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**Addressing the impact of
commodity derivative trading**

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Addressing the **impact** of **commodity** derivative trading



A Common Fund for Commodities
sponsored project managed by
De Novo Agricultura Pty Ltd



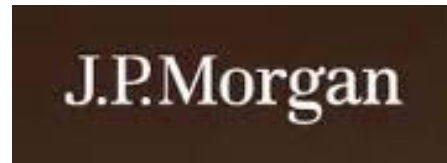
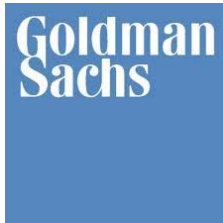


Core objectives of the project

1. To create a dialogue around commodity derivatives and their impact on commodity prices between leading investment banks and UN related entities pursuant to the UN Special Assembly in April 2013.
2. To address the core underlying issue of insufficient supply response to growing demand.
3. To create an on going action based agenda.



Participants





Key conclusions: Commodity derivatives

- Financialization versus Supply and Demand fundamentals a difficult issue to find genuine common ground on.
- Defining the externalities of Futures and OTC markets difficult to agree on.
- Physical markets without futures markets are experiencing high levels of price volatility.
- Liquidity critical for pricing efficiency.
- Need for clarification of key terms e.g. speculators and investors and common usage.



Key conclusions: Commodity derivatives

- Evidence for and against contradictory and view dependent, hence regulation likely to be so. Real need for deeper on going debate to create a common understanding to inform the policy debate.
- Development of market access crucial for emerging markets (IFC initiative), local hedging instruments and capacity building.
- Agreement that expanding supply is a priority and an area for joint focus.
- Pension funds also represent consumers hedging their long term risk.



Key Conclusions: Supply Expansion

- Agreed by all that supply expansion is critical to re-establishing healthy inventory levels and reducing fundamental drivers of price volatility.
- Most investment and potential for growth is required in higher risk geographies e.g. Africa, Latin America, FSU and Asia.
- Private sector reluctant to invest directly in supply side due to systemic risk of agriculture, country and credit risk allied with the scale of projects available.
- A number of banks launching investment funds for African agriculture with local sponsors.



Key Conclusions: Supply Expansion

- Key areas of focus are:
 1. Short term: Trade , pre-export and input finance.
 2. Medium term: Capital expansion and existing logistics.
 3. Long term: Core infrastructure and human capacity building.



Uncertainty in the bank market

- Banks reassessing exposure to agricultural commodity derivatives. Uncertainty of regulatory situation e.g. Dodd Frank and French regulation.
- Profitability being reduced therefore attractiveness investment and risk capacity contracting.
- Pension funds scaling back or exiting from commodity index products due to poor returns and a break down in the negative correlation with equities and fixed income.
- The current environment makes investment difficult at the institution and industry level.



Recommendations moving forward

- **Commodity derivatives:** We are seeking a single representative entity to co-ordinate with the banks and work through the CFC for potential follow up meetings and an on-going channel for communication.
- **Supply side expansion:** an ambitious potential research program was proposed (USD 9 million) for a multi-year project, but with banks facing acute cost reductions and uncertainty over future regulation of the sector there is reluctance to commit to such a project.
- Real interest has been expressed to work in the area and selectively look at public-private investment where viable commercial opportunities exist.



Other considerations

- Banks make multi billion commitments to this sector via their lending and trading activities. This will continue and hedging and market liquidity are crucial.
- There needs to be a broader consortium of interested institutions to boost supply side investment and share risks and learning.
- Food demand is continuing to rise rapidly in emerging markets and weather risk and supply risks appear to be increasing.
- Volatility likely to rise and be sustained even if speculative levels are reduced.
- The need for action on supply side investment is **URGENT**.



Final take away

- There is a genuine willingness on all sides to work towards a better common understanding and an action oriented agenda as described.
- Opportunities to build on this should be pursued where possible, with realistic initiatives proposed.
- Channels of communication are to be kept open with this end in mind.