Economics

Outlook on Cotton Markets and Marketing for 1986

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As this is written in mid January, the nearby outlook for the cotton industry is very bleak, but there are some possibilities of daylight on the horizon. The basic problem is a substantial over-supply of cotton world-wide. Although the details of the 1986 government program had not been announced as this is written, it appears that U. S. production will not be substantially reduced in 1986.

The important question is how soon and how much will other cotton producing countries respond to the low world prices for cotton that are mandated under the 1985 Farm Bill. In fact these low world prices have already existed for several months. Some estimates are that the world price is so low that U. S. market prices must fall by as much as 20 cents below the current support price to make U. S. cotton competitive in world markets.

The 1985 Farm Bill gives clear mandate and the mechanisms to make U. S. cotton competitive once again. It appears unlikely that any cotton farming operations can survive in 1986 outside the farm program participation. With a target price of 81 cents and the government responsible for absorbing the difference to the world price, the total cost of the cotton program in 1986 will be massive.

At this point in time, it seems very unlikely that the market price for cotton will be above 50 cents per pound for the 1986 crop, and several analysts believe that we will not make substantial progress in reducing world cotton carryover during the 1986-87 marketing year.

Where is the light on the horizon? The improving prospects are primarily related to a declining value of the dollar relative to other currencies. The first indications of a change in outlook is at least a slowing of the growth of imports of cotton products and some growth in U. S. mill consumption of cotton.

There is a strong possibility that the dollar will continue to weaken in 1986. The primary source for this weakening will be the falling price of oil which will be a major force in holding down the rate of inflation. The continued low level of inflation should result in falling interest rates in 1986 in spite of a generally strong economy. The drop in interest rates will need some help from declines in the national budget deficit. Actually the drop in interest rates will have a favorable direct impact on the budget deficit because interest payments on the national debt are a substantial part of government expenditures each year. While Gramm-Rudman may not cause a substantial reduction in the 1986 deficit, it should, at least, substantially reduce the growth of the deficit. Falling interest rates and declines in the growth of the deficit should result in less demand for the dollar and therefore further weakening of the dollar.

The prospects are very good for domestic consumption of U. S. cotton in 1986. Government programs will assuredly result in high levels of exports of U. S. cotton with correspondingly high costs to government. A year from now, we should be able to see 6 to 12 months into the future that stocks of cotton will be down substantially and government costs of keeping U. S. cotton in the world market should be falling.

The prospect of very low cotton prices (perhaps as low as 35 cents) will have substantial impact on the synthetic fiber industry. This could be a major rout for the cotton industry, except that textile mills will treat this low cotton price as only a temporary situation and not make major changes in equipment to displace synthetic fibers. The falling oil price will benefit the synthetic fiber industry because that is a major source of cost for them. But, cotton growers will also benefit from the falling oil price as they see lower prices for fuel, fertilizer and pesticides.

The near-term outlook, then, is such that cotton farmers have no realistic alternative to participation in government programs. The good news is that changes are already underway that will result in a more viable cotton industry 2 to 3 years into the future.

With government programs so completely dominating the pricing of cotton in the near-term and no realistic possibility of growing cotton outside of the government program the use of forward pricing strategies of forward contracting, hedging in futures contracts and hedging in options have little or no value.