THE BUYING POWER OF WHEAT

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Only once the past seven years, namely in 2001/2, were wheat farmers able to produce more wheat than could be consumed locally. Therefore, according to the principles of supply and demand, the price of wheat should be high. But this is not the case. In fact, it seems as if the price falls as the shortage grows. This is because import parity prices are dictating local prices. As a result, a ton of wheat has gradually lost so much of its buying power that wheat is no longer profitable – even when production is down.

Supply and demand

The demand for wheat in South Africa is about 2,4 million tons per year. As Table 1 shows, in the past two seasons the demand was only 1,7 and 1,5 million tons. In 2003/4 the average price for wheat was R1 509 per ton, while in 2004/5 it dropped to R1 171 per ton. In 2003/4, when there was a shortage of only 79 255 tons, the average price was R1 361 per ton.

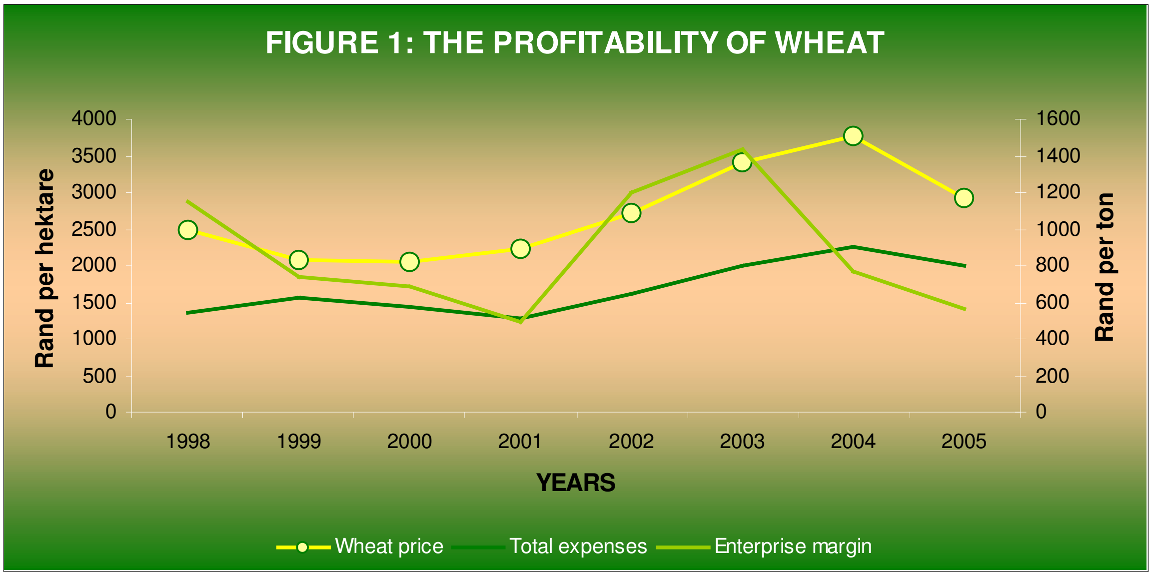
TABLE: CROP SIZE OF WHEAT

Year	Area	Crop	Shortage	Price*
	Ha	Ton	Ton	Rand/ton
2004/05	829200	1699280	-700720	1171.27
2003/04	748000	1540000	-860000	1509.92
2002/03	941100	2320745	-79255	1361.30
2001/02	959400	2492880	92880	1090.94
2000/01	860000	2122440	-277560	895.00
1999/00	718000	1725000	-675000	817.00
1998/99	748000	1531000	-869000	1000.00

** Average price of wheat in the Eastern Free Statet*

Local shortages of wheat can very easily be sourced from the international market because international stocks are very high. Every year SA millers release a cultivar list setting out the wheat they are prepared to buy from SA farmers and the criteria this wheat must comply with. Unfortunately, these criteria don't apply to imported wheat. Local wheat is then often mixed with imported wheat to boost the latter's quality. South African farmers don't always get the premium due to them for delivering high quality wheat. As a result, it is the import parity price of international wheat, irrespective of its quality, that determines the price of local wheat – and not the local levels of supply and demand.

In 2002, but especially in 2003, the profit margin of wheat in the eastern Free State reached highs of R1 369 and R1 605 per hectare after which it dropped to losses of R315 and R607 per hectare in 2004 and 2005. Although the price per ton had dropped in 2005 (after peaking in 2004), the biggest reason for the loss in profitability was the fact that there was a lower yield due to the drought.



Total production costs of wheat increased steadily from R1 291 per hectare in 2001 to R2 248 per hectare in 2004. There was a slight drop in costs to R2 012 per hectare in 2005. Farmers in the eastern Free State therefore weren't able to make a profit, despite local demand exceeding local wheat supplies by far. The low yield was therefore not compensated by a higher price, as should be the case in a free market.

Buying power

The income generated from wheat is calculated by multiplying price by quantity, or the yield per hectare with the price per ton. The cost of wheat production can also be linked to the yield per hectare.

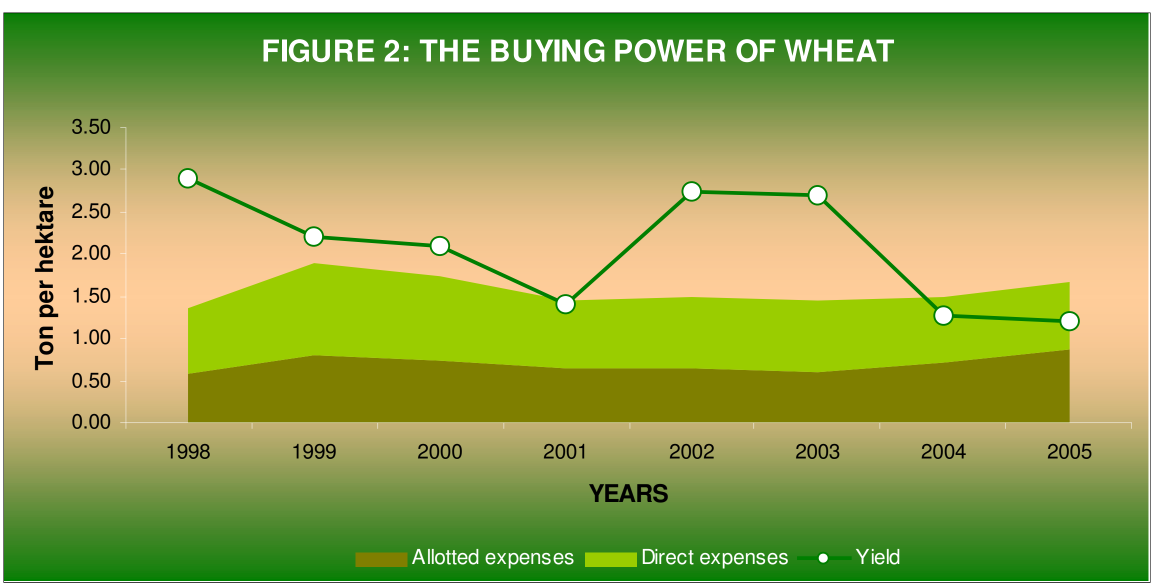


Figure 2 shows that at the average price for 2001, a yield of about 1,5 tons per hectare would be needed to cover total costs per hectare.

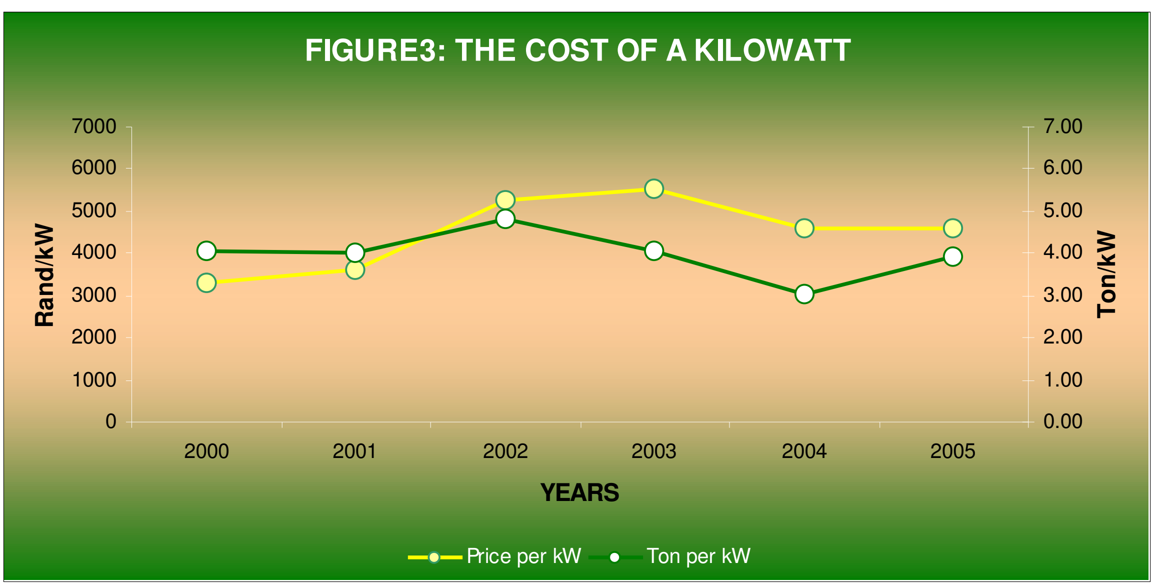
Yields reached 1,9 tons per hectare in 1999, then evened out before showing a gradual rise in the past four years. In 2005 the buying power of wheat, in terms of production costs, was 1,7 tons per hectare. Farmers therefore needed a minimum yield of 1,7 tons per hectare and a price of R1 171 per hectare to cover their production costs. But actual yields that year were only 1,2 tons per hectare, resulting in a loss of R607 per hectare.

In 2002 and 2003 the yield of wheat was of such a nature that farmers could easily cover their costs. Yields of 2,7 tons per hectare left farmers with an additional 1,2 tons per hectare to use to defray capital and management costs. In 2004 and 2005 wheat could not even defray its production costs and, in addition, farmers were short 0,2 to 0,5 tons per hectare on their yields.

In those two years, wheat could therefore not even contribute to defraying capital and management costs, again despite of local demand exceeding local supply by 860 000 to 700 000 tons.

The price of a kilo watt

Local farmers receive import parity prices for their wheat, irrespective of their production costs and local supply and demand levels. Over the past two years, this price didn't cover production costs and there was a shortage before capital equipment could be purchased. Tractor prices increased sharply from 2001 to 2002 when the rand weakened against other currencies. Since then, the rand strengthened substantially and tractor prices first stabilised before dropping in 2003 and 2004 (see Figure 3).



But, despite tractor prices having dropped, farmers will still need about four tons of wheat to buy 1kW of tractor power, as was the case in 2002 when the exchange rate was high, because the wheat price is so low in 2005. In 2004, farmers could buy 1Kw with 3 tons of wheat.

Even playing fields

The low import parity price of wheat in 2005 is the result of a strong rand that was mostly under R6 to the dollar during the season in question. In addition there is an over supply of wheat on the international market and it is possible to import wheat, especially from Argentina, at a cost below the local production cost. In 2004 and 2005 wheat prices were in no way affected by the low harvest caused by the drought.

If the playing field is level, there would be no excuse for local farmers not to compete internationally. But most overseas countries subsidise their farmers heavily and as a result these farmers' production costs are substantially below those of South African farmers. Secondly, the South African climate is far more variable than the climates in countries that South Africa competes with.

Thirdly the negative labour laws have made local farmers' wage costs uncompetitive against those of farmers in countries such as Argentina.

International supply and demand forces therefore aren't fair to South African wheat farmers. As a result imported wheat depresses the local wheat price to below the level at which it can be cultivated for profit in South Africa.

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