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Wheat Prices Peaking as Glut Subdues Best Performer (Update1)  
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(Updates percentages in second paragraph.)

By Tony C. Dreibus

July 19 (Bloomberg) -- The five-week rally in wheat that made it the best performer of any commodity is under threat as prospects for the second-biggest stockpiles in almost a decade overwhelm damage caused by drought.

Wheat rose 38 percent to \$5.92 a bushel in Chicago since June 9 as a lack of rain in Russia, Kazakhstan and the European Union and floods in Canada hurt crops. That prompted the U.S. Department of Agriculture on July 9 to cut harvest estimates by 1.1 percent, while global inventories will be the second-highest since 2002. Prices will drop 17 percent to \$4.94 by Dec. 31, based on the median in a Bloomberg survey of 14 analysts.

"I don't think prices will hold these higher levels," said Pete Sorrentino, who helps manage \$13.1 billion at Huntington Asset Advisors in Cincinnati and correctly predicted the 2008 crash in commodity prices. "We're going to be getting some massive harvests, and that's going to keep stockpiles swelling."

The 50 percent jump in stockpiles from a quarter-century low in 2008 shows there's little chance of a return to the record \$13.495 reached that year and the food riots that erupted from Haiti to Egypt. The world's poorest nations will spend 37 percent less on cereal imports this year than at the peak, according to the United Nations, whose food-price index has fallen 24 percent from an all-time high in June 2008. Cheaper wheat may boost profit for Kellogg Co., the largest U.S. cereal maker, and General Mills Inc.

#### Russia Drought

Prices rallied from a three-year low of \$4.255 on June 9 as drought and flooding damaged crops. Russia, the world's fourth-largest exporter, declared emergencies in 17 regions by July 15, and Canada said July 9 it would pay as much as \$432 million to farmers hurt by floods, the biggest aid package ever under the country's AgriRecovery disaster-relief program.

While output may be lower than originally estimated, stockpiles will still reach 187 million metric tons by the end of the season in May 2011, the USDA estimates. That's 62.6 million tons more than in 2008 and equal to three years of production in the U.S., the world's biggest exporter.

"There are very plentiful stocks," said Christin Tuxen, an analyst at Danske Bank A/S in Copenhagen who was the most accurate first- and second-quarter forecaster surveyed by Bloomberg. "U.S. crop progress has been good, which suggests there might be some further downside for wheat." Tuxen expects prices to drop as low as \$4.25 before the end of the year.

## Speculator Holdings

Speculators including hedge funds also are still betting the rally will end. Their net-short position, or wagers on lower prices, on the Chicago Board of Trade fell 52 percent in the week ended July 13 to 16,927 contracts, U.S. Commodity Futures Trading Commission data show. Speculators have held a net-short position since June 2009.

Wheat's surge since June 9 is the biggest in the Standard & Poor's GSCI Index of 24 commodities. The gain topped corn's 19 percent advance and is more than three times the 9.8 percent jump in soybeans. The S&P GSCI Total Return Index, tracking the net amount investors received, advanced 2 percent over the same period. The gauge slumped 46 percent in 2008, the worst crash since at least 1970.

For now, traders are focused on production rather than stockpiles. Wheat futures traded on the CBOT jumped 9.2 percent last week, the biggest gain since November, after drought worsened in Russia and lower grain output was forecast in Kazakhstan, Germany and France. All the countries are exporters.

Wheat rose 0.8 percent to \$5.92 as of 8:27 a.m. in London.

Futures are pricing in \$6.73 by the end of 2011, exchange data show. The December 2011 contract traded at \$5.80 about five weeks ago, indicating some traders expect drought and flooding to tighten supply through the end of next year.

## No Crop Benefit

While rain is forecast to return this week to France, Europe's biggest wheat producer, it may do little to bolster yields.

"The rain has come too late," said Sebastien Poncelet, a consultant at Paris-based farm adviser Agritel. Ripe grain soaks up moisture like a sponge, yielding less flour, he said.

In the U.K., "the last thing we want now is solid rain in the last week of July and first two weeks of August," said Gary Sharkey, the head of wheat procurement for St. Albans, England-based Premier Foods Plc, the U.K. maker of Hovis breads. "That would obviously delay the harvest but would also ruin the quality."

Production in other countries may help offset the declines in parts of Europe and Canada, said Dale Mohler, a senior meteorologist who specializes in agriculture forecasts at Accuweather.com in State College, Pennsylvania.

## Bigger Harvests

"Ukraine is going to have a decent crop," Mohler said. "It's been too wet, and that slowed down the initial harvest. That looks like it's going to improve. Farmers will be able to harvest and they'll have good yields because of the rains."

The U.S. crop will be bigger than originally anticipated, the USDA said July 9, raising its estimate 7.2 percent to 60.3 million tons. Domestic stockpiles will total 29.8 million tons in the year that ends in May, 12 percent more than a year earlier, the USDA estimates.

Wheat was the fourth-biggest U.S. crop behind corn, soybeans and hay last year, valued at \$10.6 billion, government data show.

Yields are improving in Kansas, the biggest U.S. producer of winter wheat, the most common variety grown in the country. In the northwest part of the state, yields may reach 60 bushels

(1.63 tons) an acre, said Darrell Holaday, the president of Advanced Market Concepts, a commodities consulting and brokerage firm in Wamego, Kansas. In May, analysts, growers and agronomists had expected 40.7 bushels an acre after touring fields in the state.

#### Bulging Silos

Silos are filling up in some areas, forcing growers to cover harvested crops with plastic tarps.

"They're storing wheat on the ground in northwest Kansas, and they're not done yet," Holaday said.

Production in Australia may rise about 2 percent to 22.2 million tons, Commonwealth Bank of Australia forecast this month. Output is rebounding after droughts in 2007 and 2008. The USDA expects bigger harvests in Argentina, Brazil and the European Union.

Global stockpiles are equal to about 28 percent of consumption, USDA data show. Any figure above 25 percent means a "limited" potential for a shortage, said Mike Zuzolo, the president of Global Commodity Analytics in Lafayette, Indiana.

"The second half of the year will still be mired by surplus stocks," said Abah Ofon, an analyst at Standard Chartered Bank Plc in Dubai who expects prices to drop to \$4.30 before the end of the year. "That is going to put a cap on how far prices can actually go."

#### Profit Boost

Lower prices may help to bolster profit for cereal makers. Kellogg, based in Battle Creek, Michigan, will report earnings per share of \$3.58 this year, compared with \$3.16 last year, according to the mean of nine analyst estimates compiled by Bloomberg. The stock has fallen 4 percent this year in New York trading. General Mills, which produces Golden Grahams cereal, will post earnings per share of \$2.49 in its fiscal year ending in May, up from \$2.24 a year earlier, based on eight estimates.

The stock rose 0.4 percent this year in New York.

The price of wheat "could drop as fast as it's gone up," said Alexandre Marie, a grain analyst at Bourges, France-based Offre et Demande Agricole, which advises about 5,000 farmers.

"The market is looking first and foremost at production levels, but forgets that behind it are enormous stocks of wheat in the world."

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