2-29-2008

Grain Situation and Outlook; Cattle Market Fundamentals

Alan May
South Dakota State University

Matthew Diersen
South Dakota State University, Matthew.Diersen@SDSTATE.EDU

ECONOMICS COMMENTATOR

South Dakota State University | No. 497 | February 29, 2008

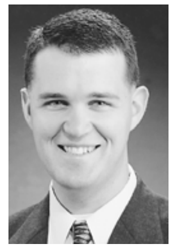
Grain Situation and Outlook

by
Alan May
Extension Grain Marketing Specialist

CORN: The shift from a supply driven market to a demand driven market has been a primary reason for the strength in corn prices over the last year and a half. There is little question that the strong demand for corn is driving prices higher. Even with the higher production from the 2007 crop thanks to 15 million additional acres of corn in 2007, the corn market is reflecting this strong demand by bidding up the price of corn in an attempt to "buy" acres for 2008. However, the conventional wisdom throughout the grain market is that there will be fewer acres of corn planted this year. This is due to a variety of reasons such as higher fertilizer costs, crop rotation concerns and costs of other inputs. The unanswered question at this point is how much of a decline in corn acres will occur in 2008. With current carryover supplies estimated at 1.43 billion bushels, there is concern that a decline of planted acres to corn combined with even modest growth in demand will shrink the current supply estimate to lower levels following the 2008 harvest.

Ethanol has been the primary driver in the growing demand for corn. The current USDA estimate of corn used for ethanol is 3.2 billion bushels in 2007, a 50% increase over 2006 and a 100% increase over 2005. It remains to be seen if this rate of growth can be sustained by the ethanol industry in the 2008-09 marketing year but it appears likely at this point that demand for corn from the ethanol industry will continue to grow in the next year. In other words, if export and feed demand remain strong this next year, any growth in demand from ethanol will likely result

(*Grain Outlook … continued on page 2*)



Cattle Market Fundamentals

by
Matthew Diersen
Associate Professor/
Extension Specialist

Higher input costs are affecting different segments of the cattle industry in South Dakota. Cattle feedlots are facing higher feed and transportation costs. They in turn bid less for feeder cattle and calves than would otherwise be the case. Cow-calf producers face increased corn and forage input costs and higher rental rates indirectly driven up by higher returns on those very inputs. Offsetting some of the cost increases are relatively high fed cattle price projections. There are also some subtle inventory changes that may reflect shifts in the underlying fundamentals affecting profitability of cattle enterprises.

Input prices continue to be high and volatile. Corn prices have moved higher and become quite volatile in recent weeks. During January alfalfa hay prices reached the record high level and other hay prices set a record high level in South Dakota. Grazing fees also reached record highs in 2007. In the January issue of *Agricultural Prices*, National Agricultural Statistics Service reported that rates in South Dakota averaged $21.00 per month for animal units, $25.20 per month for cow-calf pairs, and $23.00 per month per head. The rates have steadily increased in recent years and are the highest state-level rates behind Nebraska.

Basis Changes

The basis on fed cattle was wider than normal during much of 2007. The basis here is calculated as the monthly cash price from Sioux Falls minus

(Cattle Market … continued on page 2)

(Grain Outlook … continued from page 1)
in a reduction in carryover supplies putting even more support under a corn price that is already near historically high levels.

SOYBEANS: The soybean market is facing much the same supply concerns as the corn market. The carryover supply of soybeans from the 2007 crop is 72% below the record high carryover of 2006. Domestic crush volume is currently estimated by USDA at 1.84 billion bushels. The domestic crush has steadily increased the past five years and while exports are lower than a year ago, the demand for soybeans from foreign buyers is considered strong, especially in the face of tight domestic supplies. Both of these demand components have contributed to the drawdown of domestic soybean supplies, but the primary reason for this dramatic one-year decline is the huge decline of soybean acres in 2007. Soybean producers planted 12 million fewer acres of soybeans in 2007 and this lowered production by over 600 million bushels in one year.

The conventional wisdom in the market is that more acres will be planted to soybeans in the U.S. this coming year. The soybean market has been participating in the bidding war for acres and as a result, the average price for old crop soybeans as of late-February is $13.50 with new crop beans at $13.00. This price increase over the last few months has made soybeans more attractive even if net revenues may be potentially greater from corn. The increase in soybean acres will be due to lower input costs and a desire by growers to maintain a rotation between corn, soybeans and other crops. The primary question will be the degree of shift into soybeans and the potential impact this may have on growth of domestic soybean supplies and the possible pressure this could put on price as we move through the rest of 2008.

WHEAT: Although wheat prices have been influenced by the bullish nature of corn and soybeans, the wheat market is facing its own set of very bullish fundamentals that have been simmering for the last five years. From 1998 through 2002, the U.S. was burdened by huge domestic supplies that kept prices below $3.00 for winter wheat and below $3.50 for spring wheat. The drought of 2002 was felt in the U.S., Canada, and Australia and as a result, the U.S. was able to export higher quantities of wheat, reducing domestic wheat supplies by almost 40% in one year. Since that time, a combination of fewer acres, variable yields, and consistently growing demand has led to the smallest projected domestic supply of wheat in over 60 years. The same is true for world supplies. As a result, wheat prices are at historic highs; the old crop price for spring wheat in South Dakota in late-February exceeds $20.00 per bushel and the price for 2007 winter wheat is slightly above $14.00 per bushel.

Winter wheat acres in the U.S. are 4% higher than a year ago, but that will likely have a minimal effect in raising the carryover supplies unless yields are higher than average. The question going into this spring will be how many spring wheat acres will be planted? At this time, it seems apparent that spring wheat acres will not increase. The conventional wisdom in the wheat market is that spring wheat producers are concerned about higher input costs, particularly fertilizer and the ongoing battle with disease issues that have reduced yields in the past. If spring wheat acres do not increase, it will be difficult for wheat supplies to rise to levels of previous years. This means price volatility and strength will likely be the norm for the next year, but where price levels will settle over time is difficult at best to determine. With current prices at such historically high levels, it is impossible to determine the extent of any further possible price increase as well as the extent of a possible price downturn in the event other factors apply pressure to the wheat market. However, with the extremely tight supplies of wheat world wide, it seems likely that wheat prices in 2008 could match or exceed the current USDA projections of $6.45 to $6.85 for the current marketing year.

(Cattle Market … Continued from page 1)
the monthly average of the nearby live cattle futures price. Increased transportation costs may have been a factor in the wider basis. The basis followed the seasonal pattern for the year, but was very wide (or quite negative) during January and during September through December. The wide basis was quite localized as the 5-Area steer price and nearby futures price moved consistent with

expectations during the same period. For planning purposes, the five-year average basis has been quite reasonable to use and would be recommended for 2008 (Table 1). One could make a slight adjustment lower to account for continued higher trucking costs.

For producers using the feeder cattle futures or options contracts the basis during 2007 was unusually low during January and then quite high during June and August. The basis here is calculated as the monthly cash price for South Dakota feeder cattle minus the monthly average of the nearby futures contract. The pattern is quite variable during individual years as local factors (especially small volumes traded) can affect the prices observed. The five-year average is probably a more accurate representation of basis levels to expect when hedging (Table 1).

Table 1. Cattle Basis versus the Nearby Futures, Average from 2003-2007

Month	Live Cattle ($/cwt)[a]	Feeder Cattle ($/cwt)[b]
Jan	-1.64	0.01
Feb	-2.62	0.50
Mar	1.86	2.09
Apr	0.52	2.97
May	4.22	5.73
Jun	0.89	6.29
Jul	-1.36	2.22
Aug	-2.05	3.58
Sep	-2.02	2.07
Oct	-2.72	3.10
Nov	-0.74	-0.07
Dec	-2.29	2.40

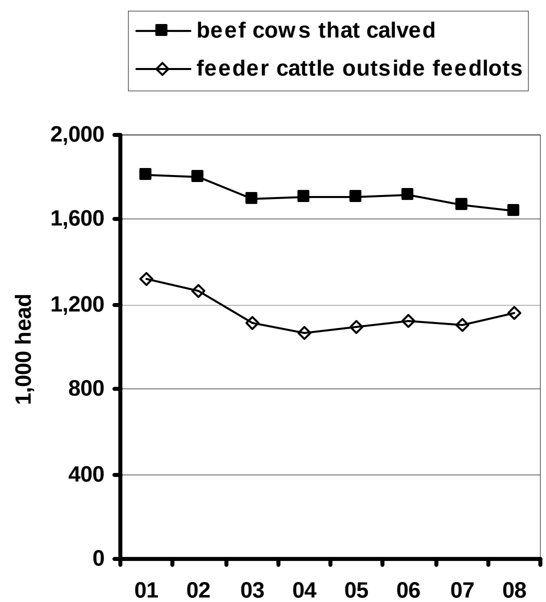
Notes: [a] Reflects cash price at Sioux Falls minus the nearby live cattle futures. [b] Reflects the cash price for feeder steers at South Dakota locations minus the nearby feeder cattle futures.

Inventory Changes

The cattle cycle continues to be disrupted by spotty drought conditions and higher feed costs. In the *Cattle* report, NASS reported that as of January 1, 2008 there were 96.7 million head of cattle in the U.S. The number of beef cows is down slightly, as is the number of beef replacement heifers. The decline in heifers is among those expected to calve in 2008. It is as though the industry is geared up to try again to expand unless cost conditions worsen. The number of "other" heifers and the number of calves are smaller than last year, thus there is a smaller pool of potential replacement heifers to draw from at this time. The price implication would thus be negative for fed cattle prices for the first half of 2008, and then positive for the second half of 2008.

The South Dakota inventory levels have generally followed the U.S. patterns in recent years. The total inventory on January 1 was unchanged in South Dakota at 3.7 million head. The beef cow and beef replacement levels are down slightly (Figure 1). Pasture availability has been pressured by dry conditions and some (anecdotal evidence of) conversion of pasture to cropland.

Figure 1. South Dakota January 1 Cattle Inventory



Source: USDA-NASS

A slight difference from the U.S. situation is a small increase in "other" heifers and in calf inventory levels in South Dakota. Combined with steers and subtracting cattle on feed gives feeders outside of feedlots. The number of head outside of feedlots is up slightly in South Dakota. Because the "other" heifer inventory is up also, South Dakota producers could breed additional heifers this summer while the rest of the country would have to wait another year to expand. Short run feed supplies are adequate, but pasture rents will pressure expansion.

Calf Prices

The smaller beef cow and replacement inventory levels suggest a smaller calf crop in 2008 and from a supply side slightly higher calf prices this fall compared to 2007. Calf prices should also be supported by relatively high fed cattle prices which are partially offsetting higher corn prices. Note that upside moves, such as occurred in 2005, are unlikely as the overall inventory of cattle remains high compared to 2004. Any inability to expand would weigh on calf prices this fall.

The cash prices for stocker steers from South Dakota locations can be compared to the CME feeder cattle index to obtain a location basis. The five-year average suggests a basis of $11.67 per cwt for November. That basis can be added to November feeder cattle futures, which have been around $112 per cwt, giving a futures-adjusted price of $123.67 per cwt. The November 2007 price for stocker steers was $120 per cwt.

****

ECONOMICS COMMENTATOR

****

Department of Economics
South Dakota State University Phone: 605-688-4141
Box 504 Scobey Hall Fax: 605-688-6386
Brookings, SD 57007-0895 E-Mail: Penny_Stover@ sdstate.edu

125 copies of this newsletter were produced at a cost of less than $100

SOUTH DAKOTA STATE UNIVERSITY
Economics Department
Box 504
Brookings SD 57006-0895

Change Service Requested