



Riding the Crop Year Roller Coaster

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Crop year 2002 will be remembered for many years to come — remembered not just for dramatic cuts in U.S. crop production, but for the shortfalls that hit numerous countries and crops, bringing world feed-grain inventories to the lowest levels in 30 years (in days of usage). But will this mean anything for grain merchandisers in the United States?

Many U.S. elevators will handle substantially less volume this year, and some will have quality problems in local crops. But the impact goes deeper. Making this a profitable crop year for handling feed-grains and wheat will be a challenge.

- Don't bet this was a weather rally that will disappear quickly.
- Expect much greater basis volatility

than in recent years.

• Expect unusual grain flows this year. Western Nebraska feedlots may need to pull more corn from Iowa or Minnesota. Central Midwest corn will again flow to the Southeast.

• The new ethanol plants will also redirect corn inventories.

• Search out alternate markets and new trading partners to capitalize on the changes.

• The new CBOT delivery system for corn and soybean futures is conducive to carrying charges in the delivery month (especially on corn). Before the delivery month, steep inverses can and may occur. But the system hasn't been tested in a year such as this so it's unclear how spreads will react. Overall, expect narrower spreads than last year.

• Missing bushels will be expensive this year in the deficit areas. Paying up for fringe

volume seems expensive but may work well this year. Basis volatility creates opportunities, but you have to have bushels.

- Managing logistics efficiently along with your basis position will be especially important. Logistics was easy with the big carrying charges of recent years: Fill early with hedged ownership, and hold it until the carry went away. Now it's more like managing a hotel than managing an apartment building that collects steady rent.

- Old basis histories and charts will be a poor guide for merchandising decisions this year. Lay them aside.

- The best basis values could easily appear as quick-ship opportunities that reward flexible shippers.

- Plan for higher credit and working capital needs this year.

- Mistakes are costly in volatile markets, whether in hedging, price, spreads, or basis.

Global situation has major impact

Higher futures prices aren't a short-term situation tied to U.S. production problems. It goes far deeper than that — to a global situation that cannot be changed overnight.

World production of wheat and coarse grains peaked in 1998 then fell by 57 million tons to 1.436 billion tons this year on a steady decline of 55+ million acres.

During the same period, world usage of wheat and coarse grains rose 39 million tons. As a result, world ending stocks have been declining steadily and are now down almost 100 million tons in five years to just 66 days of usage.

That seems comfortable, but it includes all coarse grains (corn, sorghum, barley, oats, millet and rye) and wheat in the world. China holds 75 million tons, or 28%, of those ending stocks, although arguably it's difficult to know exactly

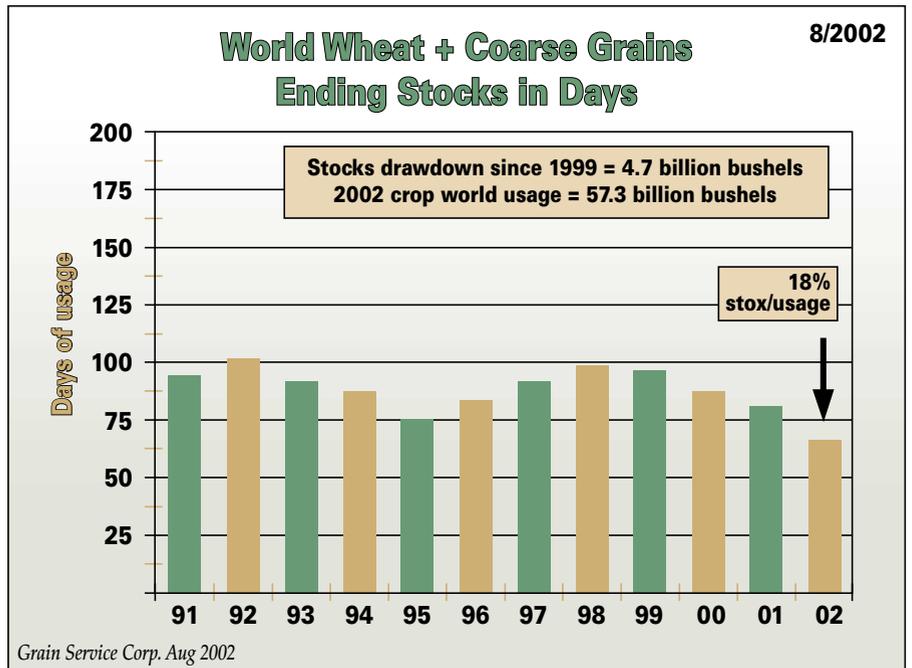


Figure 1: World ending stocks have been declining steadily and are down almost 100 million tons in five years, to just 66 days of usage.

what China's stocks are or what the government may do with them. Excluding China from all numbers to adjust for that uncertainty leaves only 55 days of inventories left in the world, an even smaller cushion.

Statistics are interesting, but

forecasting their implication can be a daunting task. Even with the current tightness, world famine isn't at hand. The world ag markets can trade on a more "just in time" basis than in the old days, reducing the need for massive stockpiles. New trade pacts and globalization have

Total World Wheat plus Coarse Grains			
Crop Year	Hvstd Acres	Production	Use
1981	1452	1204	1179
1991	1347	1354	1365
1996	1365	1491	1449
1997	1332	1494	1456
1998	1315	1479	1452
1999	1275	1462	1471
2000	1272	1442	1472
2001	1272	1463	1486
2002	1276	1437	1495
	Million acres	Million Metric tons	Million Metric tons

Figure 2: Production of wheat and coarse grains peaked in 1997/98.

opened doors that allow grain to move efficiently in new directions. But the pattern of declining stocks is troubling and concern is rising.

The first and toughest challenge is to shake off years of bearishness and complacency over surpluses. World demand is rising steadily and world harvested acreage of wheat and coarse grains peaked 20 years ago in 1981 at 588 million hectares (1.45 billion acres), and has declined steadily to 516.6 million hectares (1.276 billion acres) this year.

Until this year, the world situation was still OK. Restoring the declining production will be difficult, and another shortfall next year would be extremely serious. The acreage cuts have occurred here and abroad. The world's average yield has also been flat for five years at about 1.13 metric tons per acre.

But let's be optimistic. Assume the world's total production of

wheat and coarse grains for 2003 crop somehow equals the record reached in 1997 crop, and assume usage stays unchanged instead of rising the usual 1/2 to 1%. The

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world's ending stocks would still drop slightly in 2004.

If total production in 2003 crop rises to 2001 levels and usage rises slightly, ending stocks in 2004 could decline by another 10 days' usage.

This year, wheat production in the major exporters — Australia, Canada, the U.S. and Argentina — has fallen sharply. And the only sizable increase in corn production in 2002 will be in China. The upshot? Some traditional grain trading is changing.

- The former Soviet Union has become an important wheat exporter, exporting nearly as much wheat as Australia this year.

- The FSU sold wheat early to avoid winter problems at the Black Sea. Much of it was sold at prices below U.S. corn or wheat values.

- The U.S. will import European wheat this year, believed to be the first time. Brazilian meal is also scheduled for import into the U.S.

- China will be the world's second largest corn exporter this year. China has been an aggressive seller, but that should slow and allow U.S. business to rebound.

- Mexico is now the third largest corn importer behind Japan and South Korea, positive news for the United States.

Ending stocks tight

U.S. ending stocks will also be very tight in both corn and wheat. But even if final corn production exceeds 9.0 billion bushels, that's like adding a few drops to the ocean. The impact would be felt more in localized basis moves than in world prices. A few points to watch in U.S. trading:

- The new ethanol plants will compete for corn, but an offset is potential liquidation of cattle in Western lots in the months ahead.
- Mexico will continue to pull U.S. corn and sorghum and support the basis in the Plains.
- Forward basis values in the Eastern United States and Western Corn Belt rose sharply

even before harvest began. Some buyers are already factoring in next summer's tightness.

- Elevators in the better corn production areas also face challenges. Their bigger crops will force many to scatter shipments through much of the year. But small carries and high basis will penalize this.
 - Forward selling strong basis for spring rather than waiting for "the top" will provide some cushion against the inevitable basis dips that occur.
 - The downside in U.S. futures looks limited. Low prices don't ration demand and don't encourage production.
- Every crop year has distinct merchandising features and there is no way to predict for sure what will evolve. These tips are just that — tips. Things that can't happen often do happen; and things

that seem certain may have been discounted early.

Conditions change and flexibility and an open mind will be important assets.

(Note: all statistics and percentages are from the August 2002 U.S.DA/FAS reports. Since that time, Australia and Canada have reduced their crops further. Crop years vary slightly by country and as such, "ending stocks" will not denote a single point in time, but is a general frame of reference.) 

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