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The Cotton Market

What can the wool industry learn from this relatively young Australian industry?

Produced for the CRC for Premium Quality Wool undergraduate program by;
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The Australian Cotton Industry

- young industry
- mature marketing philosophy
  – sophisticated techniques
  – PRM is integral
- small by world standards
  – both production and consumption
- significant player in international trading
  – 5-10% of world export market
- no government support
- drought and environment is its worst enemy

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The Players / Sectors

- producers
  - approx. 1500 growers
- production (bale = approx. 165kg)
  - 1997 2.7 million bales
  - 1998 3.2 million bales
  - 1999 3.4 million bales
- marketing organisations (merchants)
  - about ten marketing/merchant organisations
  - 50% Australian based (80% of crop)
- processors (Australia)
  - 10 ginning organisations (1st stage)
  - 5 cotton spinning mills (2nd stage)

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Industry Infrastructure

- 90% to 95% of the crop is exported overseas
- domestic industry consumption
  - 150,000 to 225,000 bales p.a.
- top 30% produce 80% of the crop
- average grower highly geared
  - high capital costs
  - high production costs
- modern farming techniques
  - high technology adoption

Grading / Testing

- Merchants do the grading
  - similar to Sale by Description (SxD)
- uniform grades (types)
  - based on USDA standards
  - micronaire, staple length, trash content, strength, uniformity, colour
- independent classing in Australia
  - applies to grading disputes

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What can the wool industry learn from the cotton industry?

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similarities

- both fibres
- objectively and subjectively measured
- many different grades world-wide
- production is a risky business

differences

- Australia
  - fewer cotton producers
  - higher capital costs per grower
- SxD is universally accepted for cotton
- PRM is a part of life for cotton

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Marketing Differences

- fewer links in the chain
- Australian cotton is uniform
- transparent marketing and pricing
  - artificial effects easing for wool
- Australian wool is more comparable to US cotton
  - diversity of product
  - per capita cost per producer
- Australian wool is a big player in a small market

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Cotton Marketing

- forward contracting dominates
  - up to 80% of crop
- pools
  - offered by merchants
  - average pricing
  - tax management
- cash forward contracts
- price risk must be managed
  - hedging through marketing organisations and financial institutions

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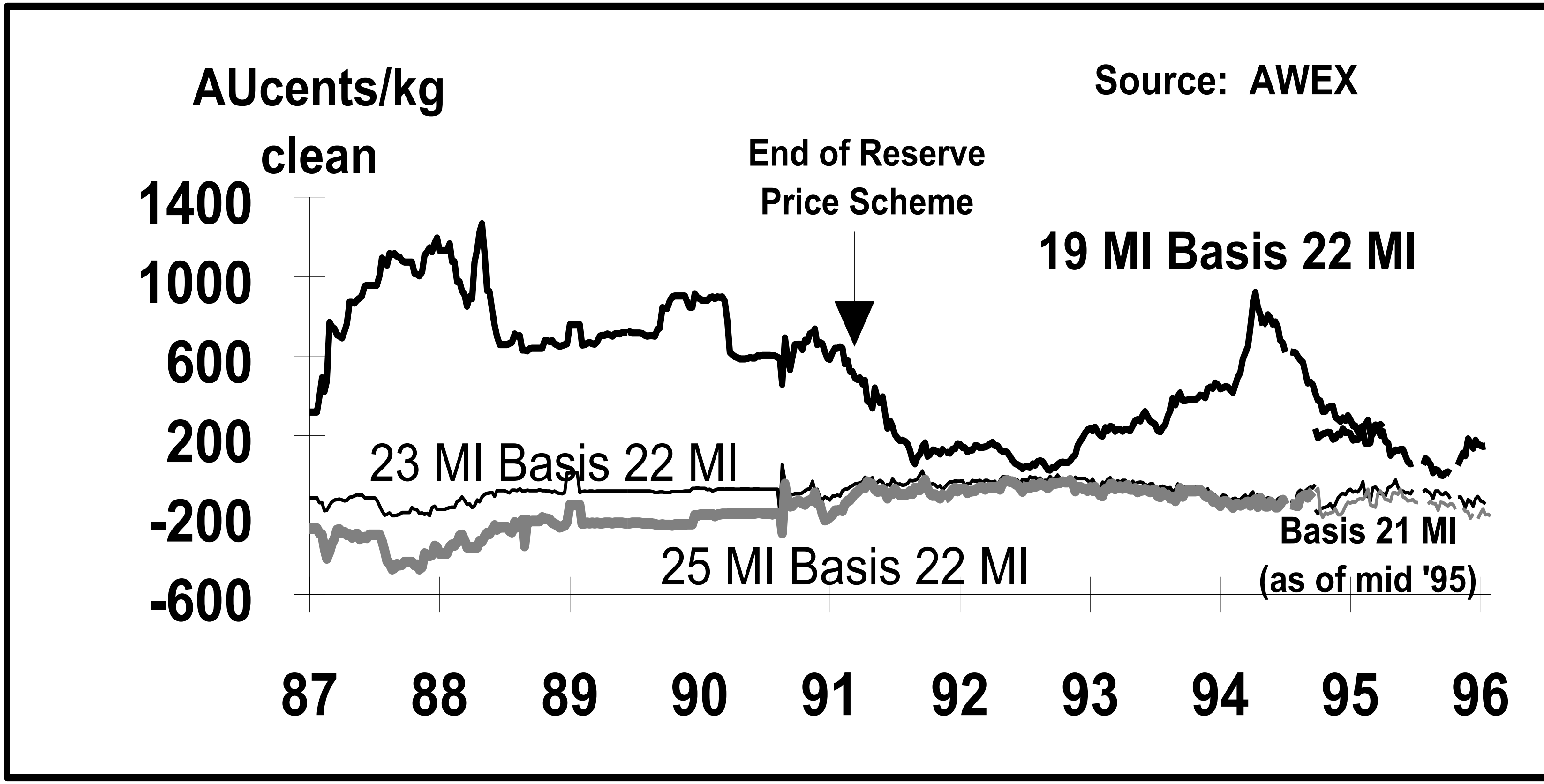
Basis Risk



Australian Wool 19, 23 and 25 MI Basis Futures 1987-1996

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Hedging Techniques

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Merchants

- options
- "hedged to arrive"
- minimum price contracts
- collars
- currency hedging

Financial Institutions

- caps
- collars
- FRA's
- forward starting caps
- etc.

Risk Management Adoption

- Do you think the wool industry is likely to adopt risk management strategies in line with the cotton market?

- Wool Futures
  - volume is growing steadily
- Processors
  - Michells; fully measured wool as part of buying specs
- Forward Contracting
  - supply is contracting
- Wool Producers
  - larger firms are utilising PRM techniques

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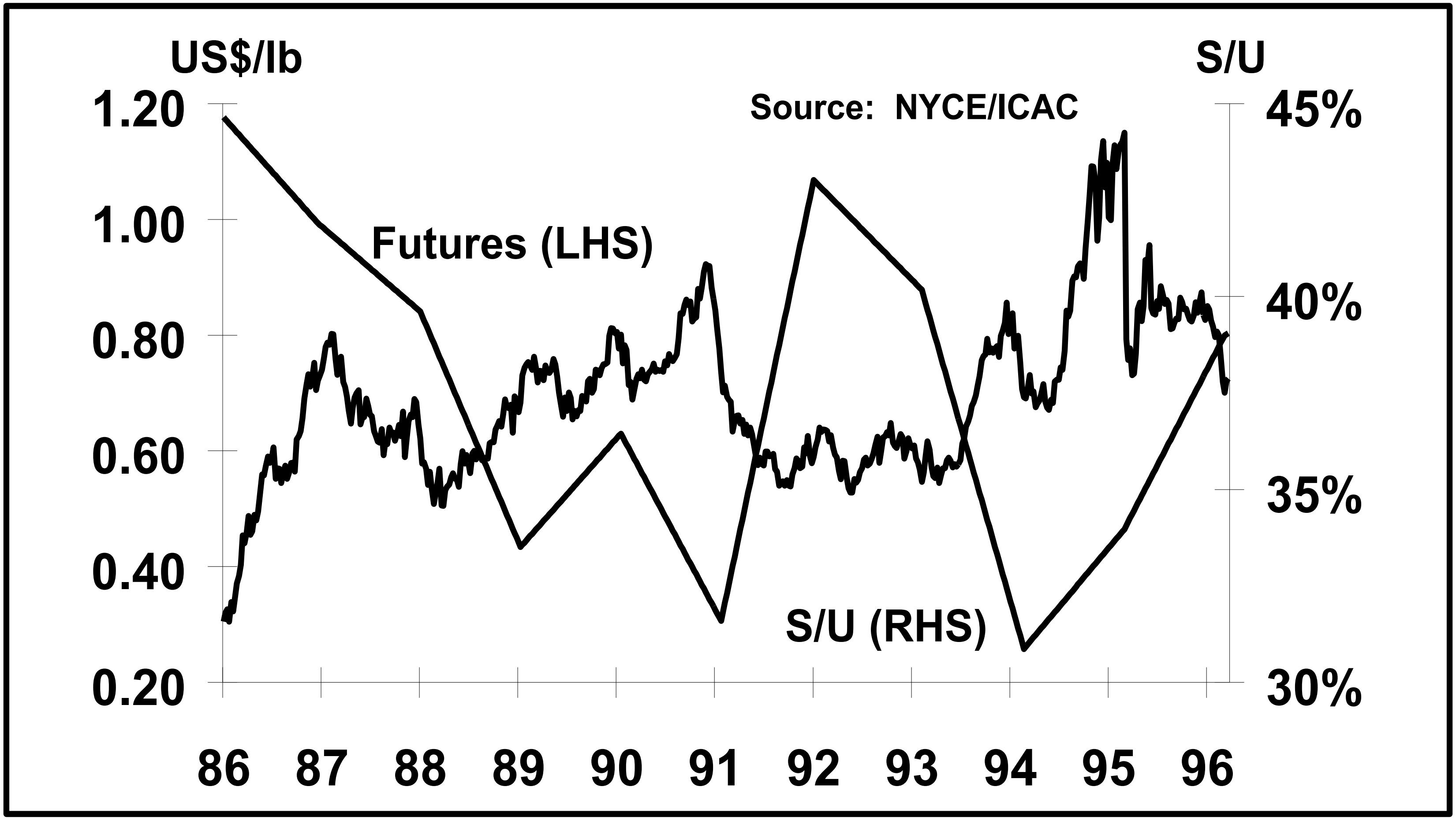
Global Cotton S/U and Price



S/U = Stocks-To-Use Ratio

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www.woolwise.com

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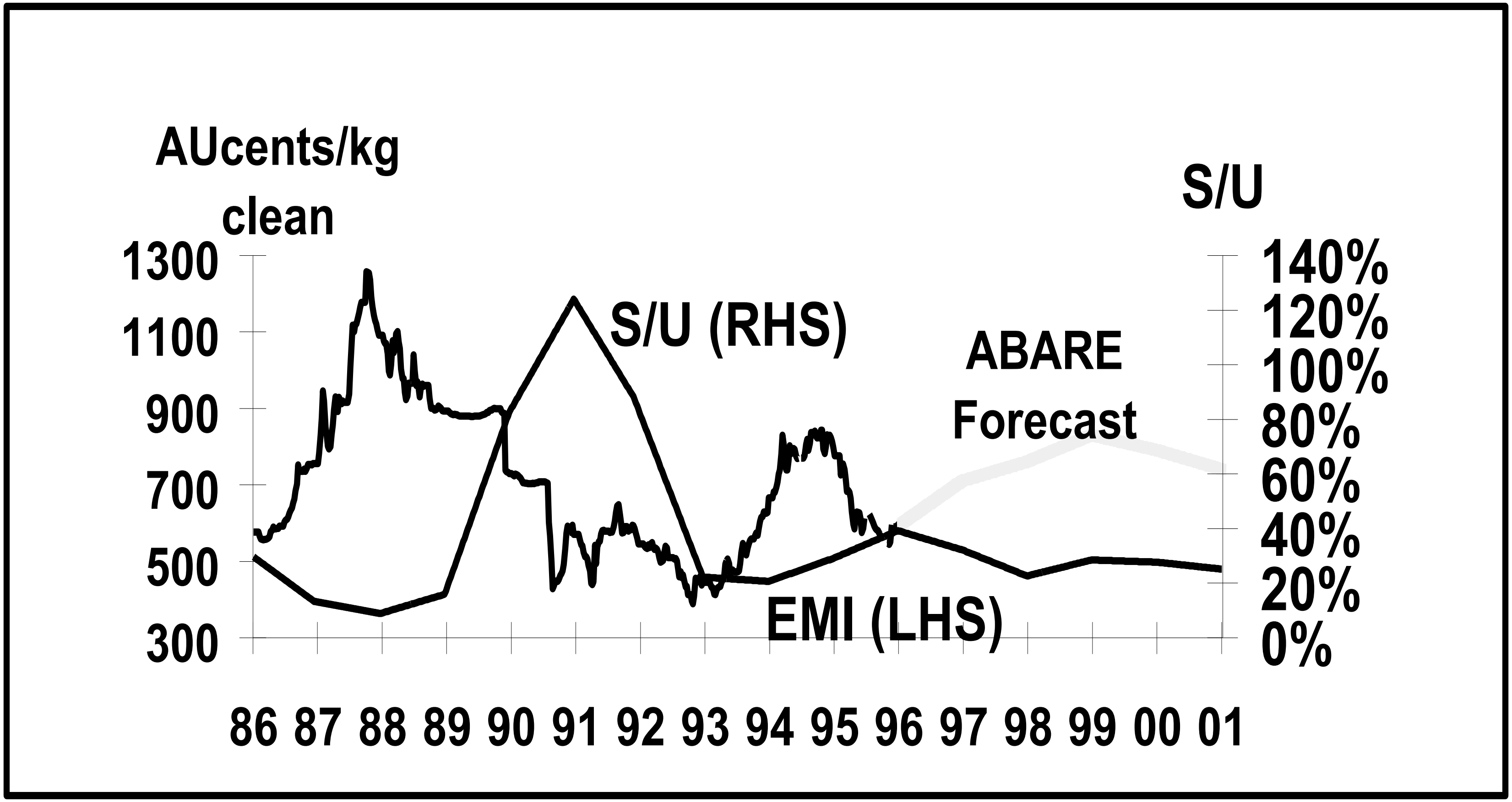
Australian Wool S/U & Price



S/U = Stocks-To-Use Ratio

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Volatility Comparisons

Global Stock and Price Movements 1986 -1996

	Stock / Use Ratio			Price (Weekly Settlement)		
	Range	AVG	s.d. (%AVG)	Range	AVG	s.d. (%AVG)
Cotton	31-45%	37%	10%	0.3045-1.1490 *$/lb*	0.6927	20%
Wool						
Aust.	9 - 124%	43%	79%	389 - 1257 *c/kg clean*	710	28%
Global	5 - 44%	25%	62%			

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Further Reference

- ABARE (1992), *Marketing Alternatives for the Australian Cotton Grower,* AGPS, Canberra

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