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Knowing and Managing a Grain Basis

Grain Basis

- Basis = Cash – Futures Price

Characteristics of Basis

- Less volatile than futures or cash price
- Basis can be positive or negative
- Basis has seasonal trends

Factors that Determine Basis

- Transportation costs
- Local supply and demand conditions
- Quality variation from underlying futures contract specifications
- Availability of substitutes

Knowledge of Basis Information is Critical

- Evaluating forward pricing opportunities

- Evaluating grain storage decisions

Trends in Grain Basis

- Basis tends to be "wider" in the months prior to contract expiration due to uncertainty

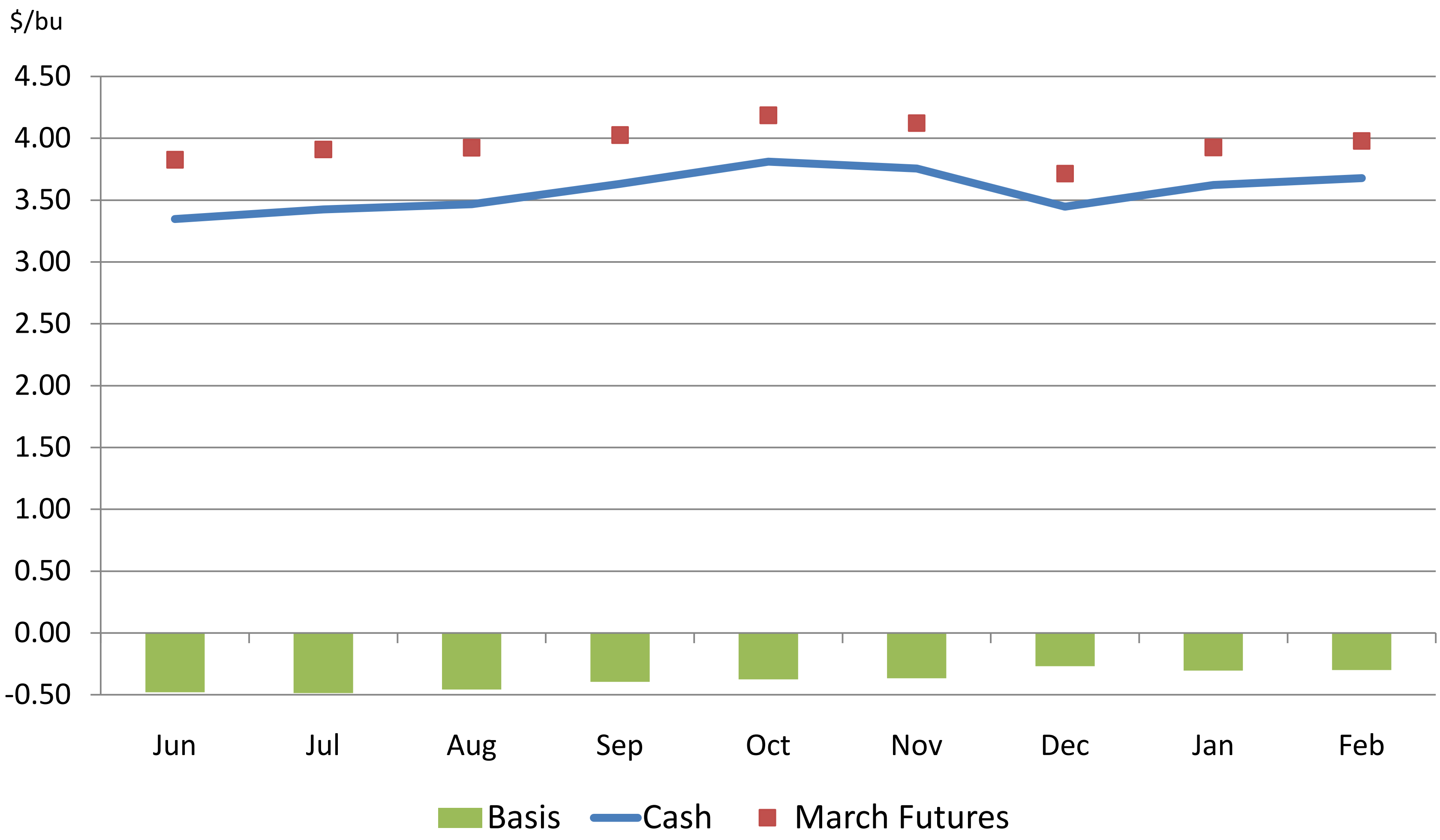
- Basis tends to equal transportation cost as the contract reaches expiration due to the lack of uncertainty

Seasonal Basis Trends

- Basis tends to be the weakest at harvest
  - ✓ Ample grain supplies
  - ✓ Greater demand for transportation services

- Basis tends to improve post harvest
  - ✓ Improving local supply and demand
  - ✓ Less demand on transportation services

Figure 1. Texas panhandle cash wheat price and March Kansas City futures price as the delivery month approaches



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Tracking Basis

- Cash price vs. nearby futures contract

- Provides information necessary to evaluate
  - ✓ Storage decisions by combining ----------
    - ❑ Expected improvements in basis by storing
    - ❑ Value of storage offered by the futures market deferred contract (storage) – harvest contract
    - ❑ For more information on the storage decision see publication entitled “Post Harvesting Marketing Alternatives” (RM2-30.0)

- Forward cash contract and basis contract offers for harvest delivery
  - ✓ Forward basis offers are more stable than cash or futures but do vary
  - ✓ Tracking forward cash and/or basis contract offers may help identify excellent pricing opportunities

Basis Table

Nearby Futures Contract					Harvest Delivery			
Date	Cash Price	Futures Contract Month	Futures Contract Price	Basis	Forward Cash Contract Offer	Harvest Contract Futures Price	Implied Basis	Basis Contract Offer

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Managing Basis Risk

- Forward Cash Contract
  - ✓ Locks price and basis

- Basis Contract
  - ✓ Locks basis with price to be determined at or prior to delivery

- Synthetic Basis Contract
  - ✓ Combination of a forward cash contract and a long position on the futures
  - ✓ Final price is determined when futures contract is offset
  - ✓ Transaction costs do exist and margin calls are possible

- Minimum Price Contract
  - ✓ Establishes a floor price and allows the opportunity to benefit from rising prices

Diagram of Basis Forward Pricing Decision

		Basis	
		Acceptable	Unacceptable
Futures Price	Acceptable	Forward Contract	Hedge
	Unacceptable	Basis Contract	Do nothing