WEEKLY OUTLOOK

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WILL SOYBEAN BASIS RECOVER?

Soybean basis levels became historically weak in many areas this summer and basis remains very weak in most areas. The question now is, when will the basis strengthen to more normal levels?

As soybean futures soared above $8.00 then above $9.00 this summer, basis weakened to unprecedented levels in many areas. Near maturity of the July 2007 futures contract, cash prices in Illinois were $.60 to $.90 under the price of that contract. The basis was $.30 to $.40 weaker than the extremely weak basis of the previous year. Even cash prices at the Gulf dropped below futures prices. Those cash bids were quoted at $.18 over August 2007 futures on July 10, 2007 and $.12 under August futures on August 24, 2007, $.60 weaker than on the same date in 2006. Cash prices remained well under the futures price at delivery markets during the maturity of the July 2007 futures contracts. This failure of cash and futures prices to converge at maturity of the futures contract is similar to the problems experienced with the soft red winter wheat futures contract at Chicago for the past year or more.

Cash bids for harvest delivery of the 2007 crop are also extremely weak. For various regions of Illinois, for example, the new crop bids on July 19, 2007 were $.70 to $1.25 under November futures. Some, but not all areas, saw some modest strengthening of the basis by July 26. Still, the harvest basis is $.30 to $.40 weaker than on the same date last year and $.40 to $.50 weaker than during September 2005 when hurricane Katrina interrupted soybean shipping.

A number of reasons have been cited for the extremely weak old-crop basis this summer. These include historically large stocks of soybeans which depressed cash prices and the increased speculative interest in owning futures contracts. June 1, 2007 inventories of soybeans in the U.S. were estimated at 1.09 billion bushels, 100 million larger than the inventory of the previous year and nearly 400 million larger than the inventory of June 1, 2005. The presence of those large stocks allows end users to be less aggressive in bidding to acquire their needs. Speculative interest in owning soybeans was driven largely by the 11.4 million acre decline in U.S. soybean plantings, modest concerns about U.S. weather conditions, and concerns that South American producers would not make a large increase in soybean plantings for harvest in 2008. Basis remained weak, however, even as futures prices declined sharply beginning on July 16.

So, were producers harmed by the extremely weak basis? For those holding unpriced 2006 crop soybeans or for those making new crop sales, the answer depends in part on whether the cash or futures market reflected the real value of those crops. If the cash market reflected value, it might be argued that those selling old crop inventories or a portion of the new crop were not harmed by the weak basis. While the recent decline in prices (both cash and futures) has resulted in lower returns for holders of inventory, that is a separate issue from the weak basis. If futures markets reflected true value, then holders of unpriced old crop inventory were negatively impacted by the weak basis. Those clearly negatively impacted by the weak basis are those who were holding hedged inventories (short futures or hedged-to arrive contracts). Buying futures and selling cash soybeans (lifting the hedge) at the weaker than expected basis results in a lower than expected net price. Conversely, long hedgers benefitted from lifting hedges during a period of extremely weak basis. If the new crop basis remains weaker than normal through the fall months, there may be some implications for pay outs on crop revenue insurance products, depending on the level of prices at that time.

The prospects for a much smaller U.S. harvest in 2007, and the subsequent decline in stocks, suggests that 2007 crop basis levels will eventually return to more normal levels, but will be influenced by the nature of speculative activity in that market and by the prospective size of the 2008 South American crop. Prospects for a substantial strengthening of the basis during the upcoming marketing year suggests there is a potentially large return to storage of the 2007 crop. On July 26, 2007, for example, the average harvest bid in central Illinois was $1.14 under July 2008 futures. If that basis strengthened to a more normal level of -$.15 to -$.20 by next spring, the market is offering storage returns of $.90 to $1.00 per bushel. As the new crop is priced, sales should likely be made for delivery well after harvest, particularly where on-farm storage is available. Unless deferred delivery basis bids are aggressive, those sales may have to be made with futures.

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