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This week, cotton futures prices topped \$2.00 per pound. A year or so ago, the big debate in the cotton world was whether cotton could reach the history-setting level of a \$1.00 per pound. How things can change!

There are a number of reasons for the surge in cotton prices. Simply stated, there is a shortage of the stuff. How did this shortage sneak up on us? A number of factors came together to create a supply imbalance not seen in cotton since before the World War I.

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First, global stocks of cotton were drawn down sharply as less cotton was grown and shipped through the global supply chain due to competition from other crops. Many farmers switched to different crops when cotton was below 80 cents per pound. In particular, the ethanol boom of a few years ago convinced many farmers it was time to switch into corn production as corn paid better than cotton. Previously, cotton had been stuck in an anemic price range of about 40 cents to 70 cent per pound. Corn, on the other hand, soared when government support of ethanol production pushed that commodity up to unheard of price levels with corn now worth more as a fuel additive for our cars than as fuel for our stomachs!

Next, there was bad weather. Flooding in Pakistan, a poor crop in China and a bad Monsoon in India combined to seriously undermine global cotton production in the season leading up to the recent surge in cotton prices. As much as one quarter of the global cotton crop was somehow affected by this bad weather and at a time when there was less cotton grown because it was more profitable for farmers to grow other crops.

Finally, government actions further aggravated the situation. India, one of the world's largest cotton producers, slapped export quotas on raw cotton and yarn in an attempt to maintain a good supply of moderately priced cotton for its textile industry. But cotton prices in India did not moderate and all this policy did was to cause an acute shortage of cotton and yarn in China, the major export market for these products. What a way to treat your customer! As a result, stocks of cotton in Chinese government warehouses began to run low. Without the ability to freely import cotton and yarn from India, and faced with a poor domestic crop and low country-wide inventories, Chinese mills have had little choice but to enter the world markets and buy everything in sight.

And there's more. When the grip of the global recession began to ease on economies everywhere, demand for textiles and apparel rose. Over the past 50 years or so, the U.S. and Europe often led global recoveries. But this time something was different. China played a major role as an end consumer of products. The Chinese government pumped huge amounts of money into their economy in an effort to ward off recession. It largely succeeded. Domestic demand soared, a recession was avoided in China, but demand for cotton jumped to levels not seen in years as local mills struggled to produce enough product to not only meet restored demand in the U.S. and Europe—but the demand of local consumers as well. Chinese textile producers are no longer solely reliant upon the global markets for their livelihood. Domestic sales have now become a new standard for the world's largest textile industry and have placed even further demands on the cotton supply chain.



There are also other factors that have contributed to the run up in cotton prices, some more obvious than others. Higher energy costs have played a role not only in terms of shipping cotton, but also to physically grow the crop. There's another factor too—speculators in the cotton market. A weak U.S. dollar has helped to inflate commodity prices. It is often said that the wherever gold goes so does cotton. During this run up, a safe haven for investors has been gold and other commodities. When the stock markets were shaky during the recession, there was a lot of money to be made betting on higher commodity prices. In terms of cotton, sensing a quick buck, hedge funds swooped into the market just as the run up in prices began and the sheer size of their positions elevated prices well beyond what has normally been the case in the cotton markets.

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And, yes, there is one other factor: psychology. Panic is driving the market these days. Fear of not being able to secure a supply of cotton has left many clothing companies scrambling and even more mills wondering if they can stay in business if the price continues to rise and if there will be a consistent supply of cotton to be had at any price. It is this panic in the marketplace that has helped to elevate cotton prices even more. For many years, the retail and apparel side of the textile supply chain set the rules for what it was willing to pay for its raw materials, be it fabrics or raw cotton. But the panic in the market has weakened the grip of these companies. Raw material suppliers appear to have at least temporarily gained some ability to push higher costs on to their customers and, indirectly at least, to the customers of those customers.

Needless to say, all of these factors have put the cotton industry in the precarious position of meeting soaring demand from a reduced production base. The bottom line: There's simply not enough cotton to go around.

Of course, not all textiles are made of cotton and the fabric is only one component of the final price of the item. Unfortunately, polyester and other synthetic fabric prices trend to track with cotton and have risen significantly as well. Labor has become more expensive as has electricity, and pretty much all of the input costs of producing a final product. Sounds like an end-of-the-world scenario...

But there's hope on the horizon. Production will return. \$2.00 cotton will move many farmers back into the game. A few years ago, many in the cotton trade forecast a reduction of U.S. cotton acreage from about 10 million acres to just six million. Funny how things change: Today, most analysts feel the U.S. market will actually grow to about 13 million acres this year. As the U.S. is the world's largest exporter of cotton, that's a good thing.

So all is not lost. Production will return and prices should moderate over time. Will we go back to 40-cent cotton anytime soon? No. Cotton prices will remain high for the next couple of years—certainly above \$1.00 per pound and it is possible that the record run-up in cotton prices will continue. But eventually prices will moderate as more supply comes on line. It just takes time. It takes almost 200 days to grow a cotton crop. Because of this long lead-time, it will take time to bring production to a level that meets world demand.

But, then again, there's only so much acreage to grow cotton. Perhaps that's best left for another discussion on another day!