

Global Corn Stocks Likely The Key To Land Values/Rents On Into 2012-13

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We keep hearing about high land values and strong cash rents across the Midwest. THE main factor in pushing these values higher has been very strong corn prices during the past year. So the question of continued strong land prices comes back to the corn market. Will the corn market move up or down in 2012?

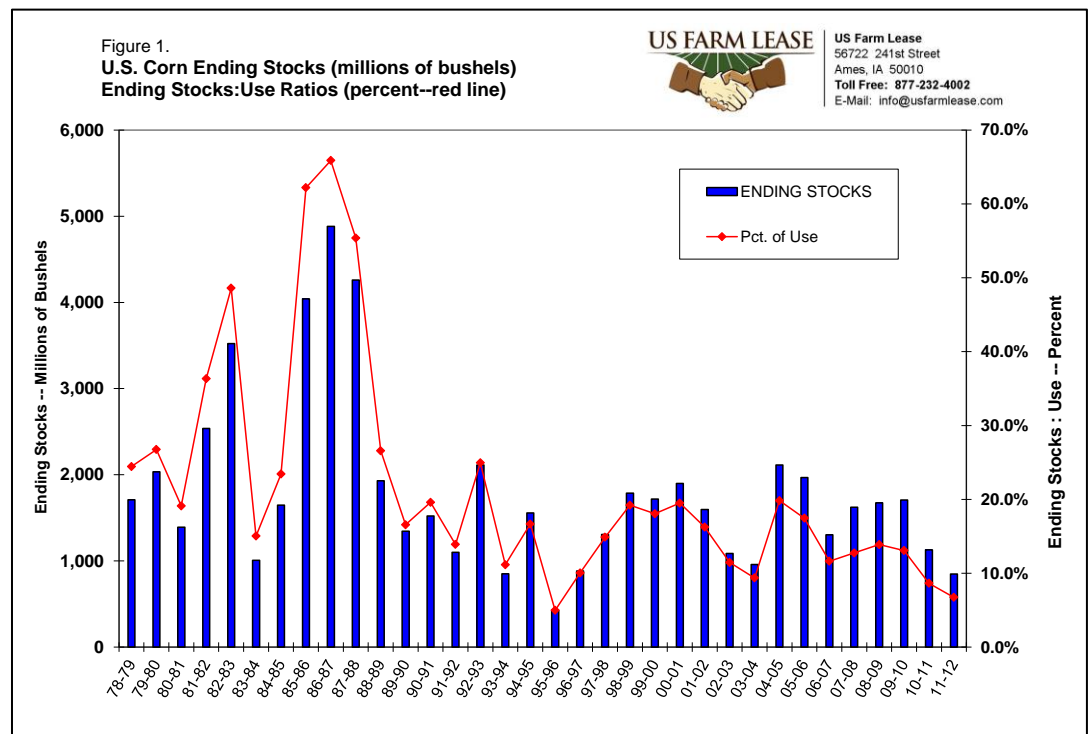
No one can predict commodity market prices. No one. But we can look to fundamentals in the market to get a sense of market direction. There are many factors that move commodity prices, but ultimately long term price direction is driven by fundamental supply/demand in the market. The grain markets function is to balance supply and demand.

We are currently seeing a very tight supply/demand situation in both U.S. and World corn. Supply/Demand can be measured over time by looking at the stocks to use ratio. In simple terms, take the current ending stocks projections and divide them by the total use (demand or disappearance) for the year. In the United States the USDA is currently projecting ending corn stocks at 848 million bushels (mbu) and total demand for the 2011-12 crop year at 12.605 billion bushels (bbu). If you divide 848 mbu by 12.605 bbu, you come up with the U.S. stocks to use ratio of 6.7%.

Another way to look at the supply/demand situation is to come up with the number of days that the ending stocks will "supply" the market. If total use for the entire 2011-12 crop year is 12.605 bbu, we are using 34.534 mbu of corn every day. If we divide the ending stocks of corn (848 mbu) by 34.534 mbu, we come up with a 25 day supply of corn on September 1, 2012. We have not seen this tight of a supply since September 1996 when we got down to an 18 day supply. And we will NEVER run out of corn. Remember, the markets function is to balance supply/demand. So if corn supplies get too tight, the market will move higher to "ration" usage. This is sometimes called "demand destruction". Prices move up to high enough levels that end users (i.e. livestock producers, world importers or corn processors) cannot afford to pay for corn and slow down or quit using corn for their needs.

So relatively speaking, how tight is the corn supply? Anytime ending U.S. corn stocks get below a billion bushels, our supply/demand is tight. If you look at the chart in Figure 1, you can see that we have only seen U.S. stocks to use fall below 10.0% in 3 of the past 33 years (1996, 2004 & 2011). We have not had two years in a row with stocks to use below 10.0%. So our current situation is unprecedented.

How do we work our way out of a very tight S&D



situation? Normally we see two things happen. First, the market reacts to the upside and farmers plant more acres of corn in the year following a year with very tight supplies. The market “buys” acres and thus production is normally increased the following year and stocks of corn are rebuilt. Secondly, the price increase also slows the demand for corn and overall use goes down, also contributing to an increase in ending stocks.

In the current 2011-12 crop year, production did not go up, in fact we dropped production in the U.S. by 137 million bushels. We are seeing a reduction in the demand side of the market (total use is projected to be down 449 million bushels or 3.44%), but ending stocks have gotten tighter. The crop year doesn't end until September 1, 2012. We could see corn prices work higher into 2012 to further reduce the usage side of the supply/demand equation. And remember, we need to influence farmers to plant more acres in the spring of 2012. Price will likely have to move higher (at least relative to other crops) to get that job done.

In the spring of 1996 farmers increased corn acres by 7.7 million acres (+10.8%) to help balance S&D. In the spring of 2004 we saw an increase of 2.2 million acres (+2.8%) planted to corn. And this past year, 2011, we saw farmers plant an additional 3.7 million acres (+4.2%) to corn to help balance the supply/demand, but due to lower yields we did not see an increase in overall production.

We will need a minimum of 93.5 million acres of corn planted in 2012 with average yields (154.0 bpa) to get U.S. corn stocks to use back above the 10.0% level. This would be an increase of 1.6 million acres (+1.7%) from 2011 and would leave carryout at just 1.300 billion bushels. This would not be a “surplus” situation by any means.

That is the situation in the United States. Guess what? We live in a global environment today and we also must look closely at World supply/demand, not just what is going on in the USA. When we look at World corn we generally look at World coarse grains because we see other feedgrains substituted for corn around the world. Coarse grains include grain sorghum, rye, barley, oats, millet and mixed grain.

It happens that the World coarse grain situation is also very tight. World stocks to use is projected to be 12.7% on September 1, 2012. There are only 3 years that have been tighter in terms of stocks to use: 2007, 1974 and 1973. As you can see in Figure 2, we have had World coarse grain stocks that have been lower than this year's projection of 160.6 million metric tons (mmt), but we have only 3 years (one in recent history) that the World stocks to use ratios have been tighter. You have to remember that the World is consuming over two times the coarse grains today as we did in 1970 (total use in 1970 = 623 mmt, total use in 2011 = 1,266 mmt).

World demand for coarse grains will very likely set a new record with the 2011-12 season at 1,266 mmt. World consumption of coarse grains has shot up 12.3% since the 2006-07 crop year when prices started to move higher. In other words, the argument that demand is suffering as a whole globally due to high prices doesn't hold water. Can that change? Certainly it can, but today's situation is much tighter than a year ago and we haven't put the South American crop in the bin and it will be a little while before we plant the 2012 U.S. corn crop. There are several areas of the U.S. that are dry. We will need to recharge the moisture profile across the Midwest in order to produce trendline yields this year. We can't afford yield problems unless we plant substantially more corn acres this spring. Between now and March 15 farmers will be watching the market to see how much corn to plant.

The corn market moved to nearly \$8.00 in August and has stayed above \$5.75 since. It would seem that corn prices will have to work back up to slow World demand.

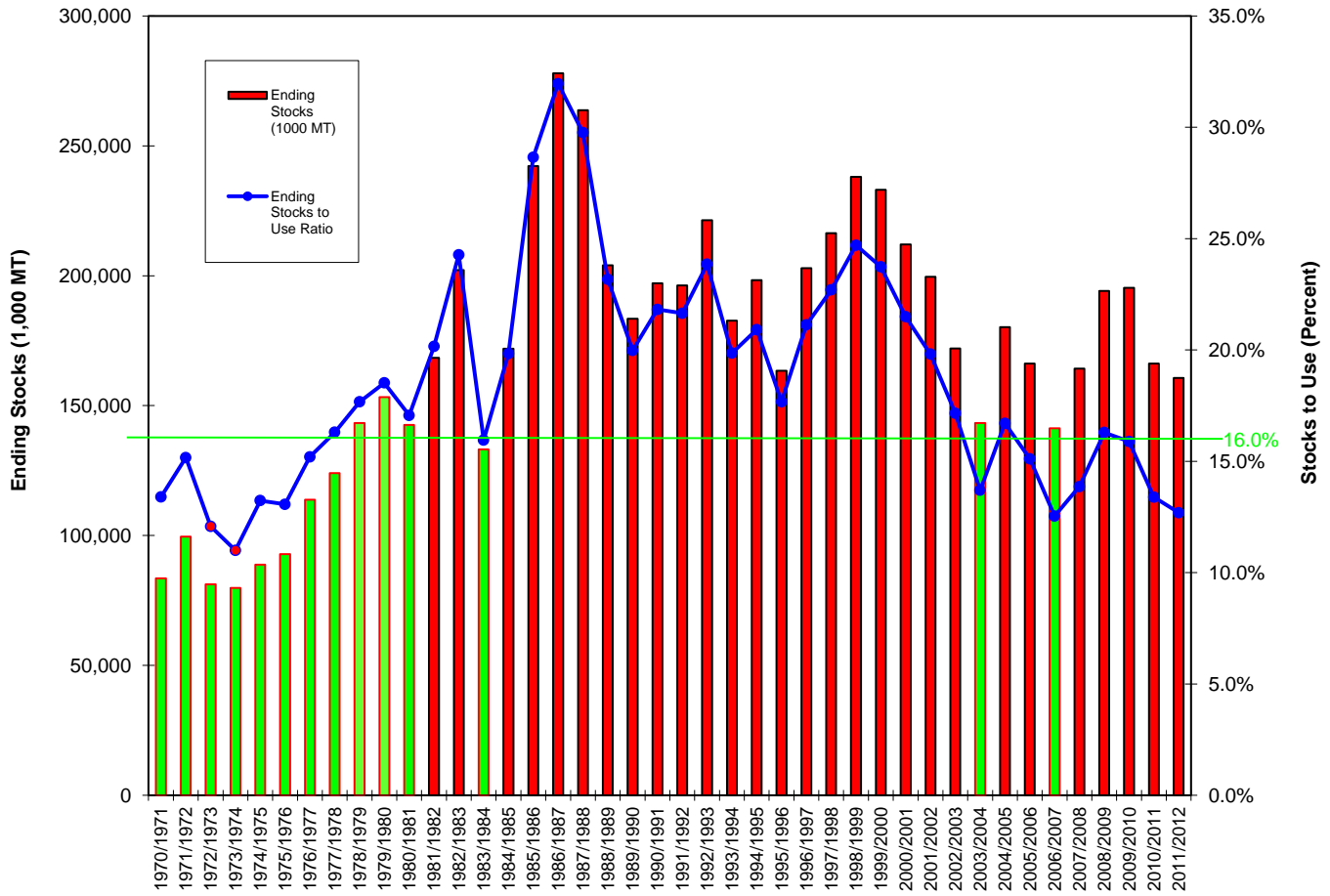
All of this talk about U.S. and World supply and demand may not seem to have anything to do with land values and farmland rental rates. But yet it has everything to do with them.

Figure 2.
**World Course Grain Ending Stocks
 and Stocks to Use Ratio**

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If corn prices do move back up to ration usage and attract more acres in 2012, that means that gross farm income will be high again in 2012. Higher gross farm income will push land values and rental rates up. There are many other factors that will impact agriculture and land values, but this is a big one to watch. The next two to three months will be critical in determining profit potential and thus land values going forward.



Monthly Nearby CME Corn Futures
January 2005 to January 2012
 Open-High-Low-Close Bars
 Each Bar = 1 Month

