A NEW ZEALAND CROSSBRED WOOL FUTURES MARKET

by

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CHAPTER 1

INTRODUCTION AND THESIS GUIDE

1.1 Introduction

The New Zealand wool clip approximates six hundred and sixty million pounds greasy weight, and is made up of over ninety eight per cent crossbred wool.[1/]

Growers may sell their wool by public auction in New Zealand, by private treaty to an individual buyer on their farm, or by auction in the London market. Most wool is sold at auction with only about twelve per cent being sold privately. Auction sales are held in eight selling centres: Auckland, Napier, Wanganui, Wellington, Christchurch, Timaru, Dunedin and Invercargill.

1.2 Market Risks

Risk of loss arising from the uncertainty of future developments is an important element in agricultural marketing. The extent of these risks varies among farm products. While it may seem that risks would be greater for perishable products, in actual fact, greater aggregrate marketing risks may occur with less perishable commodities such as wool. This is because they are accumulated by sections of the marketing "chain" for comparatively longer periods, and the greater the period of ownership the greater the possibility of a decline in price. These price risks may be coming more important

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1. In New Zealand this term applies to lustre wool varying in fineness from 36's to 56's irrespective of the breed or cross of the sheep.

than physical risks which are being reduced with improved storage and handling techniques.

Risks in agricultural marketing may be handled by private enterprise or by group action. Group action includes floor price schemes and other centralised policies. Under private enterprise risks may be handled in five main ways. They may be covered by insurance, reduced through increased information, reduced by combining successive marketing services, assumed by the firms themselves, or "transferred" to others.

Price risks and some other risks may be "transferred" to others by means of forward contracts and/or futures markets, the more advanced and sophisticated of these being futures markets. This study deals with the feasibility and relevance of establishing a futures market for wool in New Zealand.

1.3 Objectives of the Study

This study was suggested by the New Zealand Wool Marketing Study Group. The original proposal called for a study of the relative "efficiencies" of existing wool futures markets in providing protection against price movements in crossbred wools, together with the likely gains to be obtained from basing storage decisions on cash and futures price information. Because of the considerable computer time necessary for such a study and the fact that the Study Group required completion of the work as soon as possible, it was decided to reduce the scope of the study to an estimation of the need for a crossbred wool futures market and factors to be considered in establishing such a market.

1.4 Sources of Information

The study is based on survey and historical data. The surveys used have been described in Chapter 2. The historical data on New Zealand wool prices was collected for other Wool Marketing Study Group projects. The prices are based on estimates of average wool prices made by the Wool Commission appraisers after each sale. Where more than one sale occurred in the same week, the estimated wool prices have been averaged.

The data on the Sydney futures market was collected from the files of a Sydney Floor member, while the data on other futures markets was gained from a variety of sources which have been referred to in the text. Where this has occurred (O) has been used to refer to those references which appear in full in the Bibliography. The Australian wool prices used are the Australian Wool Board's weekly quotations for 64's average quality wool which are related to prices paid for wool in Australia each week.

General information on the wool trade in New Zealand was supplied by the Massey University Wool Department.

1.5 Abbreviations

Throughout the text the Sydney Greasy Wool Futures Exchange, the London Wool Terminal Market and the Wool Associates of the New York Cotton Exchange, have been referred to as the Sydney, London and New York futures markets or exchanges.

1.6 Thesis Guide

This section describes the contents of the remaining chapters of the thesis.

The role of market surveys and the surveys used in the study have been described in Chapter 2. Chapter 3 discusses the economic functions of a futures market.

Chapter 4 describes the actual trading procedures of existing futures markets, while Chapter 5 estimates the effectiveness of the London and Sydney markets as hedging media.

An estimate of the need for a crossbred futures market is made in Chapter 6. This chapter summarises the extent and effects of crossbred wool price fluctuations and the stabilising influence that a futures market would have. The possible locations for a crossbred futures market and the likely success of a market in New Zealand are dealt with in Chapter 7. Chapter 8 examines some of the problems which may be encountered in setting up a futures market.

The main findings of the study, together with some administrative suggestions are given in Chapter 9.

Technical terms and terms peculiar to futures markets, which have been used in the text, are explained in Appendix A.