The *Grain Service* Newsletter

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JUNE 2002 versus NOVEMBER 2002

Rather than dwell on the minor changes between the October and November USDA reports, we looked back to June before the worst crop problems arose. By the June 12 report it was clear, however, that US production was declining, and USDA made the first cuts on their report. Corn production was set at 9.65 billion bushels, usage at 10 billion bushels, and 2003 ending stocks at 1.3 billion bushels. In the week after that report, December 2002 corn futures traded around $2.25 to $2.30. Now production is around 9.0 billion bushels, usage is reduced 200 million bushels to 9.8, but ending stocks are down to 848 million bushels. Yet Dec 2002 corn futures closed on Nov. 14 at $2.44, not much above June levels.

The 2002 crop *world* corn projection in June showed 606MM tonnes production, usage of 626 MM tonnes, and ending stocks of 103 MM tonnes. Now production is down to 590MM tonnes, usage has been cut 6MM tonnes, and ending stocks reduced to 99 million tonnes (even after the upward revision in China stocks explained in the next paragraph).

World wheat statistics are clearly more worrisome. In June, production was forecast at 590 MM tonnes, usage at 596 MM tonnes, and ending stocks at 156 MM tonnes. Now production is down 21 MM tonnes (770MM bushels), to 569 MM tonnes, but usage has remained steady. World ending stocks comparisons are difficult to evaluate. USDA raised China's wheat stocks 40MM tonnes this month on a multi-year revision, but it's highly *unlikely* that much of those stocks are accessible to the world market. (China imports and exports only minimal quantities, and has consistently consumed more than is raised internally in recent years.) Effectively, world ending 2003 wheat stocks would be just 132 MM tonnes if it weren't for the revision in China's stocks. In June, Dec Chicago wheat futures were about $3.00; now they're about $3.90. At least wheat futures reflect the tighter S&Ds.

In the world S&Ds, since the June report usage of total grains (coarse grains, rice, and wheat) has been cut 25 million tonnes, 40 million tonnes of wheat and 5 million tonnes of corn were *added* to China's inventories, & world ending stocks are up just 5 MM tonnes. That means that excluding the China adjustments, world ending stocks projections have been *reduced* 40 million tonnes even on lower usage. And total world usage continues to exceed production in virtually all commodities.

November 14, 2002 USDA Supply/Demand Report

	2002 crop Corn		2002 crop Soybeans		2002 crop Wheat	
WORLD	**Oct.**	**Nov**	**Oct.**	**Nov**	**Oct**	**Nov**
Carry-in	124.78	128.83 *	31.74	32.45	159.56	198.22*
Production	590.00	589.74	184.49	188.80	569.77	569.34
Usage	623.30	620.04	189.99	191.14	598.16	595.10
Ending Stox	91.48	98.53	26.11	29.68	131.18	172.46
U.S.						
Carry-in	1599	1599	208	208	777	777
Produc.	8970	9003	2654	2690	1625	1616
=Supply	10584	10618	2865	2900	2487	2474
Exports	2000	1925	850	890	950	950
Feed	5650	5675	NA	NA	150	150
Food/Seed	2170	2170	165	165	1016	1016
Crush	NA	NA	1675	1660	NA	NA
USAGE	9820	9770	2690	2715	2116	2116
=End Stox	**764**	**848**	**175**	**185**	**371**	**358**
(stox/use)	**7.8%**	**8.7%**	**6.5%**	**6.8%**	**17.5%**	**16.9%**

World figures are in million metric tons; US S&D in million *bushels*
*** after adiustment to China stocks**

It's amazing the corn market shows so little ability to rally. But as the US harvest winds down and cheap feed wheat disappears, the picture may change quickly. China could continue to export corn to the Asian markets, but the overall tightness remains. The longer-term situation leaves far less downside price potential versus the upside unknown. Low prices will do little to discourage demand or to ensure adequate acres for 2003 – worldwide. The explosion in wheat prices this week should serve as a wake-up call to everyone that similar reactions can occur in *any* commodity this year! And you won't get any advance warnings of such moves.

In US soybeans, the June report used a 2.87 billion production estimate, usage of 2.85 billion, and ending 2003 stocks of 265 million bushels. November 2002 futures were about $4.80 shortly after that report. Now production is down 170 MM bushels, usage has been cut 140 MM bushels, and still US ending stocks for '03 are down to 185 million bushels. November futures closed November 14 at $5.70, up 90¢ since June. The tightening soybean situation along with world veg oil demand has forced prices to respond.

US PRODUCTION

USDA did tweak corn production, but expect more changes in the final January report. Iowa's corn yield was only raised 1 bpa to 160 on this report, and even skeptics seem sure that's too low. But some other states may be trimmed more, and overall corn production may not change much.

In soybeans, however, the final number could go either way from this 2.7 billion estimate. Approximately 200 million bushels were forecast for Arkansas, Tennessee, Louisiana and Mississippi production this year, but 70 million of those were still in the field a week ago. Continual rains all but ensure some losses at this point. And other areas that are behind may lose more as well. Don't expect the January final soybean production to be significantly higher than this report.

WHAT ABOUT 2003?

Most of the attention so far has focused on 2002 crop size and usage. But with razor-thin carryouts projected, ensuring sufficient 2003 crop acreage *and* realizing good yields are critical. For example, assume corn acres rise from 78.8MM this year to 80MM next year. Assuming 91.5% harvested and a 139 bpa yield, production would be 10.1 billion bushels. If usage is about 9.9 billion, ending stocks in 2004 would only climb to around 1.0 to 1.1 billion. That's only 10.6% of usage, *not* a burdensome number. Using this year's 78.8 MM acres and a yield of 138, production might only reach 9.9 billion next year, barely covering usage.

It's too early to state for certain what will happen with acreage, but there are signs corn acres will rise. The catch is that current predictions favor a continuation of the Midwestern/Plains drought into next year. *That* could prove catastrophic. Overall, betting on low corn prices in the months ahead looks risky. End users should increase coverage.

SOFT RED WHEAT

The November S&D left SRW carryout unchanged at a snug 40 million bushels. (It was 78 million last year and 135 million in the 2000 crop year.) The tight S&D situation is reflected in high basis, approaching 55 over at the Gulf, and big futures inverses into new crop. (Chicago December futures are running almost 70¢ over July futures.) Much of the recent strength in export basis and spreads came from sales to Egypt. Political considerations and government-subsidized financing play a big role in this business, and Egypt has paid substantial premiums for some U.S. wheat over French wheat.

The tight S&D situation makes it likely that a merchant will 'come for' the delivery stocks sooner or later. As of November 8, there were around 3 million bushels in Chicago and 21 million in Toledo. That compares with 4 million in Chicago and 25 million in Toledo at this time last year. Basis is well over delivery value and wheat is loading from Chicago by rail (around ½ million bushels the first twelve days of November). Wheat is leaving Toledo also, but not very fast *relative to the stocks*. Only 300M or so was loaded out during the first twelve days of November. Quality may still be a problem for merchants and millers looking at these stocks. It's possible that some Toledo wheat will move to Norfolk by rail against the recent Egyptian business. But it'll probably take a Lakes program to make much of a dent in the Toledo stocks. Traders are watching closely to see if boats show up to load before the Lakes close.

Few country elevators still hold large positions in old crop SRW ownership. Those who do should work on reducing positions. Merchandising over the balance of this crop year will be a 'big boys' game. Get to the sidelines and leave it to them.

Also attracting attention this fall has been LDC's (Dreyfus') plans to import French milling wheat through the port of Brunswick, GA, even though the talked-about tonnage isn't large. Apparently the first vessel intended for Brunswick attempted to load at La Pallice, a secondary French grain port, but encountered quality problems. It appears that at least some of this wheat was intended for the flour mill at Milner, GA and LDC has replaced it with rail wheat from the eastern Midwest. But French wheat continues to be priced at a big discount to U.S. SRW and we still expect to see wheat imported. There have been reports of freight bookings from Rouen, the major French grain port, to the U.S.

(Note: There has been some confusion about wheat imports through Brunswick and through Wilmington, N.C. LDC is involved in both. The Wilmington facility is operated by a group of nearby feeders and is designed primarily to transfer grain or wheat from vessels to trucks. The Wilmington group is importing feed wheat from the U.K., and we'd be surprised to see milling wheat come in there. (There are no flour mills within easy trucking distance of Wilmington.)

Brunswick, Georgia, on the other hand, is a public facility operated by the Georgia Ports Authority. It does transfer from vessels to rail. There are two flour mills in central Georgia and another in northwest Georgia that are potential buyers of wheat from Brunswick. One of them is owned by Conagra, which might avoid imported wheat due to public relations considerations.)

New-crop SRW: Rains have caused significant planting problems across the south from Dallas to the Eastern Shore. We'll still end up with more acres, but not as much as earlier intentions. There's been decent farmer contracting this fall and there are a lot of firm offers and 'call me's' around $3.00 cash ($3.25 to $3.40 July futures depending on basis). New-crop basis indications from exporters and flour mill buyers are thin, and country elevators are generally setting bids at historical levels. We recommend staying long basis on any new-crop wheat you buy unless you can sell it well *above* historical levels. Harvest values are obviously at a big discount to old-crop. We bet that some of the old-crop strength will spill over into harvest. Certainly, folks in early harvest areas shouldn't forward sell basis unless you get a big premium over mid-summer values.

DECEMBER/MARCH CORN SPREAD

After trading out to a 5¢ carry in early November, the Dec/March corn futures carry has narrowed to only a cent or two. Country elevators with risk positions in this spread likely have *short* hedges in December that they need to roll forward. There is still a decent shot at catching the carry back out a *little* wider than the current level. But the chances of a big move that way aren't as good as the odds of a big move the other way. Under the right cash grain conditions, there's no reason December futures can't trade *over* March futures.

The Illinois River basis for December shipment has been up against delivery value for some time. It'll probably take a big basis break to widen the futures carry more than a few cents. We doubt that'll happen. The River basis is supported by very high basis in many of the domestic markets. (Gulf corn basis is about 10¢ higher than this time last year despite the relatively slow shipment pace.)

It's likely that cash corn on the River would be significantly tighter still were it not for excellent crops and heavy corn loadings off the Mid and Upper Mississippi and for the big bean export program at the Gulf. The China bean program has kept corn boats out of the lineups. By early December, the bean program will be slowing and northern Mississippi River ports will be closing. That cuts off the 'easy' corn supplies from the big Iowa crop. Should supplies tighten much, there's little room for the Illinois River basis (Vs. CZ) to rise since it's already at delivery value. That means the impact will be mostly in December futures gaining on March futures. We aren't predicting that this scenario will play out, but it's a realistic possibility. Continue to work on rolling short hedges out of December against bushels you'll carry forward.

CORN BASIS

The corn basis clearly reflects the wide disparity in supply availability this season. Chicago and Iowa corn basis is impacted the most by their large crops, while the 'fringe' markets are working extra hard to source grain. As harvest winds down all over, watch for arbitrage trading to increase as a way for merchandisers to hedge their bets. Being net short corn basis this year could be highly risky, but shorting one market while buying another could be lucrative. Whether Eastern values decline or rise, the spread between that area and Iowa should

Corn Basis	2001	2002	Change vs 2001
CIF Gulf	+24 Z	+34Z	+10¢
Chicago rail	+3Z	+8Z	+5¢
KC rail	+3Z	+15Z	+12¢
Columbus OH	-0- Z	+27Z	+27¢
Cincinnati OH	-5Z	+9Z	+14¢
E. Iowa processor	-6Z	-15Z	-9¢
Dubuque IA	-11Z	-10Z	+1¢

narrow, for example. For those not inclined to arbitrage-trading, basis in the outlying areas is high enough to justify selling outright for logistics or to *reduce* total ownership. Central areas can move more slowly to let basis catch up.

BEAN BASIS

Harvest is mostly over, futures are steeply inverted, and basis for nearby shipment is generally high. Short-term the basis can certainly remain strong or rise further, but be cautious and watch for opportunities to liquidate ownership! The inverses argue against holding inventory basis ownership *long-term* and argue for being short basis with DP. For example, a +10 Jan sale (at any market) equates to +29 July today. Add about 20¢ for the value of money and the basis will have to be almost +50 July in that market by June, just to break even if you hold ownership. We also recommend getting some of your long hedges out into forward futures months as you get short DP.

ORIGINATING FARM-STORED GRAIN

Basis is high for both corn and beans in many markets. Corn futures carries are narrow and bean futures are sharply inverted. Even though it's early in the crop year, this allows you to offer farmers some attractive 'paper' alternatives to holding grain in farm storage. For example, January bean futures are around 18¢ over July futures at this writing. Your customers might find basis contracts Vs. July with a basis level 18¢ higher than the current basis Vs. January futures very tempting. In many areas, it pencils to offer 'better than free' DP (deferred pricing) by absorbing some freight, making advances, or even offering negative charges in the form of premiums for beans not priced until the spring or summer. The corn price structure doesn't allow origination programs that are as aggressive as for soybeans. Still, cheap, or even free, DP can be justified in some markets. That should be attractive to some farmers, especially if they have quality concerns.

NATIONAL GRAIN & FEED

NGFA's annual Country Elevator Council meeting will be held in St. Louis this year, December 8-10. This conference is always well worth attending. Non-members are welcome also; check www.ngfa.org or call NGFA at 202-289-0873. A few of the agenda topics include:

- Federal v. state warehouse/dealer regulation
- Post-Enron accounting changes
- New trends in cash grain contracts

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"Do something every day that you don't want to do; this is the golden rule for acquiring the habit of doing your duty without pain." - Mark Twain