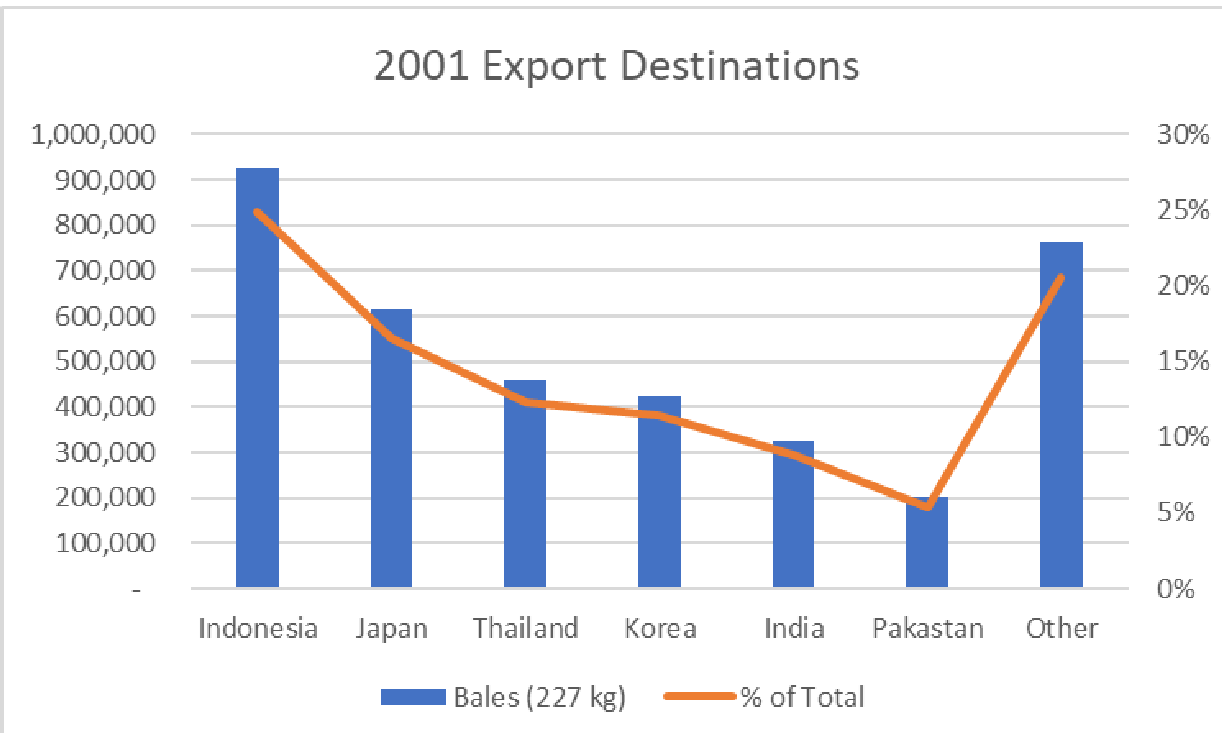
Structural changes to Australian cotton export markets

By Tony Geitz, Australian Cotton Shippers Association

2020 will remain as one of the biggest Australian supply chain shocks we will probably see in our lifetimes for a range of reasons but for the purposes of this article lets focus on international cotton trade.

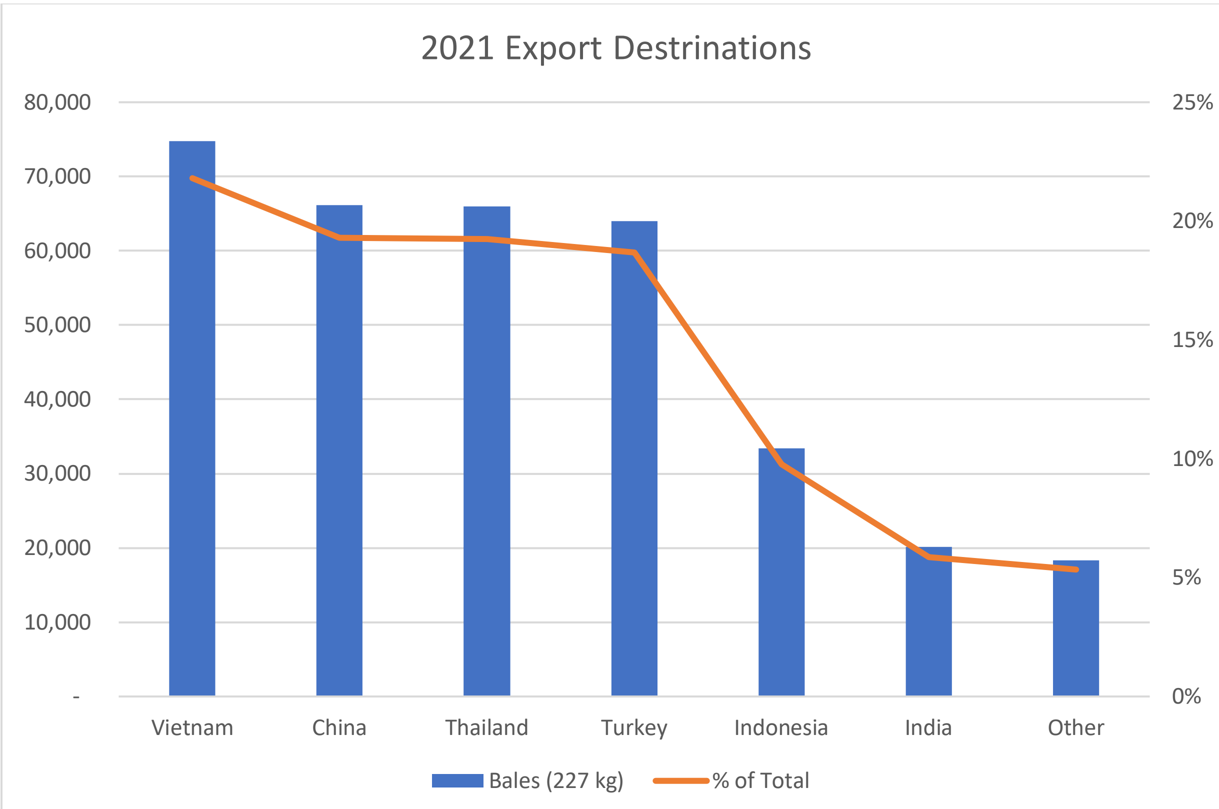
The reasons are a combination of several factors - obviously COVID-19, China's soft ban on Australian cotton, but somewhat understatedly, the broader effect of the US trade deal with China on external markets. Going back 20 years to 2001 let's take a snapshot of what our export market looked like. This is also the same year that China became a member of the World Trade Organisation (WTO) and probably one of the largest watershed moments in global trade.

In 2001 China didn't rank on the top six export destinations for Australian cotton and all six of those ranked importers were located to the point of origin.



By 2003 China had moved into the position of sixth largest importer of Australian cotton and was ranked only slightly smaller than Pakistan. In 2004 China had moved into second place taking 21% of our crop - ahead of Korea but still some way behind Indonesia who was taking 32% of the crop. In 2005 just four years after China's ascension to the World Trade Organisation they became Australia's number one export destination taking slightly below 36% of the crop. The number one position one that China would occupy for some twelve years and at its peak exports grew to a staggering 68% of the crop in 2012.

Today we are experiencing the full extent of the China soft ban. ABARES' most recent data to the end of the first quarter reveals China's imports have fallen to below 20% of the total exports for this period. It's important to bear in mind that the majority of those reported exports would be 2020 crop cotton. Vietnam now year-to-date occupies the number one export position. Thailand, Turkey and China all have roughly the same market share at 19%.



So what does this tell us apart from highlighting the meteoric rise and fall of Australian cotton exports to China? It actually tells a very positive story; our market is adjusting and diverting export volumes to non-China destinations. Our international competitiveness has done a lot of heavy lifting in the last six to nine months. Basis values landed Chinese main ports have decreased in the order of USD 40/bale to one of the most competitive levels we have seen in the last fifteen years.

In a somewhat very fortunate turn of fate, domestic cash values (ex gin) have remained above long-term historical averages and certainly well above break-even levels. How can all this readjustment be occurring without losing more in Aussie dollar basis terms per bale? The short answer is the US-China trade deal. In an effort not to dive too deep into the complexities of this deal, China and the US are doing significantly more agricultural trade volumes than the past in relative terms and this also includes cotton.

ICE Futures will always trade the machinations US balance sheet which is decidedly tighter based not only on the Middle Kingdom's demand for US cotton but also some production concerns. The net result of the combination of these and a couple of other factors has been supportive of ICE values and this has insulated Australian and other origins around the world from the basis decreases required to compete with US cotton in non-Chinese markets. One of the unsolved puzzle pieces though is as we see global ending stocks continue to rise, is that prices are still supporting Australian production. That is also the case for many other producing countries.

So if we believe in the supply and demand fundamentals of a global balance sheet, eventually a pricing signal will have to come that discourages the continuation of building ending stocks outside of the US. Where will that pricing signal come from? If we assume that the US balance sheet remains tight it will continue to be supportive of ICE Futures.

In the context of 2022 crop being one of the largest Australia will produce since 2018, our cotton needs to find "volume" new homes and very actively compete to displace the US and Brazilian bale in every non-China market possible. The only way it can do this is via relative basis values. Let's hope ICE and the AUD/USD exchange rate continue to support good returns for Australian growers.

Ends

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