



# WEEKLY OUTLOOK



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## **MORE SOYBEAN ACREAGE IN THE U.S. IN 2006?**

There seems to be widespread agreement that U.S. producers will reduce corn acreage and increase soybean acreage in 2006. A shift in that direction, however, seems to be contrary to the direction suggested by current and emerging market fundamentals.

One of the primary reasons for expecting more soybean acreage and less corn acreage in the U.S. this year is the large increase in the direct costs of producing corn relative to the increase for soybeans experienced over the past few years. The larger increase in costs have been driven primarily by high costs of nitrogen fertilizer. The higher cost for corn is expected to result in some switch to soybeans in areas where soybean yield potential is generally high relative to corn yield. Concerns about a dry growing season in 2006 might also motivate a more widespread increase in soybean acreage due to the perception that soybeans are more tolerant of dry growing conditions. A rebound in total acreage in those areas with prevented planting in 2005 may also contribute to an increase in soybean acreage, although spring wheat should compete well for that acreage.

Whether or not a switch in acreage from corn to soybeans in 2006 is the right thing to do from a broad market perspective will depend on the yields of corn and soybeans that materialize in 2006, the magnitude of production in the rest of the world, and the world demand for corn and soybeans. Current world production and demand prospects, however, seem to be relatively more favorable for corn than for soybeans.

Domestically, there is a high likelihood of continued rapid expansion in the use of corn for ethanol production. That use is projected at 1.6 billion bushels this year, 277 million more than used last year and 432 million more than used two years ago. The year-over-year increase totaled 13 percent last year and is projected at 21 percent this year. Assuming a trend corn yield in 2006, the increase in corn used for ethanol during the 2006-07 marketing year may be equivalent to production from more than 2.5 million acres.

Domestic feed and residual use of corn during the 2006-07 marketing year will be supported by expanding beef, pork, and poultry production. A modest 2 percent increase in feed use would be 120 million bushels. The potential increase in feed use of corn might be limited by increased production of by-product feeds from the ethanol industry. Under the simplifying assumption that one-third of the corn used for ethanol is returned to the by-product feed market, and half of that substitutes for corn feeding, a 360 million bushel increase in corn used for ethanol, for example, would produce by-product feed to substitute for 60 million bushels or corn. Even if all of that by-

product is fed domestically, the net increase of 60 million bushels of corn feeding is equivalent to about 400,000 acres.

U.S. corn export prospects for the remainder of the 2005-06 marketing year and for the 2006-07 marketing year have improved significantly for at least two reasons. First is the shortfall in production in Argentina. The USDA currently projects the 2006 harvest there at 610 million bushels, about 160 million smaller than the 2005 harvest. Exports from Argentina are expected to decline by an equal amount. Larger reductions are possible. Second is the increasing evidence that China will progressively be less of an export competitor and an eventual importer of corn. The rate at which that will occur is not certain. Chinese corn exports for the current year are projected at about 235 million bushels. The U.S. could easily experience an increase of 150 million bushels in export demand from reduced competition from China in the year ahead. A 225 million bushel increase in U.S. corn exports next year is not out of the question and would be equivalent to about 1.5 million acres.

The expected increase in consumption of U.S. corn during the 2006-07 marketing year can be supported from inventories of the 2005 crop if acreage does not decline much and the U.S. average yield is near trend. A large decline in acreage, and/or a shortfall in the average yield, would likely result in a significant decline in year-ending stocks. If corn consumption increases over time, as expected, more U.S. corn acreage will eventually be needed even with trend yield increases.

For soybeans, the need to expand U.S. acreage in the near future is not obvious. The 2005 South American crop is expected to be record large, U.S. ending stocks for the current marketing year are expected to equal 20 percent of annual consumption, and world stocks of soybeans are expected to equal 25 percent of annual consumption. Growth in consumption of U.S. soybeans is expected to occur at a slower rate than the growth in corn consumption. Domestic meal consumption for livestock feed should grow at a rate equivalent to corn feeding. The main difference, however, is that the magnitude of fuel use of soybean oil will likely be a much lower level than ethanol use of corn in the immediate future. Exports of U.S. soybeans will be supported by growing Chinese demand, but competition from South America will remain stiff.

One of the functions of the market is to direct U.S. production decisions in an environment of much uncertainty about world demand, competition from other areas, and growing season weather. Based on current conditions, however it appears that the soybean prices need to be at a level to discourage a large increase in U.S. acreage in 2006.

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