

# Agricultural Marketing Guide >>



## Understanding the Barley Futures Contract

### Introduction

Barley is the major feed grain in Canada and Alberta is Canada's largest barley growing province. Between 2005 and 2011, the Canadian barley crop varied between 7.6 and 11.8 million tonnes. Alberta produced between 3.8 and 5.4 million tonnes in those years.

About 75 to 80% of the Alberta crop is used as feed, mostly for cattle but some is used for hogs. Alberta produces between 800,000 and one million tonnes of malt barley each year.

In Alberta, barley production is mainly concentrated in the central and north-central portions of the province, although significant amounts are also produced in the Alberta Peace Region and just south of Calgary. The cattle feeding industry is concentrated in the south with the hog feeding industry mainly in central Alberta. As a result, large amounts of Alberta barley are shipped southward.

### Market Background

Most Alberta feed barley is traded on the cash market at the daily cash price. While this is an effective and efficient market, it forces barley growers and users to deal with price fluctuations. Growers are nervous about prices falling and buyers worry that prices will rise.

Both sellers and buyers can protect themselves against price fluctuations in the cash market. Both may lock in prices by using forward contracts (a guaranteed price for a guaranteed quantity) or by hedging the barley price using the Barley Futures contract. See [Using Hedging to Protect Farm Product Prices](#) for more details on using hedging with futures contracts to lock in a price.

The Barley Futures (BF) contract is traded at ICE Futures Canada (ICEFC), formerly known as the Winnipeg Commodity Exchange. The contract offers barley growers an opportunity to lock in a price before making a cash sale. It also offers barley users the ability to lock in the price of a major input.

This module discusses the origin, specifications and some uses of the Barley Futures contract.

### Uses of the Barley Futures Contract

The BF contract was designed specifically to meet the needs of barley growers, livestock feeders, barley merchandisers (grain companies and grain dealers) and feedmills. It serves three key functions:

1. **price discovery,**
2. **a complement to the cash market and**
3. **a price risk management tool**

#### 1. **Price discovery**

The Barley Futures contract is used as a **price discovery** mechanism for feed barley. In other words, growers and users of barley are able to “discover” a fair market value for the crop for some future time period at any time during business trading of the BF contract at the ICEFC. A futures contract does not “set” a fair market value for a commodity. It “discovers” a price through an auction system connecting buyers and sellers. See [Commodity Futures Markets: How They Work](#) for more details on futures and price discovery.

Growers and users are also able to monitor feed barley prices by watching the BF contract prices. The nearby contract month is the closest month that is trading. For example, in August, the nearby contract is October. A grower may want to watch or track either the nearby or the contract month that is just after the month he/she plans to sell cash barley. For example, if a grower plans to sell some barley into the local cash market in November, he or she would follow the December barley futures. A barley buyer needing supplies in November would do the same.

#### 2. **Complement to the cash market**

The futures market is a good tool for monitoring prices as it is designed to **complement, but not replace the cash market** in western Canada. The original specifications of the contract paralleled as closely as possible the barley-pricing practices of that region, so prices in the futures market reflect feed barley market conditions in the area.

#### 3. **Price risk management**

As was stated above, a BF contract can be used as a way to monitor the barley market, but its most effective use is as a **price risk management tool** to protect growers and users from feed barley price fluctuations. A grain farmer can protect him or herself from lower prices by a process called hedging through a Registered Futures Commission Merchant (RFCM), often called a commodity broker. A barley user can also protect him or herself from higher prices by using hedging. For more details on hedging, see [Using Hedging to Protect Farm Product Prices](#).

Price risk can also be managed by a producer by forward selling barley through a deferred delivery contract (a guaranteed price for a guaranteed quantity) offered by a grain buyer. A barley user can also forward buy barley through a forward contract offered by the grain company of a seller. Grain companies use BF as a hedge to protect themselves when they guarantee a price in a deferred delivery contract with either a barley grower or barley user.

## **Contract Specifications**

Every futures contract must have tight specifications for the market to function properly. Barley futures specifications are no different. **Table 1** shows specifications of the contract.

**Table 1. ICEFC Barley Futures Contract**

Pricing Reference Point	FOB on truck at elevators, east of Saskatoon, Saskatchewan.
Symbol	BW
Pricing Basis	Free on Board points in the Par Region
Currency	Canadian dollars
Contract (Delivery) Months	March, May, July, October, December
Contract Size	1 contract = 20 tonnes known as a "Job Lot" 5 contracts = 100 tonnes known as a "Board Lot"
Par Contract Quality	Non-commercially clean No. 1 CW Barley at 2% max dockage and max 0.5 ppm vomitoxin
Discount (\$7.00/t)	Non-commercially clean No. 2 CW Barley at 46 pounds per bushel (288 grams/0.5 litre), 2% max dockage, max 0.5 ppm vomitoxin, max 2.5% other cereals, and max 1% wild oats
Trading Hours, electronic	Open: 8:00 p.m. Central Time Close: 3:00 p.m. (the next day)
Minimum Price Change	10 cents per tonne (\$2.00/contract).
Daily Price Limit	\$10 per tonne above or below previous close, expandable to \$15
First Notice Day	One trading day prior to the first delivery day
First Delivery Day	First trading day of the delivery month
Last Trading Day	Trading day preceding the 15th calendar day of the delivery month

## Trading Months Beginning and Ending

When trading of one of the Barley Futures trading months, say October 2011, ends or expires, trading of that month in the following year, in this case October 2012, automatically begins. The last trading day of the Barley Futures is the trading day preceding the 15th calendar day of the delivery or futures month.

## Margins

Any person or company wanting to buy or sell BF contracts must deposit cash with their commodity broker. These deposits are called "margins". On June 29, 2012, the ICEFC minimum initial margin for one 20-tonne barley contract was \$200.00. The exchange minimum maintenance margin, or amount required to continue to hold open one 20-tonne barley contract was \$200 on January 9, 2015. See [Commodity Futures Markets: How They Work](#) for more details on margins.

## What to Do With Futures Contracts

A barley producer who has sold a BF contract, called holding a “short” position, has made a legal commitment, and that commitment must be dealt with. A barley user who has bought a BF contract, called holding a “long” position, has also made a legal commitment that must be dealt with. There are several ways a farmer who holds a “short”, or “sell”, Barley Futures position can fulfill his obligations.

1. The barley grower can sell his cash barley to any buyer he chooses and buy back his futures position. Buying back the “sell” futures is called an **offset**.
2. The grower can **deliver** his barley against his futures position.
3. The grower can enter into an “Exchange of Futures for Risk” or “Exchange for Risk” (EFR).
4. The grower can enter into an “Exchange of Futures for Physical” or “Exchange for Physical” (EFR).

Choice One, offset, is the most common way of dealing with a “sell” futures position. The farmer arranges to sell the barley privately, perhaps to a neighboring feedlot. Or, he may decide to feed it to his own livestock, sell it to a feedmill or keep it in the bin until market conditions improve. What he decides to do with the cash barley is his own business. However, he must honor his BF contract obligations even if he feeds the grain to his own livestock.

To offset, the producer can buy his way out of the “sell” or “short” futures contract, by taking an offsetting position in the futures market. In the same way he previously sold the futures contract (to initiate his hedge), he buys back his position. He can offset his “sell” position by phoning his broker and placing a “buy” order. He will pay the prevailing futures market price at that time. Once the buy order is filled, the farmer no longer has the legal obligations of his initial “sell” contract because it has been “offset” by his “buy” futures order. See [Commodity Markets: How They Work](#) and [Using Hedging to Protect Farm Prices](#) for more details on offsetting or rolling a contract.

For example, let’s say that a barley grower sold four Oct. BF contracts (80 tonnes), at \$140/t. In September, the barley is harvested and sold to a feeder for \$125/t (when his local basis is \$5.00/t over). The same day, the barley grower tells his broker to buy back the four Oct. BF futures contracts. The four Oct. contracts are bought back (offset) at \$120/t. The net selling price to the grower would be \$125/t for the cash barley plus a \$20/t gain on the “sell” futures contract, or hedge, for a total of \$145/t not including broker commissions.

If, however, the grower could not find a buyer for the cash barley at an acceptable price in October, there are other alternatives. The grower can store the barley, and roll the Oct. “sell” futures to a later month by buying back the Oct. BF contracts and selling a later futures month, say, March. “Rolling” moves the hedge forward by a number of months for the cost of one commission paid to the commodity broker.

Choice Two, for dealing with a “sell” futures contract, is to deliver his barley against his futures position. Another module will deal with delivery against futures contracts.

Choice Three is known as “Exchange of Futures for Risk” or “Exchange for Risk” (EFR) where

the holder of a “sell” position exchanges his futures with a holder of a “buy” or “long” barley futures position. Exchange for Risk is rarely used and requires a thorough understanding of the process.

Choice Four is “Exchange of Futures for Physical” or “Exchange for Physical” (EFP). EFP is also rarely used.

## **Common Barley Futures Contract Questions**

### **What volumes must producers use with the BF contract?**

One BF contract consists of a 20 tonne unit. However, it may be difficult to get orders for less than five contracts filled - sold or bought. The ICEFC only quotes prices from bids, offers or trades of a minimum of five contracts.

### **Can the BF contract be used as a speculative tool?**

Yes, speculators can buy and sell BF contracts depending on which way they think the price will move. Speculative traders do not have to grow or accept delivery of barley.

### **Who is allowed to trade BF contracts at the ICEFC Exchange?**

Registered futures commission merchants (RFCMs), more commonly known as commodity brokers, are the only people who are licensed to buy and sell futures on ICEFC. They do it on behalf of barley growers or users or speculators.

## **Additional Information**

RFCMs, or commodity brokers, often have a large amount of material available on Barley Futures for prospective customers.

See [Commodity Markets: How They Work](#) and [Using Hedging to Protect Farm Product Prices](#) for more details on futures contracts and how to use them.

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