The World Cotton Market

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International cotton prices have presented a distinctly soft appearance during the past couple of months, with the A Index falling to its lowest point of the season to date on March 15. On the previous day, March 2009 New York futures came within 10 cent points of touching a life-of-contract low (39.91 cents per lb, recorded on November 20, 2008).

Throughout much of the period under review, New York futures were influenced in part by falling equity values in many of the world's main financial centres and unexpected strength in the US dollar, which continued to draw money out of commodity markets.

By the middle of February, open interest in New York had fallen to a three-year low of around 115,000 contracts, against a peak of just over 300,000 almost a year earlier. Nonetheless, in recent days, influenced to some extent by a sharp fall in the value of the US currency, some observers have identified renewed interest from the speculative community in commodity markets.

Pressure on physical prices has stemmed in part from a need to compete for business with US cottons, which have provided a benchmark against which offers of other growths have been measured. With mills seeking to reduce their average purchase prices in these straitened times, heavily discounted quotations for 2008–09 crop Texas descriptions, containing bark and with a low Micronaire value, have attracted a great deal of attention.

Moreover, comments from some of the main Asian importing markets suggest even some of the less barky cotton, with prime Micronaire, while carrying less of a discount, has been used with very limited effects for the yarn end product, and has therefore proved popular with mills with stricter quality requirements.

US sales increase

US upland export sales registrations increased sharply, when nearby futures started to slide back into the 40s-cents per lb, hitting the highest weekly total for the season during the seven days ended February 19. Commitments tailed off slightly in subsequent weeks, but have remained higher than during much of the season to date, and cumulative upland export sales by the second week in March were seven per cent more than at the same stage last season.

The re-emergence of Indian cottons as a more competitive force has also been a notable feature. It had long been anticipated that offers of the sizeable exportable surplus held in India, partly by private ginners and traders, but also by state marketing agencies, would become a market factor at some stage during 2008–09.

What appears to have influenced sellers of Indian to adopt a more aggressive approach to new business was an announcement by the government that it would allocate funds to offset losses incurred by the Corporation in operating the minimum seed cotton price program in force this season.

The scale of this season's operations would suggest a commitment of up to Rs. 25 billion (US$500 million). The Cotton Corporation of India was instructed to dispose of its accumulated supply (believed at the time of writing to be in the region of 8.4 million bales of 170 kilos) by 'offering discounts for bulk purchases', since when it has sold 3,520,000 bales to domestic mills, bringing the Corporation's total commitments to nearly 5,000,000 bales.

The government has also included cotton in a scheme which provides a tax credit to exporters of five per cent. The tax credit is backdated to April 1, 2008, and runs through to July 1 this year. By the end of February, export sales registrations were placed at close to 1.4 million bales (170 kilos), compared with the Indian Cotton Advisory Board's latest export forecast for the season of 5.0 million bales.

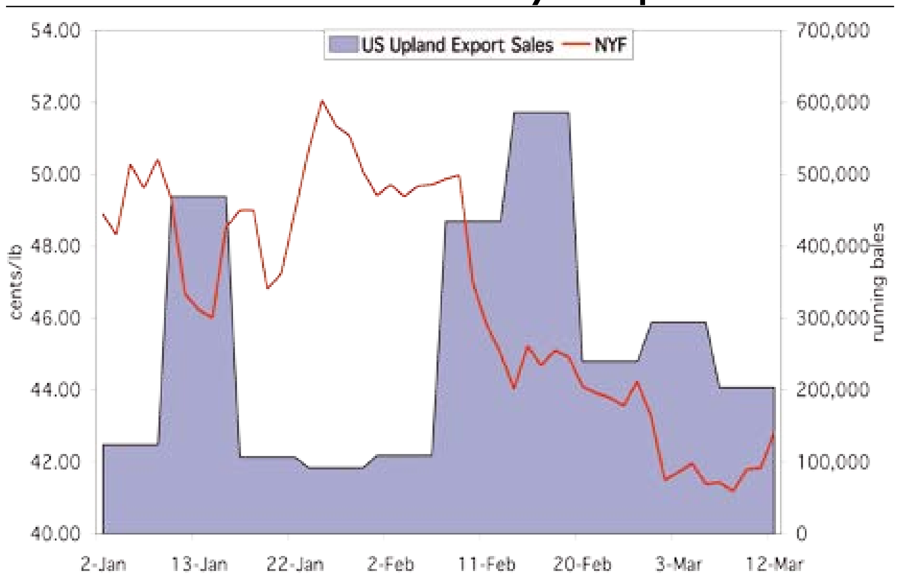
Sizeable unsold stocks still under state control, not just in India, but in China and Uzbekistan, as well as cotton held in the US government loan system, continue to overhang the market. Such supplies, according to Cotlook's rough estimates, account for perhaps 6,000,000 tonnes, or around one quarter of global production this season.

The most sizeable portion (2,700,000 tonnes) is unsurprisingly held in China. Beijing is unlikely to release those stocks back onto the market in the immediate future, as such a move would undermine its stated aim of stabilising domestic cotton prices and thereby underpinning cotton plantings. But presumably, at least a portion of those supplies will need to be gradually released back onto the market in the coming months.

In the United States, the difference between the Adjusted World Price (based on Cotlook's Far Eastern quotations) and nearby New York futures will repay close scrutiny during the months ahead, as that relationship will determine the pace with which US cotton moves out of the government loan and into marketing channels.

Uzbek marketing policy remains somewhat opaque and complicated by the list-

FIGURE 1: New York futures vs weekly US export sales



ing of one of the three state marketing agencies on the International Cotton Association's default list. Moreover, pressure to sell from a need to generate foreign currency earnings does not appear to have been as acute as in previous seasons.

Nonetheless, an expectation is evident in international trade circles that Tashkent will need to become a more aggressive seller in the near future. The ample supply still to come to market would seem to limit the potential for a significant recovery in international prices in the short term.

Looking to the longer-term outlook, Cotlook's estimates for 2009–2010, initially released in late February, are scarcely encouraging. We currently predict that production will fall only modestly next season to 23,253,000 tonnes (as at the time of writing).

A substantial recovery in Indian output is foreseeable, with farmers having obtained satisfactory returns from the last crop, contrary to the trend in a number of other countries. The drop in Chinese output is expected to be less than previously anticipated, with a rise in domestic prices and confirmation of a government subsidy on the use of high quality planting seed expected to boost planting intentions.

We project a modest recovery in world consumption next season, based on the tentative assumption that the global economy will begin to show signs of recovery either towards the end of this year or early in 2010.

Therefore, based on the current projections, world stocks could grow in 2009–2010 by over 300,000 tonnes, marking the sixth consecutive season in which additions have been made to the balance sheet.