

Wheat Outlook – Good Prices but Likely Softening

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The Colorado wheat market rallied to within a nickel of \$8/bu in 2011 – this was a monthly average price received by farmers and not a small number of daily transactions. Can the market repeat that in 2012 or 2013? It is unlikely. Wheat stocks are ample and the crop, while problematic in some regions of the state and country, will likely be decent. World stocks and future supplies also look good. Any strength in the wheat market will be due to spillovers from a strong corn market or some other unforeseen surprise impacting world grain markets.

Wheat prices in 2011 were typical for a grain market facing uncertainty and the threat of a short crop. There was much dry weather in Eastern Europe and Western Asia wheat growing regions over last winter. The events were troubling enough that the Russian government prohibited wheat exports. As is typical in grain markets, when there is a short crop or threat of tight supplies the market price increases to ration supplies among the users that need the product the most. This process was complete early in 2011 and the wheat market has been softening since harvest. The U.S. corn market then experienced the same type of event. There was much uncertainty over the size of the corn crop through the summer 2011 growing season and the market rallied substantially as the strong demand had to compete for bushels of the potentially limited crop. This price strength in the corn market added some strength to the wheat market through the summer and fall.

We start 2012 with many of the same supply and demand conditions as this time last year. The difference is that the most likely factors to impact wheat markets are not as strong. And there are also some new wrinkles that will make 2012 different from 2011. Last winter's La Nina weather pattern was considerably stronger than the winter of 2011-12. The La Nina persists but the U.S. southern plains have seen some rainfall. Not enough to recover from drought but enough to potentially grow a wheat crop. Similarly, the northern plains and Cornbelt states have not seen the normal La Nina heavy rainfall or snow and are relatively dry. Worldwide, the wheat growing regions have seen good precipitation. Australia has seen too much moisture but Eastern Europe and Western Asia are in reasonable shape. There is some concern about strength of the winter and potential losses but dryness is not the concern like last year. Dry weather does persist in the oilseed growing regions of South America – another normal La Nina result. All of this news most likely leads to an ample world wheat crop but lingering concerns about feedgrains and oilseeds. It is our impression that wheat markets will be under much pressure this year – and possibly next – to move to lower prices. However, there will be support for wheat prices due to volatility and uncertainty in other major grain crops. There will also likely be increases in the feeding of wheat that will mainly be limited by volatility spillovers from other markets.

2012 will be an interesting wheat marketing year for Colorado – of the unfortunate kind. The dry weather last winter in Kansas, Oklahoma, and Texas allowed cash prices in those regions to move up strongly relative to futures. We had hoped to see this basis improvement extend into Colorado. But it has not happened. The more-or-less normal wheat crop in the hard red winter

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wheat states has stopped the improvement of cash prices relative to futures prices. Colorado merchandisers appear to have a wait and see attitude as there is plenty of wheat. This attitude and continued weak Colorado basis will not change if the crop continues to be normal. Only if there is more pronounced dry weather and a significant crop shortfall will cash prices return to improving relative to futures prices.

Given the market events we have seen the past years with wheat, a bit of a recap is worthwhile. It is important in seeing how the market for 2012 and 2013 has changed and will be different from three to five years ago. So what has happened over the past years to make the wheat market do what it has done? World wheat stocks have historically varied between 25-35% of consumption from 1975 through 2002. Stocks-to-consumption of 35% was ample wheat while 25% were tight. However, starting with the 2003/04 crop year world stocks-to-consumption fell below 24% and that decline continued until during the 2007/08 crop year when world stocks fell to a record low of 20% of consumption. This was the main cause of the record high wheat prices in early 2008. It can also be argued that prices were too high because of speculation. This is especially the case in the more thinly traded wheat contracts. Regardless, the market was also in a panic and priced wheat accordingly. However, the USDA World Agricultural Supply and Demand Estimates (WASDE) report reveals the dramatic recovery in 2008/09 and 2009/10. In two years, world stocks increased from 20% to 31% of consumption. That was a phenomenal increase and was due to record high production in wheat growing countries. World use was also record high but the use increases were far less than production increases. 2010/11 or 2011/12 did not continue that trend of increasing production but world stocks have maintained 31% of consumption. For the last three crop years the world stocks-to-consumption level is as high as it has been for the last ten years.

For the crop year of 2011/12, the February 9, 2012 USDA WASDE reported U.S. wheat production was estimated to be 2.0 billion bushels, down from the prior two years of approximately 2.2 billion bushel crops each. Domestic consumption for this 2011/12 crop year is estimated at 1.2 billion bushels, very much inline with the prior two crop years. Exports for 2011/12 are estimated to be 975 million bushels, down 26% from the prior year and up 8% from 2009/10. As a result, U.S. stocks this year are up slightly from the prior year but down 11% from 2009/10. Regardless, this is still a 41% stocks-to-use ratio – ending stocks are 41% of domestic use and exports for the crop year – which are very ample supplies. The WASDE reported 845 million bushels of ending stocks for 2011/12, this is up from 862 million bushels in 2010/11 but down from 976 in 2009/10. The U.S. stocks-to-use ratio is 41% and this is up from 36% last year. Wheat production and use in the U.S. has not paralleled the world conditions. The U.S. has planted fewer acres to wheat over the past 20 years while worldwide the production and consumption grows solidly. Use for the U.S. crop has historically been for export but the share for domestic use has expanded while exports have been trending down. The higher wheat prices of late did encourage planting of wheat. The 2008/09 crop year saw over 63 million acres planted to all wheat, 2009/10 had over 59 million acres, 2010/11 saw almost 54 million acres, and 2011/12 had more than 54 million acres. The strong prices since 2006 have encouraged planting but mainly to the extent of stopping the decline in acreage. We will have to see if the strong market, and the weak dollar, affect these trends in exports and acreage.

The USDA Winter Wheat Seedings report was released on January 12, 2012 and estimated 41.9 million planted acres. We were expecting more acres with the high prices and were not surprised by the increases. Winter wheat seedings were 3% above last year and 12% above the year before. With this increase in winter wheat plantings, and if we see comparable increases in spring wheat plantings, then the forecasts for all wheat is reasonably 57-59 million acres. Colorado planted 2.4 million acres to winter wheat for the 2012 crop, 4% above last year but 2% below the year before. Acres in Kansas, Oklahoma and Texas were up 8%, 8%, and 11%. Of the 18 largest wheat growing states only North Carolina also increased acreage – up 14%. All other large states showed decreases. Colorado has for the most part followed the rest of the nation in wheat production trends. Acres have declined but appeared to be leveling off at 2.0-2.5 million acres, and it may be that declining trend has stopped. The high prices over the past five years have encouraged wheat planting. Colorado wheat production was 81.8 million bushels in 2011. That was 20% below the two phenomenal years of 2010 and 2009. But 2001 saw the fourth largest harvest in the past 12 years. Average yields were 40.0 bushels per acre in 2011, 45.5 in 2010 and 40.6 in 2009.

The U.S. and Colorado winter wheat crop in the field is facing challenges. As of November 28, 2011, the USDA Crop Progress report showed 100% of Colorado's winter wheat crop had been planted and 99% had emerged. In the fourth week of November, 7% was in excellent condition, 43% was good, 40% was fair, 9% was poor, and 1% was in very poor condition. The Colorado crop is not in great condition but is substantially better than last year. The conditions in the 18 largest wheat producing states were: 7% in excellent condition, 45% good, 35% fair, 9% poor, and 4% in very poor condition. This year's national crop condition is very comparable to last year. The crop in Texas is in the worst shape. Crops that are in the high plains are in the poorest condition. Kansas and Oklahoma wheat crop conditions were comparable but a little better than Colorado. Crops in the Corn Belt and west coast were in the best condition.

USDA Crop Progress reports will be issued again April 2, 2012. Wheat crop conditions will be reported then and we will see how dry the winter was. The USDA Prospective Plantings report will be issued March 31, 2012 and then we will know estimates of acres planted to spring wheat. Accurate forecasts of acres and yields will be difficult until the winter and spring weather is observed and we see these reports. Until then, what we have for forecasts indicate an increase in acres, and yields comparable to the last two year's better-than 40 bushel per acre average, with U.S. production returning to the 2.2 billion bushel level. Forecasts also suggest a slight increase in domestic food use, increased feed use, and stronger exports. The weak U.S. dollar has the potential to increase exports but the world does not appear to be hungry for them. All of this translates into increasing stocks for the 2012/13 crop year.

Reasonable forecasts for the U.S. suggest 2012/13 ending stocks between 850 million and 1.1 billion bushels. With the lower of the two stocks numbers, a \$7.00 per bushel wheat price is forecast, and with the higher ending stock number, a \$5.75 per bushel price is forecast. It is likely that the historical relationship between corn and wheat will hold these wheat prices up but that the supplies in Colorado as well as abundant U.S. stocks will limit what buyers have to pay to secure Colorado wheat.