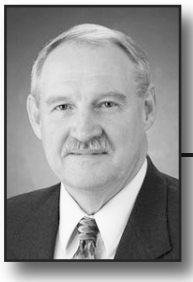
Corn Demand Improving



grain outlook

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December 2010 corn futures traded to a high of $3.95 in mid-April, retreated to a low of $3.67 early last week, and then rallied back to $3.95. The current price is about $.40 above the contract low established in early September 2009 and about $.75 below the high reached in early June 2009. The contract high, reached in mid-2008, is over $7.00.

Weakness in corn prices starting in mid-April primarily reflected supply considerations: generally favorable weather for planting, expectations that acreage could exceed March intentions, and expectations that the 2010 yield would be above trend value due to a majority of the crop being planted early. The current strength in corn prices reflects more favorable demand prospects. There is a fair amount of optimism about corn demand in each of the three major categories of consumption.

Recent data confirm increasing production and consumption of ethanol. Expansion is being driven by extremely favorable ethanol blending margins. Wholesale gasoline prices have increased from about $2.00 per gallon in mid-February 2010 to over $2.40 now. During the same time period, ethanol prices have declined from about $1.75 per gallon to about $1.60 per gallon. The current spread between gasoline and ethanol prices results in a very high return to ethanol blending, even before the $.45 per gallon blender's tax credit. The price spread is large enough that E-85 prices could be competitive at the retail level. Favorable blending margins should continue to support demand for ethanol so that corn consumption for ethanol production during the 2009-2010 corn marketing year could exceed the current USDA projection of 4.3 billion bushels. There is on-going concern about the "blend wall" for ethanol if mid-level blends are limited to 10 percent, but that wall clearly has not been reached yet.

The recent increase in hog and cattle prices has also triggered ideas that feed and residual use of corn during the current marketing year might exceed earlier expectations. Even with a decline in the feed and residual use of sorghum and another summer of relatively low feeding rates for wheat, however, feed and residual use of corn above the current USDA projection appears unlikely. The low level of use during the first half of the year combined with declining hog and cattle numbers and expanding production of distillers' grains makes the current projection of 5.45 billion bushels look a little high. That projection is 200 million bushels above use during the 2008-09 marketing year. That category of use is feed and "residual", so that surprises can occur. The USDA's June 1 Grain Stocks report will shed more light on the rate of use.

Improving corn export prospects have provided most of the recent optimism about corn demand. The release of some corn from domestic reserves in China, along with the issuance of import licenses a few weeks ago, has been followed by some small purchases of U.S. corn. China has not imported significant quantities of corn since 2001-02 (40 million bushels). The last year of large imports was 1994-95 (170 million bushels). The magnitude of U.S. corn imports by China this year is very uncertain, but recent purchases come at a time when overall sales of U.S. corn have been increasing. The USDA weekly reports indicate that new export sales averaged 50 million bushels per week for the four weeks ended April 22, compared to an average of 28 million per week in the previous 10 weeks. New sales need to average 38 million per week from now through August in order for sales to reach the USDA's 1.9 billion bushel export projection. Weekly shipments averaged 38.2 million bushels per week during the seven weeks ended April 29. To reach 1.9 billion for the year, shipments from now through August need to average about 38.8 million bushels per week.

The tug of war between improving demand prospects and expectations for a large crop in 2010 will likely continue, resulting in a continued wide trading range for corn prices. Stronger demand, however, increases the importance of crop size. If improved demand is confirmed, there may be less downside price risk and an opportunity for a move back to recent highs if crop problems develop. Δ

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