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SOYBEAN PRICES COLLAPSE: WHAT NEXT?

August 2004 soybean futures reached a high of $10.26 on March 24, 2004 and traded to a low of $7.05 on July 16. While some have termed the decline as unprecedented, it is reminiscent of some past price behavior.

July 1977 soybean futures reached a contract high of $10.64 in May 1977 and traded below $6.00 per bushel in July 1977, declining nearly $4.00 in less than a month. July 1988 futures reached a high of $10.995 in late June 1988 and declined to $8.20 at maturity, dropping $2.00 in the last week of trading. The most dramatic decline was in 1973, when the July contract reached a high of $12.90 in early June 1973 and traded below $6.50 in early July. However, the contract rebounded to $10.25 at maturity.

The current price decline has also been associated with a free fall in the basis. The central Illinois cash bid was $1.34 above August futures on July 8 and $.235 above that contract on July 16. Again, the collapse in the basis is not unprecedented. The Chicago cash bid was $1.14 above August futures in early June 1973 and was $1.35 below that contract in late July. Such a collapse did not occur in the summer of 1977. The difference that year was that July futures did not attain the large premium to the August contract that occurred in both 1973 and 2004. Such large inverses appear to be a mistake.

What now? Will prices remain low and continue to decline as has typically been the case with the demise of bull markets, or will there be a final gasp higher as in 1973? The answer may be determined primarily by two factors. The first is how well processors and end users have prepaid for the extremely tight inventory situation. The extreme tightness in U.S. stocks has been advertised since December 2003 and the shortfall in South American production was advertised early in the spring. If end users prepared for this scenario, one would expect that their inventories of product, particularly soybean meal, are larger than normal. In addition, arrangements for imports of soybean meal might have been made. The latter does not seem to be the case, however, as the USDA lowered the projection of marketing year meal imports by 150,000 tons in last week's report of supply and demand prospects. The projection of soybean oil imports was increased by 50 million pounds.

The second important fundamental factors is the timing of the availability of new crop soybeans. The crops in Arkansas, Louisiana, and Mississippi appear to be maturing earlier than normal, but there is some disagreement on how early harvest will occur. Those early harvested soybeans may be needed in the domestic processing market, so logistics could be an issue as well.

Beyond the next 4 to 6 weeks, the size of the U.S. crop will be the most important price factor. After that, Chinese demand and South American crop prospects become important. The market will continue to follow the USDA's weekly report of crop conditions to gauge yield potential, but considerable uncertainty about corp size may persist as late as early September. Crop condition rating as of June 11, slowed 68 percent of the crop in good or excellent condition, with the highest ratings in Kansas, Kentucky, Mississippi, and Tennessee. Ratings were also above the national average in Illinois and Iowa. Based on historical relationships, current ratings point to the potential for a high average yield, but such potential has not always materialized. The most recent instance, of course, was last year.

In spite of a recent slow down in soybean imports by China, the USDA expects an 8 percent increase in soybean consumption and a sharp rebound in imports by China during the year ahead. Chinese imports totaled 790 million bushels in 2002-03, are projected at 660 million for the current year, and at 880 million in 2004-05.

The USDA projects a 7 percent increase in South American soybean area for the coming year. Acreage is expected to expand by 10 percent in Brazil. A return to more normal yields in 2005 would result in a large increase in South American production, projected at 21 percent by the USDA.

The soybean market appears to be making the transition from an environment of reduced supply and high prices to a one of abundance, and perhaps surplus, and low prices. If the large crops do materialize, prices will likely decline even further, but uncertainty abounds. The lessons learned this year include the merits of spreading sales throughout the marketing year and the merits of using options in making pricing decisions.

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