China just one factor behind increasing global demand for agricultural commodities

Investors – institutional and non – are once again flocking toward the agricultural sector, having noted that it offers great opportunities. Experts in demographics, meanwhile, have intensified their warning that the demand for food is rising and that there is an increased risk of famine in vulnerable areas. In fact, the prices of agricultural commodities are at about the same level as in 2006, just before the bull run of 2007-2009 when potash prices went above USD 700/ton. However, the conditions exist for another jump today as the supply situation remains tight. Agricultural scientists and the UN Food and Agriculture Organization (FAO) have warned of the risk of imminent famine as the demand for food will be increasing at ever faster rates than supply. The dire prediction is that global demand for food will double by the year 2050 while supply will struggle to keep up.

There is only one solution: agricultural productivity must increase. For that to happen, apart from promoting global food security occupying an ever more central role in politics, agriculture itself must become more prosperous and more economically viable, such as to sustain the drivers of agricultural investment intact for the long term. The world's population now stands at 6.6 billion and the UN estimates it will grow to nine billion by 2030. Meanwhile, the residents of China and other rapidly emerging economies are consuming ever higher quality food, thanks to evolving consumerism, as millions join the ranks of the 'middle classes' – demanding more meat. Nevertheless, agricultural commodities are no longer just about food; they are increasingly being used for the production of biofuels such as ethanol and biodiesel, competing with food production. Against this background, the central problem is the availability of arable land, which is becoming ever more limited – not to mention the availability of water. Agriculture itself needs to ‘revolutionize’. Greater yields must be extracted from smaller and more fertile and mineral rich plots. In other words, not only will the rich countries need to produce and export more agricultural commodities, agriculture must become more efficient, resulting in increased productivity per unit area.

Agriculture and agricultural products therefore will become more important targets of future investment. Certificates and other derivatives on agricultural commodities have gained over the past months just after the sharp price correction of “commodities” of 2013. An important component of the companies benefiting from increased demand for agricultural production include agrochemical producing fertilizers as well as seed producers and agricultural machinery manufacturers.

China combines all of the drivers of increased demand for agricultural commodities as it battles for a leading role in their consumption and trade. In order to win this battle, China has mandated state run grain trading institution, COFCO (China National Cereals, Oil and Foodstuffs Corp), to challenge the world’s most powerful agribusiness groups, including Archer Daniels Midland, Bunge or Cargill. Last March, COFCO bought a 51% stake of the Dutch grain trading house Nidera and it is about to sign an agreement with Singapore’s Noble Group to form a joint venture for trading and processing agricultural products. The USD$ 1 billion operation – which could be announced in a few days according to Bloomberg – engages a Chinese private equity fund and would give COFCO a 60% stake in the new company. Historically in charge of supply of food on behalf of the Government, COFCO’s goal in 2010 was to invest at least $ 10 billion in overseas acquisitions by 2015. However, the plan has only just started to gain steam and it is only now that the established food distribution giants have taken notice as the much bigger and more profitable COFCO starts to make waves, reducing their ability to profit from China's growing Chinese hunger for raw materials. Indeed, Beijing, which already buys 60% of the world's soybeans, this year, could become the largest importer of wheat while doubling its corn imports. Meanwhile, milk is more expensive, as corn, soybeans and other agricultural products – boosted also by higher fuel prices, increasing the cost of shipping.

All of this should eliminate any fear that potash prices should fall further; indeed, last week CANPOTEX signed its Indian contract at USD$ 322 per ton, averting the USD$ 200/ton, worst case, scenario predicted last summer when the Russian-Belarusian potash cartel BPC broke up. Now, Uralkali is selling on the principle of higher volume at lower price, which makes it the effective price setter, forcing all other major players to follow suit. However, the new Potash Corp CEO Jochen Tilk, who has succeeded the retiring Bill Doyle, will continue to push for a supply managed rather than volume driven market. The demand for agricultural commodities will contribute to Potash Corp's strategy and could ultimately persuade Uralkali and Belaruskali to re-establish a 'cartel', boosting prices upwards.