The world cotton market

By Matt Robinson, Cotton Outlook

Price volatility has been a feature of global raw cotton business since we last wrote for *The Australian Cottongrower* in mid-September. The A Index stood at 52.95 cents per pound on September 15. A month later it had risen by nearly seven cents, to 59.65 cents per pound, but at the time of writing the Index has again retreated to the mid-50s cents per pound.

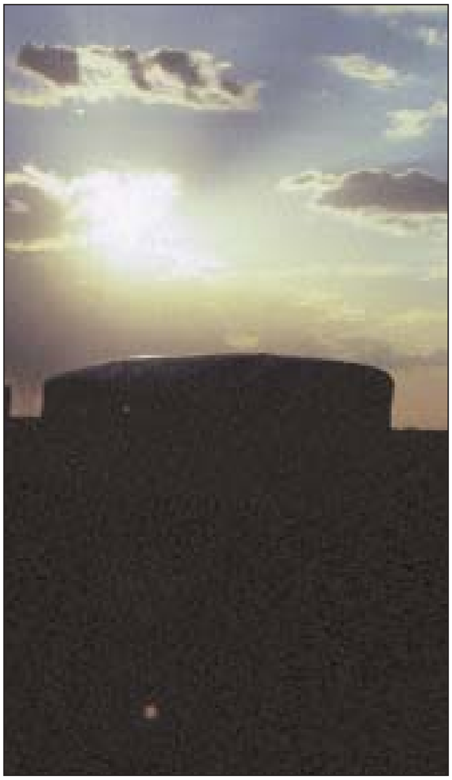
Wide price fluctuations have also been witnessed in the long staple market, with doubts growing over the available exportable surplus of Egyptian and US Pima during the remainder of the season. The premium commanded by these varieties over upland values has widened to levels last seen during the 2001–02 season, when upland prices, it will be recalled, fell to their lowest level in recent history.

The upturn in global prices (both for upland and long staple cottons) was unexpected and generally considered paradoxical in view of a statistical outlook which, early in the reporting period, was far from bullish. Improving crop prospects in several countries, including Australia, portended a surplus in supply, an outlook that contrasted sharply with the deficit that seemed likely only a couple of months earlier. During October, confidence in production estimates outside of the US, India and Australia and most notably in China and Brazil was dented somewhat and yet prices came under pressure.

DRIVING FORCE

As has so frequently been the case in recent times, a more influential force driving prices was speculative trading on New York futures. Speculators developed a net long position during the first half of October which reached a peak of 25.9 per cent of a substantial open interest during the week ended October 14. Subsequently, that net long margin was trimmed and by November 4 had declined to 15.9 per cent of the open interest.

The other usual suspect when large price swings occur is of course China and the period under review proved another example of that market's significance for global price development. As evidence mounted of damage to crops in eastern provinces, and prices of domestic cotton



strengthened, Chinese mills turned their attention to the international market.

In particular, interest was forthcoming for higher grades, with a short supply of those qualities available from the domestic crop, and cotton from Xinjiang not expected to reach major spinning regions until early next year. A further influence was the desire to exhaust 2005 import quotas before their expiry on December 31 and thus enquiry focused on cotton available for delivery before that date.

Sizeable sales of US, Uzbek, West African and Australian were noted. As prices rose, however, buying interest diminished, as did the availability of 2005 import quotas. Elsewhere, holidays came increasingly to the fore and, in the overall absence of significant buying support, prices during the second half of the reporting period drifted lower.

The legacy of the surge in prices has continued to be felt both at the main producing origins and in yarn markets. A wave of new crop purchasing by the international trade was noted as prices rose and, as a consequence, many origin sellers have since appeared more comfortable with their sales position and been reluctant to concede ground on price.

The firmness of replacement costs has rendered many international traders cautious about reflecting the full extent of recent declines in New York futures in their asking rates (especially for non-US growths). The repercussions for spinners have been manifest in their increasingly vociferous complaints that they have been unable to reflect recent rises in raw cotton replacement costs in yarn selling rates. The associated squeeze on margins of profit has no doubt contributed to the aforementioned slowdown in mill purchasing.

US EXPORT SALES

By the beginning of November, US export sales registrations were higher than at the same stage in 2004–05, with commitments to China sharply up, but those to almost all other major destinations down. Supply and demand estimates continue to suggest that China will have an unprecedented import requirement in 2005–06 well in excess of 3,000,000 tonnes.

The impact of the recently-signed textile agreement with the United States (due to come into effect on January 1) and Beijing's exchange rate policy moving into 2006 could prove important influences on China's consumption potential.

The dominance of China arguably renders a meaningful assessment of the short to medium-term price outlook especially difficult at present. No clear consensus is discernible among traders as to the probable direction of prices in the months ahead.

A case for declining prices could be made with reference to fundamental factors and most pertinently the relatively high level of world stocks. Potential bears could also refer to the continuing uncertainty over statistics emerging from China and in particular doubts over whether consumption in that country is growing to the extent suggested by yarn production data. The recent sluggish pace of US export sales registrations may also bring downward pressure to bear on New York futures.

A bullish argument would principally be founded on greater confidence in China's apparent import requirement (and would perhaps focus particularly on the reported shortage of higher grades available from that country's crop). In addition, with greater volumes of US cotton now entering the government loan, a short-term spike in New York futures may be required to release cotton into export marketing channels.

Looking further forward, the progress of discussions in the US Congress has suggested that the controversial Step 2 export subsidy for upland cotton could be abolished at the end of the current marketing year.