



WEEKLY OUTLOOK



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FOCUS ON CROP SIZE AND ENERGY PRICES

Two broad fundamental factors appear to be influencing corn and soybean prices as the growing season reaches the last stages. One of those factors is the potential size of the 2008 U.S. harvest and the other is the level of energy prices. Crop size is important for obvious reasons and energy prices are important in determining the value of crops for biofuels production. That link is especially important for ethanol and corn prices.

The USDA will release a new production forecast for corn and soybeans on September 12. There appears to be a fairly wide range of expectations for the size of the new forecasts, which will primarily reflect a reassessment of yield potential. The dry end to the growing season in some important production areas has some leaning toward smaller yield forecasts. Improving weather in southern growing areas and relatively high crop condition ratings suggest to others that yield forecasts might hold steady or increase.

As of August 24, just ahead of the survey period for the September yield forecasts, the USDA reported that 64 percent of the corn crop and 61 percent of the soybean crop were rated in good or excellent condition. If those ratings held through the end of the growing season, past relationships between crop condition ratings and the trend-adjusted U.S. average yield would point to 2008 average yields of 154.4 bushels for corn and 43.5 bushels for soybeans. Such a corn yield would be 0.6 bushels below the August forecast, but the soybean yield would be 3.0 bushels above the August forecast. Over the past 35 years, the largest increase in the U.S. average soybean yield forecast in September was 2.2 bushels in 2006. That year, the actual U.S. yield was 3.1 bushels above the August forecast.

Another way to form expectations about the September yield forecasts using the crop condition ratings is the change in condition ratings since the survey period for the August forecast. The percentage of the crops rated good or excellent since that time has dropped two percentage points for both crops. Such a decline points to a 1.3

bushel decline in the corn yield forecast, to 153.7 bushels, and a 0.4 bushel decline in the soybean yield forecast, to 40.1 bushels. Those calculated changes could be adjusted by the crop condition ratings released on September 2. Beyond the September yield forecasts, the location and amount of rainfall in early September will likely be more important for soybean yields than for corn yields. If the estimates of harvested acreage and the forecasts of consumption during the 2008-09 marketing year remain unchanged, the lower yield forecasts based on the change in crop condition ratings during August would point to year ending stocks of 1.03 billion bushels for corn and 106 million bushels for soybeans.

Prices for crude oil and the resulting price of unleaded gasoline have implications for the price of ethanol and the price ethanol producers can pay for corn. As a guide, the maximum economic value of ethanol is the price of unleaded gasoline, adjusted for the difference in energy content, plus the blender's tax credit. That credit is currently at \$.51 per gallon, but is scheduled to decline to \$.45 in 2009. The current price of wholesale unleaded gasoline of about \$2.70 per gallon makes ethanol worth about \$2.26 per gallon with a \$.45 blenders tax credit. Assuming that the price of corn and distillers grain move together and that the non corn cost of making ethanol is about \$2.60 per bushel, the breakeven price of corn for ethanol producers is about \$5.00 per bushel.

Factors beyond crop size and energy prices could be important for corn and soybean prices. The ultimate size of the world wheat crop, prospects for South American soybean production, world economic conditions, and perhaps the value of the U.S. dollar will influence export demand. The profitability of the U.S. livestock industry will influence domestic feed demand. The year over year decline in domestic soybean meal consumption since April and the sizeable year over year decline in the domestic soybean crush in July indicate some weakening of feed demand, although part of the decline is likely the result of larger supplies of distillers grains.

Current prospects for supply, consumption, and stocks suggest that corn and soybean prices will remain relatively high, but will likely trade in a wide range for an extended period. That volatility will likely increase even further with the start of the 2009 planting season.

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