Three Reasons to Like Pre-Harvest Pricing

New crop prices, particularly soybeans, have rallied nicely from their February lows. Higher prices for the 2005 crop are creating some interesting early season pricing opportunities. I’ve spoken and written a number of times on the importance of pre-harvest marketing. In last year’s issue of “Talking Crops” I examined the tendency for new crop corn and soybean prices to decline between spring and harvest. I want to review this tendency again, and then I will offer you two more reasons to embrace pre-harvest pricing.

A quick look at the following two graphs shows that historical price patterns point toward more favorable new crop pricing opportunities in the spring. The first graph shows that since 1980, the price of the average December corn futures contract has declined more than 20 cents per bushel from mid-April to early October. A decline of some size occurred in 17 of the 25 years since 1980 (68%). This includes, including last years decline of over $1.00 per bushel from spring to fall – the largest decline ever!

Soybeans follow a similar pattern, as shown in the graph below. Since 1980, the price of the average November soybean futures contract has declined more than 30 cents per bushel from early May to October. The odds of a new crop price decline in soybeans do not quite match those in corn, but they are still impressive. In 15 of the 25 years since 1980 (60%), November bean futures were lower at harvest than they were in the spring.
Clearly we need to temper our look at this information with a well-worn caveat, “past performance is no guarantee of future results.” But average price declines of 20-30 cents per bushel are too large not to grab our attention. By themselves, seasonal tendencies offer a compelling reason to consider pre-harvest marketing, but they are not the only reason I like pre-harvest pricing. Allow me to share two more reasons to consider pricing early. One reason involves the current farm program and how loan rates and loan deficiency payments (LDPs) work. The other reason requires you to look at your own operation and your own cost of production to define a price that is profitable for you.

Let’s first consider first the current farm program and how the possibility of an LDP creates another reason for pre-harvest pricing. During the winter months I led a number of talks on the subject of marketing grain (43 talks in 7 different states since mid-November, including the Master Marketer Program in Lakefield). I often like to start my talks with a specific situation and a question. For example, I might ask participants to consider the current (mid-March) situation where they have the opportunity to price new crop soybeans at a cash price near $5.70 per bushel. Then I ask them a question: What are two different actions you could take today to get a price better than $5.70 for your soybeans at harvest? One answer should be obvious – do not price your soybeans and hope that prices trend higher in the months ahead. The other action is less obvious and relies on your understanding of how loan rates and LDPs work. This action involves pricing your new crop soybeans for $5.70 per bushel. Then, so if prices...
trend lower into harvest and lower than your local loan rate, you will get an LDP to put on top of your original $5.70 selling price.

This is exactly the scenario that played out a year ago in both corn and soybeans. At this time last year, I spoke with a number of producers who were lamenting their early new crop sales in corn. They had made some new crop cash sales at $2.25 per bushel, only to see even better opportunities for cash sales of up to $3.00 per bushel. Did they receive “only” $2.25 for their corn at harvest? No! By the fall of 2004, LDPs of 25-30 cents per bushel were common throughout Southern Minnesota. Collecting the LDP pushed their final price to over $2.50 per bushel! Producers who would not consider pre-harvest pricing used the LDP to boost a poor harvest price back up to the loan rate. Producers who priced grain in the spring did better – they used the LDP to boost a good corn price into a great one! The possibility of LDPs creates upside price potential in a down market, but only if you are willing to price grain before harvest.

My third reason to like pre-harvest pricing relates to knowing your cost of production and a price that is profitable for you. Several years ago, early in my career as a Grain Marketing Specialist with the University of Minnesota, I spoke to a group of producers on the topic of pre-harvest pricing. It was February and new crop cash soybean prices were trading near the $6.00 mark. I asked 40 producers, “How many of you can make money on $6.00 soybeans?” I saw 40 heads bob up and down, a clear indication that $6.00 beans were profitable. I asked a follow-up question, “How many of you have priced a portion of your new crop soybeans?” After unanimous agreement that $6.00 beans were profitable, I was dismayed to learn that not one producer had taken the initiative to lock-in that price.

We can argue about how much to sell at a breakeven or modestly profitable price. But there should be no argument about the need to get something sold when a good opportunity arises. Knowing my cost of production and seeing a profitable price is reason alone to act.

While I am an avid supporter of pre-harvest pricing, let me add one cautionary thought on new crop pricing. I am not interested in pre-harvest pricing of new crop grain at prices that are at or below my loan rate. I repeatedly challenge producers to look at their local loan rate as their minimum pricing objective. Harvest prices of $4.60 soybeans and $1.60 corn may make for dreary headlines, but the real price received by the farmer will be that low harvest price plus an LDP that should get the total per bushel price back up to the loan rate. With this minimum price in mind, I want to avoid strategies that offer the risk of getting less than the loan rate. New crop pricing at cash prices less than the loan rate offers just such a risk.
Consider the current situation in corn. In recent months, December corn futures have traded as low as $2.25 per bushel. Does it make sense to price new crop corn with December futures trading at $2.25 or lower? Assuming a new crop basis of 45 cents under the December price at harvest, $2.25 futures would point to a new crop price of about $1.80 per bushel, 5 cents below my $1.85 loan rate. Selling new crop corn can work if prices continue to trend lower and the LDP rises. Here’s the rub - if corn prices increase just enough to eliminate the LDP (it wouldn’t take much of a move), I will end up with a new crop price less than my loan rate. I find this possibility very unappealing. Producers have heard me say many times that your loan rate is insult enough, let's not take risks that offer us even less.

I have outlined here three strong reasons for pre-harvest pricing. One argument rests on the strength of some well-established seasonal price tendencies in the market. Another argument involves understanding the current farm program, and how you can get a higher price in a lower market by combining a forward price with a higher LDP. Still another argument for pre-harvest pricing asks you to know your cost of production and to define a profitable new crop sale. Finally, I added a cautionary note about the perils of new crop pricing below your loan rate. I’m pleased to witness a growing number of producers willing to be proactive and set a price on a portion of their expected production before harvest. There is a risk in pre-harvest pricing. I hope that you now you also understand the risk not taking action.

About the author: Edward Usset serves as a Grain Marketing Specialist for the Center for Farm Financial Management at the University of Minnesota, the developers of FINPACK and MARKETEER software. Working with his colleagues at CFFM and in Extension, Ed has helped develop the award winning “Winning the Game” series of workshops. He also leads the “Minnesota Master Marketer Program”, a six-day program of intensive marketing training for grain producers. Ed has also taught several courses at the University including "Grain Marketing Economics" and "Futures and Options Markets". You can reach him at usset001@umn.edu.