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Market Facts

Corn And Food Price Inflation

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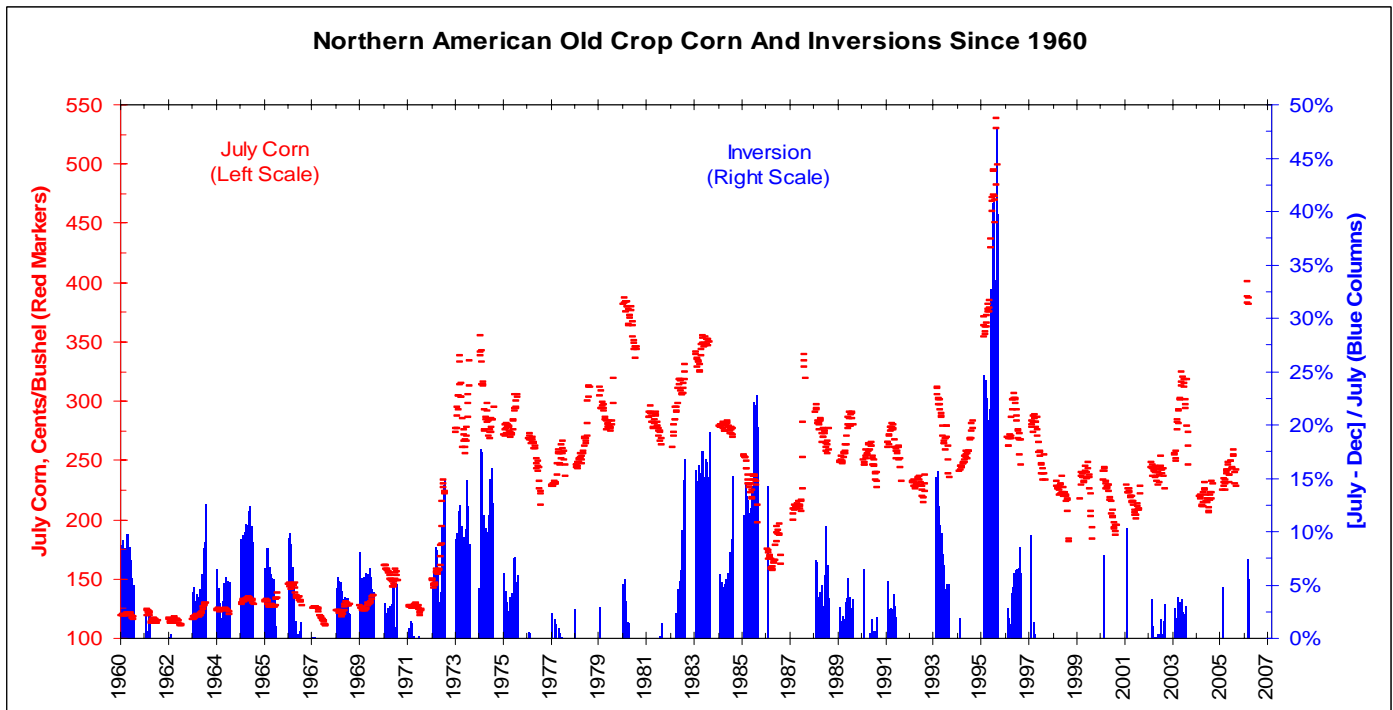
Unintended consequences are not unpredictable. We warned in a November 2006 [Market Facts](#) of the looming disaster brought about by the government's wrong-headed support for grain-based ethanol. Last week's USDA crop report reinforced the obvious: The fuel market can exert a bigger claim on corn supplies than can the food market. The end result, for those confused about the U.S. political process, will be political rationing of grain supplies and multiple layers of subsidization.

Not only have corn prices moved higher, but the inversion (blue columns), or premium of "old crop" July corn (red markers representing weekly averages here and on following page) to "new crop" December has started to move higher.

This inversion premium, now 4.6% of the July price, can move substantially higher as livestock feeders, food processors, and distillers scramble for supplies to tide themselves over until the fall harvest. The 1996 premium exceeded 40%. Anyone so foolish as to go short July had better be able to deliver physical corn against it; being long December is useless as a hedge.

Previous inversions broke after July, but previous inversions never had to contend with a third major use of corn, ethanol production. **It is different this time, and we are not afraid to say so.**

Northern American Old Crop Corn And Inversions Since 1960



Food Price Inflation

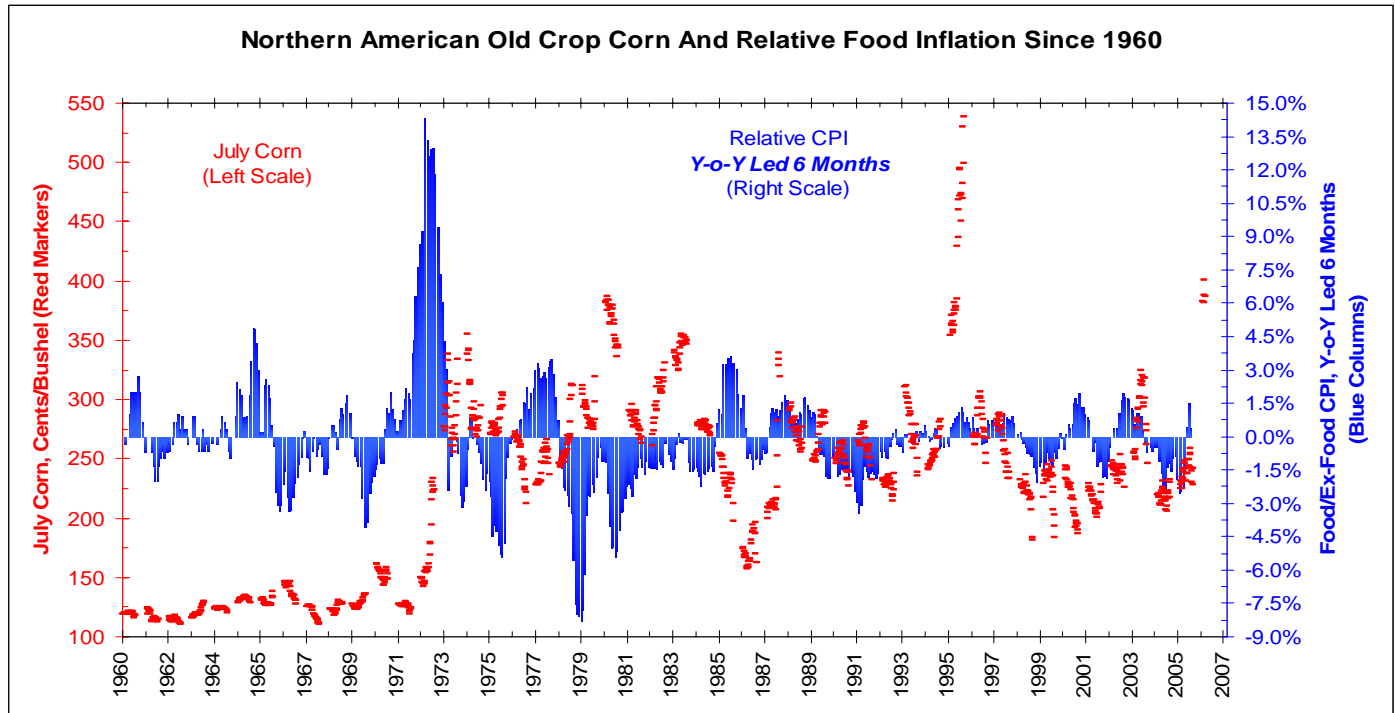
The Bureau of Labor Statistics, in its never-ending quest to prove inflation does not exist if you dissect matters sufficiently, reports the All-Urban CPI ex-food and as well as a CPI for food. If we compare the year-over-year growth rate of the food index to

the ex-food index (blue columns, following page) and lead it six months to allow for supply chain effects, can we see the impact of old crop corn price changes?

The answer, somewhat surprisingly, is "No." The greatest relative surge in food prices occurred

during the early 1970s, and it led – not followed – old crop corn prices. Conversely, large corn rallies between 1973 and 1985 did not lead to relatively

higher food price inflation. And the 1996 spike was digested beautifully, we are happy to report.



Conclusion

Our collective fear of uttering the words, “It’s different this time,” is high enough to prevent us from doing so when the facts warrant.

A reading of history would leave us sanguine; yes, old crop corn is moving higher and the inversion to December is growing as well. We have seen worse and survived.

Yet the ethanol market is a new and major source of demand for corn. We have no experience in the corn market equivalent of a bought deal, wherein a non-food industry can outbid the food industry for food. We do have experience with government interference in both agricultural and energy markets, all of which can be summarized as “not good.” That will not be different this time.

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