

**Charlie Carey Remarks
NGFA Convention
Walt Disney World Swan Hotel
Orlando, Florida
March 30, 2009
10:30 – 10:50 a.m.**

[Introduced by Hal Reed, First Vice Chairman of NGFA and President, Grain and Ethanol Group, The Andersons]

Thank you, Hal, for that kind introduction.

- I am honored to address the annual National Grain and Feed Association Convention.
- It is a tremendous opportunity to address the trends within our industry and to share information – to get your perspective about our products and services, how we are meeting your expectations, and where we could do better.

2008 was quite a year, and I think it is fair to say that the past few months have been some of most tumultuous and difficult times that any of us has ever seen.

- The problems that began with the U.S. housing bubble have spilled over into virtually every other area of our financial markets and the global economy.
- We now see tremendous dislocations in credit and lending markets, as well as interest rate, equity, foreign exchange, energy and commodity markets.
- Credit and lending markets are simply not functioning right now as investment and commercial banks deleverage and hoard cash in order to bolster extremely weak balance sheets.
- Fixed income and interest rate markets have been very negatively affected by the banking crisis.
- Equity markets have been extremely active, but principally due to extreme volatility.
- Foreign exchange markets, too, have been greatly affected by volatility flowing from worries about global economic growth; weakness in key economic indicators in China and Japan and concerns about weakness in the London banking sector; among other factors.

Even though we've also had some of the most volatile commodity markets in decades, I am proud to say that through all of the turbulence, our grain and oil seed markets have worked.

- Adverse weather, demand from China and India, and the weak dollar all drove the markets to record prices in 2008, only to have the collapse of the economy send prices back down again.
- This is in addition to the tight credit markets that has prevented some grain elevators from forward contracting, disallowing farmers to sell forward their crops.
- Because of the volatility, the exchange was forced to raise margins.
- We are well aware that no one enjoys paying higher margins, but because of our central counterparty clearing system and our practice of marking-to-market, we didn't have a single case in which a customer didn't get their money from the exchange because of a counterparty credit default.
- And we all know that was not the case for other markets, and now we are all paying the price for it.

We also spent a good deal of time last year talking about convergence in our wheat contract.

- We held customer meetings with just about every major commercial and producer group that participates in our markets who would meet with us.
- We commissioned studies of our markets.
- We sent surveys to customers.
- We spoke with our regulators.
- And we engaged the NGFA on multiple conversations.

Based on this input, we received regulatory approval to make substantial changes to our wheat contract.

- We firmly believe that these changes will improve the convergence of cash and futures prices at the expiration of the futures contract.
- Changes to the storage rates include introducing seasonal premium charges, consistent with cash grain storage practices, that increase during the period from July through November to 8 cents per bushel per month.
- During the remainder of the crop year from December through June, the premium charges remain at their current level of 5 cents per bushel per month.

Three additional delivery territories are also being added.

- The delivery areas include shuttle train loading facilities in a 12-county area of northwest Ohio; barge loading facilities on the Ohio River from Cincinnati to the Mississippi River; and barge loading facilities on the Mississippi River from below St. Louis to Memphis.

- The northwest Ohio shuttle loading locations will be added at a 20 cent per bushel discount; Ohio River locations at par; and Mississippi River locations at a 20 cent per bushel premium.
- In all, significant delivery capacity will be added to the wheat contract and this additional capacity will be in the flow of SRW commercialization and will allow many new participants to deliver on the contract.

Finally, the exchange is recommending that the vomitoxin level for par delivery be lowered from three parts per million (ppm) to two ppm.

- Wheat containing three ppm of vomitoxin will continue to be deliverable at a 12 cent per bushel discount, and wheat containing four ppm of vomitoxin will continue to be deliverable at a 24 cent per bushel discount.
- The seasonal storage rate and additional delivery locations are proposed to be implemented beginning with the July 2009 contract month, and the lower vomitoxin level will be implemented with the September 2011 contract month.
- Also, as a reminder, the current allowable vomitoxin level of 4 parts per million will be reduced to 3 parts per million beginning with the September contract this year.
- Beginning with the September delivery, all shipping certificates will be marked at either 4 ppm or 3 ppm vomitoxin.
- The shipping certificates marked at 3 ppm will be delivered at par and the certificates marked at 4 ppm will be delivered at a 12 cent discount.
- All shipping certificates outstanding following the July expiration will be marked as 4 ppm, consistent with current specifications.
- This stepping down in allowable vomitoxin represents the Exchange's commitment that deliverable wheat will be consistent with the most common wheat traded in the cash market.
- We also limited the number of grain certificates that non-commercials market participants can hold.
- This change, consistent with current independent research results by the University of Illinois, will help prevent institutional cash-and-carry arbitrage from overwhelming the delivery system, and will result in better cash-futures convergence.

We are monitoring our markets closely and we are continuing to talk with our customers.

- We have more potential changes we can make to the wheat contract if the upcoming changes are not sufficient.
- We continue to work closely with the NGFA and will be ready for additional quick action if that action is needed.
- However, recent empirical data points toward better wheat convergence performance and this is before the full positive effects of the actions I've describe here have even been realized.

Results centered on the role of speculators in our markets.

- According to three separate and independent studies, the percentage of open interest held by large traders has essentially remained the same for approximately three years.
- In February, Informa Economics released a study concluding that “there is little empirical evidence that large trader groups, such as index funds and managed money, were routinely detrimental to the studied futures markets.”
- Studies by the Commodity Futures Trading Commission and the Government Accountability Office reached identical conclusions.
- We also recognize, however, that there remain differences in opinion and that no matter what the numbers say, you may not draw the same conclusions.
- We accept these differences, so long as we agree on the most important trait of our markets, which is the value of *transparency*.

There are bills working their way through Congress that would limit market participants.

- This whole conversation started because oil prices hit \$147.
- Pointing the finger at speculators as an easy target.
- All we are saying is that our markets must remain transparent.
- The Informa Economics study, looking at the major U.S. futures markets with significant speculative and index fund participation, found interesting results we should keep in mind in these tumultuous times: *correlation* does not imply *causation*.
- Specifically, Informa found that changes in trading positions by any category of trader, including commercial and speculative groups, did not cause changes in prices.
- However, when the researchers looked at the relationship the opposite way, they did find that changes in price cause most all categories of traders to change their positions.
- This research shows that all categories of traders are reactive rather than proactive traders – no single group drives prices higher or lower they simply react to the changing price.

I don't know when these legislative proposals will be finalized. I do know that CME Group will continue to work with customers – not only to provide traditional derivatives contracts that you depend on to manage your risk, but also to bring out new products to expand your options.

- Earlier this month, for example, we launched swaps on the S&P GSCI Index.

- This over-the-counter product is based on the index calculated by Standard & Poor's and will be accessible via CME ClearPort, an open clearing service that was started at NYMEX.
- Last April CME Group requested approval to clear corn basis swaps and calendar swaps for corn, wheat and soybeans.
- The CFTC issued an order on March 18 and the Exchange will begin clearing these corn basis swaps and calendar swaps for corn, wheat, and soybeans on April 6.
- And we plan on listing dozens of more OTC Ag contracts that customers have requested as hedging tools.

It promises to be an interesting year as the Exchange moves to launch new products to help firms in today's global economy hedge their risks.

- However, it is also a good time to look back over the past year and determine how we got to where we stand today.
- Now, a reasonable person might ask, how did we go from the record prices of 2008 to where we stand now?
- The simple fact is – fundamentals.
- Reams of independent research have been compiled over the past several months.
- Not one was able to find a single example of market improprieties.
- At the same time, many fundamental market factors have changed in just a few months time.
- Last summer, there were all time high demands in a majority of commodities.
- With the onset of the financial crisis this fall, the bottom fell out and demand decreased dramatically, though that is likely a short-term event.

We are always impressed by the ability of farmers in general – and U.S. farmers specifically – to respond correctly to market forces.

- We believe strongly that if farmers are presented with the correct incentives, they will produce.
- And in 2008, they were given the correct incentives, and they responded with record crop production.

For only the third time since 2000, world corn production exceeded corn consumption.

- This is important because world stocks-to-use had fallen below 15 percent, the lowest level since 1973.
- Now, thanks to the world's farmers and particularly U.S. farmers, the world corn stocks-to-use ratio is back around 20 percent, still low by historical standards but much improved over last year.

A similar story has occurred in wheat.

- While we faced dangerously low stocks last year at this time, the world's farmers produced a bumper 2008 crop driving wheat stock above pipeline levels.
- In fact, due to the 2008 bumper wheat harvest, the world is again feeding wheat to livestock in significant quantities for the first time in a few years.
- While the bountiful 2008 harvest has played a significant role in the fall of agricultural prices, the world is in a much better position as we have been able to add to a dwindling grain stock position, and fewer people should go hungry because of it.
- The world needed a good 2008 harvest and, thankfully, we got it.

Of course, grain supply is not the only story, and not the only reason grain and oilseed prices have fallen.

- I don't know if people realize the incredible era that we live in.
- Within this decade, millions of people have moved from abject poverty to relative middle-class status.
- Now think about that, many millions of people, perhaps even 1 billion people who were poor in 2000, are no longer poor in 2009.
- This movement of people out of poverty and into relative middle-class standing is probably the largest since the Industrial Revolution.
- And, given the sheer number of today's mobilization, it is probably bigger than the Industrial Revolution.

It is significant that our industry has had the rare privilege of participating on the front-lines of this historic world event.

- There has been steady increase in demand from poorer countries, as people there eat more food – especially more protein.
- More people are better nourished thanks to more grain, a lot more meat, and much more milk.
- In the past decade, says Carlo Caiani of Caiani & Company, an investment-advisory firm, the consumption of milk has grown seven-fold, and that of olive oil six-fold.
- China's role has been profound, reflecting its enormous economic progress and huge population.
- China is consuming twice as much vegetable oil (instead of less healthy pork fat), 60 percent more poultry, 30 percent more beef and 25 percent more wheat.

When people move out of poverty, as we have said, typically their diet improves to include animal protein in the form of meat and dairy.

- This takes an enormous amount of grain.

- The markets have reacted to this incredible increase in demand.
- However, with a world recession in progress, obviously the markets have had to adjust to a global economy that is not growing at the pace seen just one year ago, and in fact may be contracting.

That said, just because the recession has quieted demand in the short term, this does not imply a long-term trend.

- The *Economist* reports that, despite the incredible growth over the past decade, people in China still, on average, consume only one-third as much milk and meat as people in wealthy countries such as Australia, America and Britain.
- The gap is even larger with India, which is also growing fast.
- Overall, protein intake in Europe and America is unlikely to expand much, but a combination of rising incomes and population in developing countries could increase demand by more than 5 percent annually for years to come.

Expanding supply at the same rate will be difficult, because the amount of arable land under cultivation is growing by only a fraction of a percentage point each year.

- In China and India, many of the most fertile areas are the ones being developed for roads and factories.
- That means existing land is becoming more valuable, and must become more productive.
- The consequences stretch from one end of the food chain to the other, as higher food prices prompt a response.
- Indeed, agrochemical growth is expected to be 17 percent this year, despite the global economic tumult.

Another issue that has changed markedly is the U.S. biofuels outlook.

- Last year saw generous ethanol production economics and the expectation that ethanol production would continue on its then current historical growth trend.
- Unfortunately for the ethanol industry, the global recession has changed that outlook.
- For the first time in many years, demand for energy has actually fallen due to significant reductions in world factory production.
- U.S. citizens are actually driving less and consuming less gasoline now than one year ago.
- This, of course, has adversely affected oil and gasoline prices and is really challenging the ethanol industry.
- It is possible that 2009 will see the first yearly decline in U.S. ethanol production in more than 10 years.

The question is whether the ethanol and biofuels industries are based on solid fundamental economics that will recover, or whether their growth over the past ten years is just another example of bubble economics.

- It may be too early to answer that question definitively, but here are some facts to ponder.
- Prior to last year, the last major decline in U.S. crude oil consumption occurred in the 1970s.
- Clearly, the long-term trend in both U.S. and world energy consumption is toward greater use.
- Meanwhile, U.S. crude oil production has been in decline since the early 1970s.
- That's correct: despite record prices and all manner of energy economics over the years, the United States hit its peak in crude oil production almost 40 years ago.
- So each year we typically consume more crude oil than in the prior year while at the same time we produce fewer barrels of oil than in the prior year.
- Each year, each month, each day, the situation becomes worse.
- We can fill this gap with imported oil, or we can continue to pursue locally grown alternatives.
- We believe it is much too early to write off the U.S. ethanol industry.

Another factor that we sometimes overlook, but has a tremendous impact on commodity prices, is the value of the U.S. dollar.

- The first half of 2008 was marked by historical weakness in the U.S. dollar.
- Economists at the Exchange were constructing price charts while holding the U.S. dollar constant last year, and determined that the grain and oilseed price rally would have been 20 to 25 percent smaller had the dollar maintained its strength.
- Likewise, as the economic crisis accelerated into full swing last year, and the world demanded dollars as a safe haven, the dollar strengthened.
- Holding the dollar constant, we would see that the fall in commodity prices, just like the increase in the first half of 2008, would not have been as severe.
- The point is that changes in the value of the U.S. dollar can affect commodity prices, typically causing those prices to be more volatile.
- And with economic stimulus programs being adopted and with the Federal Reserve beginning to monetize debt, we must remain cognizant of how this can affect the dollar and, indirectly, affect commodity prices.

Today, we have looked at a variety of factors that are having an impact upon our markets.

- And I think it is fair to conclude that, as the *Economist* puts it, at a time when much of the global economy is falling apart, and demand for both consumer goods and the firms that make and finance them is collapsing, the notoriously cyclical world of agriculture is holding up remarkably well.
- We have a good history working with NGFA to improve our markets because we believe the NGFA wants the same things we want – liquid, transparent markets that efficiently perform their price discovery and risk management functions.
- The United States serves as the principal provider of grain and oilseeds to the world and, as such, represents the primary market for price discovery and risk management for the global grain and oil seed marketplace.
- CME Group, working in close coordination with our user base, the CFTC and with organizations such as the NGFA, is committed to ensuring that our grain and oilseed markets continue to function effectively as we build for the future.
- We look forward to working with you as we address the challenges that are before us today as well as those that may arise in the future.

Thank you very much.....

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