Did Corn Prices Reach their “Ouch Point”? 

November 10, 2010, Chris Hurt  hurtc@purdue.edu

In the first day of trading after the November USDA updates the upward trend in corn prices looked vulnerable. There are two basic reasons. The first is due to continued tightening of stocks of basic farm commodities which makes the 12.6 billion gallon ethanol mandate more vulnerable to government reduction. The Grocery Manufacturers Association, the National Meat Association and others filed suit against the EPA for raising the blending rate to E15 (for 2007 and later model vehicles) arguing that high farm commodity prices will put undue upward pressure on food prices. A logical next step would be for these groups to request EPA to lower the 12.6 billion gallon mandate under the emergency clause. This may especially be true with the sharp tightening of U.S. soybean and cotton stocks as well in the USDA update.

A second factor is the growing possibility that corn prices may have reached a height where end users are unwilling to pay up any longer. Even though the USDA lowered corn yields by 1.5 bushels to 154.3 bushels per acre in their November update, that decline was fully expected. There is preliminary evidence that exports and domestic feed use may be reduced due to high prices. Plus the USDA increase of 100 million bushels of ethanol usage to 4.8 billion bushels may be suspect. I will take these in order.

First, export sales of corn have been weak since the October 8th USDA update which was the catalyst for corn prices to move upward by 60 to 80 cents per bushel. In the three weeks previous to these escalated corn prices, export sales averaged 32 million bushels a week. In the three weeks after the early-October higher price surge, export sales dropped to an average of just 15.8 million bushels per week. Over the past five years corn exports in the three weeks after the October report were 15% lower while this year they are down over 50%. Weekly export sales numbers are highly variable, so it will take more weeks to be sure if foreign buyers are backing off at the higher prices.

Second, my estimates for the livestock sector have been that $5.50 U.S. cash corn was about the highest they could pay and still cover all costs. This is roughly equivalent to $5.75 on December 2010 futures. On the day of the November report, December 2010 corn futures raced to $6.035, signaling prices nearly 30 cents above livestock producer corn break evens. USDA also felt higher feed prices would cut livestock feeding as they reduced feed usage by 100 million bushels. The most bullish news from the November report came in soybeans and futures markets respond with meal rising $17 per ton which also increase feed costs and may ensure additional livestock production cutbacks in coming months.
Finally the USDA increased corn usage for ethanol by 100 million bushels as usage so far this marketing year (since September 1) has been running about 18% ahead of the same period last year (Darrel Good rhttp://www.farmdoc.illinois.edu/marketing/weekly/html/110810.html ). However, ethanol margins have been very strong since late-August so we should expect a high output. But, the industry has excess capacity and thus ethanol producer margins will likely fade when blenders meet their 2010 ethanol purchase requirements. If so, the pace of corn use for ethanol could fall back to 4.6 to 4.7 billion bushels for the 2010 crop.

So, did corn prices reach their highs for calendar 2010 on November 9, 2010? If you are reading this at some later date, you may already know. There are some equally compelling bullish arguments as well. First, the potential cut-backs in usage mentioned above are just that-potential-they are not yet confirmed. Second, USDA suggests that U.S. ending stocks at 6.2% of use will be very tight, and thus any other surprises that increases usage or indicate smaller production in the Southern hemisphere could set prices moving much higher. Third, USDA’s numbers suggest that world inventories are also tighter dropping ending stocks to about 15% of use, which is similar to the tightest stocks in the past three years and with the record tightness being about 12% in the early 1970s.

Prices may have peaked for now around the $6.00 mark on December futures. Downside movement could be to the $5.40 level with December corn trading in the $5.40 to $6.00 range. Markets will continue to watch weekly export sales (released on Thursday mornings). Any corn sales to China could cause upward price movement. Any signs of cut-backs in animal production could also be signals that prices have been high enough. Appeals to EPA to cut the 2011 ethanol mandate could be bearish. And of course the final size of U.S. production and prospects for Southern Hemisphere production will be important.

One thing is clear however, and that is major reductions in price should not be expected until U.S. and world supplies of major commodities are more abundant. That probably cannot occur until the 2011 U.S. and Northern hemisphere harvest nearly a year from now.