WEEKLY OUTLOOK

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WEAKNESS IN SOFT RED WINTER WHEAT BASIS PERSISTS

The soft red winter wheat basis in virtually every location has been generally very weak for about three years. There have been occasions of more normal basis behavior, but those periods have not lasted.

After the close of futures trading on September 18, 2009, spot bids for soft red winter (SRW) wheat in southern Illinois were quoted in a range of $2.50 to $2.96. With December 2009 futures at the Chicago Board of Trade (CBOT) settling at $4.5725 on the same date, those bids reflected a basis ranging from -$2.0725 to -$1.6125. Basis at markets deliverable for CBOT wheat futures contracts are also extremely weak. For example, basis levels on September 18 were quoted at -$.91 to -$.90 at Toledo, -$.94 to -$.93 at Chicago, and -$1.92 at St. Louis. This magnitude of basis has been common for an extended period of time.

Basis levels for hard red winter wheat (HRW) are on the weak side as well, but not to the same extent as the weakness in SRW basis. Spot cash bids for HRW in western Kansas were reported in a range of $3.69 to $3.97 on September 18. Those bids were $.75 to $1.03 under the settlement price of December 2009 futures at the Kansas City Board of Trade.

The weakness in the SRW basis comes in the face of a much smaller crop in 2009. Production is estimated at about 412 million bushels, 202 million bushels (33 percent) smaller than the 2008 harvest. The harvest in Illinois was estimated at 48.38 million bushels, 25.22 million (34 percent) smaller than the 2008 harvest. On the surface, the much smaller crop along with a large carry in the futures market that strongly encourages storage of the 2009 crop might be expected to result in a stronger SRW basis at most locations. Those factors have been offset by a very slow pace of SRW wheat exports and an unwillingness of producers and others to store SRW wheat in the production areas.

The USDA reported that as of September 10, 2009, 14 weeks into the 2009-10 marketing year, only 33.5 million bushels of SRW wheat had been exported. That compares to cumulative exports of 89 million bushels at the same time a year earlier. In addition, unshipped sales stood at only 29.5 million bushels, down from 39 million bushels a year ago. The overall decline in exports reflects much smaller shipments to Egypt (down 83 percent) and Mexico (down 64 percent), the two largest customers for U.S. SRW wheat.

While the weak basis and large carry in the futures market encourages storage of the 2009 SRW wheat crop, producers and some country elevators are reluctant to tie up storage space with wheat. Instead, space is devoted to the upcoming corn and soybean harvest. Producers in Illinois, for example, typically deliver about 75 percent of the crop to market in June, July, or August.

The continuation of the extremely weak SRW wheat basis implies a fundamental disconnect between the value of SRW wheat to end users and the value established in the futures market. The inability of cash and futures prices to converge at delivery markets during the maturity and delivery period of the futures contracts also implies a disconnect between cash and futures value, as well as a delivery process that is not robust enough to allow convergence of cash and futures prices. Nonconvergence persisted through the delivery period for the September 2009 futures contract in spite of a number of changes to the wheat contract specifications. Those changes included higher, seasonal storage rates and the addition of alternative delivery locations. Further changes in contract specifications are being considered to accommodate (force) convergence of cash and futures prices. While there are ways to force convergence (cash settlement or forced load out of deliveries), the focus on storage rates threatens to weaken other performance aspects of the wheat contract. The two major issues continue to be largely ignored: 1) the disconnect between SRW wheat values and CBOT futures prices and 2) delivery locations that are out of the commercial flow of wheat.

Current low cash prices for soft red winter wheat, along with prospects for a continuation of weak basis levels into the 2010 marketing year, may discourage SRW wheat seedings this fall. In addition, late maturity and harvest of the corn and soybean crops may tend to limit seedings in some areas. The USDA will release an estimate of seedings in the second week of January 2010.

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