The futures market



Producers of agricultural commodities are quite vulnerable to price shocks as agricultural markets have an inherent tendency towards instability. This situation of variations in the prices of agricultural products became particularly critical after the global financial crisis in 2008.

The CAP

Traditionally, European agricultural markets were highly protected through the guaranteed price system of the original Common Agricultural Policy (CAP). However, the subsequent CAP reforms towards a reduction of market support gradually exposed the European agricultural sector to price variations.

Faced with price volatility, farmers became increasingly interested in futures markets for agricultural products and futures contracts can now be traded for a variety of commodities.

Futures

Futures **contracts** (or simply '**futures**') are standardised, binding agreements in which a buyer and a seller agree to trade a specified quantity of an agricultural commodity at an agreed price on a given future date. The price of the futures contract is determined through an auction process at the Futures Exchange, based on the balance between demand and supply for these products, whose courses are monitored on a daily basis.

Advantages and disadvantages

Futures markets perform two key functions which can be helpful for farmers:

- **risk management:** farmers have the possibility to 'lock in' a certain harvest price for (a part of) their agricultural production, thus excluding the possibility that their selling price will fall in the future;
- **price discovery**: farmers can estimate the selling price for their agricultural products at the beginning of the production process.

However, the use of futures also implies several disadvantages:

- farmers need to pay **commissions** and **fees** to brokerage firms and advisors to manage these complex financial products on their behalf;
- if the futures market is **not functioning properly**, the futures price is likely to be different from the price on the physical markets, thus farmers might receive a lower price than the one agreed in the futures contract.

The trading volumes and the number of farmers using futures in Europe remain far more limited than those in the United States. The recent experiences of European futures markets also show that a futures approach is not equally suitable for all agricultural sectors: exchanges for crops and oilseeds are rather successful as these products are relatively easy to standardise and store, while the perishability of meat and dairy puts structural limits on the development of their futures markets.

advisor: *consulente*
agreement: *accordo commerciale*
auction: *asta*
binding: *vincolante*
exchange: *borsa*
futures: *contratti a termine*
to lock in: *fissare, bloccare*
perishability: *deperibilità*



HOW DOES THE STOCK EXCHANGE WORK?

The Stock Exchange works on the "supply and demand" principle. If something is very popular, like oil, then that item will be more valuable. If something is very unpopular, like old cheese, then that item becomes less valuable. Good investors try to figure out what will become more popular and more scarce (or rare) and invest in that product.

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1 Find the synonyms of these words in the text.

1. Goods .....
2. Defenseless .....
3. Fluctuation .....
4. Safeguarded .....
5. Decrease .....
6. Supervised .....
7. Profitable .....
8. Drawback .....
9. Rewarding .....
10. Lack of endurance .....
11. Expansion .....

2 Complete the sentences.



1. Agricultural markets tend ..... unstable.
2. The global ..... crisis in 2008 determined critical ..... in the prices of agricultural products.
3. Price volatility is a ..... of the reduced market support, due to the late CAP reforms.
4. By locking in a certain harvest price, farmers can cover themselves against the ..... of their selling price.
5. Futures contracts usually need to be managed by ..... firms and advisors.
6. The ..... for their agricultural commodities can be assessed at the first stages of the production process.
7. Futures are more common financial contracts in ..... than in .....
8. The futures market ..... be universally valid for all kinds of agricultural commodities.

3 Answer the questions.

1. What is price vulnerability due to?
2. When did this process become particularly critical?
3. What led to the gradual exposition to price variation?
4. What kind of agreements are stated between a seller and a buyer?
5. When do farmers establish the selling price?
6. What compromises the feasibility of development for futures markets?





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