Cleveland on Cotton: Cotton Prices Hold on Signs of a Better U. S. Crop

September 08, 2024

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Just as the light appears at the end of the tunnel, we are run over by an oncoming train.

Cotton's best export sales report in months was met with a triple digit selloff, a very bearish response to six weeks of positive fundamental news. It all points to the severe price damage that demand failure continues to heap on the market.

As we have discussed for a year, the price equation continues to be dominated by weak cotton demand. December settled the week at 67.88 cents, down almost 200 points on the week, and all the result of a week ending (Sept. 6) selloff. Yet, despite the week-ending price bearishness, the market continues to be poised to challenge the low 70s, but first must get through the September and October WASDE reports from USDA. The September report will be released Sept.12.

The week-ending selloff was based on two primary factors. First the U.S. crop appears to have benefited from improved moisture conditions over the past two weeks. Too, while the market expected a smaller crop than the 17.0 million bales suggested in the July crop report, the market has always felt that the August estimate of 15.1 million bales was far too small. The U.S. crop is likely some 500,000 bales larger than the August estimate, or closer to 15.6-15.9 million bales. Do not discount the ability of the seed companies' genetics to surprise.

Additionally, and as expected, growers have shown little to no inclination to commit any current crop cotton to merchants. Too, the merchandising community has increased its short position in the market. These two factors have added to the bearish overtone in the market and driven prices back near the long term 66-67 cent price support level. Nevertheless, as has been commented for several months, the 67-cent area should hold dedicated support in the market. Higher prices will come with time.

Yet, we return to a subject discussed several times in the past two months. The current demand situation has caused the December contract to be very highly correlated to the spot price of cotton, i.e., the October contract. That is, December futures are essentially as good of a predictor of spot prices as the October contract. Thus, December prices have remained just below and even occasionally at a premium to the October contract. This is an indication that the market lows have been established. Thus, while the December contract may have to battle the 67-69 cent level for the next six weeks, futures should climb above 70 cents and, in fact, work the 70-75 cent price range.

The market does remain nervous about the September crop production report. As noted, the crop is better than reported last month. Additionally, traders have major concerns with respect to the "new and improved methodology and scientific reasoning" USDA is using to calculate its production estimates.

Textile mills were very aggressive buyers on the week as net purchases of upland were 207,500 bales. Seven major buyers surfaced, with Pakistan taking 74,100 bales – again emphasizing the disaster facing growers in that country. India, again reflecting significant crop production difficulties, purchased 44,800 bales. Other major buyers were Turkey (22,700 bales), Costa Rica (18,800 bales), Mexico (17,200 bales), Bangladesh (12,900 bales), and Vietnam (11,900 bales). However, exports continued as the weak link to higher prices, as shipments totaled only 164,100 bales.

The USDA September WASDE report will be released Thursday, Sept. 12. The New York Cotton Roundtable group will discuss the report at 1:30 pm Central time, just after the report's 11:00 am release. Here's how you can listen and participate in the discussion.

It is expected the estimate of U.S. production will be increased some 500,000 bales or more. However, look for world production to be reduced, as problems persist in both Pakistan and India. Additionally, world carryover stocks are expected to decline. However, consumption will be flat or slightly lower.

The report is expected to be mildly positive, once the realization of a bigger U.S. crop filters through the market.

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