

World Cotton Market

By Michael Edwards, Cotton Outlook

A glance at the statistical position would suggest that the price outlook has improved further since we last wrote for *The Australian Cottongrower*, in mid-May. At that time, Cotton Outlook's supply and demand figures implied a contraction of world supply during 2003–04 — for the second successive season.

Production was forecast to fall short of consumption next season by 463,000 tonnes, a smaller deficit than in 2002–03, but a positive price signal nonetheless. Since then, the size of the prospective deficit has grown to almost 1,250,000 tonnes, the single largest adjustment on the supply side being a sharp reduction in the production forecast for Australia and, on the demand side, a further upward revision for China.

Based on current assessments, therefore, over the two seasons, close to 3,000,000 tonnes will have been removed from the world supply. In consequence, stocks are forecast by the end of July 2004, to fall to their lowest level since the mid 1990s — a period of record high prices.

Further positive developments have included the official end of the SARS episode. Furthermore, the latest data from China imply that its impact on domestic yarn production was much less pronounced than had been feared. Crops in the northern hemisphere have made a less than perfect start. Following an unexpected collapse in late May and early June, New York futures have recovered strongly. All of the foregoing should have lent strong support to the bull side.

The Cotlook A Index has indeed made some progress — the 2002–03 value rising over 2.00 US cents to just over 60.00 US cents at the time of writing. And the forward (2003–04) value

maintains a premium of about 3.00 US cents. But the upward momentum has been far less impressive than might have been anticipated, given the state of the global balance sheet for next season.

Equally worrying has been the very modest volume of business that has been practicable during the period under review. What has restrained the upward momentum of international prices?

Part of the answer appears to lie in the depressed state of textile business in many parts of the world. Sluggish economic growth, in particular in several industrialised countries, has clearly been one factor undermining the final demand for textiles. Another important influence has been the aggressive penetration of world textile and clothing markets by China, since the country's entry into the World Trade Organisation late in 2001. The emergence of the 'China factor' has proved more rapid and more far reaching than many had supposed.

Predictably enough, manufacturers in Europe, Japan and the United States have borne the brunt of the onslaught. But other developing countries have also seen their exports displaced by Chinese goods, and the process appears to have contributed to deflationary pressures in the textile market generally.

Against this background, spinners have encountered the utmost difficulty in passing on higher raw cotton replacement costs to their customers for yarn. Resistance to higher yarn prices has acted as a brake on the rise of raw cotton prices.

In particular, the size of the price differential between asking prices for nearby shipment and new crop offers has thus far proved impossible for many spinners to digest. For their part, trade sellers have shown themselves reluctant to discount offers of new crop, while the underlying statistical position is positive for prices, and while price ideas at origin remain very firm, accentuated by the depreciation of the US dollar over recent months.

Where do prices go from here? Clearly, the lacklustre market conditions referred to earlier have tended to slow consumption, and meant that a greater volume than anticipated of 2002–03 crop remains unsold, principally in trade hands, as the new crop shipping months approach.

That supply may weigh upon the market, unless it can be quickly be absorbed — for example by an upturn in import purchasing by India (where statistics indicate a tight supply position) or by a resumption of large-scale purchases by China. Recent reports from the latter market note a return of confidence in the textile sector, and a broad recovery of domestic raw cotton prices.

By the end of May, China's 2003 imports had risen to 375,000 tonnes, still leaving over half of the quota for the year, 856,000 tonnes, unused. But import demand on the scale witnessed in the early months of the year has been conspicuously lacking.

Some reports indicate that the dearth of new enquiry is related to the manner in which the import quota, divided between state enterprises and 'processing trade' (linked to textile exports) is being managed. Whatever the case may be, the timing of China's re-entry into the international market will be crucial, if the bullish statistical outlook is to be translated into a tangible reality.