Thompson On Cotton: The Straw That Broke The Camel's Back

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The seemingly inevitable occurred this past week as cotton prices fell below 80 cents for the first time since November 2, 2022. For over four months support at this level held firm amid mounting negative influences. Last week proved to be the straw that broke the camel's back as the market was bombarded by a host of discouraging data. Hawkish comments from the Fed, a slightly bearish WASDE report, declining export sales, stronger than expected employment numbers, topped off by a bank scare, all served to drive cotton futures to their biggest one-week decline since October 31, 2022. Friday's limit down trading took May futures to 78.18, for a loss of six cents. While new crop futures, focused more on a hopeful long-term horizon, suffered smaller losses, closing the week clinging to support at 80.25.

Previous attempts to curb inflation appear to be having little to no effect. Fed Chairman Powell, testifying before a Congressional committee, stated the size of the next interest rate hike hasn’t been determined. However, he stressed if data indicated a need they are prepared to increase the pace of rate hikes. In anticipation of such, stock prices tumbled, bond yields rose, and commodities declined. Employment numbers, a key piece of data watched by the Fed, did little to calm these fears. A vibrant labor market continues to outperform expectations. To the dislike of the Fed more than 300,000 additional jobs were created in February despite stubborn inflation. If next week’s consumer price index doesn’t reflect a significant decline in prices, the Fed will resort to a heavy-handed interest rate hike at their March 22nd meeting. Furthermore, the bond market is experiencing an inverted yield curve wherein payments on short-term Treasury bonds exceed interest paid on longer-term bonds. This is often seen as a precursor to a recession since it has preceded all ten recessions since 1955.

It’s obvious our current economic climate is not conducive to cotton demand. March supply and demand numbers and recent export sales are testament to that. In the WASDE report, U.S. numbers remained unchanged, with domestic production at 14.6 million bales along with 12 million bales of exports keeping the U.S. ending stocks at a respectable 4.3 million bales. However, world-ending stocks were bearishly increased by two million bales.

Weekly U.S. exports were less than encouraging with net current crop sales of 118,300 bales declining 31% from the previous week. Worse yet, there were 68,300 bales of new crop sales canceled as buyers continue to roll these out to future marketing years. But on a positive note, shipments of 290, 400 bales were the highest since August of 2022 while exceeding the pace needed to meet current export estimates. Also, offering a sliver of hope demand could be returning, Pakistan and China were the major destinations despite all their woes.

Where to from here? Anytime a long-standing support level is breached there is great fear as to where new support will be found. Keep in mind when we were last here a gap in the futures chart was left unfilled at around 75 cents. Thus, this will likely be our next level of support. As for December futures, though still being heavily influenced by May, the closer we get to planting the more it takes on a life of its own. No doubt, this break in support will further reduce planted acreage to cotton. The market will watch closely USDA’s intended plantings report scheduled for release on March 31st. In the meantime, old crop prices will be subject to economic conditions which at this point and for the foreseeable future look very bleak.