Thompson On Cotton: Cotton Is Caught In A Catch-22

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As sounds of fireworks fade, the excitement of ringing in a New Year comes to an end. Evidently, someone forgot to tell the cotton market for last week’s trading brought fireworks of its on. Following an early week decline of nearly three cents, March futures rallied over five cents before closing Friday at 85.68. Oddly, this was done with little or no supportive economic data, nor any sign cotton consumption was improving.

Challenged by high inflation, high interest rates, the fallout from the Ukrainian – Russia conflict, and escalating Covid infections in China, global economic demand remains very weak. As a result, U.S. exports fell 2 percent last month while U.S. imports declined by 6.4 percent, narrowing the trade deficit by 21 percent. This was the steepest monthly decline since February 2009. In keeping with this, last week’s cotton exports sales and shipments were once again bleak. Current crop sales totaled only 39,600 bales, when 170,000 a week is needed to meet export estimates. There were no sales recorded for the 23/24 crop. Shipments were no better at 93,600 bales, far short of the 262,000 bales a week needed to meet estimates. There were 7,700 bales of sales cancelled all by China.

One may ask what inspired last week's market rally considering all the negativity surrounding it? One notable factor, Index Funds began rebalancing their positions and will continue to do so through this week. This could provide some price momentum as heavy buying is expected. Another market stimuli were Friday's job report numbers which all markets , equities, and commodities alike, took as a sign the Fed may be able to tame inflation without driving the economy into a severe recession. It had unemployment falling to 3.5 percent, its lowest level in 50 years. In and of itself, this would be viewed as negative because a red-hot labor market fuels inflation. However, countering this wage growth has slowed 4.6 percent from this time last year. The thought process here being declining pay checks results in less spending. If so, this will lower inflation over time and curb the need for hefty interest rate hikes. Although short term, a decline in spending doesn't bode well for cotton consumption. As a result, cotton is caught in a Catch-22.

Where to from here? Thursday is a big day with the release of not only export sales figures but the January WASDE report, as well. It's very likely world cotton consumption will be reduced again further increasing world ending stocks. This coupled with yet another week of horrible export sales would put extreme pressure on the market. Nevertheless, leading up to this witching day, Index Fund buying could foster a continuation of last week's rally, pushing prices higher. Be aware there is a large amount of cotton still in the hands of growers who are looking to price it at 90 cents. If there is a return to this level look for it to be short-lived as grower selling will put tremendous pressure on prices. Thus, we advise lowering one's expectations to something just shy of this and placing a GTC at a level where futures price and basis achieves your target. Fortunately, at this time of year most cotton is sold albeit possibly on call. We say fortunate because merchants have significantly reigned in their basis offerings with some temporarily exiting the market. Not a total surprise, as their need to be aggressive is lessened due to low mill demand.