Marketing The 2009 Soft Red Winter Wheat Crop

grain outlook

DR. DARREL GOOD
Extension Economist University of Illinois

Producers of soft red winter wheat in Illinois typically deliver a majority of the crop to market at or shortly after harvest. Estimates of monthly marketings provided by the USDA indicate that an average of 62 percent of the crop was sold for delivery in June or July in the five crop years from 2003-04 through 2007-08. An additional 13 percent was sold in August. On average, only 6 percent of the crop was sold after January following harvest. Monthly marketing estimates are not yet available for the 2008-09 marketing year since that year just ended on May 31.

Producers in Illinois typically do not store much wheat beyond August following harvest because wheat is generally produced in small quantities and does not compete well with farm storage for corn and soybeans. In addition, some commercial storage facilities discourage farmer storage of wheat as well. Selling wheat before, at, or immediately after harvest has been a good marketing strategy since post-harvest price changes, on average, have not covered the full cost of owning and storing wheat. In some years, however, a large carry in the structure of wheat futures prices along with a potential strengthening of the basis encourages storage of the crop. That appears to be the case this year.

For the 2009 crop, prices have moved higher since late April. July 2009 futures, for example, are currently near $6.60, about $1.30 higher than in late April. Bids for harvest delivery in southern Illinois continue to reflect a relatively weak basis. The average harvest delivery bid on May 29 was about $.96 under July 2009 futures. Still, that is a much stronger basis than the average of $1.76 a year ago. Further price increases may occur on the basis of the deteriorating condition of the winter wheat crop, a late maturing soft red winter wheat crop, delays in seeding the spring wheat crop, and concerns about the corn crop. Any additional price increases will encourage harvest sales in Illinois.

Producers, however, may want to more closely evaluate the storage decision for the 2009 crop. There may be more potential for post-harvest strengthening of the soft red winter wheat basis due to a much smaller crop than in 2008 and the potential to reduce year-ending inventories. Last month, the USDA projected 2009 soft red winter wheat production potential at 422 million bushels, 192 million smaller than the 2008 crop. Stocks at the end of the 2009-10 marketing year will likely be less than 90 million bushels, compared to an estimated 159 at the beginning of the year. Any further reduction in crop size could reduce inventories even more.

In addition to the potential for basis improvement, the wheat futures market is currently reflecting a large carry. At the close of trade on May 29, September futures settled $.265 above July futures and December futures settled $.225 above September futures. Slightly higher prices were offered through May 2010, with May 2010 futures $.73 above July 2009 futures. The large carry, particularly from July through December, reflects two changes in the specifications of the Chicago Board of Trade wheat futures contract. The first of those changes is in the structure of premium (storage) charges. Prior to July 18, 2009, the maximum premium charge on futures contracts is $.00165 per day (about $.05 per month). From July 18 through December 17 the maximum premium charge is $.00265 per day (about $.08 per month). The larger premium charge is reflected in the carry. The maximum premium charge from December 18, 2009 through July 17, 2010 returns to $.05 per month. This "seasonal" premium charge structure will continue into future years.

The second change is that beginning on September 1, 2009 the par delivery grade will have a maximum of 3 parts per million of vomitoxin compared to the current par grade of 4 parts per million. Delivery of wheat with 4 parts per million will still be possible after September 1, but at a $.12 per bushel discount. That difference is also reflected in the magnitude of the July-September spread.

The bottom line is that producers are faced with a $.50 premium of December 2009 futures over July 2009 futures and a $.64 premium of March 2010 futures over July 2009 futures. The interest cost of holding wheat priced at $5.60 from July to December, at 6 percent interest, is about $.14 and the cost to March 2010 is about $.22. With no improvement in the nearby basis, the carry reflects a return to storage of about $.36 from July to December 2009 and about $.43 from July to March 2010. Basis strengthening, if it occurs, would add to those storage returns. Returns to wheat storage are much larger than currently reflected by the smaller carry in new crop corn futures and the inverted soybean market. Soft red winter wheat producers are facing a favorable pricing scenario heading into harvest, a combination of rising prices and an opportunity to earn a large return from a storage hedge. Δ

DR. DARREL GOOD:Extension Economist, University of Illinois