

High Stakes, Low Grades

By Cliff White, Australian Cotton Shippers Association

We all know from experience that every cotton season is different and each season brings with it, new challenges to overcome. This season has unquestionably been defined by quality and the simple reality is, that for a significant portion of the 2025 crop, we haven't produced the high grade cotton we're accustomed to.

While the reasons behind this season's lower grades are relatively straightforward, the variation in valuations is far more complex. A range of factors have influenced pricing and there's no doubt that significant variability in discounts - across both forward-contracted and tendered cotton - has left many growers and merchants questioning the wide spread in value assessments. It's understandable that such disparity in price expectations has led to concern and confusion.

To understand current market dynamics, it's important to distinguish between the forward and spot markets - and the different risk profiles they carry. It is also important to emphasise that without a functioning forward market and the ability to lock in attractive prices - sometimes years in advance - it would be extremely difficult, if not impossible, to manage and market large crops. The forward market is essential to sustain an efficient cotton supply chain in the global market.

Forward Market

When participating in the forward market, a cotton buyer agrees to purchase bales well in advance of production - taking on several risks in the process. These include price and basis risk, quality risk and the risk of non-delivery. The longer the lead time to delivery, the greater the risk, as more variables can emerge - as we've clearly seen over the past few months.

In Australia, forward purchases are typically made on the assumption that base grade Middling 31 or better will be delivered. This expectation is shared by our export market buyers, who value the consistent high quality of Australian cotton and are willing to pay a premium over competing growths. Our high grade cotton consistently outperforms other origins in the export market, and this is reflected in the basis offered to growers.

These quality assumptions underpin the viability of forward sales, which are essentially limited to high-grade cotton. Forward selling of lower grades carries significant risk, given the industry's usual expectation of a consistently high grade crop. The substantial value gap between Australian high grade cotton and lower grade cotton from other origins is reflected in the forward premiums and discounts (P&Ds) we see in the market.

Spot Market

When it comes to the spot market, the assumptions underpinning forward contracts no longer apply. Instead, we must respond to the realities of the crop at hand. This season we've seen a limited supply of high grade cotton and an abundance of lower grades. Naturally, when supply and demand conditions shift, so too do the relative values of those grades.

The availability of similar qualities from other exporting countries - along with relative pricing and underlying demand - are key factors in determining value once it becomes clear we have lower grades to sell.

In recent weeks there's been a perception that tendering cotton has produced better returns than selling under a forward contract with fixed P&D terms. However, when all things are considered, this may not necessarily be the case.

The dynamics of Australia's cotton marketing system means there is always a buyer for every cotton bale produced - and this is an important point to remember. When cotton is tendered ex-gin on spot terms, there can be more than a dozen potential buyers assessing each lot. Each buyer brings a different commercial need based on their individual trading position, contracts and market outlook - resulting in a wide range of valuations

As many will attest this season, those valuations have varied significantly, with the difference between the highest and lowest bid sometimes exceeding \$50 per bale. These are commercial decisions made by buyers in a highly competitive market. While it's impossible to know precisely why a particular buyer pays a certain price on a given day, it's likely that they had a specific need for the cotton at that time - and were willing to pay a premium to secure it.

While the indicative daily price is published for a base grade of Middling 36, the reality this season is that relatively few bales have met that standard. As a result, premiums and discounts on spot transactions have shifted significantly.

In the forward market, as shown on most buyers' P&D schedules, there is typically little premium offered for a Strict Middling 21 grade. This is based on the assumption (outlined earlier) that the higher basis included in the contract pricing would result in delivery of Strict Middling. However, in the current spot market, where high grades are in short supply, that previously modest premium has expanded substantially. While a forward contract might include a 25-50 point premium for a Strict Middling 21 grade, today's spot conditions are seeing that premium stretch to anywhere between 300 and 500 points.

Forward Spot Comparison

When comparing forward and spot market outcomes, it's essential to consider these market conditions. It may appear that spot prices are outperforming forward P&Ds - but this is largely driven by the stronger premiums now being paid for the relatively few high grade bales available. In short, the value difference between Strict Middling and lower grades remains significant - something more like the forward P&D.

Ultimately, a bale of cotton - like any commodity - is worth what someone is prepared to pay for it, whether that's months in advance or on a given day. To place blame solely on a forward P&D schedule risks overlooking the fundamental differences between market conditions at the time of contracting versus those at delivery.

Time for change?

Given how much the Australian cotton industry and indeed Australian cotton quality has evolved, some merchants may consider revisiting base grade. For more than 30 years, it has been set at Middling 36 staple however with significant advances in cotton production, Australia consistently produces a higher quality. Shifting the base grade to Strict Middling 37 would recalibrate P&D schedules to better reflect the true value and quality of Australian cotton.

Ends

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