# The Euro's Impact On Grains Should Be Minor

This Is One Market That May Escape Mindless Linkage

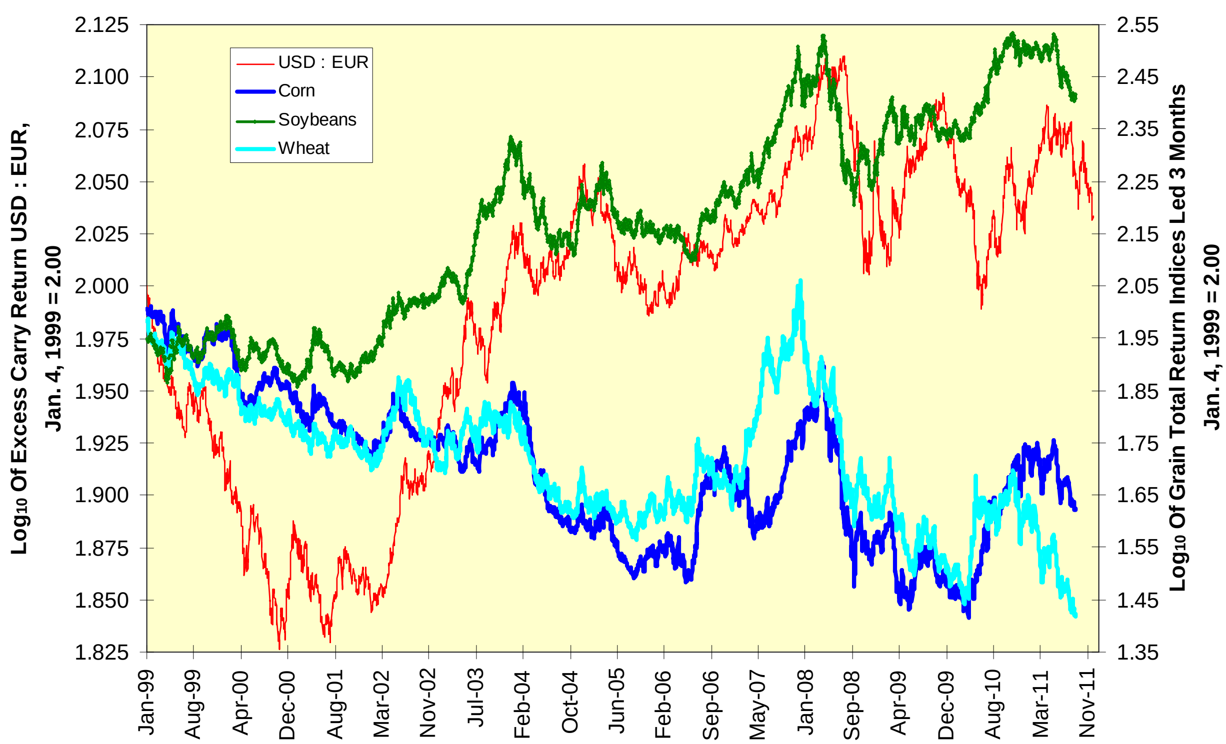
As I noted in a pair of columns in December 2010, (Commodity-Currency Correlations Unstable and Currency-Commodity Correlations: Round Two) you really have to separate all currency-commodity analysis into either individual pairs or certainly into small groups of related commodities. The generalization of something called "commodities" is to be avoided at all costs when discussing commodities.

**The Euro And Individual Grains**

The really strange and completely unavoidable intraday linkages between the euro's exchange rate to the dollar, the U.S. stock market however measured and individual commodities such as gold and crude oil are just a fact of life these days; you can lament the effect of algorithmic trading on intraday correlations but that will be as useful as writing a diatribe against the color blue. Fortunately, this has not spread to a relationship between the euro and the corn, soybean and soft red winter wheat markets. This wheat market is the basis for Chicago-traded futures even though the hard red winter wheat traded in Kansas City is the more important export market.

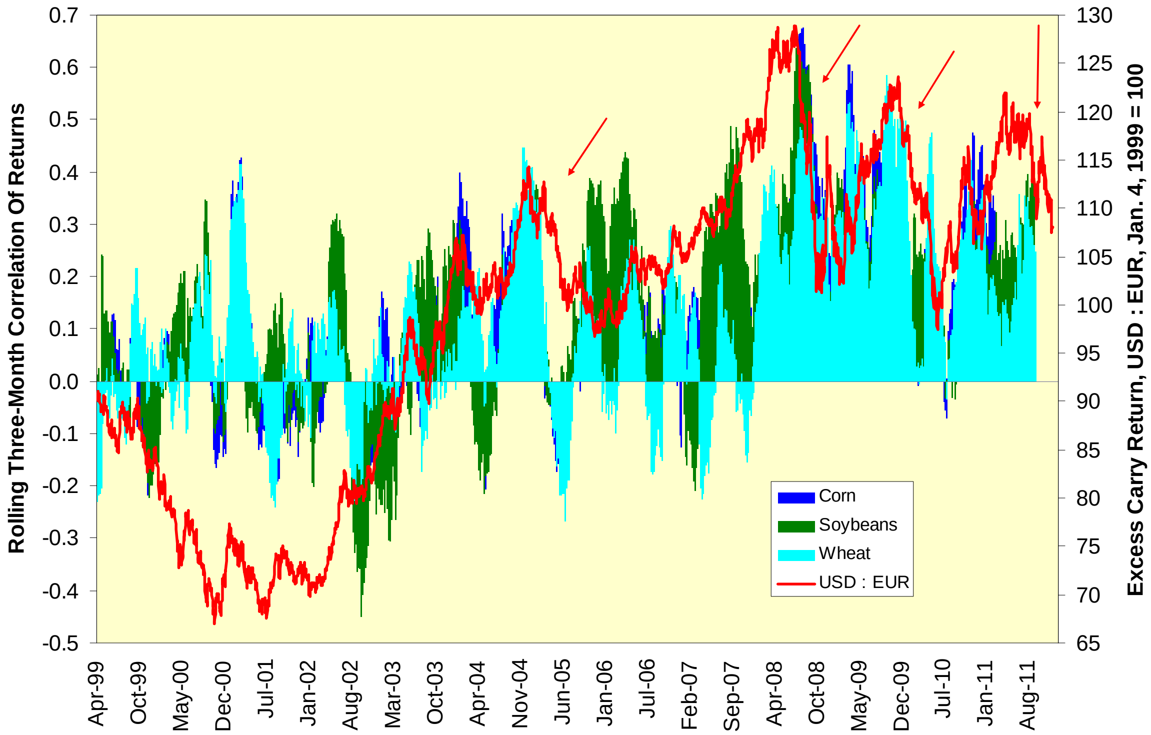
Let's map the excess carry return for borrowing the dollar and lending the euro against the total returns for the Dow Jones-UBS indices led three months for these three agricultural markets going back to the January 1999 inception of the euro (Idle thought: I saw the Berlin Wall rise and fall; will I see the euro coalesce and dissolve?). The chart below is plotted on a common logarithmic scale to depict percentage changes.

**Euro And Grain Prices Weakly Positively Correlated**




A simple visual inspection suggests the relationship is weak but positive, especially for the very important soybean market. Let's step out of the realm of visual inspection and take a look at the rolling three-month correlation of returns for these three agricultural markets overlaid against the excess carry return for the euro.

**Post-2002 Euro Weakness Led To Declining Correlation Of Returns**




The weak positive correlation is confirmed. I have highlighted some episodes of euro weakness, such as the first half of 2005, the second halves of 2008 and 2009 and the present episode with red arrows. Each time the euro has turned down, the rolling three-month correlation of returns has turned down as well.

If the relationship holds, further weakness in the euro should exert only very modest downward pressure on grain prices and it will do so with decreasing strength. In other words, the euro can do anything short of blowing up and it should not matter for agricultural markets.

This is a major relief for those weary of mindless statistical trading. For the grain markets, at least at present, factors such as global income levels, weather factors, growing conditions and all of those other quaint fundamental factors still matter.