



Weekly Outlook: Ethanol Production Remains Strong

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A number of factors have contributed to the increase in corn prices that began on June 30, 2010. Two factors stand out. First was the shortfall in the size of the U.S. crop. While the 2010 crop was not "small" in the traditional sense, it was more than 900 million bushels (7 percent) smaller than the USDA's August forecast and more than a billion bushels smaller than some of the early season private forecasts. The second factor has been the rapid increase in ethanol production and the corresponding increase in corn consumption. Both exports and domestic feed consumption of corn during the current marketing year are expected to be near the level of last year's consumption. However, the use of corn for ethanol production is forecast at 4.95 billion bushels, 382 million more than used last year and 250 million above the USDA projection in September 2010.

Corn processing for ethanol results in the production of a co-product, distillers dried grains or similar products depending on the process used. About one-third of the corn used for ethanol production, then, is returned to the market as livestock feed. These co-products substitute for other feed ingredients, primarily whole corn, in either the domestic or export market. Still, the expected 382 million bushel year-over-year increase in corn used for ethanol production represents a "net" increase in consumption of about 256 million bushels.

Weekly and monthly ethanol production estimates provided by the Department of Energy indicate that ethanol production during the first quarter of the 2010-11 corn marketing year that began in September 2010 was nearly 19 percent larger than during the first quarter of the 2009-10 marketing year. Production in the second quarter was up about 11 percent year-over-year. Last year, ethanol production was at modest levels in the first half of the corn marketing year and increased in the last half of the year. As a result, year-over-year increases in ethanol production will be smaller in the last half of the current marketing year than in the first half. Ethanol production during the last half of the year (March-August) will need to be only about 2 percent larger than production of a year ago to support marketing year corn consumption at the projected level of 4.95 billion bushels. For March 2011, ethanol production is progressing at a rate 6 percent higher than in March 2010. With a continuation of high crude oil and gasoline prices, ethanol production should continue at a high rate and corn use may well exceed the USDA projection.

What are the threats to ethanol production? Legislation has been proposed to immediately end the \$0.45 per gallon blenders' tax credit that is due to expire at the end of 2011. The proposal is not likely to be

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successful. If it were, the demand for ethanol by blenders would be determined primarily by the relationship of ethanol and gasoline prices. Ethanol prices are currently about \$0.45 below gasoline prices. A continuation of that magnitude of price spread, or even a much smaller spread, would keep ethanol demand very strong. A large spread is expected if gasoline prices remain high. Weekly ethanol production estimates will provide information for continued evaluation of likely corn consumption.