New York Futures

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The bearish mood that has overtaken New York continues firmly entrenched. Gone are the rally hopes of 90 cents — now people would give just about anything for something with a six in front. As in 2001, when prices peaked and proceeded to fall almost unabated, the prospect of a large world crop (Chinese and US in particular) was at the crux of the weakness.

The USDA's July report seemed to confirm what the market has been telling us for months. Higher world production is on its way provided we don't get a significant crop failure. In 2001 prices declined from the high 60s to 28.20. In 2004 prices will decline from 86 to where?

In the USDA's July supply and demand report, world production was forecast at 104.73 million bales, a new world record. That is up 1.85 million from the previous month's estimate and more importantly, 10.84 million more than last year. Production increases in China (1.0 million to 30.0 million), India (500,000 to 12.5 million) and US (400,000 to 18.0 million) provide most of the gains.

Consumption rose in the July report by 300,000 to 100.16 million bales, also a record high. In the end, world ending stocks were projected at 37.79 million, up 2.44 million from last month and 4.86 million above last year. The concerns suggest that figure will rise further.

While it is easy to point to the increased production as the most visible target for wounded bulls to shoot at, there are plenty of other targets to explore. China's "May Day" shift in monetary policy probably accelerated the market's decline more than any other event.

In addition the sharp rally in the fall moved more cotton early from growers hands to merchants than normal. This created hoarding and long basis positions that to this day are still being unwound. The question for the market will eventually shift away from supply and back to demand which can only come after the size of the crop has been better determined.

For instance, we know China is still in need of cotton for the August–October time period. But how much? India is likely to return to the market as well but again for how much? Asian countries which have been buying hand to mouth still need coverage through the end of the year. How much?

The sharp decline in New York's prices has created a real reluctance by the mills to cover out forward. There are several reasons such as competition and even the eventual phasing out of US textiles quotas in 2005. Both of these events have mills managing inventory (both raw material and finished product) delicately.

New York's outlook will continue to struggle under the weight of a 10 million bale increase in production estimate. Until this changes it is hard to imagine anything other than small brief oversold corrective rallies. The real window of opportunity for a significant rally is the August to October time frame.

That is when world supply and US supplies will be their tightest. If by chance crop prospects begin to dim, then prices could in fact return to the 60s as the stocks to use ratio would warrant higher prices again.