



INTERNATIONAL COTTON ADVISORY COMMITTEE

1629 K Street NW, Suite 702, Washington, DC 20006 USA

Telephone (202) 463-6660 • Fax (202) 463-6950 • e-mail secretariat@icac.org

The World Cotton Outlook*

Terry Townsend
Executive Director

Cotton supply and demand are reaching historic highs in 2004/05. Harvested area was up 11% to about 89 million acres, the highest since 1995/96. The world yield is climbing to a record of 640 pounds per acre, up 70 pounds per acre (13%), the largest 1-year increase in 20 seasons. Production is soaring to an estimated all-time high of 119 million bales in 2004/05, up 26% from the previous season, the largest year-to-year increase ever. World cotton mill use is rising to 106 million bales for the first time in 2004/05, up 8%, the largest year-to-year increase since the mid-80s.

With production exceeding consumption in 2004/05, world ending stocks are expected to rise from 36 million bales last season to an estimated 48 million on July 31st 2005. The Cotlook A Index is projected to average 53 cents per pound in 2004/05, down 15 cents (22%) from a 6-year high in 2004/05.

Lower cotton prices are likely to reduce world production in 2005/06 and the rate of growth of world consumption is expected to slow. World production is forecast to decline by 10% in 2005/06 and will likely fall slightly below world consumption, while net imports by China (Mainland) are projected to skyrocket from an estimated 6.7 million bales this season to 13 million in 2005/06. As a result, the Cotlook A Index is expected to average 66 cents per pound in 2005/06, thirteen cents above the average expected for the current season.

During the last five seasons, ICAC forecasts of the average Cotlook A Index at this time of the year for the coming season were overestimated three times (by 5 cents for 2000/01, 16 cents for 2001/02 and by about 14 cents for 2004/05) and underestimated twice (by 4 cents for 2002/03 and 7 cents for 2003/04).

Initial projections for the 2006/07 season suggest that world production and consumption will equal about 111 million bales. Net imports by China (Mainland) are projected at 13 million bales for a second season. Consequently, the forecast for the season average Cotlook A Index in 2006/07 is 66 cents per pound, the same as the projection for 2005/06.

Lower Prices Leading to Reduced Production

Lower cotton prices in 2004, combined with the anticipated return of normal weather in 2005 after near-ideal conditions last year, are likely to reduce world production in 2005/06. Planting in the Northern Hemisphere is now largely completed, and world cotton area is forecast to decline by 6% from a 9-year high in 2004/05. Yet, the harvested area is still expected to be one million

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acres (2%) above the 10-year average. Farmers generally base planting decisions on their income during the previous season, which has been boosted by record yields in many countries. In addition, international prices rallied almost 10 cents from a low 47 cents per pound in mid-November 2004 to the end of March, encouraging plantings.

Despite lower prices, structural factors continue to sustain world production. The expanded use of new technologies is contributing to lower production costs. At current exchange rates, marginal production costs, and in the case of the most efficient producers total costs, are below 55 cents per pound in several countries. According to the ICAC survey of the cost of production of cotton, in 2004 the world average variable cash cost per kilogram of lint production was 52 cents per pound.

Government measures in several countries continue to support producers having costs of production above market prices. Direct government support to the cotton industry increased from \$3.4 billion in 2003/04 to an estimated US\$4.7 billion in 2004/05 due to lower market prices and higher production. No changes in the cotton policies of the developed countries are expected in 2005/06. However, the EU is decoupling 65% of payments to cotton producers beginning in January 2006. This change is expected to begin affecting production in 2006/07. The U.S. has pledged to abide by the requirements of the WTO ruling on Step 2 by July 1, 2005. The Secretariat estimates U.S. exports based primarily on availability and competing supplies. Therefore, whatever change is implemented in the Step 2 program is not expected to affect the volume of U.S. cotton exports during 2005/06.

Yields will be key to production in 2005/06. The biggest uncertainty in predicting yields for 2005 relates to how much of the 2004 spike was due to exceptional weather and how much was due to technology shifts. Based on recent averages and trends in each country, and assuming normal weather, the world yield in 2005/06 is forecast at 620 pounds per acre. The estimate is still the second highest ever, thanks to the advances in technology, including biotechnology. It is estimated that 26% of world cotton area will be planted to biotech varieties in 2005/06, up 2 percentage points from this season, accounting for about 35% of world production and exports.

World production is forecast to decline to 108 million bales in 2005/06, down 11 million bales from the record this season, still the second largest crop on record. The production of the top 4 countries is expected to fall by a combined 10 million bales.

Production in China (Mainland) is expected to decline from 6.3 million tons in 2004/05 to 5.8 million tons next season, down 8% from the record in 2004/05, still the third largest crop on record.

For the U.S., assuming 13.8 million acres planted, 6% abandonment and an average yield of 760 pounds, down 10% from 2004/05, U.S. production is forecast down 10% to 20.6 million bales, still the second largest crop and 2 million bales above the 10-year average.

Yields in India took off from a 5-year average of 300 kilograms to an estimated 376 kilograms per hectare in 2003/04 and an estimated 415 kilograms per hectare in 2004/05. This is a major breakthrough as India has one-fourth of the world cotton area. However, yields in India remain half the average in the rest of the world. Due to lower domestic prices, production in India is forecast to fall to 15.6 million bales, down 15%. Production in Pakistan is expected to decline to 10 million bales, down 14%.

Plantings in Central Asia are relatively unaffected by fluctuations in international prices, and production in Uzbekistan is projected down 75,000 tons (7%) to 980,000 tons. Production in Turkey is projected to decline to 867,000 tons, down 33,000 tons from this season.

The African franc zone producing countries are severely affected by the weakening of the U.S. dollar against the euro, to which their common currency is pegged. As a result, overall production in the CFA zone is forecast to decline to 923,000 tons in 2005/06, down 110,000 tons (10%) from the estimated record this season.

In contrast, 2005/06 plantings in the Southern Hemisphere are expected to remain at nearly 9 million acres in response to likely higher prices during the second semester of 2005. Overall production is projected unchanged from the estimated record of 12 million bales in 2004/05. The appreciation of the real against the U.S. dollar is hurting the cotton industry in Brazil and production is projected to decline about 300,000 bales from the estimated record of 6.4 million in 2004/05.

During the last five seasons, ICAC projections at this time of the year of world production for the season ahead were underestimated three times (by 300,000 tons for 2000/01, by 1.2 million tons for 2001/02 and by 4.1 million tons for 2004/05) and overestimated twice (by 150,000 tons for 2002/03 and by 400,000 tons for 2003/04).

Consumption Growth Slowing

World cotton consumption is affected by economic growth, fiber prices, trade rules and consumer preferences. IMF projections released in April suggest that world GDP will grow by about 4.3% in 2005 and 2006, down from 5.1% last year but still above average. The textile industry will be positively affected by economic growth and by the elimination of quotas on textiles and apparel trade among WTO members on January 1, 2005.

Other things equal, a 20% decline in cotton prices translates into a 1% increase in world cotton consumption. Since cotton prices have risen since November 2004, the rate of growth of world consumption is projected to abate in 2005/06.

Research by the Secretariat, using previous joint work with FAO, suggests that because of textile quota elimination and the resultant ability of importers to source products more efficiently, the world is consuming two million bales more of cotton each year. Research and promotion have also supported cotton consumption. Research by the Secretariat suggests that as a result of research and promotion expenditures, world mill use of cotton rose by 1.4 million bales between 1998 through 2003. The total increase in world mill use between 1998/99 and 2004/05 is 21 million bales. Therefore, quota elimination accounts for about one-tenth of the increase in mill use and research and promotion about 6% of the increase in consumption over the last six seasons.

Average crude oil prices rose about 50% from \$34 per barrel in March 2004 to \$51 per barrel in March 2005, while cotton prices fell 24%. As a rule of thumb, a \$1-increase in crude oil prices translates into a one cent-increase in polyester prices. International polyester prices are currently about 20% above cotton prices. Nevertheless, rising cotton prices in 2005 are likely to slow the rate of growth of cotton mill use from an 18-year high of 8% this season to 2.5% in 2005/06. World cotton mill use is forecast to reach 109 million bales, up 2.8 million bales.

During the last five seasons, ICAC projections at this time of the year of world consumption for the coming ahead were underestimated each year (by between 900,000 bales and 8 million bales for 2004/05). Forecasts of China (Mainland)'s consumption were underestimated during the last 5 seasons.

The textile industry in China (Mainland) has been the driving force of world cotton mill use since 1998/99. Total cotton use is expected to climb to 8.6 million tons in China (Mainland) in 2005/06, up half a million tons (6%) from the estimate for this season and double the level of

mill use in 1998/99. China (Mainland)'s share of world mill use is projected to climb to 36% in 2005/06, up from 23% in 1998/99.

China (Mainland) is the main beneficiary of the abolition of quotas on textile and apparel trade among WTO members on January 1, 2005. U.S. imports of textile and apparel from China (Mainland) grew by 37% in volume between January 2004 and January 2005, and by 28% in value, which reflects declining prices. During the same period, overall Chinese (M) textile and clothing exports to the EU grew by 46% in value. Safeguard petitions to limit the growth of imports from China (Mainland) to developed countries are multiplying in numerous textile categories, as allowed until 2008 under WTO rules.

Cotton mill use in the rest of the world is expected to reach a record of 15 million tons in 2005/06, up 100,000 tons. Mill use is forecast to rise 3% in India and Pakistan. Combined mill use in the top 3 countries is projected to reach 66 million bales in 2005/06, 61% of world mill use, sharply up from 40 million bales in 1998/99, 47% of the total. Cotton mill use in the rest of the world is projected at 43 million bales in 2005/06, down 2 million bales from 1998/99.

Most of the increase in world cotton consumption at the end-use level is occurring in industrial countries while increases in cotton mill use are taking place in developing countries. The expansion of mill use is being fueled by textile exports.

The largest source of retail level demand for cotton in the world is the U.S. U.S. imports of textile and apparel in 2004 were 11% higher than in 2003 in volume and 8% in value. Imports from China (Mainland) rose 41% in volume, boosting their market share from 20% to 25%. Total end-use consumption of cotton in the U.S. reached a record of nearly 22 million bale equivalents in 2004. However, cotton's share of domestic consumption of all fibers declined to 39.5%. U.S. cotton mill use fell to 6.4 million bales, while imports of textile and apparel continued to rise. Net cotton product imports reached the equivalent of nearly 15 million bales, accounting for 70% of domestic cotton consumption. U.S. mill use is headed lower because imports of textile and apparel are rising much faster than the rate of increase in retail sales. U.S. mill use is projected to decline to 5.9 million bales in 2005/06.

World Exports Reaching Record

The gap between production and use in China (Mainland) is forecast to widen to 2.8 million tons in 2005/06, one million tons more than the estimated gap this season. Record imports by China (Mainland), combined with lower production and rising consumption in the rest of the world, will boost world trade to unprecedented 36 million bales in 2005/06, up 3.7 million bales from the current season. The United States is forecast to export a record 14 million bales in 2005/06, 38% of world exports.

China (Mainland) is expected to increase its imports to a record of 2.8 million tons in 2005/06 to cover the projected gap between domestic consumption and production. Mill use is expected to exceed domestic production in India and Pakistan by a combined 1.2 million bales in 2005/06, a 5 million bales-shift from 2004/05. As a result, international cotton trade is forecast up 5 million bales (15%) to reach a record of 36 million bales in 2005/06, 34% of projected world production.

Little Changes in Stocks

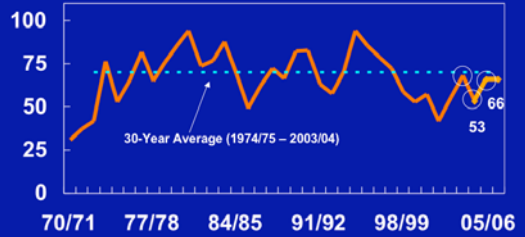
World ending stocks are projected to slip to an estimated 47 million bales by July 31, 2006. The world stocks-to-use ratio would decline to 43%, down 2 percentage points from the estimate for 2004/05. However, the stocks-to-use ratio outside China (Mainland) is projected at 80%, up 8 percentage points from the ratio anticipated for 2004/05, and the highest since the 1950s.



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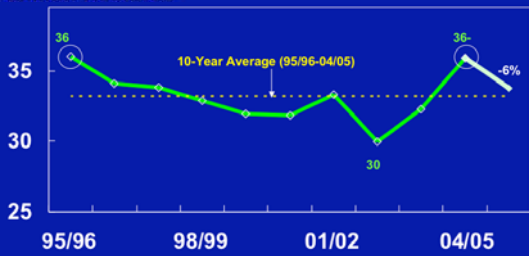
COTLOOK A INDEX

Season-average, U.S. Cents per Pound



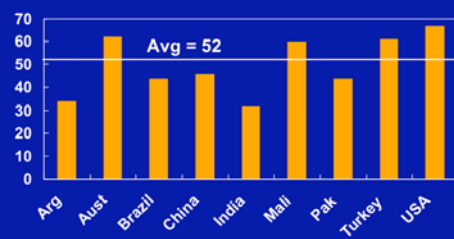
WORLD COTTON AREA

Million Hectares



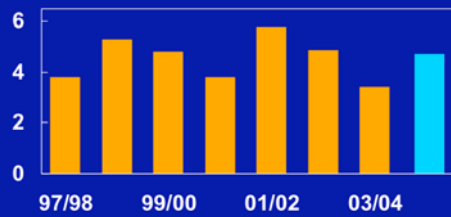
Variable Cash Costs of Lint Production

US\$ per Lb.



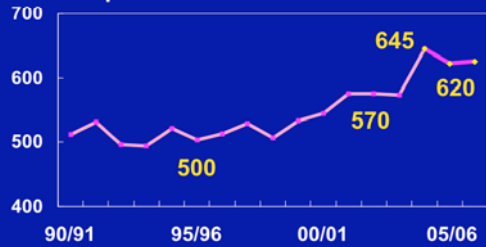
DIRECT GOVERNMENT ASSISTANCE TO COTTON

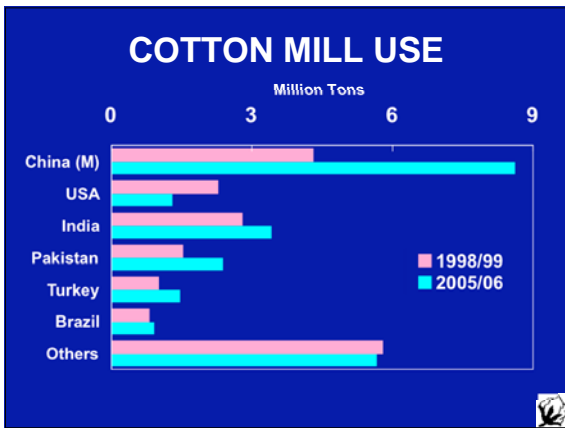
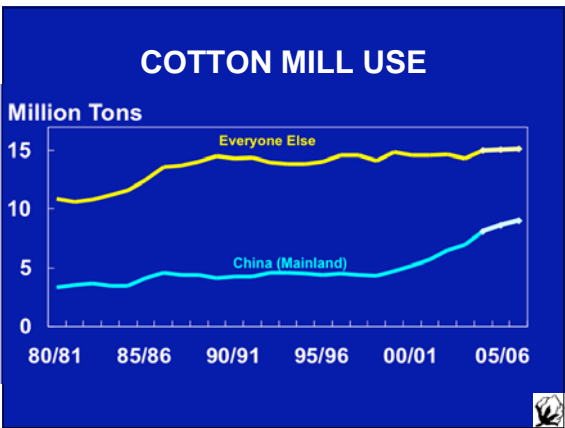
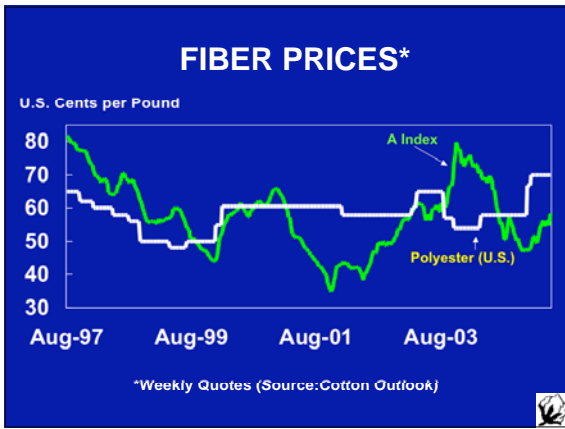
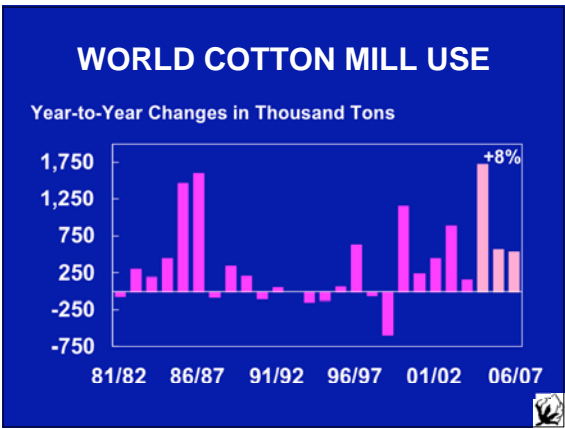
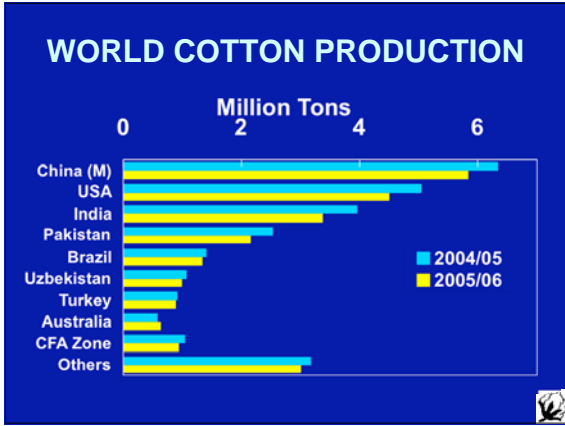
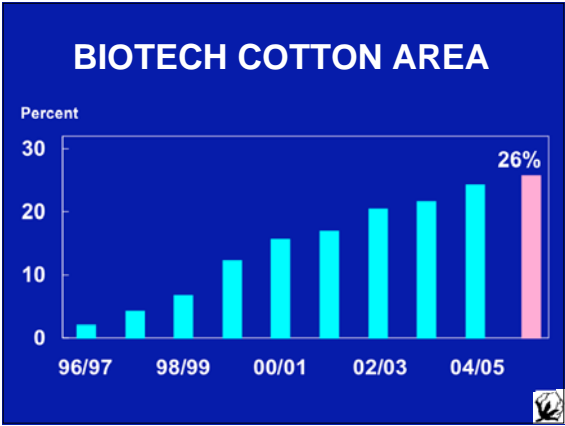
Billion \$



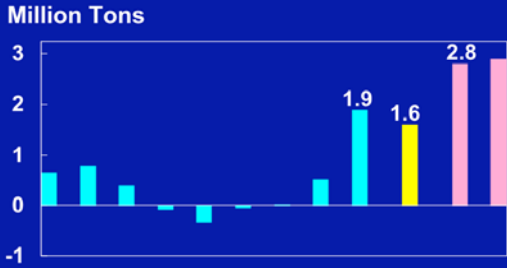
WORLD COTTON YIELD

Pounds per Acre

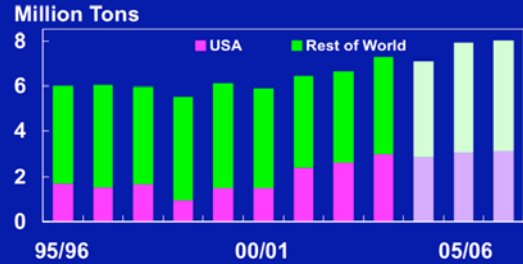




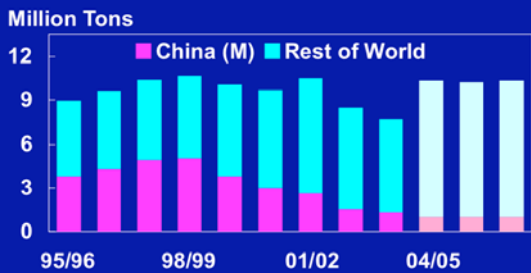
CHINA (M) NET IMPORTS



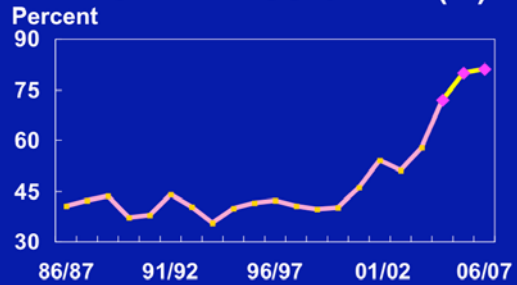
WORLD EXPORTS



WORLD ENDING STOCKS

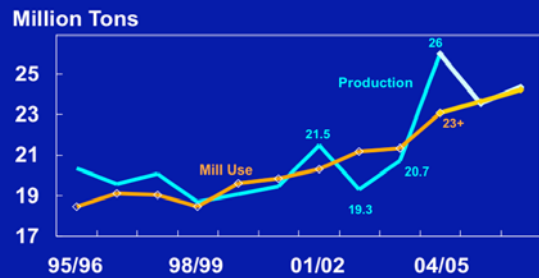


STOCKS-TO-USE RATIO: WORLD-LESS-CHINA (M)



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WORLD SUPPLY AND USE



TALKS ON AGRICULTURE

