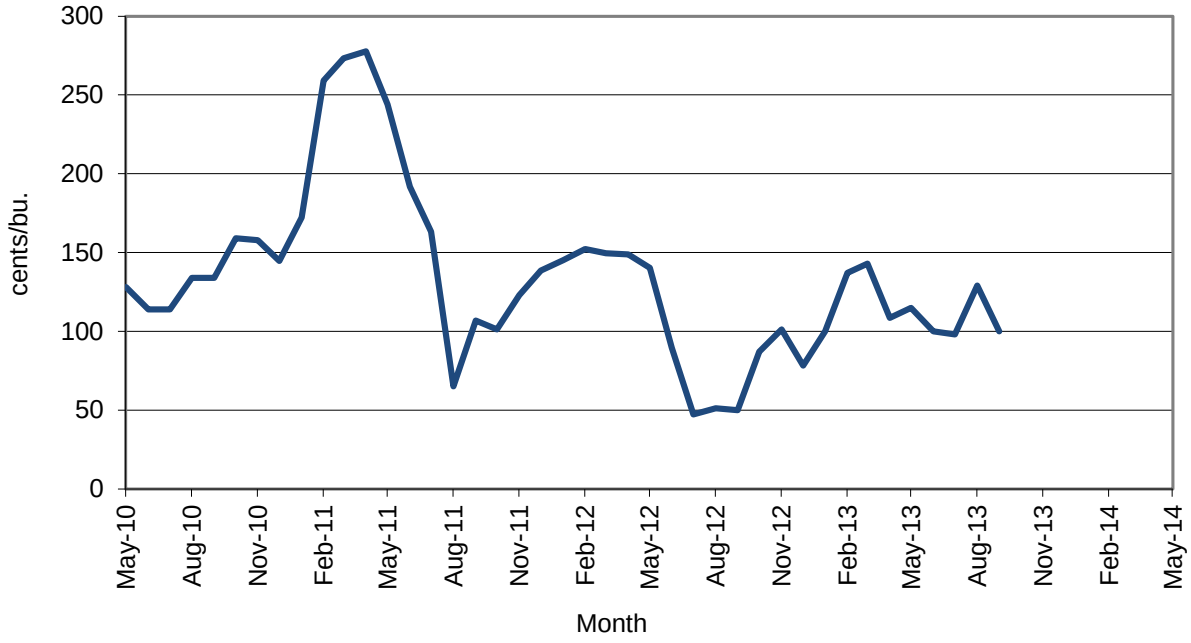
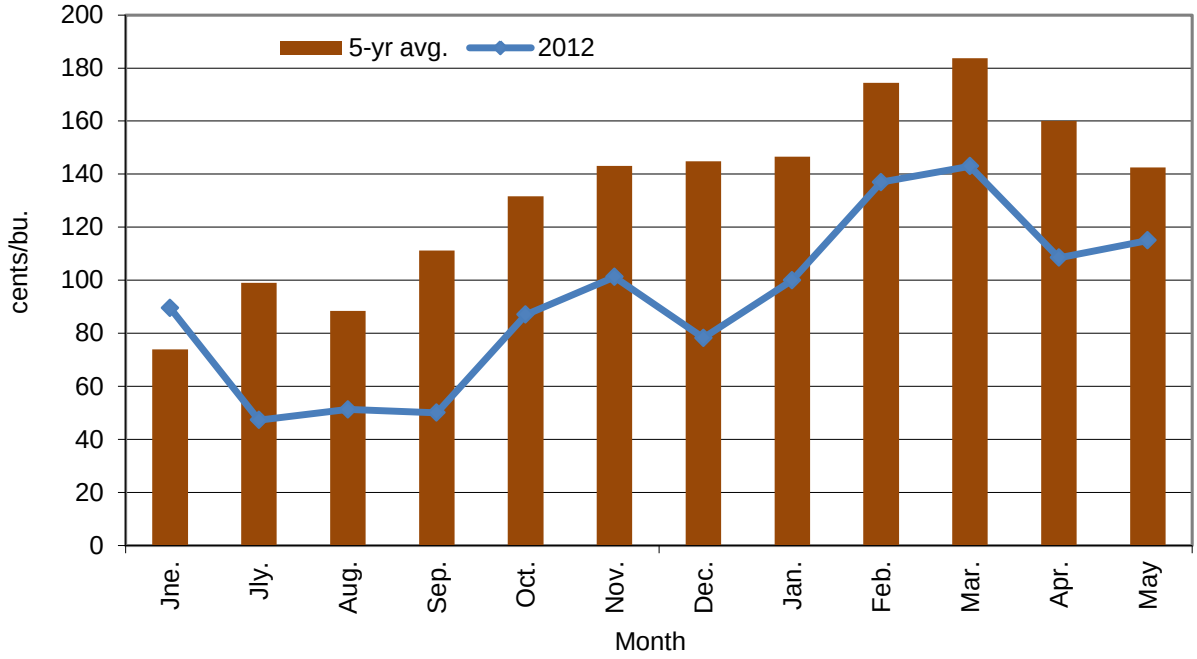


Figure 10. Portland - MGEX HRS Wheat Basis, Seasonal Trend, 2010-2013 Crop Years



Conclusions

HRS wheat, traded on MGEX, is the dominant class of wheat in North America in terms of quantity, value, and trade. MGEX spring wheat futures provide access to the pricing of HRS wheat for the industry. The MGEX spring wheat contract provides numerous trading opportunities for those with knowledge of price spreads between HRS, HRW, and SRW wheat. Hedging and merchandising opportunities are enhanced by a stable and predictable basis between the MGEX HRS wheat futures and prices at country elevators as well as export terminals. Overall, the MGEX HRS wheat futures contract provides a highly liquid tool for trading and hedging in North America's flagship wheat.