WEEKLY OUTLOOK

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LESS INCENTIVE TO STORE EARLY HARVESTED CORN

Prospects for a sharp draw down in U.S. and world grain inventories during the current marketing year suggest that spot cash corn prices will move higher over the next several months. However, recent price behavior has resulted in less incentive to store the early harvested crop.

Prospects for large year-ending U.S. corn stocks and a large 2006 harvest, along with ideas that transportation costs could remain high, resulted in a very weak new crop corn basis during most of August. In addition, spreads in the futures market became relatively wide. In mid-August, for example, the average harvest delivery bid in central Illinois was $.37 under December 2006 futures, $.52 under March 2007 futures, and $.70 under July 2007 futures. Depending on expectations about basis levels in the spring of 2007, the market was offering about $.50 per bushel to store the crop from harvest to late spring of 2007. That potential return to storage exceeded the full cost of storage, including interest, for many producers. Cash bids for harvest delivery at that time were near $2.00. Through a combination of low prices and a large return to storage, the market was strongly encouraging producers to plan to store as much of the unpriced crop as possible.

The price structure changed over the past few weeks as the market worried about a late harvest and a harvest that could get stretched out due to a period of wet weather. There are also some who believe that the USDA's September production forecast overstates the potential size of the 2006 crop, pointing to an implied high average ear weight in that report and reports of lower-than-expected yields in some areas. In addition, crop condition ratings (60 percent in good or excellent condition as of September 17) do not point to a yield as high as the 154.7 bushels forecast by USDA, even though actual yields have exceeded yields projected by crop ratings for the past 7 years. It is rare, but not unprecedented, for the production estimate in January after harvest to be below the September forecast following an increase in the forecast from August to September. Over the past 35 years, that scenario occurred three times (1973, 1974 and 1990). There were only 8 years in total over the past 35 that the January corn production estimate was below the September forecast by a meaningful amount. The USDA will issue a new production forecast on October 12.

On September 22, the average spot cash bid for corn in central Illinois was $2.30. That bid was $.2525 under December futures, $.385 under March 2007 futures, and $.5325 under

July 2007 futures. For corn stored from harvest until March 2007, the market was paying $.13 cents less for storage than in mid-August, while the return to storage until late spring 2007 was down $.16. Forward cash bids for January delivery in central Illinois are currently only about $.14 above the spot cash bid. Depending on the magnitude of expected basis, the market is paying about $.35 to $.40 to store corn from now until late spring 2007 in central Illinois.

On the cost side, commercial storage rates have increased in many areas for the first time in a number of years to finally acknowledge the increasing costs of building and owning storage facilities. Commercial storage rates may exceed the current carry in the market so that forward pricing corn stored commercially for later delivery is not profitable. The carry, however, exceeds the out-of-pocket costs for using existing on-farm storage facilities, but the returns for forward pricing have been reduced.

Storing corn unpriced may still be an acceptable marketing alternative for a portion of the crop since market fundamentals suggest that prices could move significantly higher as the marketing year progresses. For high cost storage situations, however, an increase in futures prices along with a typical strengthening of the basis will be required to recover the full costs of storage. In those situations, other alternatives can be considered. Those alternatives include just selling the crop at harvest and avoiding the substantial cost of ownership. For those who believe that futures prices will increase, the stronger basis and smaller carry in the futures markets now mean that basis contracts or replacing cash sales with long futures positions can be considered as an alternative to physical storage. Ownership of call options, rather than a basis contract or ownership of futures, might also be considered in order to manage downside price risk. However, at-the-money call options are rather expensive, raising the cost of ownership through options, so that strategies to reduce the options cost might be considered. These strategies generally involve selling call options with higher strike prices against the long call options. Such strategies reduce the net cost, but also establish a price ceiling.

For the 2005 crop, loan deficiency and counter cyclical payments were very large for corn. As prices move to levels that reduce or eliminate these payments, there is more incentive to develop sound marketing strategies for corn. Strategies should adjust as price levels and price relationships change.

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