

Viewpoint



South American outlook

(The following article was written Dec. 27, 1982, by David M. Bartholomew, senior soybean analyst for Merrill Lynch Commodities, Inc., at the Chicago Board of Trade. Bartholomew is a frequent contributor to JAOCS. In the article, Bartholomew discusses the potential negative impact on Brazilian yields of heavy rains during planting time, and how monetary policies may slow marketing of Latin American soybeans in 1983, leading to crushers operating throughout the year rather than in a brief period following harvest.)

As the new crop season begins, there are some observations that can be made which will be useful in making market projections for 1983. Planting is now virtually completed in Brazil and is making rapid progress in Argentina. It has been a difficult experience for Brazilian farmers as approximately 50% of the prime area was delayed 3-4 weeks by frequent rains and another 25% has had a very irregular beginning, also due to rains.

This latter area suffered in several ways. Erosion has been serious, even though fields are terraced. Seeds were washed out even when the terraces were not breached. But many terraces could not hold so much water and were washed away. Then there is the problem of rains having washed away the fertilizer and herbicide that has been applied. A second application may not be made, due to high costs and unavailability of additional financing except at very high interest rates. Finally, the rains caused crusting of the soil which prohibited emergence of some seedlings. Where this was of serious proportions, replanting was necessary, just the same as where seedlings were badly washed out.

Thus the early appearance of the crop in Brazil is not as uniformly beautiful as in some years, and this causes people to become pessimistic about potential yield. First projections were for a crop of 14.7 million tons, vs 12.8 last season. More recently, these were reduced to 14.0 million and many private estimates are 13.0-13.5 million, with a few even smaller. But it must be remembered that the soybean plant can branch out to fill open spaces left by poor emergence. This ability to compensate can result in better yields than predicted.

Argentina, on the other hand, has had ideal weather thus far. All that remains to be planted is that which follows wheat, and the harvest is moving rapidly. The area has been expanded to such an extent that a soybean crop of 5.0

million tons is commonly expected vs 3.8 million last season. Paraguay will probably have about 500,000 tons.

For at least three years, marketing people have prepared for a combined Brazil/Argentina/Paraguay crop of 20 million tons, but once again that looks just out of grasp. Other than unfavorable weather, the restricting factor has been that Brazilian area is not expanding as fast as had been expected. Southern areas are diversifying to corn and other crops. Northern virgin area still is being brought into soy production, but not at the same rate as previously. And this rate is likely to slow considerably in the years ahead because funds are no longer available for the subsidization of farm operating loans. Whereas these have been available in past years at the extremely attractive rate of 15% per year, they are set at 45% this season, and will be nearer the open market rate of 70% next season.

The reason for this change is simple. With a frighteningly large external debt of over \$80 billion, the banking system is simply saying that no more money is available for subsidizing production that may otherwise be uneconomical. The same message is being sent to soybean crushers of Brazil. Various financial subsidies provided the incentive to develop and expand. But now the capacity equals 22 million tons. Obviously, it is being utilized only at a level significantly below this, so there is no reason to encourage even more capacity.

In past seasons, Brazil has sought to utilize some of this surplus crushing capacity by allowing the industry to import soybeans with the provision that the oil and meal which resulted would be exported. Certain financial concessions were provided in an effort to increase export earnings this way. (This system has been known as "draw-back.") That also is being terminated. It has been realized that the crushers did not make money on this program, and there was a net out-flow of dollars since transportation costs had to be paid in dollars. Brazilian crushers will continue to process Paraguayan soybeans, and maybe Uruguayan and Argentine as well, but for a fee for the account of the originating party rather than as principal. (This is sometimes known as "toll crush.")

Many other financial reforms are taking place in Brazil and Argentina and other countries as well where borrowing capacity has been exhausted. Prices of food and other items are being adjusted toward world levels, where previously they have been subsidized so as to hold down costs. Most of the population has not realized this subsidizing had been

taking place because government had found it politically expedient to be silent on this subject. Quite correctly, governments reasoned that resolution of the ultimate problem would fall on some subsequent regime. Now time has run out and present regimes have to face the unpleasant task of economic redemption. Whether that can be done without tragic consequences remains to be seen, but presently there is resentment building among the populace against what they perceive to be an unnecessary interference from outside domination. Even if economic (and therefore political) chaos is avoided, there will at least be a period of some years when demand growth for food and other items will be small or stagnant, and may even be reduced for a time.

The United States has been partly responsible for the growth of these debt problems. In an effort to stimulate agricultural exports in the mid-1970s, it was decided by Washington officials to provide low-cost credit for three years from date of purchase. Previously, such concessional terms were restricted to six months, because it was felt that longer term credit was not wise for food-type commodities which were consumed and did nothing for the recipient country's capital enhancement. Now it is evident that the previous judgement was wiser, but unfortunately it is too late to reverse the situation.

Market Considerations

Some immediate and longer term considerations are worthy of discussion in view of current circumstances. These will relate to conditions in South America, but also must take into account those in the United States, as well as principal countries of destination for exports.

The Brazilian crop will be later than desired, due to the retarded planting season for a large percentage of the area. This has already resulted in a higher bid than normal from both Brazilian crushers and exporters. The local crushers need to assure the arrival of early harvest supplies from those regions which planted early and have not had to replant, because they have sales obligations for shipment of meal and/or oil early in the season. Similarly, exporters need to assure a supply of beans or products early in the season for the same reason.

Argentine sources have made a few sales of soybeans and/or products. Farmers there are better prepared to make some sales for harvest delivery because of a more optimistic crop outlook. This applies to all crops and is acknowledged to pose a problem for storage space. Since soybeans are nearly the last of the important crops to be harvested, there could be a real logistical problem. Moreover, it is recognized, with the Brazilian crop being late in a major proportion of area, that there will be a more direct competition against Argentine origin when that harvest begins.

Presently, there have not been early offers from producers in volume large enough to saturate the demand for shipment at that time. Probably there will not be, unless a more optimistic outlook develops for the Brazilian crop during the growing season. But, if the Brazilian crop outlook remains pessimistic, producers there will continue to

refrain from selling aggressively in hope of securing better prices later.

Argentine producers will be reluctant sellers also, for the same reason and for other reasons as well. They will also store and hold as much of their crop as is physically possible for monetary reasons. Each day that they can wait before selling will yield more pesos. Inflation is about 200% per year, or more than one per cent every two days. Under such circumstances, there is a disincentive to convert a crop into paper money until absolutely necessary, not only because of a gross lack of confidence in the future of the currency, but also because of a lack of inclination to invest in anything else with money from sale of crops.

This will mean that the crushing industry will be able to operate practically all year rather than just for several months, as has been traditional. Moreover, it is worthy of note that Argentina had adopted a policy of imposing an export tax on soybeans (25%) which is higher than oil and meal (15%). This will also help assure 12 months of operation. In addition, it is making the crushing business profitable.

Some concern is being expressed in Argentina about potential outcome of the elections in late 1983. It is said that a majority may prefer to return to a more authoritarian type of rule. If that happens, then it could be that marketing of grain may return to monopoly control of a National Grains Board. According to some sources, that possibility explains the surge in farmer interest in shifting away from production of grains toward oilseeds. It is possible that oilseeds marketing would not be included in that monopoly. However, there was a time when oilseeds were included. Crushers say it was an era when profits were guaranteed. No marketing skills were required. It was simply a routine business of mechanical operation of the plant and handling the in and out freight and traffic. But there was no challenge or reward for superior performance and crushers would not want to return to that life-style. Currently, however, it appears that farmers will continue to expand the production of oilseeds and it is estimated that the Argentine soybean crop could reach 10 million tons before 1990.

Price Outlook

It appears that Chicago soybean futures have begun the lateral or horizontal channel that we predicted in mid-November. The low end is established at the equivalent of the price support program of the United States. This would equate to \$5.40-\$5.50 per bushel, after allowing for freight and merchandizing differentials. The high end is equated to the interest rates and storage cost mark-up that will induce farmers to sell, or ultimately where the government will sell supplies of any kind surrendered by farmers.

The big question is: "How long will this horizontal tendency last?" The answer is: "Until something happens that will cause prices to break out the top of the channel." Presently, it seems that would require a major crop problem in South America, or a significant improvement in demand,

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which would have to relate to either a significant weakness of the U.S. dollar or a significant improvement in the world economy or both.

Just now it appears less of those will happen, so price action may have to remain horizontal for a long time. It does not appear that planted area in the United States will decrease in 1983. In fact, it probably will increase because the present price support level is looking very good to farmers as costs of production are declining.

So the weather in Brazil and Argentina in January through March will be watched very closely. Then the U.S. planting intentions report in February will also be of keen

interest. After that, attention will focus on U.S. consumption statistics as the season will be half gone. Russia's increased utilization of soybean meal is important, but that increase may be offset by decreases in other areas of Europe.

Traders will be focusing more attention than normal on South America during the next six months, first to see how the crop is developing and then to see how it is being merchandized. These factors are the most likely ones that could offer hope for prices to break out of this horizontal channel.

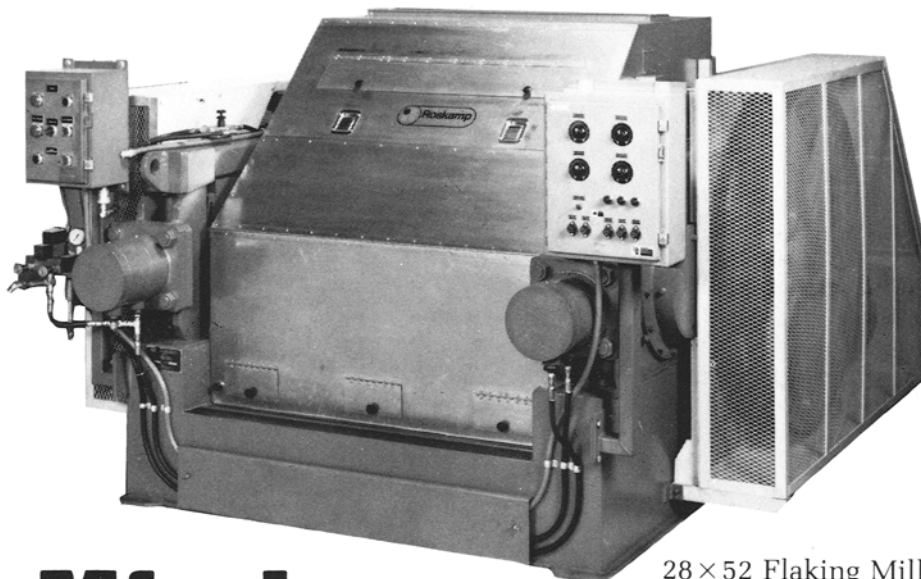
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