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SANCTIONS, RATIONS, AND NATIONS

The recent spate of events in the Ukraine, aggravated by the tragic air crash of MH-17, is well known and was followed by sanctions on Russia by the US and the EU. Russia reacted in turn by imposing sanctions in specific food commodities. All of these events have had little impact on the world food prices this year given the abundance of grain production in the US and South America. Usually a Russia/EU/US issue leads to a sudden spike in oil prices and increase in volatility. Unfortunately, the grain markets do not get as much attention. I consider it unfortunate because the effects of such changes are lasting in the agribusiness value chain.

Russia and the Ukraine export most of their grain production out of the Black sea region. To give a perspective of the Black Sea region's food production capabilities, I shall use the USDA numbers published earlier this month. First, on the wheat front, Russia is expected to produce 59 MMT and export 22.5 MMT, Kazakhstan is expected to produce 13.5 MMT and export 6 MMT, Ukraine is expected to produce 22 MMT and 9 MMT. Second, on the coarse grain front Russia is expected to produce 40.5 MMT and export 7.4 MMT, Ukraine is expected to produce 36.5 MMT and export 18.5 MMT. If we consider wheat alone, the Black Sea region produces 1/7th of the global wheat. Most of the countries that rely on this wheat are the North African and Middle Eastern countries. In addition, the Ukraine is a producer of sunflower seeds/oil, and Russia is big producer of beet sugar. The take away from these numbers is that this part of the world has a profound impact on the global food chain, both in terms of prices and sustainable supply.

This year, the world has been so far fortunate to see a bountiful crop in North America and South America. This bounty has been compounded by an increase in global food inventory levels. Hence, despite the volatile European situation we are now witnessing, consumers seem to be in a state of calm.

Now should be a time to reflect on supply and price signals and proactively plan for next year. First, prices always have a lower bound, and the velocity with which it approaches a lower bound is always slow. Mathematically speaking, prices have a minimum of zero, and the rate of decrease in prices is monotonically decreasing. Conversely, when the prices go higher they theoretically have no upper bound, and the rate of price increase is faster as prices go higher. The consumer should incorporate this simple mathematical model in preparing for 2015 budgets. Second, given Russia's stance on keeping retail prices of food from increasing domestically, either exports or inventories will go down. In either case, the dependence on wheat from the US will be greater as Argentina's supply is yet uncertain. Third, this year the global farming industry has witnessed prices plummet and yields improve. In South America, farmers have already locked in fertilizer purchases for next year. Given these conditions, next year's global planting intentions appear to be up in the air.

My conclusion is that a few nations such as Russia, the US and the EU dominate wheat and grain production in the world. Consumers around the world need to be cognizant of the impact of a sudden supply shock. It doesn't seem to be happening now, but it's good for consumers to be prepared for 2015. Sanctions create disincentives, rations artificially distort price equilibriums, and consumer nations usually end up paying the price.