

GRAIN OUTLOOK

January 17, 2007

Mike Woolverton, Ph.D.
Extension Grain Economist
Kansas State University
mikewool@agecon.ksu.edu

Delicately Balanced Markets

The USDA released its World Agricultural Supply and Demand Estimates report on Friday, before the three-day Martin Luther King, Jr. holiday weekend. The report set off a chain-reaction of volatility that is likely to be a persistent characteristic of the delicately balanced grain and oilseed markets the rest of this crop marketing year. The USDA estimates were slightly bullish for the already hot corn market, which sent corn price limit up for most of the day to ten-year highs. The USDA report was not as favorable for wheat and soybeans, but the corn price move pulled the prices of those commodities up to near their daily limits.

Corn estimates were not far off industry expectations, but in this year of surging demand and corn stocks scarcity it didn't take much to stimulate run-away buying activity. The key summary points from the corn report were a reduced production estimate to 10.535 billion bushels because of slightly fewer acres of corn harvested and a drop in national average yield to 149.1 bushels per acre. The total usage estimate was down because of lower estimated feed consumption, but it was still 1.23 billion bushels higher than the production figure. That reduced the year-end carryover stocks estimate to 752 million bushels which at the end of the marketing year will give about a three-week supply of corn. Many in the trade expected the USDA to increase its estimate of corn usage for ethanol production; which it did not do, and still expect that number to be increased in later estimates. The end result will be a tremendous squeeze on remaining stocks and perhaps further price spikes to ration the available supply of corn.

The USDA report reduced estimated wheat exports by 25 million bushels which eased the tightness in carryover stocks. But the big news for wheat was confirmation of the widely anticipated increase in winter wheat acres planted. The increase was nine percent; 3.5 million acres more than last year; slightly less than expected by the trade. Wheat acreage in Kansas, the leading winter wheat producer, was up five percent. Oklahoma was up seven percent and Texas up eight percent.

Wheat price had faded in recent trading days, but despite the bearish news, wheat price was pulled up by limit-up corn on Friday. The wheat market faces a dilemma. If wheat price remains high, export demand will be choked off, but if wheat price does not remain high, wheat acreage will shift into corn or soybean production. At winter meetings and coffee shops, wheat producers are freely discussing the possibility of replanting winter wheat acres to row crops in the spring depending on wheat-corn-soybean price ratios.

The U.S. average soybean yield dropped slightly in the World Agricultural Supply and Demand Estimates report reducing total production to 3.188 billion bushels, but still leaving this year's production at an all-time record high. Estimated exports of U.S. soybeans were reduced, which increased ending carryover stocks to 575 million bushels, also an all-time record high. South American production estimates added to the bearish tone of the soybean report. Although there are a few areas of drought stress in Brazil and Argentina, early season growing conditions have been nearly ideal for Southern Hemisphere crops. The USDA raised estimated soybean production for Argentina by one-half million metric tons. The Brazilian production estimate was left unchanged, for now, at one million metric tons more than last year. It is surprising, given the fundamental supply and demand factors, that soybean price is in the seven dollar range. It is the competition from corn for acreage that is currently supporting soybean price.

It will be two months before corn planting begins in the Southern United States, but corn already appears to be winning the battle for acres. Some producers say they will stay with their normal rotations, but most are talking about planting more acres of corn - some

substantially more. Seed corn sales were brisk in December and some producers are already reporting of having to settle for second or third choices of seed varieties.

The question is just how many more acres of corn are needed this year? The key to answering that question correctly is to estimate the demand for corn needed to manufacture ethanol. Each new ethanol plant will add about 37 million bushels to corn demand per year; and an average of one new plant is coming on line each week. To meet all needs will require production of about 11.9 billion bushels of corn in 2007. In order to do that, assuming trend line yield, U.S. producers need to plant about 10 million additional acres of corn this spring. That leads to a second question. From where will the additional acres of corn come? Some will come out of cotton. Some wheat acreage, especially spring wheat, will be switched to corn. Recent estimates are that perhaps five million acres or more will come from soybeans. A five million acre reduction in U.S. soybean production will yield enough to cover needs, but will drop supply low enough to support the price we now see in the market. If seven million acres are pulled out of soybean production, a shortage of soybeans will cause price to rise from the current level.

One can think of several scenarios that would disrupt the delicately balanced markets and cause even more price fluctuations than we have experienced up to now. If weather cooperates and allows producers to start corn planting early, they might overshoot on corn acres. Unless corn acreage increases far beyond current estimates, we would need to have ideal growing conditions and high yields to cause corn price to fall substantially, but that possibility does exist. The additional corn acres would cut deeply into soybean acres causing soybean price to increase.

The other side of the weather coin, poor planting and/or growing conditions, might lead to short crops of both corn and soybeans, causing prices to move up from current high levels.

Given the delicate balance and unprecedented dynamics of the marketplace, no one can predict with certainty what will happen going forward. But one thing is certain:

fluctuating prices during this marketing year will result in potential revenue fluctuations for the average producer in the tens of thousands of dollars. Timing of sales will be critical. The usual advice to sell grain and oilseeds in increments using forward pricing techniques still applies. At present, it is possible to lock in selling prices on the 2007, 2008, and 2009 crops at well above long term averages. Now is the time for grain and oilseed producers to become proactive sellers.