

\$3.50-The new Corn Norm'

Corn price highs and lows have different definitions to different people. For example, the dairy farmer may prefer when corn is cheap to reduce the cost of feed. For crop farmers, low corn prices mean a tightening of the proverbial belt on margins and profitability. What we learn from this is that the definition of "normal" is relative to what is grown and produced. However, there are many factors that demonstrate the new long-term "normal" may be \$3.50 per bushel (bu.).

In order to understand this paradigm shift, we need to explore what caused the record high prices seen in 2012 and why it will be very difficult for the markets to sustain that high for any length of time over the next five to ten years. A market "perfect storm" combination of global demand (mostly from China), ethanol, and weather all played major roles in contributing to these record prices; not to mention, the United States' dollar index traded down to its lowest level in history in 2008.

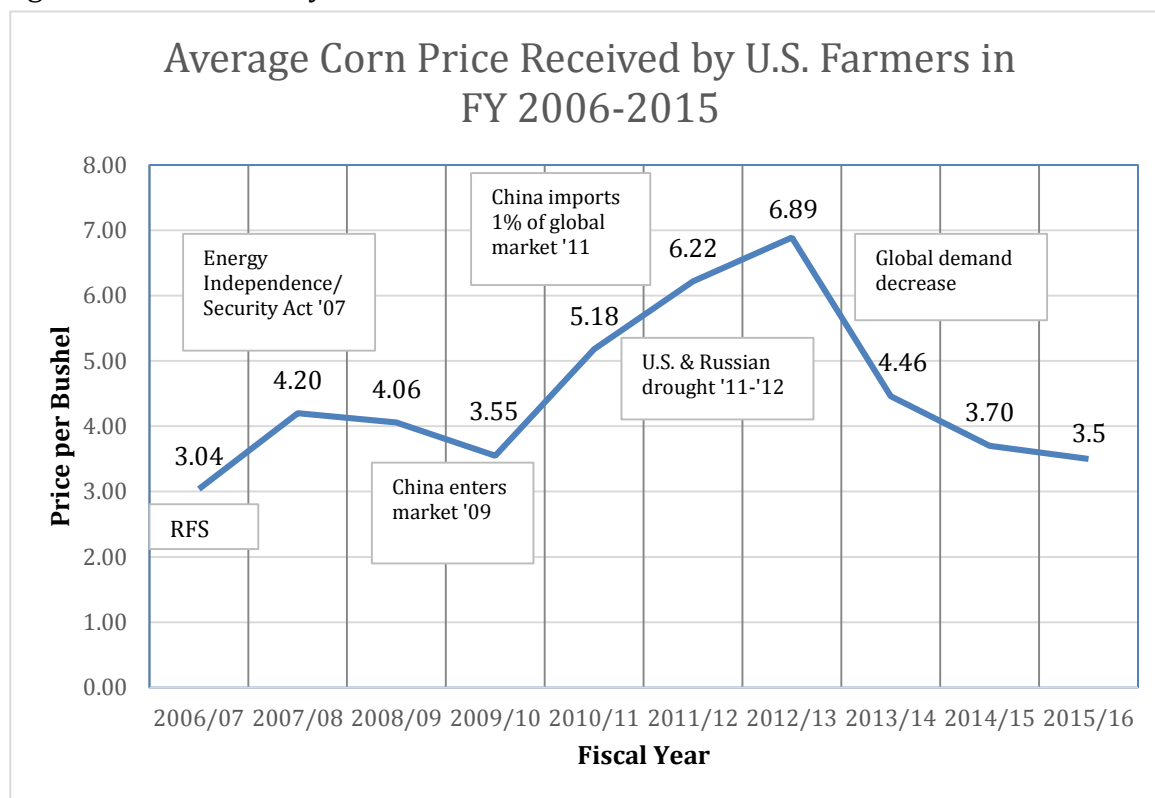
Demand

US corn demand into ethanol went from 1.6 million bu. in 2005 to 5.0 million bu. in 2010. This increase can be first attributed to the Renewable Fuel Standard (RFS) congress established in 2005. RFS mandated that the minimum usage of ethanol must rise to 7.5 billion gallons by 2012. Next, the Energy Independence and Security Act was passed in 2007, mandating that minimum usage volume of ethanol to increase to 36 billion gallons by 2022. By 2010, 90% of all vehicles manufactured in the US could run on a 15% blend of ethanol gasoline (E85) generating a whole new demand market for ethanol. Essentially, these factors created a new and somewhat artificial market for ethanol.

Global corn demand has been steadily increased for the past thirty years, but the rate of production increase was near 2% annually until 2003. From 2003 through 2011, world corn demand averaged 4-5% growth annually. Moreover, beginning in 2009 China came to the world market and became a net importer of corn. In 2011 China imported 1% of all corn produced in the world. The massive boom in the Chinese economy enabled consumers to enjoy more animal products, which by association required more corn consumption. For the first time ever, the Chinese had additional income to purchase steaks, pizza, cheese, ice cream, and other substitute goods that are replaced when income levels are low.

Supply

To combine ethanol and an increased global demand for corn, the weather dealt an ace on the supply levels for corn. In 2012, the United States experienced a major drought which helped to maintain a “local” price floor averaging \$4.50. However, Russia was subsequently experiencing drought in 2011 and into 2012 that significantly damaged the world wheat supply. Soybeans are typically substituted for wheat in many countries, which was the solution for this global decrease in wheat. As any price conscious farmer would do, corn was replaced by soybeans to capitalize on the high soy prices. When we coupled this annual increase of global soybean demand over the past thirty years with other biodiesel demand pressure raising the global price, we saw ending stocks-to-usage ratio increase to the highest levels in history.



Today

These factors all lead us to where we are now and why it will be unlikely to see any sustained price of corn higher than \$3.00-\$4.00 for some time. Due to the past high prices and good yields, we have been rewarded with global stocks of corn, soybeans, and wheat reaching record highs. However, the wildcard that is different now than in the last decade



is the changing market for ethanol. According to USDA, we will not see an increased demand for US corn for ethanol higher than 0-1% from 2016 to 2025. China is in a well-documented recession and is forecasted to import its lowest level of corn since 2009.

Thus, we develop patience to as we hope the supply side deals a new hand to move corn futures up. This will come from a drought, governmental controls, or a stark increase in global growth and demand to reset global supply. For supply to decrease we would need to see a major weather event that would shrink the 2016 crop in both North and South America. The catch-22 here is due to better genetics and better technology, corn yields (with the exception of 2012) have been growing at a pace of about 2-3 bu. per acre annually. From a government perspective, the election cycle and popular anti-spending approaches, there is little in the current political pipeline that would cause any large increase in the world consumption of corn.

What does this mean for Wisconsin dairymen? Low corn prices equal low feed prices which is welcomed with to the lower global price and demand for milk, softening the margin blow that these producers are facing on the milk side. For crop farmers and dairymen who produce excess corn, it is more critical than ever to get as much production per acre out of every acre of corn that is planted. The cost of growing corn is significantly lower input costs such as urea prices have dropped as a derivative of the low price of crude oil.

Finally, now is the time to put up extra corn silage, as it is more affordable than ever to grow and store corn for feed. This provides extra protection in place for drought or an unexpected high price in haylage or even corn itself. Feeding good quality corn has become an affordable feed source to get the most milk out of your cows.

Cody Heller is the CEO of Central Wisconsin Ag Services.