

ICE Cotton Futures hold another test of the lows

By Ed Jernigan, Managing Director, FCStone Asia

The global economic upheaval that began in late 2008 has continued to reshape the world as it was known. It now appears global economic leadership is migrating from the US to China in an unparalleled short period of time. Today, Chinese growth is leading the world and there are indications that the Chinese economic slump may have actually bottomed during the fourth quarter of 2008. The Chinese government stimulus package, unlike that in the US where it is still in the planning stages, is already showing results.

People are already being hired for infrastructure projects, and the work is underway.

China has also unleashed a series of tax cuts, tactics that should remind the world of bold action taken by US President Ronald Reagan in the 1980s. The tax cuts are stimulating consumer spending. In the countryside, farmers are beginning to buy new minivans and trucks. The government has cut all taxes on these vehicles and has also provided a subsidy of up to 5000 yuan for the purchase of these products -- this is stimulating sales.

This new demand for vehicles has triggered heavy demand for tires. The tire industry is currently running near full ca-

capacity, which is boosting rubber demand. The same features of this program are now being implemented for other products. Chinese banks are profitable and lending, with January through February loans up 22.7 per cent.

Other industries such as textiles are hoping the success with the auto stimulus will encourage the government to also introduce a program for consumer goods. Chinese Premier Wen Jiabao has made it quite clear that he and his government are prepared and will do whatever necessary to stimulate growth. At the same time, the US government appears to be taking an opposite approach on taxes and so on, as it attempts to deal with the past excesses of certain sectors.

The re-emergence of the Chinese economic engine has major ramifications for cotton.

First it means that domestic cotton consumption has now bottomed and will lead world consumption as it recovers from the current setback.

The Chinese stimulus package and its effect has already had a major impact on certain commodities. As of this writing, the CRB Index of Commodities has already rallied 13 per cent off the lows of February.

US dollar collapses

The US dollar began to show signs of reaching a major top against most major currencies during week ending March 13; and on March 18, this top was confirmed as the USD collapsed against all major units following the US Federal Reserve's shocking announcement that it would buy up to an additional 750 billion USD in mortgage-backed securities and would purchase up to 300 billion USD of long-term treasury securities.

This triggered a near-record, 250-point drop in the US Dollar Index that continued into the week. Global interest rates and risk premiums collapsed overnight. As an example, the Libor rate dropped 6 basis points to 1.23 per cent.

The Libor-OIS spread, which is used to gauge bank lending, fell seven basis points to 100 points. Interbank lending rates in Australia dropped three per cent to a record low of 3.01 per cent. During week ending March 20, the Australian dollar appreciated 4.3 per cent. The USD weakness has major ramifications for the entire commodity complex.

Global optimism vs textile sector doldrums

The recent rally in ICE prices and offering rates is meeting stiff resistance from buyers.

Mills remain extremely cautious, have tight cash flow and are experiencing little optimism in their order books. In India, January's cotton textile output dropped 8.5 per cent from a year ago -- apparel output was only down one per cent.

The true state of China's textile sector remains difficult to analyse because of the NBS data. According to NBS data, cotton fabric output increased 14.32 per cent in February, while man-made fibre production grew 18.34 per cent from the previous year. This follows reports of an increase in yarn production.

Physical trade: Central Asia vs India

Spinners are apparently sensing more aggressive offers of Central Asian styles, a sentiment that is reinforcing their price

FIGURE 1: CRB Index breaks the downtrend

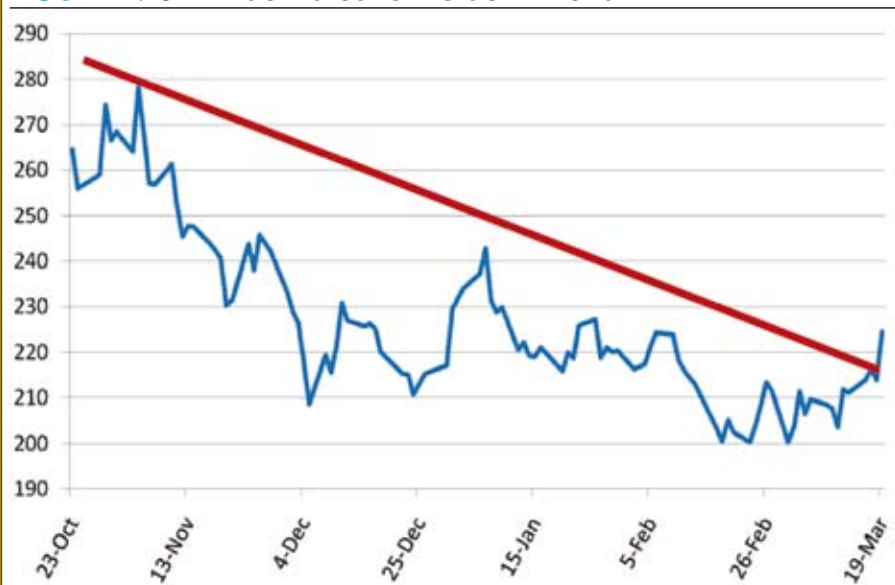


FIGURE 2: Spot Aussie dollar vs US dollar – last 12 months

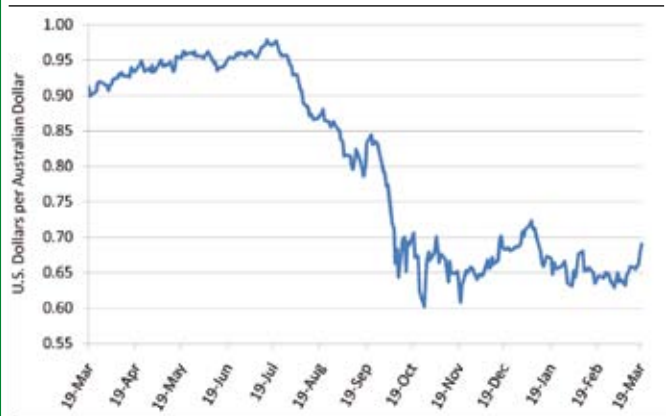
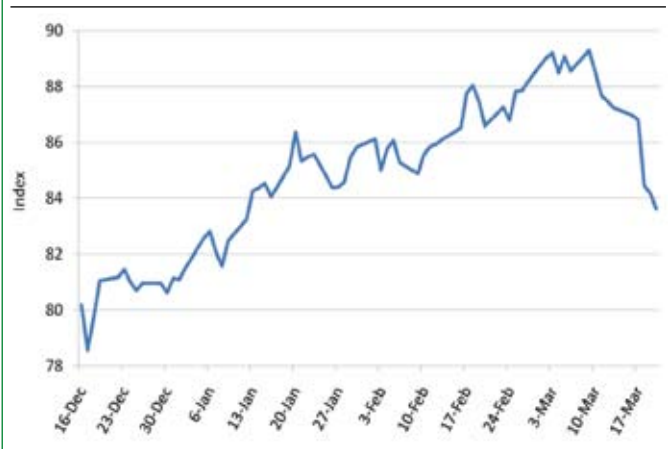


FIGURE 3: Dollar Index retreats



ideas for additional volume offtake. The unsold volume of Uzbekistan cotton as of February is believed to be double year-ago levels. Collectively, the balance of at least 500,000 tonnes of Central Asian unsold stocks is an issue. This cotton will have to move before new crop arrives in October.

This situation is starting to overshadow India's unsold inventories, at least for the moment. Recent discount bulk sales have currently relieved the burden on the Cotton Corporation of India, as export offers are now firmer with less volume available.

Currently, J-34 and Shankar-6 styles are not quoted for export. Press reports suggest that NAFED has received a state credit facility of approximately 2.379 billion rupees to finance the purchase of the 2008-09 cotton crop. Local prices at the gin are firming.

A combination of higher ICE futures and a sharp rally in the rupee/USD exchange rate have raised export offers of the popular Shankar-6 styles to the 56 to 57-cent FOB level, a rally of 300 to 400 point off the lows.

ICE Futures hold bottom

The collapse in the USD value led to a rapid rally in nearby ICE futures off the November 2008 lows, allowing the 40 to 41-cent area to again hold. The emerging chart pattern has left a well-defined rounding bottom. This suggests that the entire price structure in cotton may have now defined the low end of its price range that could hold for some time. The discount of the forward price curve to historical levels has been quite severe, adding to cotton's attraction.

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