World Cotton Market

By Michael Edwards, Cotton Outlook

The exceptional volatility of prices during October and early November has given way to a period of rather less dramatic price movements, since we last contributed to *The Australian Cottongrower*, in mid-November.

Much of the uncommitted supply of 2003–04 crop cotton is now held in merchants' hands, rather than at origin, and a fair proportion of those trade holdings, one must assume, is hedged in New York. So the fluctuation of asking prices has understandably been influenced largely by the direction of futures during the period in question.

Unexpected weakness in that market prompted a fairly swift retreat of prices in the second half of November. The Cotlook A Index, which was hovering just below the 80.00 cents mark when our last report was written, had declined to 71.55 cents per lb by November 26. Futures staged something of a recovery during December and, at the time of writing, the Index appears becalmed in the mid-70s, with prices lacking a clear direction.

The market's loss of upward momentum has been associated with a marked slowdown in the pace of import demand from China, the aforementioned retreat of futures and the still rather conservative raw cotton purchasing policy adhered to by mills elsewhere. Many spinners continue to struggle to obtain yarn prices that reflect current raw cotton replacement costs.

BULLISH VIEW

Yet the 2003–04 season's balance sheet, both in China and globally, continues to support a fairly bullish view of the market. In China, the apparent gap between supply and demand, on Cotton Outlook's current figures, remains around 1,800,000 tonnes.

During the first five months of the 2003–04 season, China purchased over 730,000 tonnes of US cotton. The volume secured from other origins cannot be known with certainty, but would seem to leave scope for additional business to be concluded over the coming months, especially as stocks at the start of the season, based on Chinese statistics, were already low.

The current focus of attention is the eagerly-awaited crop estimate customarily forthcoming at around this time of year from the Chinese National Bureau of Statistics. Whereas, in recent seasons, this official figure has proved higher than other estimates in circulation, the feeling on this occasion is that private forecasts (including perhaps our own 4,800,000 tonnes) may err on the high side.

Provincial crop surveys, and national procurement data, would seem to support that view. Many observers, while acknowledging that cotton

was dogged by adverse weather, particularly in eastern parts of the country, remain puzzled by the scale of the losses that have resulted.

FORWARD OUTLOOK

While the substantial shortfall of China's crop is likely to be the paramount influence on prices for the remainder of this season, the outlook further forward is far less clear. Cotton Outlook's initial forecast of production and consumption in 2004–05 is due for publication in February. It seems certain that a substantial expansion of cotton plantings will occur next season, as producers react to the stimulus of the higher prices obtained for their 2003–04 crops.

Although tempered in some cases by the weakness of the US dollar, returns to many farmers are the best they have achieved for several years. Another large crop can be anticipated in the United States, of which a shrinking proportion will be required by the domestic industry, whose contraction continues in the face of unremitting import pressures.

Expectations of a quite radically altered supply and demand situation in 2004–05 are already reflected in price relationships in New York, where the October 2004 contract continues to trade at a substantial discount, relative to the nearby positions. At this early stage, any assessment of farmers' intentions is of course largely speculative.

While higher prices self-evidently provide an incentive to plant cotton, other factors may also intervene. Prices for some alternative crops, notably soybeans, have recently shown similar strength to those of cotton.

There are signs that the Chinese authorities, who appear to acknowledge that an increase in cotton plantings is inevitable, nonetheless wish to avoid too enthusiastic a response to the current strength of local prices. In many major producing countries, the timely arrival of rains, or availability of water reserves for irrigation, will be a factor, not least in Australia.

Over the next few months, the tension between the strength of short-term Chinese import demand, and sharpening perceptions of farmers' planting intentions for next season, will provide the key to the market's direction.

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