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A CLOSER LOOK AT RECENT DECLINES IN GRAIN PRICES

THE DROP IN GRAIN PRICES FROM NOVEMBER 28 THROUGH DECEMBER 11 was one of the sharpest declines on record. The break followed a period of about 5 months in which prices rose steadily. During that period, soybean prices advanced about $3 per bushel. Corn prices climbed by nearly $1 per bushel.

A combination of factors triggered the decline. Unrest in Eastern Europe threatened shipments of U.S. grain to that area. The cost of storing grain accelerated along with interest rates. The higher interest rates also made the financing of futures accounts much more expensive. Disappointingly low soybean exports to date also contributed to the negative sentiment about the market.

The decline was much more rapid and prices dropped to lower levels than generally expected. Before stabilizing on December 12, soybean futures dropped about $2.30 per bushel, corn nearly 60 cents, and wheat approximately 80 cents per bushel.

One possible reason for the large and rapid price drop is revealed in the November 30 Committment of Traders Report. The report showed the total open interest (unsettled contracts) by type of trader and by commodity at the major futures exchanges. Traders whose positions exceeded 500,000 bushels had to file a report. For those traders, open interest is reported as hedging or speculation with the amount that is long, short, or spread. For other traders, open interest is reported only as a total for long and short positions.

The November 30 report revealed that in both the corn and soybean markets, reporting hedgers were net short by a wide margin. Open interest for the reporting hedgers who were short in the corn market totaled a little over 1 billion bushels, double the amount a year ago. Reporting hedgers were net short 292 million bushels, compared to 5 million bushels last year on the same date. In the soybean market, open interest for the reporting short hedgers totaled 456 million bushels, up from about 206 million last year. Reporting hedgers were net short 214 million bushels, compared to only 5 million a year ago.

As a result of the net short position among hedgers, speculators were net long on November 30. Reporting speculators in corn were net long by 147 million bushels; in soybeans, by 68 million bushels. A year ago, the reporting speculators were net long only 16 million bushels in the corn market and were net *short* 19 million bushels in soybeans. Nonreporting traders were also net long in soybeans by wide margins compared to last year.

The large open interest of short hedgers implies that farmers have sold big quantities of corn and soybeans, which is reflected in the current congestion of grain at the export markets. Heavy sales by farmers were hedged, placing a burden on speculators to take the long side of the market. Once the price decline started, long speculators became willing sellers. The short hedgers already in the market were not buyers, implying that new speculators had to be attracted. New buyers were scarce. So the sell-off intensified as long speculators ran out of margin money and interest rates accelerated. Price declines ceased when forced liquidation slowed down and prices became low enough to attract new buyers.

Prices seem to have stabilized now. Since the basic fundamentals have not changed, prices should begin to climb again. Complete price recovery in the near term will require a reduction in grain sales by farmers, a stabilization or decline in interest rates, and most important a rapid use rate of corn and soybeans. Soybean use is shown in the weekly crush and export reports. How much corn is being fed will be revealed in the Grain Stocks report, to be released on January 26.

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