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A Short-run Demand Flexibility System for U.S. Agricultural Commodities

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Poster prepared for presentation at the Agricultural & Applied Economics Association 2012

AAEA Annual Meeting, Seattle, Washington, August 12-14, 2012.

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A Short-run Demand Flexibility System for U.S. Agricultural Commodities

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Abstract

Using five monthly revisions to USDA crop forecasts (Jul, Aug, Sep, Oct, & Nov), we estimate own- and cross-commodity short-run demand flexibilities for six domestic agricultural commodities. Our findings indicate that the corn supply influences the expected harvest-time price of virtually every other major field crop. Moreover, as the share of the corn crop devoted to ethanol production grows, corn and soybean prices become more flexible, while the reverse is true for wheat and oats.

Price Flexibilities

Particularly for the short-run, demand parameters for agricultural commodities are best represented by price flexibilities, the percentage change in price for a 1% change in quantity.

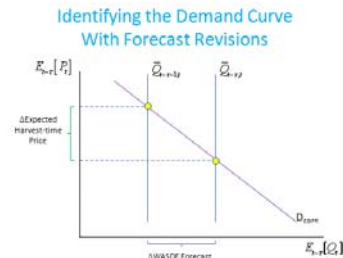
Why is that?

1. In general, quantity variation for agricultural commodities is dominated by exogenous supply shocks, especially within a crop year.
 - a. For example, weather or pests can alter the expected crop size at harvest.
2. Producers have little capacity to adjust their output.
3. Prices bear the adjustment burden to arrive at the new market-clearing equilibrium.
4. Consequently, price dependent regressions are a more accurate way to estimate demand parameters
5. See Moore (1919), Houck (1966), and Huang(1988) for more about price flexibilities.

Futures & Forecast Revisions

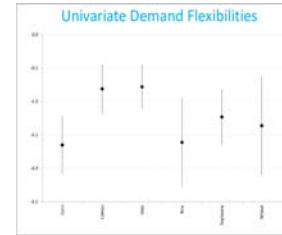
A harvest-time commodity futures price represents the market's expectation of the price once the harvest is complete. These contracts trade near-continuously, and their prices change as traders update their own expectations based on new fundamental information, such as revisions to USDA crop forecasts (e.g., Adjemian, 2012).

Adjemian and Smith (forthcoming) show that under minimal assumptions, a consistent estimate for the price flexibility of demand is generated by regressing log price changes for the harvest-time futures contract on contemporaneous within-crop-year monthly log USDA supply forecast revisions. These estimates have two immediate advantages over traditional parameter estimates: they can be recovered after a shorter passage of time, and they have more statistical power.

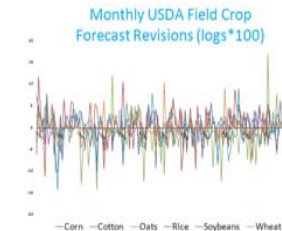


Extending their work, we identify own- and cross-commodity demand flexibilities by regressing the log futures price change for each commodity on the set of USDA forecasted supply revisions for the major domestic field crops, from 1981-2011.

Findings



USDA supply forecast revisions are more correlated for some commodities than others: corn/soybeans (0.62); cotton/oats (-0.03).



A multivariate SUR model identifies the own- and cross-commodity effects of changes to supply expectations on price.

	Price Change					
	Corn	Cotton	Oats	Rice	Soybeans	Wheat
Corn	-1.97***	-0.16	-0.83***	-0.69**	-0.52*	-0.68**
Cotton	0.08	-0.83***	0.58**	-0.04	0.11	0.30
Oats	0.05	0.07	-0.27*	-0.08	0.21	0.15
Rice	0.16	-0.48*	0.14	-1.52***	0.38	-0.38
Soybeans	0.11	0.13	-0.06	0.29	-1.09***	0.19
Wheat	0.02	-0.46	-0.86**	-0.14	0.07	-1.06***
R-squared	58%	38%	45%	41%	54%	37%

Note: These regressions include monthly dummies and macro controls.

Conclusion

- All own-quantity flexibilities have the expected negative signs, and are statistically significant.
- USDA supply forecast revisions, monthly dummies, and macro controls explain a substantial portion of the variation in futures prices for field crops.
- Corn supply shocks generate a price response for every field crop except cotton. For example, poor weather that leads to a 5% reduction in the corn supply raises expected harvest-time prices for corn (10%), oats (4%), rice (3%), soybeans (3%), and wheat (3%) prices.
- For each commodity, we estimate a models that interact both own- and corn supply revisions with the share of the corn crop devoted to ethanol. We find that corn and soybean demand have become more flexible (less elastic) and own-quantity wheat and oat demand have become less flexible (more elastic) as the ethanol share has risen.

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For further information

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