



WEEKLY OUTLOOK



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WHAT ARE SOYBEANS WORTH?

Based on a U.S. production forecast of 2.836 billion bushels and year ending stocks of 190 million bushels, the USDA has projected the 2004-05 marketing year average farm price of soybeans in a range of \$5.35 to \$6.25 per bushel. The wide range reflects uncertainty about a number of important factors, including the size of the 2005 crops in South American and the U.S.

As of October 1, the combination of the September cash price plus futures market prices for the rest of the year reflected a marketing year average price below the low end of the USDA's projected price range. The September cash price used in this calculation is the mid-month price reported by the USDA. That price does not represent the actual weighted average cash price for soybeans delivered in September (which includes pre-harvest sales). That price will be reported at the end of October. At \$5.77, however, the mid-month price was probably not much different than the weighted average price for soybeans delivered in September. Pre-harvest sales were made at higher prices, but spot sales were likely made at an average below \$5.77. Prices in the futures market are translated into an estimate of average monthly farm prices by using the three year average basis for each month from October 2004 through August 2005. Finally, the estimate of the monthly cash price is weighted by the past 5 year average percentage of the crop marketed in each month. Using this process, futures settlement prices on October 1 translated into a 2004-05 marketing year average farm price of \$5.25.

The average marketing year price reflected by the current market is \$.55 below the mid-point of the USDA's range for the expected average price. The difference might reflect a number of factors, including different expectations about the size of the U.S. crop. Based on early yield results, the market may be expecting a larger crop than forecast by the USDA in September. In addition, the market may have different expectations about the strength of demand for U.S. soybeans. Alternatively, the market may just reflect a difference of opinion about the value of soybeans, not underlying supply and demand factors.

One common way to judge prices is by examining the historical relationship between the level of year-ending stocks and the marketing year average farm price, as discussed in the August 2 issue of this newsletter. Ending stocks are normally expressed as a percentage of soybean use during the previous year and then correlated to the average farm price. As expected, there is a fairly

strong negative correlation between stocks and price. The USDA's September supply and consumption forecasts produce a ratio of projected year ending stocks-to-use of 6.9 percent. Based on the relationships of the past 6 years, this ratio projects a marketing year average price of \$5.41.

Reversing the process, current market prices (average farm price of \$5.25) reflect a stocks-to-use ratio of 7.4 percent. Using the USDA's forecast of marketing year consumption of 2.758 billion bushels, the current price reflects a crop of 2.845 billion bushels, only marginally larger than the current USDA forecast.

It should be emphasized that using the year ending stocks-to-use ratio as the only indicator of marketing year average price has many shortcomings. The process should be used only as a guide to forming price expectations. The analysis, however, does suggest that the market is currently not reflecting a crop much different than forecast by the USDA last month. Instead, the analysis suggests that the market believes that the USDA's current forecast of marketing year average price is a little too optimistic.

All of the forecasts could change on October 12, when the USDA releases a new projection of the size of the crop and perhaps revised forecasts of consumption and year ending stocks. While soybean futures prices have declined about \$.45 since the release of the September production forecast, it appears that prices have only adjusted to that forecast, not to a larger crop. Further adjustments will likely have to be made to any significant change in the production forecast.

Now that the posted county price in many areas is below the county loan rate, resulting in positive loan deficiency payments, many producers may attempt to maximize net price by separating the pricing decision from the decision about establishing the loan deficiency payment. The typical strategy is to establish the deficiency payment at harvest price lows and retain ownership of the crop to capture higher cash prices later in the year. The significant uncertainty surrounding soybean market fundamentals over the next few months could make this a risky strategy for soybeans. Some consideration should be given to managing the risk of lower prices following harvest.

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