New York Futures

By Hibbie Barrier

Déjavu, it's November 2001 all over again. Or, is it? The last time we saw a prolonged bear market like the current one was in 2001. The similarities between 2004 and 2001 are striking.

In 2000, prices rallied in the second half of the year before beginning a steady decline that lasted nearly a year. In that year the market peaked amid bullish calls for cotton to rally into the 80's and 90's.

Then the expectation of production increases around the world and in particular China weighed on the market for months. That season world production jumped nearly 10 million bales while consumption gained only 2.5 million bales. As a result, ending stocks climbed 4.3 million bales.

It's now 2004, and cotton prices have just posted the one year anniversary of the bear market. Like 2001, 2004 bulls promised much as world stocks had fallen to levels not seen since the 1994–95 "Dollar Cotton" fame. Bull calls for a return to the promised land of dollar cotton were heard in the distance.

Soon higher world production forecasts began to seep into the market — in particular China (again), and add a record US crop to boot. The result: "Presto," another year long bear market.

There are other similarities like large

unsold US grower positions. In 2001, prices started at 67 and fell to 28.20. In 2004, prices started at 86 and will fall to ... 42, 40, 35. That's the question we are asking.

In the USDA's November supply and demand estimates, the government raised ending stocks 2.60 million bales to 44.55 million. This increase was primarily the result of a 2.01 million bale increase in beginning stocks to 35.49 million bales.

Of this increase, 1.60 million bales were the result of revisions to China's data dating back to 1990–91. It seems the USDA thought their numbers must be wrong given that correct projected stock levels were not sufficient to cover current consumption needs.

World production rose 2.05 million bales to a record 111.72 million. This was the result of a 1.0 million bale increase in the US crop to a record 22.50 million

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bales and smaller increases in Pakistan and Central Asia.

Consumption was raised 1.53 million bales to 102.93 million. A 1.25 million bale increase in China's consumption provided most of the changes as yarn and fabric output numbers continue to support higher consumption figures. In the US, ending stocks gained 800,000 bales to 7.50 million as a 200,000 bale increase in exports to 12.50 million partially offset the 1.0 million production increase.

Given the bearishness of the numbers, the market was braced for another leg down. Instead prices held. This marked the second time the market has recovered from an overly bearish report in the past few months.

Has the record crop been totally discounted in New York? A quick survey of traders would suggest not. In fact, I would say by far the majority of people in the trade are overwhelmingly bearish.

People by and large are expecting March to trade in the mid 30's sooner rather than later. It is hard to argue against this as well. Not only is there a huge US crop, but India, Pakistan and even China are considered to have more than last year. Add to this the lack if import inquiry from some of last season's major importers and it is quite easy to fall into the bear's camp.

So why has the market found support in the mid to low 40's?

On the surface it appears that last season's sharp reduction in world stocks is still percolating beneath the market. Combine this with the extreme price volatility of the 2003–04 season and we see why mills have gone hand to mouth buying cotton.

That's what a year long bear market will do to you. It is easy to get accustomed to buying cheaper each month and the only thing you need to do to accomplish this is wait.

On the other side the growers are hesitant to sell at current levels versus the 80 cent level seen only a year ago. Reluctance to sell cotton is being felt within China, West Africa and especially in the US. As of this writing it is almost impossible to buy Chinese type 129 cotton, their highest grade.

Chinese import demand continues for US, West African, Central Asian and Australian high grades. Basis levels for these grades are likely to remain firm all year long.

In the US, rains in California have reduced the quality of a portion of this crop. In addition, late season rains in Texas, the Delta and Southeastern US have not helped quality as well.

What we have not seen, however, is demand for the medium grades — the middling 34 and 35 staple cotton. As always, low grades are finding willing buyers, especially in the Far East and Turkey.

FALLEN FAR ENOUGH

I am going to go out on a limb and say I believe New York cotton prices have fallen just about far enough. I also know this opinion flies in the face of the majority view so let me offer a few ideas to contemplate in support of my view.

First, cotton is traded around the world in US dollars. The US dollar is now at lows we have not seen since 1995. Add to that China, where rumours of a currency revaluation are starting to become even more convincing.

Second is the continued rise in prices of polyester and manmade fibre. The rise in crude oil prices this year has put upward pressure on polyester prices around the globe. Even countries which have been plagued with excess capacity are seeing inventory reductions and price increases which are now higher than cotton. This is

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leading to an overall increase in cotton's share on the spinning system.

The third thing I want to discuss is the 2005–06 production outlook. This year the world produced over 109 million bales of cotton, a record. The reasons for the gigantic increase had explanation on several fronts.

The relative high price of cotton last season and into the spring encouraged acreage expansion around the globe. Next was the increase in yields in several key producing countries.

In the US, for instance, the 2004 crop is set to post new records. Yield gains were also seen in India, Pakistan and China. All of this begs the question: Can this feat be repeated with cotton prices in the mid to low 40s?

Farmer dissatisfaction in China is well known. The Chinese government has moved to establish a state buying program in hopes of supporting domestic prices and preventing a flight of acreage to other commodities.

West African growers are facing significant losses from low world prices and the weak US dollar. Brazil, the darling of the cotton world, will be faced with a similar dilemma. Switch to soybeans or stay with cotton. They are also confronted with whether or not to proceed with planned acreage expansion at unattractive prices.

Standing in the way of any meaningful gains in New York is a largely unsold US crop. An unsold West African crop is also waiting for an opportunity to sell.

We can look back at the fall of 2001 when prices dipped below 30 cents and the US had large unsold quantities of cotton to see how this scenario could unfold. Of course no two years are exactly alike so we must be careful with our conclusions.

Without some major unforeseen fundamental shift, it may take a few months to work through the selling that hangs over the market. This will limit New York's ability to rally without a corresponding rise in world prices as reflected in Cotlook's A Index. New York will follow the world price trend at least for the next several months.

But if history tells us anything, it won't be long before New York focuses on next year's production for direction. World consumption is now at 100 million bales. Can the world produce that amount with prices in the low 40s?