Cooperative Extension Service

WEEKLY OUTLOOK

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INTERIOR CORN BASIS WEAKENS

On the surface, prospects for the 1995-96 marketing year suggest a very strong basis for corn. Production is expected to be nearly 20 percent smaller than last year; carryover stocks are modest so that storage space will be fully adequate; and consumption remains very high. With orderly marketing on the part of producers, these supply and demand conditions should be very supportive to the corn basis. In fact, basis levels at export markets continue to be very strong. On August 18, the Gulf basis for No. 2 yellow corn was quoted at $.42. That is, the Gulf price was $.42 higher than the September futures price. The basis at that market has been steadily strengthening over the past few weeks. That strength reflects the excellent pace of corn exports, averaging over 45 million bushels per week over the past four weeks.

In contrast to the Gulf basis, the interior Illinois basis has weakened since the first of the month. On August 1, the central Illinois farm price was about $.10 under September futures. On August 18, that price was about $.16 under September futures. The cash bid for harvest delivery was about $.20 under December futures. The new crop basis has weakened by $.02 to $.03 over the past 4 weeks.

The reason for the weaker interior basis is higher transportation costs. Spot Gulf barge rates have increased by 40 to 45 percent over the past 4 weeks, while rates for October shipment have increased by about 30 percent. The higher rates reportedly reflect strong exports, some backlog of shipments resulting from the flooding earlier this year, and a number of barges still loaded with fertilizer.

Rail freight rates are not readily available. However, there are numerous reports of rail car delays. In some instances, the movement of cars loaded for the Gulf have been delayed several days. Uncertainty about car availability and shipping schedules tend to weaken the basis in addition to the effect of higher freight rates.

Corn basis levels this fall will have an important impact on the producers decision to store a portion of the crop. Currently, the new crop bid for harvest delivery in central Illinois is about $.20 under December futures. With a $.10 spread to July 1996, the July basis is $.30 under. By June, the

July basis is expected to narrow to about $.05 under. The market, then, is currently paying about $.25 per bushel to store corn from October to June (eight months). That is not enough to pay for commercial storage, but will just about cover the out-of-pocket costs of on-farm storage. After paying 10 percent interest on the value of the corn, the expected basis improvement would provide about $.08 per bushel to cover the cost of using the on farm storage facility until June 1996. To capture that return to storage, producers would need to forward price the corn for June delivery. If the corn is not priced, the basis gains may be offset by declining price levels. There is also the possibility to augment the basis gains from a rising price level.

The potential returns to storage may change as harvest approaches, as basis levels fluctuate and spreads in the futures market change. Those changes should be monitored closely to make an informed storage decision. If potential returns to storage are attractive at harvest time, the decision to store the corn priced or unpriced will have to be made. That decision will be based on the price level at harvest time. A continuation of relatively high prices may suggest forward pricing the stored grain, while substantially lower prices would favor storing corn unpriced.

With relatively small spreads in the futures market, some analysts suggest storing corn on paper, with the ownership of futures or call options. The cost of owning futures is primarily the basis appreciation which occurs after the corn is sold and futures purchased. That cost is currently about $.25 for owning futures from October 1995 to June 1996. As mentioned above, that is about equal to, or slightly higher than the out-of-pocket cost of on-farm storage.

The use of call options adds one more cost item — the premium paid for the option. The premium for an at-the-money ($2.90) July 1996 call option is $.18 per bushel. The time value for deferred options makes ownership with call options very expensive, more expensive than commercial storage. The major advantage of ownership with call options is that the loss from lower price levels is limited.

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