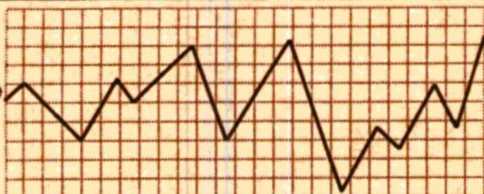

WEEKLY OUTLOOK

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NOVEMBER 24, 1997

CORN AND SOYBEAN PRICING STRATEGIES

Corn and soybean prices have declined from the highs of the first of October, but are still generally higher than we expected for this time of year. In the eastern corn belt, the spot cash price of soybeans is near $7.00 per bushel. For the year, the USDA has projected the average price in a range of $5.90 to $6.90 per bushel. The spot cash price of corn is about $2.70. The USDA's projection for the marketing year average is in a range of $2.45 to $2.85. Even though corn and soybean prices are "high" in relation to expectations and in relation to the USDA projections for the season's average, farmers are reportedly generally very reluctant to sell significant quantities of the newly harvested crop.

There are at least four reasons for the reluctance to price corn and soybeans. First, it is reasoned that if prices can strengthen in the middle of harvest, as they did in October, then higher prices are likely later in the year. Second, the memory of the corn price rally in 1995-96 and soybean prices above $8.00 in each of the past two years makes producers less aggressive in accepting what appears to be a good price too early in the year. Third, confidence in domestic and world demand suggests little downside risk to prices. Fourth, the continuation of the strong El Nino weather pattern raises concerns about production problems somewhere in the world over the next 10 months. A significant production problem, without the grain reserves that were available in the mid 1980s, could produce very high prices.

What to do? It is often useful to look at the price structure for marketing clues. For corn, the nearby basis in central Illinois of about $.05 is typical for this time of year. With the current carry in the futures market, the spot cash price is $.23 under July futures. By the first week of June, that basis would be expected to be about -$.05. If so, the market is paying about $.18 per bushel to store corn for 6.5 months. For farm stored corn, the primary cost of holding corn is the interest on the value of the crop. The interest cost for 6.5 months on $2.70 corn would be about $.11 per bushel, assuming a combination of CCC interest rate and market interest rate. With a typical spring time basis, the corn market is encouraging the storage of corn being held on the farm. Expected basis appreciation exceeds the interest cost of holding by about $.07 per bushel. The net gain in value for storing would be augmented if the price level goes higher and would be reduced or eliminated if the price level declines.

The expected return to storage could be captured by hedging the stored corn. That strategy captures the basis gain and eliminates downside price risk. The flip side is that hedging

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eliminates the opportunity to gain from a price level increase and subjects the producer to margin risk. One alternative would be to buy put options on the stored corn. On November 21, $2.90 July 1998 put options were priced at $.17 per bushel. With a spring basis of $.05, those options provide a minimum price of $2.68, yet allow the producer to benefit should prices increase significantly. The net cost of such a strategy is relatively low, since the market is offering a net return of about $.07 for storage.

For soybeans, the current price structure is quite different. The spot cash basis in central Illinois is not as strong as last year at this time, but is stronger than "normal" at about -$.08. However, there is very little carry in the futures market. The spot cash price is only $.19 under July futures. If that basis, narrows to a typical -$.10 by early June 1998, the market is only paying $.09 for 6.5 months of storage. Interest cost on $7.00 soybeans for 6.5 months would be near $.28. The market is clearly not encouraging storage of soybeans. Any sales should be made in the spot cash market. In the case of ownership, alternatives for storage should be considered. Owning futures or using basis contracts eliminates the storage cost and allows producers to benefit from price level increases. Such strategies have downside price risk, and in the case of owning futures, has margin risk and income tax implications. An alternative is to price the soybeans and purchase deferred call options. On November 21, $7.25 July options were priced at $.39 per bushel. Those options exceed the interest cost of storing soybeans by $.11 per bushel and were $.06 out of the money. Viewed in that manner, call options are $.17 per bushel more expensive than farm storage, but eliminate the risk of lower prices.

Issued by Darrel Good
Extension Economist
University of Illinois

Return Service Requested

CES Newsletter Service
University of Illinois
at Urbana-Champaign
69 Mumford Hall
1301 West Gregory Drive
Urbana IL 61801

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