



28 February 2013

The Australian wool market was strong again in February, showing great resilience despite some large offerings, and finishing at around 1,140 USc/kg. In this edition of the monthly newsletter, we take a look at the forward wool market, where it seems to us there are some very positive developments occurring, and some good opportunities for growers. We also have a quick look at the latest global economic situation.

The Wool Forward Market

The wool forward market is another avenue for farmers to sell their wool, where buyer and seller agree to a price for a given volume and quality of wool to be delivered at some future date. Effectively, the forward price is based on the expected future spot price at time of delivery, and normally incurs some discount to take into account the price movement risks for the buyer.

The risk to entering into a forward contract for buyer or seller is that the eventual spot price has moved disadvantageously from the agreed forward price, or that one of the parties will default. To reduce the latter risk, forward contracts typically occur through a clearing facility, such as ASX Clear (Futures) or Riemann.

So the benefit of this market is that it assists the management of price risks for both buyer and seller. Effectively, it complements the operation of the auction market.

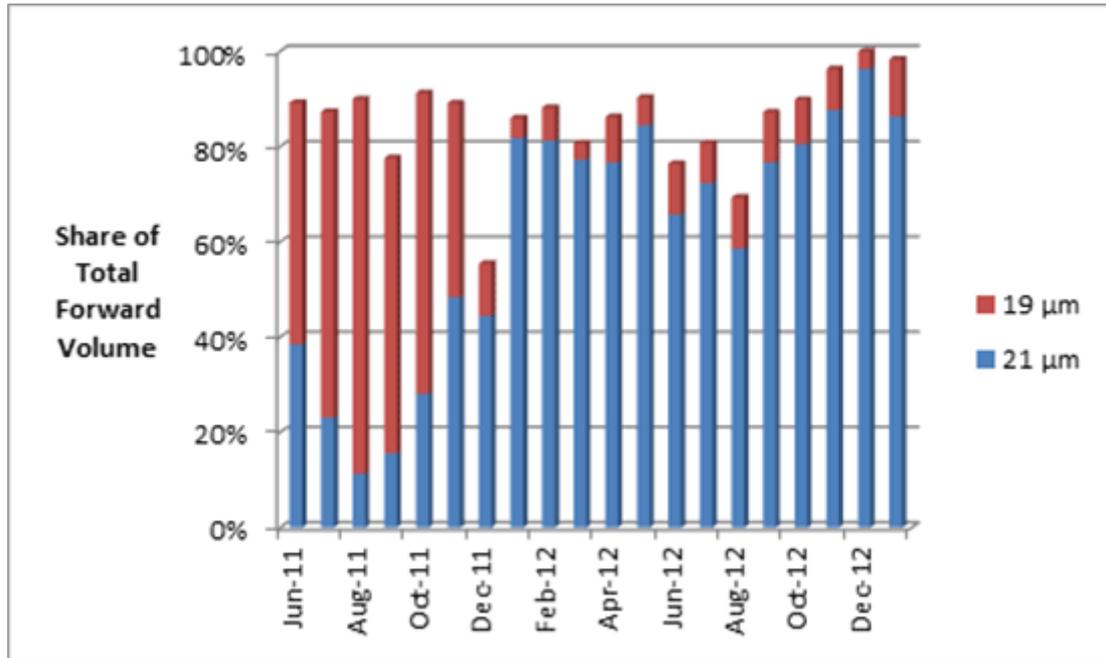
What is happening to the Wool Forwards market

The futures market has experienced some serious turmoil in recent years, particularly due to the collapse of New York-based futures trader MF Global in November 2011. One of the potential side-effects has been the steady growth in the use of forward contracts as an alternative, and to provide some insight into this shift, we have looked at the volume of wool forwards contracts cleared by [Riemann](#).

Since establishing their wool forwards facility in June 2011 (195 tons transacted), forward contract volumes have been increasing at an average of 16% per month. The wool volume traded in January 2013 represented a 244% increase from January 2012. In fact, the last eight months have seen an average 301% growth in volumes year-on-year.

Now we must keep in mind that the overall volumes transacted on this market are small – even now only 1-2% of monthly auction offerings. Nonetheless, the largest single trading month of the last 20 months (June 2012), saw nearly 1.2 m kgs contracted – equivalent to over 6% of the total auction offering.

The vast majority of wool forward contracts are for 19 micron and 21 micron wool. These wool micron classes represent 86% of the volume traded through the forward market, the bulk of which is 21µm wool. In the last three months these 2 diameter classes have represented more than 95% of the wool forward contracts.

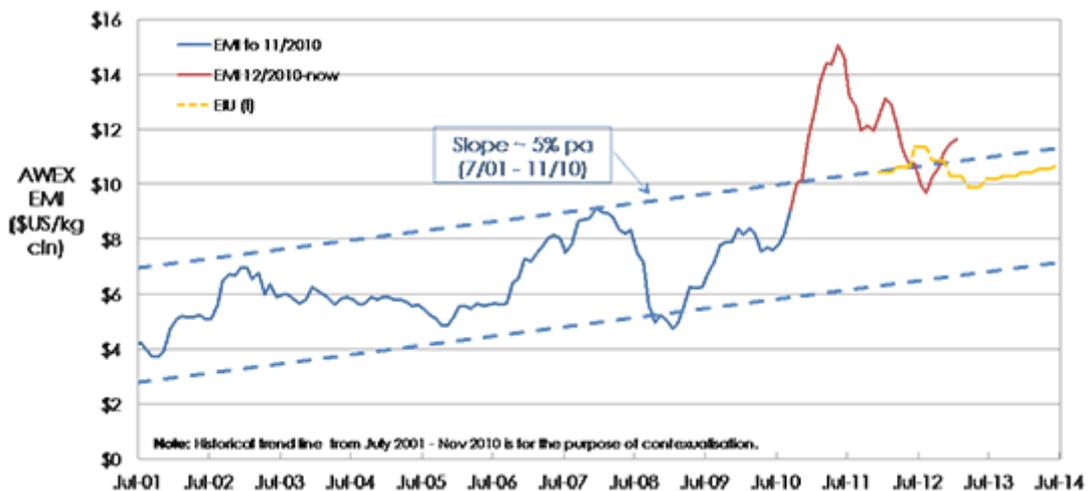


The largest share of trading volumes for dates beyond January 2013 occurs within the next three months (61%). This once again is dominated by 19µm and 21µm wool, of which the latter makes up the majority. Finally, it may be worth looking at the prices on offer in this market, especially when one considers that the prices of wool (especially the 21-micron band) are so strong in historical terms. Offers of 1,100 AUc/kg for 21-micron wool delivered in December 2013 exist, which may be of interest.

Global snippets

While China's economic growth rate has slowed, there are some positive signs emerging, and the London-based Economic Intelligence Unit (EIU) has revised upwards its forecast for Chinese GDP growth to 8.5% for 2013, reflecting the impact of the stimulus being applied. They also note that, if the US Congress can resolve the 'fiscal cliff' impasse, and thus avoid automatic spending cuts and payroll tax rises, the US economy will achieve a (relatively stellar) GDP growth rate of 2.1% for 2013, and 2.4% for 2014.

While on the subject of the EIU, revised forecasts for wool prices have also been released. The following chart summarises the outlook to July 2014, where we have converted the AUD estimates of EIU into USD using the FX outlook supplied by IMA-Asia. In short, the outlook is for the EMI to track at the upper end of the current long-term USD trend range. ABARES releases its long-term outlook on 6th of March, which will provide an interesting comparison with the EIU values.



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