

The Global Outlook for Cotton

An address by
Lawrence H. Shaw, Executive Director
International Cotton Advisory Committee
Washington DC USA

At the annual meeting of the
American Cotton Shippers Association
Naples, Florida
May 15, 1998

It is a pleasure to be with you this morning to discuss the economic outlook for cotton from the perspective of the staff of the International Cotton Advisory Committee (ICAC). The focus of the ICAC has since its founding in 1939 been the observation of the world cotton situation. In the 12 years I've served as Executive Director, I've tried to extend the meaning of the term "observe." First to regular forecasts of cotton prices, to forecasts one and two seasons ahead, to estimates and forecasts of supplies by type, to world export sales and now to daily updates of the forecasts on the Internet.

In these 12 years and in the 20 years I spent forecasting the cotton situation before joining the ICAC, I have been looking for the perfect cotton season, in which production and consumption are balanced and where the outlook is for stable prices.

The 1997/98 season looked like a good candidate. World production and consumption seemed likely to be at about the same level (**Chart 1**) and prices, according to our models were likely to be at the 78 cent level for the Cotlook A Index. But the prospects for the perfect season started dwindling early in the season as East Asian currencies became unglued and cotton prices started dropping.

Initially we thought the price drop was due to the possibilities of cancellations or postponements of sales and an eagerness of sellers with unsold supplies to get their business accomplished as soon as possible. As the season developed, the cancellations and defaults didn't seem to be occurring and the economies of many of the countries such as Thailand and the Republic of Korea began to stabilize, even though the situation in the biggest importer in the region, Indonesia, remained uncertain.

Then the other shoe dropped. China, whose export potential had declined as a part of the currency revaluations, announced plans to sell excess agricultural commodities. China's textiles had lost significant competitive advantage to Thailand and Indonesia with the new currency values. Manufacturers, who had abandoned markets to China in these countries, now were able compete once again. China on the other hand was reluctant to devalue its currency.

At first there was the tender for 300,000 tons. Then an announcement that government stockpiles would be reduced by 500,000 tons.

We have known for some time that China had excess stocks of cotton. Domestic policies and the complexity of the Chinese situation had led to significant imports of cotton from other countries in the last three years despite adequate production to meet demand in the aggregate. The loss of competitiveness in textiles and in many other industries appears to have been the trigger to a change in Chinese policies that non-Chinese observers might have suspected many years earlier.

With the new scenarios of China exporting significant quantities of cotton in 1998/99, our statistical models suggest that the Cotlook A Index will average about 73 cents in 1998/99, about the same level likely to be averaged in the 1997/98 season.

China in Detail

Because China has been the key factor determining the new outlook for 1998/99, let's look at the China situation in detail.

This season China is likely to have stocks of 4 million tons (18.4 million bales) (**Chart 2**) at the end of this July; we have indications that they could be a bit larger. What we do know is that stocks rose an estimated 2 million tons from 1993/94 to 1996/97. In 1997/98, stocks have been essentially unchanged. With all figures about China, there is some room for error. Perhaps the low estimate for Chinese stocks at the end of 1996/97 is 14 million bales (3 million tons) and the high estimate 23 million bales (5 million tons) (**Chart 3**). Most of the discrepancy is in the category of government stocks, held by the Bureau of Cotton and Jute and in the so-called State Reserve, located in warehouses in non-cotton areas. But stocks are also held by the military, farmers, textile mills and non-mill users of cotton. Aside from the use of these excess stocks to provide export revenue, it would seem that government policy might be to reduce stocks to the 2-3 million ton level.

The Chinese government lowered prices offered to farmers in 1998/99 (**Chart 4**). Prices have clearly been above international levels these past two seasons. As a result we would expect area to decline; however, part of the lower price will be offset by input subsidies. Officially, the Chinese government expects area to be unchanged in 1998/99, as Xinjiang's area rises and other regions experience declines. In the last six years, the area planted to cotton in Hebei, Henan and Shandong, the largest cotton region of China in the late 1980s and early 1990s, declined from 3.8 million ha to an expected 1.5 million ha this coming season.

Chinese cotton yields were quite high on a national basis this last season (**Chart 5**), probably due to regional shifts. There is little in the way of uptrend in Chinese yields, as they seem to have reached their potential. Somewhat less than record yields this coming season will result in a 4 million ton (18.4 million bale) crop.

China is using about 4.8 million tons (22 million bales) (**Chart 6**) 4 million tons in textile mills and 800,000 tons in non-mill uses. The government is enforcing a reduction in textile capacity and lower use is expected in 1998/99. To the extent that there is excess production of textile products in China at present, China's reduced competitiveness with East Asian countries will accentuate it.

Exports plus the gap between production and consumption will go a long way toward reducing stocks, especially if imports are held in check. We do not expect state-owned mills to import cotton in 1998/99. Imports by joint ventures are estimated at 200,000 tons or 1/3 of their use. Exports are currently estimated at 425,000 tons, the 225,000 remaining from the 300,000 ton tender and the additional 200,000 reduction in state stocks announced recently. The switch from being a net importer of 800,000 tons (**Chart 7**) to a net exporter of 225,000 tons will have a substantial impact on cotton prices. Generally our models suggest that a 100,000 ton change in China's net exports causes a 2 cent change in the Cotlook A Index.

The World Consumption Outlook

China is not the only game in town and what is going on in China does not reflect the overall demand for cotton. Let's now look at the fundamentals for cotton demand.

First, textile mill activity and cotton consumption do not go on in a vacuum. The basic stimulus for cotton demand is the world economy

Changes in textile mill fiber consumption track the changes in the world economy (**Chart 8**). The increases in world GDP in the last several years have been substantial (**Chart 9**). The International Monetary Fund had expected world economic growth to continue at 4% or so in 1998. However, the Asian economic crisis led to a revision in this outlook to around 3% earlier

this year. It is possible that we have not fully appreciated the impact on the world economy of the changes which are going on in East Asia. These countries had been the backbone of a substantial portion of the world economy, growing at rates in excess of 7% a year. Now they are expected to contract at about the same rate and the IMF's revision may be just the first in a series of reassessments of the world situation.

Even 3% world economic growth leads to significant increases in world textile fiber consumption. However, the reality which we must deal with is the fact that most of this growth is going to synthetic fibers (**Chart 10**). Cotton's share of world fiber use has declined about 5 percentage points in recent years (**Chart 11**). Current prices are helping to stem the declines, but the problem has not gone away.

World cotton use has increased in recent years (**Chart 12**) as the negative impact of the restructuring of the economies of the former Soviet Union and its Eastern European allies have waned. Most of these economies were using cotton at a rate which couldn't be sustained in the free market. Plus their internal demand was weak. Now most of the economies in the region are showing positive economic growth and contributing as opposed to subtracting from world textile fiber consumption growth. However, the declines in East Asia are expected to lead to a leveling off in world cotton use in 1998/99.

The real strength in cotton demand has been in the USA. North American cotton use has increased steadily (**Chart 13**) and net domestic consumption in the USA, or mill consumption plus imports of textile products less exports of textile products) took still another jump in 1997 (**Chart 14**).

Doing the arithmetic, I think you can see that without the growth in cotton use in the USA, world cotton use would be declining.

We earlier noted that Chinese cotton use is not rising. Recessions in India (**Chart 15**) and Brazil (**Chart 16**) are putting a damper on world cotton use. East Asian cotton use has been declining for a number of years (**Chart 17**) but the increased competitiveness of these economies may lead to a slight reversal in 1998/98. The outlook for the Japanese economy, which is the source of final demand for many of the products of these countries, is bleak. Net domestic consumption (**Chart 18**) of cotton in Japan is expected to decline further in 1998/99. New currency parities are likely to lead to a reversal of the declines in Korea (**Chart 19**). US export sales to both Thailand and Indonesia seem to be holding up well (**Charts 20 and 21**).

World Supply Outlook

In general there is a relation between cotton prices and production (**Chart 22**). Thus world cotton production has declined in the last three seasons with lower cotton prices (**Chart 23**).

Production is likely to decline in China, and be relatively unchanged in both Uzbekistan and Turkey. Production could rise in India and Pakistan assuming some recovery in yields from this past seasons when actual output was substantially below levels expected early in the season.

World yields are not growing (**Chart 24**). In fact, there has been no increase in world yields in the last six years. Since the ICAC has kept records, there has been no six year period in which yields didn't increase. Cotton yields are also not rising in the USA (**Chart 25**). It appears that we are on a kind of yield plateau, requiring a new breakthrough for yields to rise in major countries and the world.

US production in 1998/99 is likely to fall about 13%. Production is likely to be slightly higher in the Southeast and lower in other regions, with the major drop occurring in the Mid-South. As a result of these regional changes, the supply of cotton by type will show the largest declines in medium types, with smaller drops in the production of other types.

The Price Outlook

From an analysis standpoint, we separate China from the Rest of the World. We look at stocks in the world outside of China and then we factor in China's impact through its foreign trade, whether China is adding to supplies elsewhere in the world or drawing these supplies down. There are two reasons why this procedure works: We are never quite sure about the stock situation in China; and China's status as a net importer or exporter doesn't necessarily follow logically from the supply situation in China, yet it is China's activity as either a large importer or a large exporter that affects prices.

Production of cotton outside of China is expected to continue to drop in 1998, for the third year in a row (**Chart 28**). With world demand holding, the ratio of stocks at the end of the season to use during the season will decline (**Chart 29**). This indicator is inversely related to cotton prices and thus based on supply and demand changes outside of China there will be a tendency for prices to rise.

However, the supply tightness outside of China will be relieved by Chinese exports (**Chart 30**). China was a significant net importer of cotton in 1994/95, 1995/96 and 1996/97. But exports at the end of this season combined with reduced imports will lead to cutting China's net import position by more than half in 1997/98 and reversing it to a net export position in 1998/99. It is assumed that China will import 200,000 tons and export 425,000 tons next season.

The combined result of increased tightness of supply outside of China and China's trade will be little change in the average of cotton prices from this season to next season. Even with the low level of the Cotlook A Index at present, this measure of prices will average about 72 cents in 1997/98, Our models suggested that the average level of the Cotlook A Index in 1998/99 will be 73 cents.

What about the premiums and discounts for various types of cotton in 1998/99?

The premium for Pima cotton has held in 1997/98 (**Chart 31**) as increased supplies permitted basic demand for this type of cotton to be met at slightly lower prices. US Pima seemed to be sold out several months ago, but the export sales kept rising. Egypt has large stocks but is holding its price unchanged despite growing evidence that production in 1997/98 was substantially above official estimates. The supply outlook for 1998/99 is for lower production in both the USA and Egypt. Area planted in the USA has been hampered by the weather, particularly in California. The Government of Egypt did not announce a guaranteed price for growers this season and farmers, evidently expecting the worst, planted 100,000 acres less than expected. Still Egypt will have large stocks. However there is a reluctance to offer this cotton to the market at reduced prices. Thus the premium for Extra Fine cotton is likely to be maintained next season at about 60%.

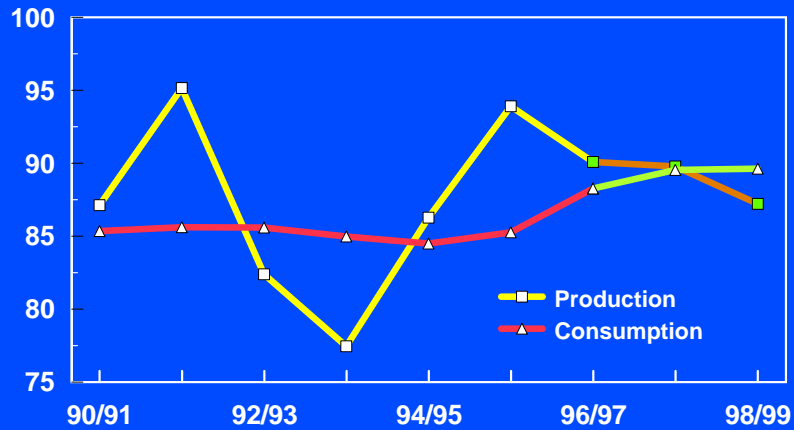
Fine cotton is typified by SJV. The weather situation in California is likely to lead further supply reductions for fine cotton and the premium for SJV types (**Chart 32**) is likely to rise in 1998/99; the average premium in 1997/98 to date has been 14%, but the current premium is substantially above that at 24%. A higher premium is likely to characterize most of 1998/99.

The discount for coarse count cottons has been extremely low and shrinking in 1997/98. At present there is insufficient supply of these types being offered in the market for Cotlook to quote a B Index. The tightness of supply of these types is likely to continue in 1998/99 and it may be that there will be little difference in the price of B and A Index type cottons.

Whether 1998/99 will be a good year or bad year will depend on your perspective, but it hardly seems like a perfect year. And I guess I will just have to go on looking for that perfect season next year.

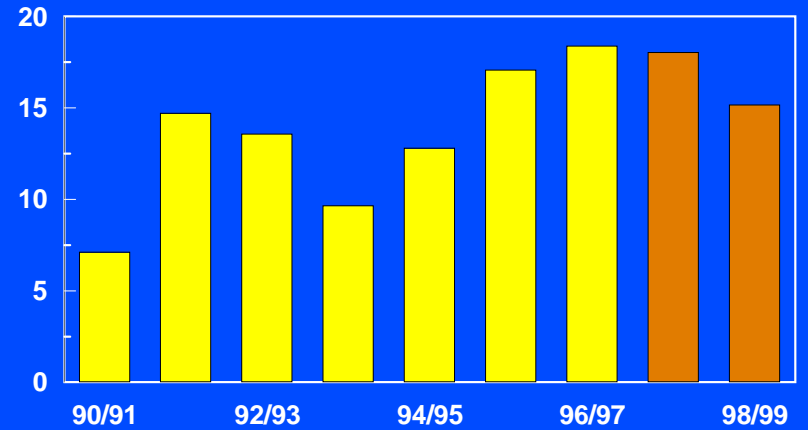
WORLD COTTON

Million Bales



ENDING STOCKS: CHINA (M)

Million Bales

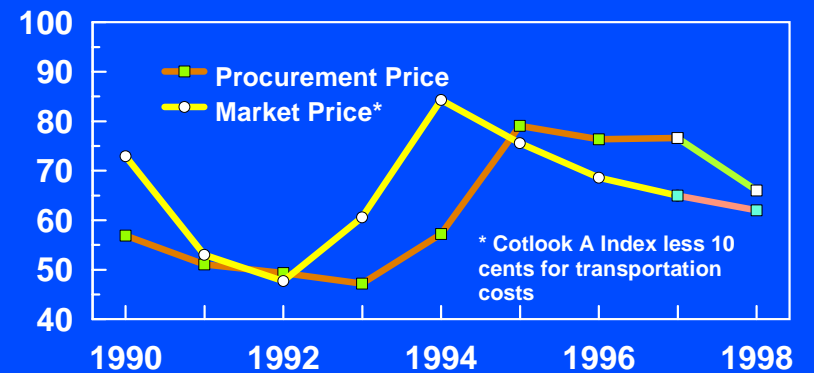


1996/97 China End Stks

	Low Est. Mil. Bales	High Est. Mil. Bales
Govt.	10	16
Mill	2	4
Farmer	1	2
Other	1	1
Total	14	23

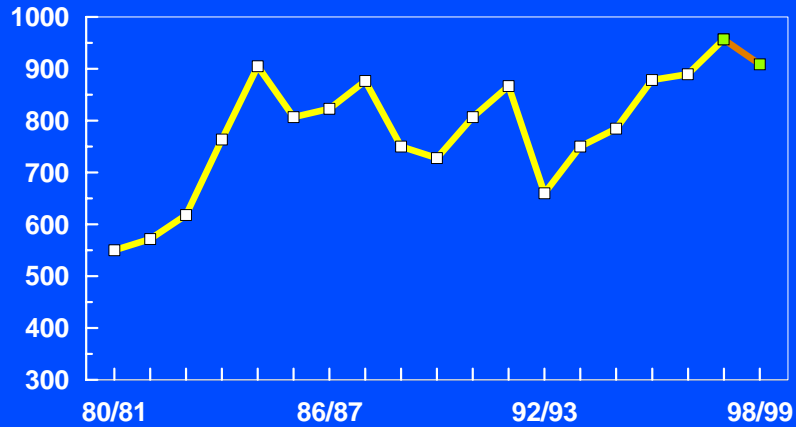
CHINA (M) COTTON PRICES

US Cents per Pound



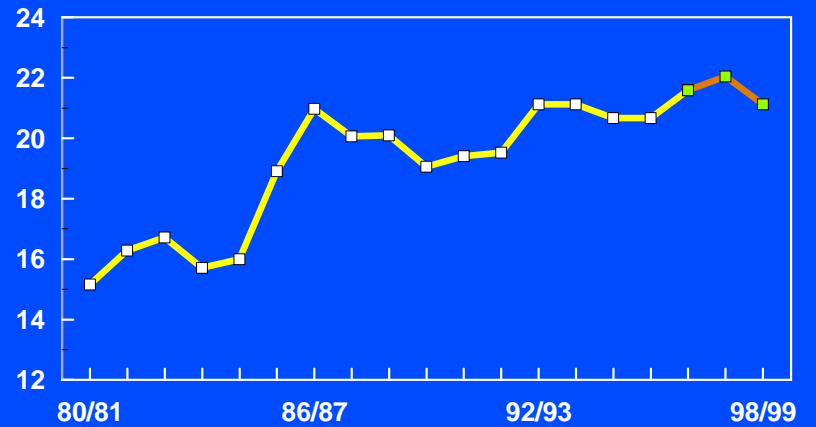
COTTON YIELDS: CHINA

Pounds per Acre



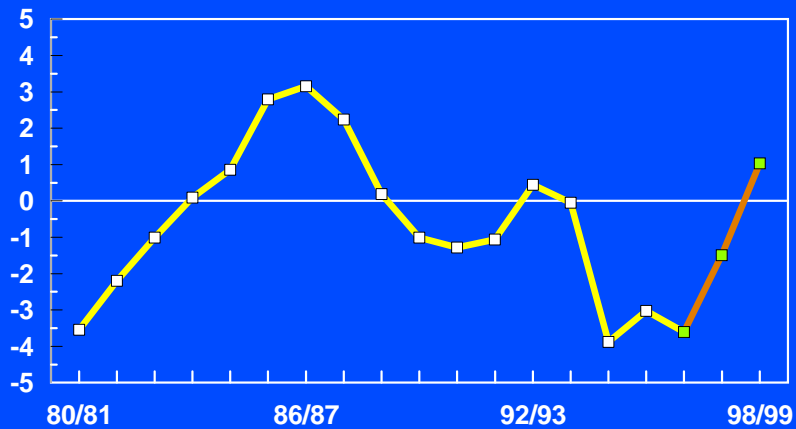
CONSUMPTION: CHINA (M)

Million Bales



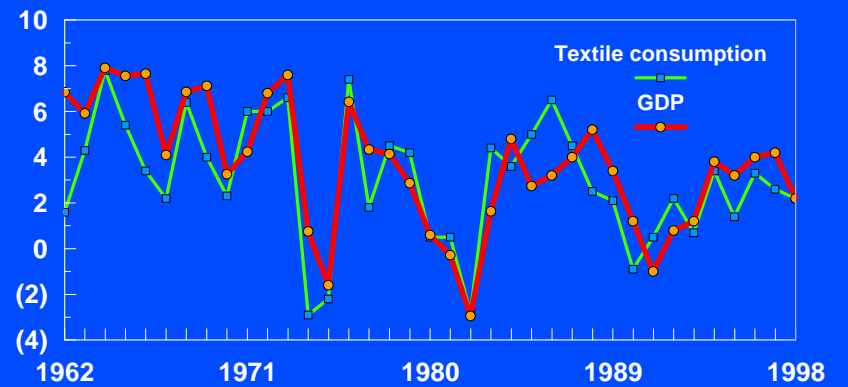
NET EXPORTS: CHINA (M)

Million Bales

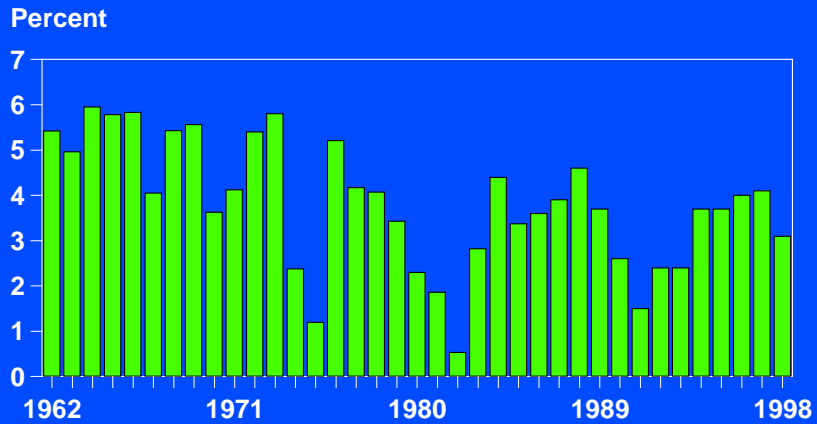


WORLD ECONOMIC PERFORMANCE AND TEXTILE FIBER CONSUMPTION GROWTH

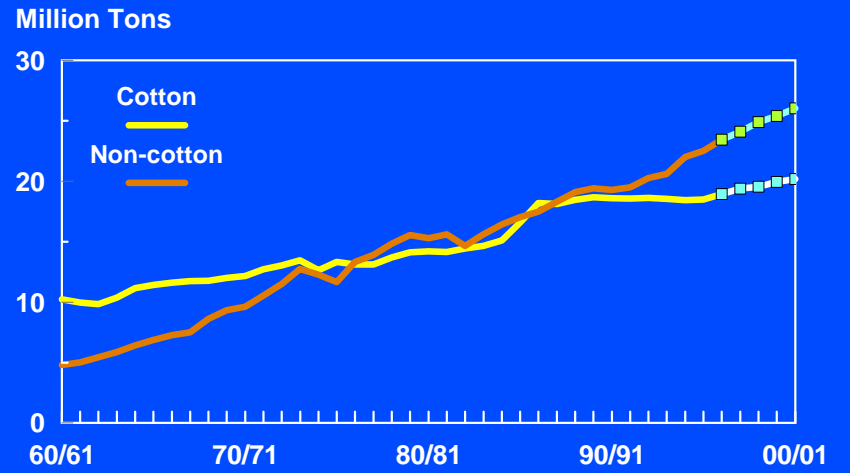
Percent



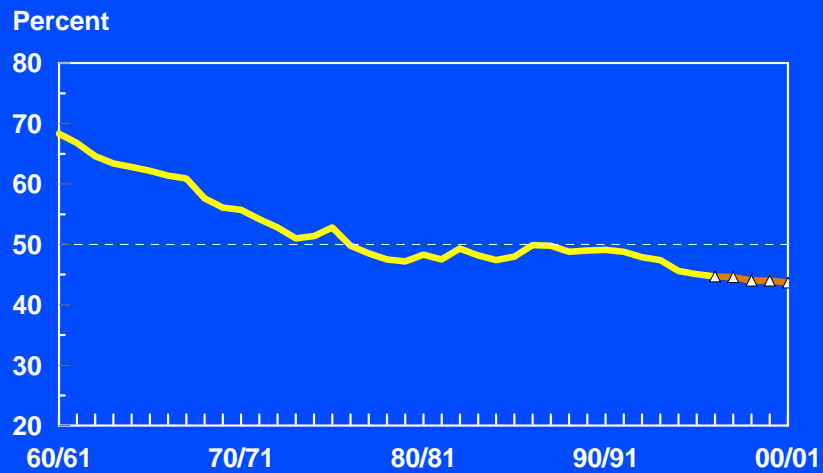
WORLD ECONOMIC GROWTH Changes in GDP



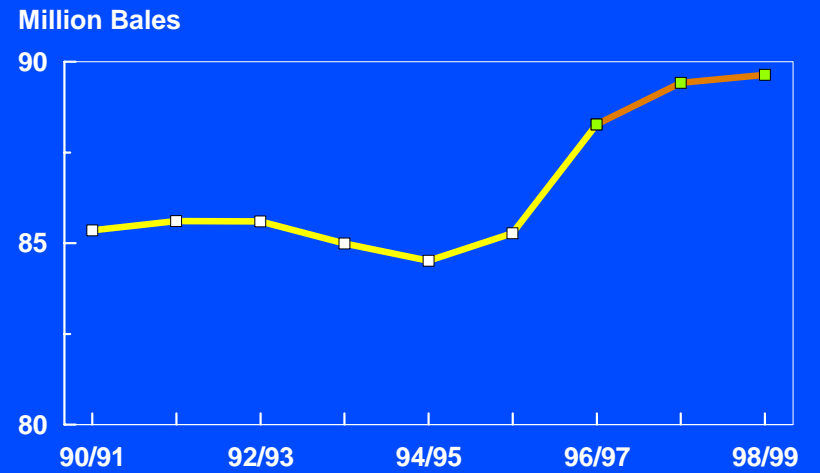
WORLD FIBER CONSUMPTION



COTTON'S % OF FIBER USE

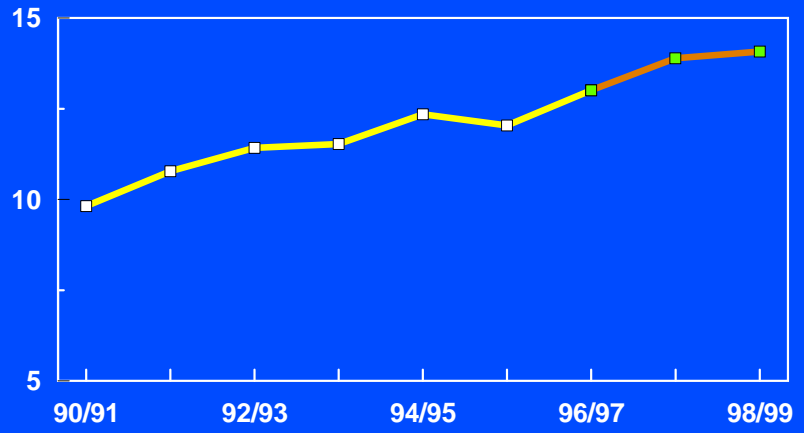


WORLD COTTON USE



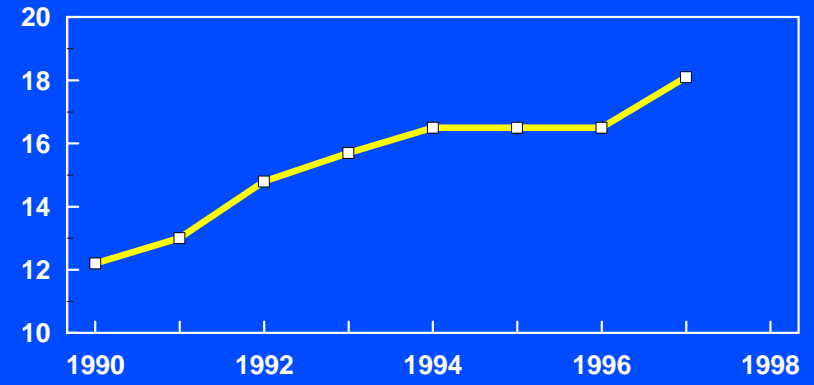
COTTON USE: N. AMERICA

Million Bales



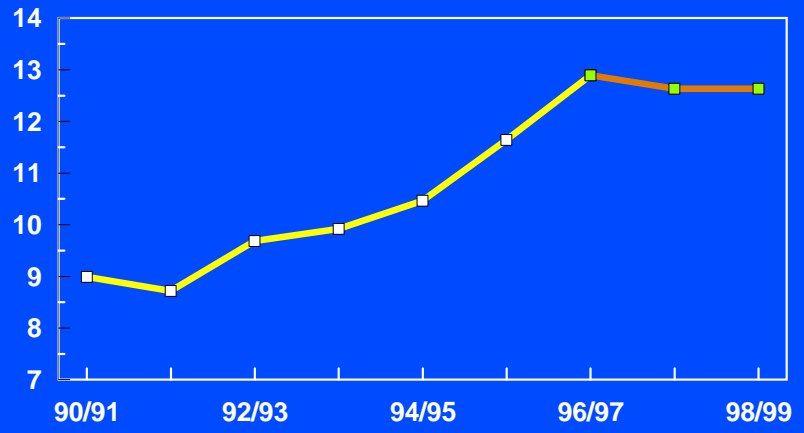
DOMESTIC CONSUMPTION: USA

Million Bales



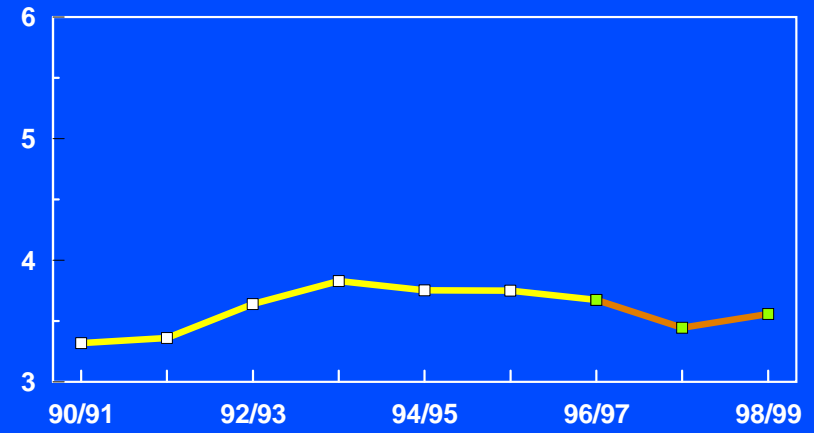
COTTON USE: INDIA

Million Bales



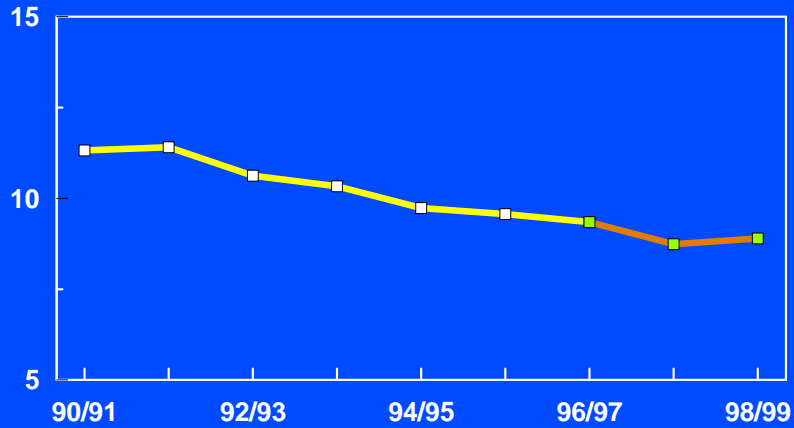
COTTON USE: BRAZIL

Million Bales



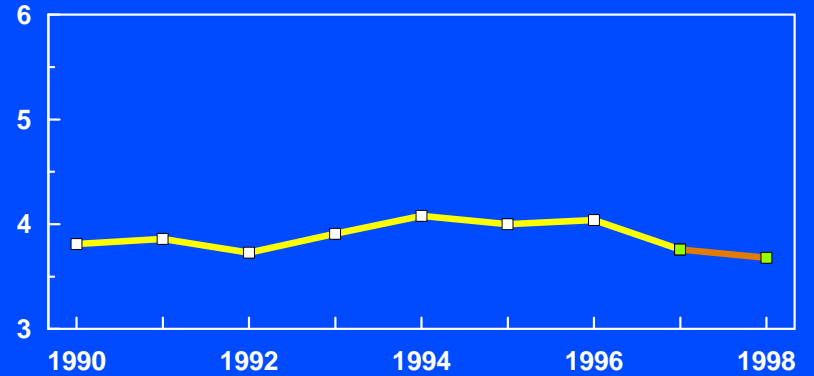
COTTON USE: EAST ASIA

Million Bales



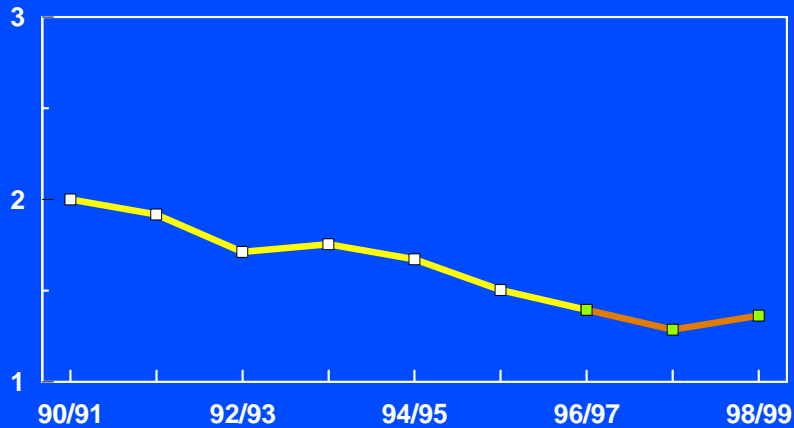
DOMESTIC CONSUMPTION: JAPAN

Million Bales



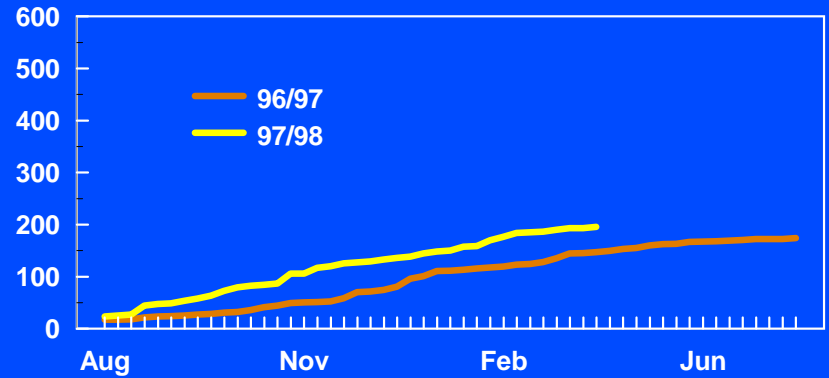
COTTON USE: REP. OF KOREA

Million Bales



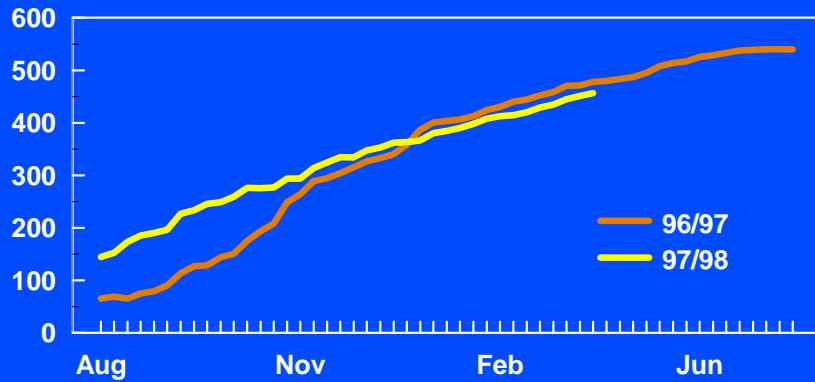
US EXPORT COMMITMENTS: THAILAND

Thousand R. Bales



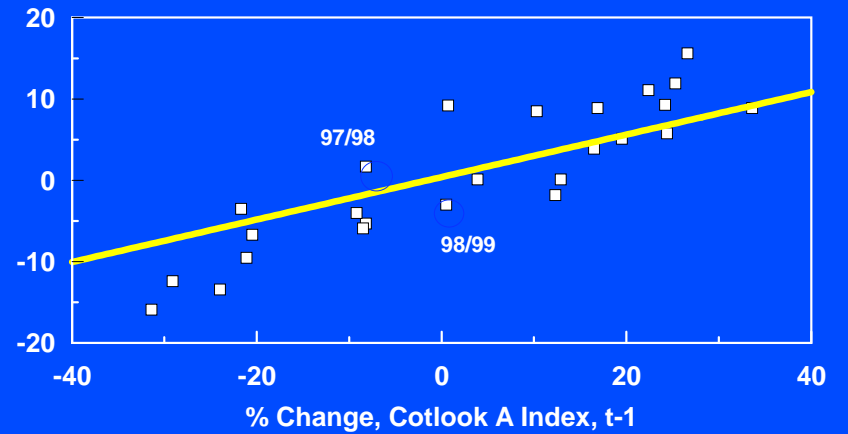
US EXPORT COMMITMENTS: INDONESIA

Thousand R. Bales



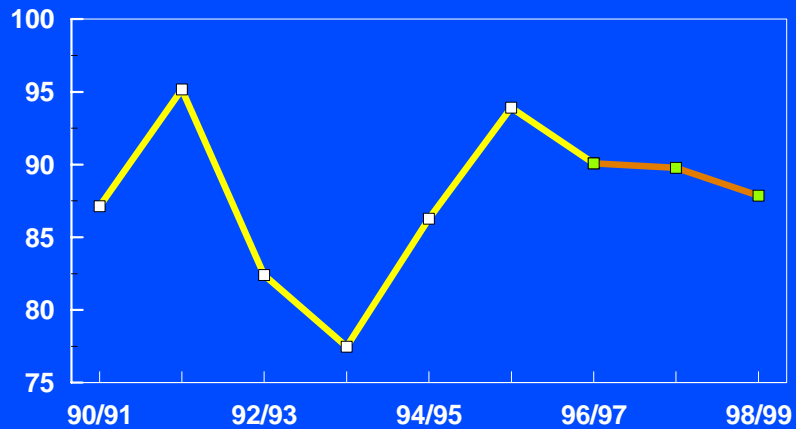
WORLD PRODUCTION & PRICES

% Change, World Production



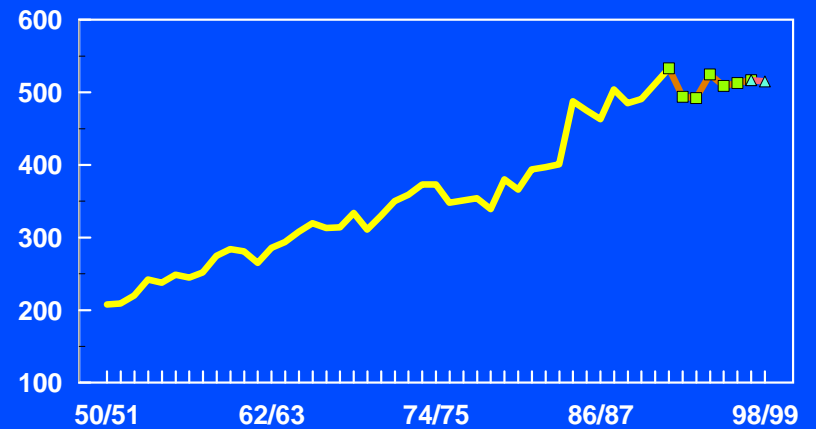
WORLD COTTON PRODUCTION

Million Bales



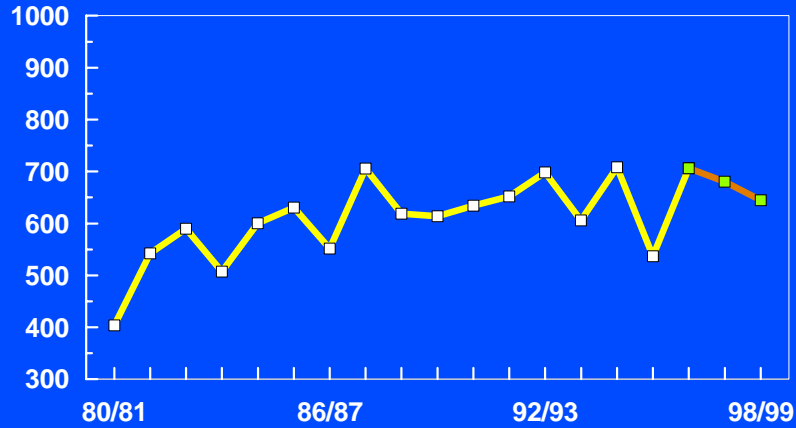
WORLD COTTON YIELDS

Pounds per Acre



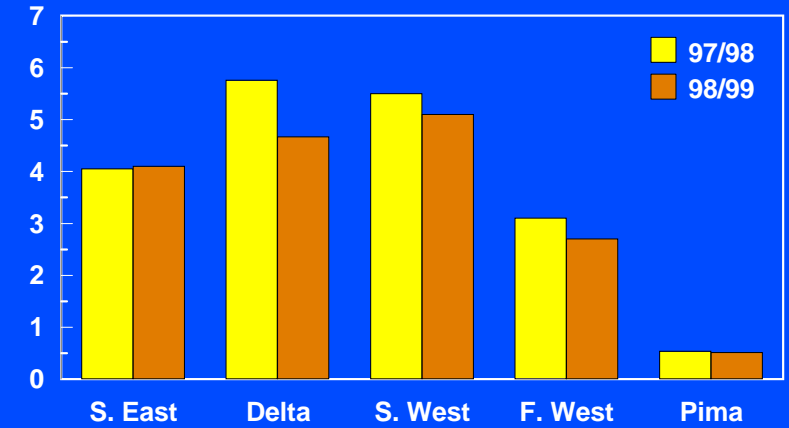
COTTON YIELDS: USA

Pounds per Acre



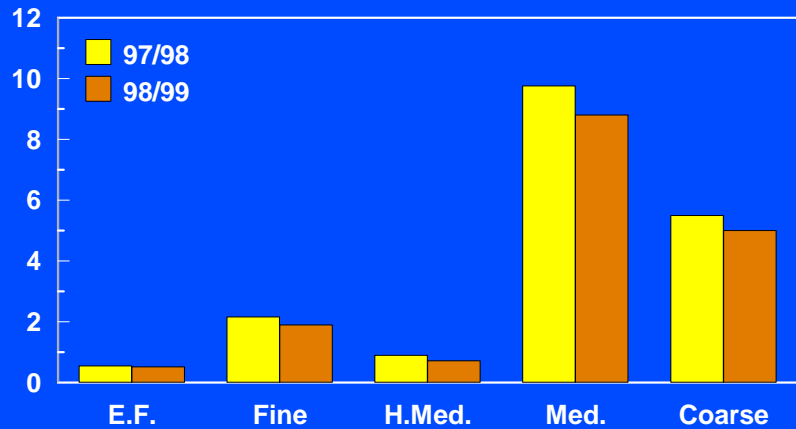
PRODUCTION: USA

Million Bales



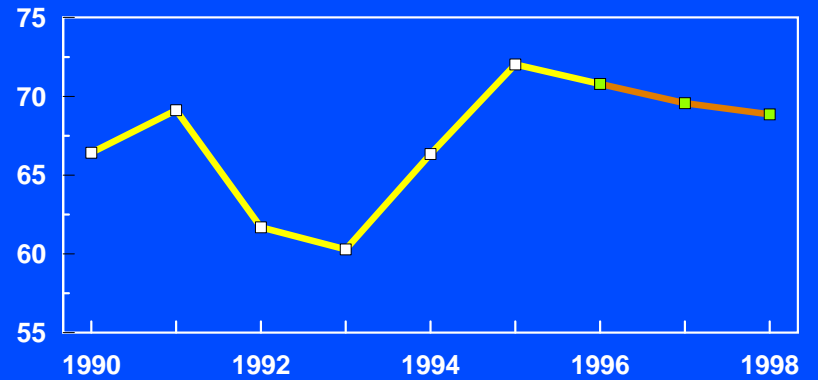
PRODUCTION: USA

Million Bales

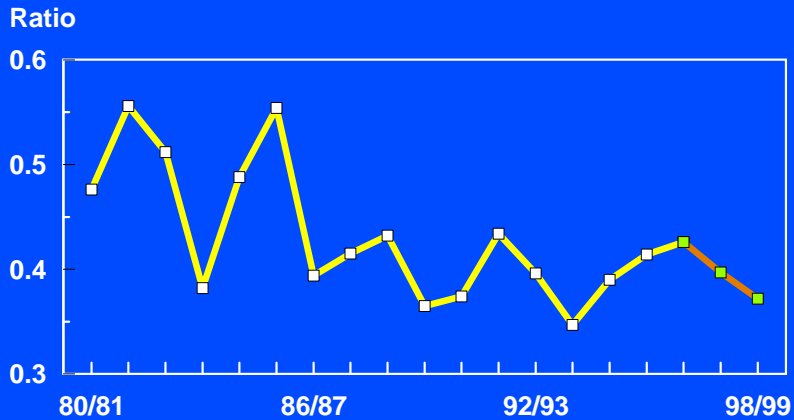


PRODUCTION: WORLD-LESS-CHINA

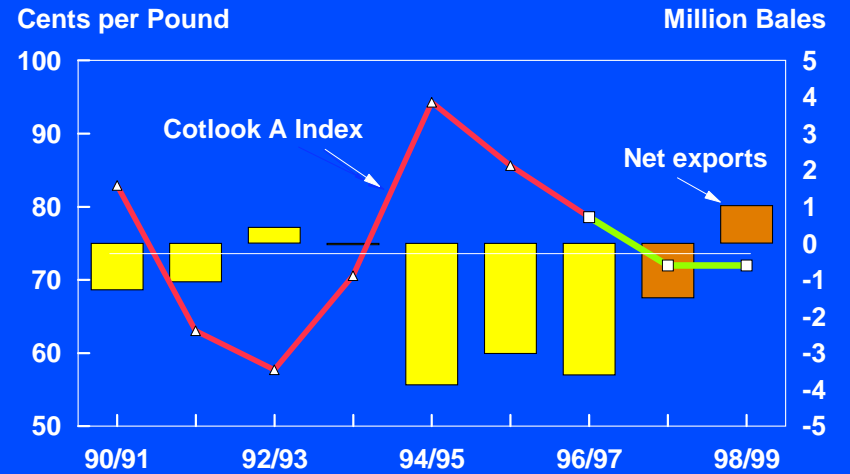
Million Bales



ENDING STOCKS-TO-USE WORLD-LESS-CHINA

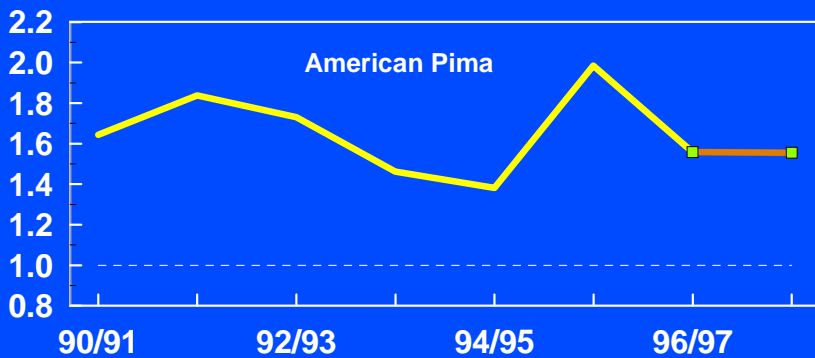


CHINA (M) & COTTON PRICES



COTTON PRICES

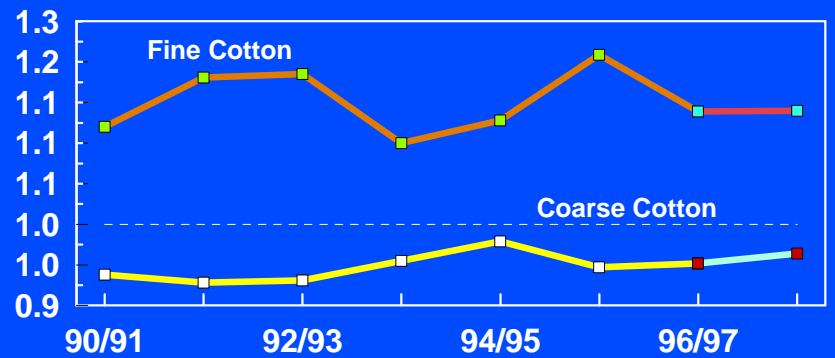
Cotlook A Index = 1.0



1997/98 through April 30

COTTON PRICES

Cotlook A Index = 1.0



1997/98 through April 30