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Decisive Marketing

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Supply or Demand?

What is driving soybean, corn and wheat prices? Is it supply concerns or strong demand? Market price rallies that are based on supply worries tend to be volatile and short lived. Prices often rise sharply on crop concerns to ration expected tight supplies, but the rally ends as prices reverse and decline quickly. Demand driven markets or price uptrends based on strong demand tend to last longer. Prices are supported in order to attract grain deliveries to continue meeting the substantial needs of users. Supply driven markets must be watched closely so that producers can react quickly and aggressively with sales to capture opportunities before they are gone. In contrast, demand driven markets tend to require more patience and attention to market signals.

Strong demand has appeared to support soybean prices. But the USDA's August supply/demand estimates forecast record 2010 soybean production that would exceed expected use in the year ahead. This would lead to an increase in US ending stocks from the 160 million bushels (2009-10 marketing year) to 360 million bushels (2010-11). This seems negative, but some analysts believe that the USDA could be underestimating soybean demand. Some of these analysts suggest the final old crop carryover may be closer to 100 million bushels. World soybean use continues to grow and 2009-10 US soybean exports held up well in spite of a large South American crop that provided export competition. They also argue that 2010-11 exports may also be underestimated. The USDA projects somewhat lower Brazilian and Argentina soybean production with increased global use for2010-11. However, the August projections lower 2010-11 US soybean exports from the current year's 1.470 billion bushels to 1.435 billion bushels. While the USDA's estimates are reasonable, old crop soybean exports along with crush projections have increased as the year progressed and some analysts believe that this strong demand will continue.

Old crop basis strength and limited futures market carry are market signals that suggest strong demand as well. The basis strength indicates that users are bidding up cash prices to acquire remaining old crop soybean supplies before the 2010 crop is harvested. September 2010 soybean futures prices are offering a premium over the November contract's prices (inverted market), also suggesting nearby soybean demand bidding to meet needs. Although not as strong, new crop futures market signals indicate good demand as well. The distant month new crop soybean futures only offer limited market carry, signaling a reluctance of the futures market to offer storage returns.

Although a record soybean crop is expected, a few supply concerns do remain. Many report that they are finding more SDS in soybean fields and this could impact yields. There is also concern about the dry conditions in the Southeast and how it might impact total production. While soybean supplies are expected to grow, strong demand will use most of the anticipated large crop and any supply reductions would be a concern.

Strong demand is playing a role in the corn market. Increases in old crop corn use projections and expected increases in new crop use have steadily chipped away at both old and new crop expected carryovers in recent months. The current projected new crop corn carryover of 1.312 billion bushels appears more than adequate. But, in spite of forecasting record corn production, the USDA's projections for 2010-11 ending stocks have declined more than 500 million bushels since the May estimates. Global grain demand is also strong with world coarse grain use expected to exceed world production. This coupled with wheat production problems in some countries could lead to more US corn export demand.

Will the size of the corn crop shrink? Most agree it will be a big crop, but some problems remain. This past week's *"Pro-Farmer"* Midwest crop tour has found some problems in what is generally a good crop that could lead to somewhat lower production than the USDA has forecast. The corn futures market is offering some carry for distant month contracts and some new crop cash bids reflect somewhat weaker than normal basis. This suggests the markets are still anticipating a large crop and is sending signals to delay delivery. However, with strong demand, a large crop is needed and any reductions in production expectations would likely be bullish news.

Supply concerns may best describe the wheat market. Although the USDA lowered expected 2010-11 US wheat carryover in the August estimates, it remains at a very large 952 million bushels. World wheat use continues to increase and is expected to exceed production, but global wheat 2010-11 carryover is still expected to remain well above 2-year ago levels. Wheat supply concerns arise from reduced Canadian production and drought conditions in Russia and other Former Soviet Union countries. This has led to wheat export limits or bans in the drought stricken countries. These production concerns, along with speculative buying, have contributed to the recent run-up in wheat prices. The price decline during the past two weeks, the more than adequate wheat supplies, political action to reduce exports and concerns about production in a few countries make this market look (for now anyway) more like a supply driven market.

Strong demand supports prices and supply concerns leads to volatility and risk. Both seem to be occurring. Additionally, other factors such as energy prices, the value of the dollar, economic conditions, etc. continue to have influence the markets. Producer sales decisions must also consider their individual production expectations, the amounts of production already sold, local basis, storage capacity, cash flow needs, tax situation and the amount of price risk they are willing to bear.

Strong demand appears to provide support for both the corn and soybean markets. Disappointing yields could still cause supply driven market rallies, especially for corn. Both corn and soybean markets remain in uptrends and should be watched for technical signals that the trends may reverse. This is especially true for soybean prices that are near the top of the USDA's current forecast price range and are close to breaking a steep uptrend. At this point, market signals may favor storing corn. Market carry and potential for basis gains suggest that storage returns are possible for storing corn. The lack of carry suggests that basis gains and higher price levels are necessary to provide storage returns for soybeans.

The supply concerns in the wheat market may be providing a pricing opportunity for those intending to plant wheat this fall. In spite of production problems and export bans, domestic and global wheat supplies appear to be more than adequate. Current wheat prices offer profitable wheat production and protecting these prices for 2011 production seems like good advice.