New York Futures

By Hibbie Barrier

After nearly two years of speculation on China reentering the cotton market as a net importer, it is finally happening. At the time of our last update New York was trading in the low 50s and the market was struggling with near term direction.

It seemed the tightness in world supplies was in equilibrium with world demand. Since then supplies have gotten tighter and demand stronger. The result: higher cotton prices around the world with New York now approaching the 60 barrier.

In the USDA's March supply and demand estimates, world production was placed at 87.99 million bales, up 350,000 from last month. World consumption is estimated at 97.07 million bales, up 300,000 from last month.

The major changes in both production and consumption occurred in China. The USDA increased production 600,000 bales, while raising domestic use by 500,000.

The world ending stocks estimate was put at 37.56 million bales, down 290,000 bales from last month. This represents a 38.7 per cent stocks to use ratio. This is the lowest level since the 1994–95 season.

The tightness in the cash markets has been felt in almost every major producing country. In China for instance mills there are paying domestically the equivalent of over 70 US cents per pound for cotton. Given this, it is no wonder the Chinese have been big buyers of all growths. They started by looking for high quality high grade cotton.

As these supplies became less and less available, they turned to the lower end of the quality spectrum.

At the same time China was kicking up dust in their search for cheaper supplies, the Far Eastern countries began to realise the game was changing. Despite conflicting signals between lagging yarn prices and yarn demand, higher raw cotton prices were beginning to squeeze mills' profit margins. Far Eastern mills found themselves waiting on lower cotton prices to no avail.

MILLS SCRAMBLE TO COVER

So as China entered the market, Far Eastern mills scrambled to add coverage. Now for the first time in years, cotton buyers were faced with rising prices and tighter supplies. Growers around the world sensed the change and began to raise their prices expectations.

The Australian basis was one of the first to rise. This was soon followed by West African, Uzbekistan and eventually US. Now merchants fortunate enough to be in long basis positions found themselves in an enviable position. Complicating matters even more was the fact that buyers' bids were not rising as fast as growers' ideas.

So merchants were having difficulty deciding where to sell. If they sold at mill bid levels, where were they going to get additional supplies for the balance of the season? This mindset was reflected in Cotlook's A Index which reflects the world's cheapest five growths of 1-3/32 inch cotton delivered Northern Europe. This index has now risen over four cents since the beginning of the year and shows no signs of weakening in the near future.

In New York, the funds have reached record long positions. As of this writing the funds were over 50 per cent net long — holding over 64,000 long futures outright and net long after taking out shorts was over 46,000 contracts.

Not only is the net percentage at historic levels, so is the outright open interest. This fact has kept the market somewhat subdued as the fund sector is thought to be fully invested.

Any further strength will have to come from the trade. Either in the form of additional demand or short covering.

ON-CALL FIGURES

To further illustrate this point let's look at the on-call figures. Unfixed on-call sales (sales made to mills but not yet priced), stands at over 25,000 contracts for the May and July time period. This volume is partially offset by unfixed on-call purchases (purchases made from growers but not yet priced), at just over 3,000 contracts. The lack of on-call purchases has its roots in a smaller Australian crop, the current US farm program and the amount of cotton moved early in the season.

The on-call purchases can be slightly misleading as US cooperative groups have tremendous latitude in reporting these positions. But even so, we can look at the volume of cotton placed and redeemed in the US loan to get an idea of US marketings.

The most recent figures place the amount of cotton placed in the loan at 12,693,700 bales with 9,734,500 redeemed, leaving 2,959,200 left in the loan. If we add in the amount of cotton

"popped" (not placed in loan), we would add another 2.5 million bales. By adding these figures together we can account for approximately 15.2 million bales of a 17.1 million bale crop.

The real question for the market will come down to whether or not demand can be sustained at the current pace and what will be next year's production.

DEMAND SIDE

As for demand, European mills have all fallen on hard times as a weak economic picture and the weaker US dollar are affecting their ability to move yarn stocks.

The dominant players on the demand side continue to be China, India, Pakistan, United States and Turkey in that order. Any major disruption to consumption in these countries could have an effect on New York prices. The most vulnerable are Turkey and Pakistan which could both be negatively impacted by war in the Middle East.

PRODUCTION PROSPECTS

As for next year's crop production prospects, New York prices above 60 cents are likely to encourage expanded acreage. China, India, Pakistan and Brazil plantings are all expected to expand. Australian acreage could rebound somewhat if the drought gets broken soon. West African countries are likely to try to increase plantings, but a weaker US Dollar and civil unrest may prove to be insurmountable.

In my last update I suggested US acreage would be unchanged to slightly lower. Since then, a wet winter and low grain prices relative to higher cotton prices has me revising US acreage up toward 14.5 million acres. Given this, a normal planting and growing season could pressure new crop prices. Likewise any interruption in crop progress could really magnify an already tight situation and send New York to levels not seen in a couple of years.

Going forward, mills will continue to resist paying higher prices as much as possible as the overall economic outlook is still on shaky ground. If the market finds a way to shake the fund longs out, we could see a correction of five to eight cents. Remember they have a very large position.

As for now, I still like the market in a larger context allowing for some sort of correction. For that reason I recommend hedging the downside risk with options to allow you to participate on any additional rallies above 60 cents.