PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Local corn prices dip below $2 in some areas

Even before the current farm bill was adopted, we shared our concern that a $4 plus plateau in corn prices, which was being widely predicted, was in all likelihood no plateau at all. In our November 15, 2013 column (http://tinyurl.com/n6jvrvh), we wrote, "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….

"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."

Even so, we were shocked, but not surprised, to see a newspaper headline announcing corn prices that were well below the $2.00 level. It was news of an elevator in the Minot, ND area that priced corn at $1.73 per bushel. Yes you are reading that number correctly $1.73 as the result of a $1.50 negative basis on a $3.23 futures price. And, that $3.23, itself, is 20 percent below the supposed $4.00 plus plateau.

Before going further, let us look at what the term basis means in the context of agricultural commodity demand. Basis is the difference between the spot price of a commodity, in this case corn, and the nearby futures price. The basis reflects risk, transportation costs, local demand, and transaction costs among other things.

During a period of unstable prices, the basis widens (gets larger) to reflect the increased risk. The basis tends to narrow in rising markets and widen in falling markets, reflecting changes in perceived risk.

Locations further from the futures delivery point and ultimate user post a negative basis to reflect the cost of transportation to the delivery point. Similarly locations nearer the end user or export terminal may offer a positive basis, reflecting lower transportation costs.

Corn grown in an area with high demand, say an ethanol plant or sizeable livestock herd, will see a smaller negative basis. If the local supply is lower than the local demand the basis can even be positive to draw in the additional needed corn.

To cover the cost of handling the grain, grain dealers charge a fee that is reflected in the basis, and thus the ultimate price that a farmer receives.

We agree that it took a combination of circumstances to bring about a -$1.50 basis—an anticipated bumper crop, railroad problems, full elevators, and the lack of local demand—but circumstances will not pay the bills no matter how they came about.

And it is not only in North Dakota that we are seeing situations in which farmers are facing an unusual basis. Coming from the upper Midwest we always watch the prices and basis (generally negative) in those areas. And living in Tennessee, we also watch the prices and basis in West Tennessee (generally positive). During the first week in October 2014, both areas showed a negative basis in the range of 30-40 cents.

All of this raises the question of what the next couple of years are going to look like. An examination of the 1995-2001 period may give us a hint. Between the high prices we experienced in 1995 and the lows that began in 1998, corn year ending stocks increased from 426 million bushels to 1.8 billion bushels and the season average price paid to farmers (basis included) tumbled from $3.24 to $1.94 and $1.82 the following year. This time around we have seen ending stocks increase from 821 million bushels to over 2 billion bushels and the price has plunged.

Without increased demand or significantly reduced supply, the price in the 1998-2001 period remained below $2.00 for the whole period. The year to year variation in year ending stocks made little difference. It was only the ethanol mandate and the subsequent demand for 5 billion bushels of corn for ethanol production that lifted corn prices out of the doldrums.

Prices next year are likely to remain low even if stocks drop a little. It seems that it takes a constant stream of bullish news to keep prices up—like increasing demand for corn for ethanol production. It doesn't take bearish news to keep prices down, only the absence of news of a sharply reduced supply or a significantly increased demand.

And if prices remain low, the current configuration of farm policies may not provide the kind of help farmers will need.

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