SOME THOUGHTS ABOUT THE PRICE OF COTTON

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It is said that those who will not learn from history are doomed to repeat it. In fact, history is seldom, if ever, exactly repeated. People do learn and circumstances do change.

The price of cotton for the 1971 crop was substantially above that of the year before. Furthermore, the futures market is forecasting that the price during the 1972 cotton harvest will decline very little from the price received for the 1971 crop.

The price rose even more dramatically in 1967, but retraced nearly 40 percent of that gain during the sale of the 1968 crop. As can be seen in Table 1 and the figure, the December 1968 futures contract overestimated its maturity price by 3 to 6 cents during most of the period that it was actively traded. The December 1968 futures contract seems to have been responding primarily to the 1967 market conditions rather than realistically forecasting the market conditions that would prevail during the marketing period for the 1968 crop. It appears that the December 1972 futures contract is following the same errant pattern as its predecessor four years earlier.

How can one learn (benefit) from an understanding of the history of the 1968 experience? If he is confident that he is witnessing an "instant replay" of the 1968 situation and he is a cotton grower, he will fix the price for his 1972 crop based upon the overestimate of the price by the futures market. This can be done by the cotton grower selling futures contracts. But most cotton growers will find earlier contracting in a manner common during the summer of 1971 to be their best vehicle for fixing the price of their cotton.

The market price of cotton has become completely disengaged from the support price and likely will continue to be completely independent for the immediate future. During these periods of "free market" pricing, the futures market does play an important role in the pricing of cotton.

The Arizona cotton grower can watch the futures prices as an indicator of the value of his next cotton crop even before he has planted the crop. However, he cannot expect to realize the full futures price because the futures market is really pricing cotton that is ready for delivery at points located a considerable distance from Arizona. The market differential between the New York futures price and the Arizona cash price allows 2 to 3 1/2 cents for transportation differential and other costs associated with making cotton eligible for delivery on futures contracts. The price at which the Arizona cotton grower contracts to sell his crop is directly related to the futures price because the buyer will normally hedge by selling futures contracts at the time he commits himself to buy cotton from the grower. The buyer knows the price at which he can sell futures contracts and from this he deducts a margin that will at least cover his delivery costs if it should become necessary to deliver on the contract rather than making an offsetting purchase of futures contracts as he would do under normal circumstances.

Now we should look for the causes of the cash price changes in 1967 and 1968 in order to gain some insight into what to expect in 1972. It appears that the price rose sharply in 1967 because of the prospect of short supply, particularly in the longer staple lengths. Because of the government programs that were in effect at the time, carryover from the year before declined by more than one-fourth, and with a sharp reduction in number of acres planted the prospect was another large reduction in carryover during the 1967 crop year (Table 2). As the crop year progressed, it became apparent that yields per acre would also be at their lowest level in a number of years.

The government program was changed and the high prices realized by growers in 1967 encouraged them to expand plantings of cotton in 1968. The increase in acres planted when combined with a return to yields per acre near the all-time high contributed to a 50 percent increase in production from its very low level in 1967. The high price in 1967 had two other major effects on the market for cotton in 1968. Production in the foreign free world increased by nearly 10 percent, and the demand for cotton declined because the high price accelerated the shift from the manufacture of all cotton fabrics to blends using only part cotton.

The rise in the price of cotton during 1971 again seems to be associated with the concern about the prospect of a short supply of cotton. With the exception of a very small increase during the 1968 crop year, the carryover has declined in each crop year since August 1, 1966. The prospect was that during the 1971 crop year domestic consumption plus exports would once again exceed U.S. production. The buyers responded to this prospect of scarcity by contracting with producers so as to assure themselves of cotton to satisfy their needs. Nearly 30 percent of the 1971 Arizona upland cotton crop was contracted and had its price fixed between planting and harvest. Several thousand bales of 1972 Arizona crop cotton were contracted before the 1971 crop reached the midpoint of harvest.

What are the potential effects of the 1971 cotton price on the market for 1972 crop cotton? It is to be expected that foreign production will expand in 1972 as it did in 1968. The increase in foreign production may not be as large this time since the price increase in 1971 was not as dramatic as it was four years earlier. The loss in domestic consumption is not likely to be as large as it was in the earlier period because the share of the blends in the domestic market seems to have stabilized on a plateau.

The greatest uncertainty about 1972 lies in the quantity of U.S. plantings and production of cotton. It is possible that growers may find offering prices on contracts prior to planting time high enough that they will find it profitable to contract and expand plantings substantially beyond their base allotments. The full cooperation of those who finance cotton production will be required. If there is substantial increase in planting beyond the base allotments because of contracting, the cotton not covered by contracts will find substantially lower prices in the 1972 market than was true during the 1971 harvest.

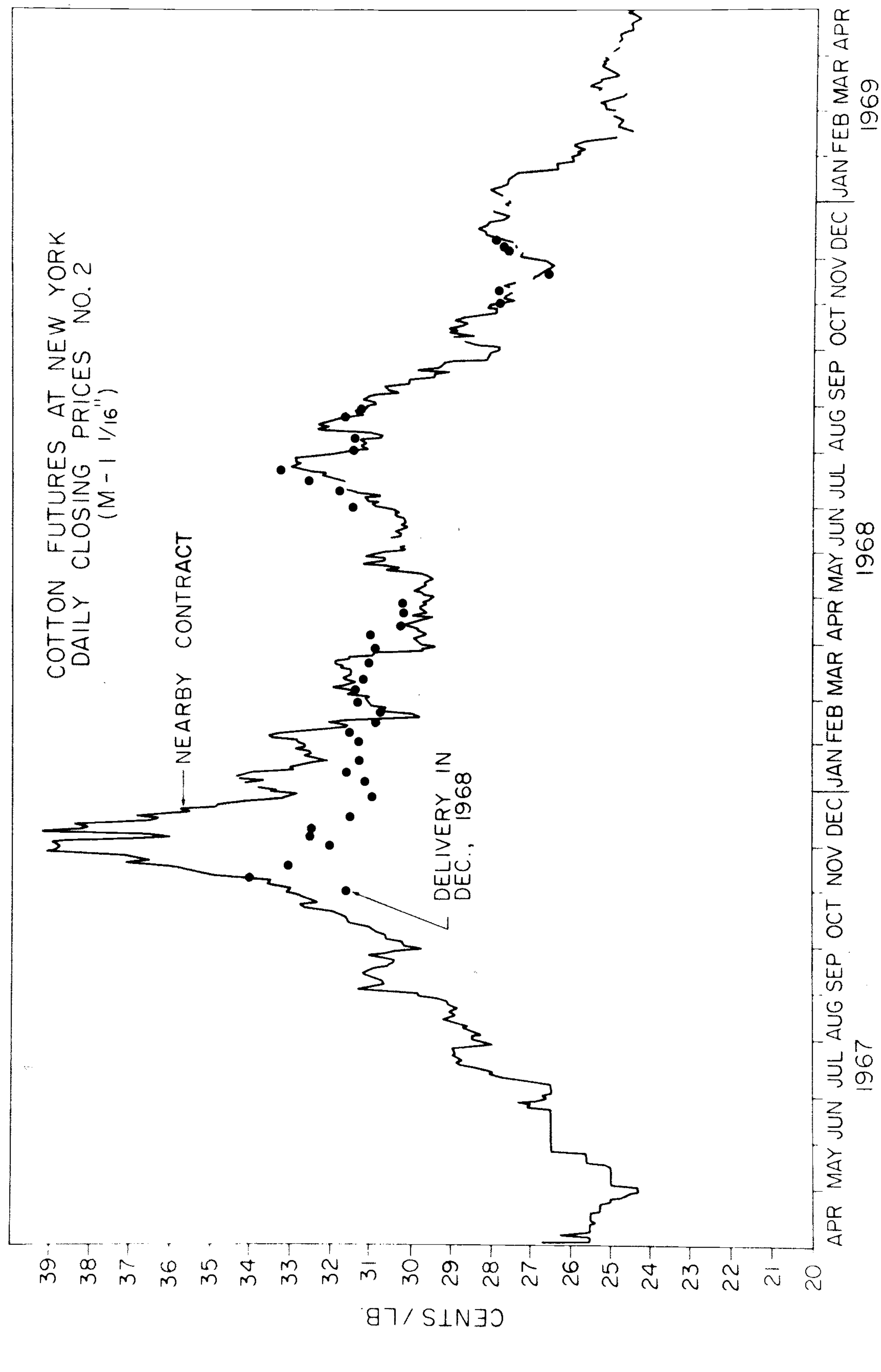
Table 1. Closing Prices for the December, 1968 Futures Contract for Selected Dates

Nov. 1, 1967	31.60	April 5, 1968	29.95
" 9 "	34.00	" 12 "	30.35
" 17 "	33.18	" 19 "	30.28
" 30 "	32.05	" 26 "	30.30
Dec. 4, 1967	32.60	July 1, 1968	31.40
" 7 "	32.50	" 9 "	31.79
" 13 "	31.45	" 16 "	32.60
" 28 "	30.95	" 23 "	33.25
		" 31 "	31.40
Jan. 4, 1968	31.17		
" 10 "	31.60	Aug. 8, 1968	31.37
" 18 "	31.25	" 23 "	31.65
" 30 "	31.28	" 27 "	31.21
Feb. 5, 1968	31.49	Nov. 1, 1968	27.80
" 12 "	30.85	" 8 "	27.85
" 21 "	30.70	" 21 "	26.57
" 29 "	31.30		
		Dec. 5, 1968	27.60
March 5, 1968	31.33	" 6 "	27.72
" 11 "	31.15	" 9 "	27.95
" 21 "	31.01		
" 28 "	29.88		

Table 2. Prices, Production and Carryover of Upland Cotton

Year Beginning August 1	Price M - 1 1/16"	U.S. Carryover	U.S. Production	Foreign Free World Production
	(cents/lb)	-------------million bales---------------		
1965	31.5	14.0	14.7	23.6
1966	24.7	16.6	9.5	22.8
1967	30.6	12.3	7.1	23.9
1968	26.9	6.3	10.8	26.1
1969	25.1	6.4	9.8	26.1
1970	25.6	5.7	10.0	23.3
1971 estimated	30.0	4.2	10.5	25.6

Source: <u>Cotton Situation</u>, Econ. and Stat. Analysis Div., E.R.S., USDA.


COTTON FUTURES AT NEW YORK
DAILY CLOSING PRICES NO. 2
(M-1 1/16")
NEARBY CONTRACT
DELIVERY IN DEC., 1968
CENTS / LB
20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39
APR MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB MAR APR
1967
1968
1969