

Corn Prices Set To Rebound On Ethanol Demand, Economic Recovery

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By Myra P. Saefong

A flailing economy and record crops have worked to pull corn prices some 20% off their 2009 peak, but analysts say the move is only a temporary setback, with an economic recovery under way and ethanol demand on reliable footing.

"Nearly a third of the domestic corn output in the U.S. is being used for ethanol production and this volume is set to expand even further," Commerzbank analysts wrote in a recent research note. "This should push up prices."

Ethanol--made primarily from corn in the U.S., since the nation is the world's largest producer and exporter of the crop--is a fuel additive used in reformulated gasoline.

"This year, 12.95 billion gallons of renewable fuels are mandated to be used in fuels sold in the U.S., up from 11.1 billion gallons in 2009," said Brian Milne, refined fuels editor at Telvent DTN. While that mandated demand will not be satisfied exclusively by ethanol, "demand for ethanol will continue to rise with the mandate, which runs to 2022."

Corn for use in ethanol production has already increased nearly fivefold from the year 2000 to 3.6 billion bushels in 2008, according to the National Corn Growers Association, which used preliminary data for 2008.

It wasn't too long ago that ethanol demand was actually outgrowing corn and risked--maybe even succeeded in--sending prices for corn and its byproducts, including feed for cattle, to unreasonable levels.

Renewable fuels got a "bit ahead of themselves in the public eye in 2008 when gasoline was over \$4 a gallon and the race to biofuels was on," said Chris Kraft, president of CKFutures.com. "High fossil fuels lead to high demand for ethanol, which lead to historically high grain prices, which made ethanol as expensive as gasoline."

In 2009, corn continued to be supported by expectations of increased demand for ethanol, as well as difficult growing and harvesting conditions that year--"too much rain followed by early cold and snowfall before all the crops were harvested," said Milne.

Forecasts of a bumper corn crop have combined with the downturn in the nation's economy and falling oil prices to withdraw some of that support.

On Jan. 12, the U.S. Department of Agriculture raised its estimates on the nation's corn crops by 2% from its November forecast to a record level of 13.2 billion bushels. That's 1% above the previous record set in 2007, the USDA report said.

Prices sank more than 7% the day the report was released and posted subsequent declines in eight of the 11 sessions thereafter.

"Corn has been the darling of the funds and the focus of reallocation of moneys ... in the first week of January," according to a report from commodity broker and researcher Linn Group. "Stats had been mildly supportive also--at least a bull case could be built."

But with the latest USDA production and usage report, "that story has evaporated," the report said. "We ... look for a year of deteriorating corn prices with only strong energy prices to help stabilize this market at reasonable levels."

Year-to-date, corn has posted the weakest returns among the major commodities, with returns of -10.3% as of Jan. 22, according to Deutsche Bank.

Corn futures prices have dropped from a \$4.50-a-bushel high in June 2009 to trade recently at \$3.60 on the Chicago Board of Trade.

With the lower prices for corn, "ethanol industry fundamentals have improved significantly over the last six months," said Neil Koehler, president and chief executive of Pacific Ethanol Inc. (PEIX), a producer and marketer of low-carbon ethanol.

Fourth-quarter crush margins, the relationship between corn and ethanol, were "better than the average over the last two years," he said. "Supply and demand are in relative balance" and in 2008, the industry saw the largest increase in capacity it has ever experienced, prompting an excess of supply over demand.

With the current corn crops estimated to be the largest in history, "the corn outlook for ethanol producers looks good over the next year," he added. "There is more than enough corn grown in the U.S. and globally to comfortably meet all of the end uses of corn and support increased ethanol production this year and the years ahead."