

1993 Cotton Management Economic Notes

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ton,” it is important to look at some economic fundamentals taking place in the market.



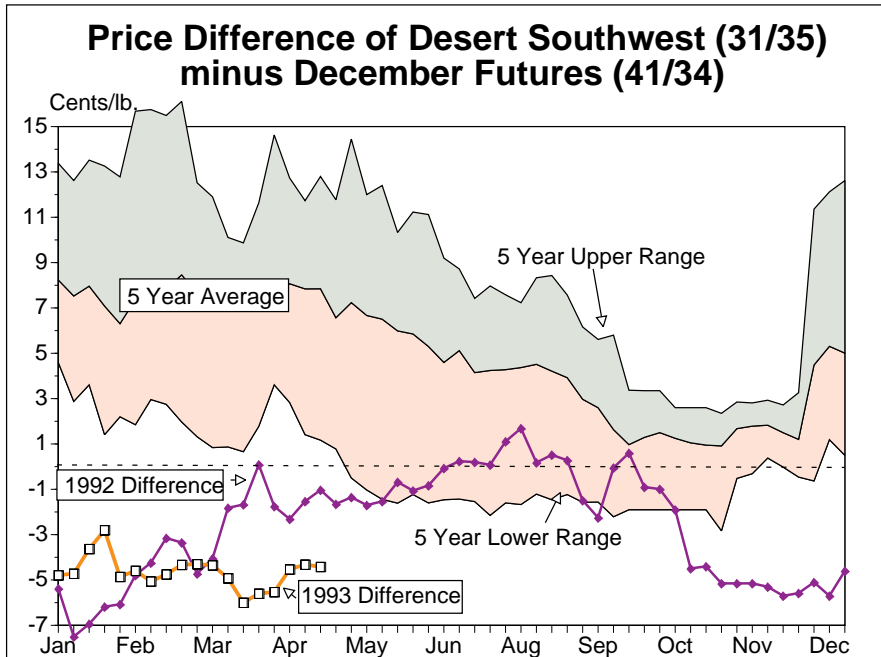
Regional Price Differentials

The New York Cotton Exchange Futures Market is most often utilized as the benchmark for price comparisons around the world. How much lower have Arizona cash prices been compared to past history? The figure to the right shows the difference between Desert Southwest (DSW) spot prices (31/35) and December Futures (41/34). Contracts on the exchange are only traded for grade 41, staple 34 cotton, but over 75 percent of the cotton classed last year in Phoenix met or exceeded grade 31, staple length 35.

The five year average and range of price differences from 1987 through 1991 indicate that Arizona prices were noticeably lower than December futures for 1992 and 1993 than prior years. DSW 31/35 spot prices are currently 5 cents lower than December Futures and about 12 cents lower than the 1987-1991 five year average of weekly price differences. Before attributing all of Arizona's price erosion to "sticky cot-

Demand and Supply Factors

For the last two years exports have dropped over ten percent every year. Export commitments for the August 1992 to July



1993 marketing year are at their lowest level since 1985, down over 1 million bales from last year. World stocks are at very high levels making the export market very competitive. In contrast, domestic mill use is expected to reach 9.9 million bales for 1992/93, the highest level since 1950 and 3 percent above 1991/92. But sluggish exports and an increase in carryover stocks have outweighed the increase in domestic mill use.

<u>Recent Prices</u>	<u>May 14, 1993</u>	
	<u>Upland</u> (¢/lb)	<u>Pima (ELS)</u> (¢/lb)
Spot	57.00	87.50
Target Price	72.90	105.80
Loan Rate	51.15	88.15
Dec '93 Futures	60.30	

Note: Upland Spot for Desert SW grade 31, staple 35;
 Pima Spot for grade 03, staple 46. 4/30/93; Phoenix Loan Rates

Asian countries typically import around 50 percent of the raw cotton traded in the world

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market. Strong import demand from these countries gives Arizona and California a location advantage to the rest of the US. The abundance of world cotton supplies in the last two years has eroded much of our location advantage. Furthermore, US domestic mills are primarily located in the Southeast.

Quality of the US crop is also an important factor when comparing different grades of cotton. Many buyers come to the West and pay a premium since other regions can not produce a quality that is acceptable for their milling needs. Growing conditions last year were quite favorable in the Southeast and High Plains area of Texas so that these regions were able to compete with Western cotton. Over 35 percent of the cotton classed in Lubbock last season met or exceeded a 31 grade whereas less than 3 percent of their cotton achieved this standard in 1991. Staple length was also greatly improved with over 20 percent of their cotton with a staple length of 35 or better, less than 3.5 percent of their cotton met this length in 1991.

San Joaquin Valley Comparison

San Joaquin Valley (SJV) is the closest market to Arizona in terms of historical quality and location. Since the SJV was not labeled with a sticky cotton problem, a comparison of DSW and SJV prices will add insight into any price discounts associated with "sticky cotton."

The figure below compares historical price differences of 31/35 cotton for the DSW and SJV. In the first three months of 1992 DSW prices exceeded SJV prices by around 2 cents/lb., a seven year high for this time period. Then price differentials basically remained within the 1987 to 1991 upper and lower ranges fluctuating around the 5 year average until December. From January through May 1993, price differences have been close to the 5 year lower range and about 2 cents below the 5 year average. This comparison indicates that price discounts associated with "sticky cotton"

perceptions for Arizona are much less than one would be led to believe by just looking at December Futures or a price from the North Delta. Economic factors related to location (exports and domestic use) and quality (favorable growing conditions in 1992 for other regions) have definitely had an impact on regional price differences in the last year.

Implications

Regional quality differences will vary annually in conjunction with weather and insect pressures. But economic factors behind lower exports, steadily increasing domestic use, and increasing competition from the Southeast are likely to continue. A regional price premium may be the profit margin for some Arizona growers. Deficiency payments are based on a target price (72.9 cents/lb) minus the US average price received for all cotton. A regional price premium of 2 cents would yield a net price close to 75 cents whereas a regional discount of 2 cents would result in a net price less than 71 cents. Given that the break-even price for much of Arizona's cotton acreage has been estimated at 75 cents or more (Wade, et al. "1992-93 Arizona-Field Crop Budgets"), profit margins could be eliminated with a lower regional price. Thus, a keen assessment of costs and benefits associated with growing decisions appears in order more now than ever before for Arizona cotton growers.

