Thompson On Cotton: The Driving Force Behind Today's Cotton Market

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"It's the economy, stupid!" Many of you remember this phrase coined by James Carville when serving as campaign manager for Bill Clinton in 1992 referring to an election-year economic recession. Some thirty years later, it appropriately describes the driving force behind today's cotton market. This was evident last week when cotton prices were whipsawed on economic news seen going from poor to promising. Consequently, after a tumultuous week of trading small gains were made while the market maintained its sideways trading pattern.

The week began with yet another bank scare as First Republic saw over one billion dollars in deposits drawn down. In addition, several companies announced weak corporate earnings. UPS experienced its first decline in annual revenue since 2009 due to reduced shipping volume. Such economic uncertainty set off a wave of spec selling. The commitment of trader's report, reflective of activity through last Tuesday, showed that managed funds were net sellers of 1.29 million bales. Alarmingly, 64% of this was made up of new shorts. This leaves their total net short position at 2.09 million bales, the largest since mid-March. Not surprisingly, during this reporting period, cotton prices fell over five cents from 83.65 to 78.62.

Nonetheless, as hoped, these weaker prices did lead to an increase in demand. Net export sales of 194,900 bales were significantly higher than the week before and 21 percent above the four-week average. China and Turkey were the major buyers, although thirteen other countries were purchasers. Shipments, also impressive at 398,400 bales, significantly surpassed the 267,000 bales a week needed to meet estimates. This pace, if continued, could force USDA to raise exports in turn reducing ending stocks.

In yet other news, the U.S. economy slowed sharply in the first quarter of this year decelerating to an annual pace of 1.1 percent. Understandably, nine consecutive interest rate hikes have taken a toll on the housing market while triggering businesses to reduce inventories. Declining from 3.2% in Q3 of last year and 2.6% in Q4, this beat expectations and seems to be cooling inflationary pressures. However, consumer spending which accounts for 70 percent of U.S. economic activity grew at its fastest pace in two years, 3.7 percent. But a look at the accompanying chart of items being purchased still shows they are not giving up their beer for a pair of blue jeans unless they are Bud Light drinkers.

Where to from here? It was encouraging to see the market claw its way back above 80 cents. A clear signal, for now, support remains firm at this level. To get off the bottom of this 90 to 76 cents trading range, managed funds must be enticed to reverse their market sentiment. This week, the Fed is expected to announce yet another interest rate hike of a quarter of a point. We expect little market reaction as it is already being traded. More important will be Chairman Powell’s comments afterward. In addition to the economy’s effect on demand, Funds will be monitoring potential supplies as planting gets underway. Conditions in the Southwest, though slightly improved, are dire, to say the least. Seventynine percent of the cotton-producing area in Texas is under some form of drought, thirty-two percent of which is extreme or worse. In Oklahoma, it is ninety-nine percent with sixty-five percent extreme or worse. These areas normally experience planting rains in May and June. Even so, current conditions will require this crop to be spoon-fed all year which is asking a lot.