MARKET PLACE INSIGHTS
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Abstract

Good morning ladies and gentlemen:

I think this is my 14th year to speak at the Beltwide and I think the earlier years were certainly more fun. They were more fun because I had the opportunity to share some good news, but the last two years in particular, every facet of the cotton industry has continued to struggle to survive.

I think the good news is the President and Congress for the last two years have recognized the serious plight of agriculture and have passed emergency farm legislation to aid a distressed situation.

This year's legislation was even more beneficial because they doubled the AMTA payments, doubled the payment limitation for one year and put Step 2 back in the equation for the life of the farm bill. If agriculture does not improve this coming season, I believe we will once again have emergency farm legislation, primarily because it is an election year.

I can assure you that Dunavant Enterprises' export business in U.S. cotton was going straight down hill until the reinstatement of Step 2, beginning this past Oct 1. We will export this season at least 1 million more bales under Step 2 than we would have without it. Last season, when Step 2 expired on Dec 14th, we only sold for export 850,000 bales for the balance of the season, and we ended the season with only 4.34 million bales shipped from the U.S., and this was a very distressful number.

I had the opportunity in September of last year to speak to an international cotton group in Liverpool, England, and the topic of my speech was American cotton subsidies and their need for U.S. cotton to compete in world markets. It was not a popular subject with most of the cotton producing countries in attendance. I said that the U.S. must continue to subsidize until the playing field in the world becomes level, and we are a long way from that point.

I think the lack of agreement at the world trade organization meeting in Seattle was based primarily on the lack of a level playing field.

Unfortunately, I do not see the world changing in my lifetime. However, China, this cotton season, has told its producers they are going to sell at the world price and reduce their huge carryover stocks. They are doing this, but there is still a subsidy to cotton producers, but not nearly as great as a few years ago.

At this point in time, I think freedom to farm is your best vehicle in cotton. I do not want our government to get back in the business of managing our supply with allotments. I think the marketing loan, flexibility, and the POP gives you protection in times of low prices, which we are certainly experiencing today.

I know Step 2 is highly beneficial to U.S. cotton exports, and also allows our domestic textile industry to compete with subsidized cotton imports. Again, there is not a level playing field for the U.S. textile industry and they are suffering, but now improving, with Step 2.

Currently, the textile business overseas is quite good. Consumption is rising and the mills are making money for the first time in two or three years. Cotton prices are cheap and they are taking advantage of the cheap prices. Another bonus for cotton is that the price of polyester fiber has risen 10 to 15 cents a pound over the last 6 months. When oil prices started up, it immediately began to have an upward impact on polyester prices. Cotton will regain some of the market share it lost to cheap polyester prices.

As I look out five years, I think U.S. cotton consumption will decline from 10 million plus bales of this season to 8 million bales. However, North American cotton consumption will rise above its current levels. This is all made possible by NAFTA, and Mexico will be the leader in increasing cotton consumption, which will in effect reduce U.S. cotton consumption. There are a number of U.S. mills that have operations and joint venture operations in Mexico. Other mills are currently looking at business potential in Mexico and Central America.

Now, let me look at current U.S. and world supply – demand, and then try to find a bright spot for cotton prices.

USDA told us on December 10th that the final U.S. crop would be about 16.9 million bales. I think this is a good number, but the final number could be a little lower.

Domestic consumption will be 10.1 million bales and exports will escalate to 6.3 million bales, as we feel the effect of Step 2. This makes total off-take 16.4 million bales versus a crop of 16.9 million bales, and a U.S. carryover of 4.5 million bales, up approximately 500,000 bales from last season's 3,940,000. That is part of the reason for March cotton trading between 51 and 52 cents. We have already registered for export 5.374 million, 480-pound bales, and this is only the first week in January.

Reprinted from the *Proceedings of the Beltwide Cotton Conference*
Volume 1:16-18 (2000)
National Cotton Council, Memphis TN

The world numbers are a little different. World production this season will be approximately 86.3 million bales, and world consumption will be 87.9 million bales as the textile business overseas improves. We will reduce the world carryover by some 1.6 million bales, leaving us with a 37.3 million-bale carryover, an ample supply to currently keep world prices depressed during this marketing year. There is still a substantial volume of foreign cotton for sale in the world markets from Central Asia, French West Africa, Syria, Greece, Australia and Pakistan.

I think China has basically sold all they want to sell out of this year's crop, because they had a limited amount of high grades, which the Chinese domestic industry needs.

We think final Chinese production this season will be 17.5 million bales versus USDA number of 19.0. We think domestic consumption will be 20.8 million bales, so they will reduce their carryover by 4.1 million, leaving them at year-end with stocks of approximately 13.1 million bales. It is still a large number but a big step in the right direction.

The big question confronting all of us in the international trade is, will China import this season? The Chinese government has really had the clamps on Chinese imports. We know from conversations with joint venture mills that some of the mills would like to import some very high grade California SJV cotton and Australian high grade cotton for their finer yarn counts that go into the export markets.

They really don't want to spin the old crop carryover stocks because of bale condition and color deterioration. The big question is, will the government relax the tight restrictions?

I truly believe that in the spring of 2001, China will start to import a fair volume of cotton. With the recent announcement of a smaller Chinese crop, I would not be surprised to see China import a modest volume of cotton this spring.

Now that we have reviewed this current season, let's jump to the millennium 2000 – 2001 crop year.

I think we all believe that U.S. acreage is going to be large, at about 14.9 million acres, which should produce using average yields 18.6 million bales. We think the domestic industry will still consume 10.1 million bales, and I strongly believe exports will be 8 million bales plus, as we get the jump on foreign competition because of Step 2, and a much improved textile business around the world. Remember, two seasons ago (1997-1998), U.S. cotton exports were at 7.5 million bales under Step 2, and at that time, the textile business was not booming overseas.

If total U.S. off-take is 18.1 million bales versus production of 18.6, this adds 500,000 bales to our existing 4.5 million bale carryover. On July 31, 2001, the U.S. carryover will be nearly 5 million bales. Remember, I said 8 million bales plus on export, and if business is really strong, we might see 9 million bales of exports and a 4 million bale carryover. That is a long way off so I don't want to be too optimistic.

As we look at world production and consumption, this is where the numbers really change, but most of the major downward changes will occur in China.

I see world production dropping to slightly over 85 million bales, and world consumption escalating to 89,850,000 bales or a 1.2 million bale drop in production, and a 1.9 million bale increase in consumption, dropping the world carryover to 32,550,000 million bales from 37.3 million bales this season, or a drop from this year of 4.8 million bales, a big decline. We show Chinese production dropping 300,000 bales, to 17.2 million bales, and consumption increasing 200,000 bales, to 21 million bales, and we think they will also export nearly 1,000,000 bales with a normal crop. China's carryover will drop to 8.7 million bales, which I think has their house in order for the following season, and this is the primary reason you will definitely see imports in 2001.

On the surface, a 4.8 million-drop in the world carryover would be bullish on prices, but the bulk of the drop occurs in China, and they will still export some cotton next season, as well as import cotton.

The major exporting countries like French West Africa will increase production 200,000 bales. Uzbekistan will decrease production 375,000 bales, Greece will decrease production 200,000 bales, Turkey will decrease production 200,000 bales, and Syria will reduce about 100,000 bales, Australia will cutback about 300,000 bales of production, Pakistan will produce a million bales less next season, or about 9,000,000 Pakistani bales, and India will reduce 350,000 bales to 12.5 million bales. These are your major cotton exporting countries that compete with the U.S., and we project next year they will reduce production by about 2.5 million bales, and of course the U.S. will get a substantial share of export business from these reductions.

In looking at the world, China's carryover is going to be sharply lower and other exporting countries are reducing production.

The U.S. is the only country we project to really increase production and increase their carryover.

Now, let's look at the final equation and project what will happen to prices.

In looking at this marketing year, I do not see any factor that causes prices to rise five or six cents from today's level.

There is still an ample supply in the world prices. Prices could even work lower in the spring, as some of the exporting countries push to liquidate their stocks. French West Africa probably has the most cotton left to sell to world markets. However, we must remember, cotton prices today are historically cheap.

If the world would get off to a poor start in planting the northern hemisphere crops, that could add upward pressure to new crop prices which would pull up old crop prices. Also, if China would begin to buy cotton for the joint venture mills this spring that would create some additional excitement.

I would certainly continue to market my current cotton crop, with the POP, at today's level. I don't see any reason to hold onto the current crop. Certain qualities may be tight in the spring, but I would not hold for fear of lower prices.

Now, new crop is a different story. December cotton is trading around 55.00 cents, and at this level I would not hedge a bale. In fact, I would probably buy it for a speculation because none of the northern hemisphere's crops are in the ground, and won't be until the spring.

The new crop numbers are certainly not bullish in the U.S. with our increased carry over, but the world numbers give me some concern to be cautious. As I stated earlier, we show production from major exporting countries declining by 2.5 million bales, and as I stated earlier, China is getting its house in order in 2000-2001.

If the funds and speculative community would decide to go long and push December above 60.00, I would take a look at a hedging strategy, probably through options. For December to go above 60.00, and remain there, something dramatic must occur in the supply – demand balance.

It is a long way till planting time, and in my opinion, no producer should be considering hedging until we see more clearly what the supply picture is going to be, both in the U.S. and offshore. You, obviously, at this time, have no idea what the POP is going to be in November of 2000. If conditions are normal, as we approach spring, I would certainly look at buying December puts to hedge your downside. Your puts and calls will hold option premium value well into September.

However, I wouldn't hesitate, if the acreage continues to look large of hedging the basis for all territories. At these levels I would not fix the price, but sell the basis on call.

There are rumors and fact that a few of the domestic mills are struggling financially, and one went into chapter 11 reorganization last week. The industry has enough capacity to absorb a shut down if it would occur. This situation is just a caution to the U.S. cotton industry that all is still not good.

When I spoke last year at the Beltwide, I talked about how important Step 2 had been for all of us, and that we must fight to get it back, which we have done.

I said earlier how important the emergency farm legislation had been for all of us and I want each of you to know that none of this would have been possible for cotton without a united cotton industry through the National Cotton Council. I hate to visualize the future if the industry cannot continue to work together for the benefit of all of us.

United we win, divided we fall.

Thank you.