

## COTTON ECONOMIC AND POLICY SITUATION / OUTLOOK

US cotton is in a precarious situation. World demand (use) of cotton continues to increase and the US is the world's largest cotton exporter, yet US acreage was down significantly in 2007 and very likely will decline further in 2008. Prices for all major row crops are high due in-part to fuel-driven demand/price increase for corn. Prices for cotton for 2008 have improved in an effort to bid land into production. Price is not the only component in the equation, however. Costs of production are also up and will play a major role in farmer's decisions for 2008.

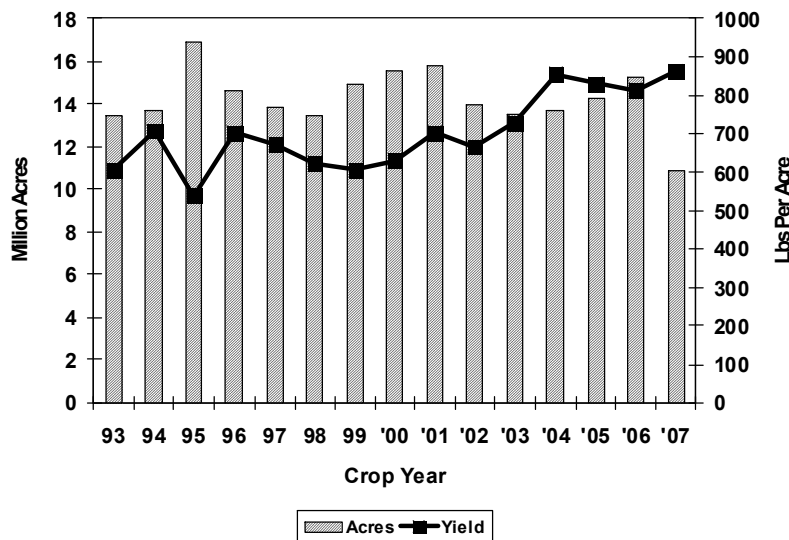
### US Acreage and Supply

In August 2007, USDA estimated the 2007 US crop at 17.35 million bales with an average yield of 783 lb/A. If realized, this would have been 4.24 million bales less than 2006. In each monthly estimate to follow, however, the crop continued to improve. In December, the crop was estimated at 18.99 million bales on an average yield of 864 lb/A.

Therefore, just over 1.6 million bales have been added to the US crop. In short, the drought in the southeast, while devastating to yields in Alabama and the Carolinas, did not have the overall impact expected (especially in Georgia), and the crop in Texas also did much better than anticipated. In fact, the current estimated yield of 864 lb/A would be a new US record yield, breaking the previous record yield set in 2004.

In 2007, US cotton acreage declined 29.1 percent -- from 15.27 million acres planted in 2006 to only 10.85 million acres. This was the lowest cotton acreage since 1989. The large decline in acres in '07 was due to higher expected prices and net returns from alternative crops such as corn and soybeans but also because cotton prices (although improved since then) were not yet improved during the planting season and when farmers were making planting decisions.

**US Cotton Acres Planted and Average Yield Per Acre**



Looking ahead to 2008, cotton prices are currently much improved. There remains uncertainty, however, as to whether such improved prices are high enough and whether cotton can maintain acreage at 2007 levels.

Acreage in 2008 may decline further. Given strong competition from corn and soybeans, the best-case-scenario would seem to be that acreage could hold level with '07. US cotton yields appear to now be on a "new plateau". The past 5 years (2003-2007), yields have averaged 819 lb/A. This compares to 647 lb/A for 1998-2002 and 646 lb/A per acre for 1993-1997. Cotton could enjoy a yield/risk advantage compared to other crops which farmers might consider in acreage decisions.

If acreage were to decline to around 10 million acres (about 1 million acres less than 2007—a number often currently tossed around by industry analysts), this could produce a crop of only about 16 to 16.5 million bales depending on yield and acreage abandonment. Subtracting about 4.5 million bales for US mill consumption, this would leave only 11.5 to 12 million bales for export without drawing down on carry-in stocks. This would certainly be a low level of exports by recent standards. In other words, if acreage and production are reduced further and exports can remain brisk, potential exist for stocks to decline and this should support prices.

### **Foreign and World Supply and Demand**

World demand (use) of cotton continues to trend upward. The US textile mill industry is steady to declining, but foreign demand remains strong. Foreign mill demand is expected to increase 5.23 million bales or 4.4 percent for 2007-08. In contrast, foreign production is expected to be down slightly from 2006 and, therefore, world and foreign stocks are expected to decline markedly.

As a result of growing demand but declining foreign production, US cotton exports are expected to rebound from the decline experienced in 2006-07. China's production has increased in recent years but so has its mill industry. For 2007, Chinese crop production is expected to be similar to 2006, while mill use is expected to increase 5 million bales.

Foreign stocks are expected to dip to the lowest level since 2003 and the stocks-to-use ratio (one measure of how tight supply is relative to demand) is expected to drop to the lowest level since 1994. A tightening foreign supply/demand picture combined with possible reduction in US cotton production for '08 should keep cotton prices well supported.

### **2008 Price Outlook**

If cotton acreage is to remain at 2007 levels, prices and net returns must compete with corn and soybeans (and also peanuts in Georgia and some other states). Yet prices cannot be too high as to retard exports. At this writing (late mid December 2007), prices for the '07 crop are around 63 to 64 cents basis the March futures and around 70 to 71 cents for the '08 crop basis the December futures.

The 2007 crop will be larger than anticipated. While cotton must be competitive and while there is concern for acreage in 2008, the larger than expected 2007 crop has, for the short-term, put a little damper on the fire. Seventy-cent cotton for 2008 can be and is competitive in some situations. Yet, most cotton producers are looking for and expecting better.

US production, while larger than anticipated for 2007, will still be well below 2006. As mentioned previously, the outlook for 2008 is for even less US production if acreage is further reduced. Because the US is the largest cotton exporter, exports tend to follow the quantity available tempered by production/available supply in other exporting countries.

Prices for the 2008 cotton crop will depend on US acreage, production, and exports. As long as exports of the '07 crop are good (and they are expected to be), concerns about 2008 acreage should keep prices supported at least into spring '08. Pricing opportunities, currently around 70 to 71 cents, could improve and producers eventually have opportunities to price around the mid-70's as we move into spring and summer. This is contingent, however, on exports remaining strong and continued uncertainties about plantings and crop conditions.

The price of cotton is linked to the need to be competitive with high-priced corn, soybeans, and peanuts. If prices of these other crops should falter- cotton would also likely follow.

### **Farm Bill Status and Update**

At this writing, the 2007 Farm Bill has finally made it through the Senate and now goes on to Conference Committee. In Conference, differences between the Senate bill and the House bill (passed in July) must be hammered out.

The Senate bill made it through, dodging several proposed amendments that would have made major changes in payment limitations and the AGI cap. These amendments would have had a major impact on southeast and Georgia agriculture had they not been defeated.

As the farm bill now goes to Conference, neither the House nor Senate versions contain any major departure from the 2002 Farm Bill as it relates to Title I (the commodity programs). There is some "tweaking" but no major changes that would appear a threat to the economic viability of Georgia crop farms.

Both House and Senate bills do contain optional income protection programs. The House proposes a revenue-based counter cyclical payment (RCCP) program containing both a yield and price component. Producers would have a one-time option to remain with the current CCP program or switch to RCCP. The Senate proposes an Average Crop Revenue (ACR) program which bases payments on state average yields. Producers could choose ACR instead of the current DCP and LDP payments. While either or both of these would be a major departure from the 2002 Farm Bill, each would be optional.

Both House and Senate bills would eliminate the 3-entity rule and replace it with direct attribution but maintain the separate payment limitation for peanuts. Both also contain reforms in the AGI (Adjusted Gross Income) cap. In either bill, the AGI test for program payments eligibility would be lowered. These changes are not expected to represent a challenge for most Georgia farms.

### **Georgia Situation and Overview**

Georgia farmers planted 1.04 million acres of cotton in 2007—down 360,000 acres (26%) from 1.4 million acres planted in 2006. Cotton, however, still remains the state's number one row crop and Georgia still ranks second in the US in acreage planted. Can the state remain above 1 million acres in 2008? If not, it would be as it was in 2007, the lowest acreage since 1994.

Several factors contribute to what farmers and regions have an economic comparative advantage to produce. Among these factors are agronomics (soils, weather, yield, etc.), cost of production, price, and access to markets. From a purely agronomic perspective, corn and soybeans do not have the advantage on most Georgia farms. But despite that, acreage of these crops expanded in 2007 due to high prices and cost advantage relative to other crops. While cotton and peanuts may have the agronomic advantage on many Georgia farms, acreage will likely continue to moderate as long as corn and soybean prices remain very high.

The following tables are early estimates of how net returns may compare for various crops for the 2008 crop year. Both non-irrigated and irrigated expected prices, yields, income, costs and net returns are shown for comparison. Expected yields and variable costs were calculated using the 2008 UGA enterprise budgets for corn, cotton, grain sorghum, peanuts, soybeans and wheat. The 2008 budgets may be accessed online at <http://www.ces.uga.edu/Agriculture/agecon/agecon.html> or by contacting your local County Extension Agent. The following estimates of net returns should be used as a guideline because individual operations will vary.

Relative net returns appear to favor peanuts, soybeans, and cotton relative to corn. High fertilizer cost and water requirements could work to a disadvantage for corn production in the upcoming season. Corn price higher than the price assumed in the comparison, however, would alter the results and bring corn equivalent to other crops. Peanut decisions will hinge on contract availability and price. Wheat, typically used primarily as a winter cover crop, due to high prices may be attractive as a grain crop and then followed by double-crop soybeans or cotton. If double-crop, soybean and cotton yields and costs should be adjusted accordingly. High prices across the board for many crops does not make the decision easy. Producers should also consider risks and crop rotation benefits.

**Comparison of 2008 Per Acre Net Return Above Variable Costs, Non-Irrigated Production**

	<b>Expected 2008 Avg Price <sup>1</sup></b>	<b>Expected Yield</b>	<b>Income</b>	<b>Variable Costs <sup>2</sup></b>	<b>Net Return <sup>2</sup></b>
Corn	\$3.75/bu	85 bu	\$319	\$252	\$67
Cotton – BR	\$0.70/lb	700 lb	\$490	\$380	\$110
Grain Sorghum	\$3.75/bu	65 bu	\$244	\$195	\$48
Peanuts	\$475/ton	1.35 ton	\$641	\$471	\$170
Soybeans	\$9.50/bu	30 bu	\$285	\$174	\$111
Wheat	\$5.00/bu	55 bu	\$275	\$151	\$124

<sup>1/</sup> Prices are based on mid-late December 2007 market conditions and future expectations. These may be subject to change as market conditions change.

<sup>2/</sup> Excludes fixed costs, land rent and any custom harvesting, storage, hauling, etc., if necessary.

**Comparison of 2008 Per Acre Net Return Above Variable Costs, Irrigated Production**

	<b>Expected 2008 Avg Price <sup>1</sup></b>	<b>Expected Yield</b>	<b>Income</b>	<b>Variable Costs <sup>2</sup></b>	<b>Net Return <sup>2</sup></b>
Corn	\$3.75/bu	185 bu	\$694	\$543	\$150
Cotton – BR	\$0.70/lb	1,100 lb	\$770	\$524	\$246
Grain Sorghum	\$3.75/bu	100 bu	\$375	\$251	\$124
Peanuts	\$475/ton	1.85 ton	\$879	\$599	\$280
Soybeans	\$9.50/bu	55 bu	\$523	\$251	\$272
Wheat	\$5.00/bu	75 bu	\$375	\$235	\$140

<sup>1/</sup> Prices are based on mid-late December 2007 market conditions and future expectations. These may be subject to change as market conditions change.

<sup>2/</sup> Excludes fixed costs, land rent and any custom harvesting, storage, hauling, etc., if necessary.