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WHEAT MARKET FUNDAMENTALS IMPROVING

The 2000-01 wheat marketing year begins on June 1. The central question is whether or not market fundamentals will improve enough to push prices above the Commodity Credit Corporation (CCC) loan rate, or even higher, in the new year. In the first projections for the marketing year, the USDA anticipated some reduction in U.S. and world wheat stocks by the end of the year. For the U.S., the reduction reflects prospects for a smaller crop and a modest increase in exports. Year ending stocks are projected at 837 million bushels, about 100 million less than the expected level of stocks at the beginning of the year. Stocks at that level would be the smallest in three years, but still represent about 34 percent of annual use. The forecast of year ending stocks will likely change with changes in the 2000 production estimate and revised export projections. For now, however, the expectation is for a continuation of abundant supplies.

Projections for the rest of the world show a slightly larger reduction in year ending stocks. Production outside of the United States is projected at 519.5 million tons, about 1 percent smaller than the crops of 1999-00. This projection will likely change a number of times over the next several months, particularly for the southern hemisphere crops which have not yet been seeded. For now, the USDA sees production declines in China (7 percent), Australia (6 percent), Canada (9 percent), and North Africa (20 percent). The crop in Europe is expected to be nearly 10 percent larger than the 1999 harvest.

While world production is expected to decline about 1 percent during the 2000-01 marketing year, consumption is expected to remain near the record level of 1999-00. As a result, year ending stocks are expected to decline to 109.4 million tons, or about 18 percent of projected use. At the projected level, year ending stocks would be the second smallest in 22 years. Year ending stocks were smaller (107 million tons) only in 1995-96. Wheat prices moved to record high levels in the spring of 1996. The current situation, however, differs significantly from that of the mid-1990s. Following large crops in 1992-93 and 1993-94, world production was relatively small in both 1994-95 and 1995-96. World wheat consumption reached a record 562.4 million tons in 1993-94, yet world stocks remained abundant. The small crops of 1994-95 and 1995-96 required a 3 percent reduction in annual consumption and resulted in a significant reduction in world stocks. Because of strong world demand, wheat prices had to move increasingly higher to force the necessary reduction in consumption. The U.S. average farm price, for example, moved from $3.26 in 1993-94 to $4.55 in 1995-96.

Current production projections indicate no need to force a reduction in world wheat consumption during the year ahead. Prices would be expected to remain relatively low until such a reduction is required, or until a drop in production of other crops increases the demand for wheat. For now, the market will be closely watching the development of the crop in the U.S. and China for any signs of such events.

The abundance of wheat for the past two years has resulted in a price structure characterized by a relatively weak basis and a large carry in the futures market. July 2001 futures at Chicago, for example, are currently nearly $.50 higher than July 2000 futures. The market has paid, and is paying, for storage of the wheat surplus. The July delivery price for soft red winter wheat in St. Louis, for example, is currently $.70 under March 2001 futures at Chicago. The March basis was about -$.15 in March 2000 and about -$.20 in March 1999. In that market, the price structure is offering about $.50 per bushel to store the crop for about 8 months. Many soft red winter wheat producers are not equipped or willing to store wheat on the farm, so that most of that storage premium is eroded by storage and interest costs. If the current price structure continues into harvest, however, producers might want to consider using some farm storage capacity to store wheat into November or December to capture basis improvement. A strategy of establishing the loan deficiency payment at harvest and forward pricing the wheat for winter delivery might be a good strategy again this year. Depending on the forward basis, futures or hedged-to-arrive contracts might be required to capture the basis improvement. The large carry in the market also provides more attractive prices for the 2001 crop.

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