

# The World Cotton Market

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**D**uring much of the season to date, two contradictory forces have acted on global prices – speculative buying of futures as part of a wider reallocation of assets by Index funds into commodities in general; versus the potentially negative influence of below expected mill demand for cotton, amid deteriorating consumption prospects.

Since our last contribution to *The Australian Cotton-grower* in late November last year, it is the former, rather than the latter, that has proved decisive.

The A Index rose steadily during December, before embarking on a steep upward trajectory early in the New Year. The Index reflected closely movements in New York futures, which in turn were strongly influenced by the bullish behaviour of many commodity markets.

Supply shortages are foreseen in many grains and oilseed crops, with bio-ethanol end uses contributing significantly to offtake. Further rises in prices for those commodities continued to portend a shift in land allocation in the United States, particularly for the coming crop campaign.

While new crop wheat futures posted similar gains to cotton during the reporting period (in percentage terms), much stronger increases were witnessed in comparable corn and soybean contracts. Many projections suggest that cotton plantings in the US will fall again next season.

Many trade estimates suggest cotton acreage in the US could fall next season to below 9.5 million acres (the lowest since 1983), compared with 10.85 million in 2006–07.

The speculative flow of money into cotton futures is highlighted by the fact that open interest in New York set successive records, increasing by 36,224 contracts between January 4 and January 18. Speculators contributed 32,044 contracts to that rise.

The global supply and demand outlook also continues to appear supportive in the medium to long term. Cotlook's projections for the current season suggest that around half of the massive addition to global stocks witnessed in 2004–05 will have been wiped off the balance sheet by the end of 2007–08 and early indications are that a further drawdown in inventories will be witnessed next season. Cotlook's initial global production and consumption forecasts for 2008–09 will be released toward the end of February.

## SOME NEGATIVE FACTORS

What might appear to be an unequivocally bullish price outlook is as always contingent upon a number of potentially negative factors. Firstly, prices are already

above the long-term average. The A Index averaged just under 70.00 cents per lb during the past 30 years, but over the past decade that average drops to below 60.00 cents.

Secondly, some observers point to potential pressure on the front month in New York as it moves towards its delivery period, as speculators liquidate 'longs' or roll substantial positions forward ahead of the March 2008 contract delivery period.

Thirdly, and perhaps most significantly, the global economic outlook has continued to deteriorate and the viability of textiles and clothing business remains in question in many countries. On the one hand, manufacturers are facing inflationary pressure on their production costs, relating not only to the hike in cotton prices, but also the strength of energy rates (reflecting record crude oil prices) and tightening credit flows.

On the other hand, concern is growing over the prospect of a slowdown in retail spending in several important consuming markets (fuelled in part by fears that the US economy could go into recession). Against that backdrop, manufacturers in many parts of the world have struggled to pass on higher production costs to their customers, to the detriment of their profitability.

A further consideration has been the appreciation of many Asian currencies against a weak US dollar, which has also affected export earnings. An increasing number of reports have referred to spinning mills in various countries (including China, India, Pakistan and Turkey) curtailing their production, rather than producing yarn at a loss.

## US FARM BILL

The final deliberations over a new US Farm Bill will also shape price direction in the months and indeed years ahead. The Senate finally passed its much-delayed version of the legislation in December. Like the House of Representatives' proposal before it, the Senate's version, which also leaves intact many aspects of the current cotton support system, has attracted criticism from the Bush Administration.

A compromise committee is in the weeks ahead scheduled to work on a final version of the bill, the 'best guess' being that the measure could be put before the President towards the end of March. But the Bush administration has threatened to veto the legislation unless significant amendments are made to the existing proposals.

These somewhat contradictory signals, when combined with heightened speculative interest in New York futures, should ensure that price volatility remains a feature of the market during the early part of the year. 