



MGEX WHEAT INDEX PRODUCTS: A STABLE AND PREDICTABLE COUNTRY BASIS FOR PRODUCERS

Producers who use futures markets to hedge their price risk rely on a stable and predictable basis for making hedging decisions. A stable basis is necessary for hedgers wishing to minimize risk. Because they reflect country-level pricing, MGEX financially settled wheat indices provide very stable basis relationships.

As an example, the following graphs illustrate the basis volatility for hard red winter wheat and soft red winter wheat for major production areas. In Figure 1, the basis in Western Kansas using MGEX's Hard Red Winter Wheat Index (HRWI) has a range of just over 55 cents, while the basis with the traditionally delivered hard red winter wheat futures contract fluctuates over a range of more than 75 cents. In this case, the HRWI futures may provide producers with a more predictable hedging outcome.

For example, if a producer sells a futures contract at \$6.50, then their actual realized price is \$6.50 plus the basis when the hedge is lifted. Basis volatility creates uncertainty in regards to the realized price. So, with the physically delivered futures, the hedge will have much greater uncertainty due to the wide variability in the basis. In contrast, the HRWI will provide a smaller range of potential outcomes. This lowers overall price risk.

Figure 1. Hard Red Wheat Basis, Western Kansas, 2000-2008.

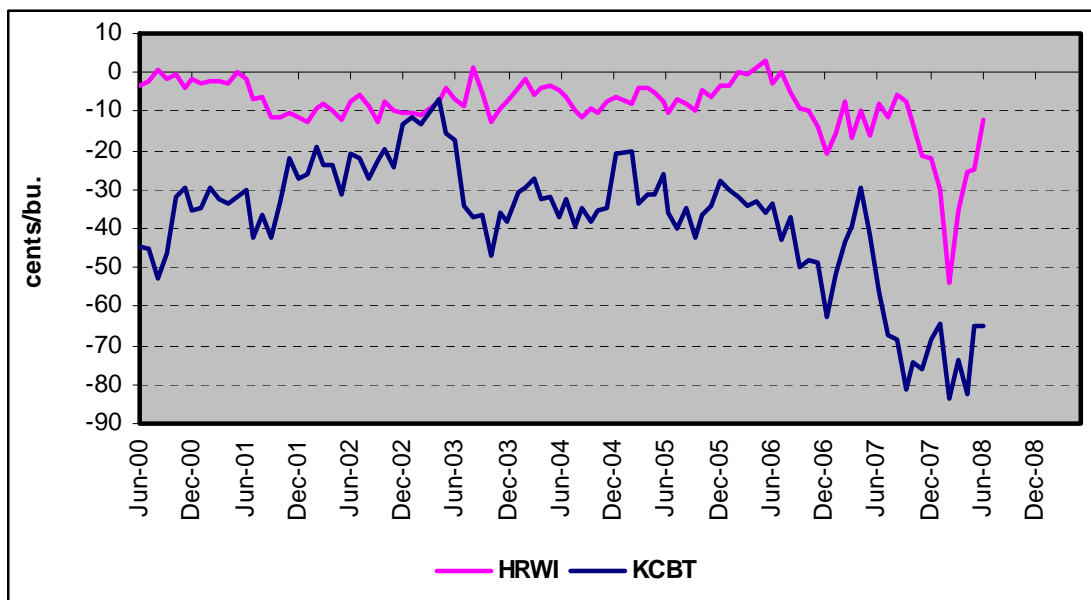
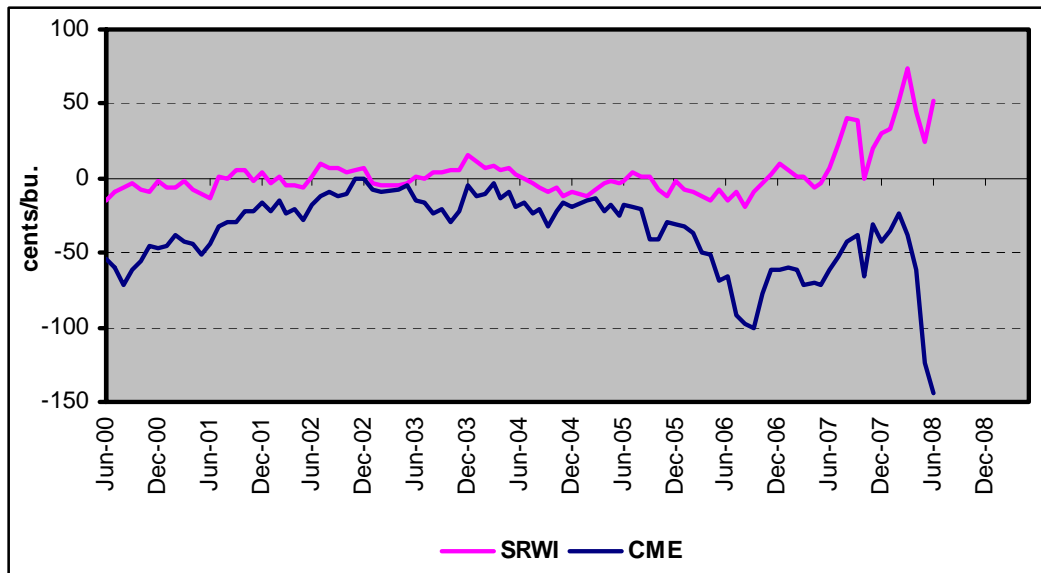


Figure 2 shows the soft red winter wheat basis in Northern Ohio using both MGEX Soft Red Winter Wheat Index (SRWI) and the physically delivered futures contract. Again, the basis is much more stable for the index contracts. The SRWI basis has a range of just over 90 cents. The physically delivered soft red winter wheat basis is much more volatile, with a range exceeding \$1.40 per bushel.

Figure 2. Soft Red Wheat Basis, Northern Ohio, 2000-2008.



Producers who manage their price risk with futures hedges must have confidence in the basis levels that will exist when they lift their hedge. So, a more stable basis is preferred. MGEX's wheat index contracts can provide producer hedgers with a predictable and stable country-level basis, which will help to facilitate their risk management programs.