

COTTON PRICE OUTLOOK

Sharon C Johnson
Cotton Analyst
Frank Schneider & Co, Inc.
Atlanta, GA

Abstract

US futures prices and various underlying cash prices are likely to reflect a bearish change in fundamentals the rest of the 1996/97 crop year as well as into 1997/98 after two and a half years of bullish conditions. Futures are expected to remain range bound in the remaining months of 1996/97 with a drop likely to the mid 60 cent area by the fall of 1997. The US should see a small decline in 1997/98 planted area and a return to normal yields, but similar demand as in 1996/97 will keep stocks unchanged. World production and consumption are also expected to be offsetting factors which will maintain ending stocks at current levels into 1997/98. A continuation of current high stocks in the US and in the world will contribute to lower prices in 1997/98.

Introduction

Let me begin by thanking Mr Meyer for inviting me to speak at the Beltwide and on a topic that is near and dear to my heart, Cotton Prices. The bulk of my price outlook is directed toward futures but I will also review the outlook for the Cotlook A index and cotton farm prices. In making these forecasts, I will discuss possible changes in the current supply/demand picture given earlier this morning as well as present our projections for 1997/98. However, no discussion would be complete regarding price direction without a look at some of the possible factors that could change our price scenario so that after you leave this meeting, you will hopefully be in a more knowledgeable position to make your own pricing decisions.

1996/97 US & World Supply/Demand

This morning's official figures on total supply of 21.8 million bales is the second highest figure since the mid-1960's due in (S-1) large part to this year's production of 18.7 million bales. The USDA consumption estimate of 11.0 million bales is also very close to the final figure that will go into the history books. (S-2) The only portion of this morning's US fundamental outlook that may prove to be optimistic is the level forecast for US exports at 6.2 million bales. Historically about 96% of upland commitments that are registered by mid-season become actual exports. (S-3) Thru Dec 26, registrations stood at 71% or 4.5 million bales. The current 1.8 million bale deficit is expected to be made up later in the season than normal. However, heavy

sales beyond the third quarter are unlikely as commitments have averaged 105% of final exports since 1986/87. Consequently, if the USDA estimate is to be met, net sales should average 145M bales per week through the first quarter of 1997. The potential exists for these sales to occur given the reductions in foreign crops but whether this potential reaches fruition is yet to be determined. If sales fail to pick up as needed through the first quarter of 1997, exports may fall short of the USDA target by 2-300M bales. However, the final level of exports may matter little as their impact on ending stocks is considerably less bullish than in the two previous years.

As pointed out this morning, US ending stocks are estimated to increase to 4.6 million bales, almost twice that of the last two years and the same level as 1993/94. (S-4) The stocks to usage ratio is also seen doubling from 13 and 14% each of the two previous years to the current 27%. It is this huge increase in US ending stocks that will play the largest role in keeping US cotton prices under pressure the second half of 1996/97 relative to the last two years.

Regarding world figures, production and consumption are estimated at nearly identical levels of 85-86 mln bales. (S-5) World production has tended to rise and fall much more than consumption as global usage has been nearly unchanged for the last 10 years. The lack of expansion with usage may seem odd given the growth in population and economic gains but three reasons help explain this anomaly: 1- The break-up of the USSR and the resulting economic chaos led to a 6 million bale decline in consumption in the FSU countries from 1990/91 to 1995/96, 2- flat world cotton yields have reduced readily available cotton supplies and 3- competition from synthetic fibers as capacity has experienced sustained growth. Nowhere is this drop in cotton usage more noticeable than in China where consumption is off sharply in 1995/96 and 1996/97 despite huge increases in cotton imports in the last 3 years. At 19 mln bales, estimated usage in the PRC is now lower than any year since the mid 1980's.

World ending stocks are estimated to rise to 37 mln bales, the highest level since 1985/86 and 800M bales above the 1995/96 level. (S-6) If we view world stocks without China, we can better see what is really available for world use. Currently, World stocks (ex-China) are 21.8 mln bales, the highest level since 1992/93 when they totalled 23.9 million bales.

1996/97 Projected Prices

Taking into account this morning's official fundamental review, my own views for 1996/97 in the US and World, and the limited upside movement in the Cotlook A Index projected by the ICAC, here is how I see cotton futures prices trading the remainder of this crop year. (S-6) In line with the seasonal increase in price into and through spring and to ensure producers will plant sufficient acres this

spring, the nearby months may approach the 80.00 level but not necessarily exceed that price. Given the sheer size of the US carry-out, heavy producer selling after Jan 1 and the competition for export sales from the Southern Hemisphere countries, futures will have difficulty moving much higher than the hi-70's. Once planted acres are assured as well as the size of those stocks rolling into new crop, futures are likely to sell-off by late spring/early summer and a possible test of contract lows basis the July contract cannot be ruled out. Currently, the March contract is trading at the low end of our projected range and may work slightly lower (100 pts) depending on the outcome of tomorrow's reports.

Although a nearterm time frame for the Dec '97 contract is not included on this slide, the current level of 76-77 cents appears to be fairly priced and may not move much higher this winter/spring. Over the last 10 years, the Dec '97 contract has generally topped out in late spring but that is more of a function of when the old crop months hit their seasonal highs. In addition, although the Dec contract is lower in price than the last two years when stocks were very tight, it is at the high end of the price range in the early months of the calendar year from 1988 to 1994. Lastly, whereas the Dec contract has tended to move several cents higher from January into the spring, the 1997 contract may prove to be the exception based on current stocks and those forecast for new crop.

1997/98 US Supply/Demand

The biggest issue for the US cotton market this spring will be farmers' planting intentions. A substantial number of cotton acres were lost to competing grains in 1996/97 due to the very poor cotton yields in 1995/96 and very high grain prices early in 1996. Until this past fall, concerns were rampant as to the potential for additional losses in 1997/98 for two reasons: A new farm bill in 1996, the Federal Agriculture Improvement & Reform Act which no longer favored cotton production and lower cotton prices during the 1996/97 growing season relative to the two previous crop years. The FAIR act disassembled the requirement that cotton payments be tied to actual cotton acreage in any given year allowing free market forces to dictate producers' preferences with crops planted. Also, the likelihood of a continuing trend away from cotton as occurred last spring in favor of grains has been considerably lessened due to a substantial drop in grain prices while cotton prices have held their ground. (S-8)

Reviewing trendline yields, variable cash costs per acre, and farm prices, we can determine that net returns per acre favor cotton over corn or soybeans in the Delta and SE. (This data was provided by the Food and Ag Policy and Research Institute [FAPRI], a combined effort of the Univ of Mo and Iowa State.) I anticipate cotton producers will plant 13.4-13.9 million acres, or 2-6% less acres to cotton in 1997/98 from the 1996/97 level of 14.2 million acres. (S-9) I am using a figure of 13.7 million acres, a decrease of 4% at this

time. By region, the Mid-South is likely to lose the most acres with a 7% decrease projected or about 265M acres as many producers who planted more corn in 1996/97 will do so again in the new crop year. A 6% drop is likely in the SE with Georgia (S-10) accounting for the bulk of the cut but the huge outlay in capital and investment in the last 3 years into cotton production and the accompanying build-up in infra-structure will likely keep most cotton producers loyal to cotton. Due to improved top and sub-soil moisture levels in the SW and specifically, West Texas, cotton acres could be slightly higher, especially as sorghum prices are much lower this year and planting rains are normal this spring. Lastly, the FW may only see a slight downward change in its acreage from 1996 and the 5-yr average. Water availability is plentiful and a much smaller percent of farmers have been or are tied to the various farm programs. (S-11)

Assuming normal abandonment of 7-8%, (the 5-yr average is 8.2% and the 10-yr is 7.3%), a harvested acreage figure of about 12.7 million acres is likely. Incidentally, this figure is very similar to 1996/97's of 12.8 mln acres.

Rather than using a trendline yield which may prove too high, I prefer to be more conservative and use a yield slightly above the 5 and 10-yr averages of 650 and 647 lbs/ac. (S-11) These may prove to be too low but yields have tended to retrench more than normal the year after record or near-record yields were recorded. If correct, a yield at or slightly above 650 lbs/ac will produce a crop of at least 17.2 million bales.

As an aside, according to Monsanto, the use of their new BT cotton seed will expand to about 2.4 million acres this spring or 18% of our planted acreage estimate. Preliminary data suggest that BT cotton seed improves yields by at least 15% as well as reducing costs associated with insecticide spraying. The use of BT cotton and other improvements is expected to contribute to yield growth or, at the minimum, maintain yields. This is important because yield variance has had a major impact on final production in recent years. For instance, if yields rise or fall by only 20 lbs/ac, using our planted area figure, production expands or shrinks by about 500M bales. With the exception of 1995/96, yields have ranged from 600-700 lbs/ac which would imply a crop size ranging from 16.0 to 18.5 million bales with our 17.2 million as a mid-point. (S-13)

When a potential crop size of 17.2 is added to carry-in, a supply of close to 22 million bales will be available for use in the 1997/98 crop year. A figure very similar to last year's. (S-14)

As to how next year's supply will be consumed, I am using a range of 10.7-11.4 million bales for domestic usage, close to the level used in the last 3 years. As usage is unlikely to vary greatly in the next 6-18 months, exports will mostly likely prove to be the "wildcard" for next year's demand.

Over the last 10 years with the exception of 1994 and 1992, exports have ranged from a low of 5.8 million bales to a high of 7.8 million bales. Taking into consideration the size and location of foreign stocks and the assumption that world production will be at or near our projection, US exports are expected to total 6.0-7.0 million bales. Total demand could then range from 16.5 million to 18.3 million bales with a mid-point of 17.4 million bales, 200M above this year's USDA estimate. Again, if this projection is ultimately correct, ending stocks could range from a low of 3.8 million to a high of 5.6 million with 4.6 million bales our current forecast, the same as this year's official estimate.

1997/98 World Supply/Demand

Making forecasts about the US fundamental situation 6-12 months in advance is difficult enough but projecting the same on a global basis with any accuracy is nearly impossible given the large number of countries involved in both production and consumption. However, if we make several assumptions on both sides of the supply/usage coin, we can project area, yield, crop size, demand and then (S-15) ultimately, ending stocks. As US area is likely to drop slightly, so should world area for similar reasons. Given the importance of cotton to the economic well-being of several key producing countries such as Pakistan, India and Uzbekistan, the drop should not be as severe as in the US. We think world area is likely to fall by 1.5-3.0% implying a figure of 32.2-32.7 million hectares vs 33.2 million in 1996. Using an average yield, a production of 85-87 million bales is reasonable barring any huge surprise from China, Pakistan, the US, India, or Uzbekistan, the 5 largest (S-16) producing countries. Let me point out though in one, if not several, of these countries, we have had production surprises in the last several years, both bullish and bearish.

Consumption is a bit easier to predict as it has experienced no growth over the last 10 years and until evidence develops to (S-17) suggest otherwise, I am going to use a range of 85-86 mln bales. This figure is in line with the 5 and 10-year averages and within the 10-year extreme high and low of global usage. Although the odds may not favor production and consumption reaching the same level, stocks would be maintained at or above the 36-37 million bale level which also represents the highest level since the late 1980's.

Polyester

Due to the important role that synthetic fibers and in particular polyester will play with cotton prices, I would like to make a couple of key points. Earlier this week Dr. Lange spoke regarding the global competition of cotton vs man-made fiber so I will limit my comments.

Just as the FAIR farm act will add support to US cotton prices, synthetic fiber competition could cap or at least provide some resistance on any extraordinary price rallies. Chemical or manmade fibers have always been used either

in conjunction with or as an alternative to cotton. The erratic nature of global cotton production and the increasing competitive nature of man-made fibers, in particular polyester, will continue to encourage the consumption of synthetic fibers at the expense of cotton.

First, let us set the stage by taking a look at how various US fiber prices have traded with a ratio of the raw-fiber equivalent of cotton versus polyester. (S-18) For the last three years, polyester has consistently been cheaper than cotton in the US, a phenomenon that is also occurring in many other parts of the world. In the last twelve months, polyester prices have fallen by more than 25% in the US and Europe. Pakistan has witnessed an even more dramatic drop of 33% while Taiwan and Japan are off 19% and 11% respectively.

World polyester production capacity, which has exceeded actual production this decade is seen expanding even further not only in the short-term but also into the next century. (S-19) Synthetic fiber capacity is forecast to increase by 37% between 1995 and 2000 with 85% of this growth occurring in the Far East and 12% in the Americas.

This increased use of synthetic fibers could spell trouble for US exports as its traditional base of customers for cotton has been in the Far East. That is not to say that cotton use will not expand. It is forecast to grow as well, but cotton will have to remain competitively priced if it is to keep its market share.

1997/98 Projected Prices

Before moving to a discussion of how futures are likely to trade, I want to review the impact of stocks-to-use ratios on prices. (S-20) This slide deals with world stocks/usage ratio versus world cotton prices. The relationship is obvious although there is on occasion, a lag between the effect of a change in stocks and prices in the same year. The International Cotton Advisory Committee (ICAC) as mentioned earlier is projecting this year's world price (the annual average of the Cotlook A index) will average 77 cents compared to the year-to-date average of 76.25. As for 1997/98, the ICAC is predicting an average of 78 cents although they forecast little change in World or US stock levels from 1996/97 into next year. My suspicions are that the psychology of maintaining stocks at such high levels will have more serious ramifications than simply a sideways trend. (S-21)

This next slide shows a similar impact of ratio on price for the US using national farm prices. Prior to 1994/95, the US stocks/usage ratio had averaged 21% for 5 years. In 1996/97 and 1997/98, US stocks will run in excess of 4 million bales pushing this ratio up to a minimum of 23%, if not higher, which in turn will pressure prices. FAPRI is predicting the farm price for cotton at 70 cents compared to a current 3 month average of 72 cents and a sizeable drop

for 1997/98, to 64 cents. Given my own bias for futures to be lower next fall but not extraordinary so, 68 cents would appear more reasonable to me.

Having reviewed both sides of the supply/demand coin, here is how I see new crop futures trading from now into 1997/98. (S-22) Longer term, our projections for futures are based on the maintenance of US ending stocks in the 4.5-5 million area and an unchanged figure for the world. For the moment, new crop prices are expected to drop toward the mid-60 cent area this fall, slightly lower than last fall's 70-72 cent range. How much higher futures trade into the winter and spring of 1998 will depend on expectations for demand in the second half of the crop year.

Let's take a quick examination of what could go right or wrong to alter the outlook. While we work through several scenarios bear in mind that the extreme changes in world ending stocks in recent years have come from equally extreme changes in production, not demand. This has not been true for the US as its changes in stocks levels have been as a result of changes in production and demand. First, if US production falls short either with acres or yields and the crop size is on the low side of 16.0 million bales, demand will have only limited room to grow, 500M - 1 million bales, before stocks become too tight again. The impact on prices would be to raise the price levels into the spring of 1998 by 5-10 cents higher as this scenario would not be known until after harvest. If on the other hand, the production shortfall is overseas in a traditional exporting country such as Pakistan or Uzbekistan boosting US exports but keeping stocks at a neutral 4.0 million, prices could rise only slightly higher, 5 cents or so, into next spring. (S-23)

Next, should world production be fully maintained particularly in key exporting countries that compete with the US, futures may have to work lower than the mid-60's to attract sufficient sales to keep stocks from expanding much beyond the 5 million level. Finally, if US production is on the high side, 18.0+ million bales, futures would be under greater pressure than forecast to encourage demand as well as decrease planted acres into 1998.

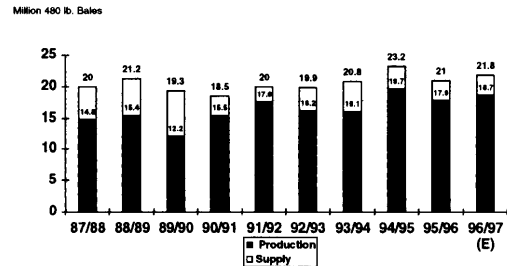
If it sounds as though we are playing dominos with the cotton market, you are right. What happens overseas in one or two countries can have a major impact on the US futures market and vice versa. We must look beyond our own backyard and keep a watchful eye on production in those countries who are in direct competition with the US for export share. We must listen with a "third ear" to changes in Chinese policy as it can have a greater impact on their net import status than any change in supply within a given year. Finally, we must remain cognizant of the competition from polyester.

Summary

In conclusion, little change is forecast in US and World stocks the remainder of this crop year and into 1997/98 but stocks are only a part of the equation that will dictate price levels. As these scenarios may change, so may our projected prices of high 70's this spring to mid-60's this fall.

S- 1

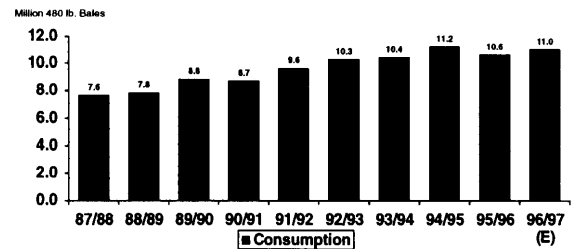
U.S. Cotton Total Supply



Source: USDA

S- 2

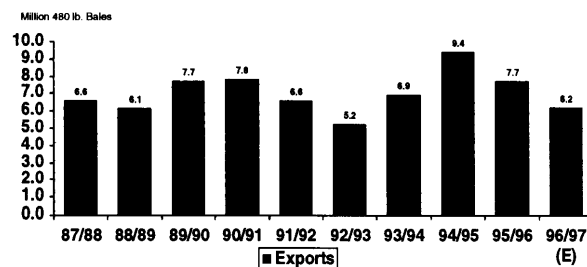
U.S. Cotton Consumption



Source: USDA

S- 3

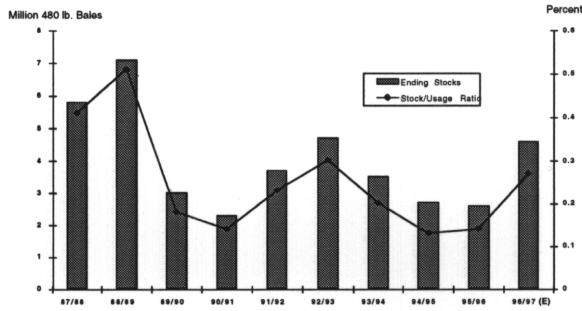
U.S. Cotton Exports



Source: USDA

S- 4

U.S. Cotton Ending Stocks with Stocks-To-Use Ratios



Source: USDA

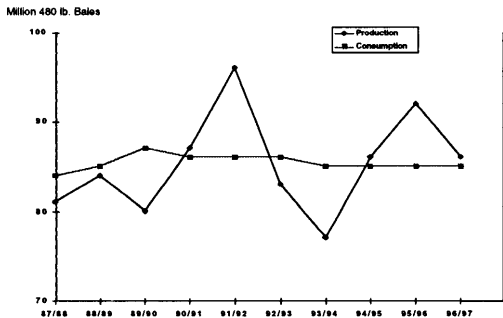
S-8

1997 / 98 Mid South and Southeast Comparative Returns

	SOUTHEAST	MIDSOUTH
COTTON:	\$.69 @ 717 = \$495.	\$.68 @ 862 = \$586.
EXPENSES	353.	427.
	\$142. NET	\$159. NET
	40% R/R OR ROI	37% R/R OR ROI
SOYBEANS:	\$ 6.20 @ 28 = \$174.	\$ 6.25 @ 27 = \$169.
EXPENSES	104.	81.
	\$70. NET	\$78. NET
	67% R/R OR ROI	85% R/R OR ROI
CORN:	\$ 2.52 @ 102 = \$257.	\$ 2.60 @ 111 = \$289.
EXPENSES	180.	180.
	\$ 77. NET	\$ 109. NET
	43% R/R OR ROI	60% R/R OR ROI

S- 5

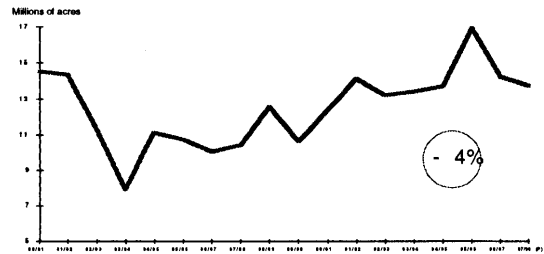
World Cotton Production Nearly Equals Consumption



Source: USDA

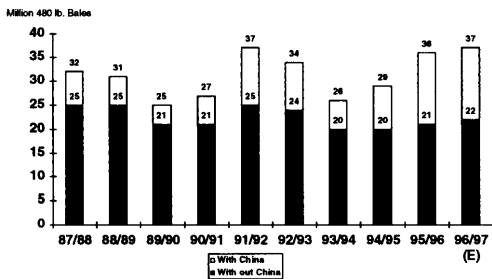
S- 9

U.S. Projected Cotton Planted Acreage



S- 6

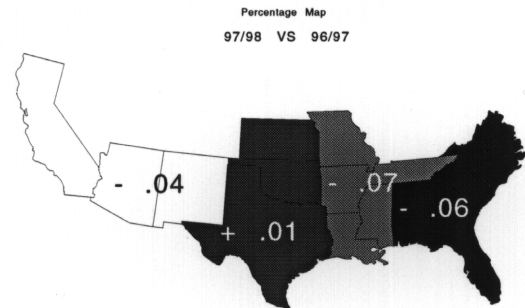
World Ending Stocks With and Without CHINA



Source: USDA

S- 10

U.S. Projected Regional Change for 1997



S- 11

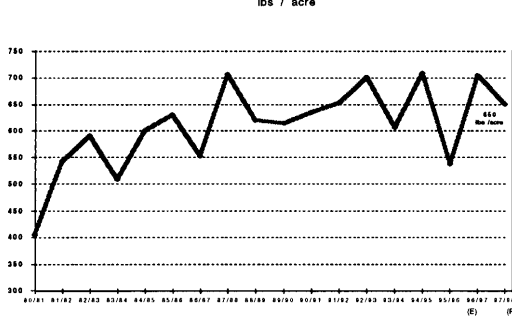
1997/ 98 US Projected Area by Region

Thousands of acres

Region	1995	1996	5 Yr. Avg	1997P	Chg
Southeast	3460	3164	2413	2965	-199
Delta	4877	3940	4260	3675	-265
Southwest	6780	5490	6005	5530	+40
Far West	1596	1383	1449	1330	-53
Upland	16717	13979	14123	13500	-479
Pima	215	264	220	208	-56
Total	16931	14243	14349	13708	-535

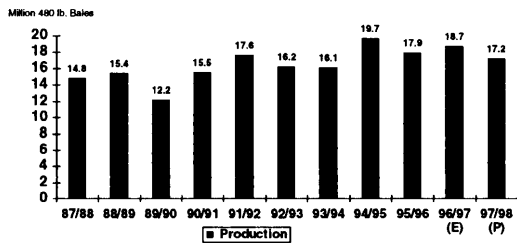
S- 12

U.S. Projected Cotton Yields



S- 13

U.S. Projected Cotton Production



S-14

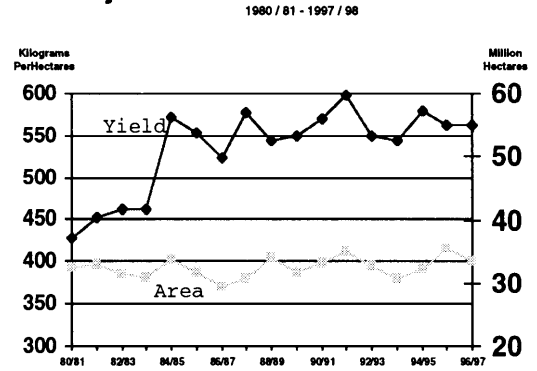
U.S. COTTON SUPPLY & DEMAND

million 480 lb bales

	1995/96		1996/97		1997/98	
	USDA	USD	FS/SJ	FS/SJ	FS/SJ	FS/SJ
Beginning Stocks	2.7	2.6	2.6	2.6	4.8	4.8
Production	17.9	18.7	18.7	18.7	17.2*	17.2*
Imports	0.4	0.5	0.5	0.5	0.1	0.1
Total Supply	21.0	21.8	21.8	21.8	22.1	22.1
US Mill Consumption	10.6	11.0	11.0	11.0	11.0*	11.0*
Exports	7.7	6.2	6.0	6.0	6.5*	6.5*
Total Demand	18.3	17.2	17.0	17.0	17.5	17.5
Unaccounted	0.1	0.0	0.0	0.0	0.0	0.0
Ending Stocks	2.6	4.6	4.8	4.8	4.6*	4.6*
Stocks/Usage Ratio	14%	27%	28%	28%	26%	26%

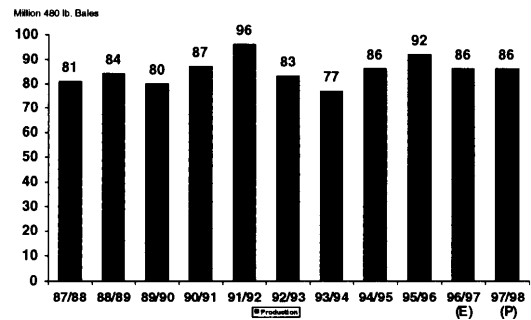
S- 15

Projected World Area and Yields



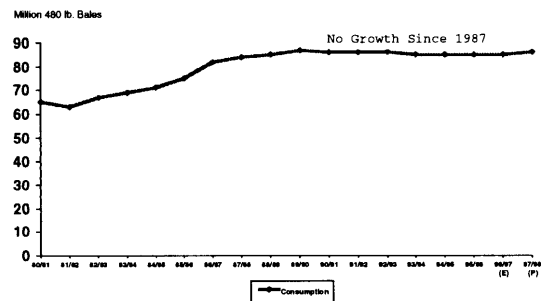
S- 16

World Projected Cotton Production

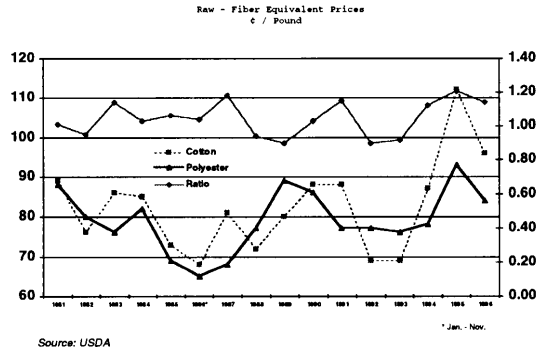


S- 17

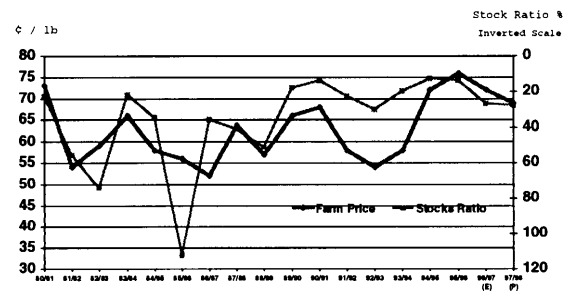
World Projected Cotton Consumption



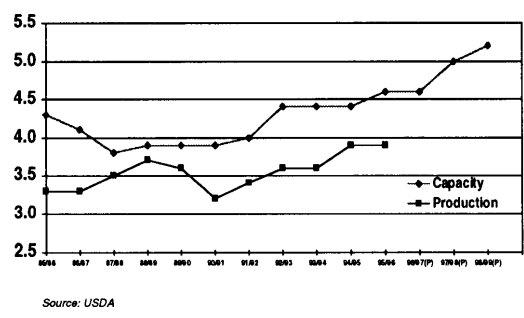
S- 18 **Cotton & Polyester Prices With Ratio**



S- 21 **U.S. Farm Price with U.S. Stocks-To-Use Ratio**



S- 19 **Polyester Capacity VS Production**



S- 22
S- 7 **Projected Futures Price Levels**

1996 / 1997	March	May	July
	January - February 74.00 - 79.00	March - April 81.00 - 75.00	May - June 77.00 - 72.00
1997 / 1998	October	December	March
	July - September 75.00 - 71.00	October - November 73.00 - 66.00	December - February 68.00 - 73.00

S-23

US COTTON SUPPLY AND DEMAND

	1994/95	1995/96	1996/97	1997/98		
				Low Yield	Normal Yield	High Yield
Planted Acres (mil.)	13.7	16.9	14.2	13.7	13.7	13.7
Harvested Acres (mil.)	13.3	16.0	12.8	12.7	12.7	12.7
Yield (lbs.)	708	537	704	585	650	715
	(Million 480 lb. Bales)					
Carryin(Aug)	3.5	2.7	2.6	4.6	4.6	4.6
Production	19.7	17.9	18.7	15.5	17.2	18.9
Imports	0.0	0.4	0.5	0.3	0.1	0.1
Total Supply	23.2	21.0	21.8	20.4	21.9	23.6
Mill Use	11.2	10.6	11.0	10.8	11.0	11.3
Exports	9.4	7.7	5.8	6.2	6.5	6.9
Total Use	20.6	18.3	17.2	17.0	17.5	18.2
Ending Stocks (bales)	2.7	2.6	4.6	3.4	4.4	5.4
Stocks to use ratio	13%	14%	27%	20%	25%	30%
Farm Price (cts/lb)	72	77	72	71	68	64

S- 20 **World Cotton Price With World Stocks-To-Use Ratio**

