



WEEKLY OUTLOOK



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WILL THE SOFT RED WINTER WHEAT BASIS EVER STRENGTHEN?

The price of December 2009 wheat futures at the Chicago Board of Trade has declined about \$.50 from the high established in mid-November. In part, the decline reflects general weakness in export demand for U.S. wheat.

For the current marketing year, the USDA has projected exports of all classes of wheat at 875 million bushels. That projection is 140 million bushels less than exported in the 2008-09 marketing year. The projection represents the smallest exports since 2002-03 (850 million bushels) and the second smallest since 1971-72. Export weakness comes in the face of an extremely weak U.S. dollar, which should make U.S. supplies very competitive in the world market. The decline in U.S. exports reflects a sharp decline in world wheat trade occurring in 2009-10, which in turn reflects much larger crops in importing countries.

As of December 3, about the midpoint of the 2009-10 marketing year, the USDA reported cumulative U.S. wheat export inspections of 440 million bushels, 186 million (30 percent) less than cumulative inspections of a year ago. The USDA's U.S. *Export Sales* report indicates that year-over-year declines in export commitments (cumulative shipments plus outstanding sales) were down 45 percent for hard red winter wheat, 52 percent for soft red winter wheat, and 10 percent for hard red spring wheat. Commitments for durum wheat were up 136 percent and commitments for white wheat were up 37 percent.

Cash wheat prices vary considerably by location and class of wheat. The price of number one hard red winter wheat in western Kansas on December 4 was quoted in a range of \$4.41 to \$4.59. On the same date, the price of number 2 soft red winter wheat was quoted in a range of \$3.34 to \$4.28 at country elevators in southern Illinois, \$4.47 to \$4.73 at country elevators in Ohio, and at \$3.82 at St. Louis, Missouri. The price of spring wheat at Minneapolis was quoted in a range of \$5.33 to \$7.03, depending on protein content.

Basis levels for winter wheat remain at generally weak levels, particularly for soft red winter wheat in southern Illinois. On December 4, cash bids were \$.77 to \$.95 under

December futures in western Kansas, \$.63 to \$.89 under December futures in Ohio, and \$1.08 to \$2.02 under December futures in southern Illinois. The weak cash bids at country locations in southern Illinois may reflect a high incidence of vomitoxin in the 2009 crop, particularly in the southwestern part of the state. The overall weakness in winter wheat basis, particularly for soft red winter wheat, however, reflects a continuation of a weak basis experienced over the past three years.

The causes of the weak basis, and a pattern of nonconvergence of cash and futures prices at delivery points at contract maturity, have been widely discussed. A consensus of causes and needed solutions has not been reached. There is some agreement that the pattern of a large carry in wheat futures prices has resulted in a disconnect in the delivery and load out process, leading to convergence problems. There is not general agreement on the causes of the persistence in the large carry in futures prices. The CBOT will institute a variable storage rate for wheat futures contracts beginning in July 2010 that is hoped will address the pattern of futures spreads exceeding the cost of ownership of futures contracts.

The pattern of weakness in soft red winter wheat (SRW) basis in recent years has not received as much attention as the problems with convergence. It appears, however, that the issue may be embedded in contract specifications. Wheat futures prices at the Chicago Board of Trade appear to reflect a "world" price of wheat without any class distinction. The delivery specifications, however, essentially make the contract an SRW contract. A difference in the fundamental value of SRW and the world price of "wheat" leads to issues with basis.

The weak SRW basis may continue until the fundamentals of the soft red winter wheat market become more aligned with world wheat fundamentals. It was thought that the much smaller SRW crop harvested in 2009 would result in higher SRW prices relative to other classes of wheat and contribute to a stronger SRW basis. Extremely weak export demand for SRW has offset some of the effect of the smaller crop. A further cut in SRW production in 2010 may finally result in some strengthening of the basis. The first indication of crop size will come with the USDA's *Winter Wheat Seedings* report on January 12.

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