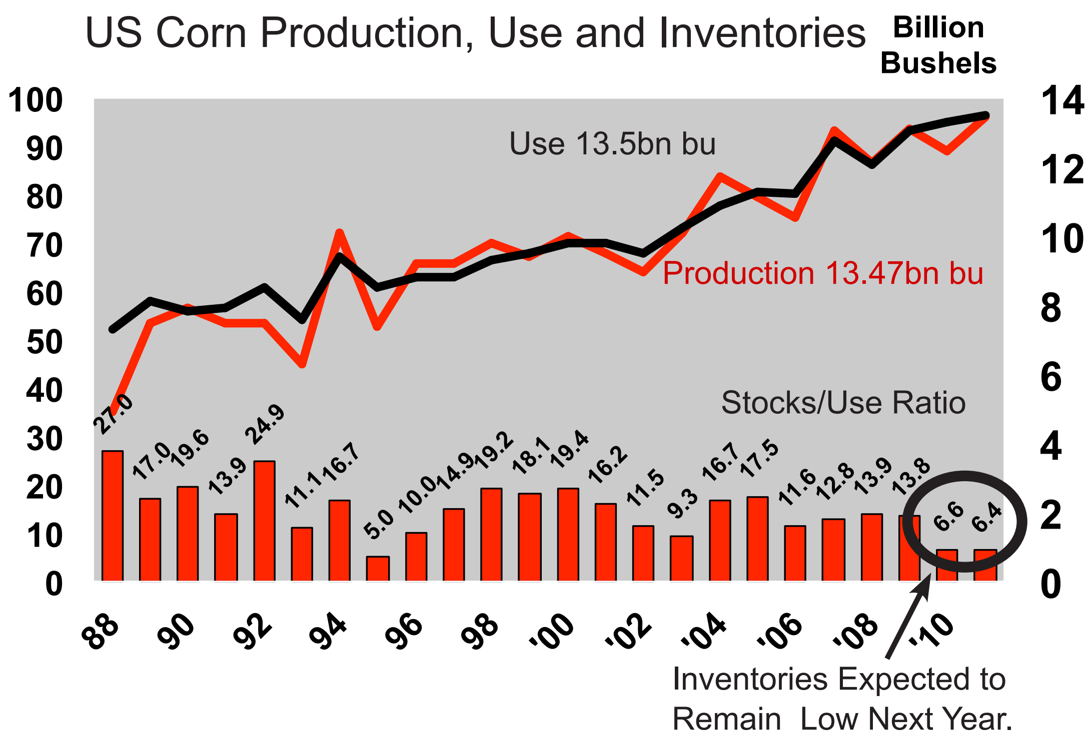
THE OHIO STATE UNIVERSITY EXTENSION

Grain Market Situation and Outlook Monthly Update



Modest Surprises in July Reports

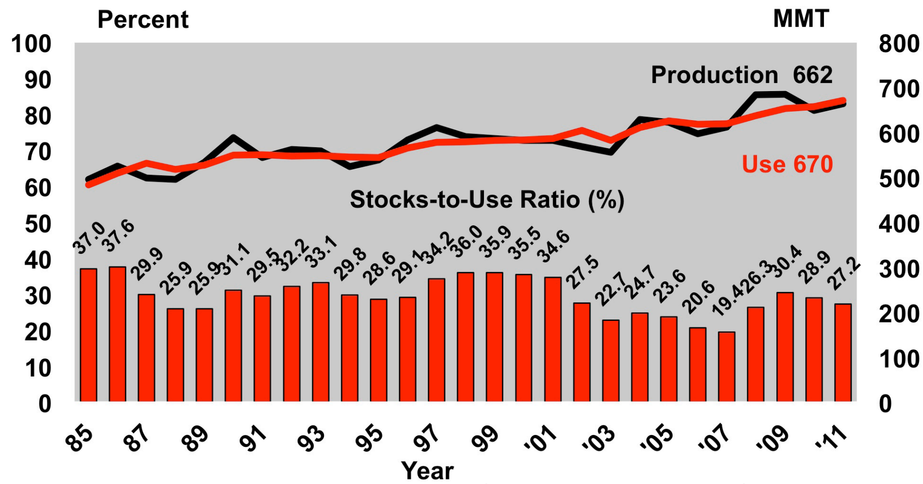
The July Crop Production and World Agricultural Supply and Demand Estimates are typically relatively staid affairs. In late June, Prospective Plantings and the Grain Stocks reports are released, and the July reports incorporate those new estimates, sometimes with some adjustments to the demand side. New crop corn and soybean yield forecasts are rarely altered, as the survey-based forecasts don't commence until August. While there were some surprises, in general, this reports released on July 12 followed the same pattern. Corn consumption was increased somewhat, and wheat yield estimates rose, but this report is largely a place-holder, as the market's attention turns to the weather and to Congress.

Based on reports from the HRW harvest, estimated 2011 wheat yield was increased from 43.1 to 44.6 bu/acre. When combined with the 600,000 acre reduction in harvested acreage (based on the 1.3m acre cut in plantings from the June reports) results in forecasted all-wheat production of 2.1bn bushels, which is about 40m bushels more than the market was expecting. Higher exports and seed use offset the changes in production and beginning stocks, to leave ending inventories slightly lower than June, at 670m bushels from 687. Forecast global wheat production was decreased by 2mmt, while usage increased by 3mmt, resulting in a forecasted 2mmt

Matthew C. Roberts
Agricultural, Environmental and Development Economics
Ag Admin 103
2120 Fyffe Road
Columbus, OH 43085

roberts.628@osu.edu
Twitter:YourEconProf

matthewcroberts.com



World Wheat Production, Consumption and Stocks

decline in global ending stocks compared to last month's forecast, and 7mmt lower than last year's ending inventories. However, production and use for 2011/12 are both 14mmt higher than the drought-diminished 2010/11 levels.

While corn yields were unchanged, and acreage declined as expected, the biggest surprise of the day was the lower-than-expected increase in corn ending inventories. Yield and acreage changes result in a harvest forecast 270m bushels higher than last month, and the grain stocks report results in a carry-in of 150m bushels higher, but feed and ethanol usage were increased by 50 and 100m bushels, resulting in an ending inventories of 870m bushels, instead of the 920-930 expected.

Soybeans had no real surprises. Carry-in increased by 20m bushels. Reduced acreage (-1.4m harvested) means reduced production (-60m bu), and with the relatively tight inventories in beans, consumption had to decline, as well. So to offset the 40m bushel reduction in availability, exports declined by 25m bushels and inventories declined by 15m bushels.

Near-term Outlook

By itself, there's not much in these reports to drive the market. But these numbers, especially for corn, provide a much stronger bullish foundation than existed previously. With inventories ~50m lower than expected, and still below 900m bushels, the margin for yield loss remains very small. And, right on cue, as we are moving through pollination, dryness seems to be increasing across many portions of the corn belt. When we combine the state of corn with the still-small global wheat inventories, the stage is set for explosive upside. The next four weeks will almost certainly provide some new short-term highs in the market before we go into harvest, so if you have selling you need to do, use the next few weeks. Expect weakness starting in mid August—the market is currently pricing lots of bad news, and except for the August reports, there won't be nearly as much news flowing into the market from mid-August until October, which typically produces a wane in prices.

VEETC elimination unlikely to affect corn prices.

The Volumetric Ethanol Excise Tax Credit (VEETC) got a lot of press on July 7, as Senators Thune (R-SD), Klobuchar (D-SD), and Feinstein (D-CA) announced that they had reached a deal to immediately eliminate VEETC and the import tariff and instead provide support for cellulosic biofuel production, biofuel infrastructure improvement, and a small-producer biofuels tax credit. This announcement has received lots of attention, especially among agricultural interests. In the past week, I've been asked at least three times what will happen to the ethanol industry and/or crop prices "now that the subsidy is gone." However, VEETC has not been eliminated. The July 7 event was only an announcement of the deal between the three senators. Only on July 18 was a bill to this effect (HR 1075) actually introduced in the Senate, and there is no corresponding legislation in the House. Since the goal of the bill is ostensibly deficit reduction (elimination of VEETC saves $6bn/year, spending is about $2bn/year), attempts will be made to insert these provisions into any debt-ceiling deal. However, there is no certainty that this will happen.

If, however, the VEETC is eliminated, what does this mean for corn prices, and the rest of agriculture? FAPRI estimates that the elimination of VEETC and the tariff result in corn prices decreasing by $0.20-$0.25/bushel on average. My (admittedly much cruder) models agree. Don't forget we are not in an 'average' year, and we are not about to start one unless we get a 170bu yield this fall. FAPRI models currently estimate that the long-term price of corn without the VEETC is about $4.50/bu, but because of the current low inventories, prices are much higher. So in a year such as this, a more instructive question might be, what happens to ethanol producers' break-even point for corn procurement if the VEETC is eliminated? According to DTN, ethanol rack prices are approximately $3/gallon, roughly at parity with wholesale gasoline. At $3/g, the shut-down point for a typical ethanol plant (i.e. the price at which a plant would rather idle than produce) is over $10/bushel of corn. If the VEETC is eliminated, and we assume that ethanol producers bear the full impact of the elimination (which I think is reasonable) then the wholesale price of ethanol should fall approximately $0.45/g (the size of VEETC), which would result in a shut-down price of approximately $9/bushel of corn—well above current market prices. Further, as Brazil currently has excess export capacity, the elimination of the tariff will not result in a large flow of imported ethanol, either.

Therefore, due to the current relatively high prices for ethanol, elimination of VEETC should have little effect on corn prices or other markets in the short run. If ethanol prices do weaken toward their energy value (i.e. E85 pricing) the ethanol industry will suffer financial distress, and it could lower corn prices, but there is no indication that these worries are justified at this time.