

GRAIN OUTLOOK

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MORE PRICE VOLATILITY

Grain and oilseed prices have been responding to forces from outside agriculture as well as to fundamental agricultural supply and demand factors. The resulting price gyrations have illustrated the interrelationships among markets. When the Federal Reserve System recently lowered key interest rates again to help the economy through the difficulties in the financial sector, the value of the U.S. dollar fell when measured against other major currencies. The world price of crude oil, which is denominated in dollars, immediately jumped up by more than four dollars per barrel. Soybean futures, which are related to the price of petroleum by the biodiesel connection, increased to over \$11 per bushel to a 34 year high and pulled the price of corn up to over four dollars per bushel. Wheat price, which is marching to the tune of a U.S. and global shortage drummer, rose to futures and cash market highs in the mid-nine dollar range, far surpassing the previous record high prices set in the 1995/96 marketing year.

Meanwhile, the stock market fell by more than 300 points because investors were disappointed that the Fed did not lower interest rates even more or at least indicate more interest rate cuts ahead. Some investors moved money out of the stock market into commodities, putting additional upward pressure on prices. In the midst of all this, commodity investment funds started to rebalance their portfolios and in the process took some profits to make their year-end income statements look better.

The USDA World Supply and Demand Estimate report for December, although widely anticipated and, for the most part, factored into market prices ahead of its release, did nothing to dampen the volatility. In the report, U.S. ending stocks of wheat, corn, and soybeans were all lowered, mostly because of stronger than expected exports. U.S. wheat ending stocks will be the lowest in 32 years, although global ending stocks were raised slightly. Corn ending stocks were lowered by 100 million bushels, however, U.S. ending stocks are still at a comfortable and market neutral level. Soybean ending stocks were alarming. The USDA lowered them to 185 million bushels, down 68% from last year at this time and only 6% of annual usage. That means at the end of this soybean marketing year; next August, the U.S. will have about 3 weeks and 2 days of soybean inventory left in the bottoms of bins scattered around the country.

When the news from the weekly U.S. export report was combined with the USDA WASDE report data, the picture for continued U.S. exports of wheat may have been even more alarming than the soybean carryover. Wheat exports continue to run well above expectations. Japan and Korea recently purchased cargos of U.S. wheat at about \$12 per bushel. High ocean freight rates pushed the delivered price up, but it shows that high wheat price is not choking off export demand. In fact, export sales of U.S. wheat are beginning to look like panic buying. Overseas buyers are purchasing ahead anticipating the U.S. will run out of wheat, which is exactly what may happen for hard red winter and white wheat. Wheat exports simply can not be sustained at current levels. Either price will have to increase more to ration the remaining supply or, as was rumored in grain markets this week, the U.S. government will step in to embargo further wheat exports.

It doesn't look as if relief will come from the Southern Hemisphere this crop season. Because of the second year of extreme drought, Australia's expected wheat exports were lowered from an already low level by another million metric tons (36.7 million bushels). The Australians are shipping what they can to regular customers in East Asia to maintain trade relationships. The weather in South America has reduced harvest prospects for wheat, corn, and soybeans. The full extent of the freeze damage to Argentinean wheat will not be known until harvest has been completed. Now, heat and dry soils are

damaging Argentina's corn and soybean crops. Brazil has received some rain in soybean producing areas, but it has been spotty. The Brazilian Ministry of Agriculture just lowered its estimate of Brazil's soybean harvest to 58.1 MMT, or about 2.1 billion bushels. (The 2007 U.S. soybean crop totaled 2.6 billion bushels.) The USDA is still estimating the Brazilian crop at 62 MMT (2.3 billion bushels) which if realized would have been an all-time-record crop. Southern Hemisphere crops will add to market supply, but replenishment of global supplies will not occur until the 2008 harvest in the U.S. and other Northern Hemisphere countries. That, of course, depends on good growing conditions and normal yields.

With so many factors, agricultural and otherwise, impacting grain and oilseed markets, we can expect continued volatility in coming months. Producers should take advantage of opportunities to use forward contracting to sell as much of their 2008, and even 2009 production as is prudent. One caution when using futures contracts to hedge: surging prices can lead to huge margin calls. Bottom line: sell in increments and work with local elevators. Let them do the hedging.