

1996 Cotton Management Economic Notes

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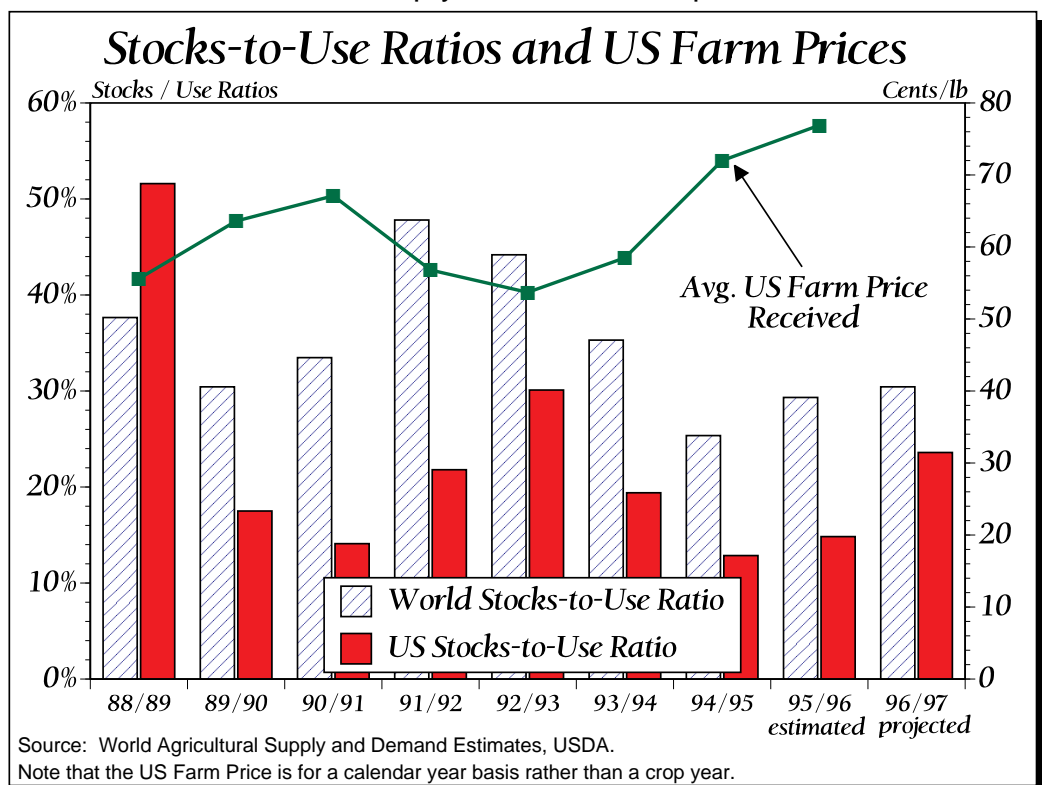


World Stocks Increase

Numbers released in the World Agricultural Supply and Demand Report (USDA) on June 12 project 96/97 world ending stocks at 35 million bales, up 1.33 million bales from the estimate for May. China's 1995 crop estimate was revised upward by 6% to reach 21.9 million bales. This revision accounts for most of the increase in ending stocks for the 1996/97 season.

Stocks-to-use ratios in the accompanying figure show ending stocks in storage on August 1 (end of crop year) divided by total use for the previous year. Total use includes domestic consumption and exports. These ratios give a good synopsis of the left over balance between demand and supply factors in the marketplace.

The world stocks-to-use ratio is currently projected at 30.4% for the end of this crop year. As shown below, this estimate is not nearly as bullish for price as what was realized for the last two crop years. But the expected left over balance



Recent Prices

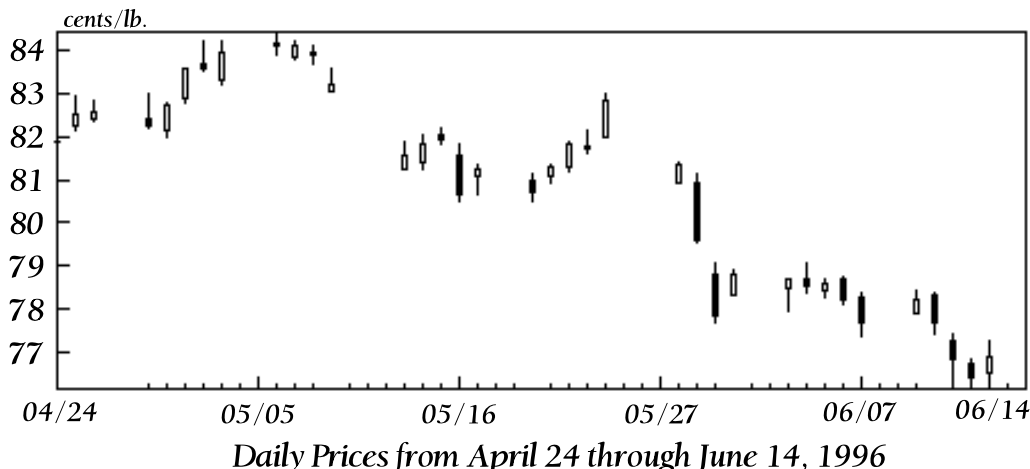
	June 17, 1996	
	Upland (¢/lb)	Pima (ELS) (¢/lb)
Spot - uncompressed	76.05	140.00
July '96 Futures	77.93	
Dec '96 Futures	76.87	
Dec '97 Futures	77.30	
Adj. World Price	69.28	

Note: Upland Spot for Desert SW grade 31-3, staple 35, add 300 points for compressed bales, Pima Spot for DSW grade 03, staple 46, 6/6/96.

between supply and demand still has much more price support than in 1991 through 1993 when the world was floating in cotton with ending stocks-to-use ratios ranging from 45% to 50%.

In comparison to last year, US production is projected to be up by 1.1 million bales even though harvested acreage is expected to be down by 2 million acres. The increase in production comes from a 650 lb. average yield estimate that is more in line with the historical trend yield. In 1995, yields averaged only 537 lbs., the lowest since 1983 and down sharply from the previous record yield of 708 lbs/acre in 1994.

Japanese Candlestick Chart of December 96 Futures



Two Candlesticks
Interpreted

(daily prices)

high →

close →

open &
low →

high →

open →

close →

low →

Source: Internet address of <http://www.nyce.com/>

US upland growers have forward contracted about 19% of their acreage as of June 1. Last year at this time 36% of upland acreage was contracted and two years ago 23% was booked. Arizona growers are similar in that 11% has been forward contracted for this year, compared to 30% on June 1, 1995. Overall, growers appear to be more optimistic that prices will maintain their current level or increase this season than in prior years. Yet recent December futures price movements, as shown in the above Japanese candlestick chart, have been less than bullish. A Japanese candlestick chart graphically portrays how the market is moving. That is, if the "candle stick" is white (black) then the closing price was above (below) the opening price. The "wick ends" give the trading range of prices for the day.

New Farm Bill Environment

With the target price eliminated under the new farm bill, producers are exposed to a different environment of price risk. That is, historically deficiency payments would offset most of the impact from a significant price drop. For this year, the equivalent target price floor has been replaced by a 51.92¢ loan rate plus a minimum 9.06¢ production flexibility contract payment (assuming 100% signup) or 60.98¢/lb., down 16% from the prior target price of 72.9¢. Even though spot and "old crop" futures prices were over \$1.00/lb. for much of the spring and summer of 1995, the average US farm price for last year was just 4¢ above the target price at 76.9¢. Lint sales that are subpar in quality pull the average US farm price lower, which historically has increased the deficiency payment for even high quality production areas like Arizona. For example, 35

to 40 percent of the cotton classed in Lubbock for the last two years was unable to make a staple length of even 34. Whereas, only 1 to 3 percent of the cotton classed in Phoenix was unable to attain a staple length of 34.

Given that December 96 futures prices are around 77¢, you could expect to "lock-in" a price of around 76¢ for DSW 31/35 by selling December futures. This price reflects an average basis (1987 to 1995) of -1¢ in December for uncompressed bales of DSW 31/35. Another alternative for downside price protection would be to purchase a put option. Recall that the premium paid for a put option gives you the right to sell futures at a specified price, but you are not obligated to sell either. Thus, a producer can still benefit from higher prices if the market turns bullish while still being protected from price drops below the specified strike price of the option.

In 7 out of the last 10 years, December futures have exceeded 72.9¢/lb. at some point in the calendar year. But in only the last two years have December futures prices been above this level for more than 20 weeks out of the year. Clearly, futures and options are not a complete substitute for the historical target price. Other strategies, such as diversification into other crops and alternative enterprises may be needed as part of a long-term strategy for ensuring minimum income levels are attained year after year. Even though an alternative crop might not seem anymore profitable than cotton, it probably has value in reducing income variability and satisfying minimum income levels. For now, don't forget the **one-time July 12 signup deadline** for enrollment in new production flexibility contracts.

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