

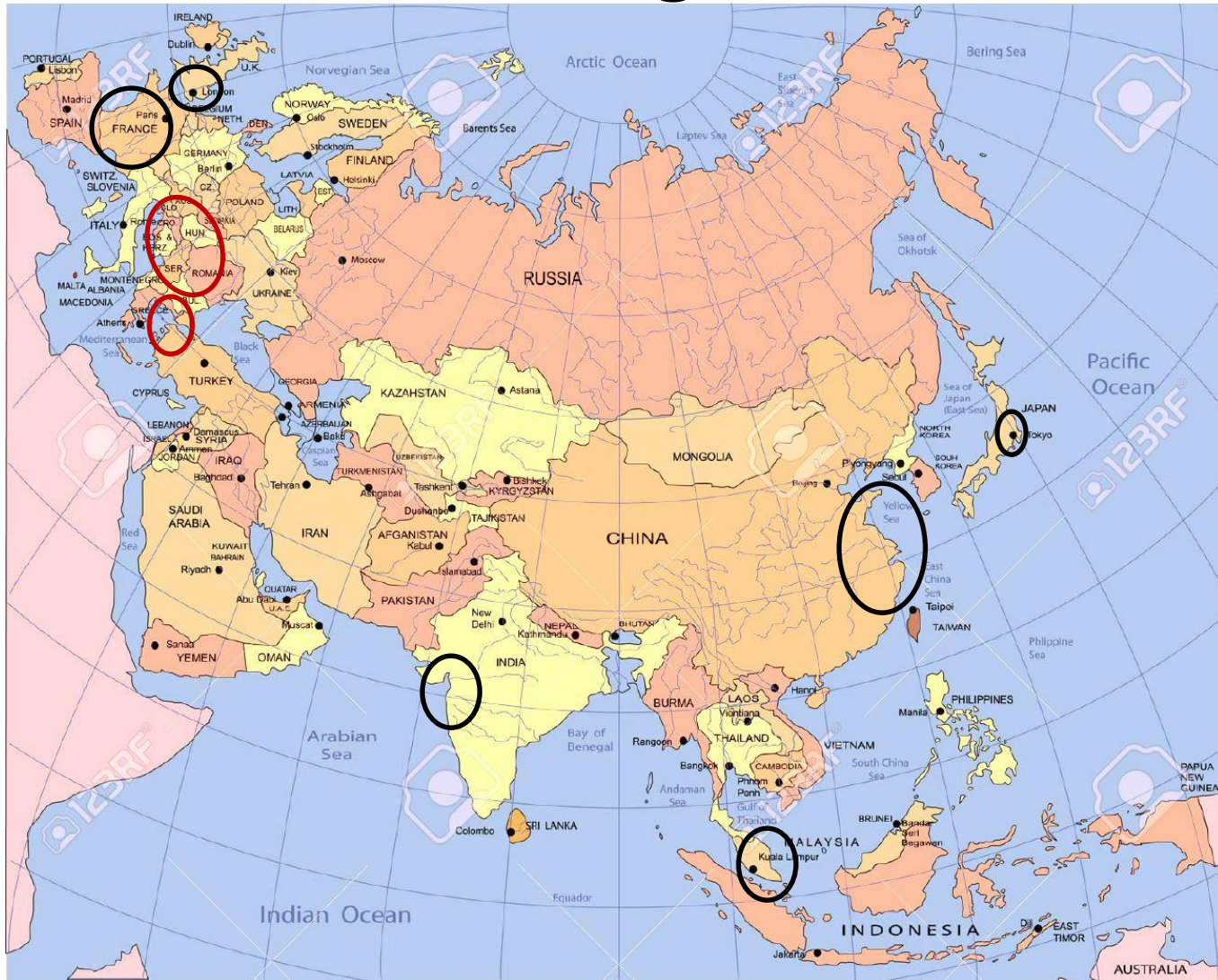
# Commodity exchange development issues

international experience:  
Lessons for Kazakhstan

# Global growth of commodity futures exchanges since 1990's unprecedented

- Emergence of exchanges on all continents
- Government support: legislation/regulation
- Financial support from banks/intermediaries
- Asia - highest commodity volume growth
- Growth drivers:
  - Liberalization of agricultural regimes
  - Trade growth – especially China
  - Computerization
  - Financial sector development

# Eurasia – major agricultural futures exchanges



# Western Europe

## London

- 19<sup>th</sup> C. softs market – coffee, sugar, cocoa – developed by wealthy end-users (Nestle, Unilever) + UK feed wheat
- Priced to reflect landed warehouse price in northern European ports such as Hamburg, Rotterdam, not producer price in W Africa

## Paris

- Started 1987 following CAP reform which replaced commodity price supports with income supports
- High volume futures contracts in French wheat, maize, rapeseed
- Trading aided by farm credit system and exchange integrity
- Cooperatives act as aggregators

***Success a result from financial integration (credit access), cooperative system, price volatility, relatively stable currency against dollar. Hedging doesn't work well when currency volatility exceeds commodity price volatility.***

# Eastern Europe – Poland, Romania, Hungary

- Poland [WGT] the largest exchange - mostly spot market exchanges for hogs, maize, wheat
- Budapest Commodity Exchange was once active futures trading center
  - Trading slowed when Hungary joined EU - complied with CAP reform
- Romanian Commodity Exchange remains small
- Issue:
  - Uneven progress in land reform and equipment modernization since end of collectivized system of land/farming in 1990
  - Lack of institutional support/trust in warehouse receipt [WHR] system and lack of credit for small farmers

***Futures markets have failed to grow in Eastern Europe because of structural obstacles, stalled modernization and government programs that limit farming flexibility, plus alternate liquid futures markets (Paris) that can serve as hedging mechanisms***

# Turkey



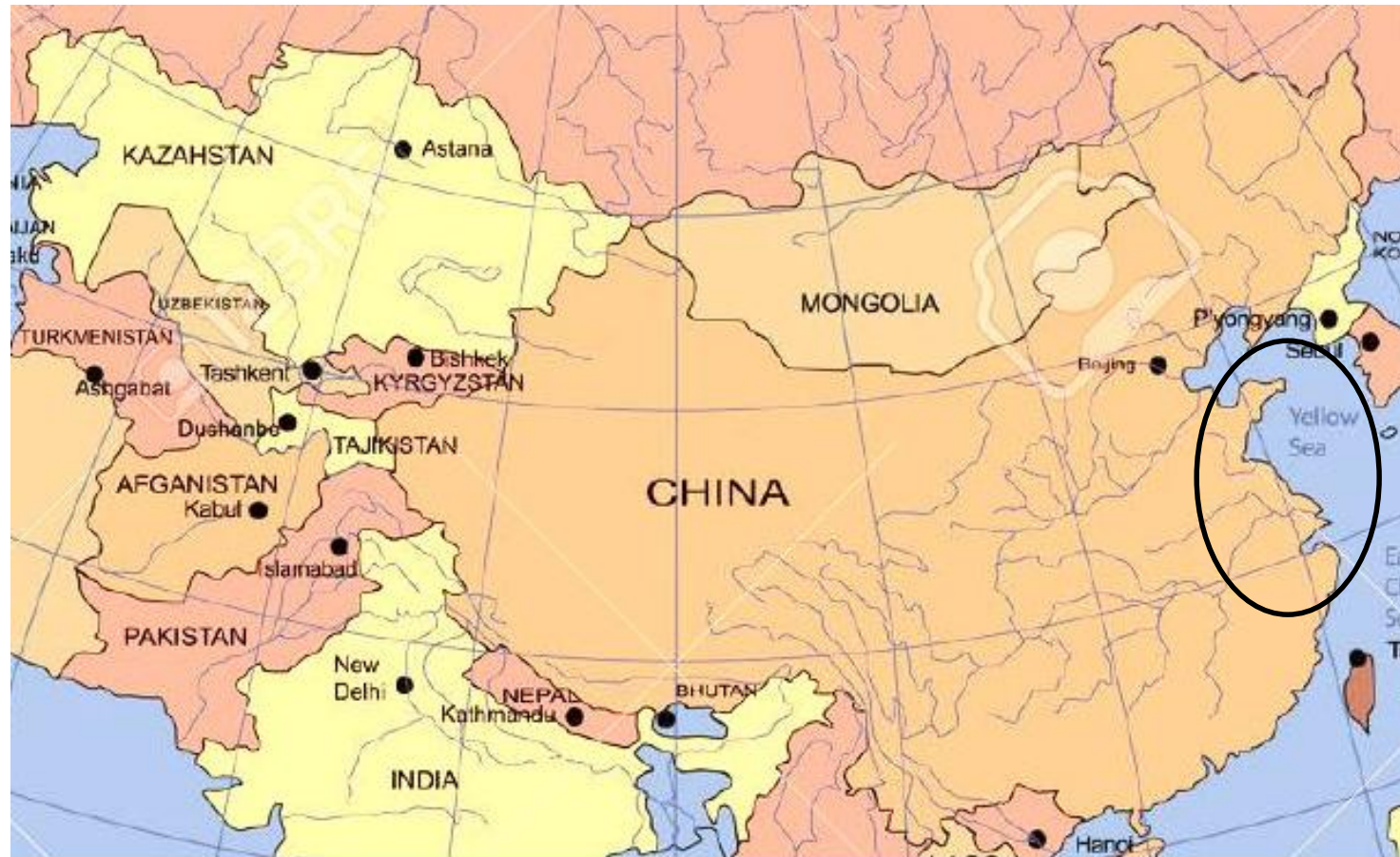


# Turkey

- Turkdex launched in 2005 (Izmir – moved to Istanbul)
- Products: Stock index, Turkish lira/euro, wheat and cotton
- Financial contracts successful based on mature industry and trust in clearinghouse (Takişbank – recognized by US as an international custodian)
- Cotton failed because of large intermediary – Tariş – national cooperative – dominated trade
- Wheat failed because of complex contract design and government intervention into price and stocks

***As Turkey dismantles wheat price support system, Exchange has announced that it is re-launching wheat contract– with single delivery point – Konya – which is the largest domestic cash wheat trading center.***

# China - Dalian, Zhengzhou, Shanghai Exchanges





# China

- Futures started trading 25 years ago
- Chinese authorities restructured exchange industry twice in 1990's because of fraud, price manipulation, weak regulation/enforcement
- Today: 3 large exchanges, mature hedge fund industry, large retail sector - some of world's highest trading volumes
- Authorities on constant guard for excess speculation, high frequency trading [HFT] abuses, price "bubbles"
- Admit futures rarely used for hedging
- Farm size less than 1 hectare/ trading unit 10 MT
- High level of government intervention in underlying commodities since 2006: price supports, storage/equipment subsidies, tariff quotas

***China is an outlier – combines state promotion of securities industry while intervening in commodity prices, stocks and imports.***

# India: Multi Commodity Exchange, National Commodity Derivatives Exchange



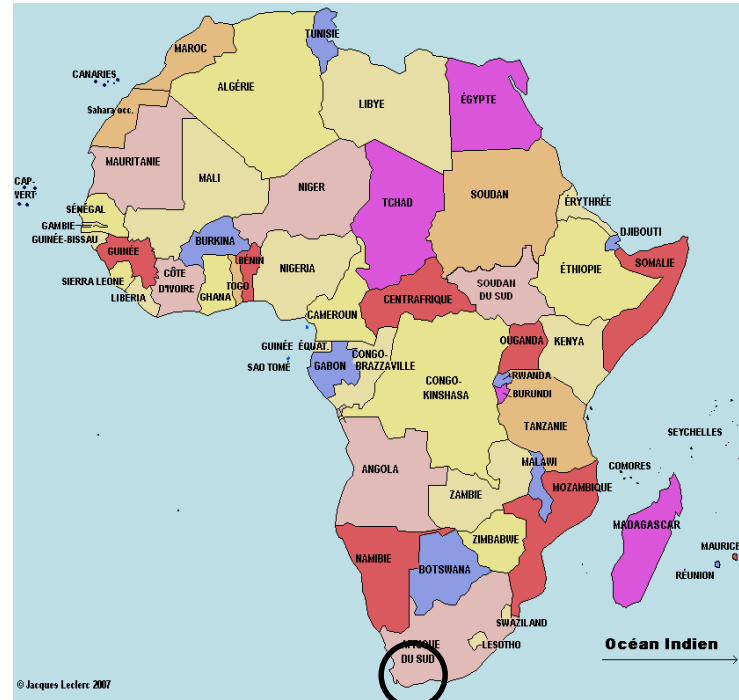
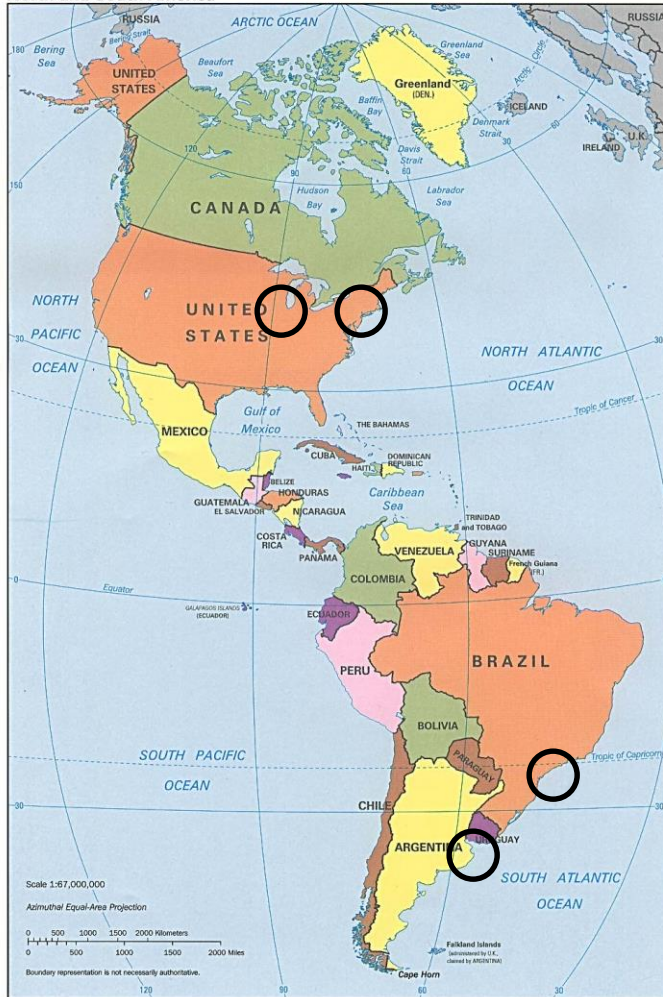
# India

- Futures trading in 19<sup>th</sup> Century until WWII, ban lifted 2006
- Only global exchanges to trade exotic goods: cardamom, chili peppers, mint oil + cereals/oilseeds
- Exchanges based on private sector initiatives
- Ecosystem approach – price dissemination, infrastructure improvement, quality rewards
- Government banned trading in wheat in 2007 for 2 years
- MCX suffered scandal 2011 involving fraudulent inventories – WHR legislation has helped restore trust

***India's exchanges have been very successful, despite trade bans and scandals. Meticulous planning and training before launch, clearinghouse integrity + financial service sector development aided futures trading growth.***

# Americas and Africa

North and South America



# Mature versus new

## Americas

- Chicago, New York in USA
- Sao Paola in Brazil
- Buenos Aires in Argentina

***These are all mature exchanges with vast institutional support and capital***

## South Africa

- SAFEX founded 2005
- Response to closure of single marketing board that bought and sold all produce at fixed price.
- promotion of WHR financing by financial institutions helped swift transition
- SAFEX designated 200 silos for delivery to replicate old 'farm to silo' system.

***Institutional & government support/ strong clearinghouse/futures contract design/planning were key to success***



# Lessons for Kazakhstan based on exchange outcomes elsewhere

- Interventionism – i.e. minimum price supports (MSPs) - is a deterrent to price discovery and establishment of futures market:
  - Turkey's wheat futures failed because of MSPs,
  - Paris founded futures exchange only after MSPS eliminated
  - South Africa founded futures exchange after the closure of marketing board and elimination of MSPs.
  - China's futures markets established almost 20 years *before* the state imposed MSPs 2006.

***Kazakhstan might consider a system of wide price bands to replace MSPs – i.e. floor/ ceiling – that could encourage trading between high and low.***

# Lessons for Kazakhstan based on exchange outcomes elsewhere

- Financial service sector development is a key to modern exchange success
  - Trusted legal and Regulatory environment with surveillance and enforcement power to oversee exchange trading. Trusted WHR system
  - Licensed brokerage community with proper skill set needed to solicit and guide customers
  - Credit availability/liquidity
  - Exchange clearinghouse based on trust and guaranty fund
  - Stable currency, interest rate environment

***Since 2008 financial crisis, followed by the rapid depreciation of emerging market currencies starting 2013, commodity exchange creation has stalled .***

# In Closing...

- Kazakhstan can learn from multiple countries/exchanges to improve its grain marketing system or lay foundations for futures market trading
- Exchanges in several countries such as India, Turkey, South Africa provide examples of success/failure. China less so because of high levels of state intervention in exchanges and markets
- Kazakhstan needs to adopt best practices for its own trade environment