We start our weekly update with focus firmly fixed upon weather once again. It is our firm belief that this is the single biggest influence on prices and direction at this time. There is pretty good agreement between the GFS and EU weather models, which raises confidence, that Argentina will see both reduced spread and volume of rainfall in the coming two weeks. In addition, the models also predict that coming rains will predominantly fall in the northern region, which accounts for less than 10% of crop output and is therefore less important for total Argentine production. Meanwhile dry conditions continue not only in Argentina but also in S Brazil as a direct consequence of La Niña. The chances of any major change look limited and we anticipate worsening drought at the key time for corn pollination and soybean filling. These conditions do not bode well for final output in either crop.

In the US there is again limited change to the growing Plains drought. The two key weather models do have some better rain prospects in the coming two weeks but this is limited in coverage, and there is an expectation of a return to colder conditions. The trend in weather is suggested to remain in place throughout the remainder of the winter season. It is drought that will be the headline grabber into the spring planting season later this month when early planting of corn begins in the Gulf States.

It seems that the weather has begun (at long last) to attract attention and there has been some strong buying in the early part of the week as consumers added to cover at historically attractive prices, and some fund short covering emerged. This allowed a sharp jump in prices, which slowed and reversed as the week progressed; this was most likely a consequence of some weather forecast improvement as well as some short-term month end profit taking. However, we see little fundamental change and would anticipate a resumption of upward momentum next week, unless we see a material change in growing conditions over the weekend.

As if the weather conditions needed any evidence, the USDA's latest winter wheat condition report showed that 44% of the Kansas wheat crop was rated as poor/very poor, which is down from 22% month on month, and also down from 20% last year. Clearly this cannot be perceived as bearish, and argue strongly against trend yields, as if that needed pointing out. Despite US wheat woes, global wheat growing conditions appear more favourable and global output has some commentators suggesting that anther record crop could be on the cards. If this is the case, and it is by no means guaranteed at this time, the likely outcome will be a change in trade flows with US exports reduced and their share switching to other origins.

Fund positions continue to remain a key issue with large net shorts still in place in corn, wheat and soybeans. At the risk of becoming boring, we suggest caution in the face of a change of heart by the funds and all that this would entail from a potentially explosive price move higher.

In summary, we remain friendly to prices in the face of an unchanged and worsening weather scenario added to fund shorts and ongoing weakness in the US$.