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# Cotton Outlook

Special Feature

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ICA - Open to the World



# Let Market Forces Prevail

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Let me begin by saying an already known fact - India is the second largest producer, consumer and exporter of cotton in the world. Rather than going into these numbers it is imperative today to address the influences such a dominant player wields across the cotton globe when there is any form of disruption, which unfortunately is the issue at center stage of the cotton world.

Since 2001, India followed a free trade policy and cotton was exported under open general license. Until recently India was seen as the new, emerging, giant exporter of the fiber after the United States. However, events during the last several months have put this belief to serious questioning.

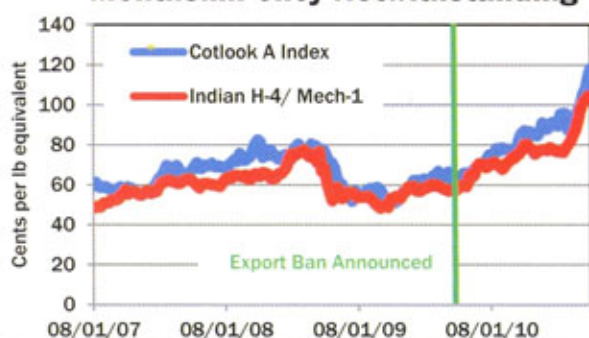
A string of measures announced by the government has cast a shadow upon local farmers, merchants and exporters, not to mention importing textile mills worldwide. Starting with imposition of export duty and ban on export registrations in April 2010, the government decided in June once again to allow cotton exports, starting October 1st. In September, the government announced plans to commence export registrations in early October, but delaying shipments until a month later, with a

mandated 45 days window of shipment performance. Effectively, between November 1st and December 15th, exports were limited to just 5.5 million bales. The number of bales allowed to be exported was probably half the amount India would have otherwise exported in a free export regime. Echoing the sentiments gleaned from numerous views put forward by the global cotton trade, it can be inferred that these arbitrary and ad-hoc policies have had major ramifications both for the sellers and for overseas buyers resulting, in major defaults and disputes, the effects of which have been catastrophic and will reverberate for long.

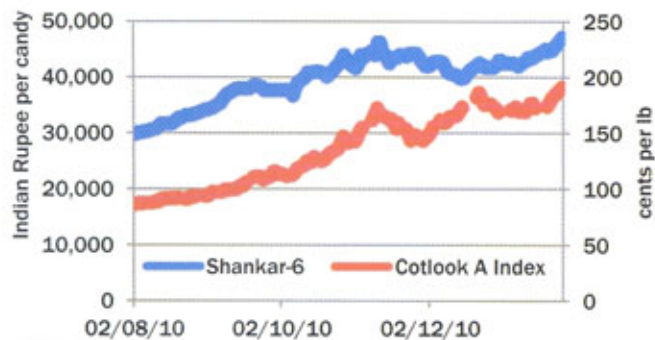
The government's actions were taken with the intention of ensuring adequate supplies for the domestic textile industry and throttling back climbing prices. While the restrictions prevented exports temporarily, it did not protect the textile sector from the sharp rise in cotton prices, domestically or worldwide. In concert with tightening world stocks, the USDA says the ban helped drive up 'A' Index prices by nearly a third, to a record high by late September, reaching an unprecedented 118.00 cents per pound. Similarly, domestic prices rose, in tandem with soaring global prices, to record levels for most dominant varieties in the country. Despite its best intention to contain domestic prices the government's interference in the open market cotton trade backfired.

Today, overseas buyers have compromised to a great extent and swallowed their mercantile pride due to the tight cotton supply situation. Once the world rebuilds stocks, which will happen at some stage, it will be very difficult to sell Indian cotton. In future, buyers will be extremely wary of buying Indian cotton for their consumption; Indian cotton will erode its true value, as buyers will price in all of the risks experienced this year, thereby leading to Indian cotton being heavily discounted against other comparable growths.

**Indian and Global Cotton Prices Soar Over Recent Months....Policy Notwithstanding**



## Gains in Indian Shankar-6 Prices Match Higher Global Prices in 2010/11



The reputation of India as a reliable source has been seriously damaged and the efforts made so painstakingly over the years to establish Indian cotton in world markets have been categorically nullified.

Looking inward, there are equally large challenges that the cotton trade faces today. Market turbulence and huge price movements inevitably strain any

system. In face of record high prices, Indian exporters holding valid bargains were faced with mass defaults on their forward contracts from ginners, and incurred huge losses as they honored their commitments to buyers at the destination. It is undoubtedly very satisfying for one party to benefit from an advantageous market situation but eventually the pendulum will swing. Business through a handshake will give way, in future, to iron-clad contracts. The implications of a breakdown in the mechanism of forward contracting, and the consequences, therefore, of being forced to rely purely on a spot market, would be disastrous for suppliers and consumers alike; forward business in India will suffer a complete collapse.

The urgent need of the hour is to develop a vibrant cotton futures market for buyers and sellers to use as a hedge, to demonstrate a quick and effective arbitration system and bring guard against those who have shown that they are not prepared to abide by the rules when the situation does not suit them, and introduce a default list of non-performers.