New York futures outlook

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As the season changes so has the New York futures market. With autumn and harvest time approaching in the northern hemisphere crop areas, New York futures have experienced a change as well.

Prices have moved from a speculative and volatile supply driven nature to a more subdued and lethargic demand lull. In the process the funds have moved from an historic 50.2 per cent net long to just under 20 per cent.

Futures prices have consequently dropped nearly seven US cents, falling from near 50 cents to below 43 cents. During this period we saw US production estimates rise then fall and world ending stocks just continue to drop. So the question becomes what now?

In the USDA's September supply and demand estimates world ending stocks were forecast to fall 580,000 bales to 39.16 million. This follows a 1.44 million bale decrease in the August estimates. Now the USDA is forecasting year on year world ending stocks to fall 7.68 million bales.

So why would New York continue any weaker? For starters we need to remember that stocks are falling faster outside of the US than within. US beginning stocks are forecast at 7.6 million bales, production at 18.13 million bales, consumption at 7.90 million bales and exports at 11.20 million bales.

This leaves new crop ending stocks at a burdensome 6.70 million bales. This is still an historically high number despite being nearly a million bales lower.

Now compare this with China for example. Beginning stocks are forecast at 13.61 million, down 1.0 million from the previous year. Production is estimated at 20.50 million bales, down 3.9 million year on last year.

Consumption increases slightly to 26.25 million while exports double to 750,000 bales. This puts ending stocks at 9.11 million bales, down 4.5 million from just last season. This explains why Chinese mills are paying the highest price for cotton in the world.

The sharp reduction over the past two years of 5.5 million bales has industry professionals expecting China to begin large imports at any moment. There is a sharp contrast between the world's two largest cotton markets with New York's direction hanging in the balance.

OTHER FACTORS

There are other significant factors influencing New York's direction outside the US and China. India, for one, is a very large user and producer of cotton. This season, sporadic monsoonal activity has raised interest in this region as mill buyers seek supplies from outside their borders. Southern hemisphere production is another point of concern.

Australia's drought has crop forecasters expecting the smallest crop since 1995 when production was just under 2.0 million bales. The West African Franc Zone has experienced poor growing weather and political unrest. As a result production estimates are tending as much as 25 per cent lower. But Brazilian acreage is forecast to buck this trend with production rebounding from last season's 3.30 million bales to 3.70 million.

YARN STOCKS

On the demand side, reports of building yarn stocks are plaguing the European mills. This is probably attributed more to currency than any drastic change in retail consuming patterns. As the Euro moved back above parity to the dollar, European mills were caught with inventory they have been unable to sell. The chief competition continues out of India, Pakistan, China and now Russian mills.

In the US, some domestic mill production schedules are beginning to slow. Several mills have begun to schedule down time in response to fewer orders and inventory reductions. In the Far East, mills continue to buy hand-to-mouth. This is being viewed as a sign of poor market conditions. The trend in these markets is being offset by strong growth in China and Russia.

Outside of the typical supply and demand arguments, this year the market is operating in the shadows of the impending rule changes with regard to deliveries against New York futures. The changes are slated to begin with the May 03 delivery. These changes will set new penalties for overage cotton according to crop year and strength.

The effects of these revisions are aimed at reducing old crop stocks on the board. Certificated stocks are currently at an all time record high above 340,000 bales. Of this amount approximately 225,000 are old, 65,000 three years old and 10,670 four years old. These stocks carry a penalty of two cents per pound per year.

For this reason, the market is leery of massive deliveries ahead of the rule changes. Intra crop spreads are reflecting these expectations trading at historically wide levels. The December–May and March–May spreads are trading at 600 and 350 points, respectively. Theoretically in a normal carry year these spreads would be between more like 360 to 400 and 180 to 220. Ultimately, the March–May spread could widen even further depending on the crop year make up of the certificated stocks when March delivery rolls around.

UNSOLD US COTTON

As we move into harvest, a large percentage of the US crop remains unsold. This is as much a function of the US farm program as anything else.

Under the new farm program growers have three essential elements to pricing. First and the most obvious is the level of New York futures. Second is the loan deficiency payment (LDP), which is calculated by subtracting the loan rate by the Adjusted World Price. This element cannot be set before the cotton is harvested.

The third and newest component of this calculation is the counter cyclical payment. This is figured by subtracting the average price received on-farm for the year or the loan rate, whichever is higher, from the target price of 72.40 cents. This payment can be a maximum of 13.73 cents figured as follows: Target price (72.40) minus loan rate (52.00) minus any fixed payments received by grower (6.67) equals 13.73.

This payment is made on 85 per cent of a grower's base production. So it is easy to see how the farm program has hampered early movement of cotton in the US. This is also encouraging heavy movement into the government loan until all elements of the pricing mechanism are in place.

SLOW COTTON MOVEMENT

Outside of the US, cotton has been slow to move at origin as well. A weaker US dollar combined with low world prices has hampered cotton movement. This has resulted in a classic standoff as mills hold back purchases while growers hold off sales. Who will blink first? History tends to favour the buyer, especially in times of oversupply.

But the fact that US production can flow into the loan and delay typical harvest selling pressure could prove somewhat supportive. In this case the large 7.6 million bale carryover could be seriously depleted by December. US consumption could eat away 3.3 million bales while exports take another 3.0 million. Another 500,000 could be stuck in the government loan reserves. This could leave US merchants a reason to buy up New York futures in an effort to shake loose additional supplies.

All in all prices are likely to remain in a trading range through the new year. Price weakness will continue to attract mill interest just as price strength will encourage grower selling. For this reason it is hard to imagine prices much below 42 cents or above 48. To break this stalemate, the market is likely to look toward planting intentions for the 2003–04 crop year. If the current rally in grain prices continues firm to higher, I believe we can expect cotton to move higher in 2003.