



WEEKLY OUTLOOK



A joint publication of the Department of Agricultural Economics, College of Agriculture, Purdue University, West Lafayette, Indiana, and the Department of Agricultural and Consumer Economics, College of Agricultural, Consumer and Environmental Sciences, University of Illinois at Urbana-Champaign.

FEBRUARY 21, 2005

BRAZIL'S SOYBEAN CROP – A REPEAT OF 2004?

As mentioned in the last issue, the recent rally in soybean prices has been stimulated, in part, by some late season concerns about the size of the Brazilian soybean crop. It is somewhat reminiscent of last year, when that crop was affected by late season dry weather.

In January 2004, the USDA judged Brazilian soybean production at 2.205 billion bushels, above, most forecasts from Brazilian agencies. That forecast increased to 2.24 billion bushels in February, but declined each month from March through June. The final estimate was for a crop of 1.933 billion bushels, nearly 14 percent smaller than the February forecast. The forecast size of the Argentine crop declined from 1.34 billion bushels in March 2004 to 1.25 billion in May, a drop of 7 percent. The large decline in the prospective size of the South American crop last year came on the heels of a very small crop in the U.S. in 2003 and contributed to the high prices experienced last spring.

For the 2005 harvest in Brazil, the USDA had a forecast of 2.37 billion bushels in January, slightly higher than the forecasts from most other sources. The USDA forecast declined to 2.315 billion bushels earlier this month, still higher than most other forecasts. Official forecasts from Brazil have been for a crop of about 2.24 billion bushels, still 16 percent larger than last year's harvest. Some private forecasts dropped sharply last week, with some talk of a crop as small as 2.02 billion bushels. For Argentina, the USDA has maintained a forecast of 1.433 billion bushels, about 15 percent larger than last year's harvest. Reports of crop conditions in Argentina continue to reveal prospects of a large crop.

The price impact of a shortfall in South American soybean production this year will be moderated by large supplies in the U.S. Stocks of soybeans on December 1, 2004 totaled 2.305 billion bushels, 616 million (36.5 percent) larger than inventories on December 1, 2003. Importantly, 80 percent of the year-over-year increase was in on-farm stocks of soybeans. The large increase supports the argument that producers have been slow to sell the 2004 crop. As a result, the futures market has been inverted much of the year and the cash basis has been extremely strong in most markets. Both of these developments are contrary to expectations for the price structure during a period of large surpluses. The corn market price structure, with a generally weak basis and large carry in the futures market, is more typical. While a slow sales

pace by producers has supported cash soybean prices, it appears that there may be large quantities to move off the farm before the 2005 harvest.

The upside potential for a soybean price rally is also difficult to judge because prices did not previously decline to the extremely low levels expected from the large 2004 crop. The current price rally resulting from Brazilian crop concerns is exactly what should be expected if prices had already fully reflected the large surplus. However, if prices had not yet fully reflected the extent of the surplus, the response to crop concerns may be more muted. That is, confidence in a rally starting from \$4.25 would be greater than a rally starting from \$5.00.

The current fundamental face off between large current stocks and Brazilian crop concerns is occurring with the backdrop of an expected decline in U.S. soybean acreage in 2005. The USDA's baseline projections show a gradual decline in U.S. acreage over the next few years as planted acreage of other crops, primarily corn, increases. A modest increase in acreage in the Conservation Reserve Program is also anticipated. For 2005, the first look at possible acreage will come with the USDA's March 31 *Prospective Plantings* report. In addition to potential changes in acreage, the soybean market will have to work through the annual unfolding of weather and crop conditions, including the potential of soybean rust.

So, what to do? First, establish reasonable price targets for selling additional quantities of old and new crop soybeans. Those targets are difficult to establish given all the uncertainty surrounding price prospects. Price expectations should probably be tempered by the current large surplus of soybeans in the U.S. Those stocks will provide some buffer for any shortfall in South American or U.S. production in 2005. There is still downside price risk. Limited damage to the South American crop and a favorable U.S. growing season could result in lower prices by late summer, with considerable pressure on basis levels. Second, carefully select crop or revenue insurance coverage, recognizing that there may be additional production and price risk in 2005 and that base price levels for revenue products are much lower than last year. Third, consider the prudent use of options as a way to manage the risk of large pre-harvest sales.

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