



# WEEKLY OUTLOOK

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**SEPTEMBER 8, 1998**

## THE CORN AND SOYBEAN STORAGE DECISION

The sharp decline in corn and soybean prices, the weak new crop basis, and the large carry in the futures market encourage producers to store the 1998 crop. In central Illinois, for example, the average harvest bid for corn on September 4 was \$1.78 per bushel, or \$.55 under July futures. If the July basis strengthens to a typical level of about \$-.10 by May 1999, the market is offering \$.45 per bushel to store the corn for about 7 months. The cost of storing corn for 7 months depends on location (on-farm or off-farm) and on the appropriate interest rate. In central Illinois, the cost of off-farm storage from harvest until May might average about \$.25 per bushel. The cost of additional drying and shrink from 15 to 14 percent moisture would add \$.03 per bushel to the cost of storage. At a 10 percent annual rate, the interest cost for 7 months storage of corn valued at \$1.78 per bushel is \$.10 per bushel. Total cost, then, is about \$.38 per bushel, \$.07 less than likely basis appreciation. Interest cost would be nearly \$.03 less if inventory is financed with a CCC loan.

For soybeans, the average central Illinois price was \$4.93, or \$.65 under July futures. With an expected basis of \$-.10 in May, the market is offering about \$.55 per bushel for 7 months storage. Commercial storage and interest cost (at 10 percent annual rate) would total \$.54 per bushel. At the CCC interest rate, the cost would be about \$.45 per bushel. For on-farm storage, the cash cost of storage with existing facilities would be less than commercial storage, making storage even more attractive for both corn and soybeans.

The risk of storing corn and soybeans unpriced is that the price level might decline during the storage period, offsetting some or all of the improvement in the basis. That is, the basis might improve as a result of a decline in July futures rather than an increase in the cash price. The only way to "lock in" the current return to storage is to forward price the crops for later delivery. The most direct way is with a cash forward contract. Forward pricing could also be accomplished with a hedged-to-arrive contract or by directly selling July 1999 futures. The choice would depend heavily on the current spring time basis relative to expectations for the actual basis next spring. The use of hedged-to-arrive contracts or direct hedging allows producers to speculate on the spring time basis. Basis may be stronger or weaker than currently offered.

While forward pricing allows the producer to capture the return to storage, it also locks in a relatively low price for both corn and soybeans. Current market fundamentals do not support prospects for a large price recovery, but the potential does exist if significant crop problems

develop somewhere in the world by next spring. As an alternative to forward pricing, producers might consider placing the crop in storage and buying July put options, or pricing on a minimum price contract. The premium for a July \$2.30 corn put option was about \$.16 per bushel. A \$5.50 July soybean put option had a premium of about \$.30 per bushel. Options increase the cost of hedging, but would allow the producer to profit from an unexpected rally in prices over the next several months. This alternative is attractive where on-farm storage facilities are available, particularly for corn, since the total cost of storage plus premium would still be less than the likely basis appreciation.

A second alternative would be to forward price the stored crop to capture the return to storage and plan to purchase call options at a later date as the time value portion of the option premium declines. This would be a successful strategy if July futures remain stable or decline in the short term.

For that portion of the crop that has not been forward priced, and for which storage capacity is not available, the alternatives for ownership beyond harvest are expensive. All other alternatives – delayed pricing, basis contracts, replacing the crops with futures or call options -- require that the producer pay the full carry charged by the market. Unless the basis strengthens or the futures spreads narrow at harvest, the carry is large. These alternatives will be profitable if futures prices increase, but they will not capture any improvement in the basis.



Issued by Darrel Good  
Extension Economist  
University of Illinois

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