Thompson on Cotton: Ominous Clouds Building on the Horizon

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Trading was rather subdued last week despite being confronted with a wealth of economic and supply/demand information. Even so, December futures advanced 82 points closing Friday at 117.69 while the more closely watched March futures improved 184 points to settle at 115.08. Nonetheless, a gain is a gain and considering not all news was positive, we should feel fortunate.

Cotton prices have risen to these lofty levels on strengthening worldwide demand. To our misfortune, this growing consumer demand for goods of all types comes amid a backdrop of labor shortages and supply chain disruptions, the likes of which have never been seen. This is creating a very dangerous market environment where uncertainties abound and there is a lack of historical guidance upon which to act.

USDA’s November WASDE report was viewed as neutral to slightly bullish. Domestically, the production estimate was raised slightly to 18.2 million bales resulting in larger ending stocks of 3.4 million bales. Offsetting this was an increase in world consumption of 700,000 bales. Global use of 124 million bales would be a return to its pre-covid high thereby reducing world carryout to 87 million bales.

Unfortunately, this increased demand is not being seen in U.S. weekly export sales. Last week, net sales totaled 128,000 bales while shipments were a paltry 87,900 bales. China was the primary buyer accounting for over half these sales. China is giving every indication their mills are in desperate need of cotton for in addition to being a major importer they will once again auction off a portion of their cotton reserves.

To date, they have purchased 2.7 million bales from the U.S. compared to 3.5 million bales this same time last year. U.S. cotton prices, even at these lofty levels, are very competitive in the world market which should foster export sales. However, there is a growing sense our inability to effectively ship cotton has China and other importing countries turning to other exporting countries to satisfy their needs. This will be watched closely for it could result in future sale cancellations.

On the economic front, inflation is running rampant which isn't new news to anyone but maybe our Administration. It was confirmed when the consumer price index rose in October 6.2 percent from a year ago, the fastest rise in three decades and the fifth consecutive month over five percent.

Brought on by consumer demand in the face of supply shortages, one must wonder how long it will be before there will be changes in consumer behavior and demand wanes. Presently, a rebounding economy and healthy household balance sheets fed by government stimulus money is cushioning these price increases.

Where to from here? Not to appear all gloom and doom, barring a change in the attitude of consumers, we see March futures picking up where December left off on its way to higher ground, at least for the short term. The managed funds, after reducing their net long position by almost two million bales over the past few weeks, now seem comfortable on the sidelines with what is still a sizeable net long position poised to return as buyers given the right encouragement.

Despite being cautiously bullish, ominous clouds are building on the horizon. Keep this in mind when pricing current crop cotton given we are at levels very rarely seen in the fall. The same holds true for new crop when one can get over 90 cents this far in advance of planting.