

The World Cotton Situation in April 1997

Presentation by
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International cotton prices have been quite stable for the last year and a half, after two seasons where prices rose dramatically from August to April. The ICAC Secretariat currently estimates that the Cotlook A Index will average 81 US cents per pound in the period from August 1996 through July 1997. As **Chart 1** indicates, prices have been below 81 cents in the first part of the season. Thus the forecast, which has moved up one cent in the last month, suggests some normal seasonal tendency for prices to rise in the remaining months of the season.

I should caution you that all Secretariat price forecasts are subject to error, both because of error in the model which we use and because of error in our estimates of the variables in the model. In April 1996 the Secretariat forecast an average price for 1995/96 of 87 cents, compared to the actual average of 86 cents, and forecast the 1996/97 average Cotlook A Index at 76 cents. By this time in the season, we generally have a good idea of what production, consumption and trade will be. However, for the season to come we are still only beginning to get a good idea of the magnitudes of production.

A year ago, we had thought that world production would be higher in 1996/97 at 19.8 million tons. Now our estimate is only 19.1 million tons (**Chart 2**). Production is expected to rise in 1997/98 to 19.5 million tons, and may reach nearly 21 million tons by the 2002/03 season. This estimate of production is several hundred thousand tons lower than forecast six months ago. We have become increasingly pessimistic about the ability of the world to increase cotton yields given existing technology and current problems.

Our estimate for world cotton consumption in 1996/97 is also now lower than our previous forecast for the season (**Chart 3**). Last April we forecast world cotton use at 19.2 million tons; our current estimate is 19.1 million tons. Consumption is expected to continue to rise in the next five years, after a period of no gains from the mid-1980s to the mid-1990s. However, we have recently reduced our estimates of consumption gains by several hundred thousand tons.

Prices this season have been relatively stable as world production and consumption are basically in balance (**Chart 4**). This balance is expected to continue in 1997/98, with relatively little change in world stocks.

The major factor behind a lower level of prices this season than in the last two has been lower imports by China. Our forecasting model for China is based on production and consumption outside the China Mainland, with China's impact on the industry measured by its net trade in raw cotton with the rest of the world. This season we expect China to import about 500,000 tons, a lower amount than the 900,000 tons imported in 1994/95 and the 700,000 tons imported in 1995/96. The impact of changing levels of China's net trade on prices is illustrated in **Chart 5**.

Earlier we had thought that China's imports would fall even more. From a supply and demand basis, China doesn't seem to need to import. However, government policies and the reaction of business interests in China to them seem to be leading to continued stock accumulation in China and higher than expected imports. China now has 45% of the world's total stocks of cotton; while such stocks would be burdensome in other countries, considering the fact that someone must pay interest charges on the capital tied up in them, they don't seem to bother the Chinese, who continue to build more storage capacity. Longer term, reason suggests that the stocks will come down. The Secretariat is forecasting a drop to imports to around 300,000 tons a year in the rest of this decade. This level is the amount of cotton currently used by China's joint venture mills.

Barter transactions in Central Asia, which had the impact of lowering world cotton prices in the early 1990s, have declined significantly in recent years (**Chart 6**). Most cotton business in Uzbekistan is now on cash terms, although the government is currently bartering 80,000 tons with Russia for fertilizer. Turkmenistan and Tadjikistan, however, continue to use barter extensively. Longer term we are assuming that barter transactions will represent about 20% of the Central Asian cotton business.

In 1997/98, the period from August 1997 through July 1998, we expect the Cotlook A Index to average 83 cents, close to current levels, though with some tendency to rise as stocks tighten. The ratio of stocks of cotton at the end of the season to consumption in the world outside of China(Mainland) are expected to fall from .37 in 1996/97 to .35 in 1997/98 (**Chart 7**).

Longer term, we expect stocks to be relatively tight as well, due to slow growth in world cotton production. (Of course, we are assuming so called "normal" weather conditions in these forecasts.) As a result, cotton prices are likely to average in the 80-90 cent range in the next five years (**Chart 8**), compared to the average of cotton prices in the 1972-1996 period of 74 cents.

Higher than average prices are a pleasant prospect for the producer, but the consumer reacts differently. Cotton is already losing share of market due to non-price factors (**Chart 9**). The higher prices expected in the next five years are likely to result in further loss of market and reduced consumption gains. Cotton's share of market has already fallen from 50% to 45%. Price factors alone will lead to a decline to 43% by 2000. If there is any further erosion in the non-price factors, the forecast gains in consumption are at risk.

Let's look at the situation in the major parts of the cotton world.

In North America, cotton use by textile mills remains strong (**Chart 10**). The dip in 1995/96 appears to be due largely to inventory adjustments at the retail level. Use is recovering in 1996/97 and continued small gains are expected in 1997/98 and the next five years. The strength in the United States is also carrying over to the country's NAFTA partners. Textile mill use of cotton is up sharply in both Mexico and Canada.

The major factor behind the remarkable growth in the North American textile industry is the increased share of market which cotton has been able to capture (**Chart 11**). Cotton's share of market at the level of the final textile consumer – the retail consumer in the case of apparel – in the USA rose from 30% at the beginning of the 1980s to nearly 50% in the 1990s. Furthermore, cotton's share of market did not decline in the 1994/95 period when cotton prices rose significantly.

This growth in share did not occur by magic. US producers and now importers of cotton products have increased their support for market promotion from \$25 million a year to over \$60 million. Currently, producers pay 75% of the promotion budget through assessments of about \$2.25 per bale or roughly .7 of one percent of the value of the bale and importers pay 25% of the budget through import fees assessed on the cotton content of imported products based on the same fees paid by producers on similar amounts of cotton.

The United States continues to be a competitive producer of cotton, especially with such a large market close to home. The US government farm program pays farmers with a history of growing cotton a subsidy whether or not they grow cotton. Thus the decision to plant cotton is based on comparing cotton returns with those from growing other crops, grains and soybeans for the most part. Area is expected to decline slightly in 1997/98 and a return to "normal" yields after good yields in 1996/97 will likely lead to a drop in production from 4.1 million tons in 1996/97 to 4 million tons (**Chart 12**). Production is expected to rise moderately in the next five years, to a level around 4.2 million tons. The USA is not likely to be a significant importer of cotton any time in the near future.

In Latin America most of the action in the cotton market is occurring in Mercosur. Cotton use is rising due primarily to strength of the Brazilian market (**Chart 13**). Textile mill use of cotton is likely to reach 1 million tons in the 1997/98 season and perhaps 1.2 million tons by 2002. This local consumption is significant support for cotton production in the region. Cotton production in Mercosur in 1996/97 should total 824,000 tons, down from 945,000 tons in 1995/96 due to reduced area despite above average yields (**Chart 14**). A return to normal yields in 1997/98, even with some increase in area, will likely result in production falling a bit more, to 790,000 tons. The price outlook for the next five years suggests that production in the region should rise to a million tons by 2002.

With demand surpassing expected production in the region, Mercosur will continue to be a net importer of around 200,000 tons of cotton from countries outside the region. Obviously, if countries within the region can deliver appropriate qualities to Brazil at competitive prices (including the impact of any preferences for trade within the region), there is a market for expanded production within the region.

Production in Australia, Mercosur's competitor in the Southern Hemisphere, continues to rise (**Chart 15**). The Secretariat has reduced its estimates of Australian yields for 1996/97 due to the impact of rains on the open crop, but a record crop, 552,000 tons, still seems likely. Area is expected to decline in 1997/98 to around 350,000 ha and output of 518,000 tons is forecast for next season.

Efforts are underway to expand Australian cotton area to new areas, including the tropical area in the Ord Valley in northern Australian, where cotton production failed due to insect problems. The Ord has abundant water resources and is thus an attraction to Australian producers who must generally worry about adequate water for the crop. Secretariat forecasts suggest that Australia might produce 800,000 tons by 2002.

Looking at the cotton situation in the other major producing areas, China remains either the number one or number two producer of cotton in the world. This year we expect China to grow 4.1 million tons of cotton, up slightly from the 4 million ton crop which was planted in 1996. Chinese production has been anything but stable, as shown in **Chart 16**. Incentives to grow cotton remain strong, although the demand for cropland for food crops remains strong as well. Difficulties with insects have kept Chinese area and yields below past levels. It seems reasonable to assume that China will produce about 4.1 million tons of cotton on average in the next five years.

Textile mill consumption of cotton appears to have recovered this season to a planned level of around 4.5 million tons (**Chart 17**). There has been no growth in Chinese cotton consumption over the last ten years and, given difficulties in producing adequate supplies, there is little likelihood that it will increase in the next five. China is now one of the larger producers of chemical fibers and textile demand for fibers will likely be met through a rising share of chemical fibers. China may remain a net importer and some lowering of stock levels is forecast. China remains a risk. Should government policy change and should they start liquidating stocks, prices could be affected.

Central Asian production, which was 2.6 million tons in 1990, is expected to be only 1.5 million tons in 1996/97. Production had fallen to 1.8 million tons in 1995/96 as a result of lower area in Uzbekistan and economic and civil disruptions in many of the other Republics. The decline in 1996 is the result of low yields in Uzbekistan and further drops in the other Republics. Output should recover in Uzbekistan, leading to 1.7 million tons for all of Central Asia in 1997/98. Production in Uzbekistan is expected to remain at the 1.2 million ton level in the next five years (**Chart 18**).

Most of the Central Asian crop will go to Russia and Europe in the next five years. Consumption in East Europe and the former USSR fell drastically with the collapse of the special trading arrangements of COMECON (**Chart 19**). This decline in cotton use is the major reason while world cotton consumption was flat from the late 1980s through 1995/96. Cotton use in Russia is extremely difficult to measure because the tax system would cripple the textile industry if all activity were reported. We currently think Russia is using around 300,000 tons of cotton, down from over 1 million prior to the collapse of the Soviet Union. Textile mill use in East Europe is generally rising now. In any event it seems that consumption in the region has stopped falling and is expected to remain at around 900,000 in the next five years.

The European Union now uses about 1.1 million tons, of which 400,000 are supplied by Greece and Spain (**Chart 20**). With a recovery in Greek production in 1997/98 of about 100,000 tons, 500,000 tons of the 1.1 million tons of use will be supplied internally. Most of the 600,000 tons of net imports in 1997/98 and future years are likely to come from Central Asia. The combined demand of Russia and East and West Europe of 1.5 million tons is about equal to expected exports from Central Asia in 1997/98. By 2002, production and exports from Central Asia are likely to be about 100,000 tons less.

India is expected to have a record cotton crop in 1996/97 of 2.76 million tons (**Chart 21**). Textile mill use of cotton in India is now the second largest in the world at an estimated 2.65 million tons (**Chart 22**). Cotton use is expected to rise to 3.5 million tons by 2002, while Indian production is likely to rise only to 3 million tons. If these forecasts prove accurate, India will become a regular importer of cotton in the next few years.

While Pakistan would be the logical source of Indian imports, there is not likely to a regular supply of exported cotton from Pakistan in the next few years. Pakistan's production is currently gauged at 1.6 million tons, 500,000 tons below Pakistan's record production in 1991/92 (**Chart 23**). The varieties which allowed Pakistan to produce the record crop have proved to be susceptible to the leaf curl virus and have been replaced by lower yielding varieties. Pakistan's production could reach about 2 million tons by 2002, assuming the development of new leaf curl resistant-higher yielding varieties by that time. Textile mill use in Pakistan (**Chart 24**) likely exceeds production this season and will probably increase in line with production in the coming years.

Turkey is the sixth largest producer of cotton in the world in 1996/97 (**Chart 25**). Production in Turkey is expected to rise from 800,000 tons currently to a million tons by 2001 as additional area is brought under cultivation in Southeast Turkey, where a long awaited irrigation project is being completed. The higher production in Turkey as a result of this irrigation project was originally destined for the export market; however, Turkey now consumes about as much cotton as the entire European Union (**Chart 26**). By 2002, Turkey is likely to use 1.25 million tons and continue to be a net importer of about 200,000 tons.

To complete our round the world tour of cotton, we need to look at textile mill use in the Far East. The Far Eastern countries need to be broken up into two groups, Japan and the Newly Industrialized Countries, such as China (Taiwan), the Rep. of Korea and Hong Kong, and the countries of Southeast Asia (Thailand, Indonesia, Vietnam, the Philippines, Singapore and Malaysia). Consumption in Japan and the NICs (**Chart 27**) ebbs slowly lower as high labor

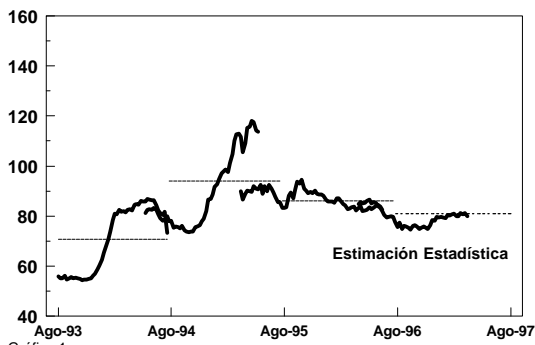
costs and better opportunities in other industries lead to shrinkage of the textile industry. At the same time, consumption in Southeast Asia is slowly rising (**Chart 28**). High labor costs and tariff reductions are beginning to affect some of the Southeast Asian countries as well. The Thai spinning industry has probably stopped growing as its protection from imports has been drastically lowered. Low labor costs still make spinning in Indonesia an attractive proposition for Japanese and Taiwanese investors, however. The net impact of the two disparate trends is stable cotton use for the Far East in total. These countries, use 2.1 million tons of cotton today. In 2002, they are expected to continue to use 2.1 million tons.

Summary

Cotton prices are expected to be in the 80-90 US cent range in the next five years (**Chart 29**), as world production grows relatively slowly, due to little growth in yields and competition with other crops for available land. Cotton's share of market is likely to fall as textile consumers react to higher cotton prices, limiting the growth in world cotton consumption. Weather developments could accelerate or decelerate these trends. And changes in government policy in China could dampen the rising price trend. We at ICAC will continue to keep watch. The World Cotton Situation is constantly changing. Keep tuned for the latest developments.

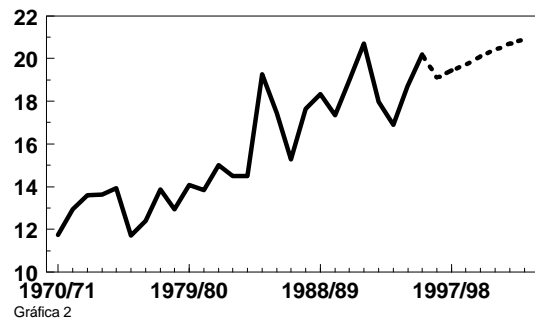
INDICE A DEL COTLOOK

Centavos de dólar por libra



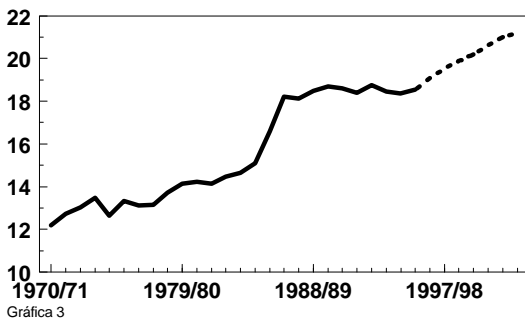
PRODUCCION DE ALGODON EN EL MUNDO

Millones de toneladas



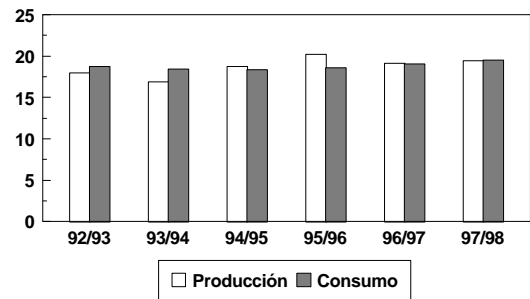
CONSUMO INDUSTRIAL DE ALGODON EN EL MUNDO

Millones de toneladas



PRODUCCION Y CONSUMO DE ALGODON EN EL MUNDO

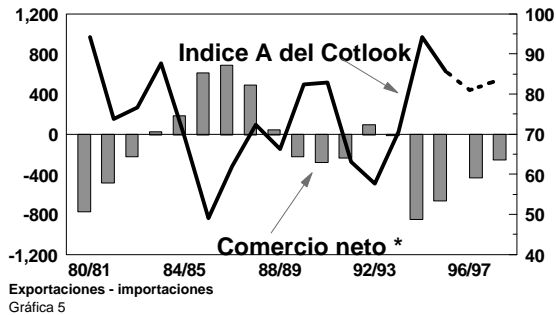
Millones de toneladas



COMERCIO NETO DE CHINA (CONTINENTAL) Y LOS PRECIOS MUNDIALES DE ALGODON

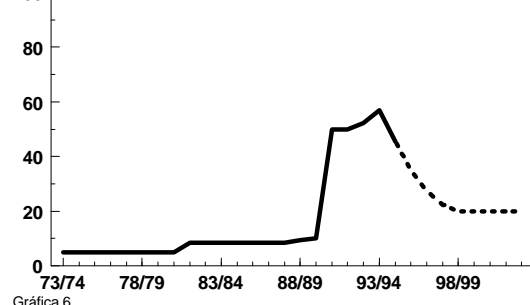
Millones de toneladas

Centavos de dólar por libra



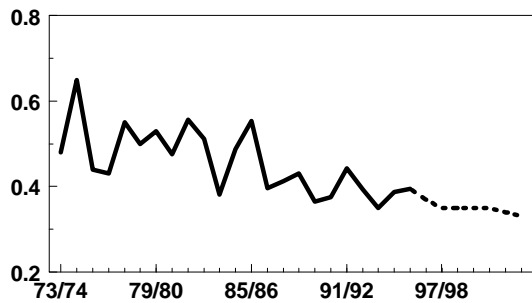
COMERCIO DE TRUEQUE EN ASIA CENTRAL COMO PROPORCION DE EXPORTACIONES TOTALES

Porcentaje



RELACION DE EXISTENCIAS A CONSUMO EN EL MUNDO MENOS CHINA (CONTINENTAL)

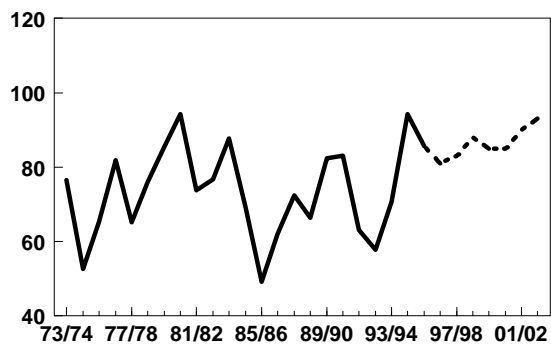
Relación



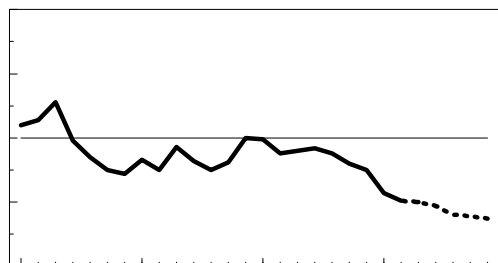
Gráfica 7

INDICE A DEL COTLOOK

Centavos EE.UU. por libra

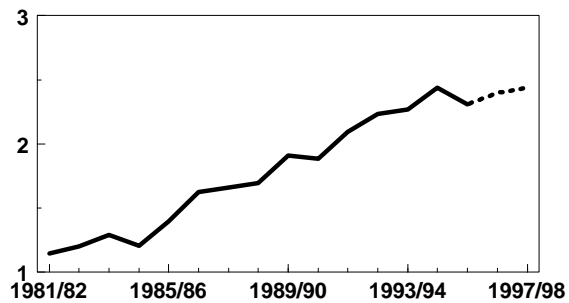


Gráfica 8



CONSUMO INDUSTRIAL DE ALGODON EN LOS ESTADOS UNIDOS

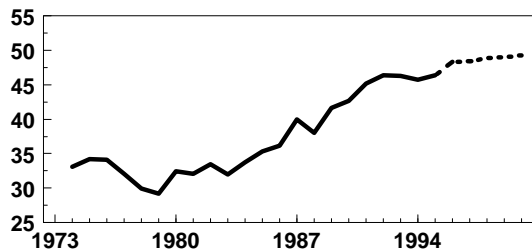
Millones de toneladas



Gráfica 10

PARTICIPACION DEL ALGODON EN EL MERCADO TEXTIL DE AMERICA DEL NORTE Consumo Final de Fibras Textiles

Porcentaje

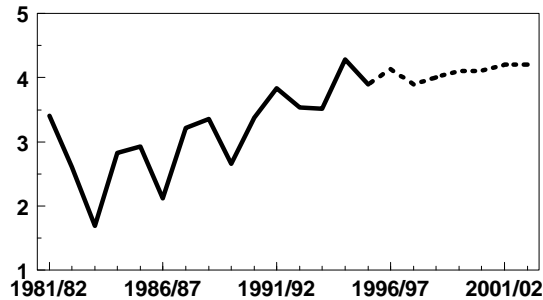


Basado en estimación de oct. 1996

Gráfica 11

PRODUCCION DE ALGODON EN LOS ESTADOS UNIDOS

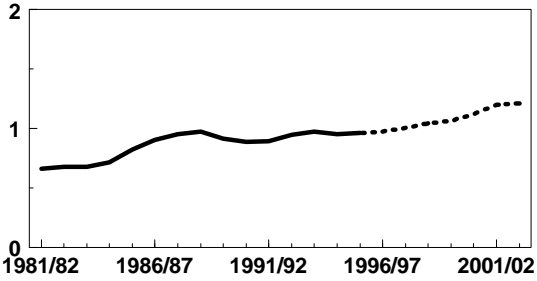
Millones de toneladas



Gráfica 12

CONSUMO INDUSTRIAL DE ALGODON EN MERCOSUR

Millones de toneladas

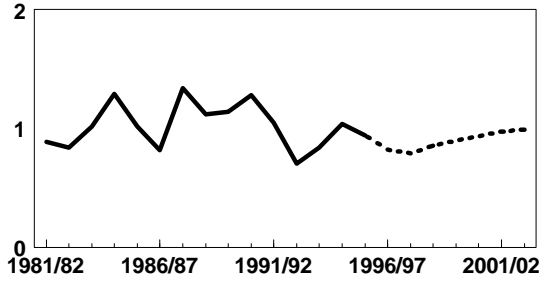


BRASIL, ARGENTINA, PARAGUAY Y URUGUAY

Gráfica 13

PRODUCCION DE ALGODON EN MERCOSUR

Millones de toneladas

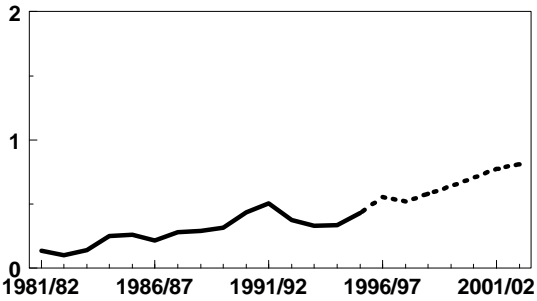


BRASIL, ARGENTINA, PARAGUAY Y URUGUAY

Gráfica 14

PRODUCCION DE ALGODON EN AUSTRALIA

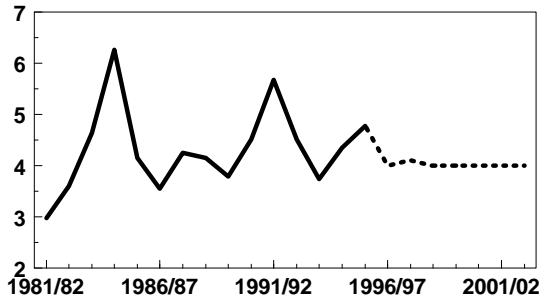
Millones de toneladas



Gráfica 15

PRODUCCION DE ALGODON EN CHINA (CONTINENTAL)

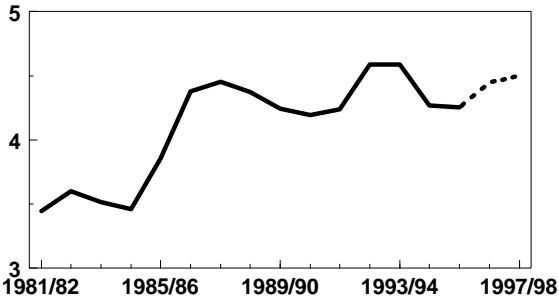
Millones de toneladas



Gráfica 16

CONSUMO INDUSTRIAL DE ALGODON EN LA CHINA (CONTINENTAL)

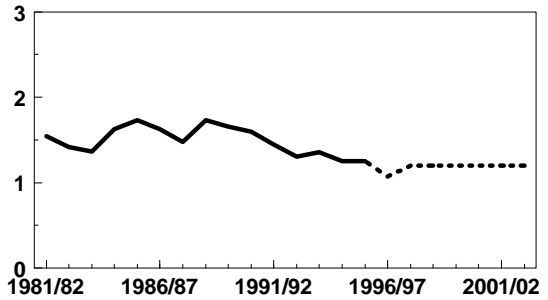
Millones de toneladas



Gráfica 17

PRODUCCION DE ALGODON EN UZBEKISTAN

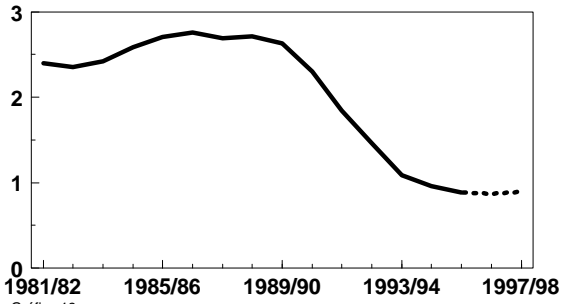
Millones de toneladas



Gráfica 18

**CONSUMO INDUSTRIAL DE ALGODON
EN EUROPA ORIENTAL Y LA ANTIGUA URSS**

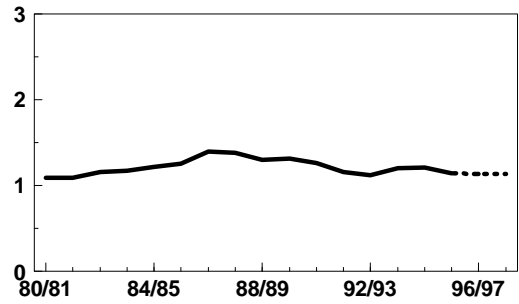
Millones de toneladas



Gráfica 19

**CONSUMO INDUSTRIAL DE ALGODON
EN LA UNION EUROPEA**

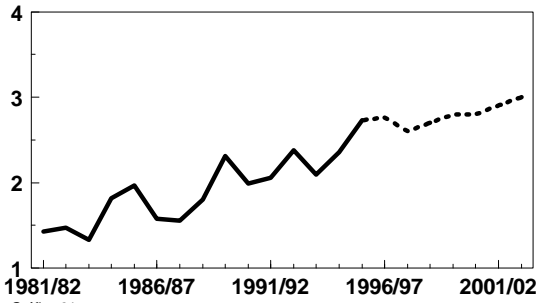
Millones de toneladas



Gráfica 20

**PRODUCCION DE ALGODON
EN INDIA**

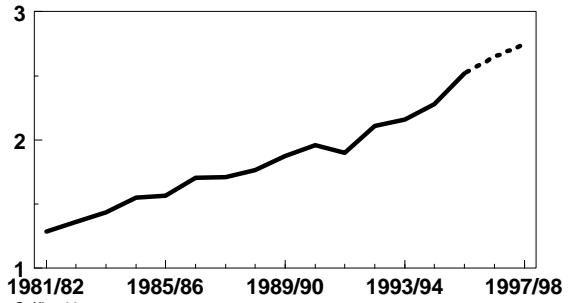
Millones de toneladas



Gráfica 21

**CONSUMO INDUSTRIAL DE ALGODON
EN LA INDIA**

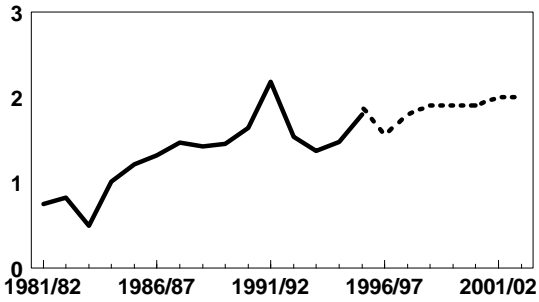
Millones de toneladas



Gráfica 22

**PRODUCCION DE ALGODON
EN PAQUISTAN**

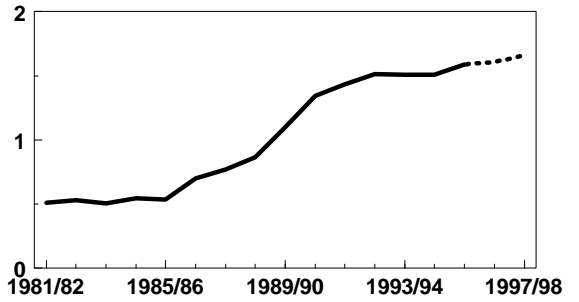
Millones de toneladas



Gráfica 23

**CONSUMO INDUSTRIAL DE ALGODON
EN PAQUISTAN**

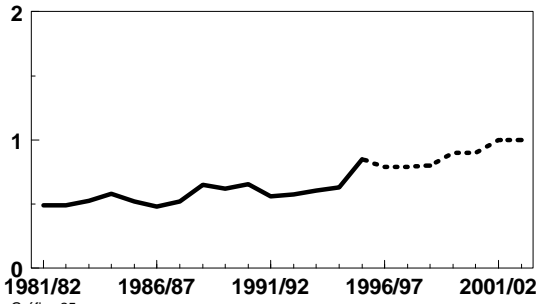
Millones de toneladas



Gráfica 24

PRODUCCION DE ALGODON EN TURQUIA

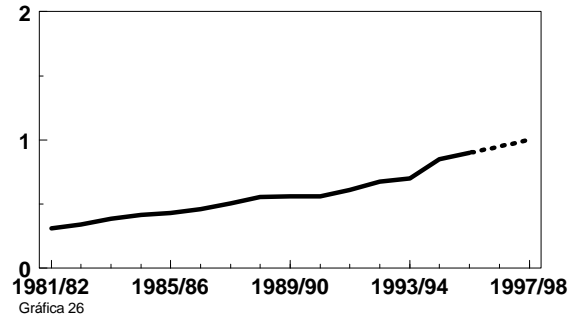
Millones de toneladas



Gráfica 25

CONSUMO INDUSTRIAL DE ALGODON EN TURQUIA

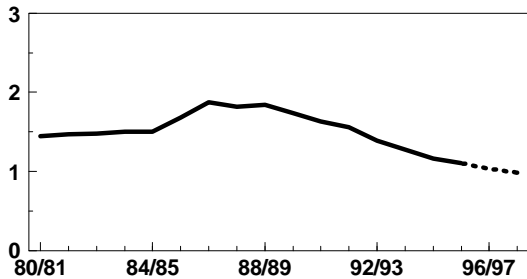
Millones de toneladas



Gráfica 26

CONSUMO INDUSTRIAL DE ALGODON EN EL JAPON Y LOS PRI's *

Millones de toneladas

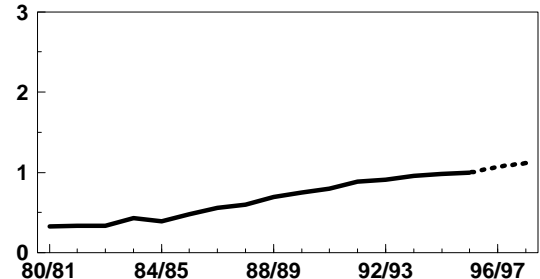


* Japón, China (Taiwan), Hong Kong, Rep. de Corea y Singapur

Gráfica 27

CONSUMO INDUSTRIAL DE ALGODON EN EL SURESTE DE ASIA*

Millones de toneladas



* Indonesia, Malasia, Filipinas, Tailandia, y Vietnam.

Gráfica 28