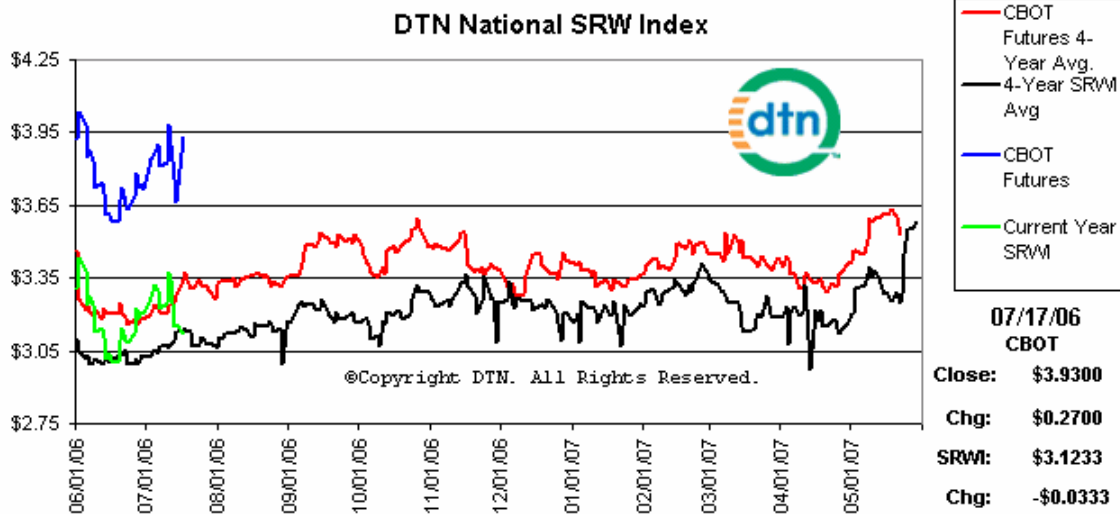




18 July 2006

# Grain Marketing Outlook Monthly Update



## What's Up With Wheat???

*"In theory, theory and practice are the same. In practice, they're not"*  
--Yogi Berra

**I've had many questions recently about the wheat market.** Most of the questions have been about convergence, or lack thereof, in the July CBOT wheat futures market. Before we answer that question, **let's review some futures basics.** A futures market is a market in the price of a good for delivery at some time and location in the future. Because prices vary over time and space, there is typically a difference between the price of the good 'here and now' and 'there and then.' We call this difference 'basis.' One of the tenets of futures markets is that the cash and futures prices should converge, i.e. **the basis should go to zero**, at the delivery point as the futures contract approaches expiration.

In the case of Chicago Wheat, Toledo is a delivery point, so for those in Northwest Ohio, there is no geographical basis, **the basis should**

**only reflect the difference in current and deferred prices**, i.e. 'now' vs. 'then.' So, as the July 2006 contract expired, we would expect the difference in futures and cash prices to vanish. Simple, no? **Apparently not.**

During mid-July, as the July contract expired, **Northwest Ohio basis hovered at 75c under**—as futures prices remained in the \$3.90 range, but cash prices hovered around \$3.15. In theory, farmers should be selling every bushel they can on the board at \$3.90+, delivering to a CBOT facility in Toledo or elsewhere, and holding the contract until expiration, when they can deliver the grain receipt against it. Why didn't this happen? **Why didn't convergence occur? Yogi had it right all along: in practice, theory and practice are different.**

In this case, **the primary difference between theory and practice is storage capacity.** In a perfect world, everyone who wants to deliver their wheat can do so. But what if the CBOT delivery elevators are full? Farmers can't deliver wheat to them to receive the receipt to deliver against the CBOT contract. **According the June Grain Stocks report, as of June 1, 2006, there were 41m bushels of wheat being stored off-farm in Ohio, a 13m bushel increase over June 1, 2005,** and that was before *any* of the 2006 harvest had been combined—which is currently estimated at 68m bushels. In this situation, practice beats theory, and beats it badly.

Further, **the expiry of the July contract doesn't mean that all of the bushels delivered against contracts**—and there were 20m bushels delivered against the wheat contract during the month of July—will suddenly leave storage. In fact, it appears that nearly all of them will stay right where they are, allowing the holders to pay the storage and collect the carry until the September contract comes around. What this all means is that **there is almost no SRW storage available** and those elevators that are taking SRW have the ability to be very, very picky about the wheat they take. Moisture standards, test weight, and vomitoxin and aflatoxin levels are all being closely monitored and penalized when out-of-spec. **This is only reasonable—if an elevator has limited space, they want to utilize it to handle material that they can sell on most easily, and that means high quality wheat.**

When we look at the forward prices for wheat, it is pretty clear that there is a shortage of storage. **The carry to January for wheat is about 50c** right now. So what does this mean for wheat? Well, clearly, the SRW market has just finished a strong harvest, and done so in the midst of very, very weak demand and large carryover stocks. Meanwhile, the futures market remains well-supported due to the poor HRW harvest out west. **Now is a time to sharpen the pencils and 'do some cipherin' as Jethro Clampett would say.** While storing SRW on-farm offers approximately 8c per month carry, and the last few years have seen only a 4-5c per month carry in corn, that doesn't mean that storing wheat is obviously more profitable. The problem is that storing a bushel of wheat 'til Jan means

that a bushel of corn can't be stored at all—and in reality, it means a bin of corn that can't be stored. **So the real trade-off is storing wheat from now 'til January versus storing corn from harvest 'til April or so.** What to do? Right now, the difference in forwards prices for corn between O/N and Jan is about 25-30c; if we assume another 4c/month to April, then that makes the O/N-April difference 37-42c. **If those spreads don't change, it does seem to favor allocating some space to wheat through the corn/bean harvest.** Also, unlike wheat, in which we know the size of the '06 harvest, we are still some months away from knowing the size of the corn and bean harvest. If the corn or bean harvest do come in small, then the storage pressure should ease on wheat, and the carries for all three crops should shrink.

**In the longer term, though, the real question is what to make of this market for SRW producers?** While the '07 and '08 futures prices remain quite favorable, given the difficulty delivering the wheat, and the extreme basis, does it make sense to take advantage of these prices? In short, I think that it does, but the devil is in the details. Is it best to sell it on the board, sell an HTA or sell a forward contract? To be honest, I'm still thinking about that. Given our experience so far this year, I might lean toward the HTA over the CBOT route, simply because you have a delivery contract with the HTA. On the other hand, **I don't expect the market to be quite this out of whack next summer,** either. What we are experiencing is an extreme imbalance in the HRW vs. SRW markets, and I fully expect to see fewer acres of SRW being planted this fall, as well as a more normal HRW crop next year. These two factors should move us toward a more normal wheat market.

When we turn to corn, **the market's attention is on the state of the crop.** For the past 3 weeks, crop conditions have been slowly sliding south. While the market is far from panic, and there has been adequate weather to foster pollination, **July has been far from ideal so far.** Given the strong ethanol and export demand expected this year, the decrease in crop condition has kept prices relatively firm. Somewhat offsetting the decline in condition is the increase in planted acreage that was released on June 30. Plantings are now estimated at 79.4m acres, up from 78m based upon the planting intentions report. With trend yield unchanged, the increased acreage implies an extra 190m bushels to be harvested. When we look at the consumption side of the corn ledger, I think that exports should come down a bit, as should feed use, but the two combined shouldn't exceed a change of 150m bushels or so, which results in ending inventories still quite close to the 1bn bushel mark, with the USDA predicting 1.077bn bushels, whereas I expect a number closer to 1.21bn bushels. **Either way, these are steep reductions from the ending inventories of the last 2 years.** Over the next month, the market will remain focused on the evolution of

the crop, and deterioration of the conditions will result in sharp price increases.

For that reason, I **would be ready to market at this point, but not overly eager**. If the market does move up further on weather, I would continue to sell into it, though.

**For soybeans, supply continues to look quite adequate**, even if yields fall a bit this summer. At this point, the USDA is forecasting a 3.01bn bushel harvest based on the revised acreage forecasts, and 1.09bn bushels being exported. Given the decline in Brazilian acreage this year, and the expectations for another decline in the coming year, these export levels are quite reasonable. **But this still portends ending inventories of 560m bushels this year, approximately unchanged from 2005/06**. My marketing advice for corn also applies to beans. If the weather scares pile up, I would try to sell into it, but both of these markets seem firm and well-supported for at least the next month.

--Dr. Matt Roberts  
AED Economics, The Ohio State University  
OSU Extension  
[Roberts.628@osu.edu](mailto:Roberts.628@osu.edu)  
<http://aede.osu.edu/people/roberts.628>