



WEEKLY OUTLOOK



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THREE QUESTIONS FOR THE SOYBEAN MARKET

November 2003 soybean futures traded to a bout \$5.10 in late July as the market reflected expectations of a record U.S. soybean crop near 3 billion bushels. Since then, the price of that contract has increased sharply, reaching about \$6.48 in early trading on September 22. The price rally has been in response to lower production expectations.

The September USDA *Crop Production* report forecast the 2003 harvest at 2.643 billion bushels, the smallest since 1996. Early yield reports have generally been on the low side, creating expectations of a lower production forecast in October. November futures have established the highest contract high since the 1999 contract reached a high of \$6.80. With U.S. soybean supplies at the lowest level in seven years, the market has become pretty dicey. Prices over the next few months will reflect three important fundamental factors.

First, and of immediate importance, is the actual size of the 2003 crop. Given the nature of the 2003 growing season, it is not surprising that yields from early maturing varieties are low. The question is how much did late August rains in the eastern and southern growing areas benefit later maturing varieties? Opinions differ widely, but it would not be surprising to see near normal yields from those varieties in eastern growing areas. Many western and northern growing areas did not receive as much late season rainfall, so that yield prospects there are lower for the later maturing varieties. Only time will tell if the USDA's September report captured actual yield prospects. Historically, there has been no correlation between production forecast changes in September and changes in October. On average, since 1970, the crop forecast in September has differed from the estimate in January following harvest by 4 percent. The "error" has ranged from near zero to 9.5 percent.

The second fundamental factor is the rate of consumption of the 2003 U.S. crop. If the crop is near 2.64 billion bushels, and the minimum year-ending stocks level is about 5 percent of consumption, use during the 2003-04 marketing year would be limited to about 2.654 billion bushels. That would be about 170 million bushels less than consumed during the 2002-03 marketing year (after the 2002-03 consumption estimate is corrected for the apparent underestimate of the size of the 2002 crop). The USDA has projected a 60 million bushel reduction in the domestic crush and a 100 million bushel reduction in U.S. soybean exports. The question is, when will the pace of consumption begin to fall in line with available supplies?

Soybean exports during the first 2.5 weeks of the 2003-04 marketing year were about 4 million less than during the same period last year. However, unshipped sales as of September 11 totaled 311 million bushels, compared to 228 million on the same date last year. All major customers, except Mexico, have booked more soybeans than at this time last year. The rapid pace of export sales to date magnifies the significance of a smaller crop.

The third fundamental factor, very much related to the second factor, is the potential size of the 2004 South American soybean crop. The size of that crop will have an impact on the demand for U.S. soybeans and soybean products. In its September report, the USDA forecast an 8.7 percent increase in soybean area in Brazil, a 4.8 percent increase in area in Argentina, and a 6.9 percent increase in Paraguay. Combined area in those three countries is expected to increase by 7.1 percent. For the past two years, soybean area in Brazil has expanded by 17.4 percent and 12.5 percent, respectively. Area in Argentina increased by 9.6 percent and 10.5 percent, respectively. The recent increase in soybean prices may encourage a larger than forecast increase this year, as additional acreage is shifted from other crops to soybeans. The question, then, is what will the average South American soybean yield be in 2004? The average was record large in 2003, with new records established in Brazil and Paraguay and the 1998 record equaled in Argentina. The USDA has forecast a 1 percent decline in the average South American yield in 2004. Production there is forecast at 3.57 billion bushels, nearly 200 million bushels larger than the 2003 harvest. An increase of that size would offset the smaller crop in the U.S.

With considerable uncertainty on both the supply and demand side of the U.S. soybean situation, pricing decisions are difficult. Increasingly, the soybean market is developing a "short-crop" pattern, with prices moving higher, basis strengthening, and inverses in the futures market growing into the harvest period. Historically, short crop years have produced some of the better pricing opportunities near harvest time.

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