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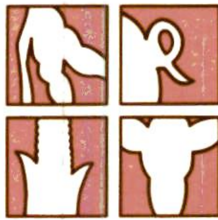

WEEKLY OUTLOOK

Department of Agricultural Economics
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PRICING NEW CROP CORN AND SOYBEANS

Prices for the 1987 crop of corn and soybeans have rallied sharply this spring and have recently become quite volatile. November soybean futures were trading at the $4.75 mark during the third week of March. The price of that contract rallied to $6.23 on June 15 as prices advanced by the permissable limit. The price of that same contract was at $5.82 1/2 on June 19. December corn futures that were at the $1.75 level in late March and early April rallied to a high of $2.16 on June 16 and closed at $2.06 1/2 on June 19.

The rally and recent volatility in new-crop prices reflect weather developments in the major producing areas. A generally hot, dry spring fostered the rally, and recent rainfall has cooled it. The strength in soybeans, though, also reflected stronger than expected soybean meal demand. The cash price of soybean meal at Decatur, Illinois, increased by $60 per ton (about 40 percent) from March 16 to June 16.

Weather markets like the one this spring, provide an exceptionally difficult environment for making pricing decisions. In general, weather rallies provide excellent pricing opportunities for the producer's of growing crops, but the timing of those sales is important. The extent of weather markets is difficult to forecast because weather is difficult to predict. That is, producers are not sure if the adverse weather will result in only a scare or if actual damage will occur. Even in the middle of a weather market, the pricing decision is difficult to make because further dry weather could result in further price gains. In addition, producers may have difficulty assessing their crop potential because of weather uncertainty. The risk on the downside is that a sudden improvement in weather will drive prices back down to the level where the rally started.

A number of approaches to a weather market can be taken. One approach is to first establish a benchmark price. In the current surplus situation the Commodity Credit Corporation (CCC) loan price is one possible benchmark. With a benchmark in place, a scale-up pricing strategy can then be followed. If a producer has an objective of pricing half of a normal crop before harvest, that process should begin as the market reaches or exceeds the benchmark. If prices move higher, additional sales, perhaps in larger quantities, should be made until the desired sales level is met.

The risk of this type of strategy is that a weather scare will turn into significant crop damage, producing sharp price increases. In this case, the individual producer may find that sales levels exceed production levels or that additional crop is not available to sell at the now significantly higher prices. Tools are available to reduce the effect of such a development.

First, early sales could be made in the futures market, rather than in the cash market. Sales made in the futures market do not commit the producer to delivery of the corn or soybeans. In addition, futures positions may be easier to lift if weather conditions deteriorate and further price strength seems likely.

Second, producers can use the options market to reduce the risk of sharply higher prices. Purchasing a put option, rather than actually selling the crop, gives the producer the right to sell futures at a given price level (strike price). The producer, however, is not obligated to sell at that price. Should prices

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price level (strike price). The producer, however, is not obligated to sell at that price. Should prices decline, a sale could be made at the strike price. If prices advance, the option is allowed to expire and the producer could then sell crops at the higher price. Purchasing call options to replace actual sales (cash or futures) provides the producer with the same kind of protection. The cost of the protection is the premium paid for the option. Producers should remember, however, that options do not provide "automatic" protection from rising prices. If prices rally, producers must still take action to capture that increase--selling the crop in the case where put options have been purchased or selling the call option. The timing of that decision is still very much a speculative decision. The benefit is lost if prices decline before any action is taken.

In the context of the current weather market, prices are declining from their peak due to improved weather. New-crop corn and soybean prices, however, are still at attractive levels. Additional weather-related rallies are certainly possible: it is still June. These periods of price increase are good pricing opportunities.

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Prices and Outlook

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