Taking Stock Of Crop Market Fundamentals

grain outlook

DR. DARREL GOOD
Extension Economist University of Illinois

Corn, soybean, and wheat prices dropped sharply following the spike on November 9. December 2010 corn futures declined by $.96 from the high on November 9 to the low on November 23. January 2011 soybean futures dropped $1.45 by November 19, and December 2010 wheat futures declined by $1.36 to the low on November 16.

Since the recent lows were established, prices have traded in a relatively narrow range. A number of factors have been cited as contributing to the wide swing in prices over the past three weeks. These include uncertainty about Chinese demand, fluctuating currency values, trading activity of commodity speculators, and the La Nina weather event. The market appears to be having some difficulty identifying value of commodities.

The value of the U.S. dollar is thought to have an impact on the demand for and/or prices of U.S. crops through the export market. A lower valued dollar relative to the value of other currencies makes U.S. commodities more competitive in the world market. That impact is diminished for soybeans, however, for at least two reasons. First, South American soybeans are also valued in U.S. dollars. Second, China is the largest importer of soybeans and the value of the Chinese currency has also remained low. In addition, while China may time purchases based on price expectations, it is apparent that the quantity of Chinese imports is ultimately based on meeting domestic needs. Those needs are currently very large.

The impact of currency values on U.S. corn exports is also muted by the fact that the largest importer, Japan, buys about the same amount of U.S. corn each year regardless of price or currency values. The price impact of export demand of corn is also diminished by the sharp decline in the percentage of the U.S. crop that is exported. Exports this year are expected to account for only 14.5 percent of total consumption of U.S. corn. The value of the U.S. dollar likely has a larger influence on wheat exports because of the very competitive market characterized by a large number of importers and exporters.

A second potential impact of the value of the U.S. dollar is on the price of crude oil which is priced in dollars in the world market. Changing crude oil and therefore gasoline prices can impact the blending margins for ethanol and influence the demand for corn. Over a wide price range for gasoline, however, ethanol blending is profitable as a result of the blenders' tax credit. This tax credit, then, is more important than the price of gasoline in the economics of blending. The fate of the blender's tax credit that is set to expire on December 31, 2010 is a major source of uncertainty for the corn market. Current forecasts are that ethanol production during the 2010-11 corn marketing year will be well above the mandated level. An elimination of the tax credit increases the possibility that production would decline toward the mandated level, depending on the future economics of blending.

While corn exports are a declining share of the market for U.S. corn, the size of that market is still important in the current environment of tight stocks. Uncertainty for export demand this year centers on China. The announcement by China about three weeks ago that the government would take steps to slow economic growth and reduce inflationary pressures was interpreted as negative for commodity demand. It is becoming more apparent, however, that controlling food price inflation is a major part of those efforts, suggesting that crop imports will continue if needed to augment domestic supplies. Diminishing stocks and higher domestic prices for corn raises the probability that China will import more substantial quantities of corn this marketing year. Such a development would support corn prices.

Adding to demand uncertainty is the uncertainty surrounding the current moderately strong La Nina weather event. Recent dryness in much of Argentina and far southern Brazil, as well as in the U.S. hard red winter wheat belt, is thought to be associated with the La Nina. The La Nina is expected to continue for the next several months. While more precipitation is expected for southern Brazil, precipitation in Argentina is expected to remain below normal at least into December. Climatologists point out that there have been four other strong La Nina events since 1960. Hard red winter wheat yields in the U.S. were below trend during each of those events, but the shortfall was large only in 1989.

Prices for corn, soybeans, and wheat will likely continue to be supported by the potential for strong export demand as well as the risk of production shortfalls for corn and soybeans in Argentina and winter wheat in the U.S. Δ

DR. DARREL GOOD: Extension Economist, University of Illinois