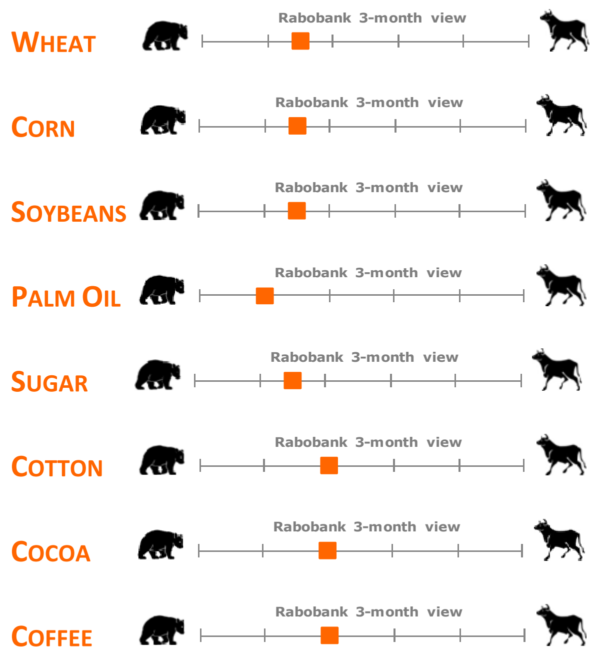
Agri Commodities Market Research

Rabobank Agri Mail – Where to for markets this week?

06 July 2011

The grain and oilseed markets are likely to show a modest recovery after the strong price reaction to the bearish USDA data released the previous week. We believe the sell-off, particularly for corn, was overdone and the lower prices will spur an increase in end-user demand. However, the correction likely marks an inflection point where the grain and oilseed complexes begin a seasonal shift lower. It is likely the USDA will make only modest revisions in next week's WASDE as it adds the new acreage data and partially adopts the Quarterly Grain Stocks report data. We anticipate only a modest increase to global ending stocks — which will differ from the outlook in 2008 — preventing the same massive decline in prices seen then.

	Commodity Price US¢/bu	6 Jul	28 Jun	% WoW	% YTD
Grains	CBOT Corn	669.0	683.0	-2.05%	6.36%
	Matif Wheat (€/Mt)	188.3	195.0	-3.44%	-21.71%
	CBOT Wheat	607.5	640.3	-5.12%	-23.51%
	Minni Wheat	862.0	839.0	2.74%	-2.21%
	KC Wheat	711.5	743.8	-4.34%	-16.39%
Oilseeds	CBOT Soybeans	1329.5	1330.8	-0.09%	-4.61%
	CBOT Bean Oil (lb.)	55.2	55.3	-0.29%	-4.43%
	CBOT Bean Meal (USD/T)	341.1	338.9	0.65%	-7.89%
	MDEX Palm Oil (MYR/Mt)	3039.0	3083.0	-1.43%	-20.32%
	Matif Rapeseed (€/Mt)	455.0	438.8	3.70%	-8.50%
Softs	Cotton No. 2	159.8	160.9	-0.72%	10.32%
	Sugar No.11	27.5	29.3	-6.01%	-14.32%
	Sugar White	770.9	764.8	0.80%	-0.85%
	Coffee Arabica	265.8	257.9	3.04%	10.50%
	Coffee Robusta	2430.0	2455.0	-1.02%	16.71%
	Cocoa (ICE)	3190.0	3018.0	5.70%	5.11%
NYMEX Energy	WTI Crude Oil (USD/bbl)	96.9	92.9	4.34%	6.06%
	Brent Crude Oil (USD/bbl	113.4	108.8	4.21%	19.67%
	Heating Oil US¢/gal	297.5	284.2	4.70%	17.02%
	US Dollar Index	75.0	75.1	-0.13%	-5.14%

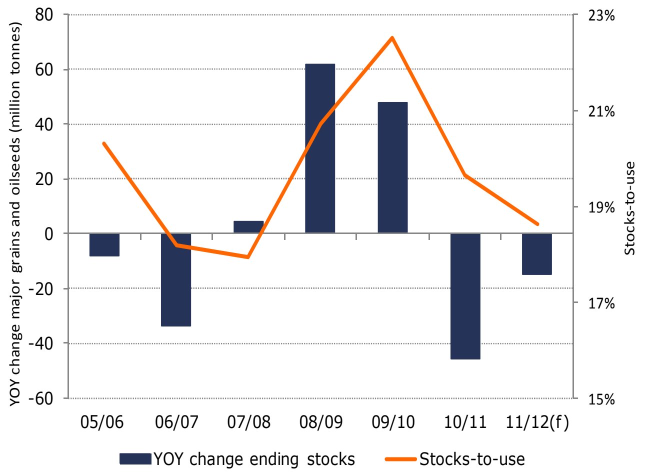


Source: Bloomberg, Rabobank

The current rally in ag commodities as measured by the S&P ag index is shadowing the 2007/08 rally

Source: Bloomberg, Rabobank

However, ending stocks of major grains and oilseeds are expected to decline for a second consecutive year in 2011/12



Source: USDA, Rabobank

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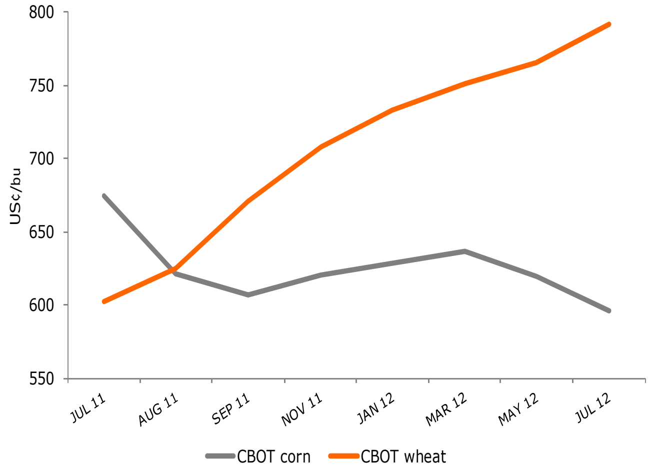
Grains

Wheat

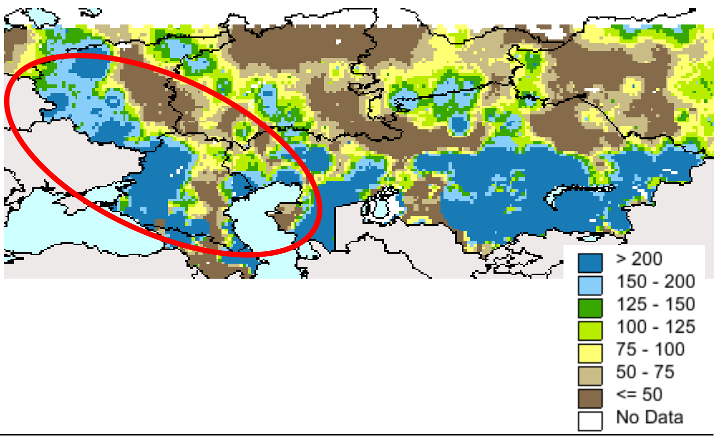
- A recovery in corn prices is likely to add support to wheat prices despite increasingly bearish fundamentals. Nearby CBOT wheat futures are now trading at an unprecedented USD 0.72 per bushel discount to nearby CBOT corn prices.
- Aside from corn's influence, a combination of harvest pressure and bearish USDA data gives wheat markets little reason to rally. The USDA reported wheat stocks 35 million bushels above trade estimates at 861 million bushels. Planted area was roughly in-line with trade estimates at 56.4 million acres.
- While the USDA reported total US wheat plantings 5% higher YOY at 56.4 million acres, Durum wheat was reduced to 1.7 million acres. This is a 50-year low and will likely continue to support the premium of Minneapolis wheat over CBOT wheat which is currently trading in excess of USD 2.50 per bushel.
- Harvest pressure and cheap Russian wheat is also adding to the bearish sentiment. The expiration of Russia's export ban on 1 July has been met with lacklustre demand and is further depressing Russian prices as their harvest begins. However, world markets will continue to closely monitor the situation in Russia as rains are causing harvest delays.
- Wheat harvesting in the EU is also under way with a wide range of yield reports coming in for France. We believe a YOY decline in EU wheat production is already priced into the market, however the return of a dry weather pattern to Western Europe could cause further yield damage.

CBOT corn prices continue to widen their premium to CBOT wheat prices at the front end of the futures curve



Source: Bloomberg, Rabobank

Rainfall in parts of Central and Southern Russian has been upwards of 200% the normal amount — causing harvest delays



Source: USDA, Rabobank

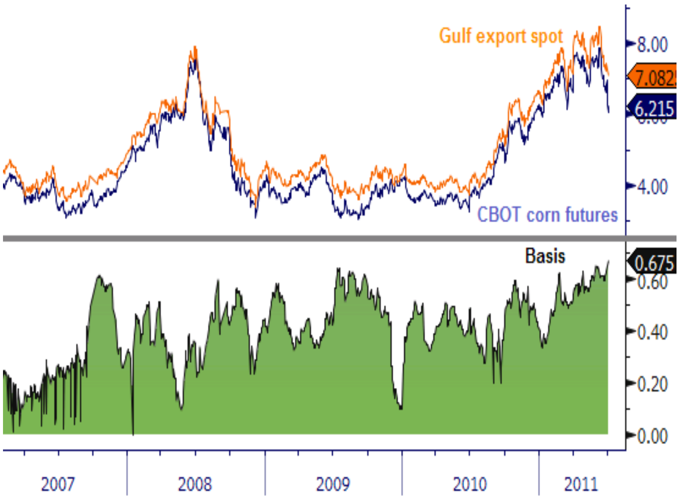
Corn

- While we maintain our view that CBOT corn prices have reached their high for the year, we believe last week's sell-off due to bearish USDA data was overdone. We expect corn prices will recoup some of last week's losses but struggle to push above USD 7.00 per bushel.
- The USDA continues to feed the market volatile quarterly grain stocks reports, causing violent CBOT corn price movements — in last week's case, it was a USD 0.69 per bushel loss in nearby CBOT corn.
- The initial bearish market reaction pushed the July contract (aided by no daily limit) sharply lower than the September contract and reduced the spread to the December contract to only USD 0.08 per bushels. However, these spreads have widened significantly in subsequent trading sessions as the market has digested the questionable USDA data and ending stocks remain low.
- The surprise to the market was USDA's Quarterly Grain Stocks and Acreage estimates which were well above even the highest trade estimate. Their report of 3.67 billion bushels of quarterly corn stocks implies feed and residual in March-May fell to the lowest level in more than 30 years. Animal numbers during the quarter would suggest otherwise, with March-May cattle on feed 5% higher YOY, broilers placed for meat production up 1.4% YOY, and 350 thousand more hogs and pigs in inventory YOY.
- Last week's US corn export sales reached a 5-week high of 692,000 tonnes, and we estimate ethanol production margins have been positive for 3 consecutive weeks. Basis levels continue to strengthen, which likely signify another week of

increases in ethanol production and export sales. Already Egypt has booked 120,000 tonnes of old crop corn and South Korea has purchased 225,000 tonnes of new crop corn. Furthermore, there are rumours that China has secured upwards of 1.5 million tonnes.

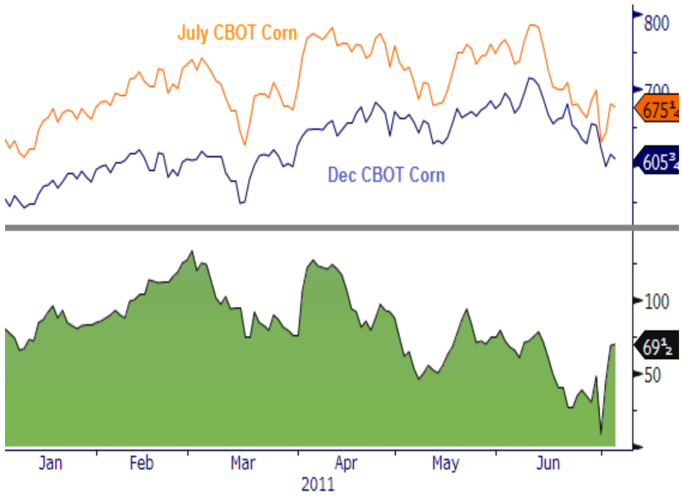
- Tempering the increased demand is improved US crop conditions and higher than expected Brazilian corn production. The weekly USDA crop progress report showed corn conditions improved 1% as of 3 July to 69% good/excellent — as compared to 71% last year. Furthermore, Conab unexpectedly increased their forecast for Brazil's corn production from 56.7 million tonnes in their June report to 57.1 million tonnes.

US corn export basis values continue to strengthen, reaching USD 0.68 per bushel — the highest level in at least 5 years



Source: Bloomberg, Rabobank

After a brisk sell-off, the premium of old-crop to new-crop CBOT corn prices is rebounding



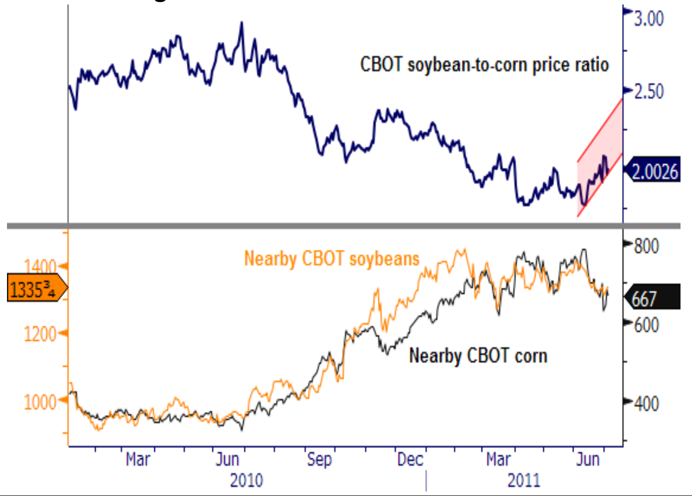
Source: Bloomberg, Rabobank,

Oilseeds

Soybeans

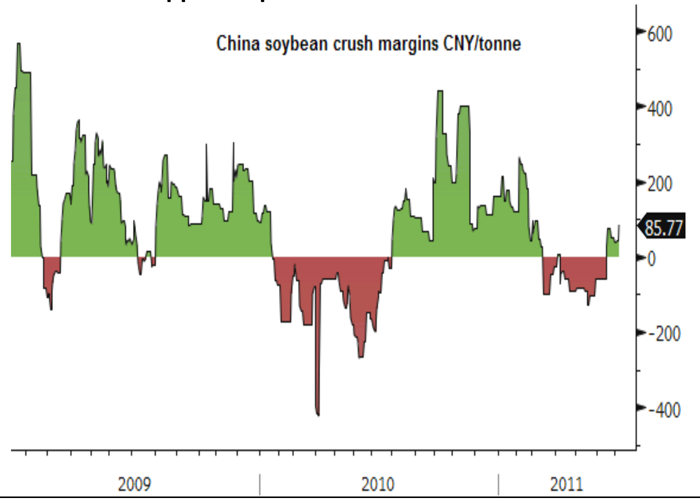
- We expect soybean prices will continue to find support this week from the USDA's report of lower than expected planted area. This will place an increased focus on weather and yield developments in coming weeks and continue to keep CBOT soybeans trading range-bound above USD 13.00 per bushel.
- According to the USDA's weekly crop progress report, US soybeans were 66% in good/excellent condition as of 3 July. This is in-line with last year and above the 5-year average of 63%. However, only 8% of soybeans are blooming which is 15% below last year and 17% lower than the 5-year average. Given the 2.2 million acre YOY decline in planted area to 75.2 million acres.
- On the demand side of the ledger, signals are mounting that China's imports will continue to show YOY increase as crush margins have recently turned positive.
- We expect the USDA will lower 2011/12 soybean ending stocks in next week's WASDE — reaffirming the importance of fundamentals in soybean price direction.

The ratio of nearby CBOT soybean to corn prices is likely to continue rising from the record low levels



Source: Bloomberg, Rabobank

A rebound in China's soybean crush margins will likely continue to support export demand

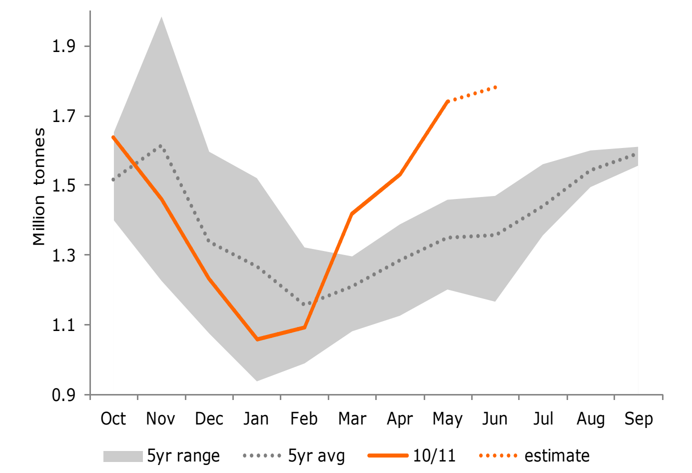


Source: Bloomberg, Rabobank

Palm Oil

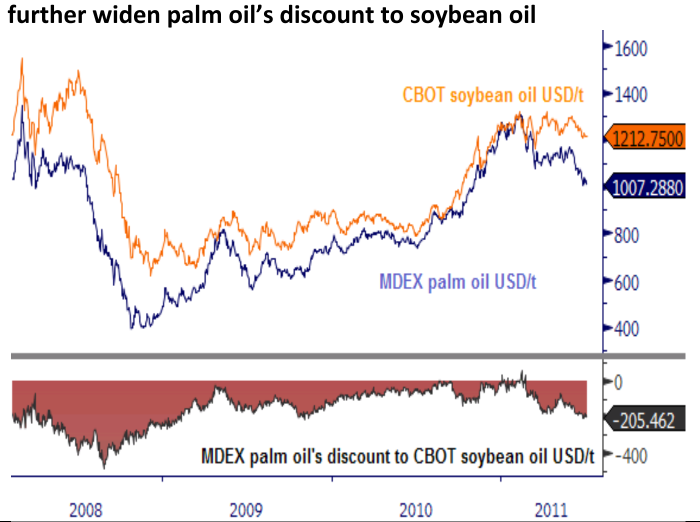
- MDEX palm oil prices are likely to see further downside leading into next week's data release from the Malaysian Palm Oil Board. The trade anticipates production increased YOY for a 4th consecutive month in June to 1.78 million tonnes. It is also expected that stocks rose 5.8% from May to 1.78 million tonnes in June.
- While this may weigh on palm oil prices in the short term, low global availability of alternative vegetable oil stocks are forecast to increase palm oil demand in the medium term.
- As record high palm oil production comes online we expect palm oil's current discount to soybean oil — which is now in excess of USD 200 per tonne — will likely continue to widen.

Market expectations for a 28% YOY increase in Malaysia's June palm oil production will weigh on prices this week



Source: Bloomberg, MPOB, Rabobank

Rising palm oil production and tight soybean stocks will likely further widen palm oil's discount to soybean oil



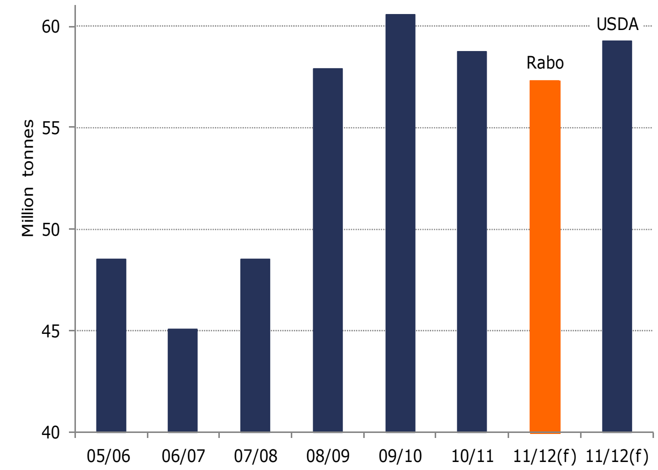
Source: Bloomberg, Rabobank

Rapeseed

- Matif rapeseed prices are likely to push higher this week as production concerns mount in Europe, Ukraine and Canada.
- Due to the continued tight outlook for Europe's rapeseed balance sheet, Matif rapeseed prices fell less than 2% during the bloodbath caused by the USDA's data release. We believe global rapeseed production will decline by more than 1 billion tonnes YOY versus the USDA's forecast of a 0.5 billion tonne increase.
- We anticipate rapeseed prices will continue to find support, as the market has yet to fully price in lower than-expected-rapeseed production in Ukraine, Europe and Canada. In our view, actual area planted in Canada will be lower than

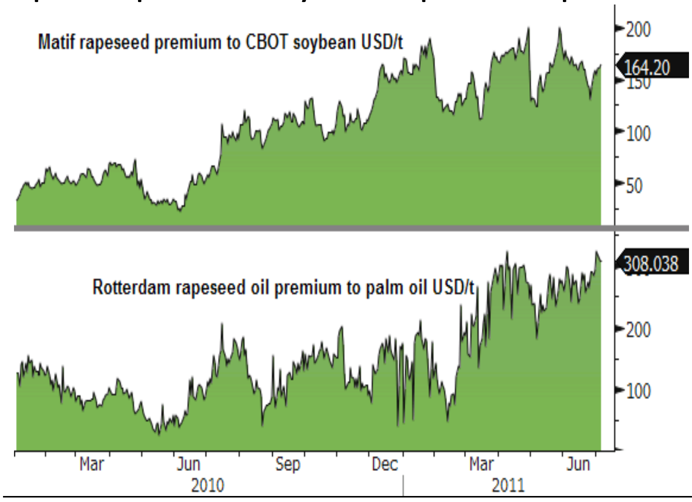
Statistics Canada's estimated 3% increase due to the excessive flooding. We maintain our forecast for YOY reduction in yields for Ukraine due to recent excess moisture and for Western Europe due to persistent dryness.

We forecast global rapeseed production will decline more than 2% YOY versus USDA's forecasted 1% increase



Source: USDA, Rabobank

As the market prices in production shortfalls, we expect rapeseed's premium to soybean and palm oil will persist



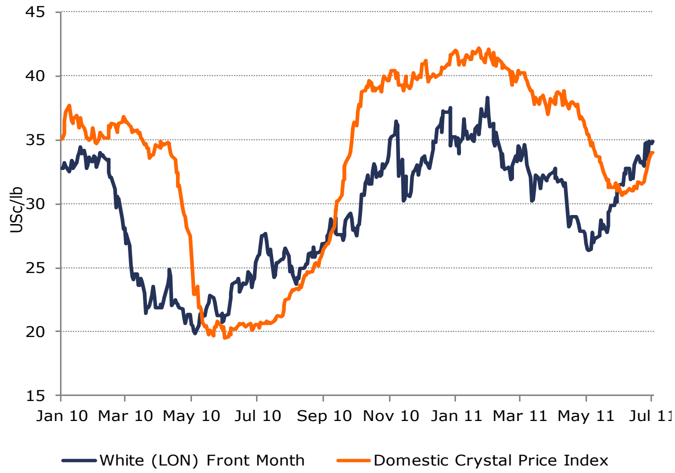
Source: Bloomberg, Rabobank

Softs

Sugar

- The sugar markets have maintained upward momentum even after the July contract came off the board as concerns about Brazil production and port congestion prompts fund buying and user short covering. The bullish dynamics in the market are viewed as short term; prices should be poised for a correction lower.
- Speculator buying support continues, with the managed money net long position increasing 63% from 17 March to 28 June. The rapid expansion of the long positions suggests much of the rally is spec based and could therefore contract just as fast.
- The Brazilian Centre/South crush is 25% behind the previous season's progress according to UNICA; the lower production is the central factor in helping prices on the NY market rally 34% in two months. The new UNICA production figures, expected in the coming weeks, will likely dictate the further direction of prices. if the forecast is higher than expected the rally could be stopped dead, while if the figures are a bullish surprise raw sugar prices could be expected to pass the 30 USc mark. In our view, much of the production shortfall has already been priced into the market.
- The Brazilian domestic sugar price, as measured in the CEPEA crystal index, has now passed the London front month white futures contract: a sign that producers are more interested in the export market due to higher international prices.
- China is expecting a large influx of sugar cargoes in the coming weeks after coming on the market to buy in May when international prices were lower. The buying spree has played a role in the port congestion in Brazil, where some waits are at two-year highs.
- The high international price for raw sugar has encouraged more selling, with the state run Thai Cane & Sugar Corporation planning to auction off 120,000 tonnes of raw sugar. The rally is also likely reducing international demand: a sign that prices could be headed lower soon.

Crystal sugar prices in Brazil have passed the international white price as processors focus on the export market



Source: Bloomberg, Rabobank

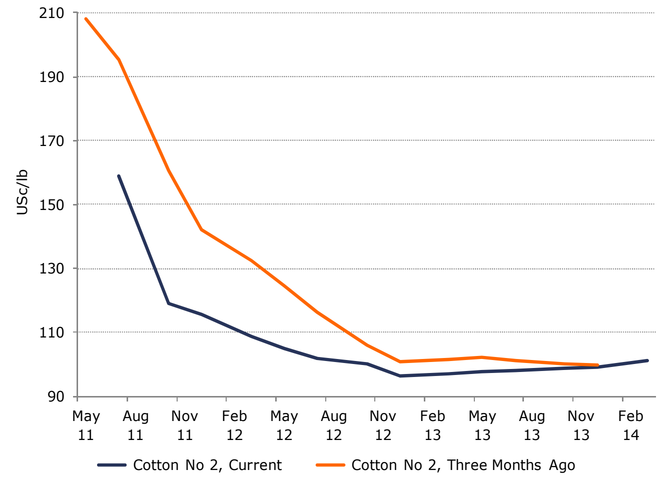
The managed money net position has risen with the raw sugar price suggesting specs helped drive the rally

Source: Bloomberg, Rabobank

Cotton

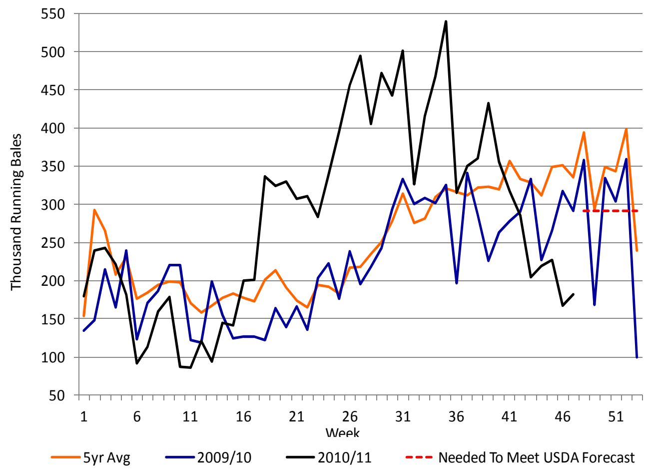
- Cotton prices are correcting lower and are expected to continue to fall due to lower demand expectations and new crop supply forecasts.
- Demand loss due to high prices and fears about global economic growth is the focal point of the market and will likely remain so. Cancellations are still occurring and US exports have fallen greatly in the past month. It is true the US has little cotton to sell, and cancellations are likely a function of this, but global consumption expectations look uninspiring.
- While the market has a bearish outlook, upside risks remain, given the thin global stocks and production concerns in the two largest exporters. There are reports of delayed plantings in India due to reduced rainfall and the US crop is in poor condition. Prices could be supported if these situations worsen.
- The front end of the forward curve has fallen in the cotton ICE market, while the back end remains elevated above historic averages; higher prices are needed in order to encourage production to restock greatly diminished inventories. We see prices falling into next season, but finding a support level near 100 USc/lb.

The cotton prices at the front end have fallen off but values further down the curve remain supported



Source: Bloomberg, Rabobank

Cotton exports from the US have dropped far below the pace needed to achieve the USDA's export forecast for 2010/11

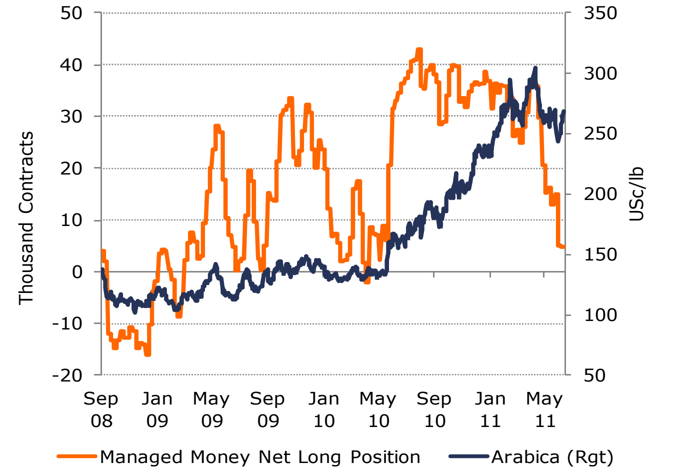


Source: USDA, Rabobank

Coffee

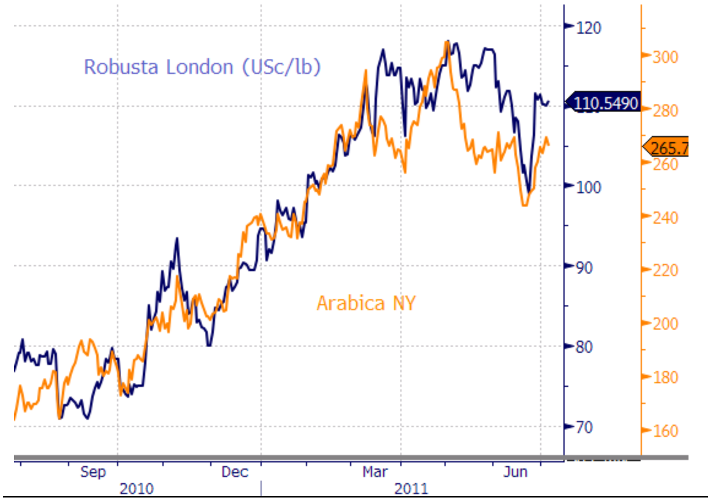
- The coffee futures markets were the top performers in the commodity space in the previous week as fears of frost in Brazil provoked short covering and speculator buying. Prices were moving lower before the frost concerns, and we forecast them to resume that trend and to ease into the start of the 2011/12 season.
- Upside risks remain in the market as ending stocks for 2011/12 are expected to be notably low, if production disruptions do occur funds could become buyers again; the speculators have decrease their net long positions significantly in the past two months, and could rebound quickly
- The Robusta market continues to be supported by a lack of available supplies in number one producer Vietnam, and while the new season's harvest looks large, the picking will not likely begin until November. With much of the beans concentrated with one entity, prices will be supported in the short term.

The speculative net long position in the NY coffee market is at a low level and could increase quickly



Source: Bloomberg, Rabobank

The coffee markets trended lower in May and June but frost fears have resulted in a turnaround

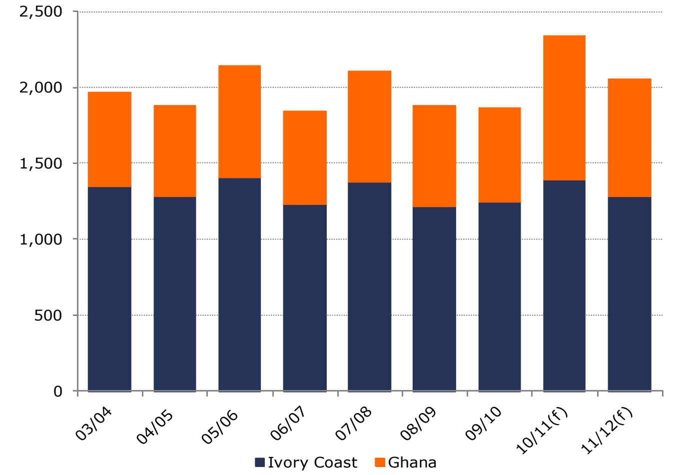


Source: Bloomberg, Rabobank

Cocoa

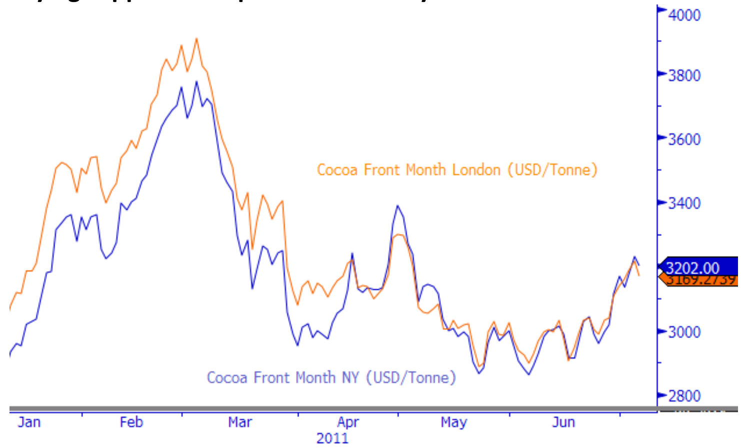
- The cocoa market continues to be influenced by large nearby supplies and production concerns about the coming main crop. While there are indications the 2011/12 crop could be much smaller than the current season's output, resulting in a major upside risk possibility, we still believe current prices are high for the amount of beans readily available. Values on the NY and London markets should ease in the new quarter.
- As an illustration of just how large the 2010/11 West African cocoa crop is, the state cocoa bean buyer of Ghana is reported to have said output in the season will reach 1 million tonnes, the most ever and an increase of 61% from the previous season. This sizable crop comes at a time when demand growth is forecast to be slow.
- Supporting values all along the curve are reports of disease in Indonesia and West Africa. The 2011/12 crop in West Africa is widely expected to be lower than the current season's bumper harvest, suggesting tighter supply, but this is relative, considering the very large surplus forecast for 2010/11.

Cocoa bean production in 2010/11 is forecast to reach record highs in West Africa, but fall in 2011/12



Source: Rabobank, ICCO

Cocoa prices on the terminal markets have been moving higher as buying support and speculator activity boost values



Source: Bloomberg, Rabobank

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