

GRAIN OUTLOOK

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RIPPLE EFFECTS

In the past 90 days, corn and wheat prices have fallen \$2 per bushel or more and soybeans are down more than \$4 per bushel; and almost none of it had anything to do with the supply and demand fundamentals of these basic commodities. Outside influences have been driving commodity markets throughout the late summer and early fall.

On the surface, oil price and the value of the dollar could be seen as the likely culprits. But their values have been whipsawed by the same factors influencing grains and oilseeds. The underground earthquakes casing ripples in the commodity markets have been coming from the financial sector. The housing bubble connected to the subprime mortgage mess was the epicenter; and its after-shocks are shaking the markets, not just the commodity markets, but now also the global economy.

When the seriousness of the risk exposure became apparent to financial firms, they tried to sell off toxic mortgage-backed assets, but were unable to do so. Many of those same firms also ran hedge funds and index funds. To get cash to stay in business they offset commodity futures and options contracts, sometimes at large losses. They took billions of dollars out of the commodities markets which had the effect of taking prices down.

Just when it looked as if agricultural commodity prices were firming up based on supportive underlying supply and demand fundamentals, the USDA released the September 30th Grain Stocks report and its Small Grains 2008 Summary. The bottom line for wheat is more was produced than previously reported; up 2%, but stocks were 3%

lower than trade estimates. That implies wheat demand has been a little stronger than assumed. Global wheat production will be 11% higher than last year, but more than usual is low quality feed wheat. Feed wheat from the Black Sea region is being priced lower than U.S. offerings now, but a relative shortage of milling quality wheat is expected to strengthen wheat price later in the fall into the winter. Dry growing conditions in Australia and Argentina should keep upward pressure on wheat price going into the New Year.

The USDA stocks report showed more corn and soybeans in inventory than the trade anticipated. Both stocks numbers can be attributed to lower demand during the summer months; domestic and overseas. The 83 million extra bushels of corn and 60 million more bushels of soybeans would ordinarily not draw much attention in a year when the row crops are slow to mature, harvest is lagging, and cushioning stocks to support potentially disappointing yields are low. But coming now during the financial crunch, the numbers may be indicating slowing global demand for commodities. If that is the case, the expected recovery in corn and soybean prices may not be as strong as previously thought.

One potential lingering ripple effect on the farm economy is the availability of credit. Agricultural lenders are being cautious about farm loans, but continue to make them. Thus far, the Wall Street credit freeze has not been felt in agriculture. The failure of Congress to pass the bailout package, as imperfect as it was, raised the level of concern that farmers might not be able to get the operating credit they need to plant crops. Sky high input prices for fertilizer, fuel, seed, etc. mean farmers must make large investments to plant crops. If commodity prices fall drastically before those crops can be harvested and sold, farmers may have difficulty paying back operating loans. That situation is the classic cost/price squeeze which is a major concern for agricultural lenders as well as for farmers.

The weather is cooperating with wheat farmers as they make good progress planting next year's crop, although rain following the wheat drills would be welcome in the Great Plains. Even though both corn and soybeans are behind the five year average in maturing,

lack of freezing weather in the Corn Belt is allowing the crops to progress and early harvest to begin. New crop corn and soybeans are adding to supplies, further depressing prices. People in the grain trade will be watching the October 10th World Agricultural Supply and Demand Estimate report to see by how much the USDA changes estimated corn and soybean yields. The report will give direction to corn and soybean prices.

Until then all eyes will be on Congress to see if agreement can be reached on how to stop the developing U.S. and global economic crisis. The hope is the ripples we have been experiencing do not turn into tsunami waves.