

East VS. West, Again

Drought continues to impact grain flow.

By Diana Klemme

Frank Sinatra crooned that love is lovelier the second time around. But any repeat of the Drought of 2012 was less than welcome this year, and it continues to impact grain flows and basis even as combines roll on the 2013 crop. The good news is all signs indicate elevators will end up with around 3 billion (B) more bushels this season: Beginning US carryover stocks are lower this year, but total production is forecast to be around 3.4B bushels higher (corn, soybeans, sorghum, wheat, oats and barley). Early corn yields indicate production may top USDA's latest estimate, further adding to the recovery. Soybean yields may lag, however, and temper the projected volume. The key is less about the total volume managers will handle this fall than how the bushels are distributed. Location is everything!

The 2012 drought left around 4B bushels of unfilled space (on-farm plus commercial) in the Western Corn Belt (WCB) and Plains last year, plus the space created by the ongoing weekly consumption of crops. This year, Western areas are likely to wrap up harvest with "only" around 2.5B bushels of empty space. That's better than last year, but far from a bumper harvest. Ground piles are still possible, even in Iowa or North Dakota, where space far exceeds volume. Sometimes harvest gets ahead of the logistics and bushels end up on the ground, and yields can still be exceptional in some areas. But overall, it's shaping up to be another year where demand and space will chase bushels in the western half of the Grain

Belt, with just the opposite situation in the East.

Numerous bins have been built since then, which only adds to the empty space in the Western states, but will temper the shortages in the East.

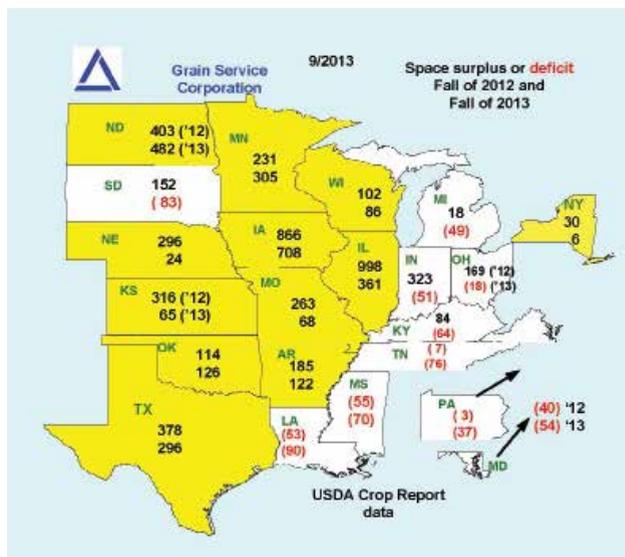
The relative imbalance in crops compared to space will impact basis again this year. Ethanol plants west of the Mississippi will again face the challenge of maintaining the steady corn pipeline needed to operate. Four states alone (Iowa, Minnesota, Nebraska and South Dakota) use approximately 230-250 million (M) bushels of corn each month just for ethanol. Through 2012 crop, that equated to around 50% of all the corn grown in those states, and turned the WCB into a corn importing region at times. This fall's corn volume in those same four states is around 6.2B bushels (carry-in plus production), up 700M over last year. As a result, ethanol will consume around 45% of the corn in those four states, down from 50% last year. That's better, but feedlots and ethanol plants can't afford to be complacent corn buyers.

To the east, the other three of the

top seven ethanol producing states are Illinois, Indiana and Ohio, using approximately 1.1B bushels of corn per year. Those states should have about 3.7B bushels of corn available this season, putting ethanol needs at around 30% of the corn inventories, far better than 2012 crop's 42.8%.

Almost all states east of the Mississippi face space deficits this fall. Corn exports are forecast to rise this year to 1.2B bushels, but that's still the second lowest total since 1985, and US exports could fall short under continued competition from Brazil's massive second crop Safrinha corn still being harvested. With corn exports still sluggish and with the big crops in the East needing homes, end users in that region should generally have an easier time originating corn than their counterparts out West.

Space limitations will force grain to move at harvest or else basis and futures will have to build a big enough carry to justify substantial ground piles. Fortunately, pork and poultry numbers are steady to higher in the East, and lower corn prices should support feed demand.



Diana Klemme is a longtime contributor to *Feed & Grain*. Contact her at Grain Service Corporation, Atlanta, GA, by calling (800) 845-7103 or email at diana@grainservice.com.

The \$64,000 question, however, is how the farmer will market corn and soybeans this season. Pre-harvest forward contracting was very low in most areas; current prices have to drive the decisions this season. The psychological tendency called “anchoring” has established the value of corn in the range of \$6 to \$7 in farmers’ eyes for two years. Bids for October on corn are now mostly under \$4.50, the lowest prices farmers have seen in three years. There will always be some selling at harvest; this year will be no exception. But expect farmers to suffer from “Sticker Shock.”

Continued high soybean prices and the inverted futures should make soybeans the more attractive crop to sell than corn. Soybean cash prices are still above \$12.50, and although \$1 to \$2 below monthly prices throughout 2012 crop, this is still near the upper end of all opportunities since 1972 and nearly three times the price of corn. (The highest single month national average cash price for soybeans was \$16.20 in August 2012.)

With space abundant in the WCB and Plains and corn prices as much as \$2.50 below the recent highs, farmers may be content to fill their farm bins with corn and shut the doors for awhile. And once corn’s in a farm bin, it can be a challenge to draw it back out. Farmers are generally well-situated for cash flow, and more crop insurance payouts will be coming for many on revenue policies. (The winter average futures price on corn revenue policies was \$5.65, but yields are extremely high in some areas which could reduce the payout potential.)

Corn exports and feed demand can both be seasonal, but corn processing and ethanol plants require a steady source of corn. Ethanol is profitable now and production is ramping up slowly as corn supplies rise. But Western plants may find it tough to keep sufficient corn in the

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pipeline if the farmers turn up their noses at \$4.50 corn. The result could be another season where corn basis in the WCB may stay unusually strong relative to other parts of the country, and force the Western Corn Belt to pull corn from other areas.

Managers in the Western Corn Belt and Plains are already offering "Free Delayed Pricing" to farmers to encourage them to bring corn to town at harvest. If prices aren't attractive to farmers, then perhaps the chance to have as much as six months to price at no charge for space will draw attention.

One offshoot of this dilemma for the Western areas is that corn hedging effectiveness has to again be measured differently than in the past. Historically Iowa and Nebraska

corn basis, for example, would often be well below Illinois River values which reflected strong export demand. But Western elevators may find themselves buying corn at relatively strong basis values — even at harvest — with continued quickship bids making the job of filling and holding at a profit even harder.

Soybean merchandising is shaping up again as another season of "fill up fast and get rid of 'em fast." The massive export program to China has export values showing to +100 Nov all the way to November with little to no carry available in basis or futures. This will be a blessing for Eastern managers who can sell soybeans and use the space for corn. Western managers may try to hold awhile and then liquidate hedged soybeans by late fall.

Some elevator managers and merchandisers have another tough year ahead. That doesn't mean corn basis has to always be high; it just means the West is likely to remain strong relative to other markets much of the time. As the old joke goes, one hunter reminds the other as they run through the woods that he doesn't have to outrun the bear to survive; he only has to outrun the other hunter.

Even with the potential for 1.8B bushels of corn on hand next September, look for the Western Corn Belt to have to run hard to capture their share of corn. Expect unusual corn movements again, but unusual circumstances create opportunities for sharp traders! ■

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