US Drought Cuts Global Grain Supplies

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The USA has been hit by its worst drought in half a century, causing a precipitous drop in crop yields as the heat dries swathes of the Mid-West's farm land.

Corn and soybean prices are on the rise as a result, with knock on effects in the meat and energy industries.

The USA's current drought is but one example of a more ominous trend of increasingly common food crises around the world, impacting not only short term prices, but longer term production too.

- According to the United States Department of Agriculture (USDA) 60% of the USA's cropland is experiencing a severe or greater drought. More than half of the counties in the USA are now officially â€œnatural disaster areasâ€• as crops fail under the withering heat. Survey statistics on crop conditions in the USA are cause for concern. Only 18% of farmers surveyed see their crops as in a good or excellent condition, with the majority pointing to more negative outlooks of crop harvest;

- In 2011, the USA made up 33.7% of the world's soybean production and 37.4% of the world's corn production ; therefore North America is key to global supply. Since December 2011 soybean prices increased by 24.3% by June 2012 to US$464 per metric ton. Similarly the future price of corn is expected to reach a record high, above US$9.0 per bushel by late August 2012, unless weather conditions dramatically improve;

- There is a growing fear of a more widespread rise in commodity prices as a result of high crop prices. Soybeans and corn are used in animal feed for most livestock, increases in pricing is increasing the cost of producing livestock that depend, causing general food prices to rise. For example the British Poultry Council estimates if the price of corn and soybeans remain where they are in August 2012 it could cause a 35.0% increase in feed expenditures in 2012 in the UK's poultry industry.

Implications

Rising prices of the USA's major crops; soybeans and corn are affecting swathes of the USA's agricultural industry. However short term rises in commodity prices are only part of the risks associated with USA's drought.

- The spillover effects of high prices of crops are not only raising the price of other foodstuffs, but also on the biofuel market. In the USA, the government is rolling out ethanol blended gasoline which produces fewer emissions. Ethanol is commonly derived from soybean crops, so a higher cost of soybeans reduces the supply for fuels, increasing the cost at the pump for consumers. Higher fuel and food prices will increase consumer spending on essential goods and transport, reducing disposable incomes;

- The world has been subjected to increasing numbers of food shortages in the past decade. The US drought is the third food commodity spike in five years, after rice shortages in Asia drove rice prices up in 2009 and drought in Russia in 2010 affected wheat prices across the world. Government policy exacerbated the impact of these droughts; the embargo on exports of wheat in Russia for example supported a 121% increase in wheat prices in US$ terms in the 8 months between June 2010 and February 2011. So far the US government has maintained an open stance, with no protectionist measures being enacted.

Prospects

The quality of the USA's crops is continuing to deteriorate as the drought remains, while the government has few options in staving off further weakening yields. According to the USDA's July 2012 Feed Outlook, output of corn between September 2012 and August 2013 will decline by 2.1% year-on-year, with similar results for soybean. A worsening of the drought in the second half of July however means expected yields will fall further as the year progresses.

- A heat wave in Russia is also underway in 2012, posing major risks to wheat and other crop exports just as the world requires it most. The fear of government protectionism and shortages are expected to put major upward pressure on food commodity prices in the second half of 2012;

- Government provisions have been enacted to support the USA's farmers; the opening of conservation land for grazing has supported the livestock industry, while emergency low interest rate loans are being provided to farmers in the worst hit regions. Though these government provisions will support farmers in the medium term, the decimation of crops in 2012 is likely to undermine the long term solvency of many farmers in the USA's Mid-West.

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