New York futures outlook

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At the time of our last update on New York futures, prices were wallowing amid a lack of demand and excess supply. But we presented the argument that supplies could tighten as growers resisted low prices in the US and around the world. This being especially true in the US where the government loan program offers growers an alternative to selling at harvest.

And so it has happened, although not for the exact same reasons I expected. The primary event that sparked the rally was the perception of an impending shortage of high grade cotton. Reluctant grower selling in the low 40s added to the dilemma.

HARVEST DELAYS

Further support came in harvest delays in the US, West Africa and Central Asian producing regions. This eventually sent merchants to New York to hedge their positions.

At the same time the fund sector moved from 3.5 per cent net long to over 30 per cent amid little selling resistance out of the trade. The combination of these events sent December futures from 42.00 to 50.10. As is generally the case, everyone has a price and New York above 48 cents was enough to shake loose some US and West African cotton at origin. The question now becomes was it enough to satisfy the market's demand and for how long?

In the USDA's November supply and demand estimates, world ending stocks rose ever so slightly to 40.0 million bales. This 170,000 bale increase occurred because of a 1.0 million bale increase in China's production estimate to 21.50 million bales.

Despite this increase, reductions in Pakistan (400,000 bales), Central Asia (240,000 bales) and US (250,000 bales) were noted. In addition, smaller reductions were seen in European countries (200,000 bales), African Franc Zone (100,000 bales) and Brazil (100,000 bales). These changes put world production down 360,000 bales to 88.14 million bales. World consumption fell 190,000 bales to 96.22 million bales.

A 500,000 bale increase in China's consumption helped offset decreases in the US (200,000 bales), Central Asia (100,000 bales), Indonesia (100,000 bales) and other selected Asian countries.

As we look at the supply and demand balance sheet we are attracted to the lower production estimates in several key exporting countries. Production cuts have occurred in countries that are also major exporters. We do not have to look any further than your backyard for evidence of the degree to which I am talking.

AUSTRALIAN SITUATION

Australia's production is currently forecast by the USDA at 2,000,000 bales. This is down 1.20 million from last year. In China, production is predicted to fall 2.9 million bales to 21.50 million. In the US, production estimates are 17.82 million bales, down 2.20 million.

But maybe more importantly than any of these, the West African and Central Asian crops are forecast to decline by 680,000 and 570,000, respectively. These two growths usually set the trend of world prices as composed in Cotlook's A Index.

The Ivory Coast alone produces approximately 600,000 bales of cotton and serves as the major shipping port for most of the African Franc Zone's exports. The recent uprising and civil unrest has drastically hampered the movement of cotton through this country as well as leaving the cotton unharvested in the fields.

Peace talks have been unsuccessful to date as mediators attempt to bring an end to the uprising. Needless to say these events have international merchants on edge. Prices at origin remain above mill buying ideas.

SEARCH FOR BETTER GRADES

The strong Euro has only accentuated the difficulty in moving this cotton. As a result merchants have turned to other growths in search of better grades. This has driven up world prices as Cotlook's A Index rallied from 48.75 to 51.50.

At first, attention turned to the US mid-south for middling 1-3/32 type cotton. This interest was short lived as fall weather turned bad. One storm after another rolled through the cotton belt raising fears of off grade cotton. The result was a flight to the Arizona and California growths.

Basis levels shot higher as merchants and mills scrambled to cover needs. The difficulty in securing cotton at origin has translated into a generally bullish feeling among merchants, especially those trading Central Asian and West African qualities.

Against this backdrop add in the China factor and the market gets really interesting. One of the contributing factors during December's fall rally was the continued interest from Chinese mills for imports.

At first their interest was in high grade US, West African, Central Asian and Australian styles. By the end of October, interest was even noted for lower grades.

China will continue to set the tone as their demand for raw cotton has been quite strong. Domestic prices within China are still among the highest prices in the world. This demand stems from the Chinese textile sector's ability to garner a larger share of the world market.

This share does not come without expense. The Far Eastern markets are feeling the pinch as are the US, Mexican and Canadian spinners. European excess yarn stocks continue to hold back demand there as well. Given the sluggish US and European economic outlook, demand remains a question mark for higher cotton prices.

As we go forward, the market is likely to remain preoccupied with quality. This may change if the market finds a way to shake loose more cotton at origin. In the US, the only way for this to happen in the near term is for New York to rally relative to the A Index.

This is a function of the government farm program. If New York rallies much beyond a 1000 point premium to the adjusted world price index, expect more grower selling. This will in turn pressure New York, or at least offer resistance to higher prices.

BULLISH TREND

For now cotton prices appear to be in a bullish trend and should continue to work higher in the coming months, as long as world prices stay firm. An analogy taken from a friend in the trade put it best. *As the level of the sea rises so do the boats in it as well.* In this instance, the sea is the A Index and world prices, the boats, are New York's prices.

If New York rallies much faster than world prices, expect movement of the US crop into the system and probably a price correction until the market senses the need to bid for more supply. In the coming months attention will turn to new crop expectations. Any move toward lower planting intentions would encourage another leg up.