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Risk Management in Cotton Trade

Shri. Arun Sekhsaria is the Managing Director of DD Cotton, an agri-commodity trading house with a deep focus on cotton. DD Cotton is amongst the country's largest and oldest exporters and domestic traders of cotton. He is now spearheading the group's strategy of deeper vertical integration in the entire commodity value chain. He is an expert in the area of risk management and quality control.

EXPERT'S Column



Shri. Arun Sekhsaria
*Managing Director, DD Cotton and
Executive Additional Vice-President, CAI*

With over three decades of experience in the commodity field, he is now an eminent voice within the cotton industry in India. He holds positions in various trade bodies and advisory boards.

He is Executive Additional Vice-President CAI and also a member of various Committees of the CAI and he represents the cotton trade on the Cotton Advisory Board of the Government of India.

India became the second largest producer, consumer and exporter of cotton and till 2011 it never had a futures contract for risk management. The crisis of 2010-11 which saw prices move from U.S. Cent/lbs70 to 230 and drop from 230 to 110 in a period of 10 months, made all stake holders nervous. During that period, few traders along with late Dr. Madhoo Pavaskar, Chief Economist, Commodity Derivatives, got together and started a cotton contract in 2011 in MCX.

Fundamentals of futures are as under:

1. It allows all stake holders to hedge the inventory of cotton efficiently.
2. It should be used as a tool for risk management and not speculation.
3. Futures allow all stake holders to hedge the

buying and selling for a longer period and avoid it to store in physical form.

4. All stake holders have different perspectives for hedging.

Benefits for all stake holders:

1. Hedge by cotton farmers: farmers can hedge kapas immediately after sowing. Once the arrivals are ready for market, hedge can unwind the sale and sell physical stock. This can allow farmers to sell their produce in advance in short hedge. It also allows the farmers to lock in the profit before harvesting.
2. Hedge by traders: traders typically buy cotton on flat price, running the risk of market fluctuations. Cotton futures allows the trader to hedge the risk by buying or

selling futures contract there by assuring reasonable margins. When markets are down and no buyers in physical markets, it can sell futures and manage its risk and avoid losses. This allows the trader to run efficiently and without the risk of bullish or bearish markets.

3. Hedge by ginner: ginner typically always start preparing to buy kapas from farmers as soon as arrivals start. In order to manage risk, ginner have two options:
 - a. Sell cotton future for forward months and give delivery on exchange.
 - b. Sell cotton futures and secure the price which can be unwind after the bales are produced.
 - c. This again allows the ginner to book their margins depending upon the view even before the ginning starts.
4. Hedge by mills which can be in two forms:
 - a. Against productions. There are times whereby mills find the fabric / yarn markets weak and futures strong. Hedging takes a position by doing a sale and the same in unwinded once the production is completed and delivered. It also allows the mills to buy in physical market any cotton suitable without the risk of carrying dead inventory.
 - b. Against long hedge. All mills carry inventory for 2-3 months. Without firm sale of value- added products, the mills run the risk of loss of price if the end product is not sold. Hence several mills who go long on inventory can hedge their risk by shorting futures contract.
5. Hedge by exporter:
 - a. Several exporters have to sell cotton overseas for shipment periods which are 3-6 months. It is unlikely that the exporters can buy physical cotton and carry the same incurring high cost. Hence hedging allows exporters to sell cotton in exports and hedge the risk in futures by going long.
 - b. Similarly, exporters and importers can also sell or buy futures against their inventory. This is possible if the demand of exports is poor and physical cotton is looking attractive. Against the position of physical purchase, futures can be sold and hedge the risk.

From the above you can see the several opportunities available to all stake holders.

All stake holders have to use the futures purely for risk management and not speculations.

In order to make the contract successful, the following principals should be adopted by the exchange.

- a. Contracts should be very robust, covering all aspects of specs and standard grades as prevailing in physical markets.
- b. There should be liquidity in the contract, matching physical arrivals.
- c. There should be a robust clearing mechanism
- d. Assaying of cotton has to be done professionally by reputed laboratories/ assayers.
- e. The PAC committee should meet regularly and make changes on a regular basis as it is an evolving process.

Advantages of trading in futures for all stake holders:

1. Working capital limits requirement reduced by nearly 80%
2. Risk of market fluctuation is limited only to the extent of basis loss.
3. There is more efficiency brought in the system.
4. Buyers have the benefit of exiting the markets any time unlike in physical.

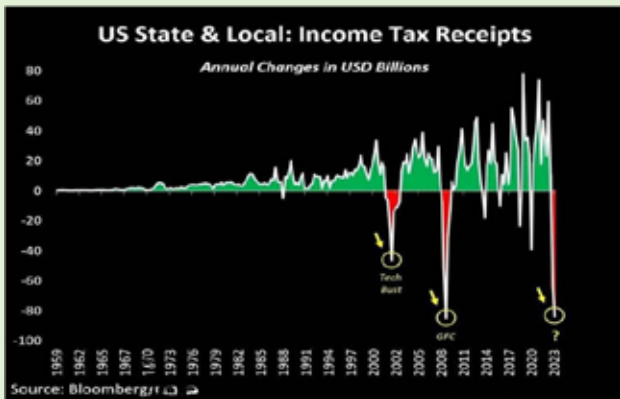
Being the world's second largest producer, consumer and exporter, India needs a very strong and scalable contract. Govt should only issue guideline and not run the exchange. In the last few years, there have been several occasions wherein govt interference has shaken the confidence of the users.

The exchange is just a platform provided for trading and the prices are governed by the market forces. In stock exchanges also there is high volatility, but the govt has not interfered in the running of the exchange. India has the potential to be the largest commodity player in the world and a strong commodity platform for trading. India should really look at China exchange ZCE which has volumes, liquidity and is China centric.

*Source : CAI Centenary Special 2022
(The views expressed in this column are of the authors and not that of Cotton Association of India)*

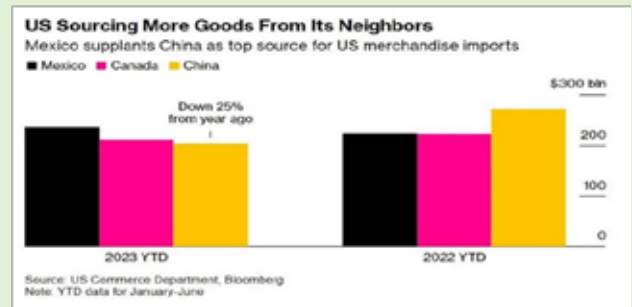
The Month That Was - Snippets for August 2023

US Experiences Worst Decline in Income Tax Revenue



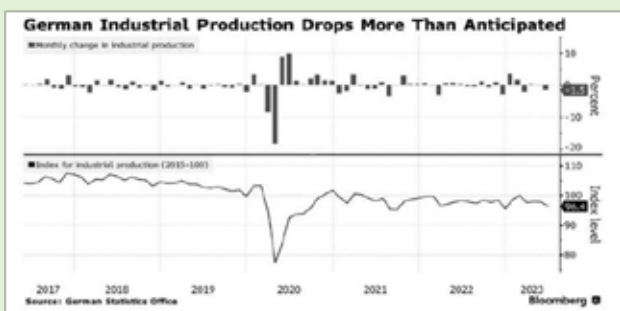
US state and local governments just experienced the worst decline in income tax revenues ever recorded. This was the second steepest year-over-year percentage decline in history, with only the GFC having a worse outcome. Note that Federal tax receipts are also dropped again, now at recessionary levels and approaching -10% on a YoY basis. This is a clear indication of the continued fundamental deterioration of the economy, which sharply contrasts with overall financial assets that remain at excessively inflated valuations.

China Now Sells Fewer Goods to the US Than Mexico or Canada Do



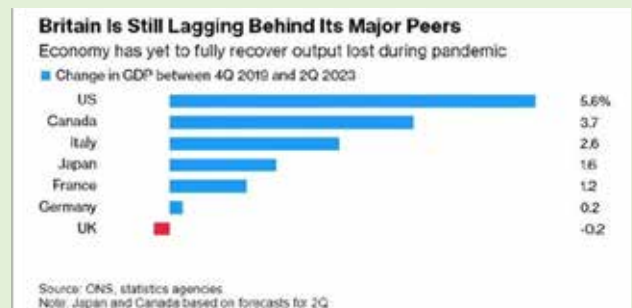
US imported 25% fewer goods from China in 1H from year ago. Mexico and Canada are top suppliers of merchandise to US. Mexico and Canada have replaced China as the top providers of goods to the US as a nearshoring push encourages more diversified supply chains. The US imported about \$203 billion in goods from China in the first six months of the year, 25% less than in the same period in 2022, based on the latest unadjusted data from the Commerce Department. The figures are not adjusted for inflation. The Asian country is now the third-largest provider of merchandise to the US behind Mexico and Canada.

German Industrial Production Drops Further



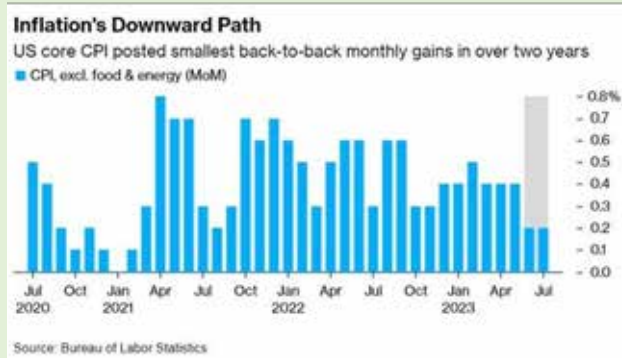
German industrial production fell for a second month in June, further holding back Europe's biggest economy after it barely exited a recession earlier this year. The drop in Germany was mirrored by lower industrial output in France and Spain during the month.

UK Economy Still to Recover From the Pandemic



The UK economy delivered its strongest quarterly growth in more than a year. Even with the modest 0.2% advance, the UK remains the only Group of Seven country that has yet to fully recover from the pandemic.

Inflation's Getting Better but Voters Just See Higher Prices



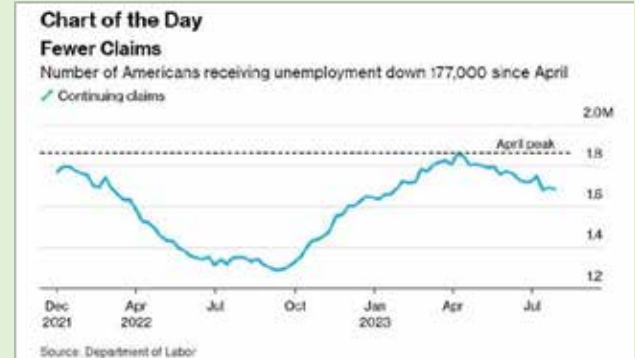
America's inflation problem is definitively getting better. That's good news for the economy and (theoretically) for Joe Biden. US consumer prices rose modestly in July, thanks in part to a pullback in costs for used vehicles, airline tickets and hotel stays. And a key measure of underlying inflation - watched closely by central bank officials and economists - posted the smallest back-to-back increases in more than two years. A sustained downward trend in inflation, paired with low unemployment and resilient economic growth, is boosting the odds that the economy can avert a recession that was once viewed as inevitable. It also likely means the Federal Reserve will leave interest rates unchanged at their meeting next month - though rates are still at a 22-year high.

Importance of Rice in Diets



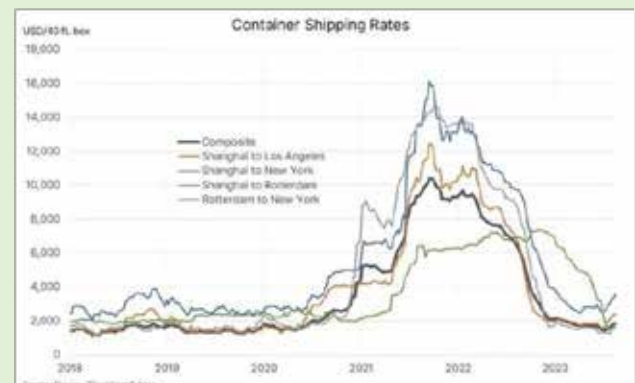
almost 15 years is renewing fears that food costs are going to get a lot more expensive for the world's poorest people. The grain is vital to the diets of billions in Asia and Africa.

Number of Americans Receiving Unemployment Check from Govt. Is Down



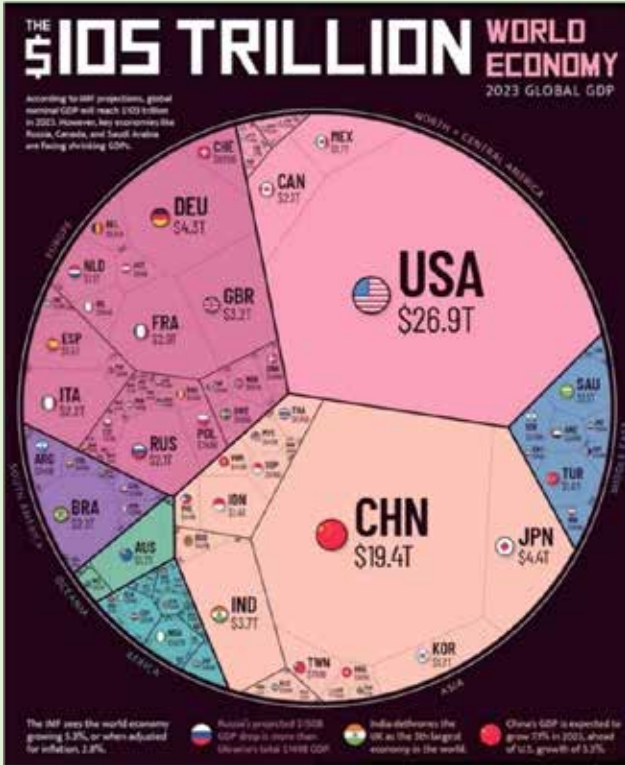
The number of people receiving an unemployment check from the government is down by almost 180,000 since the beginning of April. At the end of July, fewer than 1.7 million people -- well below the 20-year pre-pandemic average -- got unemployment. Continuing claims are now broadly near their pre-pandemic level. That all reflects a labor market robust enough that unemployed workers are usually able to quickly find a new job. The median unemployed US worker finds a job in about 9 weeks -- though one-in-five workers require six months or more.

Rising Global Container Rates



Global container freight rates trade up for sixth week during which time the Drewry composite has risen by 24% to \$1832 pr 40 ft. box, well the above the pre-Covid 5-yr avg. of \$1400. Led by strong gains on the major routes from China to LA (+44%), NY (+37%) and Europe (31%).

Visualising the \$105 Trillion World Economy in One Chart



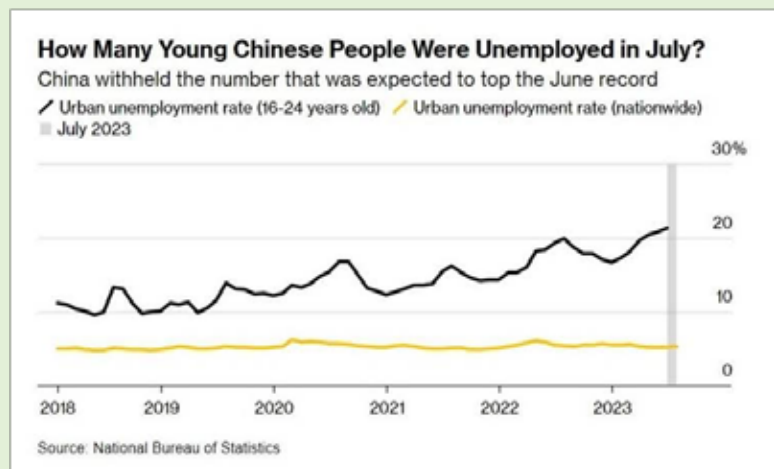
Why There Are Calls in US to Revoke China's Preferred Trade Status?



Candidates gunning to be the Republican Party nominee to run for US president in 2024 are pledging to step up America's economic confrontation with China. Some of them have a common refrain: ending what's known as Permanent Normal Trade Relations, or PNTR, with China. The idea is to reverse the decline of manufacturing in the US as it shifted to China following its 2001 entry into the World Trade Organization. There's a long history of US politicians threatening to revoke China's preferred trading status but, so far, no president has pulled the trigger.

China Is Hiding More and More Data from the Rest of the World

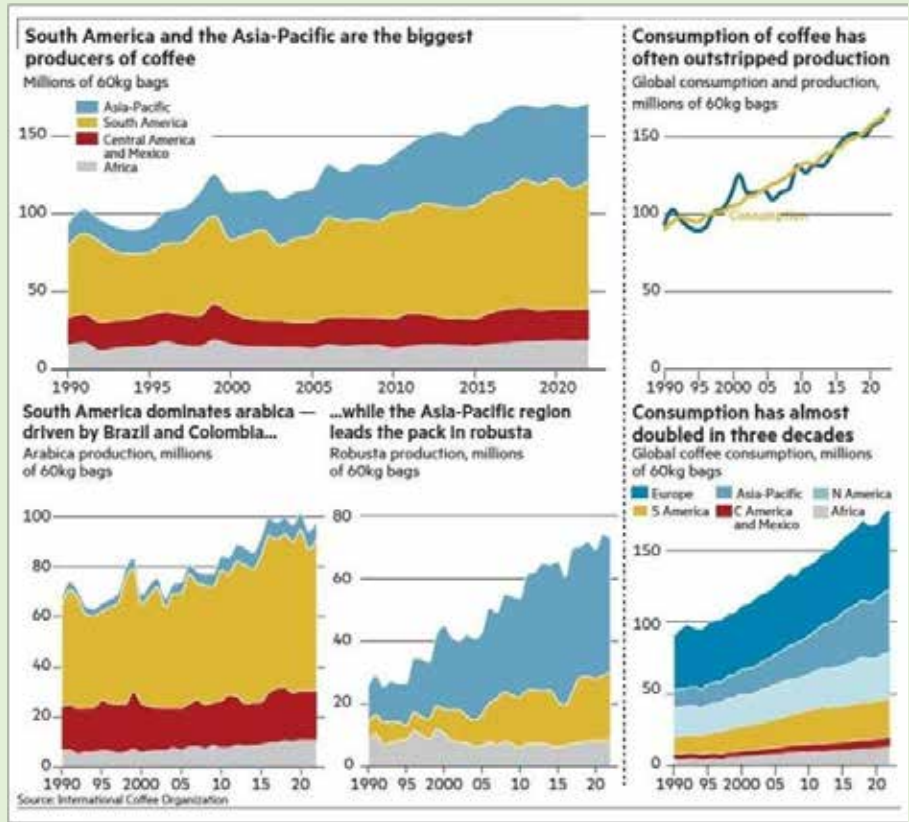
Bureau stops publishing youth jobless rate, which hit a record. Government has sought to manage narrative about weaker economy. China's abrupt decision to pause releasing data on its soaring youth jobless rate this week was the latest sign the Asian giant is increasingly restricting sensitive information – especially when it's unflattering to the nation's faltering economy. The unemployment rate of people aged 16-24 fell into that prickly category, after hitting a record of 21.3% in June. One fifth of young people being out of work is a troubling statistic for a ruling Communist Party obsessed with maintaining social stability. As China's economy battles a slew of threats to its economic expansion target for 2023, a wider range of data is being deemed



unsuitable for public consumption. President Xi Jinping's ideological battle with the US has also motivated Beijing to ringfence data it believes could advantage the Biden administration.

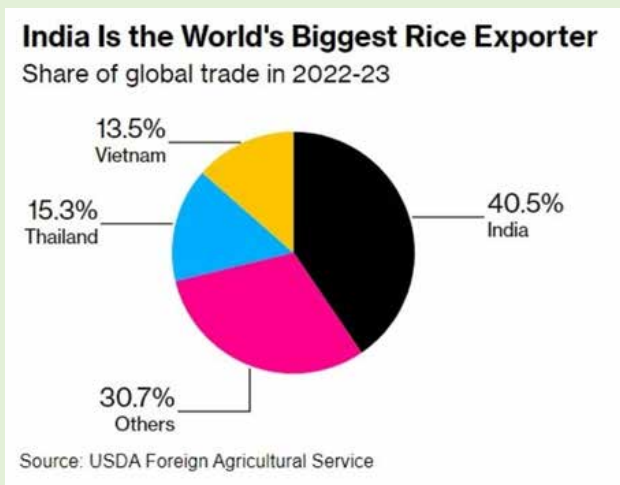
We Will Need 25 Per Cent More Coffee By 2030

About 3bn cups are drunk around the world every day, a number expected to double by 2050. But rising temperatures mean up to half of current coffee farmland could soon be unusable. Long-term growth rates in Asia and Africa – where coffee drinking is often seen as symbolic of entry into the global middle class – are racing ahead of traditional markets in Europe and North America, although from a lower base. Starbucks plans to open 9,000 shops across China by 2025, while international coffee brands Costa Coffee, Lavazza and Tim Hortons are also competing to attract the country’s rising number of consumers. This means an even larger market for beans. If current trends continue, global consumption is expected to double to 6bn cups of coffee every day by 2050.



A study by the Columbia Center on Sustainable Investment suggests we will need 25 per cent more coffee by 2030.

India Restricts Rice Exports



India, the world’s biggest exporter of rice, imposed more curbs on shipments of the grain in a move that’s likely to further squeeze global supplies of the food staple. The government will set a floor price of \$1,200 per ton for basmati rice exports, according to a commerce ministry statement. That will prevent some traders from trying to smuggle non-basmati white rice, which has been banned for exports, through customs masked as the more expensive aromatic variety, the government said on Sunday. The latest move follows the imposition of a 20% export tax on parboiled rice on Friday, confirming an earlier report by Bloomberg News. India, which had a share of about 40% in the global rice trade last year, has now either banned or put some sort of restriction on exports of all varieties of the grain.

COTTON ASSOCIATION OF INDIA



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**A CHILD'S CHILDHOOD IS FOR LEARNING
DON'T USE THEIR CHILDHOOD FOR EARNING
SAY NO TO CHILD LABOUR**

UPCOUNTRY SPOT RATES													
								(Rs./Qtl)					
Standard Descriptions with Basic Grade & Staple in Millimetres based on Upper Half Mean Length [By law 66 (A) (a) (4)]								Spot Rate (Upcountry) 2022-23 Crop August 2023					
Sr. No.	Growth	Grade Standard	Grade	Staple	Micronaire	Gravimetric Trash	Strength /GPT	21st	22nd	23rd	24th	25th	26th
1	P/H/R	ICS-101	Fine	Below 22mm	5.0 – 7.0	4%	15	17013 (60500)	16928 (60200)	16816 (59800)	16816 (59800)	16759 (59600)	16591 (59000)
2	P/H/R (SG)	ICS-201	Fine	Below 22mm	5.0 – 7.0	4.5%	15	17153 (61000)	17069 (60700)	16956 (60300)	16956 (60300)	16900 (60100)	16731 (59500)
3	GUJ	ICS-102	Fine	22mm	4.0 – 6.0	13%	20	13385 (47600)	13357 (47500)	13301 (47300)	13301 (47300)	13273 (47200)	13273 (47200)
4	KAR	ICS-103	Fine	22mm	4.5 – 6.0	6%	21	14144 (50300)	14088 (50100)	14032 (49900)	14032 (49900)	14032 (49900)	14032 (49900)
5	M/M (P)	ICS-104	Fine	23mm	4.5 – 7.0	4%	22	15663 (55700)	15607 (55500)	15466 (55000)	15466 (55000)	15466 (55000)	15466 (55000)
6	P/H/R(U) (SG)	ICS-202	Fine	27mm	3.5 – 4.9	4.5%	26	15916 (56600)	15860 (56400)	15747 (56000)	15691 (55800)	15607 (55500)	15607 (55500)
7	M/M(P)/ SA/TL	ICS-105	Fine	26mm	3.0 – 3.4	4%	25	-	-	-	-	-	-
8	P/H/R(U)	ICS-105	Fine	27mm	3.5 – 4.9	4%	26	16113 (57300)	16056 (57100)	15944 (56700)	15888 (56500)	15803 (56200)	15803 (56200)
9	M/M(P)/ SA/TL/G	ICS-105	Fine	27mm	3.0 – 3.4	4%	25	15466 (55000)	15382 (54700)	15269 (54300)	15241 (54200)	15185 (54000)	15185 (54000)
10	M/M(P)/ SA/TL	ICS-105	Fine	27mm	3.5 – 4.9	3.5%	26	16225 (57700)	16141 (57400)	16028 (57000)	15972 (56800)	15888 (56500)	15803 (56200)
11	P/H/R(U)	ICS-105	Fine	28mm	3.5 – 4.9	4%	27	16759 (59600)	16703 (59400)	16591 (59000)	16535 (58800)	16478 (58600)	16394 (58300)
12	M/M(P)	ICS-105	Fine	28mm	3.7 – 4.5	3.5%	27	16731 (59500)	16647 (59200)	16563 (58900)	16563 (58900)	16535 (58800)	16535 (58800)
13	SA/TL/K	ICS-105	Fine	28mm	3.7 – 4.5	3.5%	27	16788 (59700)	16703 (59400)	16619 (59100)	16619 (59100)	16591 (59000)	16591 (59000)
14	GUJ	ICS-105	Fine	28mm	3.7 – 4.5	3%	27	16759 (59600)	16703 (59400)	16647 (59200)	16619 (59100)	16591 (59000)	16591 (59000)
15	R(L)	ICS-105	Fine	29mm	3.7 – 4.5	3.5%	28	16675 (59300)	16647 (59200)	16591 (59000)	16535 (58800)	16450 (58500)	16366 (58200)
16	M/M(P)	ICS-105	Fine	29mm	3.7 – 4.5	3.5%	28	17041 (60600)	16984 (60400)	16900 (60100)	16844 (59900)	16816 (59800)	16816 (59800)
17	SA/TL/K	ICS-105	Fine	29mm	3.7 – 4.5	3%	28	17069 (60700)	17013 (60500)	16928 (60200)	16872 (60000)	16844 (59900)	16844 (59900)
18	GUJ	ICS-105	Fine	29mm	3.7 – 4.5	3%	28	17069 (60700)	16984 (60400)	16928 (60200)	16900 (60100)	16900 (60100)	16900 (60100)
19	M/M(P)	ICS-105	Fine	30mm	3.7 – 4.5	3.5%	29	17294 (61500)	17238 (61300)	17181 (61100)	17153 (61000)	17097 (60800)	17097 (60800)
20	SA/TL/K/O	ICS-105	Fine	30mm	3.7 – 4.5	3%	29	17322 (61600)	17266 (61400)	17209 (61200)	17181 (61100)	17125 (60900)	17125 (60900)
21	M/M(P)	ICS-105	Fine	31mm	3.7 – 4.5	3%	30	17434 (62000)	17378 (61800)	17322 (61600)	17294 (61500)	17238 (61300)	17238 (61300)
22	SA/TL/ K / TN/O	ICS-105	Fine	31mm	3.7 – 4.5	3%	30	17491 (62200)	17434 (62000)	17378 (61800)	17350 (61700)	17294 (61500)	17294 (61500)
23	SA/TL/K/ TN/O	ICS-106	Fine	32mm	3.5 – 4.2	3%	31	N.A. (N.A.)	N.A. (N.A.)	N.A. (N.A.)	N.A. (N.A.)	N.A. (N.A.)	N.A. (N.A.)
24	M/M(P)	ICS-107	Fine	34mm	2.8 - 3.7	4%	33	20415 (72600)	20415 (72600)	20331 (72300)	20331 (72300)	20274 (72100)	20274 (72100)
25	K/TN	ICS-107	Fine	34mm	2.8 - 3.7	3.5%	34	20696 (73600)	20696 (73600)	20612 (73300)	20612 (73300)	20556 (73100)	20556 (73100)
26	M/M(P)	ICS-107	Fine	35mm	2.8 - 3.7	4%	35	20921 (74400)	20921 (74400)	20809 (74000)	20809 (74000)	20752 (73800)	20752 (73800)
27	K/TN	ICS-107	Fine	35mm	2.8 - 3.7	3.5%	35	21202 (75400)	21202 (75400)	21090 (75000)	21090 (75000)	21034 (74800)	21034 (74800)

(Note: Figures in bracket indicate prices in Rs./Candy)