

# Corn Prices Zooming Up Quickly

by John Bunting

Never has the U.S. grain trade seen a mid-harvest corn price run-up without severe adverse weather conditions ... until fall 2006.

On October 11, December 2006 corn futures closed at \$2.85/bushel.

On October 12, USDA issued the crop estimate for the U.S. corn harvest at 10.905 billion bushels, down from 11.4 billion bushels in its September estimate. Corn futures at the Chicago Board of Trade (CBOT) immediately began to rise. At the close on the 12<sup>th</sup>, December futures were \$2.99 and headed higher.

At this writing (early November), December 2006 corn futures at CBOT are just over \$3.50 a bushel. To put that in perspective, since 1997 corn has averaged \$2.09 a bushel. Additionally, it is important to understand corn prices rising countercyclically to normal harvest's price.

For dairy farmers who buy grain, the rise will translate into higher grain prices. The real question is, how high will grain prices go and how long will high prices last?

If USDA's estimate is correct, the 2006 corn harvest will be the second-largest corn crop ever. However, the 2006 corn crop will not be large enough to meet an estimated 12 billion bushel demand. A significant, growing demand is coming from the rapidly-expanding ethanol industry. Since 2000, ethanol production has quadrupled to about 4.5 billion gallons. That output is expected to double by 2008.

Ethanol production will use about 2.5 billion bushels of the 2007 U.S. corn crop, according to *Farm Journal*.

Each 56-pound bushel of corn produces approximately 2.8 gallons of ethanol. In addition to the ethanol, there are by-products such as corn gluten feed, high-protein corn gluten meal and corn oil for the "wet milling" process. "Dry milling" seems to be the preferred method for new corn ethanol plants. Dry mill plants accounted for more than 70% of 2006 capacity with an average size of 42 million gallons per year, according to National Corn Growers Association. Most of the new ethanol plants being built today are dry mills with an average plant size of 60 million gallons per year.

The National Corn Growers Association (NCGA) last September published an economic analysis on ethanol plants for farmers. NCGA estimates the corn cost per gallon of ethanol at \$.804. That number was arrived at with a corn price of \$2.21 per bushel. At \$3.48 a bushel of total costs to produce a gallon of ethanol would be \$1.856.

It takes 1.5 gallons of ethanol to equal the energy in one gallon of gasoline. Recent wholesale spot prices for gasoline were \$1.54/gallon. So on an energy equivalent basis, ethanol should be selling for just over a dollar a gallon. Additional income accrues from by-product sales, which means corn prices would have to rise above \$4/bu. to make the production of ethanol unprofitable. And ethanol prices are eventually the price factors will sort themselves out. At the moment however, a lot of corn is needed to produce ethanol.

According to *The Wall Street Journal*, about 106 commercial ethanol plants in the U.S. and 48 plants are under construction, demand is the price-driver, particularly ethanol demand. There's a great deal of talk about ethanol imports, particularly from Brazil. Despite nearly doubling in 2005, ethanol imports have not been enough to decrease the demand for corn in the US.

The war in Iraq and the uncertainty of oil supply from the Middle East are pushing the idea of ethanol to the forefront. The use of ethanol as a motor fuel in the US dates back to 1908. Henry Ford was an early supporter of homegrown fuels and his early model T. could be modified to run on either gasoline or pure alcohol. Standard Oil Company marketed a 25% ethanol by volume gasoline blend in the Baltimore, Maryland area during the 1920s. Interest in ethanol then died or at waned until the 1970s, when it was revived here, courtesy of the OPEC oil embargo.

The U.S is now practically at the point of an ethanol euphoria. A November 2 article in *The New*

*York Times* talked about "Wall Street bankers, in loafers and suits," descending upon the Midwest with offers to buy ethanol plants cooperatively owned by farmers.

Grain giant Archer Daniels Midland states in its quarterly report of October 31, 2006, "Corn Processing operating profit increased due to improved ethanol and sweetener selling prices." Ethanol prices are extremely volatile. After peaking in July 2006, ethanol prices have fallen off considerably.

For the short to medium term, corn seems to be the investor crop of choice for producing ethanol. Sugar beets, it would seem, might be a better choice. However, the latest talk concerns producing ethanol from cellulose - cellulosic ethanol. There is a great deal of chatter about switch grass. There is an accompanying dream of doubling or perhaps tripling the dry matter yield per acre of switch grass. If, and it is a big if, the U.S. were to completely convert to switch grass as a fuel for automobiles, some estimate it would take 114 million acres. For comparison, the U.S. harvested about 86 million acres of corn last year.

The United States consumes just shy of 140 BILLION gallons of gasoline a year. That works out to about 383 million gallons of gas every day. The emphasis here is on every day and every day is different. Every year is different. Weather is always an unknown. Remember Hurricane Katrina!

Very little talk is given to the water and nutrient consumption needed for total ethanol use. Even less seems to be devoted to a weather-related uncertainty of crop production.

## Speculators swarming like flies

The enthusiastic talk has brought out the speculators. A recent corn Commitment of Traders report

indicates 319,853 contracts of 5000 bushels each were purchased by non-commercial interest or speculators. Last year at the same time, 151,524 contracts were purchased by speculators. Added to that seems to be an immense purchases by hedge funds. The amount of hedge fund money is only a guess because no one keeps track of the exact amount.

On October 29 article in *The Des Moines Register* seems to indicate most ethanol plants were not well covered by futures before the run-up in corn prices began. The same could be said for most farmers. Some experts are speculating corn prices will crash at any moment. Most see the present time as a period of volatility or uncertainty. The countercyclical price rise at harvest time leaves few predicting what the future may hold, but many analysts are closely watching. Some fear that corn prices, like ethanol plant construction in the U.S., may be a case of too much too fast.

Certainly dairy producers' costs for grain will rise. Grain prices will be another burden on top of other surmountable burdens. The Western states - where all the recent gains in milk production are occurring - do not produce significant amounts of corn. Upper Midwest farmers, many with home-grown grain supplies, are in the best position to weather the storm.

There may be some winners in all of this. Most will remain anonymous. One big winner will be the U.S. budget. Federal farm subsidies payments, which hit a record \$24.3 billion in 2005, will fall big-time if corn prices continue rising.

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