



Weekly Outlook: Expected Price Pattern for Corn and Soybeans

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July 16, 2012

farmdoc daily (2):134

Recommended citation format: Good, D. "Expected Price Pattern for Corn and Soybeans." *farmdoc daily* (2):134, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, July 16, 2012.

Permalink: <http://farmdocdaily.illinois.edu/2012/07/expected-price-pattern-for-cor.html>

http://farmdoc.illinois.edu/podcasts/weeklyoutlook/Weekly_Outlook_071612.mp3

Widespread drought conditions continue to reduce the 2012 U.S. corn and soybean yield potential. Yields are now expected to be well below trend value so that this year's production will qualify as "short crops".

It is widely anticipated that corn and soybean prices will reach a peak early, sometime in a relatively wide window around harvest time, and then decline as the marketing year progresses. The anticipated pattern is generally described by the adage that "short crops have long tails." The logic of this expected price pattern is based on three tenets. First, prices need to move sharply higher in a relatively short time frame so that consumption becomes unprofitable to some end users and the overall pace of consumption is reduced to be in line with expected supplies. Second, a short crop is expected to be followed by much larger production in the following year as weather conditions return to normal and producers respond to the incentives of high prices. Third, once prices peak and start to move lower, an extended period of declining prices is required in order to re-build the pace of consumption to the level of subsequent production. The timing and magnitude of the price peak and the speed and magnitude of the subsequent price decline are determined by the magnitude of the production shortfall, the timing of the recognition of the shortfall, the strength of demand for the crops, and the production response (domestic and foreign) in the following year.

There is not a universally accepted definition of a short crop, but it is generally defined in terms of an U.S. average yield that falls below trend value by some threshold double-digit percentage. For corn, there have been 10 other years since 1970 in which the crop could be classified as short. These include 1970, 1974, 1980, 1983, 1988, 1991, 1993, 1995, 2002, and 2011. The price pattern in those years generally followed the expected pattern described earlier, but with some exceptions. In particular, the timing of the price peak varied considerably in those years. The price peak occurred early in six of those years (1970, 1974, 1980, 1983, 1988, and 2002), but ranged in timing from June to November. Prices did not peak in the same month in any two of those six years. In addition, the price peak occurred in January following the 1993 harvest and in July following the 1995 harvest. For the 1991 and 2011 crops, the price peaked in August before harvest and again later in the marketing year.

For soybeans eight previous years might be described as short crop years. These include 1974, 1976, 1980, 1983, 1984, 1988, 1993, and 2003. Like corn, the timing of the price peak varied in those years. Prices peaked early, ranging from June to November, in five years; had a double peak in 1993-94 (July

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before harvest and June after harvest); peaked in April following the 1976 harvest; and peaked in March following the 2003 harvest.

At this juncture of the 2012 season, it appears likely that the corn and soybean price pattern will follow a more or less typical short crop price pattern, at least in terms of the timing of the price peak. Based on historical patterns, however, the timing of the price peak could range from the current month until after harvest. With an early harvest, a price peak by September seems most likely, assuming that prices go high enough to sufficiently slow the pace of consumption. Prices are probably not yet sufficiently high for either crop to accomplish that objective. For both corn and soybeans, there is considerable risk that the U.S. average yield will be lower than now anticipated. For soybeans, demand is also very strong due to the shortfall in the 2012 South American crop and ongoing large purchases of U.S. soybeans by China.

For producers with substantial quantities of 2012 crop corn and soybeans to sell, the window for the best price opportunities may be open for a while, but it is not possible to predict the timing and magnitude of the price peak. A strategy of spreading sales over the next several weeks may be prudent. For producers with little or no crop to sell, the major focus may be on maximizing crop insurance payments. For those with insurance products that include a harvest (October) price guarantee, there may be concern that the price peak will come and go before October. In that case, some are considering hedging the insurance payment on their production shortfall by selling futures contracts at prices higher than expected to exist in October. There are obvious risks with that strategy since prices above the selling price would result in margin payments and foregone income. Those considering hedging insurance payments may also want to consider an averaging strategy and/or the use of options to manage the risk.