

MARKETPLACE INSIGHTS

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Before examining the fundamentals of supply–demand and price, I would like to look at the conditions of the world cotton industry as all of us look to our future. It seems it is changing every six months and this all relates to China’s activity in textile exports, and cotton consumption.

When I spoke last year we were projecting Chinese cotton consumption at 27.0 million bales, and final consumption was 29.5 million bales, and today it appears their cotton consumption will be in excess of 30.3 million bales, this season, and projected higher for next season. They are literally controlling world cotton consumption as we look to our future. I will discuss this in more detail when I share my views on production and consumption in China.

I talked last year about the demise of the U.S. textile industry. I think conditions unhappily are on target. When I spoke last year I talked about U.S. cotton consumption of 7.5 million bales and trending lower. I think unfortunately I was right, and this season we think domestic consumption will be down to 6.2 million bales. The potential for a number for next season slightly below 6 million bales can be reality.

However, when I spoke last year we were projecting U.S. exports of 10.8 million bales, and they were 11.9 million bales for the season, a big number. The U.S. is rapidly becoming the major exporter of cotton and this is extremely necessary for the future of U.S. cotton production. We project today we will export over twice what we will consume domestically. It is hard for me to look back five years ago and see the tremendous change that has occurred in our industry.

Many good cotton producers, some of whom are my friends have decided to exit the business over the last three years. We talk about all the benefits the farm bill has created for agriculture but good producers are exiting the business, not entering. Yes, this season in the Mid-South, and Southeast, was a banner year for quality, yields, and price, but that is necessary for many to stay in business. Hopefully, new seed varieties will offer new opportunities for growers in both quality and yield.

You as U.S. cotton producers know better than I know that we have a real battle over the next few years in maintaining our current farm bill with no major changes. Step 2 marketing certificates, payment limitations, and target price are all threatened.

I am certainly not qualified to discuss payment limitations, and target price, but I do know that without Step 2 payments to the domestic textile industry, the cotton merchants and cotton cooperatives, who export cotton, that all of our futures are threatened. If we cannot export our cotton in volume like last season and this season, then U.S. cotton could potentially die in the loan, and the total cost of the U.S. cotton farm program will become prohibitive. It is crucial for all of us through the National Cotton Council to fight hard for maintaining our farm program. It appears that Brazil, and West Africa, are not going to back off of threats even though prices are at least 10 cents higher than a year ago. The battle will continue and we must be ready to fight for our survival.

I stated two thoughts last year that unfortunately have proved correct. I said a respected textile executive said U.S. cotton consumption could very well drop below 6 million bales in five years, and two years later it appears it will be reality, and I also said other cotton consuming countries will feel the effect of China’s aggressive cotton consumption policies. All these thoughts are happening and too quickly.

We have not even reached 2005 when all quotas are eliminated. What will happen then or is it happening now?

Before looking at the current and future supply-demand projections I would like to compliment Mark Lange, and John Maguire for the job they are doing for all of us, in the U.S. cotton industry. When you look at our future, and the threats to our future, I give them a plus, for their work. I don’t always agree with everything the Council does, but it is our future, and to not support them threatens all of us. They and the staff are special and I recognize them!

I turned the page last year and I will turn the page this year to look to the future.

We project the final U.S. crop to be 18,275,000, and U.S. domestic consumption to be 6.2 million bales, and U.S. exports to be in a range of 13,450,000 bales to 14,200,000 bales. Today, I lean toward a higher number than 13,450,000 bales only because of China, and what we see happening in that country. Our U.S. carryover on August 1, 2003, was 5.4 million bales, and we now project our carryover on August 1, 2004, to be in a range of 3.4 million bales to 4.2 million bales. I project this wide

range because none of us know how aggressive China will be over the next seven months. They will be a major player with the U.S. Their carryover stocks will be entirely too low for the volume of their consumption.

Let me share a few thoughts about U.S. cotton exports for this season. When I spoke last year I projected, as I stated earlier, U.S. exports to be 10.8 million bales, and we ended up registering 12.4 million bales, and actually shipping 11.9 million bales. Through last Thursday we had registered 9.3 million bales so we are definitely on target to break our record for shipments and registered sales.

When we look at the world the numbers they look even more friendly for the balance of this marketing year. We started the season with a world carryover of 37.0 million bales, and we think it will drop to 33.5 million on August 1, 2004. We arrive at this number by producing a crop this season of 93.1 million bales, and we see world consumption at 96.7 million bales. This is a major draw down of world stocks.

When I spoke last year we projected the world carryover to be 38.8 million bales, and it ended up 37.0 million bales, because Chinese imports were much greater than I anticipated.

Now that I have identified the U.S. and world carryovers for this season let me be more specific about China, and other markets.

We think final Chinese production to be 20.7 million bales. We think the National Bureau of statistics number when announced will be approximately 22.5 million bales so our Dunavant production number is 1.8 million bales lower than what we think the government number will be. They had a horrible crop both from yield and quality. They have been concentrating on buying the best quality cotton in the world. China has already purchased 3.4 million bales from the U.S. and probably 5.5 million bales in the world. China just recently announced their import quota for 2004 at 894,000 metric tons or 4.1 million bales, and they will import all their quota for sure. China's ending stocks on July 31, 2004, will be 7.4 million bales with a 22.5 million bale crop, a very small number considering consumption will be in excess of 30.3 million bales, and we project higher consumption for next season. If I use my number of 20.7 million bales production then the Chinese carryover will be only 5.6 million bales, and it clearly does not work without major purchases of additional cotton. China must build their carryover stocks over the next two years. They are consuming over 2.5 million bales per month. They consume in two and half months what the U.S. consumes in 12 months. It is explosive.

I said last year China would continue to take markets from other developed countries, and they are certainly hammering Japan, Taiwan, Hong Kong, Korea, Indonesia, Thailand, and Europe.

China continues to have excellent technology and it improves every year.

It is hard to believe China has one very modern textile mill that consumes about 2.3 million bales per year, and they are trying to grow that number. This mill produces very high quality yarns, and buys the best cotton produced in the world. It is a compensation mill that basically sells all of its yarns in the world markets and does very well.

China's major competitors in the world are India, Pakistan, Bangladesh, and Vietnam, who are also developing countries. However, these countries are having a difficult time competing with China.

There are two other major importers of U.S. Cotton, Mexico and Turkey.

Mexico will buy 1.625 million bales this season versus 2.22 last season.

Turkey will buy 1.525 million bales of U.S. cotton this marketing year versus 1.53 million bales last season. These two countries have been consistent buyers of U.S. cotton and will continue to be.

China is also putting pressure on Mexico and that is one of the reasons their purchases of U.S. cotton will be smaller this season.

Turkey has already purchased from the U.S. 630,000 bales and will become much more aggressive in the weeks ahead.

They have been concentrating on buying local Turkish cotton, because of price, but the local supply is drying up.

Pakistan had a very poor crop this season producing only 7.6 million bales, and they will need to import to balance supplies. I project they will buy in the world market 1.45 million bales. They have already started buying cotton, and we have sold them U.S. and Australian.

India will import only 850,000 bales because they produced a good crop this season.

The traditional buyers for U.S. cotton Korea, Taiwan, Hong Kong, Japan, Indonesia, and Thailand will continue, but their consumption has been damaged by china just like the U.S. textile industry. Five years ago Japan and Korea combined consumed 2.7 million bales per year, and this season their combined cotton consumption will only be 2.26 million bales a drop of over 400,000 bales in only five years.

Australia is still struggling even though they had rain recently. They will produce between 1.3 and 1.5 million bales depending on moisture during the balance of the growing season. We are projecting they will be back to producing approximately 3 million bales next season as they begin to build water supplies in their dams, and catchments. It is still a fine cotton in demand around the world.

As I look around the world the numbers say we are going to have a tight world supply in the spring basically of all qualities, but especially 21 and 31 grade, in 34, and longer staple.

Now for my part of the speech that I used to relish doing, but over the last few years have dreaded every minute of it. The subject is what are prices going to do for the balance of this marketing year and what is the trend for next season.

I said last year prices would trend higher into the 2003-2004 crop year, and this has certainly happened. When I spoke last year December 2003 cotton was trading around 58 cents, and it eventually traded up to 84.80 on October 30, 2003. However, what I did not pick up on is the severe price decline that would occur after the market reached its highs. It was all a matter of timing.

One U.S. Company sold China 1.2 million bales in the fall, which was the largest single sales transaction to China in my cotton career. I never dreamed March cotton prices would drop from a high of 86.00 on October 30, 2003, to a low of 67.09 in a period of one month. All the fundamentals have been and still are bullish. What happened? The commodity funds were too long, and the U.S. and international cotton trade was too long - me included.

The significant part of all this is world price only dropped 8.2 cents, and the New York futures market dropped 19 cents. During the same period of time Chinese prices were relatively stable.

Our company said back in the early fall that timing would be the answer to higher prices and we thought that would occur in the springtime as supplies got tight. Remember, we are talking about a world carryover of 33.5 million bales, and that is too tight if China is going to be a player.

As I stated earlier, China has already purchased 3.4 million bales of U.S. Cotton, and we think they will buy at least another 2 million bales, and it could be 3 million bales.

Also, as I stated earlier, they have just allocated their quota numbers for 2004, and it is 4.1 million bales. Obviously, it will not all be U.S. cotton, but we will be a substantial part of it. Certainly China has been aggressive in wheat, corn, and soybeans, and with a dismal cotton crop I cannot believe we will not be in the mix. Certainly the Chinese premier had an excellent visit with President Bush, so there may be additional excitement in the months ahead for all commodities.

I must keep reminding myself that China's year end carryover is going to be drastically low and they cannot afford not to replenish.

Now for price levels today March cotton is trading at 75.70, and I see the low range, in March at 72-73 cents, but if my numbers prove correct, I see the upside for may at 82 cents. Yes, we will produce more cotton in the U.S. and world next year, but it will not be in the market place until November 2004. We have got to get from here to there and it will be a stretch.

I think it is now appropriate to look at new crop 2004-2005. Yes, we think we will have a sharp increase in world production from 93.1 million bales to 102 million bales primarily because of price. Consumption in the world will increase from 96.7 million bales to 98.8 million bales. We project an increase in the world carryover of 3.2 million bales next year, but that cannot be considered as bearish at this early stage because none of us know what China's program will be in the next twelve months. Remember, if China wants to rebuild it's carryover to a comfortable level then prices next season can be as strong as this season. It is just to early to predict price. I think during March, April, and May, of this year, we will get that direction. I think as we look at new December at 68.55 versus March at 75.70 that is a substantial discount. I do not want to be short new crop at these differences, and at this level.

As we look at corn, soybeans, and wheat prices it is just too early to look negatively at new crop with the discounts already in place. Again, as I mentioned earlier, none of us know what pressures we will have on the farm program because that can quickly impact new crop production if it takes immediate effect.

As I mentioned world production will increase substantially next season, and we see U.S. production increasing by 475,000 bales, and U.S. cotton consumption dropping from 6.2 to 5.9 million bales. However, U.S. exports will again be the bright spot being in excess of 12 million bales.

I sincerely believe that it is too early to be negative on December cotton. I think at the current discounts I would rather be long new crop December. We think the next seven months will create a lot of excitement, which can also stimulate new crop prices.

Our company has no new crop position at this stage, but I do not want to be short.

I think U.S. cotton can be higher in March and May than it is today.

Remember I said I dreaded making a price prediction but I have stated it like I feel.

In closing, let me say thank you National Cotton Council for allowing me to be a part of your Beltwide program for 18 years.