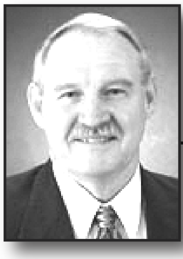
Corn And Soybean Basis Strengthens



grain outlook
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Cash corn prices in many areas are at the lowest level since October 2007 and cash soybean prices are at the lowest level since August 2007. While still high by historic standards, current prices are low in relation to the much higher costs of production experienced in 2008 and anticipated for 2009.

Prices have been pressured by a number of factors, as were outlined two weeks ago. Since then, crude oil, gasoline, and ethanol prices have declined further, keeping pressure on corn prices. In addition, concerns about economic recession have deepened, pointing to continued demand weakness. The pace of corn export sales remains in line with the USDA's projection of total exports for the current marketing year, while soybean export sales remain robust. However, the slowdown in the domestic crush of soybeans which began in June continued through September. The Census Bureau reported that the domestic crush totaled 125.7 million bushels in September 2008, 15 percent smaller than the crush during September 2007. That is the third smallest September crush in 10 years and represents the first year-over-year decline in the September crush in four years. The USDA is currently projecting a 2.3 percent decline in the crush for the current marketing year. The crush during the October 2008 through August 2009 period will have to be only 1.1 percent smaller than during the previous year to reach that projection.

While the demand side of the equation will continue to dominate price behavior, the USDA's November production forecasts could also be important. The late maturity of both the corn and soybean crops provided less data for the USDA's October objective yield forecasts than in most years. This suggests that the November forecast could deviate by a larger than normal amount from the October forecast. Anecdotal yield reports suggest that the November forecast could exceed the October forecast for both crops.

The one encouraging development during the recent decline in the price levels has been the general strengthening of the basis. In central Illinois, for example, the average cash price of corn on October 24 was about \$.40 under December 2008 futures. The basis is about \$.20 stronger than reflected by harvest delivery bids in late summer 2008, but still about \$.20 weaker than at this time last year. On the same date, the average cash price of soybeans in central Illinois was about \$.30 under November 2008 futures. The basis was about \$.60 stronger than reflected in harvest delivery bids in late summer 2008 and about \$.15 stronger than at this time last year. Importantly, the soybean basis at the futures delivery market is approaching normal levels, continuing the improved convergence experienced in July and August.

In addition to the strengthening basis, the spreads in the soybean futures market have narrowed substantially over the past month. In early October, for example, July 2009 soybean futures were priced about \$.54 above November 2008 futures. That spread at the close on October 24 was only \$.2775. The combination of a strong basis and small "carry" in the futures market results in a very small return to storage of soybeans. Even if summer 2009 basis levels returned to a very strong \$-.10 in central Illinois, the market is only offering about \$.50 return to store the crop for eight months. Interest costs on \$8.30 soybeans for eight months at 6 percent interest would total about \$.33, leaving only \$.17 to cover storage costs. If the summer 2009 basis is near the 2008 level of \$-.30, the market is offering a negative return to storage.

In contrast, the December 2008 to July 2009 spread in the corn futures market stood at \$.37 on October 24, so that the spot cash price of corn was \$.77 under July 2009 futures. If summer 2009 basis returns to the \$-.15 level generally experienced prior to 2008, the market is offering a \$.62 return for corn stored for eight months. Interest costs of about \$.13 per bushel would leave a return of \$.49 per bushel for storage. That return exceeds commercial storage costs in many areas.

A recovery in corn and soybean prices over the next six months is generally expected so that some ownership of the crops beyond harvest seems prudent. The current price structure in the corn and soybean markets suggests that holding physical inventory is the preferred way of owning corn, while owning soybeans in the form of a basis contract or futures contract may be cheaper than physical storage. Δ