2004 BELTWIDE COTTON CONFERENCES, SAN ANTONIO, TX – JANUARY 5-9

COTTON MARKET OUTLOOK UNDER EXPORT-DRIVEN CONDITIONS

Carl G. Anderson
Department of Agricultural Economics
Texas Cooperative Extension
Texas A&M University
College Station, TX

Abstract

Intensive foreign textile competition has cut U.S. mill use of cotton fiber almost in half since 1996 to near 6.2 million bales this season. As a result, the market environment for U.S. cotton has been restructured, subject to the complex and erratic forces of export demand. Consequently, price risk for industry participants -- producers, merchants, cooperatives, and textile mill buyers -- has been increased substantially.

The foreign supply, demand and policy environment adds up to an explosive combination, impacting the marketplace. In addition, the dynamic forces of economic and weather-related conditions are stirring up the supply-demand relationships, causing unexpected price movements.

Because China accounts for about one-third of the world's manufactured cotton textiles, Chinese officials play a dominate role in the cotton market. Their policy decisions affecting Chinese cotton production and cotton imports greatly influence the world price of cotton.

Producers worldwide are planning to plant more acreage to cotton this year than last season. Provided yields are average or better, production is expected to exceed consumption by several million bales. Carryover stocks will likely increase and price decrease.

Buyers and sellers of cotton will be evaluating new and low risk strategies of pricing cotton. Their strategies will likely include more use of buying and selling options along with selected futures hedges.

Introduction

The market perspective for the 2004/05 season includes increased cotton acreage from a year ago, a larger world crop, fairly stable demand, and lower prices. The 20- to 25-cent price recovery this season, which resulted from fewer stocks than the year before, and strong demand, is expected to encourage more cotton production worldwide. Thus, a record global crop of nearly 100 million bales is likely, with consumption a little less.

However, because of the uncertainty of weather conditions, planted acreage and yields could push the world crop up or down from the expected production by at least 5 million bales. Prevailing indications suggest that by the end of the new season in July 2005, carryover stocks most likely will increase by 4 to 8 million bales. December '04 futures prices might slip by this fall into the 50- to 60-cent per pound range. There is a slim chance adverse growing conditions, low yields, and a 95 million-bale crop could hold futures prices above the 60-cent range.

The expected shift from this season's strong market to lower prices is likely to appear by mid 2004. Evidence of a large foreign crop would definitely reduce market support substantially.

Market Forces Restructured by Drop in Domestic Use

The market for U.S. cotton during the last three years has turned from the stability associated with mostly domestic use to mainly depending on less than certain exports. Export demand varies each season because of both policy and foreign supply-demand developments that can shift with little warning. Officials representing foreign countries carry significant market influence.

Consequently, price moves in the U.S. will be tied primarily to yearly changes in foreign production, supplies, and demand for American cotton, and trade policies. Prices will likely change faster and greater than in recent past. The result provides a market environment for a $100 per bale or more price change between high and low in December futures.

The financial risk stemming from adverse price changes will be greater than under more stable domestic market conditions for all industry participants. The international market will be responding to a complex mix of individual country policy developments, varying economic conditions, uncertain production due to changes in planted acreage and yields, and spurts of speculative and industry trading.

Because of the lack of price stability, preferred hedging strategies will likely include the use of buying and selling of put and call options. The main objective will be establishing a price level with the flexibility of benefitting from favorable price moves.

Larger World Crop Expected

Higher prices for the 2003/04 crop are expected to encourage a sizable increase in world cotton acreage for the new season. A record crop close to 100 million bales is likely, with consumption trailing by several million bales (Table 1). The result points to a modest increase in carryover stocks. However, the possible range of production could easily vary from 95 to 105 million bales.

Despite a larger crop in 2003/04 than a year earlier, demand has remained strong and price has averaged 69 cents during the first four months of the season. Consequently, with a 27-cent per pound price increase over the 42 cents per pound in 2001/02, the stage is set for more acreage in 2004/05, and sharply lower prices (Figure 1).

Foreign Production Up

The foreign crop will likely increase for the second year in a row. Producers in China alone might increase production by 5 million bales to 28 million (Figure 2). The strongest world price (CotLook "A" Index) since December '97 is expected to encourage foreign growers to boost acreage to around 72.22 million, the highest since 1995/96 (Table 2). A record 81.0 million bale foreign crop may follow. If realized, the foreign production compared to consumption deficit gap could tighten to about 9.0 million bales. That would be the smallest production deficit since the 2001/02 season when production was 78.2 million bales and use 86.9 million for a deficit production gap of only 8.7 million bales.

U.S. Export Demand Linked to Size of Foreign Production Versus Consumption

By comparing foreign production versus consumption and size of production deficit, the opportunity for export shipments from the U.S. can be evaluated. For example, a large production deficit of 20 million bales in 2002/03 opened the door for expanding U.S. exports to 11.9 million bales.

For the 2003/04 season, the estimated deficit is only a little less at about 17 million bales. However, exports are estimated to increase more than a million bales to a record 13.2 million this season. Because the two-year deficit totals 37.1 million bales and U.S. exports are replacing only 25.1 million, foreign stocks have decreased about 12 million bales. The result is tight stocks and a 60 percent surge in world price from a season's average of 42 cents two seasons earlier.

U.S. Cotton Production Also Set to Increase

Cotton producers in the U.S. indicate they will plant some 6 to 9 percent more acreage to cotton this spring than the 13.63 million acres a year ago. Given the mostly good yields last year (especially in the Delta), new higher yielding varieties, improved tillage systems and more effective insect control programs, cotton yields will likely be above average (Figure 3).

Estimating 14.8 million acres planted with 13.4 million harvested, a yield of 668 pounds per acre totals 18.6 million bales (Figure 4). Projected mill use of 6.4 million bales and exports of 12.0 million would leave around a 4.5 million bale carryover, close to the level this season (Table 3).

Export demand for U.S. cotton may change up or down each season because of various international trade policies that stimulate or reduce trade, weather impacts on yields, and economic signals to increase or decrease production based on low and high prices of cotton lint. For instance, cotton exports from the U.S. totaled 9.4 million bales in 1994/95, dropped to 4.3 by 1998/99 and since have recovered to an expected 13.2 million bales for the current season (Table 4).

Summary and Conclusion

Sudden large U.S. export sales to China early last fall triggered the price rally above 80 cents per pound during harvest in 2003. But, the higher price this winter and spring will encourage more cotton acreage worldwide next season. Provided weather cooperates, the new crop is expected to be larger than usage.

How fast and far price declines in 2004 depends mainly on the likely recovery of the reported 22 million-bale crop in China this season to 28-29 million bales next season, and a U.S. crop of 18 to 19 million. The most likely outcome appears to be for a modest increase in global stocks and a decline in December '04 futures prices in the second half of 2004 (Figure 5).

However, a worst-case scenario would be for a bumper foreign crop that would squeeze the demand for U.S. exports to around 10 million bales and increase carryover to 6 million. That many stocks would probably send December ‘04 futures below the 50-cent level by harvest.

Regardless, this season’s highest world cotton price in six years has set the stage for another round of increasing world stocks. Weather conditions will largely determine if it will take two or three years for December futures to test the 28-cent low of the December 2001 contract.

Meanwhile, producers, merchants and mill buyers have the opportunity to use mostly option strategies to insure their selling or buying price and still benefit from favorable price moves. The market will continue responding to the broad mix of bullish and bearish news along the international market path. The key to improving income in an erratic market is to observe market conditions and develop pricing skills to anticipate and protect against adverse price moves as early as possible.

Acknowledgment

The author gratefully acknowledge the technical assistance of Caroline Gleaton in the assembling of data and preparation of manuscript, tables, charts and slides.

References

Cotton: World Market and Trade. Various issues. Monthly report by USDA/FAS.

Daily Spot Cotton Quotations. Various issues. Daily report by USDA/AMS. Cotton Program, Market News Branch.

World Agricultural Supply and Demand Estimates. Various issues. Monthly report by USDA/WASDE.

WWW.NYBOT.COM. Web site for New York Board of Trade. Cotton data.

Table 1. World cotton supply/demand, million bales.

	World				
	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**
Supply					
Acreage (mil. ac.)	79.38	83.66	75.36	81.52	85.60
Yield (lbs./ac.)	536.00	566.00	560.00	543.00	558.00
Beginning Stks.	45.57	42.64	46.94	36.87	33.00
Production	88.71	98.52	88.03	92.17	99.55
Imports	26.48	29.56	30.68	32.46	29.40
Total Supply	160.76	170.72	165.65	161.50	161.95
Disappearance					
Mill Use	92.09	94.58	97.93	97.17	96.20
Exports	25.58	29.09	30.61	32.11	29.80
Unaccounted	-0.57	0.10	0.25	0.03	0.03
Ending Stks.	42.64	46.94	36.87	32.19	35.92
Ending Stks./Use	46.30	49.63	37.65	33.13	37.34
“A” Index	57.12	41.81	55.70	69.46	

Table 2. Foreign cotton supply/demand, million bales.

	Foreign				
	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**
Supply					
Acreage (mil. ac.)	66.33	69.84	62.94	69.41	72.22
Yield (lbs./ac.)	517.00	538.00	540.00	511.00	538.00
Beginning Stks.	41.65	36.64	39.50	31.48	28.00
Production	71.52	78.22	70.83	73.96	80.93
Imports	26.47	29.53	30.62	32.41	29.35
Total Supply	139.64	144.39	140.95	137.85	138.28
Disappearance					
Mill Use	83.23	86.88	90.66	90.97	89.00
Exports	19.84	18.09	18.71	18.91	17.80
Unaccounted	-0.08	-0.08	0.08	0.03	0.03
Ending Stks.	36.64	39.50	31.48	27.94	31.45
Ending Stks./Use	44.02	45.47	34.72	30.71	35.34

Table 3 U.S. cotton supply/demand, million bales.

	U.S.				
	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**
Supply					
Planted Acreage	15.52	15.77	13.96	13.63	14.84
Harvested Acreage	13.05	13.83	12.43	12.11	13.38
Yield (lbs./ac.)	632.00	705.00	665.00	722.00	668.00
Beginning Stks.	3.92	6.00	7.45	5.39	4.25
Production	17.19	20.30	17.21	18.22	18.62
Imports	0.02	0.02	0.07	0.05	0.02
Total Supply	21.13	26.32	24.73	23.66	22.89
Disappearance					
Mill Use	8.86	7.70	7.27	6.20	6.40
Exports	6.74	11.00	11.90	13.20	12.00
Total Use	15.60	18.70	19.17	19.40	18.40
Unaccounted	-0.48	0.18	0.17	0.00	0.00
Ending Stks.	6.00	7.45	5.39	4.25	4.49
Ending Stks./Use	38.46	39.84	28.12	21.91	24.40
Average Farm Price	49.80	29.80	44.50	*61.80	

Tables 1-3: Source: World Ag Supply/Demand Estimates, USDA, 12/11/03
*Weighted average for August-October 2003. 2004/05 projected by CGA.

Table 4. Foreign Cotton Production, Consumption, and Difference, 1986 - 2003.

Year	Production	Consumption	Prod.-Cons.	U.S. Exports
	Million Bales			
1986	60.61	74.73	-14.12	6.68
1987	66.68	76.53	-9.85	6.58
1988	68.76	77.40	-8.64	6.15
1989	67.51	78.13	-10.62	7.69
1990	71.66	76.89	-5.23	7.79
1991	77.80	76.63	1.17	6.65
1992	66.08	76.08	-10.00	5.20
1993	61.32	74.95	-13.63	6.86
1994	66.27	73.17	-6.90	9.40
1995	75.52	74.98	0.54	6.68
1996	70.99	76.50	-5.51	6.87
1997	73.21	75.78	-2.57	7.50
1998	71.34	74.24	-2.90	4.30
1999	70.53	80.76	-10.23	6.75
2000	71.52	83.30	-11.78	6.74
2001	78.22	86.88	-8.66	11.00
2002	70.83	90.66	-19.83	11.90
2003	73.96	90.97	-17.01	13.20

Source: Cotton: World Market and Trades, USDA/FAS.

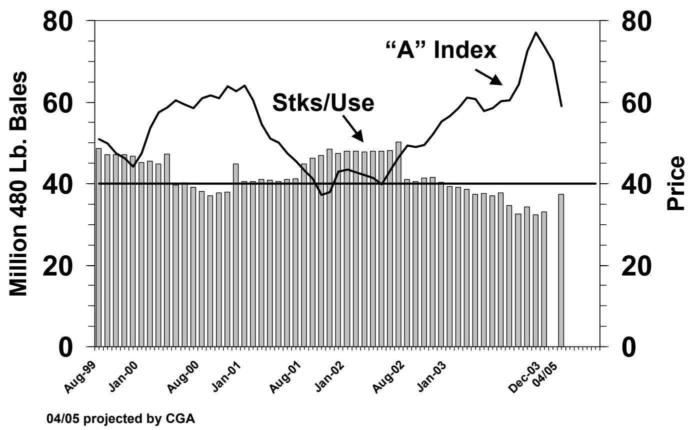

Figure 1. Cotton: "A" Index and World Stocks/Use, 1995/96 - 2004/05.

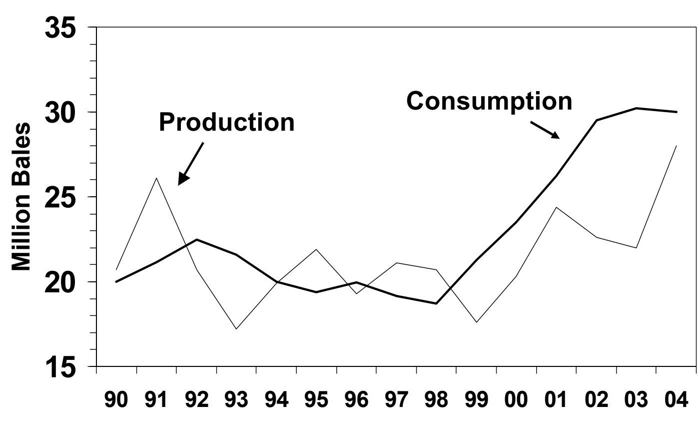

Figure 2. China Cotton Production and Consumption, 1990/91-2004/05.

Acres Planted	- - Pounds Per Harvested Acre* - -		
	600	650	700
- Million -	- - - - - Million 480 Lb. Bales - - - - -		
15.0	17.1	18.5	19.9
14.5	16.5	17.9	19.2
14.0	15.9	17.3	18.6
13.5	15.4	16.6	17.9

*91% harvested of planted acres.

Figure 3. Possible All U.S. Cotton Production.

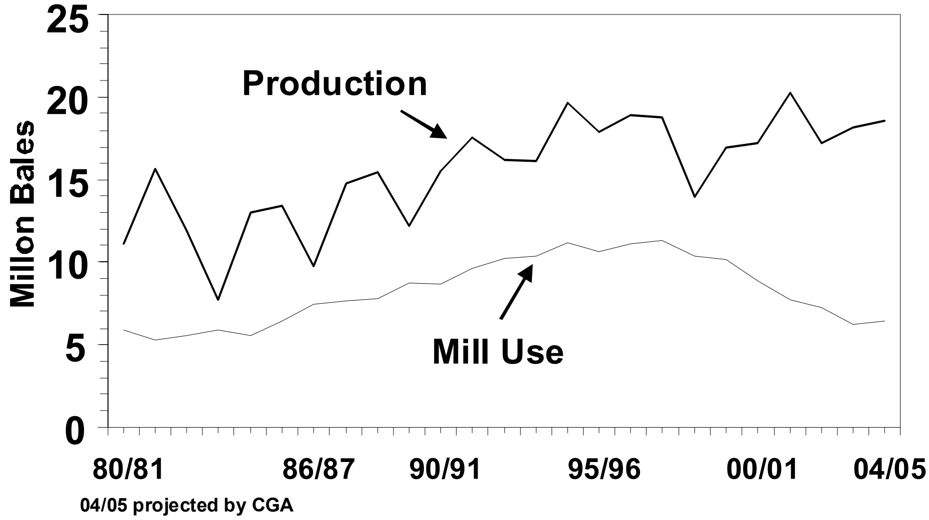

Figure 4. U.S. Cotton Production and Mill Use 1980/81 - 2004/05.

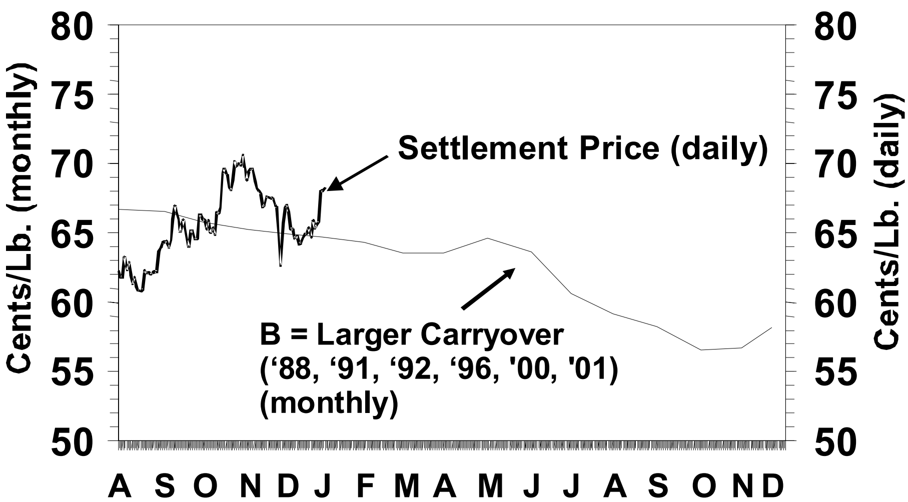

Figure 5. December 2004 Futures Settlement Price vs. December Average Seasonal Monthly Price.