APAC Agricultural Policy Analysis Center
The University of Tennessee

PolicyPennings by Dr. Daryll E. Ray

Corn crop looks good, maybe too good

For the second year in a row, we are in the middle of September hoping that the late-planted corn crop will mature before frost strikes. Last year warm weather held, and the yield came in at 153.9 bushels/acre, the second highest national corn yield on record.

If the September WASDE (World Agricultural Supply and Demand Estimates) is correct, the 2009 US corn yield will come in at 161.9 bushels/acre, nosing out 2004's 160.3 bushels/acre for a new record. With this level of production and increased demand, the USDA (United States Department of Agriculture) projects ending stocks for the 2009 crop year marginally up from last year. They also project a season average price of $3.05 to $3.65, well below the $4.08 estimated for the 2008 crop year.

That being said, we have to remember that the crop is not in the bin and a lot can happen between the September 11 WASDE estimate and harvest. If we have a normal frost date-earlier than is needed for this crop-the yield will fall, tightening up stocks and sending prices back up. In that case, recent prices could be the season low.

Higher prices could put continued pressure on the poultry, livestock, and dairy industries. Ethanol plants would feel some price pressure as well.

On the other hand, if frost holds off like it did last year, the September WASDE production and yield estimates could be right on target or even surpassed by larger numbers when combines transfer corn on-the-stalk into the nation's trucks and wagons. With a large crop, however, the price estimates could be very optimistic. As of this writing, Southern Minnesota-Northern Iowa local-elevator corn prices are some 50 cents below the USDA midrange price estimate for the 2009 crop year.

As traders become accustomed to improved corn genetics and late frost dates, it is not inconceivable that we could see prices in LDP (Loan Deficiency Payment) territory during this crop year. This is especially true if the planting schedule next spring is closer to the ten-year average and demand expectations turn out to be too optimistic.

A year ago, the talk was about a new price plateau. LDPs for corn and soybeans were thought to be a thing of the past. It was expected that the demand for grains would outpace the supply as the result of world-wide population increases, a growing middle class in developing countries, and grain agriculture's trump card-Congressional ethanol mandates.

Some also implied that increased input costs would set a floor on prices-not exactly grain agriculture's experience during the 1998-2001 period when prices were well below the cost of production.

In part, the September WASDE is able to avoid a sizeable reduction in its estimate of corn prices for the 2009 crop year by matching the increased production of corn with increased demand, keeping the ending stocks fairly constant. Feed and residual is up by 50 million bushels from last month's estimate and 100 million bushels from the projected 2008 crop year totals.

With the poultry, livestock, and dairy sectors losing money at a rapid rate, it seems unlikely that they will be increasing their demand for corn. This is particularly true given the potential for increased DDGS (Distiller's Dry Grains with Solubles) coming from 525 million extra bushels being used in ethanol production.

But maybe livestock's use of grain will not decline as much in the 2009/2010 crop year as history would suggest. Supply response in the livestock industry is different now than in decades past.

Years ago, losses in hogs would result in a quick downturn in the hog cycle as farmers culled their herds and took more sows to town or skipped a breeding cycle. The hog cycle as we know it describes the behavior of the market when it was composed of a large number of small producers. Today the industry is vertically integrated, and the level of investment is significantly higher than it was in the past.

With higher fixed costs, hog producers may find that they will lose less money by continuing production rather than shuttering their barns for a cycle or two. In that way, as the hog industry has become more vertically integrated, it may act more like the crop sector, where high fixed costs result in farmers' planting crops even when the price is below the cost of production. As long as they can cover variable costs, any income in excess of these variable costs can be applied to the fixed costs. One significant difference is crop farmers can choose among a range of crops, while livestock producers have facilities tailored to one species. As a result they have fewer options.

Wendy Holm describes just that situation in an article "HOGWASH: Straight Talk on Canada's Hog Industry," carried by the Pacific Free Press in Canada. "Canadian hog farmers are now losing an estimated $40 CAD [Canadian dollars] a head on every hog marketed. Many farmers continue to produce because high fixed cost barns made it difficult to cut back.

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Producers report losses in the range of $15,000 [Canadian dollars] a week."

Hog numbers are declining in response to economic conditions, as is the size of other components of the livestock industry. But due the revamped organizational structure of much of the livestock industry, the production changes may not occur as quickly in response to lower prices compared to price downturns of the past.

Part of the problem livestock producers face is not just the result of supply side issues. The current economic downturn and the appearance of the H1N1 "swine" flu have resulted in a drop in demand. Even if hog producers could access lower priced corn to feed fewer hogs, they could remain in trouble because of continued slack demand.

It may take five or six weeks to determine what the corn market will look like in the next year. It will take longer before we know what is going to happen to animal agriculture.

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