

Statement of
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for the
CFTC Agriculture Roundtable
Challenges In Global Agricultural Markets

It is clear that agricultural markets are both worldwide in scope and subject to myriad worldwide economic forces. No market or asset class is unaffected by the developments in the others.

Traditional production or supply issues affect agricultural markets; however, there are significant developments that are occurring in a variety of areas that are creating new and powerful influences. These factors are forcing our markets to creatively adopt new solutions at a pace never before experienced. To characterize the environment we are in, David Hightower, author of the Hightower report summed up the supply/demand situation in corn last year with the following; “ We have experienced three consecutive years of record corn production... and three consecutive years of declining ending reserves.” This clearly demonstrates the tremendous growth in demand.

CME Group has identified six significant factors that are influencing the supply and demand for grains and oilseeds; each is important.

1. Weather/Disease
2. Increasing per capita consumption in the emerging markets;
3. The dramatic impact of biofuels upon the grain and oil seed markets;
4. Reactionary governmental trade policies;
5. Financial Market turmoil and its growing impact upon the agricultural sector; and
6. Commodities have become another asset class for investors.

These factors have interacted in a manner that has led to volatile markets with high prices. The last five listed factors are doing more; they are driving structural change of unprecedented scope in the commodity markets.

1. Weather/Disease

This is a traditional factor in the grain markets. Wheat recently attained all-time record prices, coincident with 60 year lows in world stockpiles. In the past two years there have been production shortfalls in Australia, Argentina, Europe, North America, and the Ukraine due to a combination of drought in some places, untimely rains in others.

2. Per Capita Consumption in Emerging Markets: While some projections imply a slowing population growth in this century, global population is still growing and from an ever increasing base. In the short-run, GNP and personal income levels in the large emerging market countries such as India, China, Russia and Brazil are creating unprecedented per capita demand growth for animal protein. As is common in human history, as a society grows richer, its diet expands to include additional animal protein in the form of meat and dairy. Already in just the past 12 years, China has gone from a net exporter of soybeans to the world's largest importer of soybeans with soybean imports projected to easily exceed 30 million tons in 2007. Never before in history have we witnessed the impact of 2 billion people asking for a higher standard of living at the same time.

3. Growth in Biofuels: The expansion in biofuels has created additional market stress. The expectation is for continued growth in biofuel use/demand, which will result in continued demand growth for feed grains and vegetable oils. The USDA recently reported that corn based ethanol production will continue to rise placing additional demands on the crop: "driven by continued expansion in ethanol production capacity, corn use for ethanol is projected at 4.1 billion bushels 2008-9, up 28% from the current year projection. Ethanol corn will now account for 31% of total corn use, up from a projected 25% for 2007-8." The amount of corn used in ethanol production just 5 years ago was approximately 10%.

The China Daily reported just over a year ago that grain prices were rising there not due to a poor harvest but rather to feed the nations appetite for energy from biofuel, expanding at up to 15% a year, fuelled by higher crude oil prices. Add the potential for a poor season due to weather in China and demand increases more. As we can see from this discussion, it is not just the supply side of the equation

driving volatility in commodity markets any longer but unprecedented demand is starting to play a much larger role.

4. Reactionary Government Trade Policies

During the last 3 months, there has been an ever expanding pattern of increasing export tariffs and decreasing import tariffs on grains and oilseeds by foreign governments. Russia extended a grain export tariff from April 30 to July 1. In addition, they have placed an export ban upon their grain to the four CIS (Commonwealth of Independent States) states members designed to prevent re-export of Russian grain to third countries. Argentina extended their wheat export closure and announced a new, higher soy export tax that will rise by 7-9 percentage points based upon current prices. India increased its grain export tariffs while lowering import tariffs on edible oils. China has announced a further increase in edible oil imports in 2007-8 with projections currently up an additional 14%. South Korea announced the emergency lifting of import tariffs on 70 price sensitive products, including wheat and corn in an effort to confront rising inflation. The pattern we are witnessing is one of keeping domestic production off the global market while lowering barriers for the acquisition of grains and oils from the global market resulting in increased demand for U.S. grain and Oil Seed products.

5. Financial Market Turmoil

The events that began in the sub-prime sector of the financial markets are now spreading out with very serious and negative consequences throughout the nation's banking sector. Restrictive lending policies are having deleterious effects within our market place. High volatility leads to higher margins, large directional price moves require significant continuing variation deposits and all of this comes at a time when money is difficult to obtain.

From Calendar year 2000 through calendar year 2007 wheat prices have increased 147 percent, Corn is 79 percent higher and Soybeans are 72 percent higher. One of the factors contributing to these price increases is the declining value of the U.S. dollar relative to the currencies of major importing countries. Since 2000, the dollar has depreciated by 28% as measured by the U.S. Dollar Index, which is comprised of six major currencies (Euro, Japanese Yen, British Pound, Canadian Dollar, Swedish Krona, and Swiss Franc). This decline in the value of the dollar,

which is the currency in which international grain trade is conducted, means that commodity prices are, on average, 28% lower for these importers than they would be if the value of the dollar had remained constant during this period.

CBOT daily price limits for grains and oilseeds were last adjusted in 2000. Then, initial price limits were 9.5 percent of average corn prices, 11.5 percent of average wheat prices, and 10 percent of average soybean prices. Due to requests from market participants on March 28, the CBOT implemented initial price limits that are 5.7 percent of current corn prices, 6 percent of current wheat prices, and 5.5 percent of current soybean prices. CBOT's new price limits are very conservative relative to the last time these limits were changed.

The exchange is also committed to redoubling our efforts to educate the banking community on hedging, and we have held discussions with the National Grain and Feed Association (NGFA) on jointly devising and implementing this new program. Too often we have discovered that many in the banking community do not fully understand hedging and as a result, are reluctant to extend credit when markets are volatile. We believe better understanding of hedging by bankers, while not likely to solve the credit crisis in agriculture, will certainly help the situation.

We will continue to review ways in which we may deliver some form of relief in this regard. We believe that more creative product development in Exchange cleared OTC products may be one of many creative solutions that should be allowed to address today's challenges.

6. Commodities as an Asset Class- We have looked at a variety of factors that are having an impact upon the markets. Many are concerned about the involvement and impact of non-traditional users of futures markets who are increasing their investment in commodities. Included in these non-traditional categories are index funds, hedge funds, ETF/ETC product developers and others. Because investors are looking to diversify their portfolios, index fund participation has increased significantly in our markets. That said, data published by the CFTC indicates the percentage of the open interest held by index funds has remained relatively constant since 2006 when this data was first published in CFTC's Supplemental Commitments of Traders Report. Thus, while index positions are growing,

positions by commercial and non-commercial participants have been growing as fast if not faster than the index funds resulting in a market composition that has been remarkably consistent over the years.

While the composition of our markets has not changed significantly over the years, we are still cognizant of the need to ensure that our markets are performing well for our traditional market participants. As such, we want to proceed with prudence before deciding upon any changes to contract design or policies that may affect the current profiles of market users. The CFTC requires that any changes we make to our contracts that could affect prices or price relationships be implemented beyond open interest or at the beginning of new crop years. Thus, we cannot make snap changes to our contracts. This is actually a positive rule as even a well functioning market will occasionally react unexpectedly to some market events. Our task, to provide a liquid and orderly market, requires that we do no harm to a market by reacting too quickly, in effect, the prudent man rule. That said, when we gain solid evidence that a contract is not performing, we react quickly and decisively. Recall, as an example, the river delivery terms for corn and soybeans implemented in 1999.

We have worked with a broad spectrum of our customers to establish several contract changes that will soon be taking affect that will, we believe, improve market performance. Storage charges will increase for wheat beginning with the July 08 contract; storage charges will increase for corn, beginning with the December 08 contract; and storage charges will increase for soybeans, beginning with the November 08 contract. Also in July of this year the wheat delivery instrument be changed from a warehouse receipt to a shipping certificate, which will expand the effective storage capacity of the wheat contract and improve convergence in the wheat market. We have also proposed increases to the corn and soybean load-out charges to better reflect the increased cost of elevation in the cash markets. All of these changes have been established within close working relationships with our customers.

We have made the following recommendations to the CFTC regarding participation in the grain and oilseed markets by non-traditional investors:

- We've requested that the CFTC defer consideration of increases in Federal Speculative position limits until additional analysis is completed looking at the impact of increased limits on futures market performance.
- We also recommend that consideration by the CFTC of a new risk management exemption for passive investors be delayed for a period of 6-9 months while additional analysis of these proposed new regulations is conducted.
- We call on CFTC to act as soon as possible to lift the prohibition on clearing of agricultural swaps products traded in the OTC market. We believe that lifting these restrictions will stimulate innovation in this sector that could help commercial firms better manage their price risk in the current challenging market environment.

We need to be very aware of the global events, whether natural or government induced, that affect the supply/demand balance in our local markets. 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. The CME Group, working in close coordination with our customers and the CFTC is committed to ensuring that our grain and oilseed markets continue to function effectively as we build for the future.