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Weekly Outlook: Pork Producers Ability to Pay for Corn

Chris Hurt

Department of Agricultural Economics
Purdue University

August 22, 2011

***farmdoc daily* (1):135**

Recommended citation format: Hurt, C. "Pork Producers Ability to Pay for Corn." *farmdoc daily* (1):135 , Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, August 22, 2011.

Permalink: http://farmdocdaily.illinois.edu/2011/08/pork-producers-ability-to-pay-1.html

http://farmdoc.illinois.edu/podcasts/weeklyoutlook/Weekly_Outlook_082211.mp3
This year's corn crop is not big enough to meet the entire consumption base that has been built. Prices will have to be high enough to convince some end users to reduce consumption from current levels. Can the pork industry compete with other end users?

The answer is complex and will depend on many factors including how small the U.S. corn crop is and production in the southern hemisphere this winter. Ultimately the question is how high corn prices have to be to get a sufficient number of end users to reduce consumption.

The largest competitor for corn in the coming year will be the ethanol industry where USDA analysts currently estimate 5.1 billion bushels of corn use. To meet the mandated domestic Renewable Fuels Standard (RFS) will require about 4.7 billion bushels with nearly 400 million additional bushels used to make ethanol that will be exported. The 5.1 billion bushels of mostly mandated usage is 39 percent of the 2011 crop.

Mandated corn use was troublesome to the animal industries when corn was abundant. Now with short corn supplies, the concerns are even greater. Clearly use of 400 million bushels of a limited corn supply to produce ethanol to be exported to countries like Brazil is far beyond the intent of Congress in the 2007 energy legislation that established the current RFS. The short corn supply increases the odds that some end users, including the animal industries, will appeal to the EPA to consider exercising the emergency clause to reduce ethanol mandates for 2012.

Without a reduction in mandates, the cut-back in corn usage will primarily be thrust upon the non-fuel sectors represented primarily by the domestic animal sector and corn exports. There has been a general assumption that foreign customers would reduce consumption as prices rise, however in 2007/08 foreign customers increased purchases. Given the low value of the dollar and strong desire of many foreign governments to do what they can to moderate food inflation, the question remains whether the foreign sector will cut U.S. corn imports this year.

In 2007/08 the domestic livestock industry could not pay more than $6 per bushel for corn. That is no longer true as reduced per capita production over the past four years has increased farm level prices for animal products. Corn prices will have to move to new record highs on a marketing year basis to get animal industries to reduce corn use.

What are these corn price levels for the pork industry? That, of course, will vary sharply by individual producer, but the current estimate is that producers could pay about $6.65 per bushel based on a U.S. average farm price for the 2011/12 marketing year and still meet all other costs. USDA's August WASDE report forecast the U.S. average farm price between $6.20 and $7.20, with $6.70 being the mid-point of the range. The corn futures market is now expecting prices above the $6.70 USDA mid-point and closer to $7.00 per bushel for a U.S. average price received. Corn prices above $7.00 per bushel would be required for the domestic livestock industry to cut back on usage.

Pork producers were well aware of this season's corn price uncertainty and have kept expansion plans on hold. Those decisions appear fortuitous now. Estimated farrow-to-finish margins for the 2011/12 corn marketing year now appear to be slightly negative, with an average loss of $4.00 per head. This potential loss is small enough to keep the industry at about the same size. An alternative way to say this is that corn and meal prices above current levels could cause the industry to begin to shift toward moderate liquidation.

The industry remains hopeful that both China and South Korea will purchase more pork from the U.S. Greater pork exports would stimulate hog prices and enable the industry to pay more for feed. Unfortunately, domestic consumer demand is expected to be weak as consumer income growth is expected to remain modest in coming months.