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GRAIN OUTLOOK

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MARKET REACTION TO THE USDA REPORT

The USDA released the September World Agricultural Supply and Demand Estimates (WASDE) report at mid-week. Although there were few surprises in the report, market reaction was not quite as expected. The USDA raised the U.S. corn average yield estimate to 155.8 bushels; up 3 bushels per acre. The USDA attributed the increase to record high per acre stalk and ear counts as indicated by objective field survey data. The 155.8 bushels per acre will be the second highest U.S. corn yield in history; behind only the 2004 crop which yielded 160.4 bushels per acre. But the 2007 corn crop will be the largest ever at 13.3 billion bushels.

Even with the recent high price, corn exports remain strong, running about 32 percent ahead of last year. However, in a surprise move, the USDA lowered estimated amount of corn used for ethanol production by 100 million bushels. Dropping ethanol price coupled with high corn price is putting a squeeze on profit margins, causing ethanol plant managers to decrease plant capacity utilization. It appears progress on new ethanol plants under construction has slowed, reducing corn demand growth. The drop in the amount of corn used to produce ethanol was exactly offset by an increase in domestic livestock feeding of corn. A reduction in distiller's grain production and a drop in wheat feeding is pulling more corn into livestock feed rations.

All these factors resulted in a small increase in projected corn ending stocks to 1.7 billion bushels. That amount gives a comfortable carryover without being burdensome. The USDA projected average farm price range remained at \$2.80 to \$3.40 per bushel.

The bearish WASDE report should have caused corn price to drop. Instead, the following trading day, corn price increased, pulled up by a surge in soybean price. The battle for acres has begun. Corn has been trading in a narrow price band, but is likely to fall as harvest gains momentum, adding to available supply. The storage and transportation issues of handling a huge corn crop are already causing harvest-time basis to widen more than usual in many areas.

Some in the trade expected the USDA to also increase estimated national average soybean yield in the September WASDE report. Instead, the expected yield dropped slightly to 41.4 bushels per acre. August rains simply came too late in some areas of the country to significantly impact pod count and bean size. The size of the U.S. soybean crop is now estimated to be 2.6 billion bushels; down about 570 million bushels from last year's record crop. Most of that drop is due to a 15 percent reduction in acres planted to soybeans.

Soybean demand remains brisk. Beans used for domestic crushing increased due to strong demand for soybean oil from makers of biodiesel fuel. U.S. exports are running 12 percent ahead of last year, which had not been expected because of the recently harvested record crops in Argentina and Brazil. The USDA lowered the projected end-of-year carryover of soybeans down to 215 million bushels; which is about a 3 week and 5 day supply. The already high soybean price jumped even higher on the news of the possible short inventory and in an attempt to bid more land into soybeans in South America this fall and in the United States next spring. The U. S. average farm price is now projected in the range \$7.35 to \$8.35.

Everything about wheat in the USDA World Agricultural Supply and Demand Estimates report was bullish, and yet the market price of wheat dropped the next day. Due to

increased demand, the USDA estimate of human consumption of wheat products increased. U.S. wheat exports continued to be red hot at 110 percent ahead of last year. Adverse weather and quality problems around the globe has left the U.S. as the major world supplier of wheat. But, the USDA is now estimating the U.S. ending inventory to be the smallest since 1973/74. The Southern Hemisphere will not be much help this year. The portion of the Argentinean wheat crop not used internally has already been committed to export buyers. Wheat production in Australia will be lower due to the lingering drought which devastated that country's crop last year. The USDA dropped its estimate of this year's Australian crop by about ten percent; 2 million metric tons (73.5 million bushels). The Australian government is saying if rain is not received very soon, production could go even lower. Global ending inventory will be the lowest in 30 years.

So, why did wheat price drop? Near panic buying in the week leading up to the release of the USDA report had taken wheat price up higher than market fundamentals could support. Or as one market analyst put it, 'There was no new news to feed the bull.'

Indications are producers around the Northern Hemisphere will respond to market price signals and expand land area planted to wheat. However, the expansion may not be as much as some think. The steep futures market inverse; September 07 to July 08, is telling producers to expect a significantly lower wheat price in July. Plus, strong soybean and corn prices will work against a large shift into wheat.

We may have seen the top of the wheat market, as wheat planting gets underway in the Great Plains with excellent field conditions. Looking ahead, the Southern Hemisphere wheat harvest in October and November, even if reduced by drought, will add to global supply and put downward pressure on price. In February, when Northern Hemisphere wheat comes out of dormancy, wheat industry participants will judge the effect winter has had on the crop. Then, attention will turn to growing conditions during the wheat reproductive period. It is impossible to predict with certainty the influence all of these factors will have on wheat price; but if conditions are near normal, it is likely wheat price will be much lower at harvest time than it is today.