

It's a kind of Magic!

In last Friday's stocks report the USDA discovered 300 mln. bushels of old crop corn, stating emphatically that there was absolutely no comingling with the new crop. This is vintage USDA misinformation. The old crop corn stocks were of the worst quality in living memory. Over one thousand barges (1.5 mln. tons) of off-grade quality corn had been sitting at the terminals in New Orleans for weeks waiting to be blended with new crop. I know of off-grade barges that have traded as low as \$1.20, an 80 percent discount. To imagine that domestic users and shippers would not comingle one part old crop corn with nine parts new crop corn to make the grade, and release these barges from crippling demurrage charges, is absurd. We have clients in the South who in August used an extraordinary amount of this record early corn crop. Enormous quantities of good quality new crop corn were consumed in the month of August, displacing old crop and, therefore, inflating the old crop stocks. Why would elevators want to pay big premiums for August corn ahead of the main harvest, just to store that grain? That is the equivalent of a starving man paying an extortionist huge sums for food and then putting that food in the pantry!

This has occurred before. In 2007 poor quality corn was displaced with early new crop. The 2007 September report was inflated, but in January 2008, 200 mln. bushels "disappeared" because they weren't there in the first place. One thing you can say about the USDA is that they will never learn from their mistakes. They are not accountable. The more one thinks about how grain flows the more absurd the USDA statement is. It is the equivalent of the Army Corp of Engineers saying "all the water in the Mississippi is from rain that fell the last ten days; we know, we asked the fish."

In the 2010 August crop report the USDA estimated the national yield at a record. Given the extraordinary weather we have had this summer, I found that quite amazing. We had an unprecedented amount of rainfall in key growing areas in June, July and August. Some areas in Iowa received over 50 inches in these months. Nighttime temperatures were at an all time record for several weeks after pollination. Top agronomists have written many papers on the negative effects of high nighttime temperatures on kernel fill, or ear weight, and yet in their September report the USDA used a near record ear weight. Over the last seventeen years ear weight has varied by approximately 30 percent nationally. Given the detrimental effects of nighttime temperatures it never made sense to estimate such a high ear weight. Satellite images, "the greenness maps", showed the crop maturing way too fast. Corn kernels require very slow accumulation of dry matter to achieve maximum potential. Clearly that did not happen this year. Aerial photos such as those by Topflight Grain in August in Piatt county in Illinois, by no means the county most affected by excessive rain, show large drowned out spots in almost every field and a crop of a sickly yellow-green color, obviously the affects of denitrification. Last year I estimated the 2009 corn yield at 161.4. This was derived from over 50 thousand test plot yields and farm reports which have been remarkably accurate over the last several years. The June stocks report appeared to confirm last year's overestimation of the crop, but cunningly, by borrowing from the new crop the USDA has managed to validate their number. In August this year

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the very early yields were shockingly bad, and yet with all of the above, the USDA used a yield of 162.5 in September, only 2.2 bushels below last year's record which was artificially inflated by low test weight. The USDA has clearly decided that technology trumps weather. Case closed, eyes shut, brain off.

So far this year I have collected almost 20 thousand test plot yields and almost 600 farm yields, and from day one it has been obvious that the USDA has overstated this crop by an extraordinary amount. The last time they had an epic miss was in 2003 on the soybean yield. In August of that year they estimated the yield at 39.5. My estimate at that time was below 36. The final USDA estimate for that year was 33.9. That is the year that I stopped believing in the weekly crop condition reports because they had never hinted at a collapse of the yield. This year, the weekly corn crop condition reports have consistently ranked this year's crop equal to last year's record. But how does the USDA evaluate the crop on a weekly basis? Does anybody actually go in a field? The answer is an emphatic NO. In mid to late August I had clients and friends doing crop checks in South Dakota, Illinois and Indiana. I asked them how much of the corn crop was dented in those states. They answered "nearly 100 percent", "100 percent" and "virtually 100 percent" for those respective states. Those same weeks the USDA estimated those states at 10, 29 and 16 percent dented. That categorically told me that they hadn't actually bothered to go into the fields. So the USDA puts a huge emphasis on bogus crop condition reports, but doesn't read the agronomist papers, doesn't look at satellite imagery, and couldn't be bothered to look at aerial photographs that clearly showed a sub-standard crop.

So what do my 20 thousand yields say so far? You have to go back to 1988 to see such a string of catastrophically bad yields in prime areas. Just on Friday, I had a report of 6,000 acres in Northern Indiana at 118 bushels, and 4,500 acres in Kentucky at 91 bushels, down 50 percent from a year ago. A client of mine in Logan County, Illinois, who yielded 212 a year ago on 4,000 acres, is now averaging 162, down from 170 two weeks ago. My farm reports can be dismissed as anecdotal, but 20 thousand test plots are saying the same thing. Against a year ago, Indiana is running 7 bushels down, Iowa 12 bushels down, Illinois down over 20, Missouri down 17, Kansas down over 40, Kentucky down 50, Michigan down 10 and Ohio down 7, and early indications are that Nebraska is down considerably. Marginal states like Pennsylvania and the Carolinas, are down an average of 33. Farm reports from South Dakota are also disappointing, which leaves Minnesota, Wisconsin and North Dakota as the great white hopes. Cross referencing to my yields of 2008, with a national yield of 153.9, Iowa, Illinois, Missouri, Kansas, Indiana, Nebraska, Kentucky, Michigan are all lower this year. While not mathematically impossible, the data tells me that the final yield will probably fail to reach 150. As the harvest has progressed in Illinois, Indiana and Iowa, the same areas have dropped 5-7 bushels over the last three weeks. This was also predicted by some agronomists and almost certainly not read by you-know-who. I had to laugh when one of the agronomists referred to the USDA as the IRS in a corn field. Say no more.

So why is the average analyst's guess for this year's corn crop at 160?

1. These people are attached to the USDA by a very short umbilical cord.

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2. They worship the weekly crop conditions.
 3. They apparently get paid by how close they can get to the average guess.
- Many of these analysts make sheep look like independent-minded Renaissance men. Two weeks ago, five farm advisory services polled on the crop size had an average yield of 162. This is not surprising since they have told farmers to sell up to 70 percent of their crop sub \$4. The farmers responded and sold a chunk of new crop for good measure. But with the yields down so much, farmers are discovering that they have sold a lot more of their crop than they had thought. The farmer is pretty much sold out for the year, and the consumer has the lowest coverage in many years.

The world simply cannot afford the type of drop in the U.S. corn crop that my data is showing. With the losses in wheat and feed grains in Russia, Khazakhstan, Ukraine, Western Europe and Canada, there is at least a 35 mln. ton hole in export availability compared to a year ago. True to form, the USDA plugged that hole with a mere 4 mln. tons more U.S. exports of wheat and corn; more Washington magic. Russia will be lucky to get half a winter wheat crop and is almost certainly out of the export business for two years. It should be obvious that we are headed for a major food crisis. Yet the head of the USDA recently decided that it was not necessary to bring over 4 mln. acres out of the CRP, as we clearly won't need them. The world believes that China has an excellent corn crop, just like they did last year. Prices in China this year went through the roof, despite the government selling off 20 mln. tons of reserve stocks. One outfit in China, the J.C.I. Group, warned last year that the crop was much lower than the official estimates. They appear to have been right. They recently down-graded this year's crop to 153 mln. tons, over 12 mln. tons below official estimates. If they are right again this year, China will surely have to import large quantities of corn. But who will be able to sell it to them? And who is going to feed Pakistan? Thousands of square miles of agricultural land are still under water, and much of Pakistan's infrastructure, including the largest irrigation canal system in the world, has been destroyed. Pakistan was meant to be an exporter of flour and wheat this year.

With the USDA giving the markets bad signals, bad things will happen. We will clearly need more corn acres next year. This year corn on corn is yielding especially badly, and up to 35 percent of the corn in the western belt is corn on corn. Soybean yields are spectacular and the farmers have been getting \$10 -plus a bushel. Wheat acres are increasing and so will cotton acres. And now triple stacked corn has become triple smacked. Where will we get the corn acres from?

By the time it has become obvious that the USDA has been woefully inaccurate, say as in next January's stocks report, it will be too late to ration other than at a stratospheric price. The ethanol industry will probably have ownership through March, and there will only be five months in which to ration. The market could easily go to levels that we have never imagined. You can put on the brakes at 40 miles an hour, or you can wait and put on the brakes at 90 miles an hour and go into an uncontrollable skid. That is what happens when you play God with numbers. By trying to keep the phrase "food crisis" out of the papers, the USDA is guaranteeing that it will be front page headlines.

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Coming back to my farm yields that are dismissed as anecdotal, using a constant formula on just several hundred farm yields from mainly the same sources in 2007, 2008 and 2009 they predicted a yield within 2 bushels of the USDA final. Last year, for 8 consecutive weeks, the farm yields suggested a national yield of between 161 and 163.

This year the same reports for four weeks in a row, are predicting an astonishingly low range each week between 139 and 142. I am not saying that that is what the final yield will be, but I do not fudge the numbers, and they have been awfully good in the past. It is unthinkable that the USDA will ever admit to the colossal errors they have made this year and they don't actually have to. They can always pull the residual rabbit out of the hat. The residual category, which should be renamed the "we goofed category", is going to get a real work-out this year!

You know it all adds up:

1. A crop miss of 1 bln. bushels
2. Exports underestimated by 200 mln. bushels
3. A carryin overestimated by 250 mln. bushels

That's a whopping 1.45 bln. bushels, just under 40 mln. tons. Add to that the 70 to 75 mln. tons of wheat and feedgrains lost in the rest of the world, and we have lost nearly 110 mln. tons of grain in the last five months. In mid-August 2007 I warned of a imminent panic in the wheat market "not only is the USDA wide off the mark on global wheat production but they are overly optimistic on the export capabilities of several countries". I ended with "the final chapter of the story could get very, very ugly." In the following months wheat prices exactly doubled from that point. History may not repeat itself this time but it sure could rhyme.

I don't know when the USDA decided they had a mandate to keep the markets in check but clearly that is what they believe. Like Goldilocks, they like the markets not too bullish, not too bearish, but just right. I suspect the real reason that they created 300 mln. bushels out of thin air is that word of poor yields has even reached Washington, and they decided to create a 300 mln. bushel buffer against the declining carry-out, so that they can push off the day of reckoning. By distorting the price discovery process these unaccountable bureaucrats are sending exactly the wrong signals to farmers, consumers and markets world over. In doing so the USDA is about to create a Frankenstein of a market with huge and ugly worldwide implications.

Regards,
John Macintosh