Viewpoint

Soybean report

"A Funny Thing Happened . . ."

This article by David Bartholomew was prepared the latter half of October, just after the U.S. Department of Agriculture's October soybean crop forecast. Bartholomew, a regular contributor to JAOCS, is manager of the oilseed department for Merrill Lynch Pierce Fenner & Smith Inc. at the Chicago Board of Trade. In an article prepared in August, Bartholomew had said the crop probably would be smaller than the USDA anticipated at that time; the October forecast did note a further reduction. In this column, Bartholomew discusses what that reduced crop means in terms of supply and demand, and price.

To paraphrase that popular Broadway line, a funny thing happened on the way to the crop report. The USDA decided to bring its crop estimate into line with most industry predictions, thus bringing to an end the game of trying to guess what the government report will show versus what the real situation is.

In its October crop report, the USDA came down to 1,757 million bushels. That was a drop of 74 million from a month ago. The September report had fallen 50 million bushels below the August figure.

Why had the USDA estimate stayed so high compared to most industry forecasts? The answer is logical. Government strategy is to carry a built-in factor to allow for yield improvement in August and September. The crop did improve in some areas, but that improvement already was built into the previous figures. However, the crop size estimated had to be reduced because of failure to improve in other areas where improvement had been expected.

Some traders were caught by surprise who had thought the October figure might equal the September one, or maybe even increase a bit. They had made the same errors of judgment a month earlier.

Many assumed the October figure would come down a relatively modest 30 million bushels and that it would not be until January that a realistic estimate would be released. But, it was only logical that reality would surface in October because, by that time, it is no longer possible for the crop to improve. Therefore, it was time to remove the built-in potential improvement factor.

Thus, the strong price reaction in futures trade immediately followed the October crop report. Speculators were caught by surprise. A lethargic market attitude had prevailed in the several days preceding the report.

Market impact

The October estimate really didn't reveal anything new. It just came earlier than expected by the majority. However, it did convince some skeptics that the crop had been seriously and irreversibly damaged. There are some who never believe anything until it has the official stamp of a government report. Usually, those are U.S. farmers and foreign buyers. The farmers do not have access to industry estimates. The foreign buyers instinctively prefer to believe anything that will keep purchase prices from getting too high.

Unfortunately, the USDA strategy just explained produces a serious disadvantage to both producers and buyers. It develops a false sense of security among buyers so they take only light precautions early in the season. They see no urgency to buy ahead more aggressively. Thus, the farmers who must sell early in the season do not benefit from the higher prices that surely must come later.

Therefore, the only real market impact from this report is that it has built a more solid floor under prices during periods of weakness. Buyers will not be so complacent and will take advantage of minor breaks rather than wait and hope for major down moves. Farmers will be encouraged to hold off selling during those minor price breaks and will not be fearful of major down moves.

Demand?

Demand is always a big question. Currently it has little luster. Most likely, that is because of economic indigestion in much of the world. Maybe the illness will pass during this crop season, but recovery seems slow.

There are some major factors which are predictable, and the pluses seem to be almost equally offset by the minuses, but not quite, so there will be a delicate balance and a tense season.

Soybean meal demand in the U.S. is looking good as the broiler industry has entered another expansion phase. Hog numbers are not as low as had been expected. Cattle will be eating more vegetable protein and less urea because of the shortage of corn and grain sorghum.

On the other hand, animal feeders in EEC countries will reduce use of soybean meal because its price now exceeds that of corn due to the EEC's peculiar internal pricing arrangements. Nevertheless, soybean meal consumption is increasing in the USSR and Eastern Europe in attempts to use more efficiently their short supplies of grain.

Soybean oil demand is being affected by large supplies of palm oil from Malaysia and rapeseed oil in Europe. The situation has been complicated further by a static import program in India, as well as reduced shipments to Iran and, more recently, to Iraq. Yet all these oils which are considered surplus now could disappear quickly. The USSR can be expected to be a buyer of large quantities of various fats and oils by early January if not sooner, just as they were last season. Their sunflower crop is no larger and possibly smaller. Iran and Iraq will be large buyers to replenish bare stockpiles just as soon as relations return to normal. China will most likely import more oils and soybeans but the amounts are unpredictable.

The important consideration is that there is a built-in escalator in soybean demand of about 5% per season. The only seasons when this has not happened are those few instances when supply was reduced (demand cannot increase in those seasons). The only way to keep the consumption from increasing in a free market economy is to put price high enough to slow it down. That is necessary this season. Just an unchanged consumption cannot be considered. Consumption has to decline by approximately 5% instead of increase by 5%.

This is how the statistics look, to illustrate this situation, in million bushels:

Stocks, Sept. 1	359	359
Oct. production estimate	1,757	1,757
Total supply	2,116	2,116
Consumption last season	2,090	
Indicated stocks next Aug. 31st if consumption remains the same	26	
Use if consumption drops 5%		1,985
Indicated stocks if consumption reduced 5%		131

A carryover of 26 million bushels is much to tight. If that prospect comes into focus in early 1981, prices will strengthen sharply to slow consumption and assure that stocks will not be so small. A carryover of 131 million bushels is tolerable and probably prices would not need to go higher than they were at mid-October. But they dare not weaken too much or consumption would increase and stocks would be too small.

January crucial

January could be the time when the market will decide whether demand has been sufficiently curtailed, or must be reduced more. By that time, several factors will be adequately developed: (1) four months of consumption records will have become known, which usually is enough to establish the trend for the entire season; (2) the final U.S. crop report will be released; (3) harvest time will be approaching in South America, so there will be a good appraisal of production increase or decrease there; (4) the first planting intentions report in the U.S. will be released. If there is no significant increase, that could be extremely important, because beginning inventory will be small.