

Markets Improve with Lower USDA New Crop Grain and Cotton Forecasts Consider Pricing Some of the New Crop

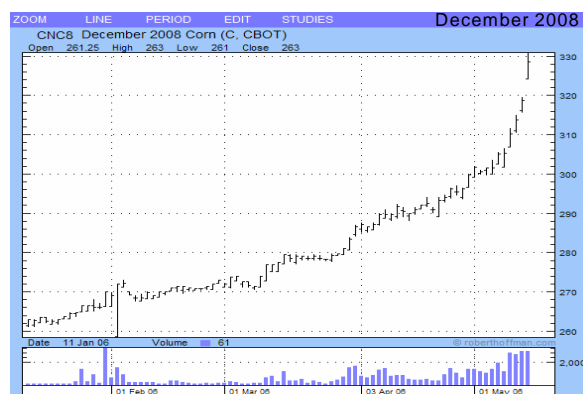
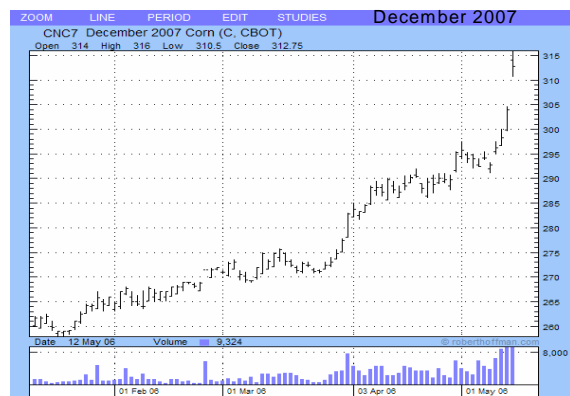
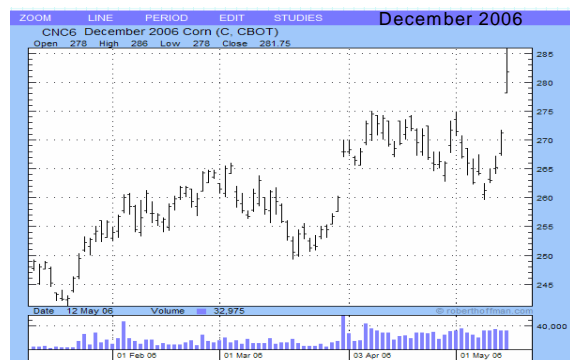
Jose G. Peña, Professor and Extension Economist-Management

After four years of weak markets, grain and cotton markets are showing significant signs of strength, especially after USDA's first U.S. production projections for the 2006/07 season. USDA's May 12, 2006 supply/demand report indicated lower 2006/07 season wheat, corn, sorghum, cotton and slightly lower soybean production. Futures markets rallied and appear to be providing opportunities to price new crops.

For example, December '06 corn contracts, on the Chicago Board of Trade (CBOT), were trading at \$2.85/bu on Wednesday, May 17, 2006, when this report was prepared, just a penny below last week's life-of-contract highs. With December '06 futures trading at close to the market highs since the 2002/03 season, it appears that it may be time to consider pricing some new crop corn and seriously look at the pricing opportunities that the market is providing for the 2007/08 and the 2008/09 season. (See Figure 1).

Corn futures trading volume hit a record high on Friday, May 12, 2006, USDA's report release date, as traders tried to gain position on market. It appears that USDA's report, lowering 2006/07 ending stocks by 1.1 billion bushel to 1.141 billion bushels from current

Figure 1: Corn Futures (CBOT)
December 2006, 2007 and 2008 Contracts



season's ending stocks of 2.226 billion bushels fueled the market. For the new marketing year, while the estimated food, seed and industrial use projections were increased by 19 percent, ethanol use was increased by 34.4 percent. Ethanol production is now expected to consume about 2.15 billion bushels of corn, or about 11 percent of the entire U.S. corn crop.

Corn

USDA's initial estimate of the 2006/07 corn crop at 10.55 billion bushels is down 5.1 percent from this past season's crop of 11.112 billion bushels. Total corn supply at 12.786 billion bushels, is projected down 3.4 percent from this past season as the estimate of production is only partially offset by higher beginning stocks. Projected domestic use and exports were increased by 7.5 and 6.2 percent, respectively, increasing the estimate of use to 11.645 billion bushels, just slightly below record use of 11.662 billion bushels in 2004 and up 5.8 percent from this season's use estimate of 11.010 billion bushels. The estimate of exports was increased primarily due to reduced foreign competition and lower global feed-quality wheat supplies.

The estimate of use at 11.645 billion bushels will exceed the 10.55 billion bushel production estimate by 1.095 billion bushels, lowering the estimate of ending stocks to 1.141 billion bushels, down 48.7 percent from this past season's ending stocks of 2.226 billion bushels. (See Table 1). If realized, the 2006/07 ending stocks will be the lowest since the 2002/03 season when farm prices averaged \$2.32//bu for the season.

The global outlook for 2005/06 corn season includes slightly lower production, increased consumption, and lower ending stocks. Lower U.S. corn production more than offsets a higher estimate foreign coarse grain production. Production increases are significant for Argentina and EU-25. Global coarse grain trade is up slightly while consumption is up 2.7 percent. China's corn stocks continue to fall; global corn ending stocks dropped 29 percent to 92 million tons, the lowest in more than 20 years. The global coarse grain situation supports a bullish U.S. corn market.

USDA's projected price range for corn is \$2.25 to \$2.65 per bushel, compared with \$1.95 to \$2.05 for 2005/06.

Wheat

The outlook for wheat in USDA's March 12, 2006 supply/demand report indicated a decrease in production, exports, and stocks, and higher prices. Total production is forecast down eleven percent from 2005/06 to 1.873 billion bushels.

While wheat production in Texas and especially southwest Texas will be sparse this season due to the severe drought underway, price bids for hard red wheat futures contracts in the Kansas City Board of Trade (KCBT) followed similar market patterns as corn. The futures market appears to be providing pricing opportunities for future

production.

Price bids for July '06 hard red wheat contracts in the KCBT were trading above \$5.00/bu on Wednesday, May 17, 2006, when this report was prepared.

Cotton

The first U.S. projections for cotton for the 2006/07 season include lower production, domestic mill use, exports, and ending stocks compared with the current season. Production is forecast at 20.7 million bales, 13 percent below the 2005/06 season. While acreage indicated for planting in March 31, 2006 Prospective Plantings report indicated that planting would be up slightly from last season, abandonment is forecast at 12 percent, due, in part, to the continuing severe drought and based on the 1996-2003 national average.

The estimate of U.S. domestic mill use at 5.8 million bales was reduced by 3.3 percent from the 2005/06 season, as mills continue to lose market shares to rising textile imports. Exports were projected at 16.5 million bales (79.7 percent of the production estimate), down 2.9 percent from the 2005/06, due mainly to supply limitations. Ending stocks are projected at 4.9 million bales, 22 percent of total use, which would be the tightest since the 2003/04 season. (See Table 1).

According to Dr. Carl Anderson, Professor Emeritus, if the 2006/07 crop projections are realized, the world "A" Index price and U.S. futures prices might rally to the 65 to 70 cent range.

Dr. Anderson contends that producers that have not protected their counter cyclical payment for the new crop need to consider call strategies that provide for a possible mid-sixty cent price on December '06 futures and lower counter-cyclical payments. Strategies to place a floor under the market but not a ceiling should be evaluated.

TABLE 1. US CORN AND COTTON SUPPLY ESTIMATES/1										
	Corn					Cotton				
	2003	2004	2005 ¹	2006/07 ²	% CHNG	2003	2004	2005 ¹	2006/07 ²	% CHNG
	Million Bushels					Million Bales				
BEGINNING STOCKS	1,087	958	2,114	2,226	5.3%	5.39	3.51	5.54	6.50	17.3%
PRODUCTION	10,089	11,807	11,112	10,550	-5.1%	18.26	23.25	23.89	20.70	-13.4%
IMPORTS	14	11	10	10	0.0%	0.05	0.03	0.03	0.03	0.0%
TOTAL SUPPLY	11,190	12,776	13,236	12,786	-3.4%	23.70	26.79	29.46	27.23	-7.6%
DOMESTIC USE	8,332	8,848	8,985	9,495	5.7%	6.22	6.69	6.00	5.80	-3.3%
EXPORTS	1,900	1,814	2,025	2,150	6.2%	13.76	14.41	17.00	16.50	-2.9%
TOTAL USE	10,232	10,662	11,010	11,645	5.8%	19.98	21.10	23.00	22.30	-3.0%
ENDING STOCKS	958	2,114	2,226	1,141	-48.7%	3.51	5.54	6.50	4.90	-24.6%
AVG FARM PRICE ³	\$2.42	\$2.06	\$2.00	\$2.45	22.5%	\$0.618	\$0.416	\$0.478	N/A	N/A
USE-TO-SUPPLY	91.4%	83.5%	83.2%	91.1%	9.5%	84.3%	78.8%	78.1%	81.9%	4.9%
ENDING STOCK-TO-USE	9.4%	19.8%	20.2%	9.8%	-51.5%	17.6%	26.3%	28.3%	22.0%	-22.2%

¹ SOURCE: USDA/NASS/ERS/WASDE May 12, 2006 Supply/Demand Report

² 06/07 production estimated; use projected by 2006 Agricultural Outlook Forum, Interagency Commodity Estimates Committee, USDA.

³ Corn in bushels; Cotton in pounds.