

2009 HARD RED SPRING CROP ABOUT ONE PERCENT LOWER IN PROTEIN LEADING TO ECONOMIC HIT FOR PRODUCERS

The 2009 Hard Red Spring wheat crop is averaging 13.7 percent protein, based on the first half of the harvest testing in the NDSU Spring Wheat Quality Survey. This is almost a full 1 percentage point lower than the traditional level. Market adjustments and discounts for lower protein are leading to significant economic hits for producers. According to Byron Richard, NDGGA President, discounts have been as large as \$1 per point of protein below 14 percent. "Some of the low protein wheat is valued at less than \$3.00 per bushel and this is a huge economic hit for producers who planted this crop under very high input costs. Even with near record yields, the current prices and discounts are putting many producers in a situation where they could lose money on this year's wheat crop," he says.

The Minnesota Wheat Research and Promotion Council, the North Dakota Grain Growers Association and North Dakota Wheat Commission are working to find near term demand for the lower protein wheat. In the meantime storage options and the FSA loan program may buy sometime for producers as the market adjusts to this year's harvest realities.

Current discount schedules are largely a market function as it tries to balance the non-characteristic oversupply of very low protein hard red spring wheat with demand. With this year's above average yields and lower average protein content there is not sufficient near-term demand for hard red spring wheat below 13 percent protein. The typical demand base is for protein nearer to 14 percent or higher, and most years that is what is produced in the region. The normal role of HRS is to strengthen mill blends with higher protein and gluten strength than is available from other production regions. That is what the wheat the market is looking for at harvest. Discounts have widened in an attempt to slow the movement of low protein wheat, until the market adjusts to current harvest realities.

This year's lower protein levels are due to the cooler than normal summer temperatures and strong crop yields being harvested in much of the region. The region may set a new average yield record this year with some analysts expecting final yields to average in the upper 40 bushel per acre range, well above the record of 43 bushels per acre set in 2004. Wheat protein and yields are inversely related, although the relationship varies by variety. Some varieties have the genetic capability to produce higher proteins and better milling and baking quality traits sometimes with lower yield potential. There are other varieties which have greater yield propensity but lower protein and functional quality. This year nearly all varieties are producing lower than average protein, but the greatest drop seems to be on the varieties geared primarily for yield.

North Dakota Wheat Commission Chairman Harlan Klein says, "This year's crop has certainly exceeded all expectations from a production and grade quality standpoint, given the challenging and delayed planting season, and it is a crop that most producers remain excited about, despite the lower average protein levels." For many producers in the western part of North Dakota it is the crop of a lifetime and a welcome reprieve from recent, persistent drought years. For producers in the eastern part of the region it is the second straight year of strong yields and high grades supported by new varieties which have

higher levels of resistance to Fusarium headblight and leaf rust, allowing reduced production problems and damage related marketing challenges.

Discounts of \$1 per point of protein are not unprecedented but it has been a number years since the HRS crop has had such extreme protein penalties. Other comparable years for notable high yields and below average protein were 2004 and 1992. In both years, average regional protein levels fell to 13.8 percent, and wider protein premium and discount scales prevailed in the market.

The discounts have become much more pronounced this year because the world market is awash with wheat that is less than 12 percent protein. Complicating factors is the fact that the hard red spring wheat market is in an atypical position. The bulk of normal demand for hard red spring wheat is 13.5 percent protein and higher with the majority of export customers demanding 14 percent. With the big crop being harvested, tight on-farm storage and the lower 2009 crop protein levels, the market is being forced to clear the channels of the lowest protein by trying to find demand for that wheat or discourage producer deliveries.

Producer options - With prices near the government loan price that may be the best shorter-term option for producers. While protein discounts are not likely to totally go away, historically these discounts tend to ease as harvest pressure lessens, market channels are cleared and the market becomes more rational. The loan program option will enable producers to participate in any general market appreciation and any LDP opportunities that may arise.

Importance of protein in hard red spring wheat - Protein content and quality are the primary selling points for U.S. HRS wheat with foreign and domestic customers. The majority of wheat produced in the world market does not have the high protein levels typically found in hard red spring wheat. U.S. HRS is used in wheat blends to improve the quality of wheat from other sources, both for protein content and protein quality traits which improve bread and noodle performance. That demand is still there, but the level of the 2009 crop which meets those minimum requirements of higher protein is in shorter supply. This has pushed protein spreads wider than normal. Premiums and overall values for higher protein wheat will likely appreciate throughout the winter as we are able to secure demand from our traditional high protein customers. The traditional customers will pay the premium because they can't utilize a 12 percent protein wheat if they need a 13 percent protein flour or higher. During the milling process typically 1 to 1.5 percent protein is lost in the conversion from wheat to flour. A key factor in securing that demand will be the final protein distribution in the entire U.S. HRS crop and the final outcome of the Canadian crop.

Demand opportunities for lower protein wheat - It will be challenging to garner strong demand for wheat with only 10 and 11 percent protein. World supplies are large and there are no big volume, price buyers to take that wheat off the market like there was in 1992 when sales were made to China, Russia and Egypt, non-traditional HRS buyers. This year Russia is selling wheat to Egypt, and China's production may enable it to even export some wheat.

For wheat with 12 percent protein and higher, demand is likely to strengthen once buyers know the true mill and bake performance of the crop. Klein says, "both domestic and export outlets are exploring the

value of this non-typical wheat and we expect stronger sales to ensue in the coming months to both traditional and non-traditional markets. As demand grows, protein discounts are likely to ease from current levels.”

Long-term impact of these discounts - Wheat is facing increasing competition from corn, soybeans and other alternative crops in our region. Factors that have led producers to look at corn and soybeans include biotech traits, reduced nitrogen costs, rotational benefits and the absence of significant cash market discounts. Certainly producers realize that the wheat market is more complex with a larger percent of the crop going directly into the higher priced food markets which demand a higher quality threshold, but the extreme level of cash discounts that can prevail for factors such as color, falling number, damage and protein are not factors that can be easily hedged or managed for price risk by producers. Pete Kappes, Chairman of the Minnesota Wheat Council, says “Every chance we get to meet with millers and bakers, we tell them the risk of quality discounts in wheat is much higher than in other crops, causing many growers to switch out of wheat so they can avoid the price risks associated with quality discounts. Millers and bakers also say they have some of the same price risks associated with quality as we do. Kappes adds, “Producers and the industry need to work closer together to help resolve the extreme level of uncertainty that prevails with cash market discounts from year to year.”

The three groups will continue to work with both domestic and foreign buyers to optimize market potential for the 2009 HRS crop, and will encourage industry collaboration to discuss ways to bring about more manageable quality pricing options to the cash market.