

August 2011 - Crop Market Update

Department of Economic Analysis



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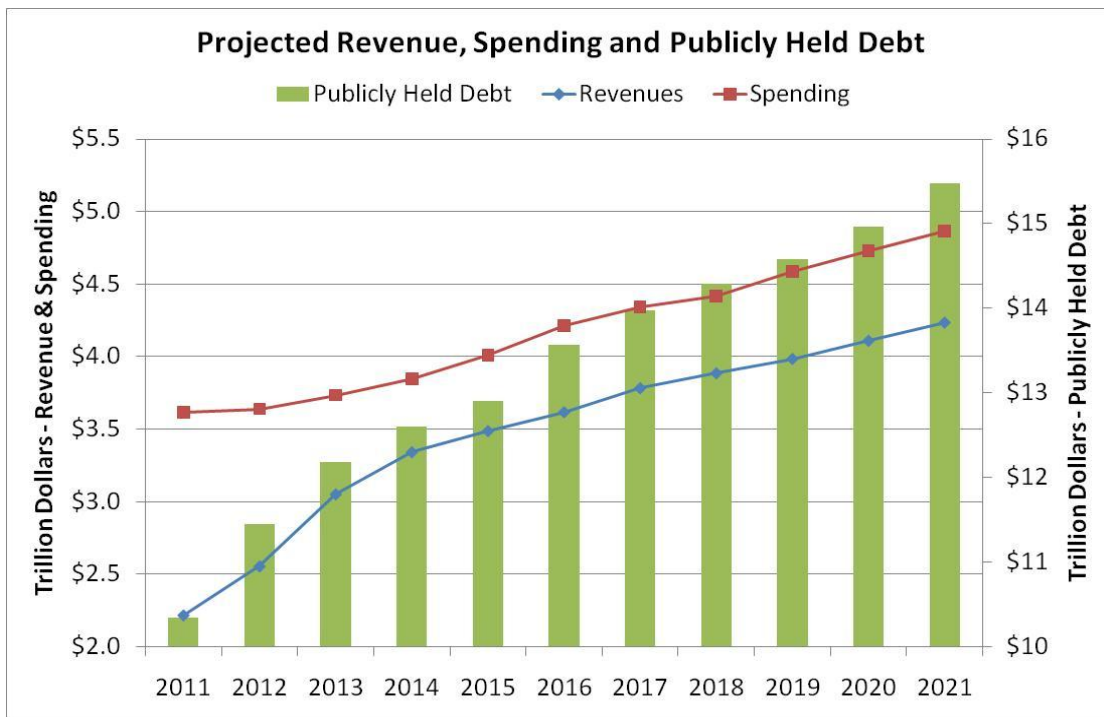
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The General Economy

How would you like to be the guys at Standard and Poor's (S&P) rating agency last week? Kind of reminds one of the phrase 'Your name is Mudd' after the Dr. Mudd associated with the Lincoln assassination plot. Listening to spokesmen from the administration over the weekend, one would have thought the raters at S&P were the epitome of reckless irresponsibility. These are the same raters we yelled at a couple years ago for not adequately recognizing the risk associated with the home mortgage mess. Now we're yelling at them for being too quick on the draw in thinking the nation warrants less than a perfect credit rating. How quickly their stars do realign.

But should we not be thanking these guys? Should we not appreciate the fact that somebody the Government (including the administration, both chambers of Congress, and all three political parties) has to pay attention to finally pointed out what we all know – if the Government continues as it has for the last 30 years, how credit worthy is the United States really? The S&P folk have been warning of a credit downgrade. They let Congress and the Treasury Department know what kind of deficit reduction was needed in order to prevent a downgrade. Congress and the Administration failed to deliver on that size of reduction. And surprise, surprise, S&P made their announcement Friday. How would S&P raters have been viewed on Monday morning if they had given the warnings, stated what needed to be done and then failed to downgrade when the Government did not meet their criteria? Should or would we have believed any of their subsequent ratings?



So what approach do the politicians take? As usual in these kinds of situations, efforts are underway to shoot the messenger, or at the very least, bring their credibility into question. The \$2 trillion difference the administration is fuming over is picking one baseline over another. Recall during the debt limit debate there was one option on the table the Democrats were proclaiming would increase revenues while the Republicans were citing it as a tax cut. And the kicker is that both were right. It all depended on which baseline one started with. Even the House Republicans faced that problem which forced a delay in the vote on an earlier package.

Current law (before the debt deal) says that the Bush era tax cuts expire next year, the previous short term patches to the Alternative Minimum Tax run out and the rules associated with cutting payments to Doctors and Hospitals will actually take hold. Under that set of projections, the Congressional Budget Office expects publicly held debt to rise to \$15.5 trillion by 2021. On top of that add roughly \$4-\$5 trillion of debt held by the various government agencies and trust funds – money the government owes itself, but debt that still counts toward the ceiling. This gives a ratio of publicly held debt to GDP ratio of 76 percent in 2021. While the growth of the debt slows as a share of GDP for a few years, it is still rising in absolute terms at a rate of almost \$500 billion per year.

What S&P asked for was action that would have reduced the debt by \$4 trillion relative to this baseline by 2021. Had the Government taken that action the ratio of publicly held debt to GDP would peak in mid decade and then actually decline with the overall level of publicly held debt stabilizing around \$11-\$12 trillion.

With the creation of the Joint Committee the Government has another chance to make the tough decisions. The S&P downgrade and the market reaction have certainly sent a strong message. Had S&P not issued the downgrade, there would have been little to drive some of these leadership actions. Maybe the S&P move will give the Committee the moxie it needs to put us on a much better path.

Crop Situation and Outlook

The August *WASDE* has started to incorporate actual production information and we are beginning to better understand the effect of this spring's delayed planting, droughts, flooding and extremely hot weather has had on the 2011 crops.

Corn Situation and Outlook

The August *WASDE* increased the 2010-11 old crop ending stocks to 940 million bushels reflecting a reduction in exports by 50 million bushels and lower ethanol production by 30 million bushels (Table 1). These reductions were expected given the slowing of old crop corn exports and slowing ethanol production in recent weeks. The pre-report estimates expected 2010-11 ending-stocks at 922 million bushels with estimates ranging from 790 million to 1.085 billion bushels.

The surprise in the August *WASDE* was the decrease from July in the U.S. average corn yield to 153 bushels/acre. While most pre-report forecasts expected a lower yield, the average pre-report forecast was 155.2 bushels/acre yield with estimates ranging from 151 to 158 bushels/acre.

This lower than expected yield was bullish to the corn market and adds concern that this crop might continue to shrink in future *WASDE* reports.

Given the expectation of a smaller crop, the use categories were all reduced from the July estimates. Feed and residual use was reduced by 150 million bushels giving an expected use of 4.9 billion bushels. This reduction assumes a greater percentage of wheat will be used in feed rations. This is the smallest level of corn feed demand since 1995-96 which was another year with extremely tight corn stocks. Export demand was reduced by 150 million bushels from the July estimate to 1.75 billion bushels. Exports are expected to decline due to the assumption of greater use of wheat in feed rations worldwide. This export assumption might be very weak given the strong and growing demand for corn in China. USDA currently estimates 2011-12 corn demand for China at 2 million metric tons – it is believed that China has already purchased up to 4 million metric tons of 2011-12 corn. Food, Seed and Industrial use decreased by 40 million bushels from the July estimate to 6.51 billion bushels. Corn going towards ethanol production is estimated to be 5.1 billion bushels which is 50 million bushels less than the July estimates.

The 2011-12 ending stocks are forecasted to be 714 million bushels which is a 5.4% stocks-use ratio or about 20 days of inventory at the end of the 2011-12 marketing-year. As I've stated repeatedly in previous columns, we do not have any capacity to absorb any further reduction in production without making further cuts in use. This will be accomplished through higher prices. USDA forecasts the 2011-12 marketing-year average price at \$6.70 per bushel ranging from \$6.20 to \$7.20 per bushel.

Table 1. U.S. Corn Supply and Use

	2008-09	2009-10	2010-11	2011-12
	Actual	Estimated	August Estimate	August Forecast
Million Acres				
Planted Acres	86.0	86.4	88.2	92.3
Harvested Acres	78.6	79.5	81.4	84.4
% Abandoned	-8.6%	-8.0%	-7.7%	-8.6%
Bushels per Acre				
Yield	153.9	164.7	152.8	153.0
Million Bushels				
Beginning Stocks	1,624	1,673	1,708	940
Production	12,092	13,092	12,447	12,914
Imports	<u>14</u>	<u>8</u>	<u>30</u>	<u>20</u>
Total Supply	13,729	14,774	14,185	13,874
Feed & Residual	5,182	5,140	5,000	4,900
Food, Seed & Industrial	5,025	5,939	6,420	6,510
Ethanol for Fuel	3,709	4,568	5,020	5,100
Exports	<u>1,849</u>	<u>1,987</u>	<u>1,825</u>	<u>1,750</u>
Total Use	12,056	13,066	13,245	13,160
Ending Stocks	1,673	1,708	940	714
Avg. Farm Price	\$4.06	\$3.55	\$5.25	\$6.70
Stocks-Use	13.9%	13.1%	7.1%	5.4%
Days of Ending Stocks	51	48	26	20

Table 2 illustrates how changes in harvested acres or yield will affect ending stocks and the stocks-use ratio. If harvested acres are reduced by 500 thousand and yield remains at 153 bushels/acre, ending stocks will decline to 643 million bushels and stocks-use will be at 4.9%. A 5% stocks-use ratio is needed to maintain the corn marketing pipeline. Similarly, if yield declines by 1 bushel/acre to 152 bushels/acre and harvested acres are unchanged, ending stocks decline to 629 million bushels at a 4.8% stocks-use ratio. A reduction in both harvested acres and yield would further drive stocks below the critical 5% stocks-use level.

Table 2. Expected 2011-12 Corn Ending-Stocks and Stocks-Use Ratio for Varying Yields and Acreage.

Planted Acres	Harvested Acres	2011-12 Corn Ending Stocks				
		155	154	153	152	151
---(Million Acres)---		---(Million Bushels)---				
92.3	84.4	882	798	713	629	544
91.8	83.9	811	727	643	559	475
91.3	83.5	740	657	573	490	406
Beg. Stocks	940					
Imports	20					
Total Use	13,160					

Planted Acres	Harvested Acres	2011-12 Corn Ending Stocks-Use Ratio				
		155	154	153	152	151
---(Million Acres)---		---(Stocks-Use)---				
92.3	84.4	6.7%	6.1%	5.4%	4.8%	4.1%
91.8	83.9	6.2%	5.5%	4.9%	4.2%	3.6%
91.3	83.5	5.6%	5.0%	4.4%	3.7%	3.1%

Soybean Situation and Outlook

The August WASDE increased 2010-11 old-crop ending stocks by 30 million bushels to 230 million bushels (Table 3). This increase in stocks came from a 5 million bushel reduction in crush and a 25 million bushel reduction in exports. This increase in stocks was expected with pre-report estimates averaging 218 million bushels.

The 2011 soybean crop is forecasted to be 3.056 billion bushels. Pre-report forecasts expected the crop to be at 3.171 billion bushels with estimates ranging from 3.115 to 3.225 billion bushels. This smaller than expected crop provides bullish support to the soybean market. The August WASDE decreased harvested acres by 500 thousand reflecting the re-survey of acreage in South Dakota. Yield is forecasted to be 41.4 bushels/acre which is lower than the pre-report expectation of 42.8 bushels/acre.

Table 3. U.S. Soybean Supply and Use				
	2008-09	2009-10	2010-11	2011-12
	Actual	Estimated	August Estimate	August Forecast
Million Acres				
Planted Acres	75.7	77.5	77.4	75.0
Harvested Acres	74.7	76.4	76.6	73.8
% Abandoned	-1.3%	-1.4%	-1.0%	-1.6%
Bushels per Acre				
Yield	39.7	44.0	43.5	41.4
Million Bushels				
Beginning Stocks	205.0	138.0	151.0	230.0
Production	2,967.0	3,359.0	3,329.0	3,056.0
Imports	13.0	15.0	15.0	15.0
Total Supply	3,185.0	3,512.0	3,495.0	3,301.0
Crushing	1,662.0	1,752.0	1,645.0	1,635.0
Exports	1,279.0	1,501.0	1,495.0	1,400.0
Seed & residual	106.0	108.0	125.0	111.0
Total Use	3,047.0	3,361.0	3,265.0	3,146.0
Ending Stocks	138.0	151.0	230.0	155.0
Avg. Farm Price	\$9.97	\$9.59	\$11.35	\$13.50
Stocks-Use	4.5%	4.5%	7.0%	4.9%
Days of Ending Stocks	17	16	26	18

Total use for 2011-12 decreased by 118 million bushels from the July forecast reflecting the smaller expected crop. The crush demand for soybeans is reduced by 20 million bushels to 1.635 billion bushels due to decreased demand for soybean meal. Exports are also expected to decrease by 95 million bushel to 1.4 billion bushels due to increased export competition from South America.

The 2011-12 ending stocks for soybeans is forecasted to be 155 million bushels which is lower than the pre-report average forecast of 168 million bushels. This low level of ending-stocks has a stocks-use ratio of 4.9% or about 18 days of inventory at the end of the 2011-12 marketing-year. This tight level of stocks supports a record price level with the U.S. marketing-year average price forecasted to range from \$12.50 to \$14.50 per bushel.

Table 4 shows how a change in acreage or yield affects ending

stocks. If harvested acreage declines by 500 thousand, ending stocks will drop to 134 million bushels which is a 4.2% stocks-use ratio. Similarly, if yield is reduced by 1 bushel/acre and harvested acres remains unchanged, the ending stocks would drop to 81 million bushels which is a 2.6% stocks-use ratio. Clearly, price would increase to curb demand to keep stocks from falling to such a low level. However, Table 4 illustrates that the soybean market is also in a tight stocks situation with no capacity to absorb further reductions in production.

Wheat Situation and Outlook

The August WASDE reduced the 2011 harvested wheat acres by 1.3 million acres but yield was increased by 0.6 bushels/acre. The yield increase dampened the full effect of the reduced acreage with production declining by 29 million bushels for a wheat crop of 2.077 billion bushels. This is slightly less than the pre-report forecast of 2.079 billion bushels.

Feed and residual use increased by 20 million bushels from the July report to 322 million bushels reflecting the expected increase of wheat in feed rations. Exports decreased by 50 million bushels from July to 1.1 billion bushels reflecting greater export competition from the Black Sea region.

Ending stocks are expected to increase by 1 million bushels to 671 million

Table 4. Expected 2011-12 Soybean Ending-Stocks and Stocks-Use Ratio for Varying Yields and Acreage.

Planted Acres	Harvested Acres	2011-12 Ending Stocks				
		43.4	42.4	41.4	40.4	39.4
---(Million Acres)---		---(Million Bushels)---				
75.5	74.3	324	249	175	101	26
75.0	73.8	302	228	154	81	7
74.5	73.3	280	207	134	60	-13

Beg. Stocks 230
Imports 15
Total Use 3,146

Planted Acres	Harvested Acres	2011-12 Ending Soybean Stocks-Use Ratio				
		43.4	42.4	41.4	40.4	39.4
---(Million Acres)---		---(Stocks-Use)---				
75.5	74.3	10.3%	7.9%	5.6%	3.2%	0.8%
75.0	73.8	9.6%	7.3%	4.9%	2.6%	0.2%
74.5	73.3	8.9%	6.6%	4.2%	1.9%	-0.4%

Table 5. U.S. Wheat Supply and Use

	2008-09	2009-10	2010-11	2011-12
	Actual	Estimated	August Estimate	August Forecast
Million Acres				
Planted Acres	63.2	59.2	53.6	55.2
Harvested Acres	55.7	49.9	47.6	45.9
% Abandoned	-0.1	-0.2	-0.1	-0.2
Bushels per Acre				
Yield	44.9	44.5	46.4	45.2
Million Bushels				
Beginning Stocks	306	657	976	861
Production	2,499	2,218	2,208	2,077
Imports	127	119	100	100
Total Supply	2,932	2,993	3,281	3,037
Food	927	917	930	945
Seed, Feed & Residual	333	219	202	322
Exports	1,015	881	1,289	1,100
Total Use	2,275	2,018	2,420	2,367
Ending Stocks	657	976	861	671
Avg. Farm Price	\$6.78	\$4.87	\$5.70	\$7.60
Stocks-Use	28.9%	48.4%	35.6%	28.3%
Days of Ending Stocks	105	177	130	103

which was at the pre-report forecast. Strong corn prices are expected to support wheat especially as price bids for acreage for the 2012 crop year. The U.S. marketing-year average price is expected to range from \$7.00 to \$8.20 per bushel.

Cotton Situation and Outlook

The 2011 cotton crop is forecasted to be 16.55 million bales which is above the pre-report forecasts that averaged 15.29 million bales and ranged from 14.75 to 15.5 million bales. The August WASDE increased harvested acres by 100 thousand acres and increased yield by 22 pounds per acre from the July report. Abandonment is still forecasted to be 30% and that may increase as the effect of the severe drought in Texas, Oklahoma and the Southeast becomes better known.

The WASDE increased projected exports by 300 thousand bales from the July forecast which reduced the impact of increased production. Ending stocks is forecasted to be 3.3 million bales which is a stocks-use ratio of 20%. This is an increase from last year but is still relatively tight as compared to previous years.

Table 6. U.S. Cotton Supply and Use				
	2008-09	2009-10	2010-11	2011-12
	Actual	Estimated	August Estimate	August Forecast
Million Acres				
Planted Acres	9.5	9.2	11.0	13.7
Harvested Acres	7.6	7.5	10.7	9.7
% Abandoned	-20%	-18%	-2%	-30%
Pounds per Acre				
Yield	813.0	777.0	812.0	822.0
Million Bales				
Beginning Stocks	10.1	6.3	3.0	2.9
Production	12.8	12.2	18.1	16.6
Imports	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Total Supply	22.9	18.5	21.1	19.4
Domestic Use	3.6	3.5	3.8	3.8
Exports	13.3	12.0	14.4	12.3
Total Use	<u>16.9</u>	<u>15.5</u>	<u>18.2</u>	<u>16.1</u>
Unaccounted	-0.3	0.1	0.0	0.0
Ending Stocks	6.3	3.0	2.9	3.3
Avg. Farm Price	47.8	62.9	81.5	95.00
Stocks-Use	37.6%	19.0%	15.7%	20.5%
Days of Ending Stocks	137	69	57	75

The bearish concern in the cotton market is reduced world demand for cotton and increased world supply. Both will lead to a lower price in the world market and place downward pressure on the price of U.S. cotton. Since over 75% of the cotton demand is from the export market, cotton is very sensitive to these global factors. However, the U.S. marketing year average price is forecasted to average \$0.95 per pound ranging from \$0.90 to 1.10 per pound.

How Might the U.S. Corn Yield Change from August to January?

The August objective yield survey was the first attempt to forecast production. USDA-NASS has a rigorous procedure where they survey fields and count the plants per acre, ears per plant and estimate the development and yield potential of the ears. These sampling procedures become more accurate as the crop reaches physiological maturity.

To get a better idea how the corn yield might change from August to the annual estimate in January, changes in the monthly production forecasts from August to January from 1965 through 2010 were analyzed. On average, corn yields increase from August to January 59% of the time. This demonstrates the effect of late season weather as well as the conservative nature of the NASS estimating procedures.

Using this information, January annual yield for corn was simulated using the historical changes in yield from August to January from 1965-2010. While each crop-year is different, looking at the change in

yields in previous reports provides a measure of the potential change in yield and further insight in regards to changes in production levels and ending stocks for the 2011 corn crop.

Table 7 shows that there is a 50% chance of the average corn yield being 156 bushels/acre when all the reports from 1965 to 2010 are considered. Considering all years assumes there is a chance that the corn yield estimate will increase. Assuming that the harvested acreage is 84.4 million acres, the potential production is 13.2 billion bushels. There is a 50% chance that the stocks-use ratio will be 7.4% or less.

Similarly, there is a 30% chance that the yield will be 151.6 bushels per acre which suggests a corn crop of 12.8 billion bushels. This would be a 4.5% stocks-use ratio and would likely trigger higher prices that ration corn demand.

The take-away message from Tables 7 is that there is a large risk that there will be a small crop to meet the growing demand which will trigger higher prices. Table 7 indicates that you need to be prepared for a smaller corn crop and the opportunities (or threats) associated with higher prices.

Energy Update: *The Dog Days of Summer Bring Energy in Focus*

It seems as if all the news in Washington over the past month has been centered on “The Great Budget Debacle.” On August 2, a debt ceiling deal was reached and signed by President Obama that immediately increased the debt ceiling by \$900 billion dollars and cut \$917 billion in spending over 10 years. During this time, we experienced an S&P downgrade of our credit rating from AAA to AA+ which resulted in our markets reacting as if they were a Kings Dominion roller coaster ride and personally making me wonder why I didn’t invest in gold before this situation even started – if only I could predict markets! Furthermore, we saw oil drop below \$80 per barrel for the first time since October 2010, making gasoline cheaper than ethanol for a brief trading period. With that said, the \$0.45 per gallon tax credit to blend ethanol into gasoline (also commonly known as VEETC) has been a topic of conversation. Many analysts thought the Thune/Klobuchar proposal of immediately eliminating the VEETC and allocating part of it into deficit reduction and the other part into other renewable fuels incentives would have been included in the recently passed Budget Control Act. Now, we are currently

Table 7. Potential January 2012 U.S. Average Corn Yield Based on 1965-2010 WASDE Monthly Yield Changes.

Cumulative Probability ^{1/}	U.S. Average Corn Yield (Bushels/Acre)	Potential 2011 Production ^{2/} (Billion Bushels)	Potential Stocks-Use ^{3/} Ratio
95%	165.5	13.97	13.4%
90%	164.8	13.91	13.0%
85%	163.5	13.79	12.1%
80%	162.8	13.74	11.7%
75%	161.2	13.60	10.7%
70%	160.0	13.50	9.9%
65%	158.3	13.36	8.8%
60%	157.9	13.33	8.6%
55%	157.6	13.30	8.4%
50%	156.0	13.17	7.4%
45%	155.1	13.09	6.7%
40%	152.1	12.83	4.8%
35%	152.0	12.82	4.7%
30%	151.6	12.79	4.5%
25%	151.2	12.76	4.2%
20%	150.3	12.69	3.7%
15%	147.9	12.48	2.1%
10%	141.7	11.96	-1.8%

^{1/} The cumulative probability is the probability that the yield will be that level or less. For example, a 65% cumulative probability means that there is a 65% chance that the average yield will be 158.3 bushels/acre or less.

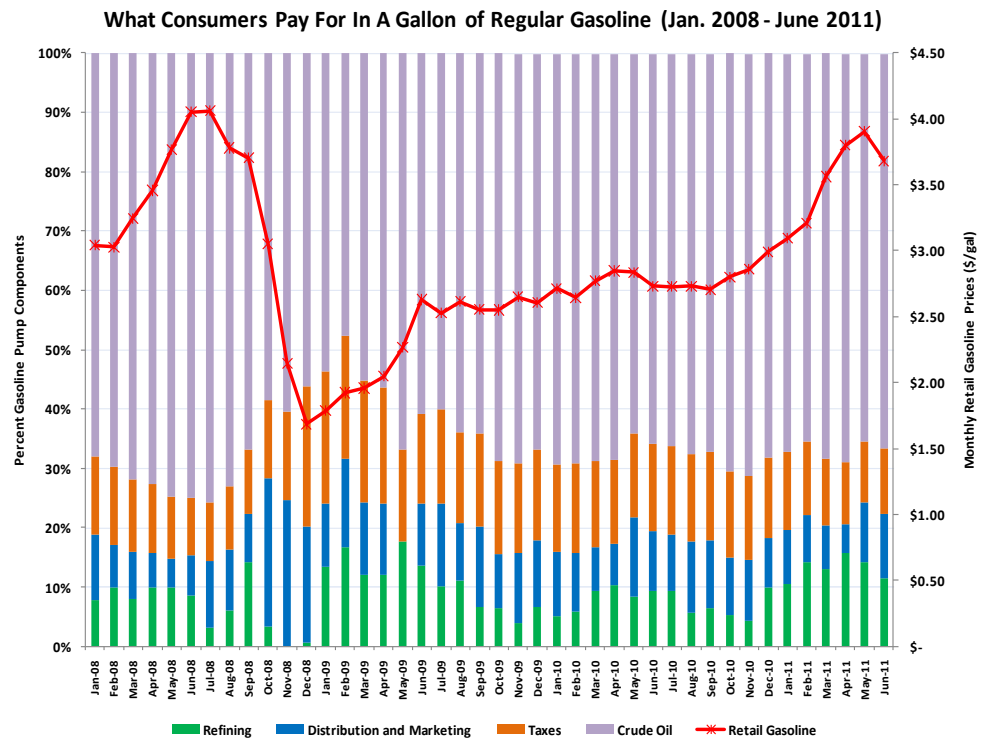
^{2/} Potential production is the U.S. average yield times the harvested acres of 84.388 million acres.

^{3/} Potential stocks-use assumes expected use of 13.16 billion bushels, beginning stocks of 0.94 billion bushels and imports of 0.02 billion bushels.

in the situation of continuing the VEETC which expires at the end of 2011. However, let's not forget that we have to somehow/someway produce 21 billion gallons of renewable fuels from advanced biofuels by 2022, which does not include corn based ethanol.

Why is \$3.50 gas priced at.....well, \$3.50?

When you take your vehicle to the gas station for a fill up, do you ever wonder why gasoline is priced the way it is? Over the past month, this question has been brought to my attention several times. Since the beginning of 2011, consumers have seen the price of gasoline increase approximately 20 percent. Consumers in most parts of the country have also seen weekly gasoline prices topping well over \$4.00 per gallon, placing a burden in the pocketbooks of consumers filling their vehicle with gasoline. It seems obvious that the price of crude oil is the main driver on whether we see higher or lower gasoline prices at the pump, but other factors also contribute to the overall price of retail gasoline. Other cost components such as refining, taxes and distribution and marketing of gasoline make up the rest of the pricing structure of gasoline. If we look at the most recent monthly data (June 2011), the monthly cost of U.S. retail gasoline was \$3.68 per gallon. Of that \$3.68 per gallon, 67 percent was driven by the price of crude oil, 12 percent by refining costs, 11 percent by distribution and marketing costs and 11 percent by federal and state taxes applied to gasoline. However, these different cost components do not stay static. Let's use July 2008 and December 2008 as examples. In July 2008, we saw oil prices peak at record highs near \$145 per barrel. But then we witnessed those same prices spiraling down to approximately \$30 per barrel by December 2008. In July 2008, 76 percent of the price of gasoline was determined by the price of crude oil. On the other hand, by December 2008, 56 percent of the price of gasoline was determined by crude oil. This is a classic example of how crude oil prices affect the consumer, but we cannot forget the value added involved in getting that gasoline to the pump.



WASDE and Ethanol Production

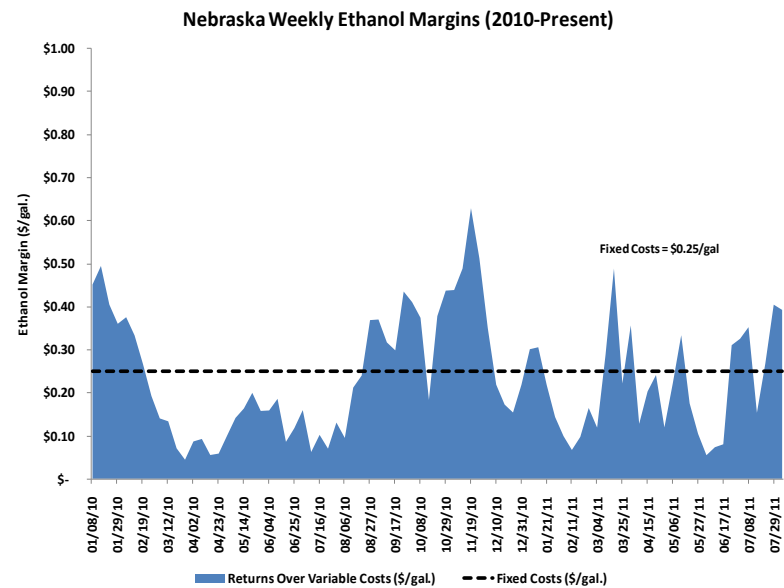
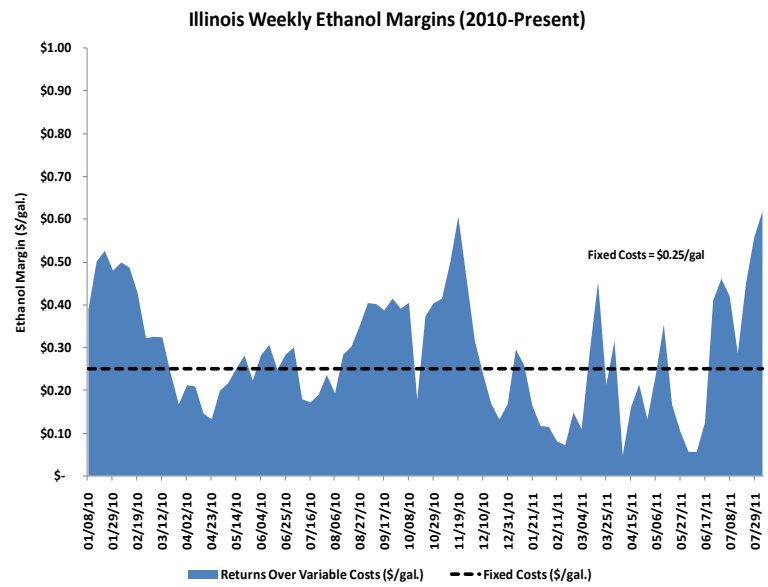
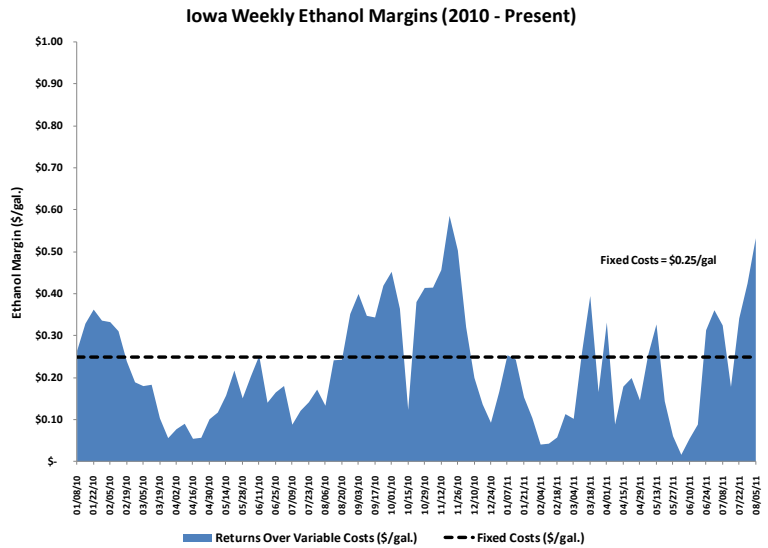
The August USDA World Agricultural Supply and Demand Estimates (WASDE) reported a 30 million bushel decrease in corn use for ethanol and by-products for old crop 2010/11. WASDE estimates that 5.02 billion bushels will be used for ethanol and by-products, or approximately 40 percent of the estimated total corn crop. After accounting for the byproduct, direct use of corn for ethanol is approximately 27 percent of the total crop. Last week, ethanol production in the U.S. rose to 908,000 barrels a day, the highest level in nine weeks. Ethanol output increased 3.4 percent, the largest weekly gain since week ending May 13, to the highest level since June 3. Ethanol inventories decreased 4

percent to approximately 18.2 million barrels, the largest weekly drop since week ending July 1 and the lowest level since week ending January 14. Overall, this level is enough supply for approximately 21 days.

WASDE projects corn production for 2011/12 to decrease by 556 million bushels relative to the July estimates due to a reduction in corn acres harvested and decreasing average corn yields by 5.7 bushels to 153 bushels per acre. WASDE also decreased the total projected corn use for 2011/12 by 340 million bushels. For the 2011/12 marketing year, WASDE decreased its projection for corn ethanol and by-products by 50 million bushels to 5.1 billion bushels, or 39 percent of the total corn crop, making corn use for ethanol approximately 26 percent. The 50 million bushel decrease reflects the tight corn supply situation and lower forecasted gasoline consumption for 2011 and 2012.

Ethanol Margins

Producer margins have been at healthy levels over the past month. Since week ending July 8 to August 5, returns over variable costs for Iowa have increased from \$0.32 per gallon to \$0.53 per gallon, Illinois from \$0.42 per gallon to \$0.62 per gallon and Nebraska from \$0.35 per gallon to \$0.39 per gallon. During this monthly period, the price of ethanol increased and outpaced the price of corn for all three states. For Iowa and Illinois, the price of ethanol increased approximately 12 percent while the price of corn (including week average basis levels) increased approximately 6 percent. However, for Nebraska, the price of ethanol also increased by approximately 12 percent but the price of corn, driven by appreciated corn basis levels, increased



by approximately 11 percent creating lower margins than that of Iowa and Illinois. Over the past month, the prices of corn and ethanol continue to be the primary drivers of higher or lower ethanol margins with natural gas prices continuing to be relatively cheap and dried distillers' grain prices staying relatively consistent between \$190 and \$200 per ton.

Even though current producer margins are favorable toward ethanol producers, rising corn prices will potentially increase profit risk in the short-term. The August WASDE sent a good message regarding the potential increase for profit risk to ethanol producers. The August WASDE reduced its projection of corn production for 2011/12 by 556 million bushels due to a reduction in acres harvested and lower expected yields. Corn farm price in 2011-12 was also raised from \$6.00 per bushel to \$6.70 per bushel indicating bullish price projections for corn in 2011/12. The key message is that profits will continue to remain in the black for ethanol producers if ethanol prices continue to rally as such over the price for corn. However, the August WASDE indicated a thorough message about the 2011/12 corn crop to ethanol producers; profit risk has certainly increased in the short-term.

Gasoline to Ethanol – A Narrowing Spread

With the \$0.45 per gallon blenders tax credit (VEETC) set to expire at the end of the year and with the recent 17 percent decrease in the price for WTI crude oil since the end of July, the issue of whether ethanol is competitive against gasoline has been brought up. With gasoline being a by-product of crude oil, gasoline follows the price of crude oil fairly closely. The purpose of the \$0.45 per gallon tax credit is to make ethanol competitive, or cheaper, than that of gasoline which provides blenders the incentive to blend ethanol with gasoline. September gasoline futures prices (RBOB) last week rebounded from an August 8 close of \$2.69 and ended the week up \$0.13 by closing at \$2.82 on August 12. However, the beginning of the month brought bearish news to the markets. Bearish factors included the debt ceiling debacle, the U.S. credit downgrade from AAA to AA+ and the plunge in the stock market, which had negative implications for U.S. economic growth and fuel demand going forward. Furthermore, reports indicated that OPEC production in July rose by 0.9% to a 6-month high of 26.8 million barrels per day.

For most of 2011, ethanol has been trading at a discount to gasoline. However, September ethanol prices (CBOT) closed even with September gasoline futures (RBOB) on August 9 at \$2.67. This past week (ending August 12, 2011), September ethanol prices traded at \$2.80 and September gasoline futures closed at \$2.82 resulting in a slight \$0.02 ethanol discount and a \$0.47 ethanol discount including the \$0.45 blenders tax credit. If this spread narrows, or even favors gasoline (meaning gasoline being cheaper than ethanol), the fate of VEETC will be a topic of conversation heading into the fall and winter months – all eyes will be on the price of oil!

