

Cotton Glut Extending Slump as Levi's Costs Slide: Commodities
2012-09-04 09:27:48.918 GMT

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By Marvin G. Perez, Whitney McFerron and Phoebe Sedgman
Sept. 4 (Bloomberg) -- Cotton warehouses from China to Australia are bulging with the biggest-ever glut, a year after record prices spurred farmers to expand output.

Harvests will exceed demand for a third year, swelling stockpiles by 10 percent to 74.67 million 480-pound bales by August, the U.S. Department of Agriculture estimates. Inventories in China, the biggest user, will triple over two years to a record as domestic demand slumps to the lowest since 2005, USDA data show. Cotton may drop 12 percent to 67.87 cents a pound by the end of the year, according to the average of 20 analyst and merchant estimates compiled by Bloomberg.

Slowing economic growth means the surplus will widen even as China, Australia, Brazil and India produce less this season, leading to the first global output decline in three years, the USDA predicts. Prices already plunged 65 percent from last year's peak of \$2.197 a pound, reducing costs for buyers from Hanesbrands Inc., the maker of Champion apparel, to San Francisco-based Levi Strauss & Co.

"There's an awful lot of cotton around," said David Wookey, a managing director and trader at Isis Commodities Ltd., a cotton merchant in Boston, England, founded 17 years ago. "You've got a large stocks situation that's been coupled with weaker global consumption."

Surplus Widens

Prices tumbled 16 percent this year on ICE Futures U.S. in New York, exceeded only by arabica coffee's 26 percent decline among the 24 commodities tracked by the Standard & Poor's GSCI Spot Index. The gauge rose 5.7 percent. The MSCI All-Country World Index of equities gained 7.6 percent. Treasuries returned 2.6 percent, according to Bank of America Corp.

The world's farmers will produce 114.1 million bales in the year that began Aug. 1, 7 percent less than the record 122.7 million a year earlier, the USDA predicts. Demand will be 108.2 million, the second-lowest level in nine years, the agency estimates. A bale provides enough material for 1,217 men's T-shirts, according to the National Cotton Council of America.

China will import 46 percent less cotton in the 12 months

through July 31, according to USDA. Consumption in the country may drop 11 percent this year, Zhang Hongxia, the chairman of Hong Kong-listed Weiqiao Textile Co., China's largest cotton-textile maker, said in an interview Aug. 20. Cotlook Ltd., the Birkenhead, England-based research company, boosted its surplus estimate by 55 percent on Aug. 23, citing the deceleration in Chinese demand.

Crop Switching

Smaller harvests may bolster prices that reached a 31-month low of 64.61 cents on June 4, said Jon Devine, an economist for Cotton Inc., an industry group in Cary, North Carolina. Hedge funds on Aug. 28 were the most bullish since February, holding a net-long position of 13,047 futures and options contracts, Commodity Futures Trading Commission data show. The December-delivery contract traded at 76.89 cents a pound today.

U.S. farmers, the largest exporters, can earn more planting crops including corn or soybeans, which reached record prices this year after a drought that T-Storm Weather LLC estimates was the most-severe since 1936, based on temperature and rainfall in June and July. A USDA report on May 1 showed cotton growers lost \$154.17 an acre in 2011 and corn earned \$194.52. While the agency won't estimate this year's returns until Oct. 1, cotton prices are 21 percent lower and corn is up 41 percent.

Indian Monsoon

Matt Huie, a farmer in Beeville, Texas, who planted 3,600 acres of the fiber last year, said he "probably would consider not planting cotton at all."

"I would expect massive reductions of cotton acreage," said Carsten Fritsch, an analyst at Commerzbank AG in Frankfurt. "This should lead to a decline in supply and to rising cotton prices next year."

The monsoon in India, the second-largest exporter, has been 12 percent below the 50-year average, the Meteorological Department said Aug. 30. The weather pattern accounts for about 70 percent of the country's annual rainfall.

Plantings in Australia during the next three months may drop more than 12 percent, according to the government. Output in Brazil may tumble 26 percent as farmers shift to soybeans, the USDA'S Foreign Agricultural Service said in a report posted yesterday on its website.

Expectations for lower prices may spur traders to break \$600 million of contracts this year, or 5 percent of global

trade in the fiber, said Terry Townsend, the executive director of the International Cotton Advisory Committee in Washington. That's down from about 20 percent in the past two years because prices are less volatile, he said.

Profit Margins

Hanesbrands, the Winston-Salem, North Carolina-based maker of the Wonderbra, saw cotton costs jump by \$200 million in 2011, Chief Executive Officer Rich Noll told analysts on a July 31 conference call. Margins have since returned to "historical levels," he said.

Levi Strauss expects lower cotton costs in the third and fourth quarters, former Chief Financial Officer Blake Jorgensen told analysts on a conference call July 10. The company cut prices in some markets in the second quarter to reduce inventories and products being sold in the spring were the "tail end of the peak cotton prices in the products we sourced last year," he said.

Cheaper cotton will mean improved margins at American Eagle Outfitters Inc., a Pittsburgh-based clothing retailer, in the second half, Chief Financial Officer Mary M. Boland told analysts on an Aug. 22 call. J. Crew Group Inc., a clothing retailer based in Lynchburg, Virginia, told shareholders Aug. 30 that margins are benefiting from declining prices for the fiber.

Cheaper Polyester

While global demand is forecast by the USDA to rise 2.6 percent in the 12 months through July, after slumping 11 percent in the previous two years, more textile makers are turning to cheaper synthetic fibers. Polyester cost 77.6 cents a pound in China on Aug. 24, according to Cotlook. Cotton traded at \$1.61, the Cotton China Index reported that same day.

China mills about one-third of the world's cotton and is the top producer of polyester, according to the Washington-based International Cotton Advisory Committee, which has 41 member states. The group projects global synthetic-fiber consumption at 47.2 million tons in 2012, 3.9 percent more than last year.

Manufacturing in China unexpectedly shrank in August for the first time in nine months, the National Bureau of Statistics and China Federation of Logistics and Purchasing said on Sept. 1 in Beijing.

"Cotton-market fundamentals are just awful," said Sterling Smith, a futures specialist at Citigroup Inc. in Chicago. "Demand is quite low, and the heavy supplies will

contain any rally. We will probably see a downward correction from the recent rally as new crops start to come to market.”

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