

The World Cotton Market

By Michael Edwards, Cotton Outlook

The period since we last contributed to *The Australian Cottongrower* has been an eventful one for the international cotton market. We concluded our previous offering by noting that those attending the International Cotton Association's annual gathering in Liverpool, in early October, appeared to see more upside than downside potential in the market. We added the caveat that, for the trade's relative optimism to be vindicated, any futures-led upturn in physical asking prices would need to be matched by a continued improvement in the yarn business environment.

Writing toward the end of November, it seems that the moderately bullish consensus we detected in Liverpool has proved more than justified, and that the condition of an upturn in spinners' fortunes has at least partially – perhaps largely – been fulfilled.

The Cotlook A Index has risen from

around 63 to 64 cents per lb at the beginning of October, towards the mid-70s cents per lb at the time of writing. The Index is once again comfortably above its long-term average. The principal driving force behind the rise of upland prices has without doubt been the New York futures market, which for most of the period has been influenced not by cotton fundamentals, but by factors only tangentially relevant to our market.

US DOLLAR WEAKNESS

The weakness of the US dollar would seem to have been the key to investors' renewed interest in commodities as an asset class. Cotton, like other commodity markets, has thus been the recipient of significant inflows of funds (relative to the size of the cotton futures market) that have propelled the market to levels that would have seemed implausible only a few months ago.

While fund buying provided the initial

impetus for the market's upturn, fundamental supply and demand considerations have also proved supportive. During the period under review, Cotton Outlook's forecast of lint output from the 2009–10 crop has been reduced by close to 750,000 tonnes, largely as a result of weather-related factors.

Our consumption figure has been about maintained, and marks a partial recovery, of around four per cent, following the unprecedented contraction of mill use, around 13 per cent, witnessed in 2008–09. The net result of the foregoing is that the size of the foreseeable reduction in world stocks during this season has increased to over 1,200,000 tonnes. The physical market has thus strengthened in tandem with futures and, though cause and effect have on occasion seemed confused, the bullish momentum has been tangible.

In addition, adverse weather has reduced the prospective supply of high grade



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cotton available to the world's spinners, a fact already apparent in classing data from the United States and China.

Sellers of Australian cotton may stand to benefit from this state of affairs, though history teaches us that the scale of any additional premiums obtainable in face of a high grade 'squeeze' often prove disappointing; all too often, spinners have proved surprisingly adept at adjusting their blends to accommodate the qualities available from the market at more competitive prices.

REVISED PRICE IDEAS

One of the more surprising aspects of the market's recent bull run has been the relative speed with which mill buyers have been prepared to revise their price ideas upward. One might have assumed that, in the wake of the exceptionally difficult trading conditions created by the recent economic and financial crisis, resistance to the futures-led rise in trade offering rates would have proved stiffer.

One part of the explanation would appear to lie in the sharp contraction of output that occurred – at virtually all stages of the textile manufacturing chain – during the 2008–09 season. Painful as that proc-

ess was, it is credited with having cleared the burden of stocks held at various stages of textile production, and thus created the conditions for a swifter recovery in prices than might otherwise have been the case. But spinners' capacity to absorb increasing prices is not limitless and increasingly frequent reports of a switch by certain mills out of cotton and into synthetics should no doubt be interpreted as a warning.

As far as the future pattern of trading is concerned, and the market's potential for a further advance, developments in China will, as always, prove of paramount significance. During most of October and November, fresh import demand from that quarter has been restricted by quota constraints.

Despite the continued strength of local prices, Beijing has proved unwilling to release fresh import quotas, presumably for fear of undermining farmers' profitability during the harvest period, and preferred to manage the supply side of the market via the state reserve mechanism.

It will be recalled that the government intervened aggressively in the market during 2008–09, acquiring some 2,720,000 tonnes of lint – roughly one third of that


season's crop – in order to engineer a recovery of the local market, following its collapse during the later months of 2008.

Prices having duly recovered, cotton from the state reserves has been fed back into the market, as the authorities have endeavoured to stabilise a market that has shown signs of overheating. A third round of state reserve auctions, involving 500,000 tonnes, commenced on November 20, but has failed thus far at least to stem a prevailing bullish trend that has gathered unforeseen momentum.

NEW CHINESE QUOTA

For some time now, the prices paid by Chinese mills for cotton from their domestic crop have been well above import parities, to the detriment of the international competitiveness of the country's spinners.

With the imminent availability of a new tariff-rated quota for 2010, the pace of import purchasing can be expected to accelerate over the coming weeks, particularly for cottons at the upper end of the quality spectrum.

If Chinese demand does indeed materialise on the scale anticipated, the recent transformation of market sentiment may become more firmly entrenched. 



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