Cotton Fundamentals Continue Bearish For Old Crop Contract Months

cotton outlook

O.A. CLEVELAND, PH.D.
Agricultural Economist
Mississippi State University

The daily 100 point trading range days are now common place for cotton futures. Additionally, 200 point plus range days are no longer unusual, to say nothing of limit up and/or limit down activity in the same day. That said, market volatility has seemingly cooled a bit, but will remain, from time to time, quite volatile. The nearby May contract has settled in the range of 72 cents, but is vulnerable to a slip to the 67-68 cent range. However, I am of the opinion that the 70-72 cent level will hold the bottom for both the May and the July.

Cotton fundamentals continue to be bearish for the old crop contract months and bullish for the new crops months. The current weak spot basis offers reflect the very bearish short term conditions of excessive U.S. and world ending stocks. The bearishness is further entrenched as certificated stocks, both certificated and those awaiting review, are in excess of 900,000 bales with prospects of climbing to 1.25 million.

Yet, fundamentals for the 2008-09 crop are bullish as world ending stocks could fall as much as 8.0 million bales and U.S. ending stocks could fall to between 3.5 and 4.0 million bales, down for an expected 9.8 to 10.0 million bales in the U.S. as of August 1, 2008.

It is the bridge between old crop prices and new crop prices that the market is attempting to locate. That is, how does the market get from the current 72 cents, basis May to the near 85, cents, basis December, a 13 cent difference. While the old crop is fundamentally very bearish and the new crop is bullish (notice the distinction between "very bearish" and "bullish"), there are bullish factors in the old crop market and some "potentially bearish factors facing the new crop December contract.

The weekly call sales report indicates that May and July call sales (mill price fixations or buying of futures) were 27,496 and call purchases (merchant fixations for growers or selling of futures) for the same two month period 3,819. Thus, required old crop buying far exceeds required old crop selling.

Spot market transactions have increased but growers continue to face a very weak basis. While the weak basis arrived with the highly volatile price activity during the first three weeks of March, it was the resulting liquidity crisis created in the cotton merchandising sector that led to the expanding basis. Additionally, the basis has been, and will continue to be weak due to the increasing level of carryover in the U.S. The new crop basis should narrow before such strength returns to the old crop contracts.

The sharp price correction of the past two weeks injected new life in the export market. However, do not expect anything more that "average" weekly sales unless the May slips to very near 70 cents. Weekly net export sales for the week ending March 20 totaled 451,800 RB, with Upland sales at 408.700 RB and Pima sales at 43,100 RB. The primary of buyers of Upland were China (191,200); Turkey and Indonesia. The primary buyers of Pima were China (31,300); India and Japan. Export shipments continue as the drag with respect to projecting higher annual exports as only 218,400 RB were shipped. Upland shipments were 198,500 RB and Pima shipments were 19,900 RB. The primary destinations for Upland were China (48,500); Turkey and Indonesia. The primary destinations for Pima were China (9,300); India and Indonesia.

Monday morning will bring us the USDA March Planting Intentions Report. Look for grower intentions to be near the National Cotton Council's January estimate of 9.5 million acres. Intentions of 9.4 to 9.5 million acres will be slightly bearish while intentions of 9.3 million acres or less will be bullish.

Growers should remain tuned to their local basis level. Old crop basis will be slow to improve, thus, market with price advances, not declines. Δ