

# August 2010 - Crop Market Update

## Department of Economic Analysis



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- Livestock Market Update: released on August 24, 2010

*3<sup>rd</sup> Annual AFBF Commodity Outlook Conference*  
*Renaissance Hotel – Pittsburgh, PA*  
*October 13 – 15, 2010*

*\*Agenda & Registration Information available on SILO\**

### **The General Economy**

This column has talked a lot about jobs over the last couple of years. One would have thought with the authorized spending of nearly \$800 billion that jobs would be much less of an issue today than is the case. The private sector has generated net job additions for each of the last seven months. Government employment jumped up and then back down as the same census workers we talked about in the spring have finished their work.

Assuming a population growth rate of roughly 1 percent, we need to be generating around 1.3 to 1.5 million new jobs a year, or just over 100,000 per month, just to keep up with new births eventually making it to the marketplace. Over the last few months, not only have we not generated those jobs, but have wiped out nearly 8.5 million additional slots.

What does it take to generate a new job? An article in the Wall Street Journal by Michael Fleischer, President of Bogen Communications Inc. in New Jersey, went through a fairly exacting accounting. For him to hire a new employee who takes home \$44,000 per year requires him to spend \$74,000. As you might expect, health care takes a big chunk, requiring the new employee to put up \$2,400 from their gross salary of \$59,000 and Mr. Fleischer to put up \$9,561. Next comes Social Security with both Mr. Fleischer and this hypothetical employee paying \$3,661. Disability insurance, workers comp and Medicare fees take another \$954 from the firm. The employee puts up \$1,131 for state unemployment insurance, disability insurance and Medicare, plus \$6,250 for federal income tax. He points out that over the last three years health insurance premiums increased by more than a third. Those rises would have been the equivalent of more than a 10 percent increase in the mythical employee's take-home pay.

Most employers don't hire people expecting to cut them loose in a few months. The cost of advertising for a position, going through the selection/hiring process, the training and new equipment costs can add up to a substantial investment. So if you were Mr. Fleischer, would you make that investment in today's environment?

From a market perspective, we are all facing considerable angst at the moment. Three months ago, most were fairly confident that while the economy would slow somewhat from the growth rates of the last six months, a double dip recession was unlikely. I suspect if you did a poll of the same economists today, you'd find a much higher percentage worried about the double dip scenario. So, from just a level of business activity perspective, you would probably be very cautious about new hires.

Then we get to the government.

At 35 percent, corporate tax rates in the United States are some of the highest in the world. Given our federal deficit situation and the call from the current administration and Congress to focus an even greater share of the tax burden on upper income and business revenues, a business owner might expect those tax rates to go even higher.

Regulations are another area of considerable uncertainty. Implementation of health care reform will undoubtedly add costs of employment. The rules and regulations written around the financial reform package will affect businesses. Probably the best example of job killing proposals, however, is legislation designed to improve water quality in the Chesapeake Bay. One version would literally set up a system where those who bring jobs into the Bay area would be fined and those who take jobs out of the bay would receive a bonus check. Hard to understand how that kind of attitude is going to kickstart job growth.

There is not a whole lot more on the stimulus side that Congress and the administration can do at this point. What they can do is work toward lowering the cost and the tax and regulatory uncertainty employers of every size now face. Putting a little certainty – as well as lowering the cost of hiring – back into the business world would go a long way toward at least getting a floor under this problem.

## **Wheat Update**

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The wheat market has produced some real fireworks over the past month. Chicago wheat futures generally added better than \$2/bushel to their price between the first week of July and the first week of August. The rally began with concerns over planting difficulties due to wet weather in Canada and crop losses due to drought in Russia and Kazakhstan. These effects were noted by USDA in the July *World Agricultural Supply and Demand Estimates (WASDE)* report, which dropped estimates of Canadian, Russian, and Kazakh production by 16.3 percent, 7.8 percent, and 17.6 percent, respectively, from the prior month's estimate. As the Russian drought intensified, wheat prices continued to escalate. On August 5, Russia announced a ban on wheat exports through the end of the calendar year, triggering a limit-up move that pushed Chicago wheat futures to their highest level since 2008 and raising questions about just how serious the wheat supply situation might be for the current marketing year.

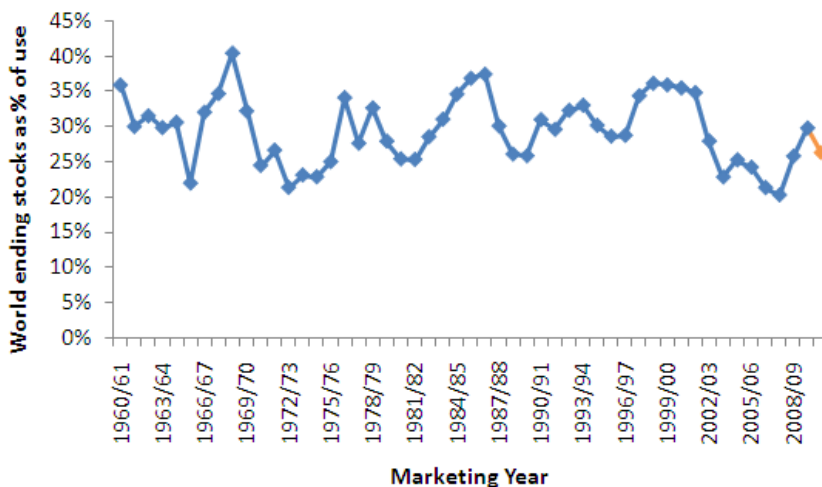
In recent years, Russia has consistently been a major wheat exporter. In the 2009/10 marketing year, Russia exported 18.5 million metric tons (MMT) of wheat (14 percent of total wheat exports), tying with Canada as the world's third largest wheat exporter behind the US and the European Union (EU-27). As recently as June, USDA projected that Russia's 2010/11 exports would match last year's level. Now that will clearly not be the case. In this month's *WASDE* report, USDA dropped their estimate of Russian wheat production by another 8.0 MMT and reduced projected exports to just 3.0 MMT. Of course, there

is a great deal of uncertainty surrounding this estimate, dependent as it is on when (or if) the Russian export ban is actually lifted.

As dramatic as the reversal in Russia's export volumes appears to be, the supply situation for wheat is far different as it was in 2007/08. Global wheat carryover at the end of the 2009/10 marketing year amounted to almost 194 MMT – equating to a stocks-to-use ratio of just under 30 percent. This was the largest carryover (in terms of stocks-to-use as well as total volume) since the end of the 2001/02 marketing year and just a little higher than average over the past 20 years. Russian 2009/10 ending stocks were actually at a 15 year high. By contrast, in 2007/08 when similar production issues developed, global stocks were at their lowest level in over 40 years. Figure 1 shows the world wheat stocks-to-use ratio since 1960/61.

For now, it looks as if the production shortfalls in Russia, Kazakhstan, and elsewhere can be covered out of existing stocks without placing anything like the stress of 2007/08 on the supply chain. The U.S., with large available stocks, should be in a position to realize very strong export sales as a result of the Russian export ban. Anticipation of this fact has clearly provided quite a bit of lift to wheat futures. This provides the strongest incentive for winter wheat planting since fall 2007.

For now, the market remains very sensitive to perceived threats to the wheat supply. This was evident earlier this week, as old crop contract prices dropped sharply from the recent spike while new crop futures moved higher still. This seems to reflect the notion that current stocks are more than adequate for this marketing year's needs but that another short crop in a major producing region would be tough to absorb. News of dry weather in parts of Argentina and in Western Australia, along with talk of a major locust hatch in Australia, set the market on edge for a time this week, illustrating just how much interest there is right now in upcoming production prospects.



Data Source: USDA Foreign Agriculture Service. PSD Online Database.

Figure 1. World Wheat Stocks-to-Use Ratio: 1960-61 through 2010/11 (Forecast)

#### US Wheat Supply and Use

	2008/09 Actual	2009/10 Estimate	2010/11 Forecast July	2010/11 Forecast August
			<i>Million Acres</i>	
Planted Acres	63.2	59.1	54.3	54.3
Harvested Acres	55.7	49.9	48.3	48.3
			<i>Bushels per Acre</i>	
Yield	44.9	44.4	45.9	46.9
			<i>Million Bushels</i>	
Production	2,499	2,216	2,216	2,265
Total Supply	2,932	2,991	3,289	3,338
Domestic Use	1,260	1,137	1,196	1,186
Exports	1,015	881	1,000	1,200
Total Use	2,275	2,018	2,196	2,386
Ending Stocks	657	973	1,093	952
Market Year Avg. Price	\$6.78	\$4.87	\$4.20 - \$5.00	\$4.70 - \$5.50

For now, USDA projects quite favorable production prospects for the southern hemisphere. In this month's *WASDE* report, USDA raised their projection of 2010/11 Australian wheat production to 23.0 MMT, up from 22.0 MMT last month. The projection of Argentine production was held steady with last month's estimate of 12.0 MMT, which would be considerably larger than last year's 9.6 MMT Argentine crop. These southern crops, however large they ultimately turn out to be, will almost certainly be augmented by large winter wheat plantings in the U.S. and Europe this fall (as well as in parts of Russia if rains resume in time). Consequently, the global supply situation could begin to look much less bullish in a few short weeks.

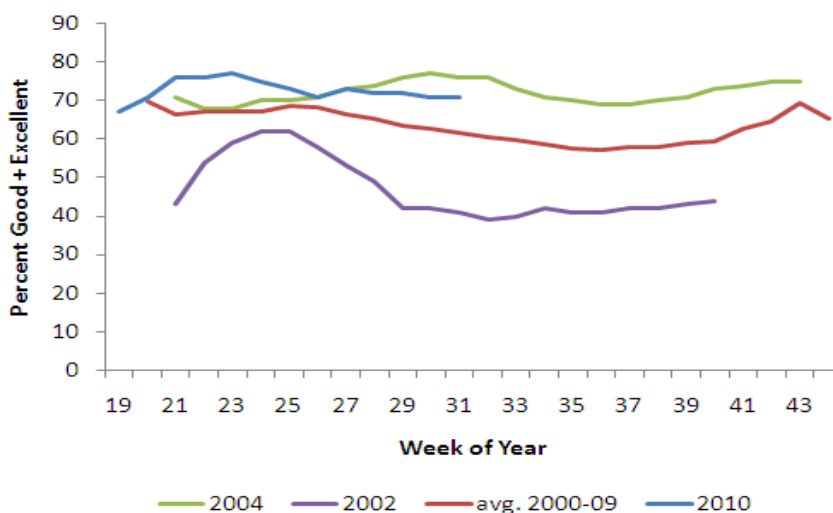
USDA's wheat balance sheet for the U.S. crop reflects the effects of the Russian production problems, with U.S. export projections raised by 200 million bushels to a marketing year projected total of 1,200 million bushels. Increased exports are offset to some degree by a slight decrease in projected domestic use as well as an increase in projected production. Still, the result of these revisions is a 141 million bushel reduction in projected ending stocks from last month's estimate to 952 million bushels. This was basically in line with pre-report expectations. While considerably lower than last month, this is still a fairly large level of carryover, corresponding to a stocks-to-use ratio of nearly 40 percent – well above the 10 year average of about 28 percent.

### Corn Update

The corn market has clearly been overshadowed by events in the wheat market over the past month. The strong weather-market rally in wheat has provided support for corn prices at a time of year when generally favorable yield prospects and a lack of significant weather stress in the Corn Belt would probably have been weighing prices down.

This month's *WASDE* report includes the first-of-the-season objective yield estimates for corn (and other fall-harvested crops). The August estimate of 2010/11 yield, at 165.0 bushels per acre, is 1.5 bushels higher than last month's trend-based yield estimate. If realized, this will be a new record yield, quickly eclipsing the previous record that was set just last year. This yield projection was a bit on the high side of the average pre-report estimate but was well within the range of published estimates.

Weekly crop condition ratings have remained supportive of above-trend yields. Through August 9, the weekly *Crop Progress* report rated the crop as 71 percent good to excellent nationally. Figure 2 shows this year's weekly crop condition as the percent rated good or excellent. Note that this year's crop condition at this point in the year is a bit better than the 10-year average. This year compares rather favorably with 2004, which had the highest season-average crop condition rating over the past 10 years. The lowest season-average crop rating of the past 10 years was 2002, which is also included for comparison



Data Source: USDA National Agricultural Statistics Service.

Figure 2. Percent of US Corn Crop Rated Good to Excellent: Selected Years, 2000 to 2010

This month's higher production estimates are accompanied by increased projections for use as well. Estimates of both 2009/10 and 2010/11 offtake were raised from last month. For 2009/10, higher exports and higher industrial use (other than ethanol) led to a carryover estimate of 1,426 million bushels, a 56 million bushel reduction compared to last month's report. For 2010/11, export projections were raised by 100 million bushels from last month to a marketing year projected total of 2,050 million bushels. This is another effect of the Russian wheat export ban, which should shift a bit more global feed demand to corn. The combined effect of lower carryover from the prior marketing year and higher offtake for the current marketing year is to reduce projected 2010/11 carryover to 1,312 million bushels. This represents a stocks-to-use ratio of just 9.7 percent, the lowest since 2003. This is clearly a supply situation that will provide strong support for corn prices throughout the marketing year.

### US Corn Supply and Use

	2008/09	2009/10	2010/11 Forecast	
	Actual	Estimate	July	August
			<i>Million Acres</i>	
Planted Acres	86.0	86.5	87.9	87.9
Harvested Acres	78.6	79.6	81.0	81.0
			<i>Bushels per Acre</i>	
Yield	153.9	164.7	163.5	165.0
			<i>Million Bushels</i>	
Production	12,092	13,110	13,245	13,365
Total Supply	13,729	14,791	14,733	14,802
Feed/Residual	5,205	5,525	5,350	5,350
Ethanol for Fuel	3,677	4,500	4,700	4,700
Exports	1,858	1,975	1,950	2,050
Total Use	12,056	13,365	13,360	13,490
Ending Stocks	1,673	1,426	1,373	1,312
Market Year Avg. Price	\$4.06	\$3.50 - \$3.60	\$3.45 - \$4.05	\$3.50 - \$4.10

### Soybean Update

National average soybean yield estimates came in at 44.0 bushels per acre, 1.1 bushels higher than last month's trend-based estimate and tied with last year's record yield. The increase in yields raises expected 2010/11 production to 3,433 million bushels. This increase in production is offset by reduced carryover from 2009/10 as well as by a 73 million bushel increase in export projections due to the current impressive pace of exports to China. The net effect of these changes is to leave projected ending stocks at 360 million bushels – the same as last month. Globally, there was no real change in the soybean supply and demand situation, but the WASDE report did note a few interesting changes for other oilseeds. Notably, projected sunflower production for Russia and Ukraine were dropped by 1 MMT each – another effect of the drought afflicting that region.

### US Soybean Supply and Use

	2008/09	2009/10	2010/11 Forecast	
	Actual	Estimate	July	August
			<i>Million Acres</i>	
Planted Acres	75.7	77.5	78.9	78.9
Harvested Acres	74.7	76.4	78.0	78.0
			<i>Bushels per Acre</i>	
Yield	39.7	44.0	42.9	44.0
			<i>Million Bushels</i>	
Production	2,967	3,359	3,345	3,433
Total Supply	3,185	3,512	3,530	3,603
Domestic Crush	1,662	1,750	1,645	1,650
Exports	1,283	1,470	1,370	1,435
Total Use	3,047	3,353	3,170	3,243
Ending Stocks	138	160	360	360
Market Year Avg. Price	\$9.97	\$9.60	\$8.10 - \$9.60	\$8.50 - \$10.00

## Cotton Update

The August *Crop Production* report projects this year's cotton production at 18.5 million 480-pound bales. That is a whopping 52 percent increase over 2009 production. This increase is largely a function of acreage. Harvested acreage is up more than 40 percent from 2009, reflecting not just larger plantings but also reduced abandonment due to favorable growing conditions in southwestern parts of the Cotton Belt. Projected yields in Texas also attest to this year's auspicious weather. State average cotton yield for Texas is projected at 769 pounds per acre, the second-highest on record next to 2007.

The cotton yield estimated in this month's *Crop Production* report, again the first objective estimates of the season, is actually lower than the 845 pound per acre projection that USDA has been using in previous *WASDE* reports. On the other hand, the objectively-estimated harvested acreage of 10.63 million acres is larger than the 10.40 million estimate from previous reports. The bottom line is an increase of 0.23 million bales in USDA's estimate of 2010/11 production compared to last month. This is more than offset by a 0.7 million bale increase in projected exports, leaving projected 2010/11

ending stocks at 3.20 million bales – down from 3.50 million in last month's projection. Globally, the supply situation also appears tighter than last month. USDA points out that their estimate of global cotton ending stocks of 45.61 million bales corresponds to a stocks-to-use ratio of 38 percent, the lowest in 15 years. All cotton futures contracts through July 2011 moved sharply higher to close at new life-of-contract highs on this news.

## Rice Update

U.S. rice production is projected to reach a new record level in 2010 – 245.9 million hundredweight (cwt). As with cotton, this surge in production reflects larger harvested acreage. The national average rice yield is projected to be down slightly from last year to 7,039 pounds per acre. This is below the trend-based 7,157 pound yield projection used in previous *WASDE* reports. This means that the August projection of rice production, while at a record high, is actually lower than the July projection. This lower production estimate combines with a lower estimate of beginning stocks to

### US Cotton Supply and Use

	2008/09	2009/10	2010/11 Forecast	
	Actual	Estimate	July	August
			<i>Million Acres</i>	
Planted Acres	9.47	9.15	10.91	10.91
Harvested Acres	7.57	7.53	10.40	10.63
			<i>Pounds per Acre</i>	
Yield	813	777	845	837
			<i>Million Bales</i>	
Production	12.82	12.19	18.30	18.53
Total Supply	22.87	18.53	21.20	21.64
Domestic Use	3.59	3.40	3.40	3.40
Exports	13.28	12.00	14.30	15.00
Total Use	16.86	15.40	17.70	18.40
Ending Stocks	6.34	3.10	3.50	3.20
Market Year Avg. Price*	47.8	62.5	60.0 - 74.0	61.0 - 75.0

\*cents/lb

### US Rice Supply and Use (All Rice)

	2008/09	2009/10	2010/11 Forecast	
	Actual	Estimate	July	August
			<i>Million Acres</i>	
Planted Acres	3.00	3.14	3.51	3.51
Harvested Acres	2.98	3.10	3.49	3.49
			<i>Pounds per Acre</i>	
Yield	6,846	7,085	7,157	7,039
			<i>Million Cwt</i>	
Production	203.7	219.90	250.00	245.90
Total Supply	252.6	269.90	309.40	299.80
Domestic Use	126.2	127.00	129.00	129.00
Exports	95.9	109.00	113.00	114.00
Total Use	222.0	236.00	242.00	243.00
Ending Stocks	30.60	33.90	67.40	56.80
Market Year Avg. Price*	\$16.80	\$14.10	\$10.75-\$11.75	\$10.75-\$11.75

\*\$/cwt

produce a 2010/11 ending stocks projection of 56.8 million cwt – down from 67.4 million cwt last month but still a large year-over-year increase in carryover. The U.S. rice situation is generally consistent with the global picture. Global rice production is estimated at a record 459.2 MMT. In addition, estimated beginning stocks are higher than last month due to an upward revision in the size of the 2009/10 crop in India. The bottom line in this month's report for rice is global 2010/11 ending stocks totaling 97.5 MMT. This is an increase in ending stocks of just over 2.5 MMT compared with 2009/10; however, due to increases in projected consumption, the stocks-to-use ratio is actually fractionally lower than last year at 21.4 percent this year versus 21.7 percent for 2009/10.