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WEEKLY OUTLOOK

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PROSPECTS FOR CORN AND SOYBEAN BASIS

Futures prices for old crop corn and soybeans have declined significantly since the highs following the January crop report. May corn futures traded at a high of $3.16 on January 14, but were $.30 lower on March 4. May soybean futures traded as high as $7.26 on January 13, but were $.55 lower on March 4.

The decline reflected a number of fundamental factors. Southern hemisphere crops continued to improve so that a record South American soybean harvest is likely and a near-record South African corn crop is expected. Exports of U.S. corn and soybeans continue at a slow pace so that the small USDA projections for the year may even be a little high. The market has become convinced that domestic corn feeding has dropped in line with the USDA projection of a 9.5 percent decline for the year. The March 25 *Hogs and Pigs* report and the March 31 *Grain Stocks* report will reveal if the market is correct about feed use. More recently, forecasters have been suggesting favorable weather conditions for spring planting. The National Weather Service 30-day outlook calls for below normal precipitation in much of the midwest, while the 90 day outlook calls for normal precipitation in that area. If the outlook is correct, the 1994 crops could get planted in a very timely fashion, increasing the odds of a large harvest.

The one bright spot for soybeans is the continuation of the high rate of domestic crush. Figures from the Census Bureau places the domestic crush for the first 5 months of the marketing year at $550.8 million bushels, down only 1.9 percent from the same period last year. For the month of February, figures from the National Oilseed Processors Association show the domestic crush was 1 percent <u>larger</u> than the crush during February of last year. The crush has been supported by record apparent domestic soybean meal consumption, record apparent domestic soybean oil consumption, and the low oil yield of the 1993 soybean crop. We use the term apparent domestic use because the month ending stocks estimates for both meal and oil do not account for stocks at locations other than mills. Other "invisible" stocks can fluctuate and therefore distort the calculation of monthly use.

Cash prices of corn and soybeans have also declined since mid-January, but not as rapidly as futures prices, as the basis has strengthened. At the close of trade on January 13, cash corn prices in central Illinois were about $.20 under May futures. At the close on March 3, the basis had narrowed to $.11 under the May futures. Similarly, cash soybean prices were about $.17

under May futures on January 13 and only $.095 under on March 3. A number of factors suggest that the corn and soybean basis in the eastern corn belt could continue to improve, and perhaps improve substantially into the spring/summer time period.

First, is the generally low level of inventory of corn and soybeans. In addition, about 200 million bushels of corn are currently in the Farmer Owned Reserve. Second, it is believed that a smaller than normal share of the corn and soybean inventory is held by farmers, particularly in the eastern corn belt. Farmer sales were heavy in January and February so that country elevators hold a larger than normal share of the inventory. That is, inventories are in "strong hands". Producers do not have large supplies to sell and elevators are hedged and willing to hold for a stronger basis. Third, livestock producers who had a short crop in 1993 will have to increase corn purchases this spring and summer. Fourth, if the domestic crush pace continues at the current pace, soybean processors will be competing for existing supplies. Fifth, demand for eastern corn belt corn should remain generally strong because of small supplies in the western corn belt and the southeast.

The potential of a strengthening basis for corn and soybeans has implications for producer marketing strategies. The only way for producers to capture a stronger basis, should it materialize, is to maintain ownership of the cash commodity. Therefore, producers desiring to price remaining old crop supplies should consider selling futures or using hedged-to-arrive contracts rather than making cash sales. Similarly, producers desiring to sell additional corn or soybeans and replace with call options should consider hedging rather than cash sales or should consider buying put options instead of selling grain and buying call options. Finally, producers who want to deliver grain and delay the pricing decision should consider price later contracts rather than basis contracts.

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