Cotton Compass

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Monday, April 27, 2020

STATE RESERVE RUMOURS FUEL RALLY

	High	Low	Close	Change (week)	Change (month)
Jul 20	57.65	52.01	55.63	+2.77	+2.62
Dec 20	58.85	54.30	57.67	+2.41	+3.02

RUMOURS the Chinese State Reserve could re-enter the market for 1 million MT (4.4 million bales) of US cotton helped propel ICE futures to near limit gains on Wednesday night – defining the tone for the week. The rumoured purchases – along with 20 million MT of US corn and 10 million MT of US soybeans – would ostensibly fulfill China's obligations under the Phase One trade deal struck with the US in October last year. And, whilst yet to be confirmed, the fact all three commodities are trading at or near decade lows means it kind of makes some economic sense for Chinese sovereign accumulation….regardless of any trade commitments.

Whilst clearly supportive, the reality perhaps is that those players "in the know" may have been purchasing ICE futures and/or physical US cotton for some weeks ahead of the "news" being leaked…..so whether it is supportive from 52 cents (the level just before the rumour broke), or supportive from 49 cents (near early April lows) remains to be seen. And, whilst it is encouraging that a strong buyer looks set to re-enter the market, the reality (as far as genuine consumption goes) is that spinning mill capacity to participate in fresh purchases will remain limited while various states of lockdown persist and downstream demand remains at a standstill.

For now, what this apparent willingness of the Reserve to re-enter the market does suggest is that some of the potentially burdensome global stock will be held away from consumptive channels, thereby tightening 'real available' stocks to use ratios.

The Crude Oil market, meanwhile, raised a few alarm bells early in the week, with the negative print on the expiring May WTI futures contract serving as a reminder of the chaos that can ensue when markets break down. If nothing else, the reality of a world where there is apparently more oil looking for storage than storage looking for oil is perhaps a canary in the coalmine as far as demand for everything is concerned. In this environment, for volatility (as measured by VIX) to now be back to its lowest level since early March feels a little bit strange.

US cotton export sales showed a net positive 15,700 bales for 2019/20 and 46,400 bales for 2020/21. Whilst far from an encouraging number, at least it was on the right side of the ledger. Shipments remained fairly solid at 273,300 bales (including Pima).

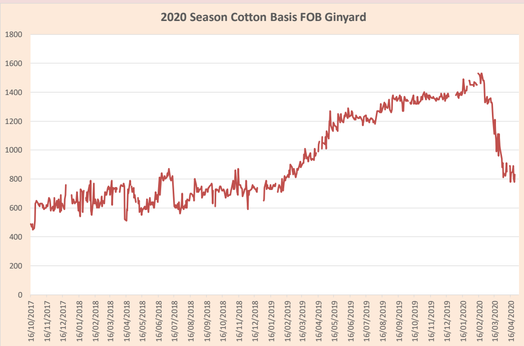
Technically, the break above resistance at 54.50 on the July chart (indicated last week) is encouraging – but will likely require confirmation of the China State Reserve rumours to be maintained. We take a look at the market today from a 'long term' chart perspective, with the chart broken into 10 cent ranges (46-56, 56-66, 66-76, 76-86 and 86-96). It is interesting how consistently these ranges are respected. Last week, July made a decent attempt at breaking back into the 56-66 cent range, but closed below the line (and below significant prior 2016 and 2019 support). We feel 56 cents could be pivotal from a long term perspective.

AUSTRALIAN CASH MARKET

	A$/bale Close	High Weekly	Low Weekly	Change this wk
2020	$508	$520	$487	+$27
2021	$540	$550	$522	+$18
2022	$507	$517	$500	+$7

2020 Crop

Small volumes of 2020 crop traded late in the week (after the pop on ICE futures) at between $520-525/bale FOT ginyard "Central Valley equivalent" levels. These prices were well above most published bids on the day, and equated to basis levels of around 1050-1100 on FOT ginyard. There were a couple of merchants active, and whilst the purchasing merchants were unlikely to have been able to "back-to-back" these bales in what is currently a stagnant export market, it appears they were comfortable taking them into their positions at that price. We suspect these kind of basis levels will represent reasonable buying for 2020 crop once confidence and liquidity return to the market….whenever that may be.



Price Outlooks 2020 Crop: No change this week.

Outlook this week: A$475 - 550/bale

Outlook 1-2 months: A$500-600/bale

2021 Crop – Decent volumes (probably in the order of 50-60,000 bales) traded through last week at $540-555/bale FOT ginyard Central Valley equivalent (approx. 1000 on May 21 FOT gy). Most of the business was conducted in the Macquarie, with some also in the Gwydir and at Dirranbandi. The bales were predominately sold by growers who previously had insufficient water/confidence to sell at $600 back in mid March.

Hedging Models – no changes

2020 Crop Hedging Model		
Prodn Guess	Sales	Orders
635 bales – 79% sold @ $600 avge	500 @ $600	B.O.C. $550
2021 Crop Hedging Model		
2000 bales – 12.5% sold @ $600 avge	250 @ $600	1350 @ $600

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EXPORT MARKET SUMMARY

WHILE much of the talk toward the end of the week surrounded the rumours around China State Reserves purchases of US cotton, the reality so far remains pretty lacklustre trade in most export markets amid factory lockdowns and very weak downstream demand for yarn, fabric and finished goods. As we have been reporting in recent weeks, there has been some ongoing US sales into China – and we suspect this has primarily been to local merchants (rather than consumers) possibly pre-empting demand from the State Reserves. *Of interest, sources suggest reasonable volumes of Australian SM 1-5/32" 2021 crop sold into China last week at between 1875 and 1900 on May 2021 CFR.* This would work (with a margin) against grower purchases made last week at circa A$550/bale FOT ginyard Central Valleys. Whilst in normal times, the rumours of China State Reserve Purchases of US cotton would likely trigger more aggressive actual 'consumptive' buying from a range of markets in order to 'defend' against a serious sovereign 'competitor' – the current reality is that many/most mills are extremely inventory heavy right now, and amid a tough credit and trade environment simply do not have the capacity to compete until downstream order flow improves.

Basis: This lack of physical demand from mills – combined with potential futures 'support' emanating from China Reserve purchase rumours – could generate a potentially challenging basis environment for non US growths. *We are seeing some evidence of Brazilian basis breaking down for third and fourth quarter shipment slots.*

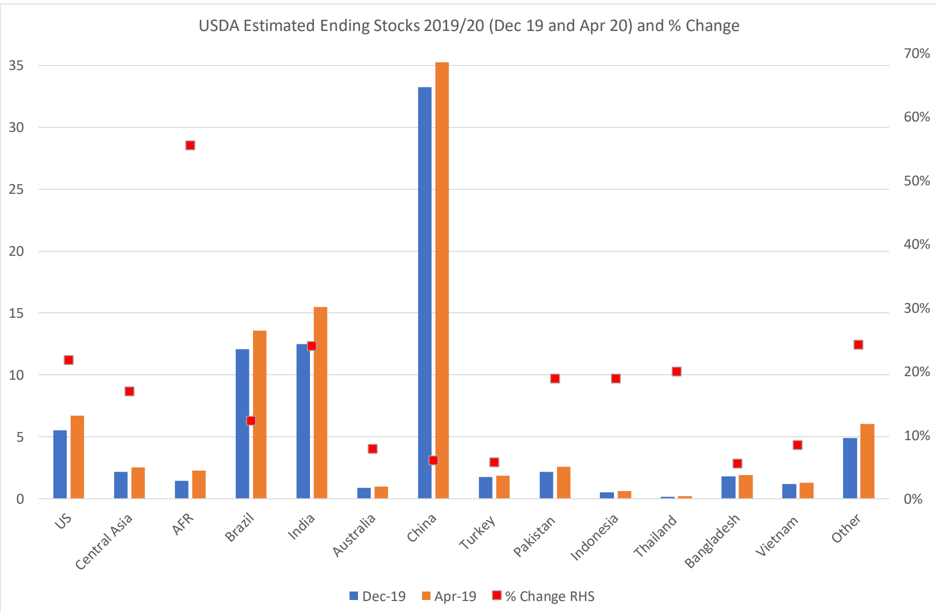
Retailer/Brandowner attitudes toward their suppliers continue to beggar belief in many instances, with little regard being shown to how delays and cancellations of orders of garments and textiles are impacting the supply chain that leads to them. We have seen evidence of contract clauses being invoked that allow retailers – many in Western juristictions - to *"suspend or cancel any delivery or order if (they) cannot use, or are hindered or prevented from using, the Goods because of any cause beyond (their) control."* Kind of looks like a a get out of jail free card….and certainly not in the spirit of contract sanctity that attempts to underpin our end of the supply chain.

***Estimated offer US c/lb (C&F Main Asian Ports, 1-1/8", 3.5-4.9 NCL)**
Note – add 120-150 pts for India, and 150-180 pts for Bangladesh

Origin	Offer Nearby	Offer Deferred	Eg Sales
Aus SM, 37	+2115 (N) May	+2130 M/J 21	+1890 (K) 2021
Aus M, 37		+1930 M/J 21	
US 31-3-36 GC	+1300 (N) May		
US 31-4 36 GC			
US 41-4 36 GC		+950 (Z) A/S	
Brazilian M, 36	+1050 (K) M/J	+705 (Z) A/S 20	
Fr W Afr (s), 36	+1165 (N) May		
****PSF**	36.56 US c/lb	-3.83 (wk)	+0.33 (month)
Yarn 32Ne-China	2.70 US $/kg	-0.01 (wk)	-0.10 (month)
Yarn 40Ne-China	3.25 US$/kg	-0.01 (wk)	-0.04 (month)
Yarn 30Ne-India	2.61 US$/kg	-0.03 (wk)	-0.04 (month)
Yarn 40Ne-Paki	3.05 US$/kg	-0.22 (wk)	-0.21 (month)

*Offers estimated based know/est levels Friday Asian business hours adjusted for futures
** PSF = Polyester Staple Fibre (1.4 D / 38mm) ex works China
*** Yarn (India) = 30Ne 100% Cotton Combed, ring spun knitting yarn (ex work)
**** Yarn (China) = 40Ne combed cotton yarn (Qiangqing Market (Zhejiang))
*****Yarn (Pakistan) = 40Ne combed cotton yarn (C&F Main Asian ports)

WHERE WILL STOCKS BUILD UP?



The USDA was already trimming global cotton use leading into the December 2019 WASDE report, to a point where year on year growth compared to 2018/19 was essentially zero. Since then, the USDA to-date, has lowered global use another 9.7 million bales (and falling probably). The USDA estimate of global ending stocks has risen 10.94 million bales (some production increases) over the same period. So where will these extra bales sit? The chart displays the USDA estimates of 2019/20 ending stocks as at the Dec 19 WASDE report and the most recent Apr 20 WASDE. The square boxes on the charts represent the % increase in ending stocks from December to April. For example estimated US ending stocks in the December report were 5.5 million bales whereas in April this had risen to 6.7 million bales or a 22% rise in the estimate. We looked at the changes hence both in absolute terms but also in % terms, given a region like the Africa, Franc Zone (for the most part French West Africa) has an absolute rise of only 810,000 bales but as a % increase in ending stocks of that growth it is a massive 55%. Broadly speaking take out Australia (which has its own small crop problems) then the remainer with under a 5% increase are major importers (China, Turkey, Bangladesh, Vietnam etc). Other importers such as Thailand and Indonesia show increases of around 10% but obivioulsy from a much lower base. There is of, course, talk that the Chinese State Reserve will begin buying US cotton, but still some think US ending stocks will increase over 7.0 million bales (a prospect unlikely to happen if the China rumour is true – depending on timing) which could see addition cotton in Government hands. If further cuts are made to global use then Indian ending stocks could be set to rise (more ending up in Government hands). Of global ending stocks, depending on what action the Chinese Reserve might take, one could see a significant portion of this sitting in Government hands. The US has a mechansim to see it shift to commerical hands relatively quickly if needed, India perhaps less so and China only through auctions – timing of their choice. If at some time in the future demand picks up, but stocks out of Government hands come slow to the market, then the value of "freely" available cotton could rise.

Cotton Compass

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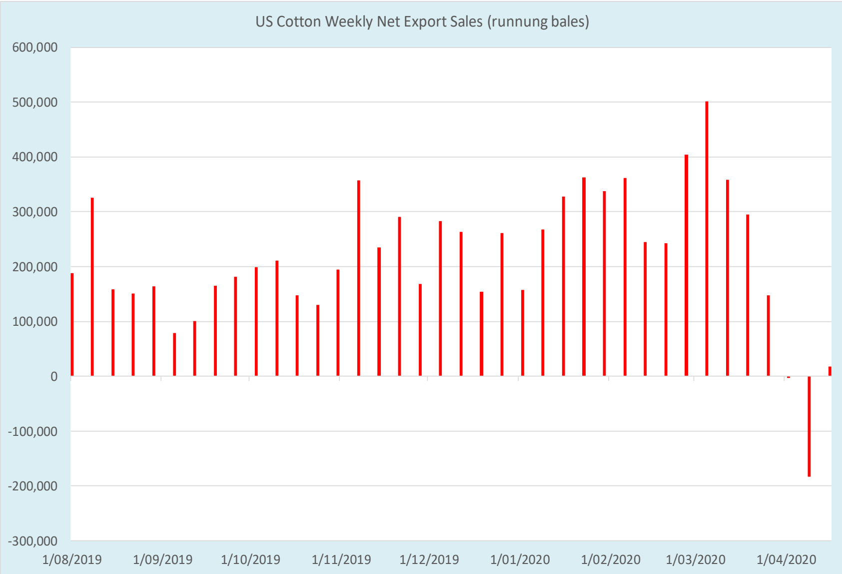
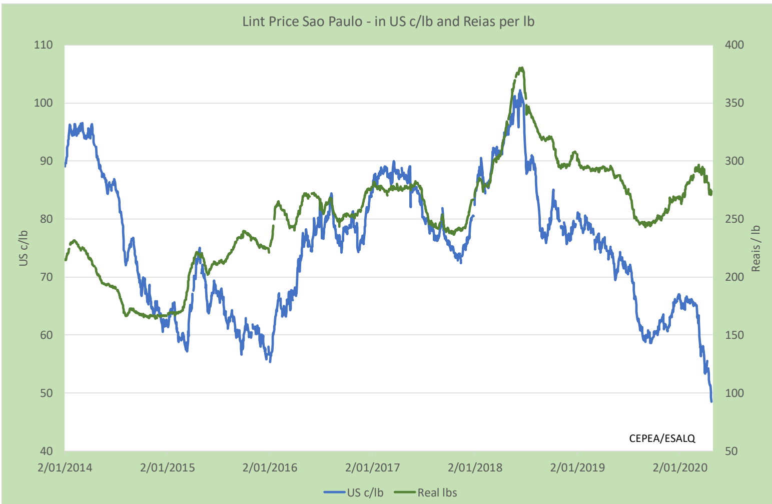
US EXPORT SALES



It took a little time, however, US export sales have succumbed to the lack of nearby demand due to various economic impacts created by various Government approaches to attempt to tame COVID-19. The chart displays net weekly US export sales (both Pima and Upland). In the past few weeks net cancellations have been the order of the day although the last report displayed a slight net positive result. Where to from here will probably depend on the type of bounce in economic activity globally (we have spent time on that in previous issues) and whether the China Cotton Reserve buys a volume of US cotton as part of the Phase 1 deal signed earlier in the year. The USDA reduced their esitmate of US exports sharply from 16.5 to 15.0 million bales. To mid-April the US had already shipped 10.1 million bales leaving in theory three and a half months (some 15 weeks) to see another 4.9 million bales shipped to reach the 15.0 million bale estimate (or 326,700 bales a week). Since the start of the year the US has been averaging 375,000 a week, however, since the calendar turned to April this average has not been met and perhaps it might struggle to be met. At mid-April there were over 5.5 million bales of outstading sales on the books. Without selling any more there is the possibility to reach 15.0 million bales, however, will all these bales ship?

THE IMPACT OF CURRENCY

The drop this year in the Brazilian Real has been dramatic and so far there is now sign of it slowing. The Real has fallen near 30% since the end of last year. Cotton prices (using ICE) have fallen 20% over the same period (although they were down 30% also at one point). If you take Brazilian cash cotton (41-3) San Paulo (Index – EQALQ) since the start of the year then it has actually risen 2.5% - the benefit of weakness in the home currency. Australian cash prices by comparison have fallen aorund 14% over the same period. While weakness in the Real is keeping the income side of the ledger in good shape for Brazilian growers the expense side of ledger will suffer on imported inputs/machinery etc along with any interest repayments that are based in US$. In terms of the balance sheet, any major producers or processors with US$ debt will have found that the US $ debt level in Real terms (home currency terms) has risen 41% over the same period. Imagine that.



BALANCE SHEET

AUSTRALIAN BALANCE SHEET

Mar-Feb year	Cottonseed ('000t)				Lint ('000 bales)			
	2016/17	2017/18	2018/19	2019/20	2016/17	2017/18	2018/19	2019/20
Opening Stock	33	85	73	50	23	30	217	460
Production	938	1128	553	160	3752	4511	2211	640
Total Supply	971	1213	626	210	3775	4541	2428	1100
Crush/Dom lint	230	70	0	0	20	20	10	10
Feed and Residual	350	920	570	170				
Exports	306	150	6	5	3725	4304	1958	800
Total Use	886	1140	576	175	3745	4324	1968	810
Ending Stocks	85	73	50	35	30	217	460	290

Cotton Compass - bales = 227kgs

The interestingly element from our balance sheet is that, if our numbers are right (and we think they are very close) then Australia carried out 460,000 bales from old crop into new crop (remember we use a Mar/Feb year – so end Feb is the end of the marketing year that we use). This is a relatively huge carryout considering a small production year.
Still reasons will be things like merchants carrying cotton to supply to valued customers given such a small subsequent crop this year, merchants carrying cotton as yet unshipped considering the current concern around contract performance, growers carrying old crop cotton to deliver against new crop sales (which could amount to more than 100,000 bales) etc etc. Getting onto the balance sheet propper – for 2018/19 (2019 crop) we made no changes to the production side of the balance sheet and simply updated exports (via ABS data). For the 2019/20 (2020 Crop) we also made no changes to the production side and in-fact did not tinker with the demand side either so the only changes are variations in 2018/19 ending stocks flowing through. Not much to see here folks.