Farmers should look to diversify export markets, says Groenewald

The unpredictability of currency exchange rates should have farmers looking to diversify export markets rather than speculating on the weakening or strengthening of the rand.

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Farmers can often be tempted to cash in on a weaker rand if, for example, they export fruit. Selling more products to international markets should, in theory, enable them to capitalise on higher prices and increase profitability.

"However, the challenge is that the rate is extremely volatile, and farmers could potentially lose more if the rand strengthens. There are however ways for farmers to reduce the volatility in export earnings through currency hedging," says Nico Groenewald, Head of Agribusiness at Standard Bank.

One option is to hedge the currency by securing a forward contract that will provide both stability and certainty. If the rand strengthens from that fixed point, producers that export will reap the benefits.

Groenewald warns farmers against abandoning their core competency of farming in a solo attempt to follow or anticipate the markets. "Farmers should rather de-risk their hedging activities by consulting experts in currency movement to provide them with an appropriate hedging strategy."

While the weaker rand favours exports, it makes imported inputs and equipment more expensive and, thereby, reduces a farmer's overall profitability.

Farmers do have the option of avoiding possible input cost inflation by buying now for the next season - exploiting today's lower prices.

"However, this option has its opportunity cost," he says. "For one thing, farmers have to use the available cash now to buy additional inputs. They should however avoid the risk of funding this from borrowings, as stock sitting in a shed or

storeroom somewhere - will cost them interest.

It is important to work out all the pros and cons upfront, before committing production cycles or hard-earned cash to any course of action.

"Specifically, farmers should never treat any factor impacting their operation in isolation. In the case of currency exchange rates, farmers should always look at them in the context of the combined impact of all the other economic indicators. Furthermore, they should also project those indicators against the context of the industry in which they currently produce."

Groenewald advises producers to also consider these factors:

- What are the existing and predicted stock levels?
- What are the major producers in the industry doing and how will their actions affect your operations performance?
- What is the international competitiveness of their industry?

He cites the dairy industry as an example of the devastating effect that a strengthening rand can have, where competitiveness had deteriorated in the face of cheap imports of powdered milk from New Zealand.

"Supermarkets will buy the cheaper products to keep their consumers happy. Dairy farmers had to adjust their production decisions over time, and many were forced to exit the industry.

"As production is inelastic over the short term, a long-term view of their market is required, to put them in a far better position to adjust their production decisions ensuring that they remain relevant and profitable.

"And, when the market is as volatile as it is now, then one of the best production decisions farmers can make is to diversify. This means that one or more of their products will cushion them against market and currency fluctuations and give their overall operation far greater flexibility and stability."