



MERCHANDISERS' CORNER *By Diana Klemme*

The Global Pond

Kids in the country learn early that a stone skimmed across a pond creates ripples that can travel far. In today's global agricultural markets, one country's problem can directly impact many other countries. Losses to the Australian wheat crop sharply boosted our exports two years ago and in 2008 the Former Soviet Union's bumper wheat crop crushed the U.S. soft red wheat basis. In 2009 it's South America that will affect us next.

Losses in South America mean overseas importers of its soybeans, soymeal and corn can face potential import disruptions as far afield as Iran to Indonesia. It's a small world after all.

Late 2008 and early 2009 were not kind to Argentina, Paraguay and to far-southern Brazil. That region received below average precipitation over most of their crop area during October through December with minimal improvement during January for much of Argentina. Precipitation improved in early February but damage is done.

Most of the Argentina soybean crop flowers in February, with second-crop soybean planting getting underway and its corn crop is in the fill stage. Estimates of soybean losses in South America were as high as 10

million tonnes in early February, or 367 million bushels, equivalent to 20 percent of Argentina's expected crop!

February production estimates are preliminary at best, but futures were already pricing the impact of reduced crops. Soybeans reacted swiftly in January, surging higher, with the July09/November09 future spread racing from a 6-cent carry in late December to more than an 80-cent inverse by late January on ideas of tighter U.S. supplies.

The United States typically starts losing soybean export business to South America by early spring. That picture is changing quickly. Barring a late season recovery in Argentina's soybean crop, U.S. soybean and soymeal exports will almost certainly exceed USDA's current projections.

Assume that just 5 million tonnes of South America's soybean production is lost, with most of it from Argentina. In a 'best case' scenario, South America might still meet projected exports by drawing down its ending stocks slightly.

Some portion of any South American shortfall will likely be covered by increased U.S. soybean and soymeal exports. A loss of 5 million tonnes equates to 184 million bushels, or 82 percent of the U.S. projected



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MERCHANDISERS' CORNER

Major World Soybean Exporters

| | Produc | Domestic Use | Exports | End Stocks |
|-----------|--------|--------------|---------|------------|
| Argentina | 49.5 | 37.2 | 14.4 | 22.2 |
| Brazil | 59.0 | 34.5 | 25.3 | 18.5 |
| US | 80.5 | 50.3 | 30.0 | 6.1 |
| World | 233.2 | 231.1 | 77.2 | 53.9 |

Million metric tonnes; 1 metric tonne = 36.7 bushels
USDA January 2009

carryout this summer. Shipping that many more soybeans would create a very big ripple in our cash markets. U.S. soybean stocks would be nearly depleted and basis could reach extreme levels by summer in some parts of the United States.

Realistically, U.S. soybean stocks will decline from the current 225 million bushel USDA projection, but our cookie jar won't be emptied. Ending U.S. stocks of 150 million bushels of soybeans, however, would equate to less than 5 percent of disappearance, about the same as in 2008 and historically tight.

An interesting aspect is that Argentina exports virtually 100 percent of its soy production, with over two-thirds of it going out as soymeal. Brazil exports about one-quarter of their soy production as meal and around 40 percent as raw soybeans, and uses the balance domestically. The United States on the other hand, exports less than 10 percent of our soybean crop as soymeal.

Several scenarios could unfold for the United States:

- South America's shortfall is small enough it can meet all export demand from their remaining soybean stocks. The United States sees little additional business.
- Some part of a 5 million or so tonne shortfall could bring new soybean export business here, but no additional demand for soymeal.
- Argentina's problems could worsen and U.S. soybean inventories could become essential to meet world demand. The United States could end up with very low soybean stocks this summer, and see greater demand for both soymeal and raw soybeans for export this summer.

It's still early to call the outcome. But what elevator managers and merchandisers can do is begin to adjust

Major World Corn Exporters

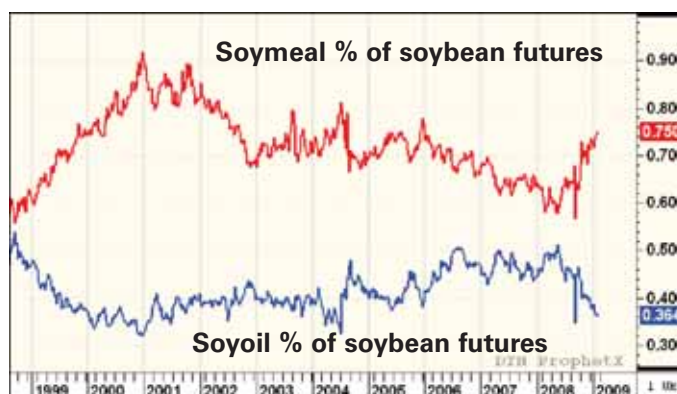
| | Produc | Domestic Use | Exports | End Stocks |
|-----------|--------|--------------|---------|------------|
| Argentina | 16.5 | 7.5 | 10.5 | .6 |
| Brazil | 51.5 | 47.5 | 9.5 | 8.2 |
| US | 307.4 | 259.1 | 44.5 | 45.5 |
| World | 791.0 | 783.2 | 76.9 | 136.0 |

Million metric tonnes; 1 metric tonne = 36.7 bushels
USDA January 2009

soybean trading plans. Areas tributary to the Gulf or that can ship to the PNW may see continued strong export demand for soybeans. Soybean crush plants tributary to ports may be more aggressive if called on to meet increased soymeal export needs.

Soybean basis often peaks in early winter in this country even before our exports begin to slow, offering little net return for carrying hedged inventory. That's still likely the case for many areas. But elevators that are most directly affected by export demand may find their market doesn't fade away as can happen when South America has bumper soy crops.

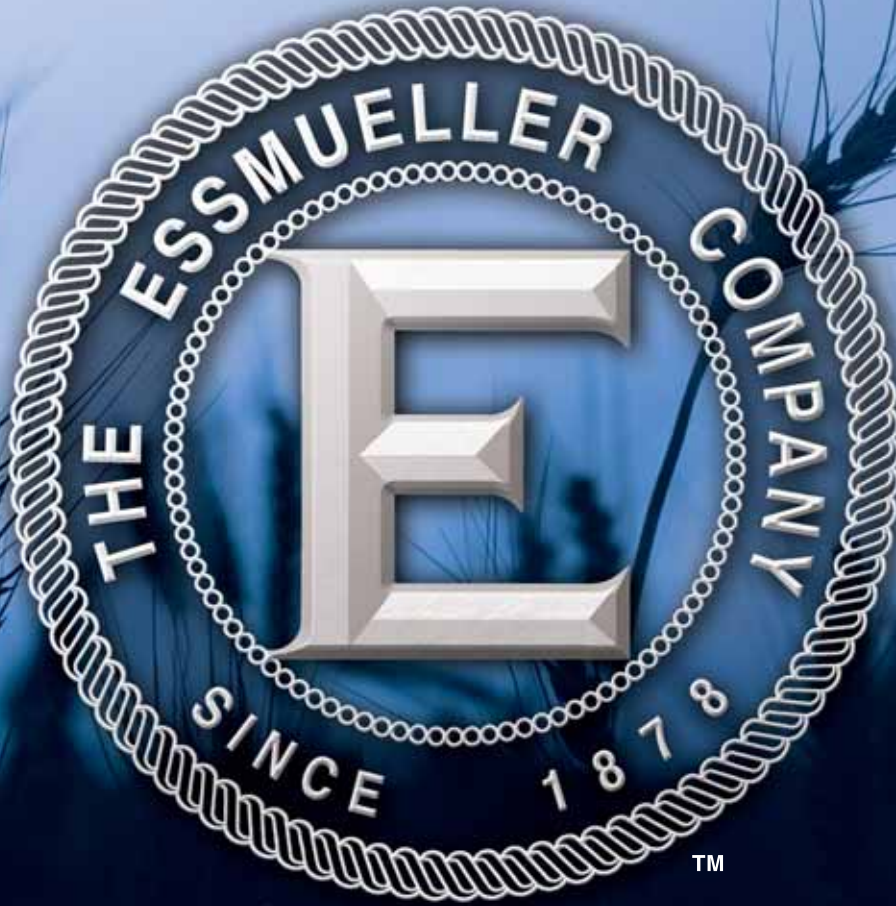
Soymeal value has gained as a percent of soy crush margin in recent months (see chart below), and may



%s reflect 11# of soyoil and 47# of soymeal value based on front month futures; product values are divided by soybean futures. % totals are typically slightly higher or lower than 100% to reflect the overall board crush margin.

rise further. With meal at 47-48 pounds of each bushel crushed, fluctuations in meal demand typically drive the ratio. To the extent that U.S. soymeal exports climb this year, soymeal basis for domestic markets could firm as a result. Look closely at the basis values that crushers will offer for spring/summer slots. Feedlots and other users near the export pipeline may want to

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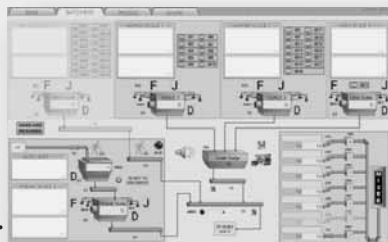
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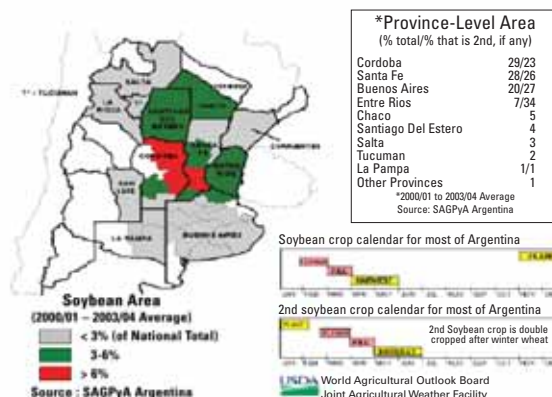
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USDA World Ag Outlook Board

Argentina Soybeans



lock in some forward soymeal basis. Manage the price risk separately via futures; forward contracts carry extra counterparty risk this year and basis is typically a less costly variable.

Old-crop soybean futures spreads may be quicker to tighten and slower to widen towards Full Carry, on concerns world importers will turn to the United States to meet their needs. Accept good futures carries if you need to hold hedged soybean inventory rather than trying to pick the best opportunity. Old-crop/new-crop soybean spreads are likely to remain volatile as the South American situation changes or clarifies.

Argentina's corn crop is also at risk. It is the world's No. 2 corn exporter, and ships over half its production. Argentina holds virtually no carryover by the end of each crop year. Shortfalls in Argentina would almost certainly force overseas buyers to turn to the United States for corn. The impact would be less than with soybeans, however. The U.S. ending corn stocks ratio is around 15 percent and we could easily export more corn without necessarily affecting corn basis or spreads.

The U.S. farmer is always an important wildcard. Tight holding can force basis to rise and heavy selling can weigh on basis – regardless of changes in South America. But that is a shorter-term, localized influence. Major losses in South America can affect everybody that lives around this global pond. Think globally, trade locally. ■



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