

The World Cotton Market

By Matt Robinson, Cotton Outlook

The period since our last contribution to *The Australian Cottongrower* has been characterised by narrow price fluctuations. The New York futures March 2006 contract has traded within a well-established range of just over four cents, touching a low of 51.53 cents per pound on December 28 and reaching its upper-limit at the time of writing.

The A Index has moved within a still tighter range of between 55.05 cents per pound, recorded at the beginning of December, and 58.45 cents, its value on January 16. The upturn both values have taken during the first few days of 2006 has pushed them modestly above their values in mid-November, though clear price direction has remained lacking during much of the reporting period. The recent firmness in New York has

been influenced principally by technically-led, speculative buying, rather than any fundamental change in the market.

Although the limits of the prevailing price range have been tested, resistance at either end has been strong. On the low side, significant mill buying support has been evident, with China remaining by far the most active market.

In the four weeks leading up to December 22, US export sales amounted to 1,610,477 running bales (of which China accounted for over half) — an average of just over 400,000 bales a week. Since then, the spot month has gained a couple of cents and holiday influences have moved to the fore. As a result, the subsequent two weekly sales volumes have averaged just over 150,000 bales.

The upper limit of the range in New York has been defined in part by mill resistance to the higher prices, but also by selling pressure generated as traders have hedged US cotton moving from the government loan into marketing channels. Entries into the loan have been seasonably heavy. But when futures have moved to a sufficient premium over world prices, as measured by the AWP (a value based on Cotlook's North European Index, which currently represents the loan repayment rate), loan redemptions have also increased.

Outside of the US, a defining feature of trade has been the difficulties experienced by the international trade in reconciling the firmness of replacement costs at the major origins with spinners' generally soft price ideas. As Australian growers will be well aware, the current level of international prices, when converted from US dollar into domestic currency terms, has generally translated into unpalatable prices to the origin seller. Moreover, good, early-season sales from Central Asian and African Franc-Zone origins, as well as from India, have rendered origin sellers reluctant to offer price concessions.

Experience tells us that international prices will not remain range bound in the longer term. But at present, it is difficult to foresee what development might sufficiently alter the market circumstances for a new and decisive price trend to become established.

The A Index has remained well below its

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long-term average of just under 70.00 cents per pound, which suggests that the downside potential is limited. But it seems perverse to predict a movement closer to that average in a season when world stocks are forecast to decline only marginally from an historically high level, according to the latest Cotlook estimates.

At this stage in the year, it is improbable that supply prospects will alter considerably. Although plantings are well down in Brazil and early crop development mixed, good rainfall in Australia and Zimbabwe have inspired optimism over production potential.

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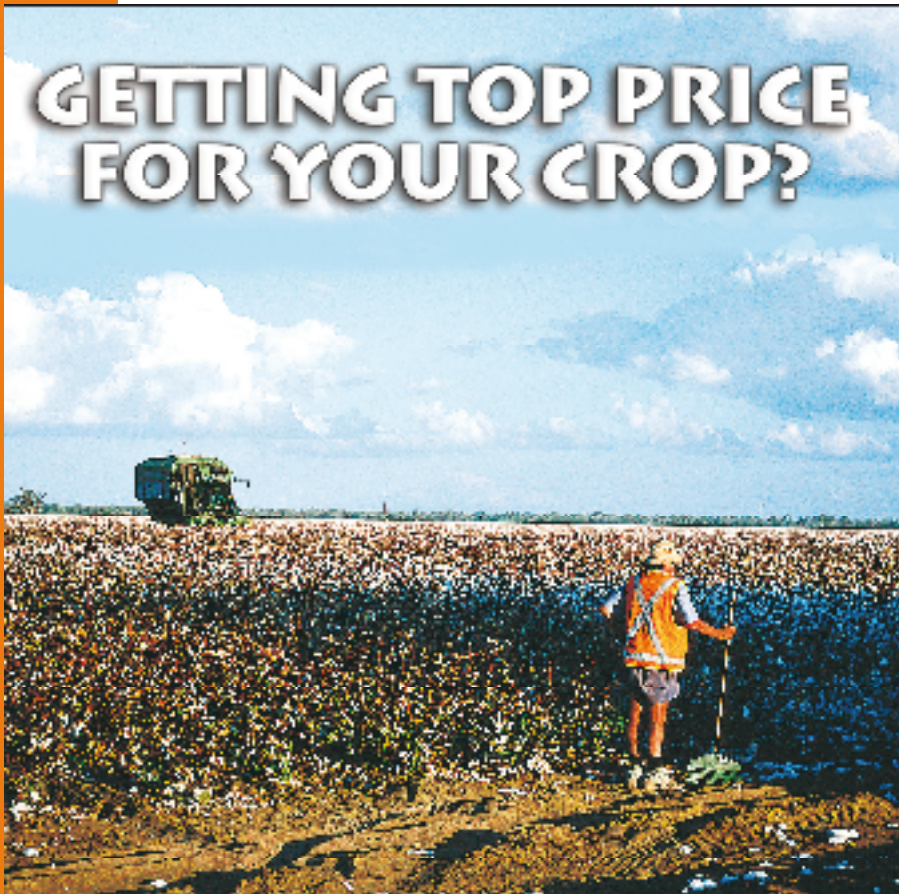
Price stimulus from the demand side seems likely to be more influential and, as always, offtake in China will be key. Although the reliability of statistics from that country remains questionable, it is generally agreed that China needs to import an unprecedented volume of cotton in 2005-06.

The pace of mill purchasing has been affected somewhat of late by the anticipation of long-awaited clarification of 2006 import quota allocations and the regime by which the allowance, above the 894,000 tonnes required under WTO regulations, will be administered. But an announcement is thought to be imminent (an

additional quota of 1,500,000 tonnes has been mentioned, at a higher, effective minimum price than in 2005) and traders have been shipping sizeable quantities of cotton to China on consignment in anticipation of a pick-up in demand in advance of the Spring Festival at the end of January.

If Chinese mill purchasing does not pick up before too long, the USDA's forecast of US exports of 16,400,000 bales (480 pounds) may not be achieved. An additional consideration in this regard is the continued passage of budget reconciliation legislation through the US Senate, which is expected to result in the withdrawal of the Step 2 subsidy on July 31. If, as is widely expected, these measures are passed into law in their current form, US shippers will doubtless intensify efforts to market and ship the unsold balance of the 2005-06 crop before that deadline.

The agreement emerging from the Hong Kong Ministerial Meeting of the WTO in December that developed countries will eliminate all forms of export subsidies for cotton in 2006 seems to confirm the assumed schedule for the disappearance of Step 2, but does not clarify the fate of the US Pima competitiveness payment, which does not currently stand to be affected by the above-mentioned budgetary cutbacks and was not challenged by the Brazilian case in the WTO.



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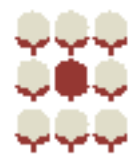
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