WEEKLY OUTLOOK

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SOYBEAN PRICES TO REMAIN VOLATILE

August is generally considered one of the most critical months for determining U.S. soybean yields. The USDA's final yield and production estimates have often deviated from the August projection, based on weather conditions in August and early September. Over the past 22 years, the final yield estimate has been below the August forecast 11 times, above 9 times, and about unchanged twice. The final estimate has been below the August forecast by as much as 3.5 bushels (1983) and above the August forecast by as much as 3.8 bushels (1994). The final estimate was below the August forecast in each of the past four years, in five of the past six years, and in six of the past eight years. The final production estimate was below the August figure in 12 of the past 22 years and five of the past eight years. As a result of the recent history of declining yield estimates after August, there may be some tendency for the trade to fade the August projection this year, particularly since weather conditions in late July and early August were spotty.

Regardless of crop size, the market continues to expect strong demand for soybeans during the 2001-02 marketing year. That expectation is based on signals that China will continue to buy large quantities of soybeans, that soybean meal exports to the European Union will continue to be supported by restrictions on meat and bone meal feeding, and that domestic soybean meal demand will be supported by a profitable livestock industry. In addition, there is optimism about soybean oil demand for the first time in about two years. Large supplies of other vegetable oils, particularly palm oil, have resulted in relatively small exports of U.S. soybean oil over the past two years. As a result of large domestic inventories, soybean oil prices declined to the lowest level in 28 years. Prices bottomed in February 2001, with an average price at Decatur, Illinois of about 12.4 cents per pound. On a daily basis, the price was as low as 11.8 cents. Recent optimism about soybean oil demand is driven by continued growth in world vegetable oil consumption and only a small increase in production of competing oils, particularly sunflower, rapeseed, and palm oil. Soybean oil prices moved to an average of 16.5 cents in July 2001 and traded to a daily high of about 18 cents.

The market tends to equate consumption with demand. The recent high levels of soybean consumption have likely been driven by a combination of strong demand (increasing population and economic growth) and low prices. It is not known which component has been the largest contributor to increased consumption. If demand truly is increasing, consumption will likely remain high even if prices increase. On the other hand, if the increase in use has been mostly a response to low prices, then consumption would be expected to decline if prices increase, even if supplies are adequate.

Beyond the size of the U.S. crop and world demand considerations, the market will also be influenced by 2002 soybean production prospects in South America. In its July report, the USDA projected a 3.2 percent increase in soybean plantings in Brazil, a 1 percent increase in Argentina, and a 4 percent increase in Paraguay. The projected increase for the three countries averaged 2.4 percent. Combined acreage in those three countries increased by 39 percent in the five previous years. Percentagewise, the largest increase was in Argentina, where acreage increased by 69 percent in the past five years.

Recently, projections from a number of sources have been for much larger increases in soybean plantings in Brazil this year. Projections have been in the range of 9 to 10 percent. The large increase is expected to be generated by a combination of somewhat higher soybean prices, continued devaluation of the Brazilian currency, and extremely low domestic corn prices. Average yields were well above average in Brazil, Argentina, and Paraguay in 2001. More normal yields in 2002 would moderate the impact of acreage increases, but a fourth consecutive record crop may be forthcoming.

Last week's improvement in U.S. crop ratings, along with precipitation in some of the dry growing areas, reduced the market's concern about crop damage. Private estimates of potential crop size are still in a wide range, but a "decent" sized crop is now expected. However, soybean prices will likely remain volatile through the remainder of the growing season. Renewed concerns about crop size may yet emerge. For the time being, it does not appear that cash prices will move above the loan level. Harvest time pricing decisions, including the use of the marketing loan program, will be dictated by the level of prices in relation to the loan price and the carry in the soybean price structure. If cash prices remain well below the loan rate and the carry is non-existent, the incentive will be to sell the crop and establish the loan deficiency payment at harvest and hold ownership, if desired, with futures or options, or with futures or options-based cash contracts.

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