



OECD-FAO Agricultural Outlook 2010-2019



Price Volatility and Price Transmission

Pretoria, 11 August, 2010

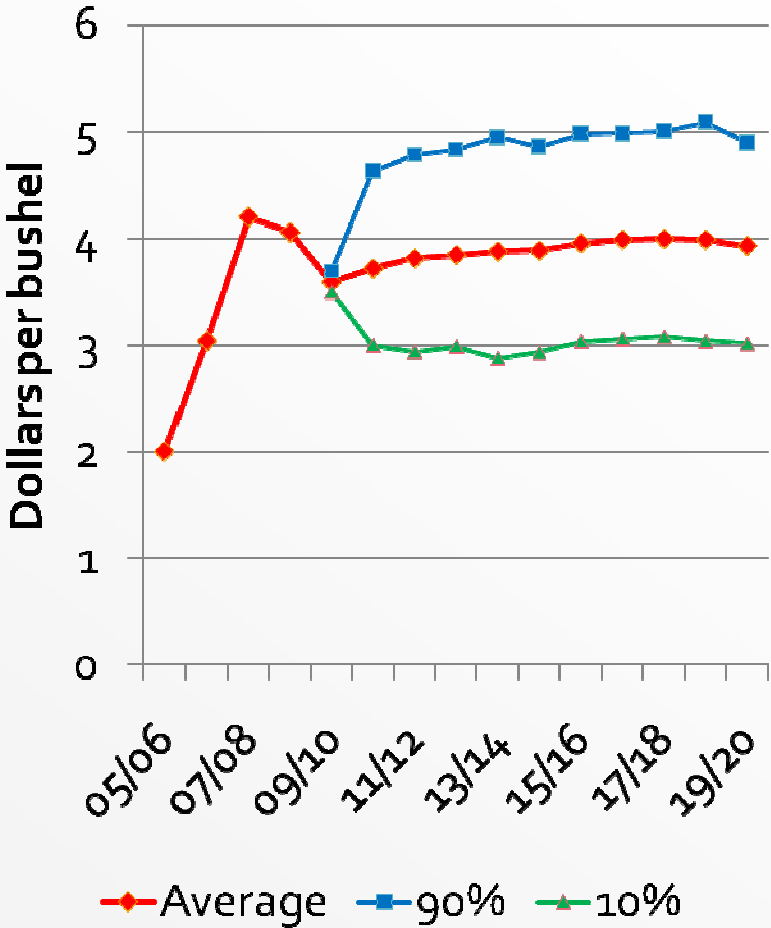
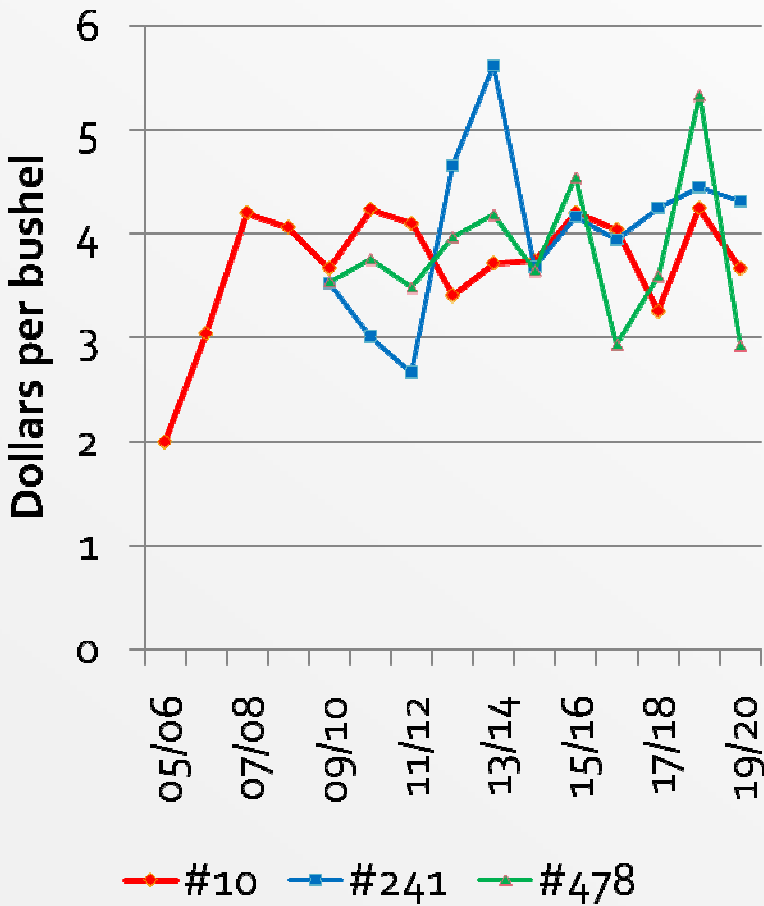
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Introduction



- **Outlooks are mostly straight lines, but life is full of ups and downs**
- **Understanding the reasons behind them enhances the use of a baseline – make adjustments from constant policy and stable weather base**
- **Models allow the simulation of complex scenarios**

You should always see more than a simple line



FAPRI Stochastic Outlook 2010-2019

OUTLINE



- **Volatility and uncertainty in agricultural markets**
- **Price transmission between the global and the domestic market**
- **Policies**

Why is volatility an issue?

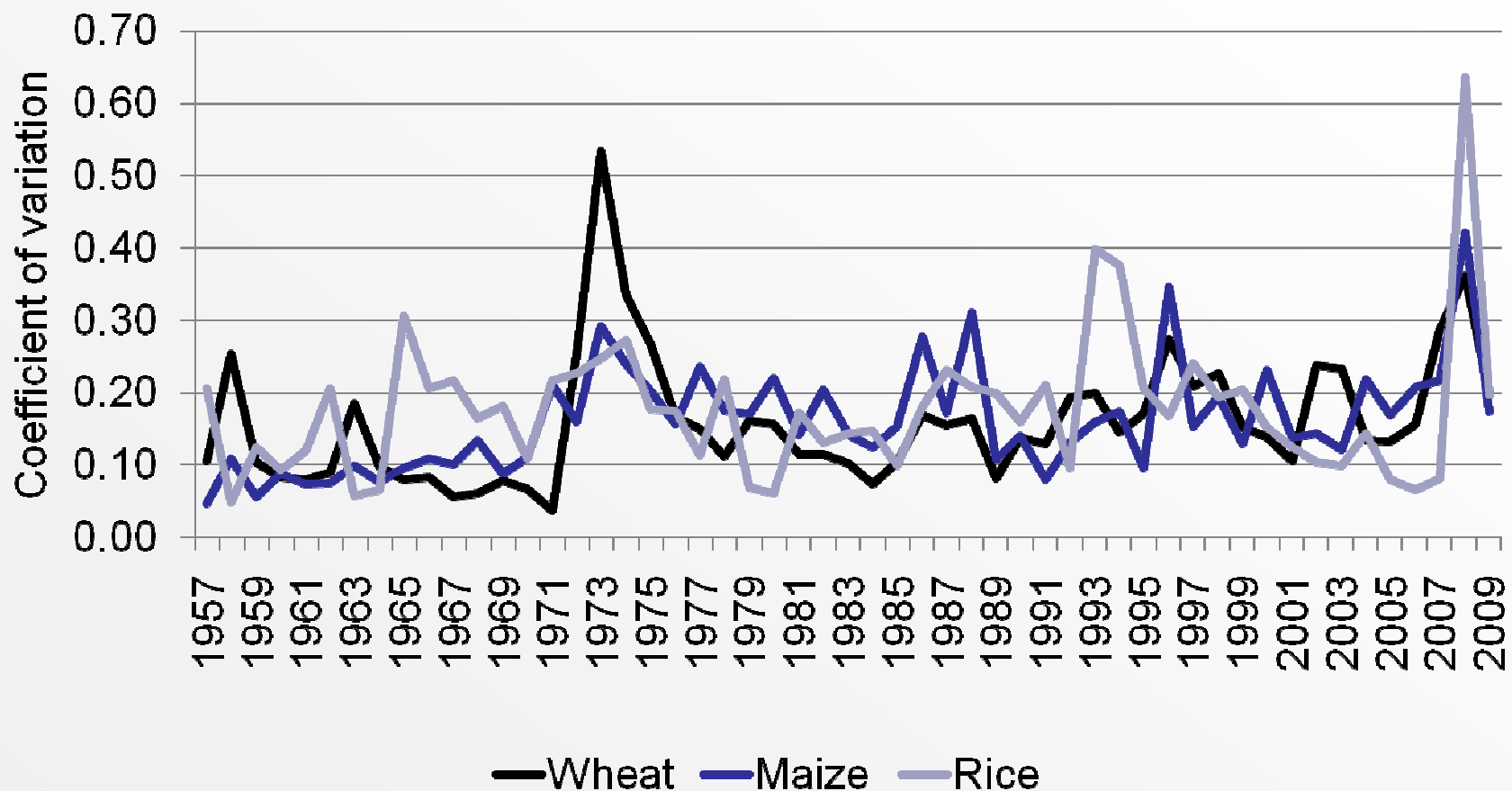


- Volatility is an important concern both at the macro level for the government and at the micro level for both consumers and for producers.
- The delay between production decisions and actual production creates risks for the producers and affects resource allocation in agriculture.
- Large variations in food costs affect especially poor consumers whose food expenditures may constitute a high percentage (as much as 70%) of household income.

Is price volatility increasing?



Nominal annualized historic volatility: cereal commodities





Future Volatility

- Assessments are mixed, but high price volatility is an on-going characteristic of agricultural markets
- Factors to consider:
 - increased linkage between energy and commodity markets,
 - presence of large institutional investors in futures markets,
 - removal of stabilization policies and the reduced public stocks of food grains
 - extreme weather events, associated with climate change.

OUTLINE



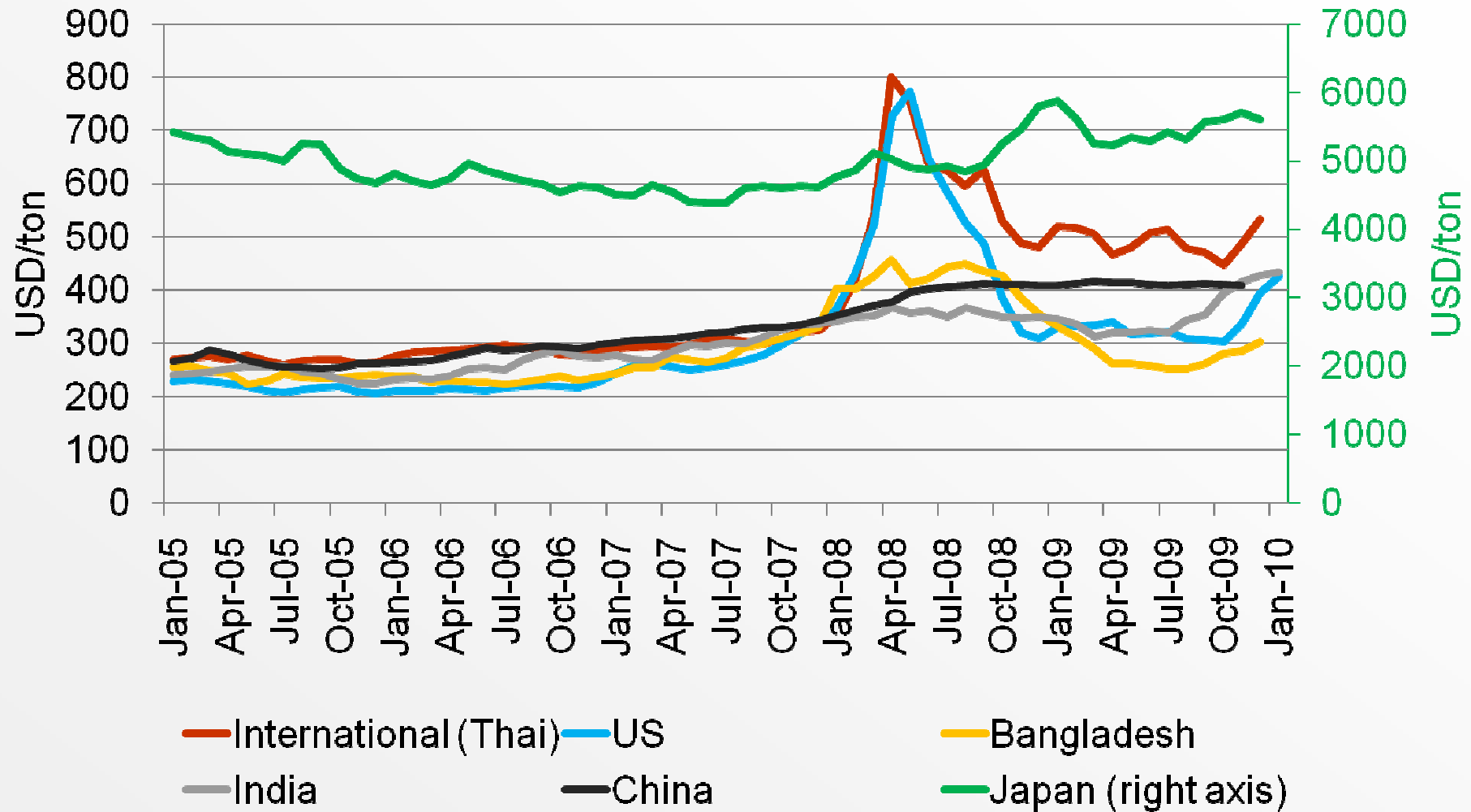
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Linking the global to the domestic outlook

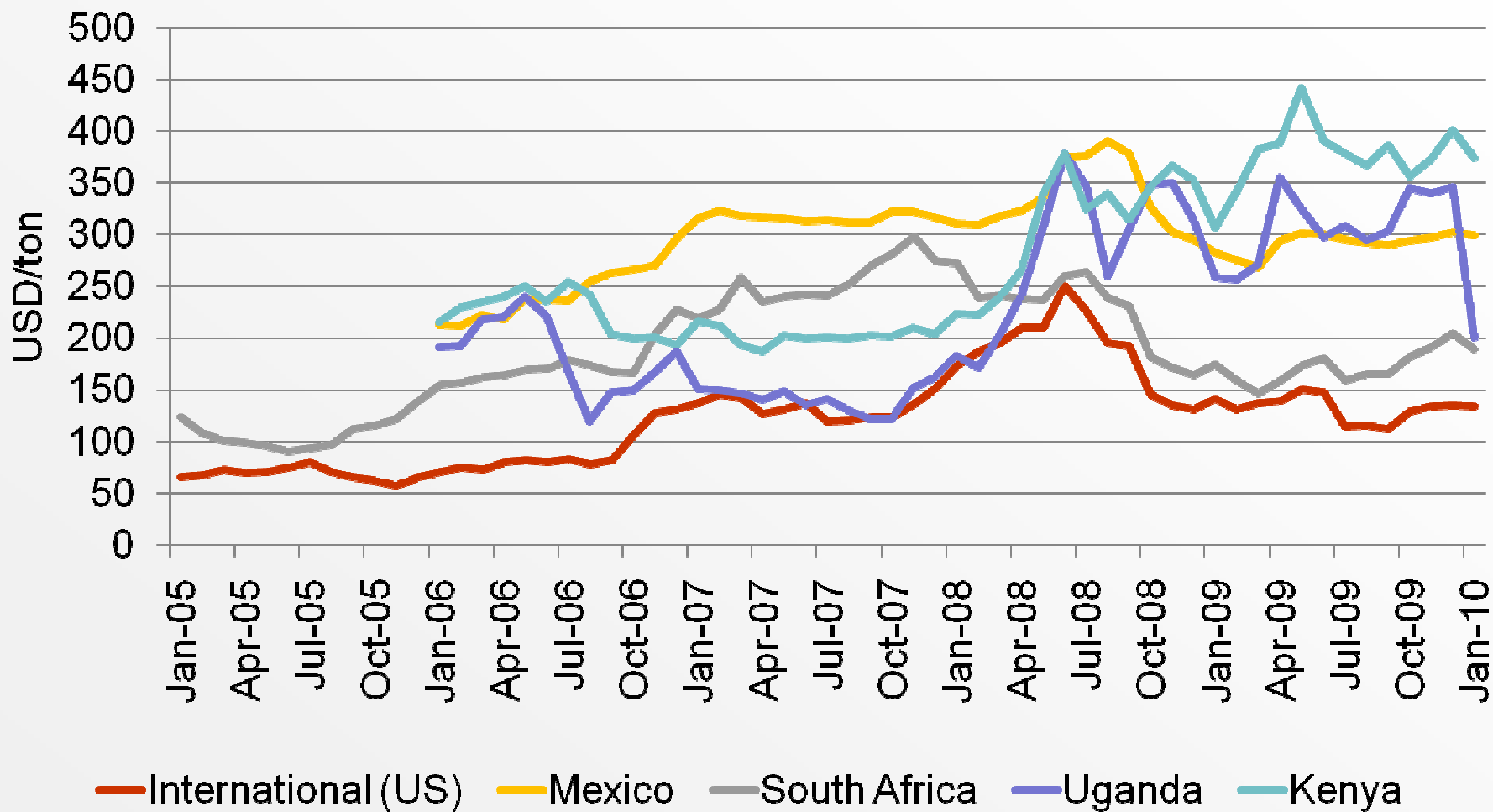


- Price transmission is affected by the movement, or the potential movement, of imports or exports.
- Account for: transaction, transport and informational costs, as well as differences in product attributes.
- Domestic policies play the critical role in price transmission (*minimum support prices, intervention policies, import or export restrictions, variable tariffs, export taxes, sanitary or phyto-sanitary regulations*).
- Market structure also plays an important role if importing or exporting agencies exercise market power in conducting their operations.

Policies can drive markets - the case of rice



Account for domestic and imported volatility – the case of maize



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Recent policy responses to higher food prices have influenced volatility



- **Trade measures:**
 - reduce or suspend import tariffs,
 - export barriers,
- **Supply measures:**
 - domestic production stimulation,
 - release of government held stocks,
 - changes to biofuel policies,
- **Consumer protection measures:**
 - retail price controls,
 - consumer subsidies for staples,
 - direct income transfers,
 - tax reduction.
- Specific impacts on volatility are complex, depend on magnitude and timing.
- Each country applied instruments as needed, no co-ordination.

} Support demand or tighten supply – global prices increase further

} Substitute domestic production for imports and promote increased self sufficiency – prices decrease

} Support domestic demand, involves government outlays – slow price adjustment

Summary and Conclusions



- New and old sources of volatility complicate the baseline.
- Evaluation of policies, markets and natural conditions is essential for projection work.
- Policy and market scenarios are important supplements to the baseline.



Thank You

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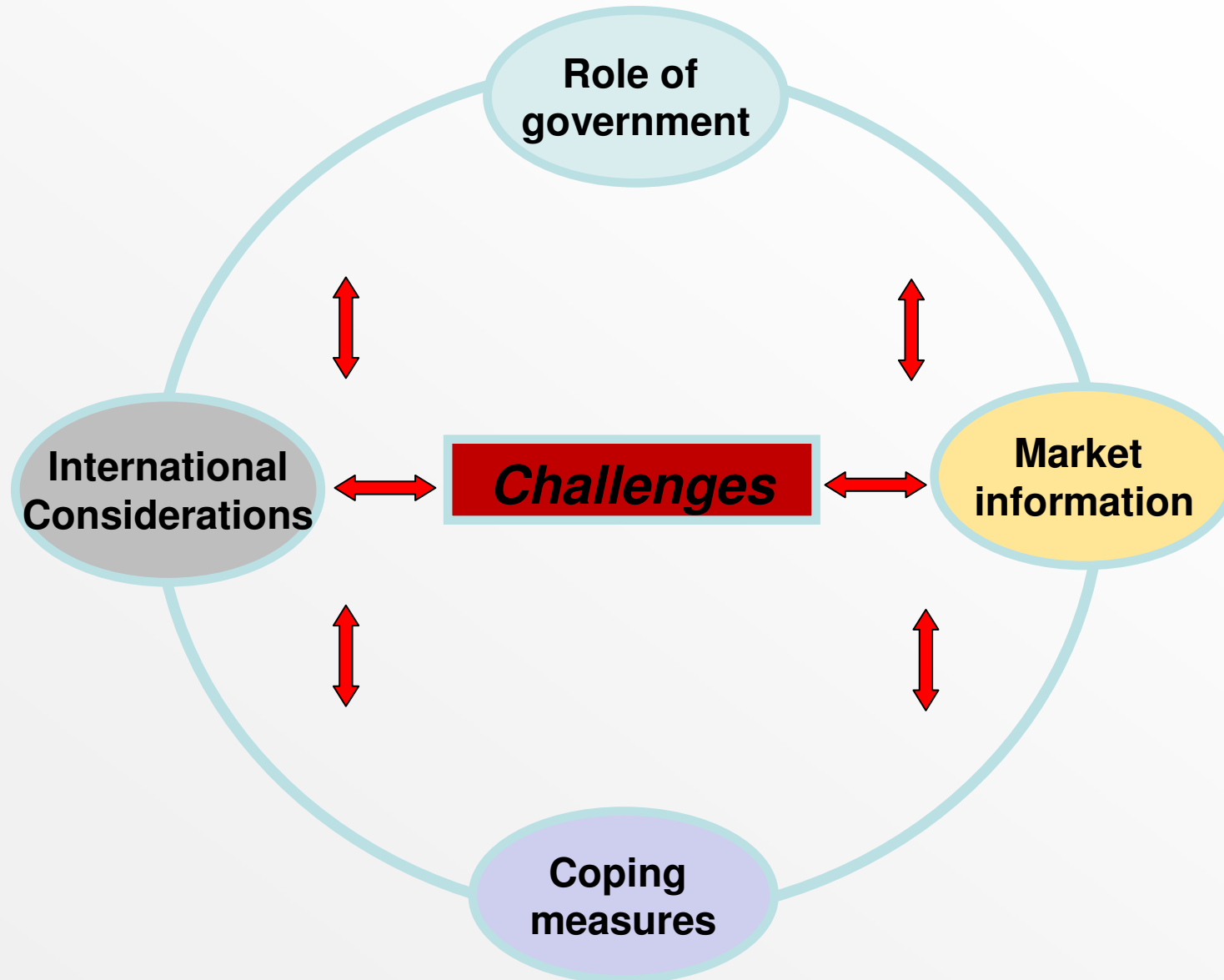
Trade

and

Markets

Division

Understanding policies...





Role of government

Good risk management practices should be diversified and targeted.

Governments have a role to play in:

- facilitating access to market and non-market strategies,
- empowering farmers to take responsibility for managing their own business risk,
- assisting poor consumers with food expenditures,
- focus on catastrophic risks that have large consequences for individuals or regions.



Complications

Policy instruments and risk management strategies may have unintended effects like:

- masking price signals to producers,
- raising prices to consumers,
- development of black markets
- transfer efficiency and distribution problems
- discourage farmers' diversification
- displace other risk management strategies.