Cotton Price Increase Gives Growers Feel For 2008 Price Potential

cotton outlook

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

Bonkers, Parabolic, Rocket in My Pocket, Disconnected…Other words are difficult to come by this week; a week drenched with market activity that had never before been experienced; one that had never wittinessed so much confusion, panic and greed. The cotton industry received a full dose of the economic principles of laissez-faire…a dosage so large that some corners will demand government action; a week when some major international merchants threatened to withdraw from New York trading; a week that saw dollar cotton and little, if any, opportunity for the cotton growers to take advantage of such prices. Of course many other stories could be told, but those will suffice for today.

Laissez-faire, the French phrase meaning something like, "let it be," or "leave it alone," or "let the market do as it wants," or maybe just "get out of the way – here comes a bucketful of big trucks, trains and tankers if you feel big enough to stand in front of them."

This week's action, while expected, came a bit faster and with much more staying power than expected. Too, the sell off at week's end should have been of no surprise. I address some of that at the end of today's newsletter, but for now let's talk about price expectations.

The New York December contract has returned to the mid to high 80's, a price I feel is well deserved. In fact, a return to the low to mid 90's is in front of us. Nevertheless, there is ample cotton available to the market to allow the nearby May and July to slip back to the high 70's, although after this week's activity the low 80's will probably hold.

Another reason that will keep both the May and July above 80 cents, and move the December to the mid 90's is the unfixed call sales versus the unfixed call purchases. The positions remain so lopsided with respect to call sales (buying futures) that the market will find solid support and will also remain very volatile with a preference to move higher. Many have had a tendency to view call sales as a single total number for all futures trading months. However, to correctly view the potential market impact, one must view the report with respect to each contract month.

While few growers were able to take advantage of this week's price increase, they now have a feel for the price potential of the 2008 crop. Thus, this week's rally did, in fact, buy more acres to be planted to cotton this year. Compared to the 9.0 million acres expect just a week ago, 2008 plantings will likely approach 9.8 million. The Texas dryland will almost certainly be planted to cotton, forsaking grain sorghum. Dryland cotton will need only one rain while the dryland grain sorghum would need two or three to make anything. Additionally, the MidSouth will increase their intentions at the margin. However, the Midsouth had sold so much of its cotton specific equipment that the acreage impact will likely be no more than 200,000 acres. The Southeast will also see a 200,000 acre increase above earlier intentions. Cotton is even taking some peanut acres in Georgia. Georgia growers can contract peanuts, but switch their land to cotton without any penalty. Too, peanuts would have to climb another $150 to $250 per ton to compete with 85-90 cent cotton. With prices for California Upland cotton approaching prices for Pima, some California growers will opt for more Upland and less Pima.

The market has settled its stomach for now. It is time for cotton fundamentals to dictate activity, but don't discount the impact the soybean and grain complexes will have on cotton prices. However, if the call sales report for the May contract remains unbalanced as we approach first notice day for May futures, then the fireworks display will light up again.

The short term remains just a shade bearish, but the long term is higher and higher. The one dollar price barrier will fall with just the slightest gush of wind.

The monthly AgMarket Network teleconference will be Thursday morning at 7:30 AM. Please join us.

The April AgMarket Network teleconference, April 2, will be a week earlier than normal and will be live. Lubbock area growers should make plans to attend that one in person.

What Happened

The fact that the cotton market rocketed higher should not have been a surprise to anyone. However, the fact that the near term 2007-08 marketing year May and July contracts led the way all week was a minor surprise. The fact that the back end contracts moved to the mid 90's, and even above the dollar level, should not have been surprising. Too, the rapid and unrealistic rise should have been a solid warning that so much air was left under the market that Thursday and Friday's limit down activity was expected.

The fun began last Friday as funds continued to soak the market with massive buying. Some merchants smelled a blow off coming in price activity and covered their short hedge positions by buying back their futures positions (called short covering). (In this case the action taken by merchants was speculative as they lifted their short positions in order to escape margin calls and take advantage of a rapid price advance.) This additional buying by merchants left no natural sellers (hedgers) in the market and opened a free for all price explosion that continued into Monday and Tuesday as more and more merchants began to lift their hedges. Essentially all cash merchandising activity came to a halt as merchants had no confidence that they could honor a 2008 crop forward contract, and thus refused to contract with growers. With growers not able to forward contract they were left out of the dollar cotton party.

Lesson One For The Cotton Grower Again….A few growers did use the options market to secure dollar cotton contracts, but only those who had developed an understanding of the futures and options activity. Don't worry….you will have that opportunity to learn that lesson again…just remember the market, like this time, will give you absolutely no time to learn and no warning…it will just happen again…take the lesson now….

Make no mistake about it. The past week was a rough and difficult week for many cotton merchants…one that effected growers and textile mills…one that we must hope is not repeated. However, the rules that allowed the market to literally become a wild west shoot out, are the same rules that the merchant dominated board of directors of the cotton exchange both wanted and lobbied for enactment. Those harmed by the market rules fell victim of the board's decision to limit delivery points and to limit warehouse space for certificated stocks. The cotton market is no longer the gentleman's market. It is a dog- eat-dog market. But after all, we are now in a global marketplace. Thus, nothing should come as a surprise….not even that the New York market failed to fulfill its sole economic purposes this past week, namely 1) provide for price discovery and 2) provide a mechanism for the transfer of price risk. To those that want to argue otherwise, don't insult your own intelligence. Δ