



COTTON MARKET COMMENTS

Financial/Economic Crisis Reduces Cotton Use, Increases Stocks and Decreases Price

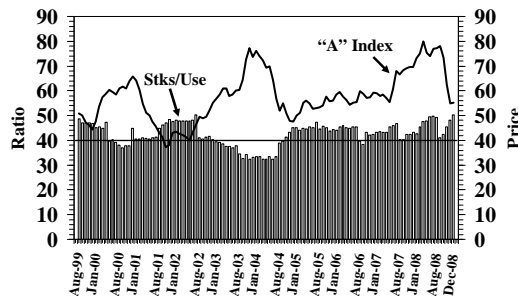
Carl G. Anderson
Professor Emeritus

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The price of cotton has steadily declined since July. March '09 futures, that was trading at 80 cents in July, is now trading close to 40 cents per pound. The USDA projected supply/demand and carryover figures are now getting in line with what low market prices have been signaling for several months.

The latest world carryover of 50 percent stocks-to-use indicates an "A" Index (world price) close to 50 cents. The 58.8 million bale world carryover is sufficient to satisfy use for six months. That is a cotton surplus.

Cotton: "A" Index and World Stocks/Use, August 1999 – December 2008



In the last year, world mill use has slowed 5.6 percent, or nearly 7 million bales. And, it appears that use may decline another 3 to 4 million bales.

The stockpile of cotton in foreign countries and the U.S. adds up to an adjusted world price (AWP) that will likely be below the 52-cent CCC loan rate for at least another year. The need to buy more U.S. cotton acreage next season has been placed on hold. Acreage will fall well below the 9.4 million planted this year to most likely the lowest acreage since 7.8 million in 1869 (yes, 139 years ago).

With a 7 million bale carryover, a harvest of some 13 million bales will be adequate. A crop of that size could be produced on less than 8 million acres.

Combined production in India, China, and other foreign countries has increased faster than their demand. World cotton yields averaged 582 pounds per acre five years ago. Today, yields average about 700 pounds, a 20 percent increase. Thus, fewer acres are needed for production to keep up with consumption.

Given the concern by growers and their bankers that crop prices have fallen substantially, the high cost of cotton production and subsequent high financial risk make corn, wheat, sorghum, and soybean production look more favorable. The shift from cotton to alternative crops will likely continue until cotton price increases substantially.

However, decreased cotton production is a harsh financial blow to the cotton infrastructure of gins, warehouses, trucking, and employees. It appears that the recovery of cotton acreage and downsized production is reaching an irreversible point.

Depressed world mill use and increased stocks have driven the world price down sharply. The result is a sizable Loan Deficiency Payment (LDP) rate.

Most producers are opting to place their cotton under the CCC loan program or into a marketing association that does. Therefore, the producer needs to evaluate buying calls to protect their LDP as well as potential counter cyclical payment.

Purchasing calls on July '09 or December '09 futures are viable. Depending on how much money you want to spend indicates whether you buy only calls (close to or out-of-the-money) or you buy calls and sell about 10 cent higher calls (bull call spread). Selling calls can place a ceiling on the price if no action is taken to adjust the spread.

BEST WISHES FOR A HAPPY HOLIDAY SEASON AND A PROSPEROUS NEW YEAR!

The Ag Market Network Teleconference will be Tuesday, December 16, 2008 at 7:30 a.m. Central Time. Speakers – cotton panel are O.A. Cleveland, Carl Anderson, Mike Stevens, and John Robinson. Pat McClatchy is the Ag Market Network Moderator. The conference will be live on radio station KFLP 900 AM Floydada, Texas; live over the Internet at www.AgMarketNetwork.net; or you can listen to a recording around noon at www.AgMarketNetwork.net. Weekly updates are made on Friday afternoon by Mike Stevens.

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