

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Question: Are corn prices on a new higher plateau?

Looking at the November 8, 2013 “World Agricultural Supply and Demand Estimates” (WASDE) <http://tinyurl.com/5ftcx3> numbers for corn, we wonder if the next couple of years might provide a test of the “new plateau” hypothesis.

According to the new plateau or new price era hypothesis, the season average prices of corn paid to farmers which broke the \$4.00 per bushel price barrier in the 2007 crop year will now average or plateau at about \$4.50 per bushel, largely due to the growth of the corn-for-ethanol market and other demand increases. Corn used for ethanol increased from 2.1 billion bushels in 2005 when the price was \$2.00 to the 5 billion bushel level in 2010.

To provide some historical context, during the period right after WWII through 1972 the season average price of corn ranged between \$1.00 and \$1.66, depending mostly on the level of the announced loan rate. 1972 saw the beginning of a ten-year period of increasing exports as corn prices doubled to over \$2.00 per bushel where it remained for all but 6 years between 1973 and 2006.

In addition to the ongoing upward shifts in demand, those expecting a new price era for major agricultural crops also point to the increased production costs of recent years as another reason that annual prices will average well above earlier price plateaus.

Turning to the November WASDE report, we see that the USDA projects the 2013 corn crop will come in at 14.0 billion bushels, well above last year’s drought-plagued 10.8 billion bushels. At the same time, total use is projected to increase by 1.8 billion bushels.

As a result, year-ending corn stocks jump from an estimated 824 million bushels in 2012 to 1.9 billion bushels at the end of the 2013 crop year with the stocks-to-use ratio increasing from 6.4 percent to 14.6 percent between the two years.

With higher year-ending stocks for the 2013 crop, the USDA projects a mid-range season average price for corn of \$4.50 per bushel, well below the \$6.89 season average price for the 2012 crop. This represents a projected price decline of 34.7 percent, the largest single-year price decline in more than 60 years.

The last time that the season average price was below \$5.00 was 2009 when it was \$3.55.

A comparison between 2013 and 2009 shows that in 2013 production is projected to be 900 million bushels higher than 2009, domestic consumption is projected to be 463 million bushels higher, and exports are projected to be 579 million bushels lower. Total use in 2013 is projected to be 116 million bushels lower than it was in 2009, suggesting that if spring 2014 planting goes well, prices could go lower yet.

Could prices drop back to the previous \$2.00+ plateau? The answer to that question depends on how one interprets history. It is well and good to draw a parallel to the move from the \$1.00+ plateau for corn to the 2.00+ plateau, but in doing so one must ask what made the new level stick? Our read of the history suggests that the new plateau stuck because of the 1977 increase in the non-recourse loan rate, thereby setting a limit to how far the price of corn could fall.

After the 1996 Farm Bill effectively eliminated the use of any reserve program through the use of the marketing loan program, we saw four consecutive years of sub-\$2.00 corn prices. As for the contention that higher production costs will do the trick, it did that not work in the 1998-2001 period when the government backfilled farm income with tens of billions of dollars in government payments.

This time around, there is no price safety net to make a new higher price plateau stick. Furthermore, if prices fall well below the total cost of production and stay there for several years, revenue insurance will be of little value as an income safety net for crop farmers as well.

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