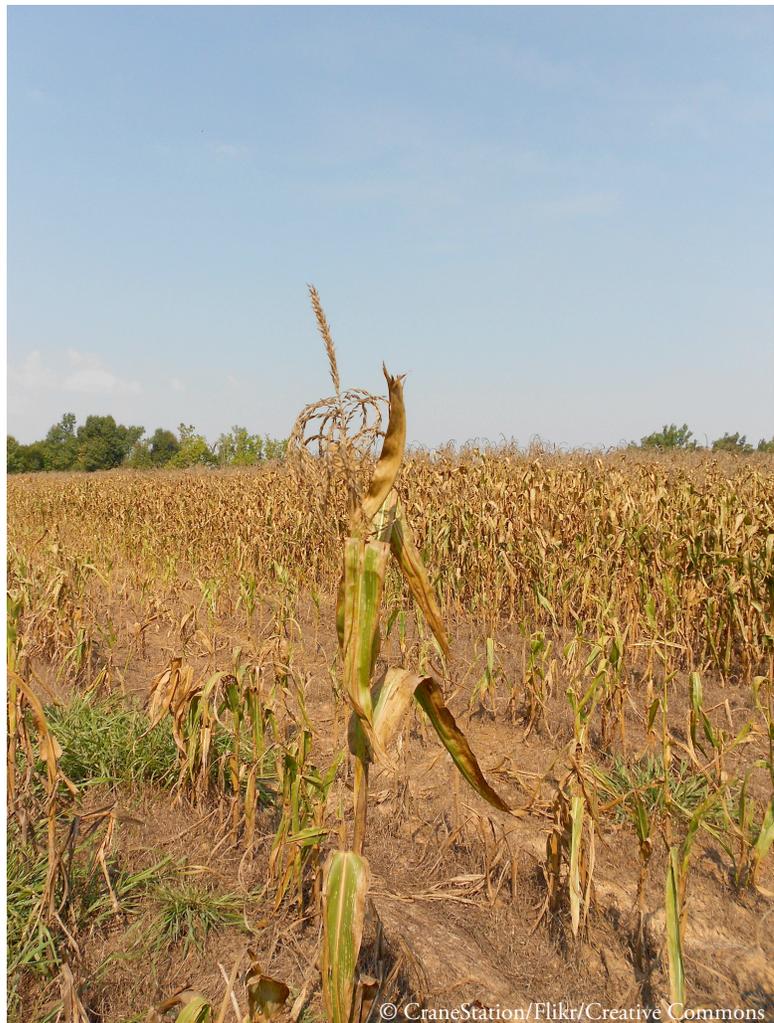


The Effect of the Midwest Drought on Florida

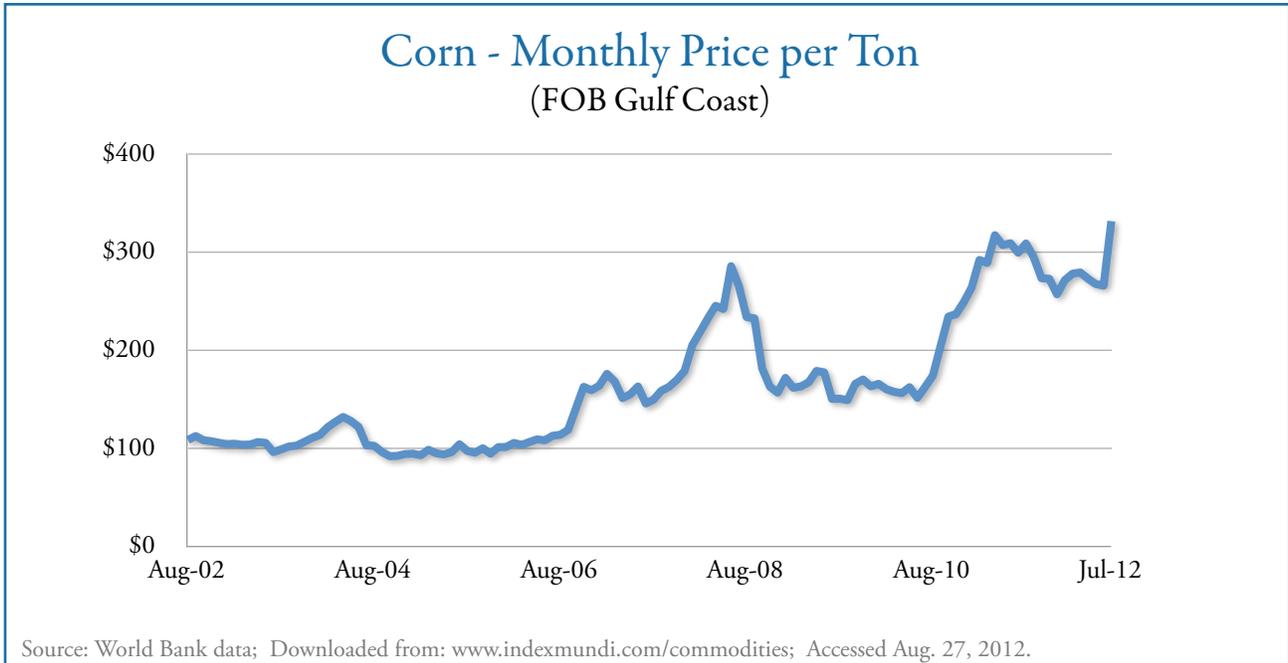
As of the first of August, a total of 1,584 counties in 32 states have been placed on the U.S. Department of Agriculture's list of primary disaster areas. This is more than half of the counties in the U.S. Most of these counties are seeing the worst drought conditions in decades. Although the remnants from Hurricane Isaac will provide relief to some areas experiencing drought, that relief is too late for this year's grain and hay crops. This will affect Florida through higher food costs as well as higher fuel prices.

This year an estimated that more than 97 million acres in the U.S. were planted in corn, the most acreage planted in the U.S. since 1937. Soybeans were estimated at 75 million acres, the third-highest on record. However, the drought is expected to severely decrease yields of both of these important crops and drive prices of grains up significantly.



Most of the U.S. field corn is grown in the Midwest, with about 60 percent of the crop coming from just the states of Iowa, Illinois, Nebraska, Indiana and Michigan. Field corn can be grown in other states (such as Florida), but only about .07 percent of all corn acreage in the U.S. for grain is planted in Florida. Interestingly though, Florida is the number one producer of sweet corn for fresh consumption in the U.S., according to the U.S. Department of Agriculture.

The drought of 2012 has significantly changed estimated yields of corn and soybeans, and the price of both commodities has recently reached record highs. The chart below shows that over the last 10 years, the price of corn has increased significantly, and has now reached an all-time high price.



The reduced production caused by the drought will affect the price of feed for animals, and will affect Floridians. With grains and hay making up a high percentage of the production costs of meat, milk and eggs, those commodities will see the largest and most immediate increases in price. There will also be increases in production costs for other items that use corn and its byproducts, including many items in the grocery store, such as soft drinks sweetened with corn sweetener.

The U.S. Department of Agriculture predicts that supermarket basket costs will increase 2.5 to 3.5 percent in 2012, and it could be higher if corn prices continue to rise. In the short run, beef prices could go down, as producers sell their stock knowing they will not have enough hay and other feed this year. However, this leaves smaller stocks of cattle and reduces the supply in the longer term, leading to potential increases in price in the future.

The Potential Effects on Gasoline

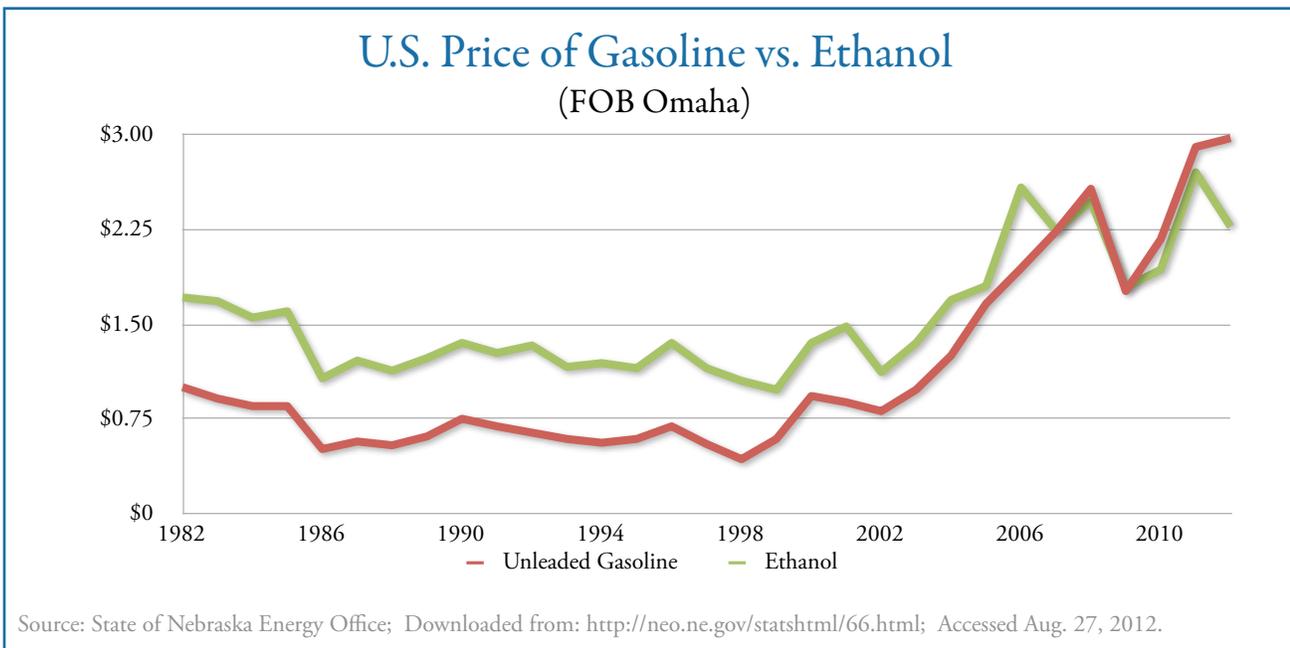
According to an upcoming article in Fortune magazine, about 4.5 billion bushels of corn will be used this year in the production of ethanol. The article indicates that beginning in 2011, more corn has been used for ethanol than for feed. This is partially a result of a U.S. law called the Renewable Fuels Standard (RFS) that requires refiners to use renewable fuels (such as ethanol) blended with gasoline. The use of 15 billion gallons of renewable fuels is required by 2015. This will use approximately 5.5 billion bushels of corn to produce the required 15 billion gallons of ethanol.

As a response to the high prices of corn and the additional costs to feed farm animals, several governors, senators and representatives have asked the Environmental Protection Agency (EPA) to suspend or reduce the RFS. The EPA started a review period on August 20, and has until November 13 to decide whether to allow this reduction or suspension.

Potential Effects of an EPA Waiver

If less corn were used in the production of ethanol, more would be available for animal feed, lowering the cost of production. However, reallocating a bushel of corn from ethanol production to animal feed does not result in a net gain of an entire bushel of corn. When corn is used for ethanol production, a 56 pound bushel of corn leaves about 17 pounds of material commonly known as “distillers grains” that can be used as a feed ingredient for livestock and poultry feed. Therefore, the net gain per reallocated bushel is around 39 pounds, although the quality of the feed is higher for corn than for distillers grains.

Although granting a waiver would appear to have an immediate impact on the use of corn for ethanol as well as the price of corn, the real effect may not be so simple because the situation is significantly more complicated. Currently, many refiners who are producing 87 octane fuel only refine their gasoline to around 84 octane. When the gasoline is blended with ethanol, the octane will rise to the required 87 octane number. Ethanol is also an effective oxygenate for fuel, and substituting away from ethanol with a higher-priced alternative may not be realistic until the ethanol price becomes significantly higher. It is also unknown how quickly and easily refineries could change processes of blending fuel. As the chart below shows, much of the time since 2007, ethanol prices have remained lower than gasoline prices.



Although the effect of a potential waiver is unknown, until ethanol prices are significantly higher than gasoline, it is expected to have little effect on the demand for ethanol in the short run. Refiners will either have to refine gasoline to a higher octane, costing money, or continue to buy ethanol for oxygenating and octane reasons until the price of ethanol gets high enough that substitutes become economic options.

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