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# Industry News

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## Implications of the U.S. embargo

The decision by President Carter to shut off shipments of agricultural commodities to the USSR had not been expected by traders at the Chicago Board of Trade, but there had been some anticipation that the longshoremen's labor union might stop loading vessels headed that way. Probably the President decided to take the initiative in an inevitable situation and use it to political advantage. Now it has developed that both of these have happened, and in addition, the longshoremen also refuse to service Russian flagships coming into U.S. ports at the Gulf and East Coast with origin or destination at any other country.

With trading in futures markets suspended for two days, USDA attempted to design offsetting programs that would keep prices from dropping when the exchange reopened. Of course, they were not entirely successful. Prices dropped anyway. It is quite a different thing to have grain and other commodities in some kind of government storage program than it is to have them actually shipped and consumed. The demand versus supply equation had been reduced significantly for wheat and corn, and, to a lesser extent, for soybeans and oil and meal.

Before the embargo, speculators in wheat and corn had mostly been bullish in expectation of higher prices. On the other hand, those in soybeans and products had been mostly bearish, expecting lower prices. Therefore, when the markets reopened, it was wheat and corn that had the most selling to be absorbed. The soya complex couldn't stay down the permissible limit even one day, and the next day made a significant recovery. There were two basic reasons: (1) Speculators who had already been short were pleased to buy back their positions at a profit greater than they had expected. (2) Commercial traders, who had also anticipated lower prices, were equally pleased to price purchases at the suddenly lower level.

On the second day after reopening, even the grains could not stay down the permissible limit. Here, also, the commercial trade decided to take advantage of the sudden drop in the market to price purchases for shipment to other destinations. With this kind of support, even speculators withdrew their selling orders because it appeared they might not have to sustain such a large loss after all.

There is another significant reason why prices did not go lower. There was little commercial hedge selling. It could have been huge if USDA had not stepped in with a program to compensate exporters for the lost sales to Russia. Exporters would have to have liquidated long futures positions taken ahead of actual grain acquisition, and they would have to have sold short hedges against grain already acquired but which could not be shipped.

It appears certain that government authorities did not fully realize the extent of the implications that would be encountered in attempting to offset the impact of such an embargo. Therefore, it has taken time to devise programs

for compensation at all levels of trade. Even now, this has not been fully accomplished. More decisions are to be expected. It should also be expected that the officials will overreact and may do more than is necessary in an effort to show good faith not only to farmers in particular, but also to others in the business. As a result, prices may return to a position of strength equal to or greater than they would have if there had been no embargo.

New markets will be developed internationally. More will be supplied to aid economically poor countries. More will be supplied to mid level economy countries, mostly in Africa, Asia and Latin America. This will not displace shipments that would have originated elsewhere. It will be added consumption to people that cannot afford it otherwise. A first step in this direction is to add four million tons of wheat to the international reserve program. A second measure is to more than double the funds for CCC credit for export sales from what had originally been intended this year, increasing it by 200 million dollars over last year. A third measure will stimulate consumption of corn in the domestic manufacture of alcohol for fuel. This is hoped to use five million tons more than would have been possible otherwise. Other plans may still be revealed.

There is no doubt that some of the cancelled sales to Russia will be satisfied with shipments from other origins. This certainly is likely in the case of soybeans and oil and meal. It probably is likely for wheat. It can be only partly true for corn or substitute feed grains because they simply are not available in such a large quantity. But in so doing, it means that the U.S. will have that much less competition in sales to other destinations.

It is expected that USDA will implement an acreage reduction program for 1980 crops of corn and perhaps wheat. Before the embargo, this was thought to be unnecessary. The first survey on planting intentions was made before the embargo. It showed soybeans unchanged, while corn was up 4% and spring wheat up 5%. Now it is considered likely that farm programs will have to be modified to encourage retirement of some acreage, but if that is done, and if weather is not favorable, there could be a short supply next season. Certainly, the weather so far has been almost the reverse of last year. There was record snow cover then, benefiting soil moisture condition for 1979 crops, which achieved record yields. But this season, there has been no snowfall of consequence at all. This may change in the weeks ahead, but it is cause for concern now. Already the winter wheat crop is recognized to be in jeopardy. It made a very poor beginning because of dry weather in September and October. Now it is being subjected to very cold temperatures without benefit of snow cover for protection. Some of this damage cannot be alleviated by subsequent improvement in weather.

Meanwhile, international values have strengthened as

shippers have sought to buy commodities from other origins to ship to Russia. They have the shipping space already secured and must use it or suffer a loss in cancelling it or selling it to another party. For example, corn for March loading from Brazil went from 22 cents per bushel over futures pre-embargo to 65 cents over the following week. Soybeans improved by 15 cents in the same time. This has tilted the demand back to U.S. origin for destinations other than Russia and has helped keep U.S. markets from going lower.

We expect this pattern to continue. The shock has been absorbed. It may not be possible to see significant strength for sometime to come, while waiting to see how all the foregoing and additional developments come to pass. But it does appear that the weakness that could have been immense originally will not be so profound after all.

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## Who will hold the carryover?

Harvest in the United States is complete. The November crop report was 2,235 million bushels, or 60.9 million tons. A semi-final report will be issued in mid-January. Most observers expect a further upward revision to about 2,250 million bushels, or 61.2 million tons.

The last USDA estimate of carryover next Aug. 31 was 400 million bushels or 10.9 million tons. Consumption rates so far have been larger for domestic crush, as expected, but exports only equal with last year, which is below anticipation. We expect this latter figure soon will begin to perform much better as Europe has been concentrating on crushing sunflower seed that could not be shipped earlier from Duluth due to labor problems.

Nevertheless, there is now the anticipation that the carryover figure must be increased when revised again in late January, if not sooner. A figure of 440 to 500 million bushels is generally accepted. This would be 12.0 to 13.6 million tons.

Whether it is 10.9 or 13.6 million tons is only academic. It is evident that supply exceeds probable demand by a wider margin than normal. As a consequence, futures price relationships between the various months show a development that is not usually seen. There is a discount of old crop months under November, which is the first new crop month in the United States. Thus, the market is saying there must be compensation to help pay for the costs of storing the surplus.

These "spreads" between various months are important to watch. They tell a lot about developments in commercialization of crop. Recently, the July has been holding at about 60¢ over January, (six months), but November has been only 18¢ over July (four months). The July/November spread could easily widen to 40¢ — the same ratio as January/July — and could go to 60¢, which is approximately equal to total cost of storage, insurance and interest on the investment.

Whether it does will be determined by three things: (1) size of inventory for delivery purposes at Chicago and Toledo, (2) size of the South American crop and (3) strategy in merchandising the South American crop. Most likely the inventory at Chicago and Toledo will remain large, so the developments in South America will be of prime importance.

### Argentina

Planted area should be 25% larger than last season. There has been some delay due to rain so that by mid-December still 25% was not sown. Planting can continue to Jan. 15. With full planting, the crop should reach 4.5 to 5.0 million

tons vs. 3.8 million last season. If not, then the increase could be smaller.

Processing facilities are being expanded slowly. Some initiative has been provided by the government which allows a 10% rebate on exports of soybean oil and others. But for this season, probably one million tons will be crushed vs. 750,000 last season.

Newly planted area continues to expand, especially in the north. Some cotton and groundnut acreage was shifted to soybeans. In the central zone, some acreage went back to grass due to improved beef prices.

Export facilities may now be built by the private sector, as this authorization was made last November. This should be of great assistance in promoting export trade.

### Brazil

Acreage is projected to be 7% above last season. Production last season was seriously crippled by drought so only about 9.7 million tons was harvested. This season a crop of 15 million tons is forecast by government officials. But producer and industry sources generally agree the crop cannot exceed 14 million tons, and some expect about 13 million tons.

Thus far, there is adequate moisture, even a surplus in some important areas. Planting in Parana (about 5 million tons) was completed with little delay by Dec. 7. Planting in Rio Grande do Sul (about 6 million tons) is always a little later with about 20% still to be sown as of mid-December. This factor may become critical. Rains every two or three days were keeping farmers from getting into the fields. If planting is delayed to the end of December, yields from those later plantings will be reduced. Maybe some acreage would not be planted at all.

Germination in Rio Grande do Sul fields already planted is excellent and early growth very good. Parana has experienced irregular germination, so that yields cannot be expected to be excellent, but could be good.

Last season began about the same way: too wet in Rio Grande do Sul, but mostly a good beginning. Early predictions in December that year pointed to a crop of about 13 million tons, with some saying 14 million and a few even 15 million. Then came dry weather in January and February.

A weather consultant in Montevideo is indicating deficient moisture again for approximately the same period. But that is based more on historical statistical probabilities than current meteorological conditions. Our studies of major drought patterns indicate no major problem this season, though some localized, lingering dryness could cause minor problems.