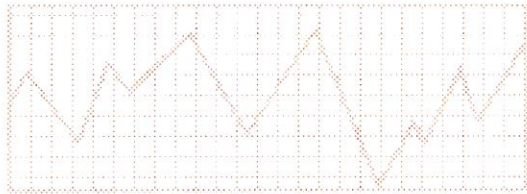




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# WEEKLY OUTLOOK

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## PRICING NEW CROP CORN

The current weather situation and the resulting uncertainty about the size of the 1995 corn crop and the price pattern over the next several months presents an extreme challenge in making new crop pricing decisions. The decisions of individual producers will be influenced by local crop conditions, the amount of new crop corn already sold, and the amount of old crop corn yet to be sold. In order to manage the combination of price and production risk, producers should evaluate pricing alternatives that provide some degree of flexibility in terms of price protection and delivery of the crop. The challenge is to acquire enough flexibility to react to changing crop and price conditions without sacrificing too much in the way of price protection.

At the close of trading on May 26, December 1995 corn futures settled at \$2.805 per bushel. The market is offering the eastern corn belt producer a 1995-96 season's average price of nearly \$2.70 per bushel. It has been 11 years since the marketing year average price was that high. The weather related rally of \$.20 over the past 5 weeks has resulted in a narrowing of the spreads in new crop futures contracts. The December 1995 to July 1996 spread, for example, narrowed from \$.13 on April 21 to \$.0775 on May 26. For the most part, then, any sales of new crop corn should be made for delivery in the early part of the marketing year.

Pricing flexibility is acquired by using futures and/or options markets or, in some cases, use of futures/options based cash contracts that allow flexibility in terms of delivery. The discussion here is limited to the direct use of futures and options. Pricing new crop corn with the sale of December futures provides protection from declining prices should crop prospects improve. Selling futures also provides flexibility in terms of time and place of delivery of the crop. The major disadvantage of selling futures is the potential for margin calls if price continues to rise. That is, producers do not benefit from rising prices unless they are agile enough to liquidate their futures positions. Liquidating futures, then, puts the producer back in an unpriced position and once again vulnerable to price declines.

For the most part, selling futures should be limited to that amount of the crop the producer is willing to deliver at the current price level. If production shortfalls prevent delivery, the producer has two choices — liquidate the futures and accept any gains or losses or roll the futures into the 1996 marketing year. Currently, December 1995 futures are \$.335 below the price of July 1996 futures.

If that discount continues, the futures position should be first rolled to July futures and then to December once the spread has narrowed.

Buying put options offers the ultimate in flexibility. A producer who buys \$2.70 December 1995 put options, for example, at a premium of \$.15 has the right, but not the obligation, to sell December futures at \$2.70 at any time before the contract expires in November. The purchase establishes a minimum price [ $\$2.70 - \$.15$  - basis] but allows the producer to benefit if price continues higher. At the same time, buying the put option does not obligate the producer to deliver corn. Producers may choose the level of price protection from the array of strike prices being traded.

The major disadvantage of buying put options is the cost (premium). Some suggest that producers consider selling call options with a higher strike price as a way to reduce the net cost of buying put options. This strategy allows the producer to establish a minimum price on part of the crop, but also establishes a maximum price determined by the strike price of the call option. In the previous example, a producer might buy \$2.70 put options at a premium of \$.15 and sell \$3.20 call options at a premium of \$.09. Such a strategy reduces the net cost (excluding commissions) to \$.06 per bushel. The producer is protected from declining prices and will participate in any rallies up to \$3.20. Gains would be capped at that level as rising corn prices would be offset by the increase in the premium on the \$3.20 call option. A similar position can be accomplished by selling December futures, buying December call options with a relatively low strike price (\$2.80 or \$2.90) and selling call options with a relatively high strike price (\$3.20 or \$3.30).

Depending on how much higher corn prices go, producers should also consider pricing 1996 crop corn. With the current price structure, that would be best accomplished by selling July 1996 futures with plans to roll that position to December 1996 at a more favorable spread sometime over the next year.

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