



# WEEKLY OUTLOOK

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## **CORN RATIONING: A REVIEW AND OUTLOOK**

Economic theory has a lot to say about the price of storable commodities such as corn. One of the things theory says is that when supplies are small, prices should rise and the futures market should become inverted — nearby prices higher than deferred prices. The high prices should discourage consumption and the inverted prices are expected to encourage producers to sell the crop in storage and encourage end users to defer consumption to a later time period. Both of these expected reactions have occurred in the 1995-96 corn market. Corn prices have exceeded the previous record high by more than \$1.00 per bushel and price inversions have been nearly record large. However, the impact of high prices on corn consumption is just recently occurring. The slow down in consumption has been so slow in developing that USDA is currently projecting an improbably low year end inventory of 317 million bushels. Why have prices gone so high and why has the response by end users been so slow? Rather than reducing consumption in anticipation of lower prices later on, end users have generally been willing to pay higher prices to maintain a presence until the promised lower prices become available. A number of factors have contributed to this behavior.

First, it is generally believed that corn producers sold a larger than normal portion of the 1995 crop early in the marketing year at what turned out to be relatively low prices. As a result, some end users had a relatively large portion of their needs purchased at those lower prices. When prices and inversions increased, producers were not able to respond with large sales and end users lived off of previous purchases.

Second, domestic livestock prices were able to adjust to the higher price of corn. Hog prices increased from \$40 in November 1995 to over \$50 in April 1996 and recently moved to \$60. Prices are currently 50 percent higher than at this time last year. While cattle prices have generally declined since last fall, feeder cattle prices have also dropped sharply. The lower cost of feeder cattle have offset some of the impacts of higher corn prices to the feed lot operator. Broiler prices have increased about 30 percent over the last two months and are currently 20 to 25 percent higher than at this time last year.

Third, domestic corn feeding has been supported by smaller supplies of other grains. The combined production of wheat, oats, barley and sorghum was down 400 million bushels (11 percent) in 1995. Production of wheat will be down again in 1996, resulting in smaller than expected feed supplies this summer.

Fourth, export demand for corn has been supported by continued economic growth and expansion of livestock production in Asia. In addition, exports of U.S. corn have been supported by a relatively small southern hemisphere corn harvest last year and continued weakness in the value of the U.S. dollar. As of May 9, sales to our major Asian customers were 16 percent larger than on the same date last year.

The recent signs of a slow down in domestic corn consumption include increased slaughter of cows, calves, and sows; an 18 percent reduction in feedlot placements in large feed lots in the seven major cattle feeding states; and reduction in industrial use of corn. Corn export sales remain very large, totaling 99 percent of the USDA's projection for the entire year as of May 9. Last week, however, there were renewed rumors of Chinese corn sales to Korea and Japan reportedly released feed grain reserves equal to about one month of consumption. Southern hemisphere production will provide some competition for U.S. exports as well.

It is still not clear that the reductions in the rate of corn consumption are sufficient to make supplies last until the 1996 crop is available. An objective evaluation will not be possible until the June 1 *Grain Stocks* report is released on June 28. Increasingly, prospects for the 1996 crop will have a role in the demand for the 1995 crop. If prospects for the 1996 crop are favorable and the sharp price discounts persist, end users, particularly importers, will have added incentive to delay as much use as possible until the new crop is available. Conversely, poor prospects would push new crop prices higher in order to convince domestic end users that "cheap" prices are not just around the corner. Either way, it appears that end users will have significant incentives to continue to reduce consumption. Continued liquidation of the cattle herd will have implications for domestic feed demand for the next two years.



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