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CORN PRICING ALTERNATIVES

A number of factors have combined to push corn prices to a low level and produce a very weak basis in most areas. This combination generally favors storage of the 2005 crop.

Low prices and a weak basis has resulted from relatively large carryover stocks of 2004 crop corn, a larger than expected 2005 crop, increased transportation costs, and the interruption to export movement through the Louisiana Gulf port. The average cash price in central Illinois on September 16 was $1.69 per bushel equal to the marketing year low reached in early November last year. That price reflects an average basis of $-0.3725. The basis is about $.16 weaker than at this time last year. The contract low for December 2005 futures has been $2.055, $.145 above the contract low for the December 2004 contract.

Cash corn prices are expected to continue to drift lower as harvest progresses, particularly if the USDA=s October *Crop Production* report contains a larger forecast of the size of the current harvest. The low prices and weak basis are generally a signal to store as much of the crop as possible, depending on availability and cost of storage. In years of large crops, the central Illinois cash price has generally reached a marketing year low during harvest and a marketing year high in the spring/summer after harvest, with the high typically being $.60 to $.70 above the harvest low. Last year, for example, the average cash price (overnight bid) reached a low of $1.695 on November 4, 2004 and a high of $2.395 on July 18, 2005. The increase reflected a $.29 increase in futures prices and a $.41 strengthening of the basis.

The strong tendency for cash prices to recover significantly from harvest lows in large crop years has a lot of producers planning to establish the loan deficiency payment (LDP) sometime in the harvest window and store the crop unpriced to capture the seasonal recovery expected by spring. That is an acceptable strategy for part of the crop, but there are a number of reasonable alternatives to consider as well. Following are some examples.

The current weak basis and relatively large carry in the corn futures market (deferred contracts higher priced than nearby contracts) offers producers with low cost storage an opportunity to establish the LDP after the crop is harvested and to store the crop priced for later delivery. That is, a large portion of the typical season recovery in cash prices is already reflected in deferred futures and can be captured by forward pricing. On September 16, for example, the average price for corn delivered in January 2006 was $1.90, $.21 above the spot cash price. Corn that can be stored for less than $.21 could be priced for January delivery. The LDP could be established any time before delivery. If established now, at $.44 per bushel, the January sale would result in a price of $2.34, minus storage costs. Establishing the LDP now would take advantage of the fact that the LDP of $.44 is larger than expected, given an average cash price of $1.69. The net of $2.13 is about $.10 above the average loan rate in central Illinois. That Apremium@ over loan value has been diminishing and may disappear if the local basis continues to weaken. Where storage is not available, or is expensive, establishing the LDP and selling corn at harvest is currently a reasonable alternative.

Forward pricing for delivery in the spring of 2006, rather than January, may be warranted, depending on storage costs and basis expectations. On September 16, July 2006 futures settled at $2.32. Even if the July basis strengthens to only $-0.16 by May 2006, as it did this past year, selling July futures at $2.32 would result in a gross price of $2.16, $.26 above the current January 2006 price and $.47 above the current spot cash price.

Another alternative is to store some of the crop unpriced, but under loan rather than establishing the LDP. This strategy manages the risk of prices going lower, rather than higher, after harvest. The marketing loan gain, if any, could be established anytime (within 9 months) after the loan is established. The crop could be priced at that time or continue to be held in storage unpriced.

For producers who want to capture the current LDP and a portion of the carry in the market, but believe there is some chance that corn prices will recover significantly more than reflected by the current carry in the market could store the crop and hedge the price by buying put options. July 2006 put options with a $2.30 strike price had a premium of $.1525 on September 16. Owning those options would allow the producer to sell July futures at $2.30 any time before the options expire next June. If the basis strengthens to $-0.16 by June 2006, this strategy would result in a minimum price of $1.9875 [$2.30-$-.16 - $-1.525] minus storage costs. If July futures move higher, the options could be allowed to expire (or sold for any remaining time value) and corn sold at a higher price. Due to the large carry in the market, storing the crop and buying put options is preferable to selling the crop and buying call options, if low cost storage is available.

There are a large number of pricing alternatives that involve some combination of the loan program and storage, and perhaps options, that could be considered, including the provision to place corn under loan and Alock@ the current marketing loan gain rate for 60 days. Many producers will want to consider a combination of strategies depending on storage availability and cost and cash flow needs. The loan certificate program is available for those who face payment limitations.

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