JULY 31, 2000

HARVEST PRICING STRATEGIES FOR CORN AND SOYBEANS

While surprises can occur, it now appears that corn and soybean prices will remain well below the loan rate through harvest again this year. If so, harvest time pricing strategies will be centered around the use of the marketing loan program. Strategy selection will be influenced by the availability and cost of storage, the magnitude of the spot and forward basis, willingness to use various pricing tools, extent to which the posted country price tracks the local cash price, and payment limitation considerations. The primary objective will be to implement strategies that will generate a net price in excess of the Commodity Credit Corporation loan rate, without undue risk of a net price below the loan rate.

Availability of permanent storage space may be a problem in areas with unusually high average yields. Some merchants anticipate that 15 to 20 percent of the off-farm storage in those areas will have to be in temporary facilities. All of those facilities will not qualify for warehouse receipts. The large crop may also keep basis levels very weak and corn futures spreads large. If so, premiums for later delivery will remain attractive compared to harvest bids, even if commercial storage charges are increased. Unless Congress makes a change, the limit for loan deficiency payments and marketing loan gains will be $75,000 for crops produced in 2000.

There are several strategies that might be considered for the harvest period. If the basis remains weak and the premium for later delivery is large, producers might establish the loan deficiency payment (LDP) on a portion of the crop and forward price for later delivery. This strategy requires that the posted county price (PCP) tracks the local cash bid fairly closely and that the premium for delivery after harvest exceeds the cost of storage. The price structure varies by location. On July 28, the price for January delivery of corn is some east central Illinois locations was $.29 per bushel above the harvest bid. That premium has been increasing as harvest bids reflect a weakening basis. If the magnitude of the premium is maintained, or continues to increase, this strategy will result in a net price well above the loan rate for farm stored corn and marginally above the loan rate for commercially stored corn. On the same date, the price for January delivery of soybeans was only $.18 above the harvest price, making this strategy much less attractive for soybeans. Even for corn, the January bid reflected a weak basis. Hedging or using hedged-to-arrive contracts might be considered as a way to capture basis improvement.

A second strategy to consider is to store a portion of the crop under loan and lock in the repayment rate (after loan funds have been dispersed) for a period up to 60 days. Again, this strategy works well if the PCP tracks the cash price and cash prices remain extremely low into harvest. The loan repayment lock-in allows producers to benefit from a post harvest price rally by selling the crop at a higher price and repaying the loan at a much lower rate. This strategy is preferable to the first strategy if
the expected price gain within 60 days exceeds the current premium for later delivery. The most likely time for a price increase is in December. The application for the loan needs to be made early due to lags in dispersement. If prices remain low into mid-October, the repayment rate could be established at that time. If prices do not rally in the 60 day period, the loan can be repaid at the daily rate at any time prior to loan maturity.

A third strategy is to establish the LDP at harvest and to store a portion of the crop unpriced. This strategy is more risky since a price decline after establishing the LDP would result in a price below the loan rate. The lower prices are at harvest, the less risk associated with this strategy. It is attractive if the expected price increase exceeds the cost of storage and exceeds the current premiums for later delivery.

For those facing payment limitation, the use of the certificate program could be considered. Under this program, crops are harvested, stored, and placed under loan. Once the loan funds are dispersed, certificates can be acquired to offset the loan. The value of the certificates is based on the loan repayment rate at the time. This transaction is equivalent to taking the LDP, except that time lags are involved. The gains under this program are not subject to the payment limitation.

A fifth strategy is to harvest the crop and store unpriced without establishing the LDP. This is a longer term strategy that established the loan rate as a price floor, since the crop can be placed under loan or LDP’s established any time prior to May 31, 2001, and allows producers to speculate on a price increase above the loan rate.

Finally, if storage space is limited, producers may establish the LDP at harvest and price the crop for immediate delivery. This results in a price near the loan rate, if the PCP is tracking the cash price. Based on current basis and spread relationships in central Illinois, this strategy is more favorable for soybeans than corn. Current spreads suggest using storage for corn. Reownership of soybeans with futures or options could be considered if prices are extremely low.

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