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WEEKLY OUTLOOK

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HIGHER GRAIN PRICES ON THE HORIZON?

Recent domestic and world developments have fueled discussions about the potential for significantly higher grain prices in the near future. The current situation has been compared to the early 1970s when prices exploded. What is the basis for speculation for higher prices? There are at least four factors that support the argument.

The first factor is the relatively low level of world grain stocks. At the end of the 1986-87 marketing year, world wheat stocks were estimated at about 176 million tons or 34 percent of the amount of wheat consumed that year. At the end of the 1988-89 marketing year, those stocks had been reduced to 117 million tons or 22 percent of consumption. The projections for the 1989-90 marketing year show ending stocks of 113 million tons or 21 percent of projected consumption. A decline in stocks is anticipated even though the 1989 crop is record large.

Stocks of coarse grains at the end of the 1986-87 marketing year totaled nearly 234 million tons or about 29 percent of consumption. At the end of the 1988-89 marketing year, stocks stood at 145 million tons or 18 percent of use. The projections for the current year point to ending stocks of 134 million tons or 16 percent of use. The smaller world inventory provides less of a buffer for a shortfall in production in the next year or two.

A second factor that supports the case for higher prices is that Eastern European countries and China could become even larger importers of grain in the near term and that the USSR will remain a large importer. Those three areas now account for about 30 percent of the world's imports of wheat and coarse grains. The argument for larger grain imports in Eastern Europe and the USSR is that if economic and political reform are to be successful, the availability of food will have to be increased quickly. In the case of China, it is thought that imports might be increased to reduce internal pressure for the kind of reform that has taken place in Eastern Europe.

In the short run, increased imports in those areas, particularly in Eastern Europe, will require very favorable terms (aid or credit) by exporters. In the longer term, economic growth will be required to support larger imports.

A third factor supporting the case for higher prices is the expectation of higher domestic inflation rates. The thought is that higher price levels in general would support grain prices, particularly in light of strong export demand and small stock levels. The expectation of higher inflation rates is being reflected in higher prices for precious metals and weakness in the value of the U.S. dollar. The expectation of higher inflation rates is not universal, however, as several economists continue to forecast a recession in the U.S. economy.

The fourth factor underlying the argument for higher prices is concern about weather in major grain-producing areas. The current dryness in hard red winter wheat areas of the United States and the extended drought in Turkey are examples that support those concerns. A number of climatologists in the United States are suggesting that weather conditions in the early 1990s will tend to be on the dry side. A severe drought in the face of low grain inventories would be the catalyst for a significant increase in grain prices.

While all the arguments for higher grain prices have some validity, they are mostly potentialities at this time and have been at least partially factored into the current price structure. As long as there is an underlying attitude that prices could move higher, producers should probably move cautiously in forward pricing 1990 crops. The current situation suggests that flexibility should be a major factor in choosing pricing tools. Hedging has more flexibility than forward contracts and options have more flexibility than a direct hedge.

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