PLEXUS Market Comments

Market Comments – July 09, 2020

NY futures continued their ascent during this holiday-shortened week, as December added another 94 points to close at 63.89 cents.

In a matter of just seven sessions the December contract has rallied over 500 points on speculative buying, leaving the physical market in the dust. The lower acreage report on June 30 sparked the rally, while the threat of a severe drought in West Texas, continuous Chinese buying and a constructive chart have kept it going so far.

US export sales slowed down considerably last week, as just 56,900 running bales of Upland and Pima cotton were added for both marketing years. Once again it was China (23,300 RB) that was leading the pack, followed by Turkey (11,900 RB) and Vietnam (10,000 RB). Shipments were impressive at 336,600 RB, and with just four weeks left in the marketing year, it looks like we will ship 15.0 million statistical bales.

Total commitments for the current season have reached around 18.1 million statistical bales, whereof 13.7 million bales have so far been exported. Compared to last season US export commitments are about 1.6 million bales ahead, while shipments are leading by nearly 0.8 million bales. That’s quite an achievement considering that we are in the midst of a depression!

China has of course played a big part in this performance, especially in recent months, as it has bought 3.7 million statistical bales this season vs. just 1.6 million bales in the previous marketing year. But even if we took China out of the equation, US export sales would still be only half a million bales down from last season.

The already substantial gap between NY futures and the physical market continued to expand this week. While NY futures gained 94 points, the A-index dropped 30 points to 70.15 cents. The Indian quote was down 50 points to 63.00 cents, while Ivory Coast dropped 200 points to 72.00 cents, as WAF origins are unable to generate any business at these lofty levels. Burkina Faso made it into the five cheapest quotes at 72.00 cents, replacing the Memphis/Eastern quote.

Had it not been for Brazilian (+100 points) and MOT (+75 points), which are both sticking to their asking basis, we would have seen an even bigger drop in the Index. With physical business outside of China and perhaps Vietnam at a near-standstill, we expect pressure on physical prices to mount, as mills are well covered and merchants don’t want to take on additional positions until the supply chain returns to a more normal flow.

The US budget deficit rose by an unprecedented $863 billion in June, bringing the total shortfall for fiscal 2020 (Oct 1 to Sept 30) to $2.74 trillion, with three more months to go. July’s deficit will be less severe because of tax revenues, but on a rolling basis we are now dealing with a yearly budget shortfall in excess of $4.0 trillion a year, which is more than 20% of current GDP. The US National Debt amounts to $26.5 trillion or about 135% of GDP.

The modus operandi has the US government issuing debt, which the Federal Reserve then mops up with ‘money’ that is created out of thin air. As a result we have seen M2 money supply jump by nearly $3.0 trillion over the last four months. So far these extra funds have mainly been hoarded as excess bank reserves and personal savings, or to buy financial assets, which has kept the velocity of money low and inflation in check.

This is likely to change and investors are sensing that. Future stimulus will probably have 'spending stipulations' attached to it, meaning that the money will have to be spent rather than saved. This could be done via debit cards that will expire within a certain time frame, or by directly subsidizing meals like the UK government has done. In other words, we expect to see a lot more money printing, which will find its way into the economy.

This 'whatever it takes' attitude by governments and central bankers might therefore prevent another deflationary episode like we have been expecting and instead put us on a direct path to inflation. This would mean that the only crash we are going to see is the collapse of purchasing power, which in turn would lead to higher nominal prices.

So where do we go from here?

From a technical point of view the market looks constructive, with the primary trend pointing higher and new spec money flowing in.

From a fundamental point of view US prices are out of line when compared to other origins, although the US balance sheet is tighter than that of its competitors. Nevertheless, it seems that the tail is wagging the dog at the moment, but the trade has little power to counter that until the next big notice period rolls around, which isn't until late November.

Tomorrow's WASDE will likely show a lower US crop (our estimate is 18.0 million bales), which could drop even more over the coming weeks due to a developing heat wave in the Southwest.

However, while the production side may suffer some setbacks, we also feel that mill use needs to come down from the 114.4 million bales the USDA has for the coming season, which starts on August 1. The economic rebound has been a lot slower than anticipated and at this point we don’t feel that mill use will exceed 108-110 million bales. We could therefore see a tightening US balance sheet and rising global inventories, which would play right into the current scenario of relative strength in the US vs. the rest of the world.

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