

The World Cotton Market

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The 2008–09 season has been marked so far by a sense of gathering gloom, with cotton prices being driven not by traditional market fundamentals, but primarily by international cash flows during an historically turbulent period in the global financial sector.

Just as New York futures benefited through much of 2007–08 from the inflow of money from funds speculating that cotton prices would rise to catch up with increases in other commodities, the No. 2 contract has responded to the flight of that capital into safe havens such as gold. Open interest in the market has declined by around one third since it peaked in March and the December 2008 contract has declined by over 22 cents per lb (30 per cent), since the start of the season.

It is noteworthy that cash prices have not reacted readily to the declines in futures. The Cotlook A Index has dropped by over 17 cents per lb (21 per cent), since August 1, and the gap between it and futures widened from six to over 10 cents per lb. The somewhat steadier trend in merchants' offering rates can be attributed in part to a tightness of available supply for nearby shipment, on which mill buying interest has remained firmly focused.

The temporary emergence of India as a strong import buyer in July helped to mop up remaining uncommitted 2007–08 stocks from a number of origins, as did a spurt of more general nearby purchasing in August when futures dipped to close at 67.00 cents per lb. Bangladesh was a no-

table taker of Uzbekistan old crop stocks and a good volume of Chinese consignment stocks were also liquidated.

The bulk of old crop carryover has been in the US, but supplies have until recently remained in strong hands. Pressure to sell has been lacking with the difference between the December 2008 and March 2009 contracts in New York considered sufficient to cover carrying charges. Cotton held as certificated stock would begin to incur age penalties if re-tendered against the March contract, but the expectation in US trade circles is that the gap between the December and March months would widen further to compensate if there was no significant taker of the December delivery.

FALLING STOCKS

Those stocks have fallen steadily from a peak of nearly 1,750,000 bales at the end of July to close 1,363,000 bales at the time of writing, following de-certifications, presumably against an increased pace of export business as prices have weakened. Similarly, stocks held in the Commodity Credit Corporation loan have decreased, but still remain well above the year-earlier level.

Moreover, with prices at their current levels, it seems likely that much of the new crop will initially move into the loan. A potential significant development is the recent decrease of the Adjusted World Price below the loan rate of 52.00 cents and the triggering therefore of Loan Deficiency Payments.

The Northern Hemisphere new crops are now made. But adverse weather in Greece and Turkey has affected the quality composition of those crops. Cotton in the US Mississippi Delta has been affected by hurricane activity, but the weather in Texas, where over half of the crop is located, has been largely helpful.

The Pakistan and Indian crops have enjoyed a favourable end to the cultivation cycle and production in both instances is expected to at least on a par with the past season. The most significant development from the supply perspective was a reassessment of output in China, prompted by the emergence of official procurement figures for Xinjiang, which suggested that 2007–08 production in the autonomous region reached no less than 3.29 million tonnes.

The inference therefore was that national outturn last season had exceeded 8.0 million tonnes, over 200,000 tonnes more than was previously indicated by many local sources.

The CC Index, which measures delivered mill prices in China, declined by five per cent during September (to its lowest level since December 2006), amid reports of a comfortable supply situation ahead of the movement of the 2008–09 crop, believed by some to be of similar proportions to the previous crop.

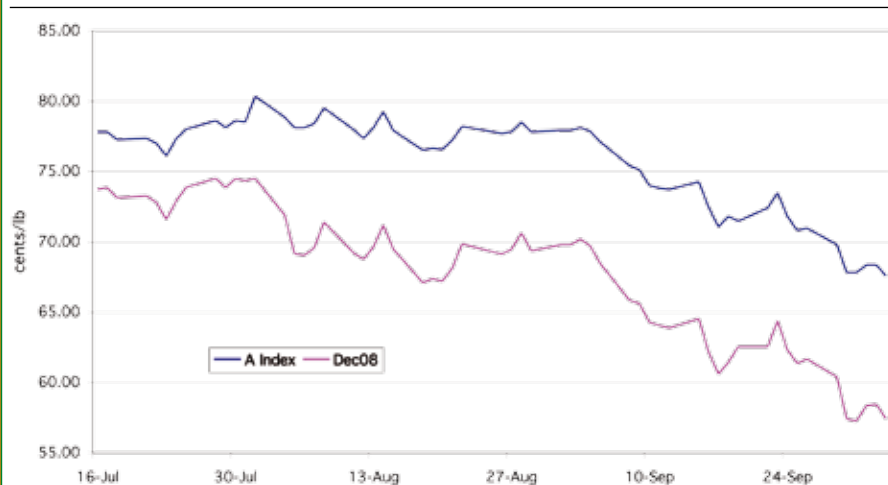
Although the Northern Hemisphere new crops have started to move, marketing of those supplies has remained slow, owing in no small part to continuing turmoil in global financial markets and the reluctance of mills to cover all but their most pressing requirements.

Merchants have also been more preoccupied most recently with the execution of higher-priced contracts, rather than adding to their sales commitments. The pace of buying at the major Northern Hemisphere origins has been lacklustre, with prices appearing unattractive to growers.

Procurement has been slow in China, while, as mentioned above, the government loan appears to be the most likely destination for much of the US crop and the smaller West African crops are already well committed.

The pre-financing traditionally required by the Uzbek marketing authorities and

FIGURE 1: A Index versus New York Futures



the introduction of much-increased minimum support prices in India and the expected greater participation of the state in marketing that crop have tended to undermine forward buying interest in those key export countries.

A good deal of focus is currently centred on demand prospects, with the global economic climate taking its toll of consumption around the world. Cotlook's latest Business Confidence Survey, conducted at the end of September, indicates that spinners in many parts of the world are curtailing operations, in face of a weak yarn offtake and accumulating stocks.

The outlook for retail spending on textiles and clothing in the major consuming centres of the US and Europe is viewed with a great deal of caution. Moreover, further evidence has emerged that, while costs are rising throughout the production chain, prices for textiles and clothing on the high street are coming under pressure.

Although Cotlook and the USDA are in broad agreement about world production prospects this season, the respective estimates being 24,504,000 and 24,768,000 tonnes, a wide difference in opinion remains over consumption.

Despite the USDA lowering its figure substantially in October, it places global consumption at 26,630,000 tonnes, well above the 25,626,000 tonnes indicated by ourselves.

The bitter irony of the situation will not be lost on cotton growers around the world, that in a season during which production costs have increased substantially and world ending stocks appear set to decline by well over 1,000,000 bales (the

first drop since the large addition to the balance sheet in 2004-05), prices have crashed just as the Northern Hemisphere harvest gets under way.

One might begin to question the impact on planted area for 2009-10 if prices remain at or below the current levels in the months ahead, when it was already considered likely, prior to the collapse in futures, that additional land would be sown to alternative crops next season.



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