# New York Futures

**By Hibbie Barrier, Fimat/The Jernigan Group**

The most interesting thing about this market right now is the level of indecision among market participants with regard to near term direction. As of this writing, New York futures are trading in the low 50s. The funds are 45 per cent net long and a large portion of the US crop is still in grower hands.

Export demand for US cotton is very strong with buyers scattered from China to Brazil. Local basis levels in the US are firm as exporters search for cotton at both ends of the quality spectrum. Civil unrest in the Ivory Coast remains an issue for West African buyers.

And China, where strong consumption and high domestic prices have almost everyone watching their every move. Can cotton prices continue the upward trend evident since November of 2001?

## DECLINING STOCKS

In the USDA's latest supply and demand estimate, world ending stocks were forecast to decline 920,000 bales to 37.92 million bales. This change was primarily the result of a 750,000 bale decrease in China's stock numbers dating back over the past two seasons.

US ending stocks were also forecast to decline 200,000 bales to 6.3 million bales. This was the result of a 240,000 bale decrease in the US production estimate. The only other meaningful change to the numbers came from a 200,000 bale increase in Pakistan's production estimate.

Since the season began, estimated world ending stocks have fallen from 40.61 to 37.92 million bales. This puts the stocks to use ratio at 39.3 per cent, the lowest since 1994 when the stocks-to-use ratio was 34.2 per cent — 1994–95 was the year of dollar cotton.

Before we get too carried away with enthusiasm, we need to remember total ending stocks that year were only 28.95 million bales — not 37.92 million as they are today. In addition, stocks-to-use numbers in the US were 12.9 percent in 1994–95 versus 34.4 per cent today.

As we look forward, New York's price direction will be affected by several factors. Right now certificated stocks against the contract stand at over 400,000 bales. This figure is at historically high levels. Adding to the weight of the stocks is the fact that they are made up of low strength and older cotton that is not attractive to buyers at current levels.

Should this change, New York will likely respond with additional strength. The difference between March and May is already trading at historically wide differences. Typical storage and interest charges are say 150 to 180 points. Today's differences are approaching 400 points.

This is the result of the rule changes for certificated stocks strength and year of growth penalties. Against this backdrop are the almost daily rumours that some or all of the certificated stocks have been sold. One day it is to China, the next Turkey, the next Brazil and so on. Whether or not any of it has been sold is not known for sure.

Only the holders of the stocks really know. Nonetheless, certificated stocks have fallen from 440,000 bales to 408,000. This fact alone gives some validity of sales activity.

Another factor that will directly influence New York is the direction of the A Index. The A Index is Cotlook's index of the five cheapest world growths of 1-1/8 cotton delivered northern Europe. This index has been particularly strong this season as the market anticipates a shortage of high grade cotton.

Country buying levels have been strong around the world. A new leg up in the A Index would surely lead to higher prices in New York. This is a function of the US farm program as much as anything else. US growers continue to eye the difference between New York and the adjusted world price.

If the spread between these two increases, we can expect good US grower sales and subsequent hedging pressure on New York. If the gap narrows, US cotton will remain stuck in the loans and in farmers hands. So from time to time New York must rally relative to the A Index to shake cotton out of the system.

Outside of the US, the West African shippers seem to have finally worked themselves into a long basis position. This fact is contributing to a stalled A Index and at least a portion of the market's uncertainty.

## DEMAND SIDE

Now turning our attention to the demand side of the equation. Mill demand has been strong in certain markets at certain times. The exception to this rule has been China where mill demand has been continuously strong for the past couple of years. Real economic growth within China as well as strong exports of yarn and finished products has bolstered demand.

In the US, the domestic mill situation has held steady but remains vulnerable to a shaky US economy. Recent mill demand from Turkey and far eastern mills has kept the fires burning for US cotton exports. For the past three months world prices have steadily risen, at least until now.

It seems some mills have reached a point where yarn sales are not as profitable at current levels. So a reluctance to pay up is catching some merchants a little long the basis. Despite this factor, merchants report that the mill sector is still uncovered past the first quarter.

## NEW YORK SCENARIOS

Now let's look at some possible scenarios for New York near term.

Number one, with a fund sector at 45 per cent net long, you have to wonder how long can the market go before some sort of correction occurs?

Number two, how patient can the mills be before pricing their on-call March, May and July purchases?

Number three, how long can the mills wait before purchasing the balance of this season's needs?

And last, number four, how much supply do the US merchants have available to them for nearby shipment?

My thoughts on these questions are that the funds will liquidate 10 to 20 per cent of their positions before we are able to rally back above the recent highs. As for the mills, they are running out of patience and as a result will fix prices into the fund liquidation for nearby months but will continue to delay forward price decisions pending a more favourable economic outlook.

As for the merchants, the strong buying basis best answers this question. At some point I believe the market will bid for at

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least a portion of these supplies. But we must remember ending stocks are forecast at 6.3 million bales, so not all of this cotton is needed near term.

### THE BIGGER PICTURE

As for some bigger issues, new crop December is fast approaching the 60 cent level. What will this do for next year's planting intentions outside of the US? Already we are hearing of acreage expansions in Brazil, China and parts of West Africa.

How much will depend on where December is trading in the late February–early March time frame. In addition, the US dollar has fallen by 15 per cent over the past year and this could weigh on foreign growers' decisions. Conversely, cotton prices as indicated by the A Index have risen approximately 26 per cent over the same period from the 40–42 level to near 57.

In the US, it is very hard to cut through the growers' moaning and groaning to get the straight scoop but here is what I am hearing.

- In the Delta, expect a 10 to 12 per cent decline in acreage as growers pocket some of the government's program money and plant less capital intensive crops.
- In the Southeast, there could be an 8–10 per cent decline for some of the same reasons plus last year's terrible crop is still fresh on their minds.
- In Texas, the area will probably be unchanged as a good season plus reasonable prices should persuade the locals to keep the faith.
- I expect acreage expansions in Arizona and California as high basis levels and a good crop has left most everyone sitting on high cotton.

So to me the US acreage figure will only be slightly lower. If we believe the USDA's world consumption estimates, we should stay friendly New York as the reduction in world ending stocks and a favourable stock to use ratio will keep cotton prices afloat.

# Independent classing initiative

Twynam Agricultural Group and Namoi Cotton have announced the formation of an independent classing service to be known as Australian Classing Services (ACS).

Commencing with the 2003 season, ACS will operate an independent cotton classing facility to be based at Wee Waa.

ACS will provide HVI and manual classing services conforming to USDA standards and best management practices as determined by the Australian Cotton Classers Association.

All cotton purchased by Colly Cotton Marketing for the 2002–03 season will be independently classed by Australian Classing Services.

According to Colly Cotton Marketing's General Manager, Kim Morison, the idea of a centralised independent classing facility has been considered within the industry for some time.

"Initially, we expect the combined throughput of Colly Cotton Marketing and Namoi will allow ACS to capture significant capital and cost-saving efficiencies," he said.

"Over time, we expect the volume of cotton classed through the ACS facility will be complemented by bales classed on behalf of other growers and shippers," he said.