

Agricultural Outlook Forum

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1998 COARSE GRAINS AND WHEAT TOPICS

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Today, I will begin as a discussant regarding the USDA wheat and coarse grain presentation, but I would also like to present five additional observations for possible discussion as they relate to grains in general.

We at AgResource do not have any major disagreement with either the 1997/98 wheat or coarse grain demand projections other than slight changes in the export assessments. We believe that implicit in this year's analysis of corn is the assumption that China will become a significant importer of corn during the latter half of the marketing year, if the 1997 Chinese corn crop is truly 105 million tons. Secondly, we believe that the South African maize crop is closer to six million tons than the February USDA forecast of 7.5 million tons.

We do have problems with the 1998/99 analysis, as can be seen on the above corn supply/demand slide. The 1998 corn acreage is too high, given the present soybean to corn price ratio, on whatever basis one cares to equate the two crops (nearby on-farm or Chicago cash, nearby futures or new crop futures).

Farm Act of 1996 Implications

Our analysis would suggest that old models of these price relationships must now take into account the fact that the pre-1996 Farm Act history of the relationship implicitly included the corn deficiency payment. This allowed bean to corn ratios of 2.4 to 1 to be considered as acreage neutral. This is not the case any longer. As shown in the slide above, such ratios now foster the planting of beans at the expense of corn. Without a crop specific deficiency payment, corn requires a ratio in the 2.1 to 2.2 range to maintain its acreage base. To date the market has not indicated such a signal, and therefore, corn will lose acreage to soybeans again in 1998. Some of the loss in 1998 corn acreage in the Cornbelt will be offset by gains in the South at the expense of cotton and the shifting of Plains winter wheat acreage to feed grains. If the spring season begins under a threat of dryness (fostered by the rapid decline in the El Nino temperatures), the movement towards soybeans, and away from corn, could even be more severe than the 500,000 acres we are currently forecasting. Incidentally, the same scenario is partially responsible for the continuing loss of wheat acreage, as was amply demonstrated in the loss of 1.7 million winter wheat acres this past fall. **POINT - Wheat and corn, without their crop-specific deficiency payments, cannot compete on a level similar to pre-1996 Farm Act conditions.**

Another point I would like to emphasize is that under AgResource's estimate for the world 1998 coarse grain crop, we have a forecast of 928 million tons. But given a smaller

carryin and expected strong demand, the 1998/99 stocks buildup will not be large and the world will remain dependent on no major crop problems throughout the world during the 1998/99 season.

World Stocks and Market Volatility

This latter point, **minimal stocks**, carries a very important consequence, volatility. Carryover stocks, both world and U.S., for wheat and coarse grains are near historically low levels and will continue as such for the foreseeable future. This fact becomes evident in the above graph of world stocks of grain for both wheat and coarse grains. Note that during the past 20 years, the rest of the world's stocks of coarse grains have ranged between 75 to 100 million tons. Meanwhile, the U.S. contribution to world coarse grain stocks has ranged from 153 million tons in 1987 to a level of 14 million tons in 1996. The USDA, and as a result the United States, is no longer willing to maintain control of grain storage for the benefit of the entire world.

This becomes very evident in the accompanying slide, which depicts the amount of grain in the CCC inventory over the past two decades. Note that at the peak in 1987, there were 3.0 billion bushels present in CCC inventory (78 million tons). Included were 2.2 billion bushels of coarse grains, mostly corn, and three-quarters of a billion bushels of wheat. In addition in 1987, as seen in the next slide, the Farmer-Owned-Reserve, which was considered pseudo-government control of grain, reached 2.7 billion bushels (70 million tons), of which corn contributed 1.6 billion bushels. Together these two programs controlled 5.7 billion bushels, or 147 million metric tons of grain at its peak. Today, the combined grain under control of these two programs is 95 million bushels, with CCC wheat comprising 93 million bushels and corn two million.

The lack of USDA involvement in grain storage has reduced total U.S. grain stocks holdings. As a result, the current and recent stocks-to-use ratios of the grains lie on the left end of the accompanying price slide. Without the U.S. involvement in the storage business, lower stocks/use ratios will continually occur. **POINT - The present and future volatility of grain prices will be greater than in the past, as annually the location of future supply/demand/price curves will occur at the steep end of such charts, where small variations in perceived stocks will cause large ranges in prices changes. This is a hazard that will remain with us for the foreseeable future.**

The U.S. Storage Situation

My third point regards a situation that has crept up on the U.S. agricultural community, but it will impact on future years and could dominate both farmer planting and marketing decisions and those of the subsequent merchandising, storage and transportation of grains. The problem to which I am referring is the U.S. grain storage situation. This past fall, evidence of this problem was made manifest which when combined with a shortage of railcars in the Plains and Midwest, resulted in large piles of grain on the ground. Most saw this as a transportation problem, but underneath this transportation situation is a problem that is just asking for quality and logistical problems to develop due to the lack of storage space. There is enough blame to be thrown around to cover everyone in the business.

The above slide captures data from the January USDA stocks and storage report and indicates that the U.S. storage capacity has continued to decline over the past ten years, both on-farm and off-farm. It tells a tale of continued abandonment of grain storage, with only isolated increases of newly built facilities. During the past two years, off-farm stocks declined by 4.6 percent to 7.9 billion bushels, while on-farm storage declined by 2.0 percent to 10.9 billion bushels. This is not a new phenomenon; it has been going on since 1987 for on-farm storage and since 1986 for commercial storage. This represents an annual average decline of 259 million bushels in on-farm storage and 167 million bushels in off-farm storage.

On-Farm Storage

Prior to the mid-eighties, on-farm storage was in an expansive stage, sponsored by the USDA's Storage Facility and Equipment Loan Program. As seen in the next slide, the 10-year decline in on-farm storage has been the greatest, in absolute terms, in the Western Cornbelt, down one billion bushels, with declines of over 300 million in both Iowa and Minnesota. In relative terms, the on-farm storage decline has been even greater (over twenty percent) in the Southwest, the Southeast, the Pacific NW, and the Delta regions.

Off-Farm Storage

The story of off-farm storage is much the same. See the slide above. With the advent of the 1985 Farm Act, the government became an active entity in its disownership of grain stocks. An overwhelming proportion of USDA-CCC grain stocks were housed in commercial, off-farm storage. The advent of the 1988 drought allowed the CCC to accomplish this task more rapidly than had been planned. CCC inventory has continued its downward trend and is presently at 95 million bushels.

The off-farm grain storage decline has been most prominent in the Western Cornbelt and the Southwestern regions. Nebraska and Texas have experienced the largest absolute declines in off-farm storage. There are localized examples of replacement construction, but there appears to be no movement towards enlarging the U.S. commercial storage capacity.

The fact is that off-farm storage continues to decline in the face of rising production and demand trends for both corn and soybeans. Thus, the pipelines for both these dominant Cornbelt crops have fostered carrying charges to promote commercial storage. The obvious solution is to encourage the building of storage. Although all grains and oilseeds are forecast to have relatively tight carryouts, their respective markets have experienced wide carrying charges. This is one of the incentives that must be present on a regular basis to encourage the building of storage.

Where should this storage be located? There is the school of thought that the consumers of these grains - millers, processors and exporters - should maintain a greater degree of control over their sources of grain, particularly if future markets, as mentioned earlier, are destined to remain volatile. That would suggest that such consumers might be encouraged to expand their own storage to maintain control, to some degree, of their supply

requirements, as they foresee them to be, over the next decade. However, to offer the most efficient use of future storage, the most favorable site for newly built storage would be at the source - farms and local elevators. This would then allow the system the greatest degree of flexibility to satisfy future unforeseen demand. **The point is not whether a crunch will occur; rather, it's just a question of when.**

Funds and Prices

A fourth point. A funny thing happened on the way to price discovery over the past half year. It appears that the Funds, under the listing of Large Speculators, have played an enormous role in the price levels of the grains. Let me present two slides. Note that the price of wheat, in this case March wheat, has a definite relationship to the size of the Large Spec trade position. The correlation comes to 97 percent, and is significant. Just as striking is the comparison between the March corn price and the Large Spec net position. In this case, the correlation was over 82 percent. The soybean relationship is very strong at over 93 percent. Though the Large Spec position represents only 7 to 11 percent of corn open interest, at any given time, it is the Funds collective net position that moves the market to either side of a market neutral value. **The point is that the price channel, in which the price discovery of grains is being traded, has widened considerably during recent years due to the Funds. A fact that those in the market would not contest.**

Feeding Survey

A final plea. Those who know me will recognize this request. The grain industry needs a national survey on feeding. Such a survey should be on a state basis and should include feeding by grain-type and animal-type. Unaccountable residuals for the grains continually appear in the quarterly stocks reports. For corn, the residual can reach one billion bushels annually and has caused this inconsistent correlation of animal demand versus the quarterly feed-residual (calculated from the stocks report). Another example shows the recent history of the wheat feed-residual with back-to-back quarterly feed-residuals oscillating between quarters by nearly 500 million bushels, 20 percent of the entire wheat demand for a year. **The trade needs a better barometer of feeding demand, a sector that is responsible for over five billion bushels, or over 50 percent of grain's annual demand.**

There are other topics which are worthy of discussion such as the Southeast Asian situation and El Nino, but I'm sure they will come up in the following Q & A period.

Thank you again for this opportunity.