

Wheat Price Swap

From the world's leading food and agribusiness bank

Flexible commodity price risk management for wheat producers

Australian producers have always been well aware of the impact of overseas markets and external influences on local agricultural prices and input costs. Many are beyond their control but some risks can be minimised. Rabobank offers access to a range of products and services to help clients manage the risks associated with volatility in agricultural commodity prices.

How do Wheat Price Swaps work?

A Wheat Price Swap allows a producer to fix the Australian dollar (AUD) price of a portion of future production.

Australian wheat prices are determined by reference to US wheat futures markets, the Australian dollar / United States dollar (AUD/USD) exchange rate and 'basis'. The exchange rate and wheat futures generally account for approximately 80-90% of a local wheat price.

Fixing the AUD price in this manner can help producers to protect themselves against deterioration in these two major influences on local wheat prices. However, wheat producers are still subject to basis risk. In addition, Wheat Price Swaps do not include fixed costs such as freight, handling charges and levies etc. Wheat Price Swaps are cash settled using Chicago Board of Trade (CBOT) or Kansas City Board of Trade (KCBT) wheat futures prices, and the AUD/USD exchange rate.

Rabobank provides Wheat Price Swaps for contract amounts as low as 100 metric tonnes, with expiry dates ranging up to two years. USD Wheat Price Swaps are available; however foreign exchange risk would need to be managed independently.

Benefits

Producers can fix a price on a proportion of their production for the new crop and the following season.

Wheat Price Swaps are cash settled, so no delivery of physical produce is required. This allows you to maintain independence in your marketing programme.

Wheat Price Swaps may be exited in the event of a change in the producer's marketing strategy, or a crop failure.

The expiry of a Wheat Price Swap can be constructed to match the timing of cash receipts for wheat sales.

There are no initial transaction costs such as brokerage and GST. Bank margins are included in the quoted price.

There are no initial deposits and variation margins required.

Considerations

The producer cannot take advantage of any favourable price movements on the fixed portion.

Wheat Price Swaps are fixed price obligations and are cash settled, resulting in a gain or a loss. In the event of production failure, losses occurring under Wheat Price Swap settlements could significantly affect the producer's financial position.

The total price risk is not covered. Producers still carry 'basis risk'.

EXAMPLE 1

Wheat Price Swap

A wheat consumer wishes to fix the price of 1,000 metric tonnes (mt) of expected purchases for the new crop.



The prices and exchange rates used in these examples are for illustrative purposes only and may not reflect actual rates.

1 March this year

Market information

- The current swap price for settlement 26 November this year is AUD 225/mt. This is a combination of CBOT wheat futures and the forward exchange rate.
- The settlement reference price is based on the CBOT December Wheat Futures settlement price on 25 November (Chicago time), and the 'WM/Reuters Australian Fix 10am reference rate (WMFXAU10)' as published by Bloomberg at 10.00am on 26 November (Sydney time).

Decision

The producer enters into a Wheat Price Swap contract with Rabobank for 1,000 tonnes, with settlement 26 November this year at a fixed price of AUD 225/mt.

26 November same year

SCENARIO 1

Market information

- CBOT December wheat futures settlement price is 340 US cents per bushel on 25 November (Chicago time).
- AUD/USD exchange rate is 0.7000 as referenced to the WMFXAU10 as published by Bloomberg at 10.00am on 26 November (Sydney time).
- The reference benchmark of AUD 178.47/mt is a combination of these i.e. USD 3.40 x 36.74371 bushels/mt divided by 0.7000.

Settlement

The producer receives from Rabobank the difference between the Wheat Swap price and the settlement reference price.

i.e. Swap price proceeds

$$1,000\text{mt} \times \text{AUD } 225/\text{mt} = \text{AUD } 225,000$$

Settlement reference price

$$1,000\text{mt} \times \text{AUD } 178.47/\text{mt} = \text{AUD } 178,470$$

Payment from Rabobank

$$= \text{AUD } 46,530 \text{ or } \text{AUD } 46.53/\text{mt}$$

The producer receives the difference between the swap price and the settlement reference price. The gain compensates for the lower price received when the producer sells the physical wheat at the same time for a cash price of AUD 178.47/mt plus or minus 'basis' and less freight, storage charges etc.

SCENARIO 2

Market information

- CBOT December wheat futures settlement price is 450 US cents per bushel on 25 November (Chicago time).
- AUD/USD exchange rate is 0.6700 as referenced to the WMFXAU10 as published by Bloomberg at 10.00am on 26 November (Sydney time).
- The reference benchmark of AUD 246.79/mt is a combination of these i.e. USD 4.50 x 36.74371 bushels/mt divided by 0.6700.

Settlement

The producer pays Rabobank the difference between the Wheat Swap price and the settlement reference price.

i.e. Swap price proceeds

$$1,000\text{mt} \times \text{AUD } 225/\text{mt} = \text{AUD } 225,000$$

Settlement reference price

$$1,000\text{mt} \times \text{AUD } 246.79/\text{mt} = \text{AUD } 246,790$$

Payment from client

$$= \text{AUD } 21,790 \text{ or } \text{AUD } 21.79/\text{mt}$$

The producer pays the difference between the swap price and the settlement reference price. The loss offsets the higher price received when the producer sells the physical wheat at the same time for a cash price of AUD 246.79/mt plus or minus 'basis' and less freight, storage charges etc.

The scenarios, prices and/or exchange rates used in the examples are illustrative and indicative only and may not reflect actual prices and rates.

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