WEEKLY OUTLOOK

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IS THE SOYBEAN MARKET BULLET PROOF?

Soybean prices have moved sharply higher over the past two weeks, even with prospects of record South American production and mounting world surpluses. The market is clearly looking beyond the current situation of burdensome supplies.

The average cash price of soybeans in central Illinois increased from $6.75 on January 26 to $7.15 on February 9. During that same two-week period, March 2007 futures increased from $7.10 to $7.49, with a contract high of $7.57 established on February 9. That contract had traded as low as $6.60 before the release of the USDA's January 12 *Crop Production* report. Similarly, November 2007 futures increased from about $7.63 on January 26 to $8.01, establishing a contract high of $8.08 on February 9. November 2007 futures have established the highest high for a November contract since the 1996 contract reached $8.25 in July 1996. The all time high is $10.46 for the 1988 contract, reached in June 1988.

The strength in soybean prices on Friday of last week was a bit surprising given the USDA's forecasts of record large U.S. and world stocks and a record large South American harvest released in a report before the market opened on Friday. Even though U.S. exports and export sales have been brisk, the USDA lowered its projection of the 2006-07 marketing year total exports by 20 million bushels, to 1.1 billion. That reduction follows a 25 million bushel reduction last month. The lower expectations for this year's exports reflect the larger projection for the upcoming South American harvest. The USDA now projects that harvest (Brazil, Argentina, Paraguay, Bolivia, and Uruguay) at 3.95 billion bushels, 55 million bushels above the January forecast and 200 million larger than the 2006 harvest. The largest year-over-year increase, 130 million bushels, is expected in Argentina. The large crop in South America should slow the rate of U.S. soybean exports in the last half of the current marketing year and in the first quarter of the 2007-08 marketing year.

Based on the pace of the domestic crush during the first four months of the current marketing year, it was generally expected that the USDA would increase the forecast of the crush for the year. Instead, that forecast remained at 1.78 billion bushels. High prices will likely slow the pace of soybean meal feeding and the use of soybean oil for biodiesel. The

forecast of year ending U.S. stocks was increased by 20 million bushels, to a record 595 million bushels. Stocks at that level represent 19.5 percent of expected consumption during the current marketing year. That is the third highest year ending stocks-to-use ratio experienced in the U.S. The ratio was higher in 1985-86 (28.5 percent) and 1986-87 (21.3 percent). World carryover stocks are projected at a record 2.1 billion bushels.

The dominant fundamental factor supporting soybean prices appears to be concern about the size of the 2007 U.S. crop. A decline in U.S. soybean acreage in favor of additional corn acreage in 2007 has long been expected. However, recent private sector forecasts about the magnitude of the switch have been larger than the early expectations. These larger forecasts seem to have spooked the market into thinking that the switch could be large enough to create a shortage of soybeans in the 2007-08 marketing year. With carryover stocks of 595 million bushels and a trend yield in 2007, soybean acreage would have to decline by more than 12 million acres (16 percent) to suggest a possibility of a shortage of soybeans next year.

The worries about reduced acreage are also apparently being augmented by concerns about the upcoming growing season. The fading of the weak El Nino weather phenomenon and the increasing number of references to the similarity to 1988 raise concerns about a summer drought in the midwest. In 1988, the El Nino faded rapidly and La Nina conditions emerged to contribute to the midwest drought. The current concern seems a little premature. Drought events in the U.S. midwest apparently do coincide with a rapid transition from El Nino to La Nina, but not every such transition is associated with a midwest drought. In addition, most models suggest that the current El Nino will give way to more normal sea surface temperatures in Nino region 3.4 rather than to below normal temperatures. Current soil moisture levels are generally more abundant than at this time in 1988.

The ability of the soybean market to move to new highs in the face of negative old crop fundamental and the willingness to respond to concerns about the 2007 crop has resulted in some attractive pricing opportunities for the 2007 crop. However, pricing the 2007 crop is a challenging balancing act. The prevailing attitude suggests that prices could continue to move higher, yet there is some risk that the soybean market will make the same mistake as last year when prices remained relatively strong and too many acres were planted to soybeans.

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