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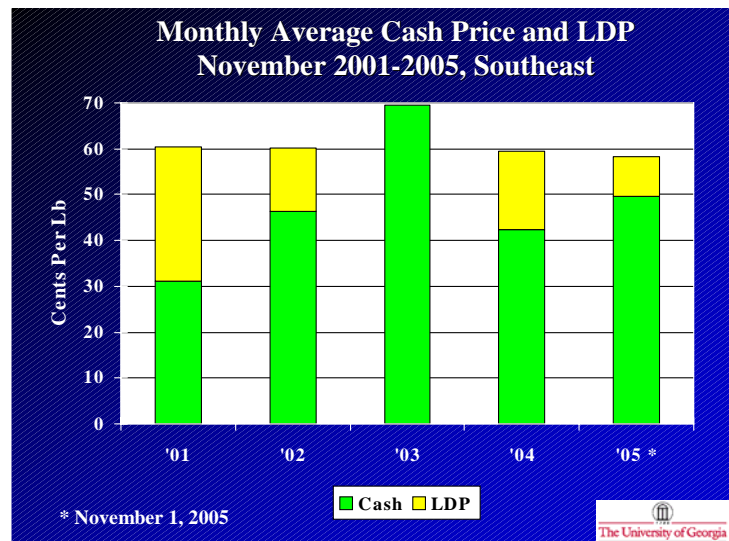
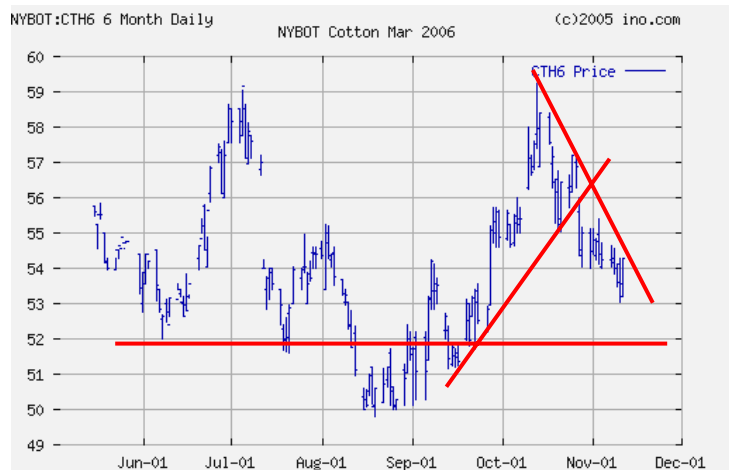
Cost-Price Squeeze

This week, I had the pleasure of speaking to Farm Credit System officers and lenders at the AgFirst Commodity Seminar in Charlotte, NC. It was a very informative meeting and, if you don't mind, I'd like to use this space to share with you just a few thoughts that I shared with them.

First, let's take a quick glance at this week's USDA numbers... as expected, the US crop was increased. The November estimate is 23.16 million bales—up about 400,000 bales from October. A larger crop was expected and already factored into the market, so I expect this number to be a non-factor. US exports were increased to 16.2 million bales. The only other numbers worth noting... the China crop was unchanged but imports increased ½ million bales and use 1 million bales, foreign production was decreased slightly but more than offset by the larger US crop, world use was increased 1.3% to 114.4 million bales, and world ending stocks declined by 800,000 bales. The world stocks-to-use ratio dropped from 45.1% to 43.9%.

All-in-all, I would conclude this to be a somewhat bullish report and should be supportive of price... meaning support at 52 cents (March futures) should hold with the opportunity for rallies to the mid-50's provided that US exports are on pace to meet the 16.2 million bales target. That's a big task but if China use (demand for imports) remains strong and the US provides it's typical 50% or so market share, it's very do-able. There is some talk that the China crop might eventually be larger and thus imports less than currently projected. If that rumor materializes, that would pressure prices to the 50-52 cent area.

Now let me quickly share with you a thought or two from this week's AgFirst Commodity Seminar. One of the main themes I tried to share with the group was the "cost-price squeeze" in cotton. The first point is price. The graph here shows total price received including LDP for the 2001-2005 crops. Time and space here preclude me explaining the concept and reasons for this approach but the bottom line is that "unless the cotton market gets back to the 60's, the total money to the grower will never change... it's just a matter of which pocket you want to take it out of." The marketing loan pretty much sets a floor of 58 to 60 cents including POP/LDP/Loan Gain or Loan plus merchant equity.

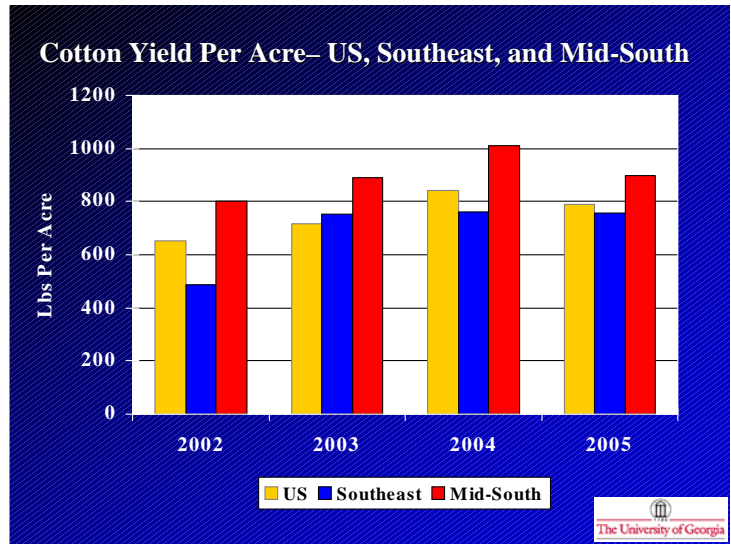


If the price side of the profit equation is not changing (which it hasn't most years recently in an export-driven market), this has a dramatic impact on net returns particularly when you consider how costs of production have increased (fuel, fertilizers, seed, chemicals, etc.).

If price (when you include POP/LDP/Gain) is fairly static and costs increasing, the only way to improve net return is through yield. This is a real challenge because so many things are beyond the growers control... yet, unless the cotton market gets back to the low 60's or better yields must improve.

As this next graphic shows, yields in the Southeast have lagged behind the US and Mid-South (USDA, October 2005). Granted, we've had our share of weather and other problems.

The Georgia expected average yield for the 2005 crop is 793 lbs/acre (USDA, November 2005). Approximately 35% of the Georgia cotton crop is irrigated. Assuming 1,000 lbs/acre yield for irrigated production, the estimated average non-irrigated yield would be 681 lbs/acre. Using this same approach, the average non-irrigated yield for the 2004 crop would be estimated at 499 lbs/acre.



These graphs point to 2 conclusions: (1) most cotton producers (US, not just Southeast) likely cannot cover even the variable (out-of-pocket) expenses without assistance from the marketing loan program (particularly so when you consider land rent) and (2) although the marketing loan program provides a "floor" price, this may not be sufficient to provide profitability for the producer without good yields particularly when you consider escalating costs in recent years.

Another conclusion is that growers have to find ways to beat the market rather than settle for the 58-60 cents scenario. This could include forward contracts when price is high plus a large LDP from the market falling later, use of Puts and Calls, basis contracts, don't POP then hold cotton unprotected, etc.

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