Managing volatility

TechnoServe
BUSINESS SOLUTIONS TO POVERTY

ICO
September 26th 2011
AGENDA

- Global stocks are down
  - Because demand is exceeding supply
  - This creates volatility
  - Which will be amplified by non commercial players
  - Instruments exist to manage volatility
  - But counterparties would need confidence in contracts
  - ICO members can formulate a vision of a desired end state
  - And in the short term disseminate pragmatic tools
PRODUCER STOCKS CONTINUE TO DECLINE

Producer opening stocks by crop year
Million 60 kg bags

Source: ICO
STOCK-TO-USE RATIO SHOWS A SIMILAR STORY

Producer stock to use ratio by crop year

Source: ICO; USDA
HOW CAN THIS BE WHEN BRAZIL IS HAVING BUMPER CROPS

Coffee production by crop year
Million 60 kg bags

Source: ICO; CONAB; Colombian Coffee Growers Federation; Coffee Network
AGENDA

- Global stocks are down

- Because demand is exceeding supply

- This creates volatility

- Which will be amplified by non commercial players

- Instruments exist to manage volatility

- But counterparties would need confidence in contracts

- ICO members can formulate a vision of a desired end state

- And in the short term disseminate pragmatic tools
BRAZILIANS ARE DRINKING MORE COFFEE

Coffee consumption by crop year
Million 60 kg bags

Source: ICO; ABIC
*2010-2014 numbers estimated
NOT JUST BRAZIL, CHINA DEMAND IS GROWING AS WELL

Starbucks Greater China stores by year

Source: TNS estimates
AND NOT JUST COFFEE, STRONG DEMAND FROM EMERGING MARKETS

Combined soy, corn and wheat demand 2000 to 2010 BRIC versus US and US combined

Million tonnes

Source: Rabobank
LAND UNDER CULTIVATION NOT GROWING

Coffee area harvested
Ha

Source: FAO
THE SUPPLY OF MILD ARABICA HAS NOT GROWN FOR 30 YEARS

Coffee production of mild Arabica producing countries*
Million 60 kg bags

* ICO defines Arabica as either natural (e.g., Brazil) or mild (including washed and semi-washed coffees. Includes total coffee volume for countries classified as primarily producing mild Arabica, but may include some Robusta volume. Excludes countries that primarily produce natural Arabica or Robusta (e.g., Brazil, Vietnam)

Source: ICO
AGENDA

- Global stocks are down
- Because demand is exceeding supply

**This creates volatility**

- Which will be amplified by non commercial players
- Instruments exist to manage volatility
- But counterparties would need confidence in contracts
- ICO members can formulate a vision of a desired end state
- And in the short term disseminate pragmatic tools
AGENDA

- Global stocks are down
- Because demand is exceeding supply
- This creates volatility
- Which will be amplified by non-commercial players
  - Instruments exist to manage volatility
  - But counterparties would need confidence in contracts
  - ICO members can formulate a vision of a desired end state
  - And in the short term disseminate pragmatic tools
INCREASED TRADING FROM OUTSIDE THE COFFEE INDUSTRY

Long positions in coffee futures and options by trader category
Percentage

Short positions in coffee futures and options by trader category
Percentage

Non-reportable
Commercial
Non-commercial

Source: CFTC
COFFEE HAS BEEN AN ATTRACTIVE INVESTMENT

Commodity Returns
Million 60 kg bags

Commodity Returns 2010

-40% -20% 0% 20% 40% 60% 80% 100%

Matif Wheat
ICE Cotton
NY Coffee
KCBT Wheat
CBOT Corn
MDEX Palm Oil
CBOT Wheat
Soybean Oil
CBOT Soybeans
Nickel
Copper
Gold
Soybean Meal
NY No. 11 Sugar
Crude Oil
Aluminium
Lead
Zinc
NY Cocoa
Lon Cocoa
Natural Gas

Commodity Returns 2011 YTD

-40% -20% 0% 20% 40%

Gold
CBOT Corn
NY Coffee
CBOT Soybeans
Soybean Oil
NY Cocoa
Soybean Meal
KCBT Wheat
Crude Oil
Lon Cocoa
Aluminium
Copper
Lead
NY No. 11 Sugar
CBOT Wheat
Zinc
Natural Gas
Nickel
Matif Wheat
MDEX Palm Oil
ICE Cotton

Source: Rabobank
AND THE WORLD HAS BECOME INCREASINGLY SCARY FOR AN INVESTOR

• Europe struggling to contain Greek crisis

• US debt spiraling

• China growth softening and leaders worried about inflation and asset bubbles

• The safe strategy of investing in equities for the long haul may not apply until the world deleverages
AGENDA

- Global stocks are down
- Because demand is exceeding supply
- This creates volatility
- Which will be amplified by non-commercial players

**Instruments exist to manage volatility**

- But counterparties would need confidence in contracts
- ICO members can formulate a vision of a desired end state
- And in the short term disseminate pragmatic tools
INSTRUMENTS EXIST TO PROTECT FARMERS

- My Price
- World Coffee price
- Put option
- Collar
- My cost of production
INSTRUMENTS EXIST TO PROTECT FARMERS

What’s actually going on out there in the real world

My Price

My cost of production

World Coffee price
AGENDA

- Global stocks are down
- Because demand is exceeding supply
- This creates volatility
- Which will be amplified by non commercial players
- Instruments exist to manage volatility

- But counterparties would need confidence in contracts
- ICO members can formulate a vision of a desired end state
- And in the short term disseminate pragmatic tools
WHAT WOULD BE NEEDED TO MAKE IT WORK

• Commitment at origin to provide recourse that would allow the trust that is required

• Education to help producers and other stakeholders at origin understand the risks of volatility and the value of hedging

• An examination of regulatory frameworks for any hurdles that might inhibit hedging from being offered to small and medium producers

• Develop strategies to ensure the market has the supply it needs
AGENDA

- Global stocks are down
- Because demand is exceeding supply
- This creates volatility
- Which will be amplified by non commercial players
- Instruments exist to manage volatility
- But counterparties would need confidence in contracts
- ICO can formulate a vision of a desired end state
- And in the short term disseminate pragmatic tools
WHAT CAN PRAGMATICALLY BE DONE IN THE NEAR TERM

• A vision of where ICO would like the industry to head.

• Better quality and more timely information which can reduce risk and reduce volatility

• Better understanding of techniques that can approximate hedging or reduce cost of hedging (e.g., selling a portion of harvest early to ensure production costs are covered, only requiring hedging on portion of crop, reducing window of exposure
AGENDA

- Global stocks are down
- Because demand is exceeding supply
- This creates volatility
- Which will be amplified by non commercial players
- Instruments exist to manage volatility
- But counterparties would need confidence in contracts
- ICO can formulate a vision of a desired end state
- And in the short term disseminate pragmatic tools