

# **Feed Grain and Wheat Market Situation and Outlook**

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## **Introduction**

Despite experiencing large increases in production during the 2003/04 marketing year, strong year-to-year increases in total demand helped support prices in the feed grain and wheat markets. The added support provided a considerably improved outlook for these markets heading into the 2004/05 marketing year.

When examining the feed grain sector, the two largest industries (corn and grain sorghum) saw total supplies increase by 636 million bushels and 32 million bushels, respectively. However, offsetting these increases were substantial increases in both domestic and export demand. Total corn use increased by a whopping 768 million bushels while grain sorghum demand nearly matched the larger supply by increasing by 31 million bushels.

Likewise, wheat supplies during the 2003/04 marketing year increased by 432 million bushels on sharply higher production. However, strong increases in export demand due to lower world competition helped to increase total wheat use by 378 million bushels, nearly offsetting increased supplies.

The ability of demand to improve during the 2003/04 marketing year helped establish a solid foundation for commodity prices. As producers began to make production decisions for the 2004 growing season, relatively attractive prices provided optimism for profit potential. As producers entered winter wheat plantings last year, new crop futures contracts were trading in the \$3.40 range. Likewise, while grain producers were making planting decisions last spring, new crop corn futures were trading in the \$3.20 range. With the foundation established with improved demand during the 2003/04 marketing year, the market's attention began to focus squarely on the prospects for the 2004 crop. The question faced by the market was whether the positive price conditions would entice larger acreage and whether the demand side of the market, which had been a major concern over the past five years, would continue its strength shown during the 2003/04 marketing year.

## **2004/05 Feed Grain Marketing Year**

The increased demand found during the 2003/04 marketing year helped to tighten grain stocks heading into the 2004/05 marketing year. Corn stocks for the 2003/04 marketing year fell to below the 1 billion bushel level for the first time since the 1997/98 marketing year and over 600 million bushels below the previous 5 year average for

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stocks. The tight stock situation helped to support price and provide significant risk premium to the market heading into the 2004 growing year. As mentioned previously, prices for new crop corn was well above the \$3.00 level heading into the planting season. This attractiveness in prices helped attract additional acreage into corn production in 2004. Corn acreage increased by 2.3 million acres in 2004 to 81 million acres, the highest acreage level since the 1985/86 marketing year. While the increase was certainly a significant change in corn acres, the magnitude of the additional acres was likely limited as competing acres were placed into soybean production. Prices for new crop soybean contracts during the planting season approached the \$8.00 level, likely drawing acres away from corn into soybean production.

Adding to the pressure of the large increase in corn acres has been a nearly ideal growing season. With only brief occurrences of weather concerns, the 2004 growing season has currently placed 70 percent of the U.S. corn crop in good to excellent condition. Field surveys of corn production have noted record high stalk counts and has increased expected U.S. yield to a record 149.4 bushels per acre, nearly 5 bushels per acre higher than trend yields. With the increase in acres and record yields, total corn production is expected to increase by 847 million bushels over 2003 to a record 10.96 billion bushels.

With the large production numbers faced by the market, the positive tone of the market at the beginning of the 2004 calendar year slowly started to erode. Since setting a high of \$3.42 in the December corn futures contract in April of 2004, the contract has slowly fallen by nearly \$1.40 per bushel. While there have been some positives on the demand side of this market, the overbearing pressure of the record crop has kept prices in a downward trending pattern. However, when looking long term for this market, these positives in demand must be considered.

First, strength in domestic and export demand during the 2003/04 marketing year has resulted in a reasonably tight stock situation entering the 2004/05 production year. Lower stocks have somewhat softened the blow of this record crop.

Second, domestic demand for the 2003/04 marketing year is expected to increase by 245 million bushels to 8.62 billion bushels. The increase in demand is being led by continued growth in ethanol production, which is expected to increase by 170 million bushels and will account for nearly 10 percent of total corn use. In addition, feed demand is expected to remain strong with increased dairy cow numbers and larger cattle-on-feed numbers along with increased grain use per grain consuming animal unit (GCAU).

Export demand is also expected to increase as lower competition in the first two quarters of the 2004/05 marketing year improves the United States' position in the world market. Export demand is expected to increase by 215 million bushels to an optimistic 2.1 billion bushels. Production difficulties, increased demand, and a change in governmental policy have depleted China's stocks of corn. Since the 1999/00 marketing year, corn stocks in China have fallen by 77 percent, falling from 123 million metric tons to 28 million metric tons. This sharp decline in stocks is believed to substantially limit

China's ability to be aggressive in the export market. In addition, aggressive early sales in major competitors, Argentina and Brazil, are expected to limit these countries ability to export corn later this fall. All of these factors point to lower competition and should provide for strong export demand during the first two quarters of the marketing year.

When examining both the short-term and long-term outlook for corn, there is potential for striking different views. In the short term, the pressure of harvest will likely keep prices trading in its current downward pattern or, at best, a sideways trading pattern. While corn harvest was only at 9 percent (slightly behind the 5 year average of 12 percent) complete through September 20, projections favorable weather conditions should provide for quick advancement. In addition, export demand during the last month of the 2003/04 marketing year and the first few weeks of the 2004/05 marketing year has been slower-than-expected adding to the pressure on prices. Through the first few weeks of the 2004/05 marketing year, corn export sales are running roughly 22 percent below last year's levels. While export demand is expected to strengthen later this fall, poor export numbers have surely not provided support for this market. With a lack of positive fundamental factors, the short-term view is for the December 2004 corn futures contract to test the psychological support level at \$2.00 per bushel.

With prices likely to continued to be pressured over the next month as harvest continues to progress, the question becomes if any appreciable price improvement can be foreseen over the long-term. Currently, low corn prices have resulted in roughly a \$0.31 per bushel loan deficiency payment (LDP). With demand expected to improve and with world corn stocks still relatively tight, there is some potential for prices to improve later this fall and winter. As such, for producers, who did not take advantage of pre-plant price strength, may consider taking LDP payments and developing a post-harvest marketing strategy to capture any price appreciation.

Looking long term to the 2005 crop, several important factors must be considered. Despite increased global corn and coarse grain production, world corn stocks are expected to fall again during the 2004/05 marketing year for the fifth straight year and are the lowest since the 1977/78 marketing year. Anytime stocks are at these relatively low levels, the possibility for price strengthening on production scares and production shortfalls is high. In addition, despite record production projected for the 2004/05 marketing year, stocks in the United States are only expected to increase to 1.2 billion bushels. While larger than the previous year, strength in export demand, should keep stocks below the previous 5-year average of 1.6 billion bushels.

With tight world stocks and the prospects of stronger demand, producers may once again be faced with relatively favorable prices heading into the planting season in 2005. This, along with weakness in soybean prices, should provide little competition for corn acres in 2005. As such, assuming normal weather in 2005, it is difficult to predict any substantial reductions in corn acres for 2005. This would setup a very similar year to 2004 in which price strength would come under attack from the potential of a large crop.

As with the corn market, the grain sorghum market is faced with larger production and rising ending stocks. Obviously, the corn market will largely influence the potential for any feed grain market. However, as we look to this grain sorghum market, it should be noted that prices have increased relative to corn prices. Historically, grain sorghum prices would have been placed at roughly 80 to 85 percent the value of corn. However, over the past 5 years, grain sorghum prices have averaged 97 percent the value of corn and have, in fact, surpassed or equaled corn prices in 2 of those 5 years. With grain sorghum production costs roughly half of corn costs, grain sorghum may be an attractive option for producers.

### **2004/05 Wheat Marketing Year**

Unlike the feed grain market that has experienced large increases in production, fewer acres in 2004 has actually reduced expected wheat production for the 2004/05 marketing year. All wheat acres fell by 2 million acres in 2004 to 59.7 million acres, the lowest level over the past 20 years. Along with lower acres, slightly lower yields in 2004 are expected to decrease total production by 214 million bushels to 2.123 billion bushels.

While production has not been an overwhelming negative factor in this market as it has been in the corn market, continued struggles on the demand side of the equation have limited price potential. The real culprit on the demand side has been export sales. Despite seeing improved export sales during the 2003/04 marketing year, larger world stocks and increased competition is expected to place wheat exports below the 1 billion bushel level for only the third time in the past 15 years. Exports are expected to fall by 209 million bushels from the previous year to 950 million bushels. While domestic demand is expected to improve moderately, the pessimistic outlook for exports is a real concern for this market.

On the world scene, global wheat production is expected to reach a record 610 million metric tons. Increased yield prospects in the Ukraine, Romania, and several EU-25 countries are expected to increase total world production and increase these countries ability to be active in the export market. Fortunately, world consumption is expected to increase substantially during the 2004/05 marketing year, helping offset much of this record production level.

Despite increased world consumption, world ending stocks are expected to increase by over 7 percent from the previous year. While increasing stocks is never a positive for a market, world stocks are still relatively tight. During the 2003/04 marketing year, world wheat stocks fell to the lowest level since the 1982/83 marketing year. That tight stock situation has helped provide support to prices over the past year. While stocks are expected to increase, the 142 million metric ton level is still the second lowest in the past 20 years.

Examining the short-term and long-term outlook for wheat provides a mixed bag of positive and negative factors. Short term, this market is gaining some support from a

delayed spring wheat crop. Harvest of the spring wheat crop was at 81 percent complete through September 20, 2004 versus 100 percent complete last year and the 5-year average of 94 percent. Taking a closer look at the numbers indicates that the major spring wheat producing states, Minnesota and North Dakota, are only roughly 70 percent harvested, nearly 3 weeks behind the normal pace. The delay in harvest has brought questions about spring wheat quality and quantity.

In addition to the delayed spring harvest, the other factor that is adding support to this market has been the surprising performance of export sales. Wheat exports have been surprisingly strong through the first 16 weeks of the marketing year actually matching the pace set last year when total export sales are projected to be 209 higher than the current year.

With the positives in this market providing short-term support to prices, the start of winter wheat plantings will likely start adding pressure to this market. As of September 20, 2004, 29 percent of the winter wheat crop was planted as compared to 27 percent last year and the 5-year average of 23 percent. The quick start to planting, along with generally favorable moisture levels in major wheat producing areas, has left little concern regarding winter wheat production to this point. A continuation of favorable planting and growing conditions would likely start to add pressure to prices.

On a long-term outlook, the pressure of lower export demand for the 2004/05 marketing year and record world production is expected to limit price potential. With new crop futures currently trading in the \$3.40 range, it is highly unlikely that winter wheat acres in 2005 will decline sufficiently enough to bring concerns about production shortfalls. In addition, when examining price trends over the past 5 years, the new crop July wheat contract has fallen by an average of \$0.46 per bushel from the first week in October to the last week in June.

With the pressures of record world production, reduced export demand, and the progression of the winter wheat crop, it is highly unlikely that this market will see appreciable price improvement by the time the winter wheat crop reaches the market. For prices to improve substantially, production shortfalls would likely be needed. With world stocks still relatively tight, the potential for price strengthening on production shortfalls would be magnified.