Are Higher Corn Prices Needed?

grain outlook

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December 2010 corn futures moved above $5.00 in mid-September, moderated in early October, and then moved sharply higher following the USDA's October Crop Production report. The month of November started with new highs for that contract.

Even though prices are at the highest level since July 2008, some analysts are projecting even higher prices, with $7.00 being a favorite target. The obvious question is why are higher prices needed? The role of the corn market is two-fold. First, corn has to be priced so that current supplies last until the next harvest. Second, corn prices have to motivate sufficient production in 2011 to meet needs during the 2011-12 marketing year. The second objective is met primarily by directing acreage decisions in 2011. Corn prices continue to adjust as the market's assessment of the "right" price needed to meet these objectives changes. This assessment changes on the basis of unfolding information about the strength of demand and about corn yield risk in 2011.

The issue of allocating current supplies is typically evaluated based on the pace of consumption relative to available supplies. If consumption is proceeding too rapidly, so that supplies are likely to be consumed before the next harvest, prices increase to slow the pace of consumption. If the pace of consumption is too slow, so that year ending supplies will be in surplus, prices decline to encourage more consumption. For the current marketing year, corn supplies are estimated at 14.382 billion bushels and consumption is projected at 13.48 billion bushels. Stocks at the end of the marketing year are projected at 902 million bushels. Year ending stocks cannot realistically be reduced much below the projected level so there is little room for consumption to exceed the projected level.

Is there any evidence that corn is being consumed too fast? Feed and residual use of corn is the largest segment of U.S. corn demand, but the rate of consumption cannot be calculated until the release of the December 1 Grain Stocks report on January 12, 2011. The USDA is forecasting a generous level of feed and residual consumption of 5.4 billion bushels. It is unlikely that the pace of consumption exceeds the projected level.

Corn exports during the current marketing year are forecast at 2 billion bushels, or an average of 38.5 million per week. The total is only 13 million more than exported last year. Export inspections during the first 8 weeks of the year averaged 34.3 million bushels per week. Cumulative inspections are 5.9 percent below last year's total. Unshipped export sales as of October 21, however, stood at 520 million bushels, compared to only 405 million on the same date last year. The pace of exports and export sales present a mixed picture – large sales, but slow shipments.

The USDA forecasts that corn used for ethanol production during the current marketing year will be 3.1 percent more than used last year. During the first 8 weeks of the marketing year, ethanol production exceeded that of a year ago by 18 percent. If the current rate of increase in ethanol production continued, corn use would exceed the projected level of 4.7 billion bushels by 680 million bushels. Such a large rate of increase will not be maintained, and feed use of corn will be reduced if production of distillers' grain exceeds the current projection. Still, corn is currently being consumed too fast and a substantial slow down is required.

Three important developments will add further information to the assessment of the pace of consumption. These include the updated corn production forecast to be released on November 9, prospects for Chinese imports of U.S. corn, and the fate of the $.45 per gallon blender's tax credit for ethanol.

Last week, we made the case for the need for more corn acres in the U.S. in 2010. Does the price of $5.40 for December 2011 corn futures provide enough incentive to expand corn acreage by 5 to 6 percent next year? Even with November 2011 soybean futures near $11.70, projected crop budgets for 2011 show an economic advantage of corn production compared to soybeans in the Midwest. Corn prices, then, appear high enough relative to the major competing crop for corn to capture more acreage next year. The question may be whether or not there is enough acreage available to get the large increase that appears to be needed. That depends in part on how many additional acres will be brought into production in 2011 and how many acres are used for winter wheat, cotton, and a variety of minor crops.

A case can be made that old crop corn prices need to move higher to slow the pace of consumption. Prospects for new crop prices are not as clear. Current prices may be high enough to attract sufficient acreage in 2011. If not, those prices may have to increase later. Δ

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