Southern Cotton Growers, Inc.
REPRESENTING COTTON PRODUCERS THROUGHOUT ALABAMA, FLORIDA, GEORGIA, NORTH CAROLINA, SOUTH CAROLINA AND VIRGINIA

COTTON MARKETING NEWS

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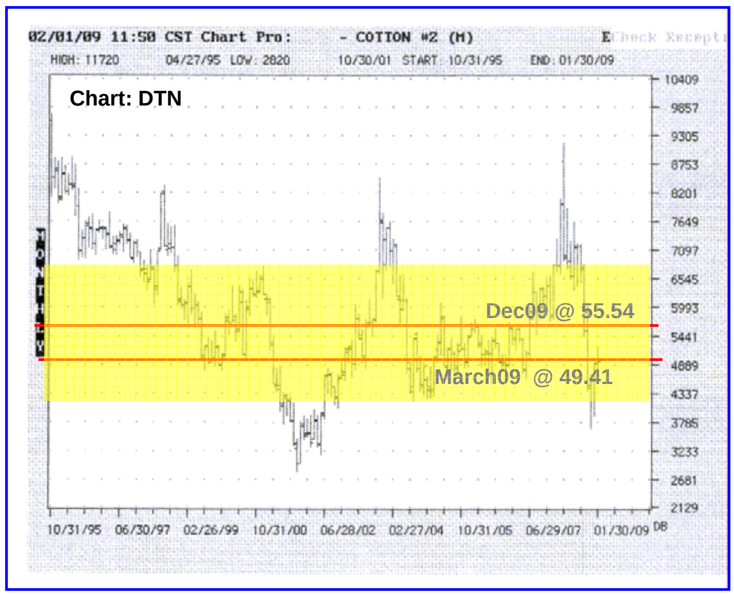
How Does The Price of Cotton Factor In To 2009 Decisions?

At a recent cotton producers meeting, I was discussing the market situation and outlook for the 2009 crop and comparing estimated net returns for cotton and other crops. I made the comment that I don't think the price of cotton is all that important….. that it's not the price of cotton that is going to drive farmers' decisions. Hear me out before you think I've gone crazy.



The chart on the right shows cotton futures prices back to October 1995 when prices were over 80 cents. Since that time, we've seen prices spike above 70 to 75 cents on three occasions. Prices were down in the 30's in 2001 and 2002 and then back in the 40's in 2004 and 2005. Prices this past Fall, back in the upper 30's and low 40's, were the lowest since 2001.

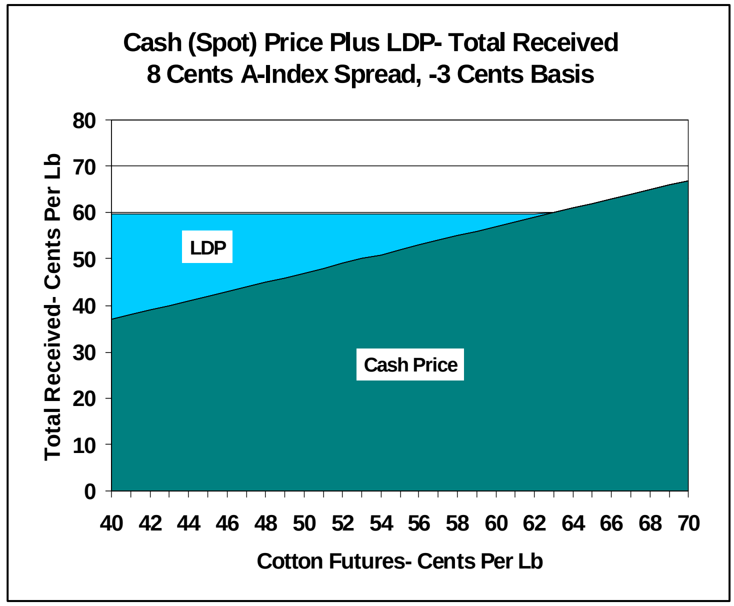
Going back to harvest time 1995, cotton prices have spent most of their time within a range of roughly 66 to 43 cents. March futures closed today at about 49 ½ cents. December closed about 55 ½ cents. Both of these prices are in the mid to low range of where cotton seems to spend most of it's time. So where am I going with all this.

In 2000 and 2001, US farmers planted over 15 million acres of cotton. Cotton (Dec00 and Dec01 futures prices) was mostly in the mid to high 50's during the time farmers were making planting decisions. As recently as 2006, acres were again over 15 million and prices (Dec06 futures) were again in the mid to upper 50's when planting decisions had to be made. Now in the span of 2 years (2007 and 2008), acreage has dropped to only 9.47 million acres and predictions are that acreage will decline again for 2009. Prices for the 2007 and 2008 crops, with exception of the speculative-driven rally last February-March, have also been mostly in the 50's. Not unlike when farmers planted over 15 million acres on 3 recent occasions. Futures prices (December) for the 2009 crop are today in the mid-50's yet there is yet very likely another acreage decline in store for this year.

When it comes to making planting decisions, the price of cotton is hardly the only consideration. Producers must take into account the likelihood of an LDP or Loan Gain or equity. The next chart illustrates the principle. When cotton prices are low, the "total money" in the producers pocket is the LDP or Loan Gain plus cash price or Loan plus merchant equity. The "total money" is not dependent on what the cash market does and it's not dependent on what the World market (A-Index and AWP) does. The total money in the producers pocket depends on how the cash price (basis the NY futures) and A-Index move together. The difference between the A-Index and nearby futures (A-Index minus Futures) I call the A-spread. The producer gains when this spread narrows and loses money when this spread widens.

The following chart assumes a spread of 8 cents and a basis of 3 cents under. The spread is often 6 to 9 cents and, of course, the basis can be more or less than this depending on location and fiber quality. When the spread narrows, that means the futures market (and cash market as well subject to the basis) has increased relative to the LDP or the A-Index has declined and LDP increased in relation to the cash market. Either way, the producer has gained.

Assuming an 8-cent A-spread and -3 cents basis, when the futures market is less than about 63 cents, the total money to the producer doesn't change. Less money for the cotton is offset by an equal increase in the LDP. Total money to the producer is just under 60 cents. Only when futures get above about 63 cents does the total money to the producer begin to increase.



Producers know this. That is why when cotton prices are low, the market alone is not always a good indicator of how net returns for crops will compare and how planting decisions will be made.

Let's take this same scenario and apply it to 2009 cotton. Dec09 closed today at roughly 55 ½. If the market does not move at all by harvest time, assuming a -3 cents basis, we'd be looking at a cash price of 52 ½. Assuming an 8-cent A-spread, the A-Index would project to be 63 ½. The AWP would be just under 45 and therefore the LDP/POP at just over 7 cents. "Total money" would be just under 60 cents. Regardless of what the market does between now and harvest, assuming an 8-cent spread and -3 cents basis, the "total money" or floor to the producer will be around 60 cents. Of course, this can vary depending on actual spread and basis.

Futures Price 01/30/09	5554	Dec09	Projected A-Index	6354
Expected Basis	-300		Adjustment	-1859
Projected Cash Price	**5254**		Est. AWP	4495
			Loan	5200
TOTAL	**5959**		LDP	**705**

We've had cotton prices in the 50's before and we've planted 15 million acres. Producers know how these relationships work and make their decisions accordingly. In the past when we had 50-cent cotton, we still planted cotton. Today, the price and marketing loan/LDP situation in cotton hasn't changed. Today and the past 2 years, the differences are (1) dramatic increases in cost of production and (2) the availability of more profitable alternatives that did not exist a few years ago. Apparently for most of the Cotton Belt, corn and soybeans have become the more profitable "something else".

Decisions for 2009 will be tougher I think. Fertilizer and fuel prices have moderated and corn and soybean prices do not appear quite as attractive as in the past. Unless the cotton market gets back up into the 60's, the price of cotton does not fully drive the producer's decision. As I've tried to illustrate, the marketing loan and LDP offer a fairly level cushion below that and in years of low cotton prices that is what producers respond to. Acres have not shifted out of cotton simply because of cotton's price nor will they for 2009. Unlike the past, in recent years producers have a profitable "something else" and that is what is really driving acres.

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