

Coffee market volatility



COFFEE is a tropical product, produced in over 50 developing countries. It makes an important contribution to socio-economic development and poverty alleviation and is of exceptional importance to exporting countries, some of which rely on coffee for over half their export earnings. For the 25 million smallholder farmers and their families who produce 80% of world production, coffee is an important source of cash income and responsible for significant employment.

Coffee is the second most traded commodity in the world. Coffee is primarily traded through the New York Board of Trade (NYBOT, for Arabica coffee) and Euronext (LIFFE London, for Robusta coffee).

The coffee market can be very volatile even over very short periods of time. There are many moving parts in the process of getting coffee off from the farm and into your cup. In particular, the availability of financial derivatives has had a significant influence on coffee prices. In fact, 80 percent of coffee bean trades are on paper only and a mere 20 percent of the trades are in real coffee beans. This contributes to a volatility spiral, with price volatility leading to speculation that amplifies volatility in the short run. Many other factors affect coffee prices, such as the weather, exchange rates, freight rates and the economy in general.

QUESTION:

Nedcoffee is looking for better ways to access and model market volatility and Value-at-Risk of their portfolio. Additional difficulty stems from the fact that portfolio comprises of contracts with delivery dates in January, March, May, July, September and November of each year. Historical market data (coffee and option prices) will be made available.

About the company:

Nedcoffee (www.nedcoffee.com) is a major coffee trader with headquarters located in Amsterdam, from which green coffee from its sourcing companies in Africa and Asia is traded and controlled. The unique structure allows its sister companies in the origins to fully focus on sourcing, processing and shipping the coffee for Nedcoffee. Worldwide, in crop season more than 350 people are employed by Nedcoffee and its sourcing companies. Nedcoffee has a rich heritage, with an 80-year history in commodity trading.