# Viewpoint

# No thanks for the memories

*(The following article was prepared by David Bartholomew for presentation at a marketing seminar held Nov. 30, 1982, in Sao Paulo, Brazil. Bartholomew, senior soybean analyst for Merrill Lynch Commodities Inc. at the Chicago Board of Trade, is a frequent contributor to* JAOCS.*)*

Many millions of people are familiar with the theme song of comedian Bob Hope — "Thanks for the Memories." A person's memory can be capricious, savoring the pleasant and dulling the unpleasant aspects. Past events mellow with age. Such nostalgia is an important part of formation of hope for the future.

Sometimes the memory has to be jolted back to some unpleasant realities. One of those times is now. Supply is heavily in surplus. Demand seems sluggish. Price tendency has been downward for nearly two years.

Specific reference is made to the soybean market. Affiliated commodities have suffered a similar fate. So have the grains.

Before going any further, it would be well to clarify the point of perspective. It's a sad memory for the producer, and for all those in the marketing chain who have been embarassed by high priced inventory in a falling market. It's *not* a sad memory for consumers, and those in the marketing chain who can benefit when the price of raw materials is dropping faster than price of products offered for sale. (A rainy day can ruin sales for suntan oil, but the umbrella merchant thrives.)

However, everyone could be more or less pleased if prices were somewhat higher — enough so that producers are reasonably compensated, but consumers do not restrict demand. (Partly sunny with occasional showers.)

## Price trend is likely to be horizontal

That is close to the probably outlook for the next 12 months — maybe longer. Any deviation probably will slightly favor the umbrella merchant. The price trend is likely to be horizontal, rather than up or down, with frequent oscillations within the approximate highs and lows established during the last half of October and the first 20 days of November.

This has happened before. Most of those who remember it would rather not have to relive those memories (except the consumer). It was from August 1967 to July 1970. It followed the big (for that time in history) bull market of 1966.

Soybean carryover as the 1966 harvest began was unbelievably low at 36 million bushels (1.0 million metric tons). So the U.S. Secretary of Agriculture, Orville Freeman, raised the support price by 10%. He believed that the United States had a responsibility to feed the world.

Farmers saw it as a no-loss situation and they began producing for government storage rather than to meet the real market demand, for demand had been curtailed by the economic forces of high prices in 1966. The weather turned favorable too, as it usually does in the last three years of the decade.

Consequently, prices dropped to the approximate equivalent of the government support level as surplus mounted higher and higher. For three years, prices coasted along in the horizontal fashion between narrow parameters. Prices couldn't go lower because government support programs absorbed supplies the market didn't consume. But neither could they go higher than the rather close mark-up at which government inventory would be sold.

Finally, the surplus carryover as the 1969 harvest began was equal to one-third of a year's total use at

327 million bushels (8.8 million MT). Efficient farmers and those with better yielding soil were making a profit at the government support price. Others were breaking even while hoping for something to come along that would make the surplus go away and drive price higher.

Eventually, the surplus did go away and prices were driven dramatically higher, over four times higher at their peak in 1973. But before that happened the support price was reduced 10%. U.S. farmers were no longer guaranteed at least to break even growing soybeans.

Could it all happen again? The answer is yes and no, or maybe. Parts of that sequence of events have already been repeated, or appear to be in the process of doing so.

Yields have been good to excellent in the United States for the past several seasons, except for 1980. Demand was curtailed sharply by the price advance during the summer and early autumn of 1980. Government support price provides a profit for farmers producing yields that are above average and a no-loss situation for most who have average yields (if they haven't paid too much for land).

Carryover in the United States is growing again. It seems unlikely this season to approach the proportionate size of 1969, even though the quantity probably will be larger. To do so would require a carryover of approximately 635 million bushels (17.3 million MT). But it could happen this season or next if demand expands more poorly than expected.

Farmers are participating in the government support program in large numbers. It is too early to know what the total will be. The support program operates as a loan program, with the soybeans as collateral. If market prices rise, the soybeans will be redeemed later and the loan paid off. Otherwise they will be forfeited and become government inventory to be sold at some level above loan value, usually 15-25%.

## Soybean support price can be lowered

The support price may be reduced by as much as 10% for the 1983 crop. This is permitted if this season's average farm price is not more than 5% above the support price of $5.02 per bushel. This provision in the farm legislation allows U.S. soybeans to be competitively priced, thereby avoiding a build-up of government inventory over a succession of years as happened in the late 1960s. So there is one thing at least which most likely will not be repeated, although that is not guaranteed. The Secretary of Agriculture may find it politically impractical to make such a decision.

Some very important things are different now than they were in the late 1960s and early 1970s. These changes may make it unlikely that there will be extensive repetition of events like that earlier era.

The U.S. dollar no longer has a fixed value in terms of gold, floating freely in relation to other currencies. Interest rates also fluctuate more freely and more widely. The value of farm land has doubled and tripled. Costs of petroleum have advanced much more than that.

Production of Peruvian fish meal and oil is down sharply, but palm products are up even more sharply. Palm oil production in Malaysia could reach 4 million metric tons in 1983 whereas palm oil was hardly heard of in the late 1960s. South America produces approximately 18-19 million MT of soybeans — about one-third of the size of the U.S. crop — compared to a negligible amount in the previous period. During the same span of time the U.S. crop has more than doubled. Changes in production of other oil and meal raw materials have not been so dramatic.

## Demand follows growth in supply

Demand is always the obscure side of the supply-demand equation. However, there are basic fundamental facts that are dependable indicators as to what lies ahead.

Demand expands following growth in supply. It is stagnant or contracts when supply is not growing. This is a function of price changes, and of course applies only when there is freedom of price response. It does not apply where there is artificial price manipulation by government.

The world, needing more of the fats and oils and proteins provided by soybeans and similar resources, will consume more when supply increases if accompanied by moderate or low price. Usually this kind of growth will be silent and subtle. Traders in the market may not realize it is happening until many months of statistics have accumulated to prove it. They have trouble shaking off the pessimism of seemingly endless burdensome supplies, concentrating attention on looking for the time when production will be reduced.

Remember that price in the surplus-producing country may drop while price in significant consum-

ing countries does not or in fact may advance. Changes in currency exchange relationships can cause interference in supply-demand response. In extreme situations supply increases but demand decreases. Again it is a function of price, but in a more complicated way.

A significant contribution to demand expansion in the late 1960s and early 1970s was that Western Europe was in the early phase of using more protein in animal feed formulation, with emphasis on soybean meal and fish meal. That has changed. Western Europe has reached a stage of protein use that is likely to increase only as population grows.

Now it is Eastern Europe and the Soviet Union that are in the early phase of protein utilization. This could be equally dynamic for the present and the next several years. In fact, as recently as one year ago this prospect had us very optimistic about demand and price outlook. Then came the realization that economies of most Eastern European nations were in serious credit exposure. They were constantly importing more commodities that were paid for on credit terms of three years and then having to renegotiate those terms for extended periods and in some instances not even keeping current on interest payments. While getting more seriously into arrears in debt on the one hand, they persisted in keeping food prices at levels significantly below equivalent current prices of imported raw materials from which it was made. Some had made no changes in retail prices for 20-30 years.

Under such circumstances, demand was obviously growing dynamically. But then that growth was brought to a very abrupt halt. Banks and exporting governments shut the door on further lending of this type and began to insist on repayment of past debt. East European retail food prices had to be increased. More increases are likely in the months ahead in order to equate them more nearly with costs of imported raw materials. Consequently, demand growth in that significant sector has been suspended currently and for the next few years.

Soviet Union demand growth probably will continue, however. Abundant resources of petroleum and


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natural gas plus gold and other precious metals are easily sold for payment for imports. But there definitely are limitations on how much of these items the world can absorb without seriously eroding prices and thereby restricting volume of imported commodities that can be purchased.

Demand for soybean oil and meal from the United States may be expanded significantly during the current and subsequent seasons by offering more liberal credit terms under a new government program. It is designed to match similar concessions offered by some other origins of these and/or comparable commodities. Will it really work? Just for a short period of time. Either the other origins will counter with even larger concessions, or they will drop out of the competition and the United States will drop its programs also. It's a political maneuver with credibility in terms of durable demand development. Ultimately, both origins may be embarrassed when the recipient country is unable to pay even lower loan costs for such largesse.

## IMF restricting production subsidies

Another significant factor which can lead to increased demand for U.S. agricultural commodities is the reduction in subsidized stimulus for production in many competitive countries. Most of those countries are overextended in international debt and are heavily dependent on the International Monetary Fund and the World Bank to service those debts. Because heavy subsidization and/or marketing expenses is a major reason for those financial problems, the IMF is insisting on reduced subsidy costs as a pre-requisite for obtaining additional funding for other purposes. The result is expected to be that uneconomic production expansion will slow significantly. That can mean improved demand for production of U.S. origin.

Mentioned earlier was the Soviet Union problem of trying to sell too much petroleum production to secure foreign exchange to purchase commodities. All petroleum exporting countries are experiencing this problem. It is likely to get worse in the years ahead. Without exception, those countries had expected they could keep raising petroleum prices as they did in the 1970s. They engaged in massive spending schemes which required borrowing against planned future income.

Those projections have crumbled. Attention is now focused on just holding present price. Even that is getting harder and harder to do. A price war has begun and can be expected to become more intense in the months and years ahead. Production quotas cannot be adhered to. More barrels have to be pumped as prices decline so that required cash flow can be maintained.

This situation is good news for the rest of the world whose economy was shattered during the past 10 years by high costs of imported petroleum. Now those countries will be able to pay for larger imports of food and feed ingredients.

Moreover, cost of those ingredients need not advance if petroleum prices do not advance and probably go down. Agriculture consumes more petroleum and steel and rubber and chemicals than any other industry. When costs of those basic items no longer advance and possibly decline, then price of agricultural commodities can level off or go down (except in seasons of adverse weather that decreases yield).

It's an obvious fact that, in farming as in any business, profit is the difference between cost of input and price of output. Somehow in the past 10 years or more that fact got lost in the dreamworld fantasy that prime economic objective should be to have higher prices each year, and prosperity was simply the product of advancing prices of output faster than cost of input.

The point is the long term trend does not have to go up at the dizzying rate of the 1970s and should not be expected to go up at all on the shorter term, which in this case means one year. Profits will be available, though meager, if costs are stable or lower.

Demand is especially precarious to predict with such volatility in international exchange rates. It will be influenced as always by price but the price that matters is the price expressed in local currency in the country of destination. Also, it will be influenced by availability of purchasing power in controlled economy countries, which will be a function of credit restraints, etc. Another consideration will be potential further price-cutting of petroleum costs.

At the present time it is reasonable to project that demand in 1983 will be increased by a modest 5% if the U.S. dollar is not strengthened further from recent trading areas and has periods of several weeks when in fact it is softer. On the other hand, demand will be stagnant if the U.S. dollar stays firm.

There is a government floor to support prices when they are soft. There are surplus stocks that will become available supply on modest price advances. So it is necessary to predict that price trend will be horizontal with oscillation up and down. That could go on for more than one year. It has happened before and it can happen again and seems to have made a convincing beginning.