

The Developments of Commodity Exchanges in China



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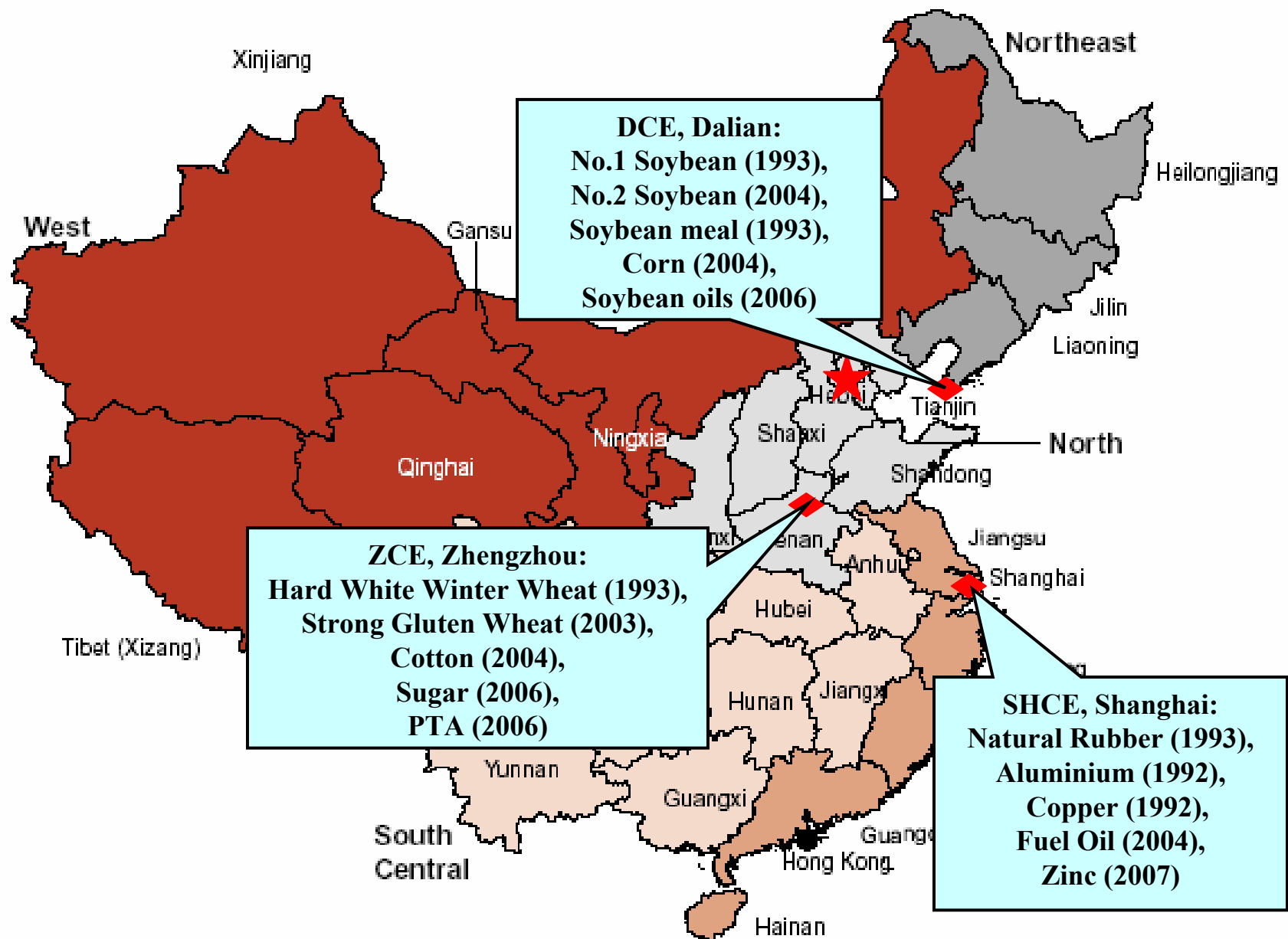
Topics of Today's Speech

- **The development and achievements of China's futures market**
- **The backgrounds of China key agriculture products**
- **The situations and impacts of China agriculture futures**



China's futures market trading





13 products and 15 available contracts in China VS 130 products in U.S.

Overview of the Commodity Exchange, 2006

	Market Turnover (bn RMB)	Trading Volume (mn)	Percent of Total	
			Turnover	Volume
SHFE	12610	116	60	26
DCE	5215	241	25	54
ZCE	3179	93	15	20
Total	21005	449	100	100



Government's attitude—— from conservative to positive

- The regulator pledged to push for the healthy development of the futures market and to boost the market's operation quality and volume. The Agriculture future markets are emphasized in serving for agriculture, rural area, and farmers and providing market insight to guide production, stabilize market and transfer risks.
- “Nine Notices on Development in Capital Market”(Feb. 2004)
- “Proposal on Drawing Up 11th 5-Year Plan” (Oct. 2005)
- “The Finance Market Meeting” (Jan. 2007)
- “Some attitudes to actively develop the modern agriculture and boost solidly social democracy new rural area building” (NO.1 document made in March. 2007)



New Futures Trading Management Statute Enacted in April

- Regulations about financial future and options dealing activities are covered in the statute. More regulatory restrictions to the participators are adjusted.
- Financial institutions including brokers and fund managers are allowed to engage in future dealing activities. That help to form diverse investor base.
- Futures corporation are allowed to engage the dealing activities in the overseas. That is a clear sign of the authorities' support to accelerate the integration of the domestic commodity market into the international market.
- State-owned enterprises (SOEs) are allowed to participate only for hedging purposes. Approved by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC).
- Structural reforms were occurring in the marketplace to upgrade the surveillance and risk management schemes.



Index futures are impending in 2007

- The China Financial Futures Exchange was established in Sep. 8, 2006.
- Index futures will push the development of physical commodity futures, enhance public awareness of the futures industry and help the public form a rational opinion on the industry.
- That will strengthen interaction between the commodity and financial markets and help upgrade the investor structure in the commodity market.
- The interaction will increase the influence of the futures market in the overall national economy and lead futures market to a new era of development.
- Experience in overseas futures market also proves that development of financial futures will add a strong impetus to the physical commodity market.



Product innovation will pace up in 2007

- The products are studied or proposed:
 - ✓ DCE: **Palm oils**, Plastics (Like Linear Low Density Polyethylene), Weather, Live hog, Ethanol, most related to the agriculture. Some index products are studied for example soybean index, climate index and composite commodity index
 - ✓ ZCE: **Rapeseed oils**, Paddy rice, Raw silk, Coke
 - ✓ SHFE: Steel, Crude oils, Natural gas, Electricity



Greater openness to international market

- As China opens its economy to global trade, producers and manufacturers need access to financial tools to hedge against price risks in commodity market.
- DCE signed cooperative memorandums with six exchanges in India, Malaysia, Argentina, Japan and Canada in 2006 and has formed strategic partnership with 13 overseas futures exchanges in North America, South America and Asia in recent years.
- ZCE signed MOU with five exchanges in India, America, Japan, Canada and Nigeria from 2005
- DCE and ZCE formed extensive cooperation with international exchanges on a wide sphere, from product innovation, market expansion to personnel training. That will help DCE and ZCE better integrate into the global futures market and enhance its global influence.



China Agriculture Market Backgrounds

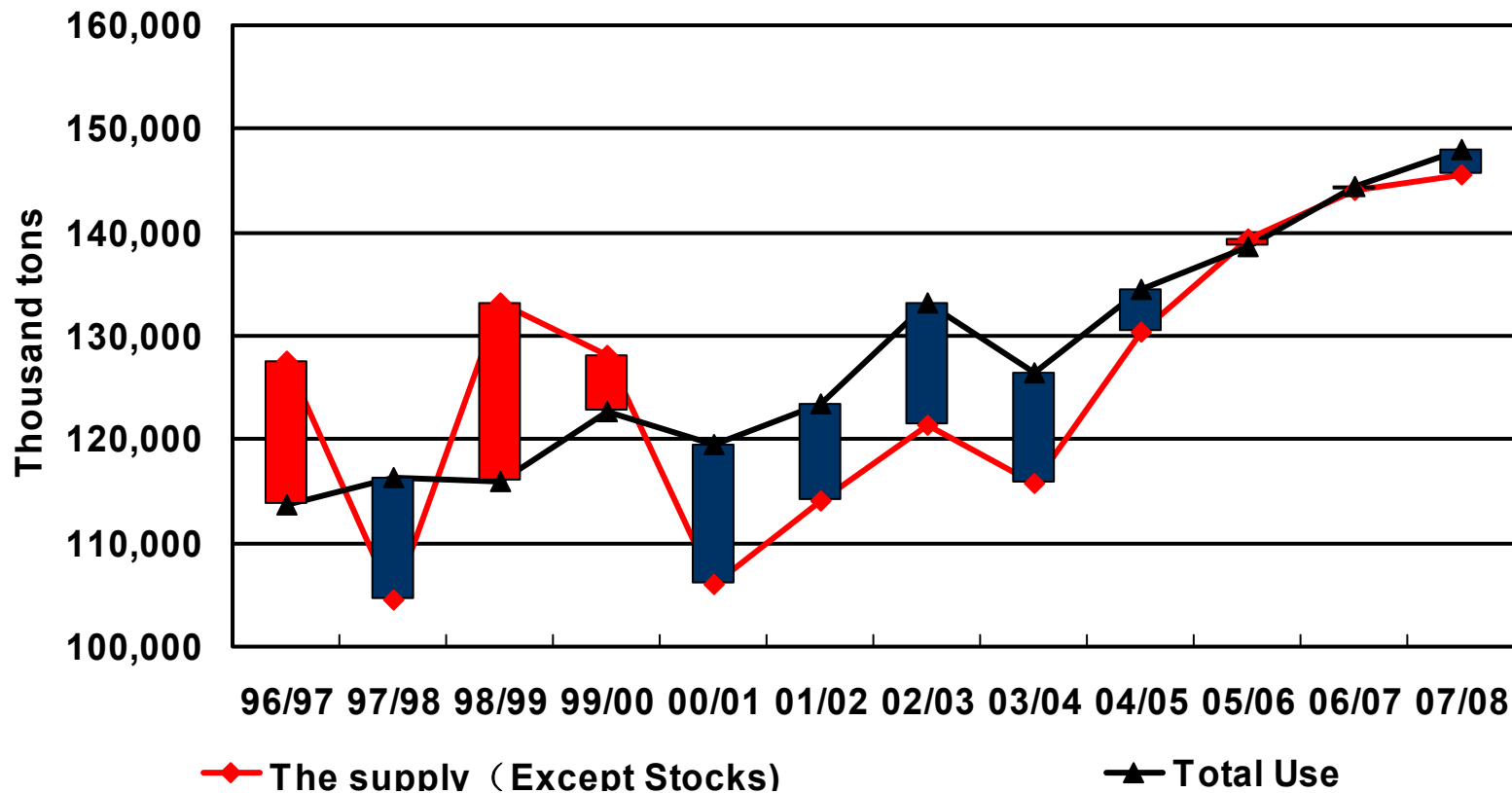
- Corn: Mostly free market with little government interference
- Wheat: Partially free market with certain extent of government interference
- Soybean: Free market influenced largely by the international market

World Ranking of China Consumption and Production of Global Agriculture Commodities

	Consumption		Production	
	Share of World total (%)	rank	Share of World total (%)	rank
Cotton	31.2	1	23.5	1
Palm Oil	15.8	1	0.8	8
Rice	29.7	1	28.2	1
Rubber	21.3	1	9.9	4
Wheat	15.2	1	15.5	1
Corn	17.0	2	17.9	2
Soybeans	19.2	2	8.7	4
Soy Oil	24.4	2	16.4	3
Tea	14.4	2	25.0	2
Sugar	6.6	3	6.3	3
Coffee	0.4	45	0.3	31

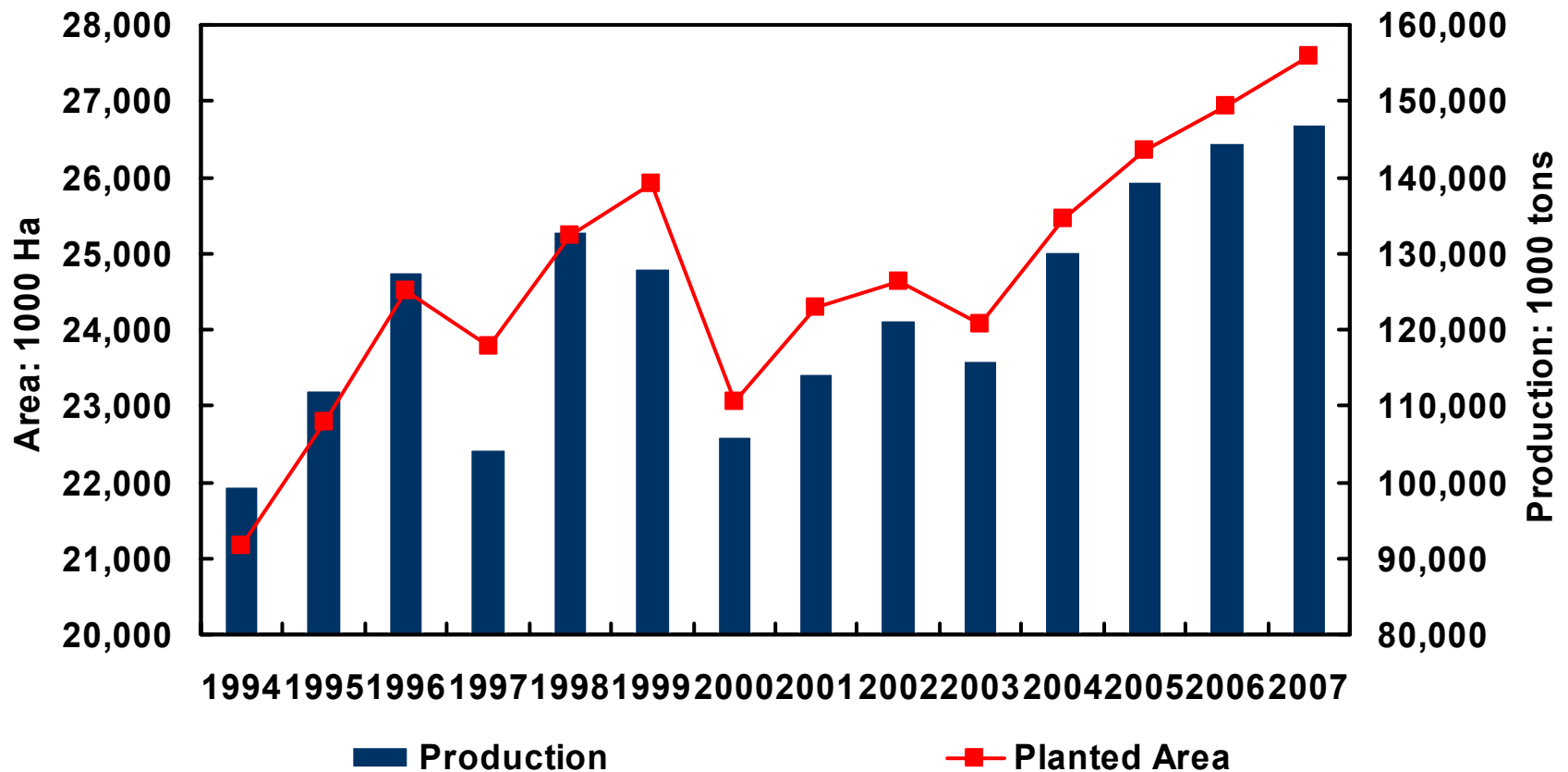


Corn: Production barely kept the pace with strong demand



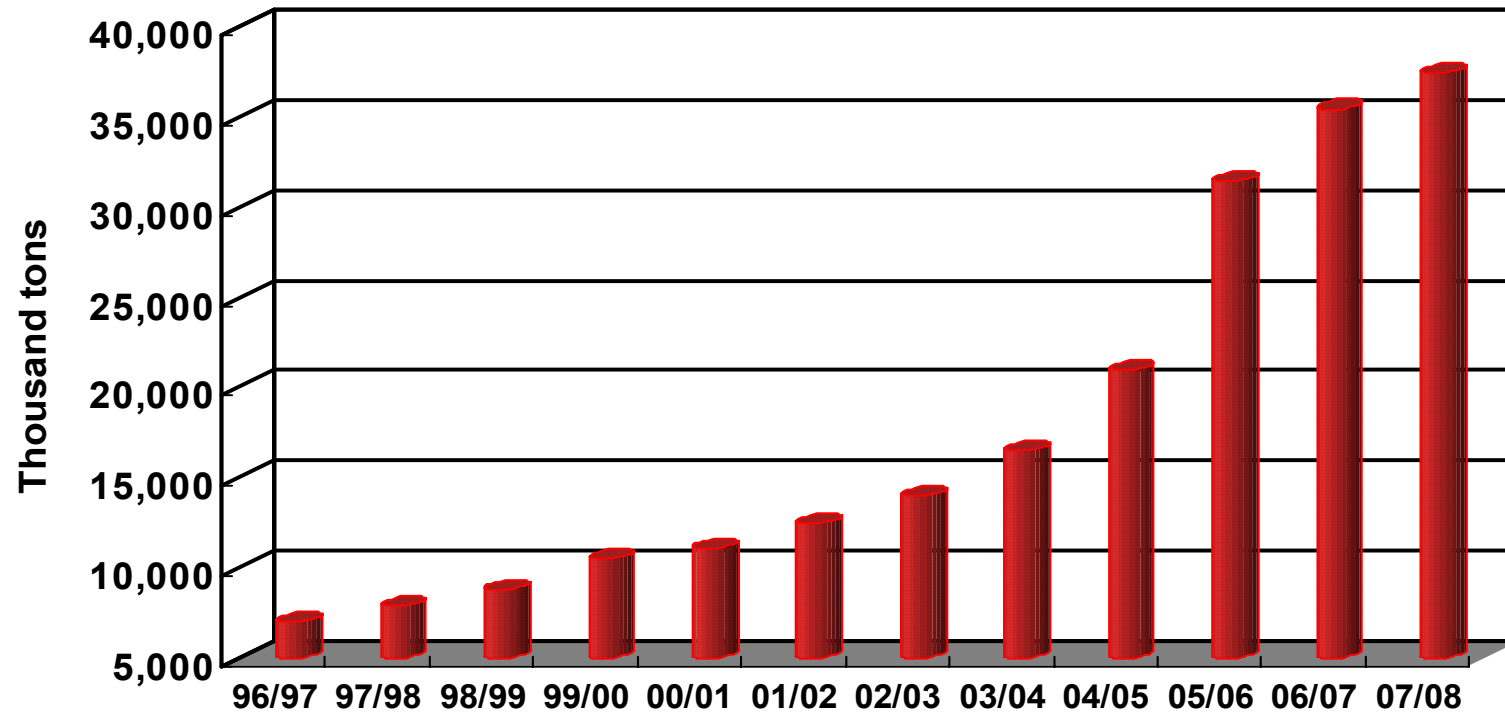


Corn: Production is expected to increase four year in a row



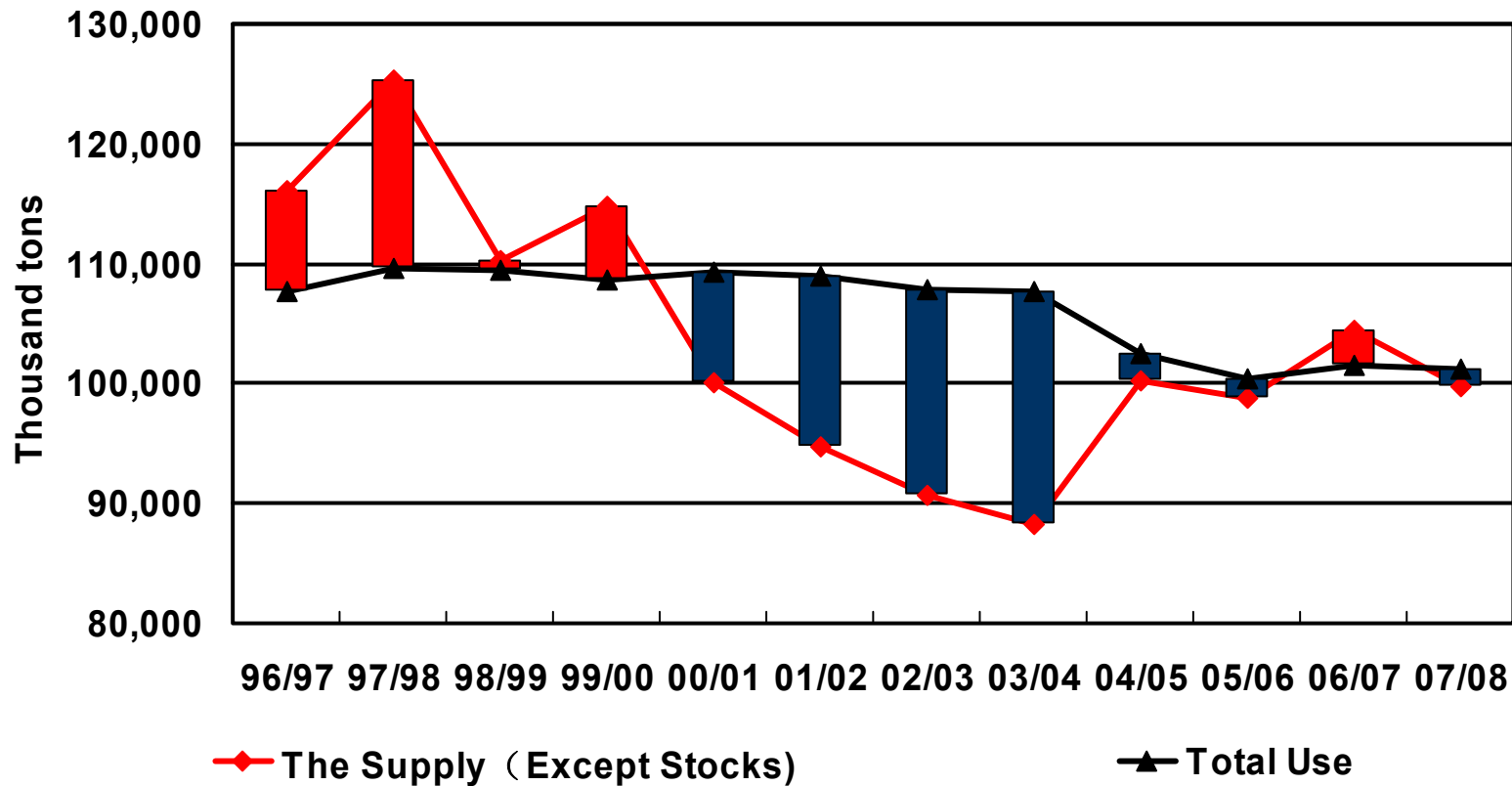


Corn: Industrial use grows rapidly



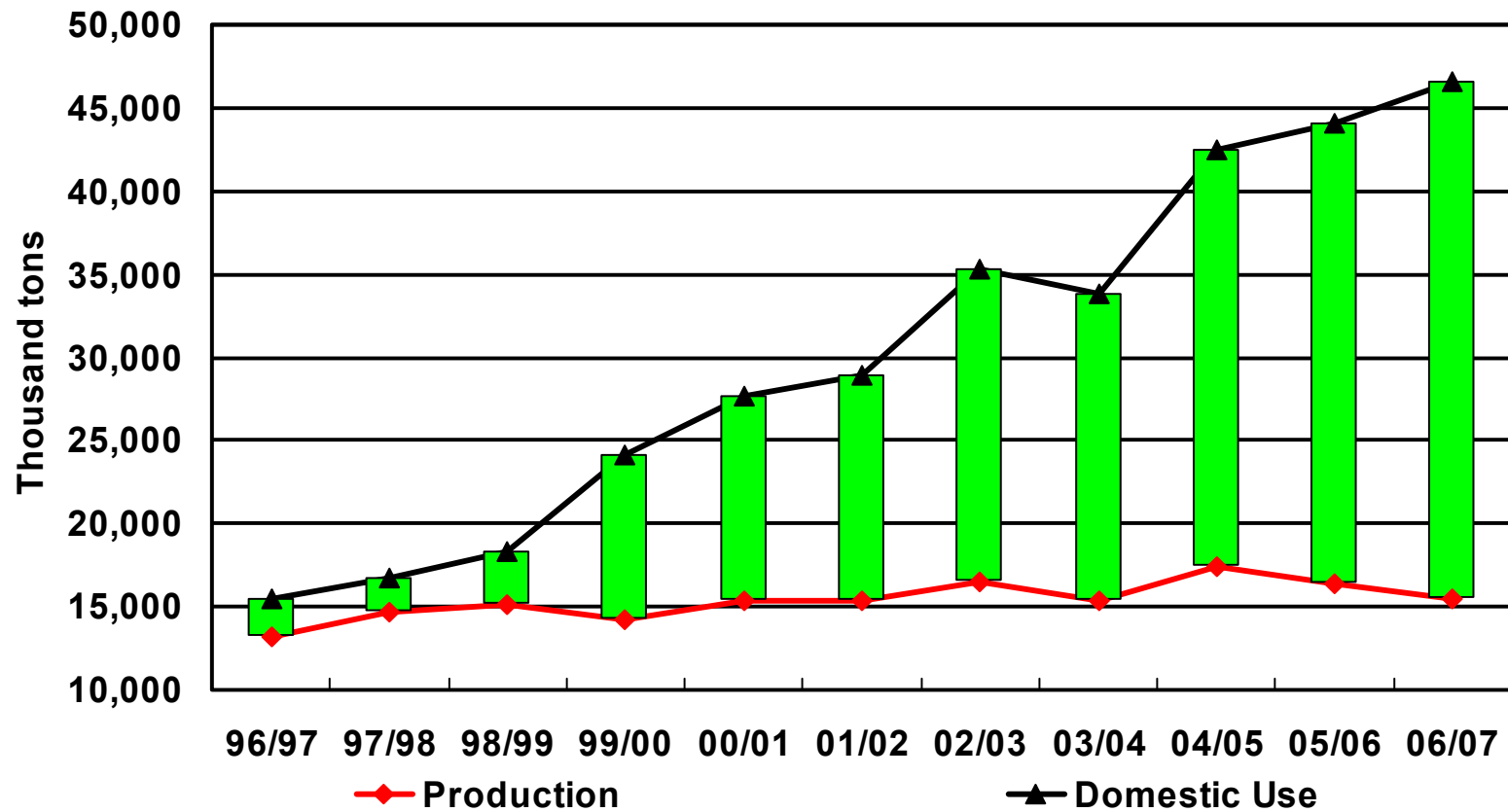


Wheat: Production fluctuated with declining demand



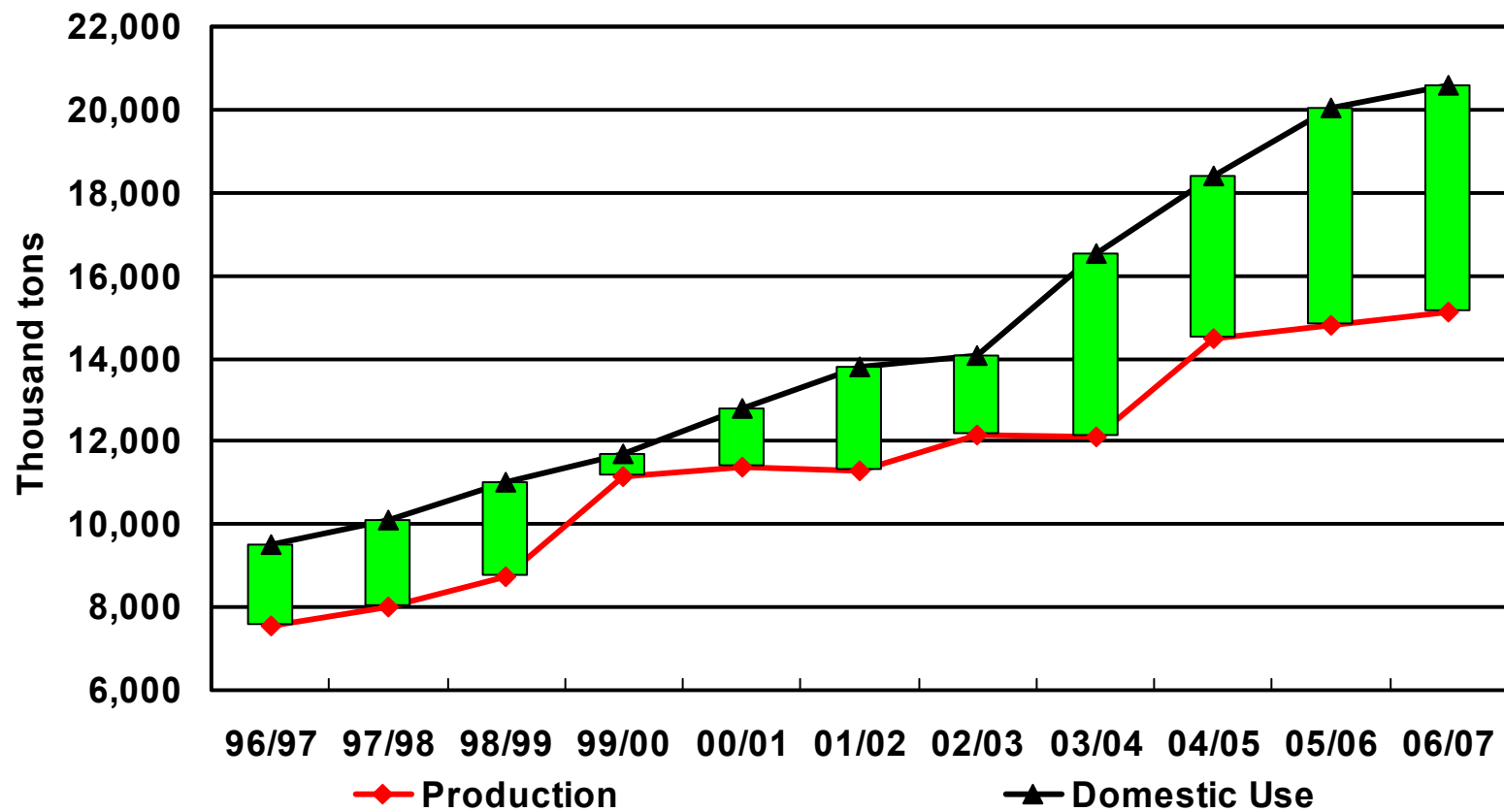


Soybean: Consumption largely depends on imports





Edible Oils: Uses Growing Rapidly





Ag-products Price Discovery and Pricing Power

- **Price discovery (By Monthly data, Sep 2004-Mar 2007)**

Stable relationship between the futures prices and spot prices, from strong to weak:

soy oils → corn → soybean → soy meal → sugar → wheat

- **Pricing power in local market (By Monthly data, Sep 2004-Mar 2007)** Futures

lead the pricing spot prices , from strong to weak:

soy oils → soy meal → soybean → corn → sugar → wheat

- **Pricing power in world market (By Monthly data, Sep 2004-Mar 2007)**

Good relationship between local and overseas future prices , from strong to weak :

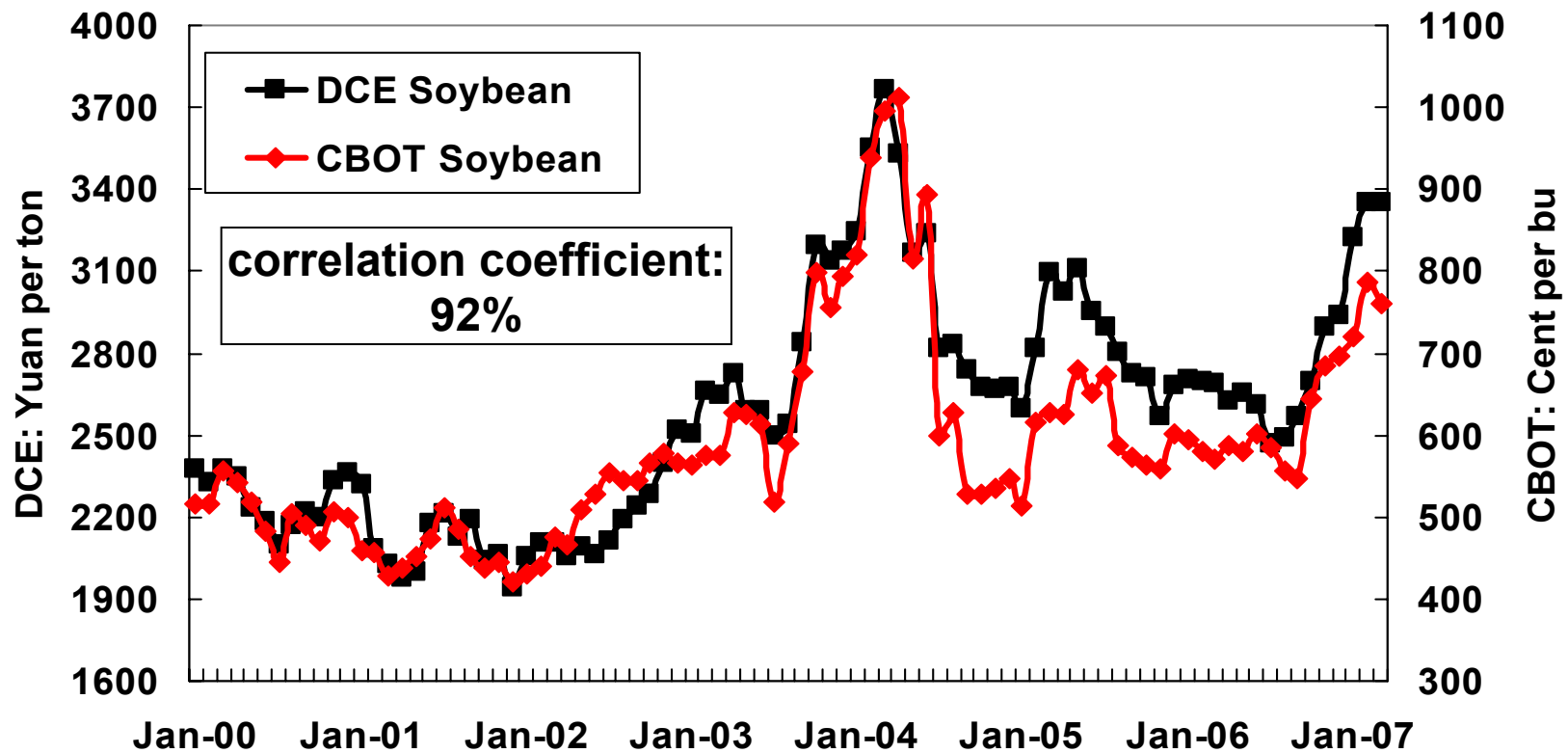
soybean → corn → sugar

Simple Results:

	Correlation Coefficient		Data Used	
	Future and Spot	Local and Overseas	Months Length	Data Origins
Corn	0.87	0.87	30	CBOT, DCE and Dalian Cash Price
Soybean	0.62	0.86	30	CBOT, DCE and Dalian Cash Price
Soybean Oils	0.95	0.86	15	CBOT, DCE and Dalian Cash Price
Soybean Meals	0.50	0.97	30	CBOT, DCE and Dalian Cash Price
Sugar	0.66	0.83	15	NYBOT, ZCE and Nanning Cash Price

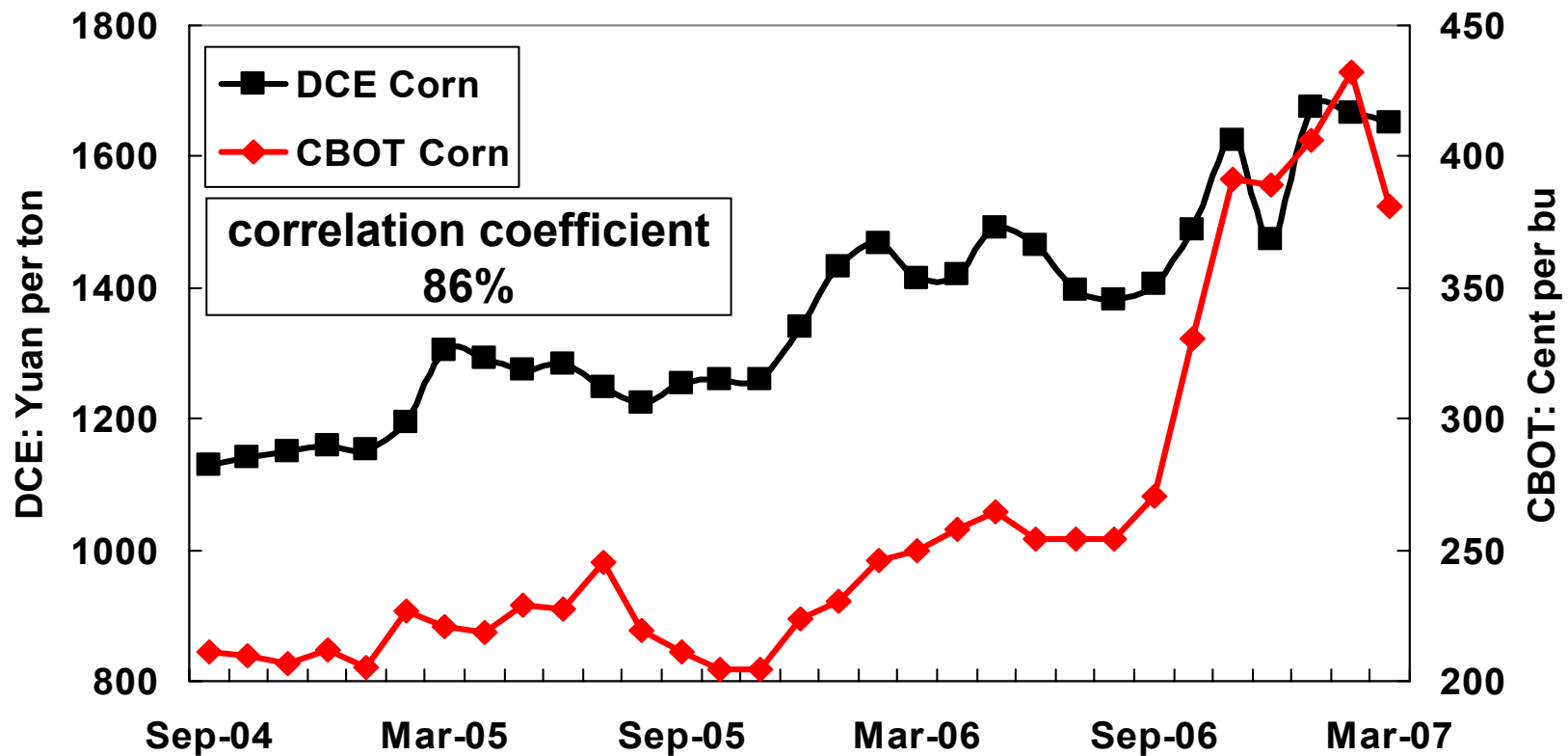


Soybean price relations between DCE and CBOT





Corn price relations between DCE and CBOT





The roles of foreign invests in Ag-futures

- Some enterprises with foreign capital or foreign background have already participated in trading of the soybean and corn futures.
- FI are still not allowed to participate in local market. No official data about the “Grey Money” and difficult to make precise assessment.
- FI’s ratio of positions may have reached 30% in corn and more than 50% in soybean meal in recent year, traders estimated
- FI major in arbitrage trading between the local and oversea markets, the chances include the exchange rate speculation, etc.
- FI are expected to play more and more important role in China agriculture futures when the index future being introduced.



Recent experiences serving farmers

- DCE have promoted the "thousand villages and ten thousand farmers" project, which educates the farmers to master the essence of commodity market and relevant marketing skills. For example, teach the farmer to learn how to understand information from EC, how to trade according to change of the future prices, how to make planting plan based on the order, etc.
- DCE have launched the Program of Serving the Rural Households. That combined to interest of the farmers with big enterprises, and orders for agriculture products with trend in the futures market. In the program farmers learn to hedge through major commodity companies to reduce risks. DCE also help capable farmers to participate the market directly and set up examples to bring along more farmers.
- The commodity exchanges made great efforts to enhance market development and transparency. DCE have launched the Program called "fostering the market." That encourages the large processing enterprises to hedge risk.
- The commodity exchanges gave more constructive policy suggestions to the government.

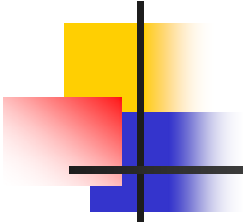


Problems faced to enhance farmers' incomes

- Large market conflict with small farmers .
- Lack of more agriculture future products to hedge the risk.
- Lack of large investors including the foreign investors.
- Underdevelopment of market information system and less transparent policy news.



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