Overcoming Soybean Basis and Cost of Ownership Challenges

Merchandising the balance of your 2017 soybeans could prove challenging without a major weather event. The U.S. produced a record 4.425 billion bushels in 2017. Even with record demand, by late August 2018, U.S. soybean ending stocks are forecast at 445 million bushels. That’s the highest level in more than a decade.

Futures price rallies during the winter months will likely be the result of adverse growing conditions and weather forecasts in South America. With a mild La Nina winter, expect Argentina and southern Brazil to remain dryer than normal. The later soybean plantings led to the March futures contract price rally that peaked Dec. 5 at $10.27 per bushel. Note the price dropped to $9.55 per bushel by Dec. 29, the last trading day of 2017 where there should be some technical chart support.

Marketing Your Cash Soybeans
Considerations should now be focused on meeting winter cash flow needs, acceptable selling levels for futures and cash prices, futures price carry, and your cost of grain ownership.

Futures price carry is defined as the difference between nearby soybean futures contract (March) and the more distant or deferred months of May and July. By late fall, futures carry was 30¢ from November to July soybeans. This amount was deemed a large carry for soybeans and might cover the cost of on-farm stored bushels. However, that carry would not cover those bushels stored commercially. To capture this carry, a farmer would have to sell futures in the deferred months (May or July) via a hedge or initiate a Hedge-to-Arrive (HTA) contract using those same months and make a spring delivery of bushels. That basis could then be set in the spring when basis tends to narrow.

Expect Wider than Normal Soybean Basis
Basis is simply the local cash price minus the nearby futures contract price. It reflects the local supply and demand and can vary by soybean processor, river terminal, elevator, or co-op facility.

The graph on the next page shows examples of the soybean basis trends since 2012 at a central Iowa elevator versus the March futures contracts each year since. The line begins with harvest in October and ends approximately March 1 when that contract goes into delivery.

Note the pattern each year is for the widest soybean basis to occur during harvest in mid-to late October. For the 2012 and 2013 crops, basis was much narrower (a smaller negative number) when U.S. ending stocks were tight. The 2014 and 2015 basis trends were wider than the two previous years. Now look at the trend that occurred for both the 2016 and 2017 crops with extremely wide basis trends.

March 2018 Soybean Futures

Source: www.cmegroup.com, Dec. 29 2017

Expect futures price volatility led by short covering (commodity funds buying back their short futures positions) to occur. Only a shock to supply or perhaps demand would likely bring speculative commodity funds back into the futures markets to create a potential rally.
Basis Trends versus March Soybean Futures
Central Iowa Elevator

Source: Iowa Commodity Challenge, Dec. 2017

Compare the 2016 and 2017 basis to the previous four years as U.S. ending stocks have increased. The result is that basis is much wider (a larger negative number). Note the trend since 2015 is for basis to narrow or strengthen from 10¢ to 20¢ per bushel from late harvest until early January. Thus, most of the basis appreciation for the winter is realized in this roughly ten-week period. Expect limited basis appreciation in January and February in 2018 despite the dismal nearby March soybean futures contract prices. That is because large volumes of soybeans are being stored and farmers need to meet their winter cash flow needs. This means the sale of bushels being stored both on-farm and commercially will likely result.

Cost of Soybean Ownership Example
Another underlying issue: where are your soybeans stored? Thus, the importance of determining your own on-farm versus commercial storage cost of ownership.

Knowing these costs for unpriced soybean bushels in storage is critical, especially for years where ending stocks are large and cash flow needs could be huge. The following 2017 soybean crop assumptions are used in this example. Cash soybeans are valued at $9.04 per bushel at harvest (Oct. 26) in a central Iowa elevator. Interest is accruing at a rate of 5% Annual Percentage Rate (APR) times the soybean cash price at harvest.

Source: Iowa Commodity Challenge, Dec. 2017

Note that the on-farm storage line (checked) is estimated at 1¢ per bushel per month while commercial storage line (dots) is 16¢ for the first 90 days and 2.8¢ per bushel for each month thereafter. Note that both of these lines are anchored to the cash price at harvest of $9.04 per bushel. Storage charges will vary depending on your own on-farm storage facilities and local elevator or co-op charges.

The dark solid line is the cash price bid at this elevator weekly since harvest. Bushels stored on-farm have a better chance of being sold above the cost of ownership than does those bushels stored commercially. If recent history is any indication, the likelihood of selling those soybean bushels for cash above the cost of ownership lines could be limited if delivering to that elevator. A significant soybean futures price increase along with basis appreciation will both likely be needed to benefit the cash price being offered and provide a margin above the cost of soybean ownership.

Conclusion
Calculate your own cost of ownership for stored soybeans. Consider creating line graphs like the example provided to assist your marketing plan and as a reminder that storage and interest are not free. Also, consider tracking your local basis weekly where you typically deliver your soybeans to better determine your own basis trends.