



WORLD COTTON SITUATION¹

Trends in Global Cotton Supply and Use

World cotton production declined in both 2007/08² (by 2%) and 2008/09 (by 10%) to 23.7 million tons, the smallest production since 2003/04. These two consecutive declines were caused principally by decreases in cotton area, as cotton prices have become less attractive relative to competing crop prices and production costs have increased. World cotton area decreased by 5% in 2007/08 and 6% in 2008/09, to 31 million hectares. The world yield climbed to a record of 795 kg/ha in 2007/08, but was estimated down to 763 kg/ha in 2008/09 due mainly to unfavorable weather.

In 2009/10, world cotton production is expected to remain stable at 23.6 million tons. Decreasing cotton returns, more attractive prices for competing crops, and expected difficulties in financing inputs are encouraging farmers to plant less cotton. World cotton area is forecast down by 3% to 30.2 million hectares in 2009/10. The average yield is projected at 781 kg/ha, slightly higher than in 2008/09, assuming more favorable weather.

In 2007/08, production declined significantly in the United States, Pakistan, Turkey, Burkina Faso and Australia, but reached new records in China (P.R.), India and Brazil. In 2008/09, the decline in world production was driven by a fall of more than 1.3 million tons in the United States. Production was also estimated lower in China (P.R.), India, Uzbekistan, Brazil, and Turkey, but slightly larger in Pakistan. U.S. production has declined for three consecutive seasons and fell to 2.8 million tons in 2008/09, down by nearly half from its record in 2005/06. Production in Turkey has declined each season since 2004/05 and fell to 450,000 tons in 2008/09, or just half its level of 2004/05. In 2009/10, production is expected to decline in China (P.R.) and Turkey, but to increase in India and the United States.

World cotton mill use was estimated stable in 2007/08, at 26.3 million tons, but fell in 2008/09 for the first time in a decade, by an estimated 13% (the largest decline since World War Two) to 22.9 million tons. World cotton mill use is forecast slightly higher at 23.1 million tons in 2009/10. This projection is based on the possibility of a slight recovery in world economic growth in 2010. Cotton mill use is expected to partially recover in China (P.R.), India and Pakistan, but to continue to decline in many smaller consuming countries that had already been experiencing long-term declines in mill use before the global economic crisis started.

World ending stocks declined slightly in 2007/08, to 12.5 million tons, but they are projected to reach 13.3 million tons by the end of 2008/09, or 58% of 2008/09 world mill use. World stocks will remain high relative to demand in 2009/10.

World cotton trade was estimated at 8.3 million tons in 2007/08. However, as a result of the decline in demand from importing countries, world cotton trade is projected sharply down to 6.1 million tons in 2008/09; this would be the smallest volume traded since 2000/01. Many countries have seen their cotton stocks increase in 2008/09, which will provide significant supplies in 2009/10. World cotton imports are forecast to rebound by 11% in 2009/10 to 6.7 million tons, helped by the expected small recovery in mill use in China (P.R.). Chinese imports are expected to increase by 17% to 1.7 million tons. Imports by Turkey and Pakistan are also expected to increase. Exports by the United States are expected to continue to decline to 2.4 million tons (-9%), whereas exports by India are projected to more than double to 1.2 million tons.

Three Crises Affecting the World Cotton Market

Since 2007/08, the world cotton market has been affected by three successive events: a global commodity price crisis, which resulted in higher agricultural production costs and reduced world cotton area; a crisis in

¹ Remarks prepared for delivery during the Director-General's Consultative Framework Mechanism on Cotton, 11th Round of Consultations, 24 April 2009, WTO Headquarters in Geneva.

² International cotton statistics are based on seasons beginning each August and ending the following July.

the cotton futures market, which hurt cotton trade mechanisms; and a global financial and economic crisis, which has had multiple effects on cotton mill use, trade and production.

- The Global Commodity Price Crisis

Prices of most commodities increased significantly between 2003 and the first half of 2008. This increase accelerated considerably starting in 2007. Crude oil prices increased from USD 29 per barrel in 2003 (annual average) to USD 133 per barrel in July 2008. The increase in energy prices triggered an escalation in fertilizer prices starting in mid-2007 and ending in the middle of 2008. The World Bank fertilizer price index increased by a factor of ten between 2003 and July 2008, and the rise in energy and fertilizer prices generated an increase in agricultural production costs. In addition, the level of stocks relative to the use of major food crops had been declining for some time, making their prices more sensitive to shocks. Demand for some food crops was boosted by government biofuel subsidies and mandates. Weather-related crop failures, speculation and some government policy decisions contributed to higher food crop prices during 2007 and the first half of 2008, and prices of many food crops remain higher than long run averages yet.

Fertilizers account on average for around 20% of overall cotton production costs, but there are large regional variations, depending on soils, weather, crop rotations and management, and the intensity of fertilizer use. Cotton is generally more expensive to produce than soybeans, maize and wheat. Cotton requires larger quantities of fertilizer than soybeans and wheat, and larger amounts of pesticides and fuel (if machine labor is used) than soybeans, maize and wheat. As a result, cotton production costs have been relatively more affected than these other crops by the crude oil and fertilizer price increases.

Prices of cotton's main alternative crops (grains and oilseeds in particular) have become more attractive than cotton prices over the last few years. This trend accelerated during 2007 and in the first half of 2008. As a result, in the countries where shifts in acreage among crops were possible, many farmers opted out of cotton production to turn towards production of alternative crops.

Higher cotton production costs and more attractive prices for alternative crops were the main factors explaining the decline in world cotton area in both 2007/08 and 2008/09.

- The Cotton Futures Market Crisis

Futures prices were extremely volatile during March 2008, mostly because of increased speculative activity at the Intercontinental Exchange (ICE) and volatility in prices of competing commodities. The Cotton #2 contract for May 2008 delivery fluctuated between 69 cents per pound and 90 cents per pound during March 2008. The Cotlook A Index, an indicator of world cotton prices, demonstrated similar volatility, reaching a high of 90 cents per pound on March 3, 2008 and falling to a low of 74 cents per pound on March 20, 2008.

The short-lived spike in futures prices caused a liquidity crisis. As a result, some merchants hedging their positions at the exchange were faced with huge margin calls and were forced to liquidate their positions at a loss. Many merchants could not recover from these losses in the physical market. Some were driven into bankruptcy and others decided to go out of the cotton business.

Other consequences of the March 2008 events are a decrease in banks' trust in the cotton futures market and a tightening of credit for merchants' margin calls, a reduced trust of cotton market participants in the mechanisms of the futures market, and difficulties for merchants to purchase in advance and at fixed prices large quantities of cotton (as was commonly done before the futures market crisis).

- The Global Financial and Economic Crisis

The world economy expanded robustly in 2007, for the fourth consecutive year, spurred by rapid economic growth in developing countries. However, August 2007 marked the beginning of a period of global economic deceleration and crisis in the functioning of the housing, financial and commodity markets. According to the January 2009 projections of the International Monetary Fund (IMF), global economic growth decelerated from 5.2% in 2007 to 3.4% in 2008. On March 31, 2009, the First Deputy Managing Director of the IMF announced that the Fund is expecting global economic growth to contract by 0.5% to 1.5 % in 2009, with only a very gradual recovery beginning in 2010. The World Bank's (WB) projections published on March 30, 2009 forecast a contraction of 1.7% in global economic growth in 2009 and a recovery to 2.3% in 2010. The global economic outlook for 2010 remains very uncertain.

While the two crises mentioned earlier primarily affected cotton production and trade, the global economic crisis is influencing mainly textile purchases by end-use consumers and therefore cotton consumption. In

addition, tightening credit conditions for textile mills are slowing their purchases of raw materials, including cotton. In some countries (for example in Europe and in the United States), the global economic crisis is accelerating a decline in cotton mill use that started many years ago, due to other factors. In other countries such as China (P.R.) and India, the two largest industrial users of cotton, cotton mill use is contracting in 2008/09 for the first time in many years. China (P.R.) accounts for around 40% of world cotton industrial consumption. Mill use in China (P.R.) rose by an average annual rate of nearly 11% between 1998/99 and 2007/08. However, 2008/09 mill use in China (P.R.) is projected at 9.0 million tons, a decline of 17% from the 2007/08 level. Likewise, Indian cotton use rose at an average rate of about 7% over the last five seasons, but a decline of 6% to 3.8 million tons is expected in 2008/09. The current decline in cotton mill use in these two countries was unexpected in early 2008. World cotton mill use is expected to fall by 13% in 2008/09 to 22.9 million tons. This would be the strongest decline recorded since World War Two.

The global economic crisis, through its impact on world cotton mill use, is also affecting cotton trade, stocks and production. The lower demand for cotton is causing a 27% drop in imports this season, to 6.1 million tons. The ratio of world cotton imports to world mill use, which averaged 31% in the last decade, is falling to 26%, reflecting tighter credit conditions, tighter operating margins for textile mills and caution on the part of textile mill operators. Chinese imports, which represented 30% of global imports last season, are expected to drop by 42% in 2008/09 to 1.5 million tons. Exporters are being forced to carry larger stocks than desired. Exports are projected down by 13% in the United States to 2.6 million tons, by 70% in India to 450,000 tons, and by 38% in Uzbekistan to 550,000 tons. Global cotton stocks are expected to increase by 6% in 2008/09 to 13.3 million tons and the global stocks-to-use ratio is expected to increase from 48% to 58%, the highest since 1998/99. Finally, the tightening of credit conditions worldwide will also affect world cotton production in 2009/10, as it is making it more difficult for cotton producers to finance their inputs.

Impacts of the Crises on the African Cotton Sector

Africa accounted for 5% of world cotton production, 2% of world cotton mill use and 13% of world cotton trade in 2007/08 (almost all African cotton is exported). These relatively small market shares imply that the African cotton market has a minor effect on the world cotton price and is therefore dependent on what happens in the rest of the world. According to the IMF projections published in January 2009, economic growth in Africa could slow from 5.2% in 2008 to 3.4% in 2009.

African cotton production declined each season from a record of 2.0 million tons in 2004/05 to 1.2 million tons in 2008/09, due mainly to decreases in area, but also partly to declining average yields. Cotton exports have also declined over the same period, from 1.5 million tons to 0.9 million tons. The share of African exports in the world total declined from 19% to 14% over this period. The significant decrease in African cotton production over the last few years was driven by a fall in production in the African Franc Zone and North Africa. Production in East and Southern Africa dropped from 2004/05 to 2006/07 but recovered in the following two seasons.

There are no direct government payments to cotton producers in Africa. Cotton production on the continent is therefore responsive to variations in world cotton prices. Lower international cotton prices, aggravated in many countries by an unfavorable exchange rate, had already weakened the African cotton industry in the seasons preceding the crises. While the commodity price crisis has not had a significant direct impact on African cotton area, due to the lack of alternative crops in many regions, the rise in agricultural production costs resulted in declines in cotton area and/or yields (when farmers applied lower quantities of fertilizer than usual). The crisis in the cotton futures market has not had a significant direct impact on the African cotton industry, as most African cotton companies make little use of hedging instruments. However, the cotton futures market crisis has affected the ability of international traders to buy large quantities of African cotton early in the season, at fixed prices. This will likely harm the finances of cotton companies and ginners. Finally, African cotton exports have been affected (as have exports from other regions) by the decline in demand from consuming countries in 2008/09. Also, the tightening of credit conditions due to the global economic crisis will make it difficult to finance 2009/10 production inputs, in a continent that is already facing high interest rates.

African cotton production is projected to continue to decline by 2% in 2009/10, driven by an expected further reduction in cotton area in the African Franc Zone. However, production in Egypt is projected to increase. Exports from African countries are expected to increase in 2009/10 to 980,000 tons.

In summary, the three global crises affecting the cotton market have worsened an already difficult situation for the African cotton industry. This situation could be alleviated by a weakening of local currencies vs. the US dollar (which would soften the decline in cotton prices at the local level) and/or an increase in cotton productivity.

The ICAC Cotton Price Forecast for 2009/10

The season-average Cotlook A Index jumped by 23% to 73 cents per pound during 2007/08. Factors other than fundamental changes in cotton supply and use contributed to the significant increase in the level and volatility of cotton prices that season. Such factors perhaps included the weakening of the US dollar, soaring prices of commodity futures, and increased participation of institutions and individuals not involved in physical cotton trade in the cotton futures market.

Taking into account the average Cotlook A Index between August 2008 and the first week of April 2009, and expected levels of cotton supply and use, the ICAC Price Model 2007 projects the season-average Cotlook A Index at 59 cents per pound in 2008/09, down by 19% from last season. The 95% confidence interval ranges from 56 to 62 cents per pound.

Based on the price forecast for 2008/09 and expected changes in supply and use, the ICAC Price Model 2007 forecasts a 2009/10 season-average Cotlook A Index of 56 cents per pound, with a 95% confidence interval ranging from 44 to 62 cents per pound. However, caution must be exercised since all commodity markets are subject to great uncertainty, and the forecast bears substantial downside risks.

Conditions in Place for Longer Term Growth

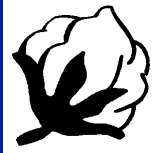
Despite the current difficulties, cotton remains a viable commodity of wealth, employment and growth in the long run. With a rebound in world economic growth expected to begin in 2010 and improve in 2011, demand for cotton will strengthen again. Technology changes in cotton production are contributing to both higher yields and reduced environmental impacts, creating the conditions for long term growth in the cotton sector. Further, consumers the world over prefer natural, renewable and comfortable cotton in apparel and home furnishings. World consumption of cotton reached a record of more than 26 million tons in 2007, and a return to that level is likely within a few years after the economic recession has run its course.

World Cotton Market: Trends in Supply and Use

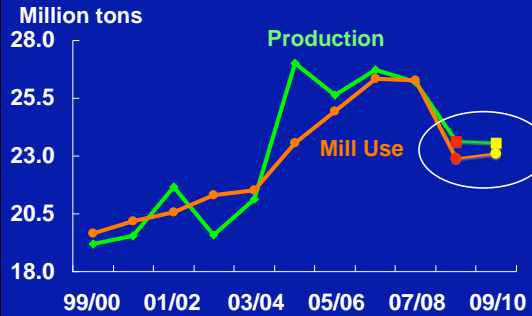
Director-General's
Consultative
Framework
Mechanism
On Cotton

WTO

April 24, 2009

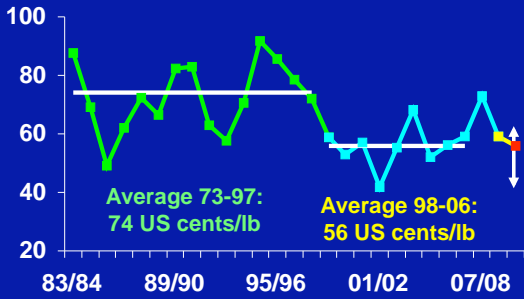


World Cotton



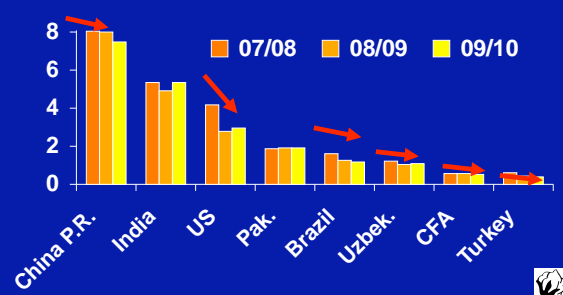
Cotlook A Index

Season-average (US cents/lb)



Production

Million tons

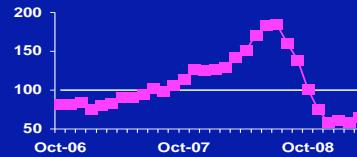


Three Crises Affecting the World Cotton Market

1. Global Commodity Price Crisis
3. Cotton Futures Market Crisis
5. Global Financial and Economic Crisis

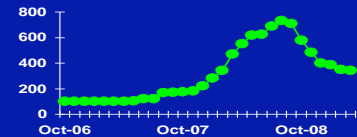
Crude Oil Prices

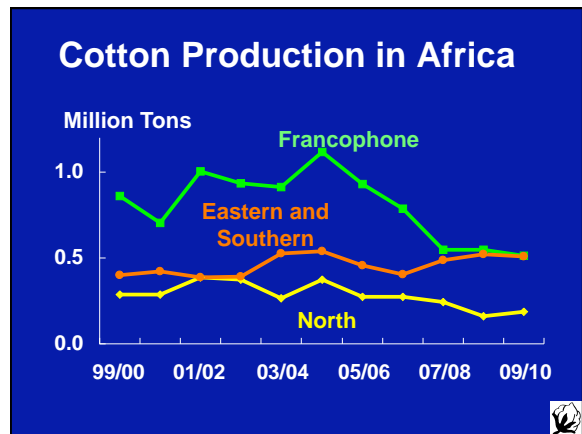
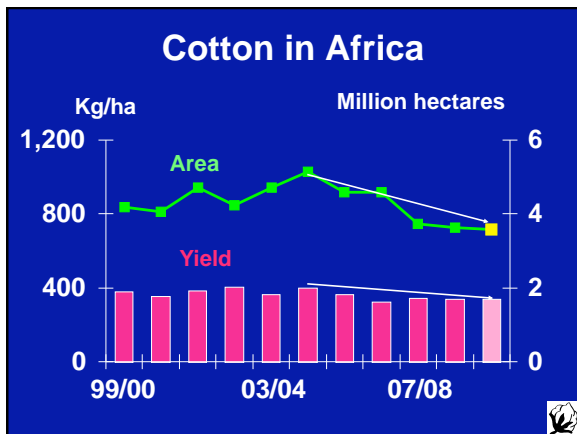
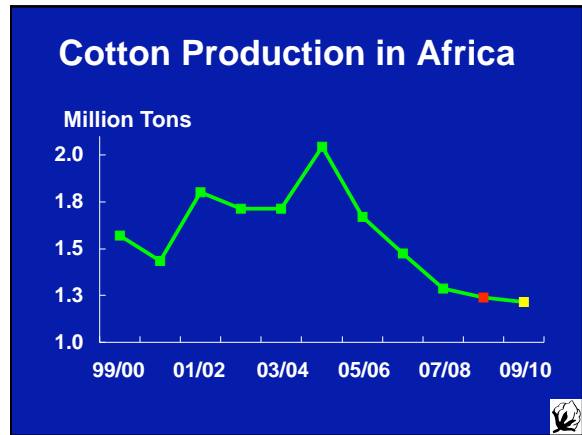
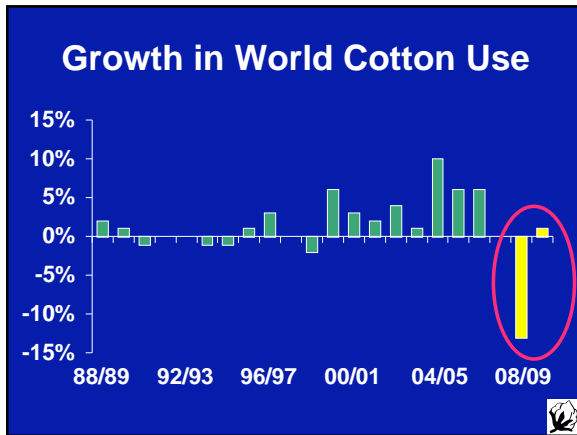
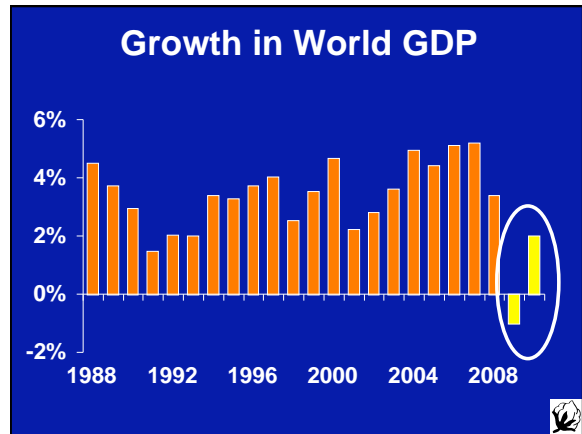
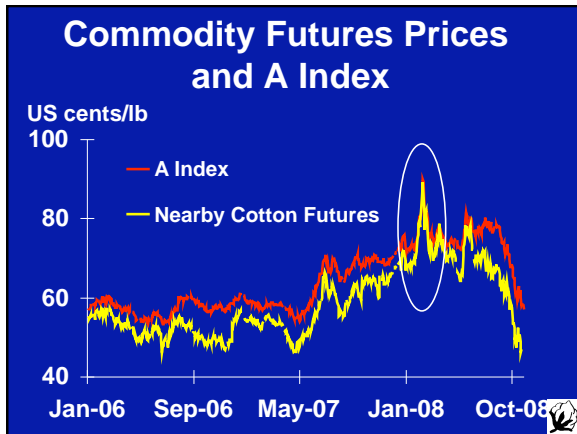
August 2006 = 100

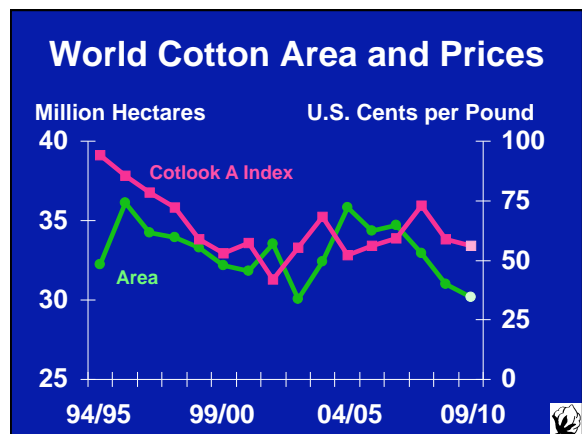
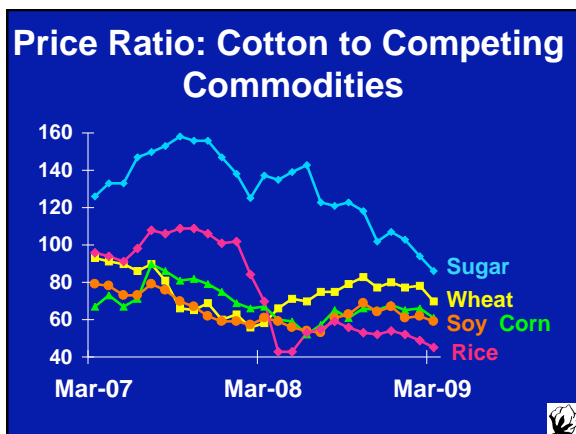
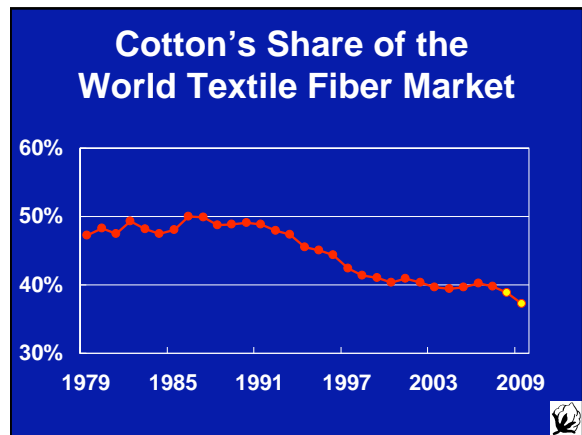
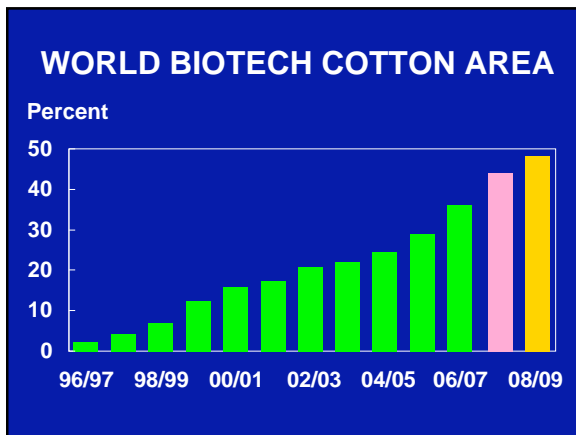
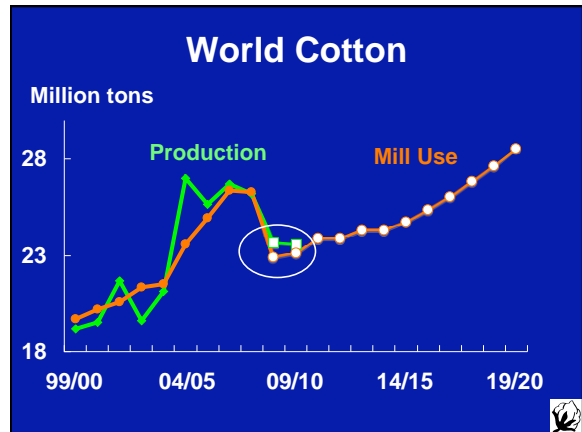
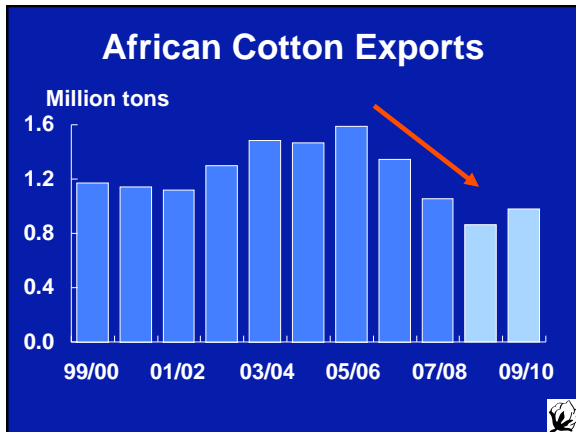


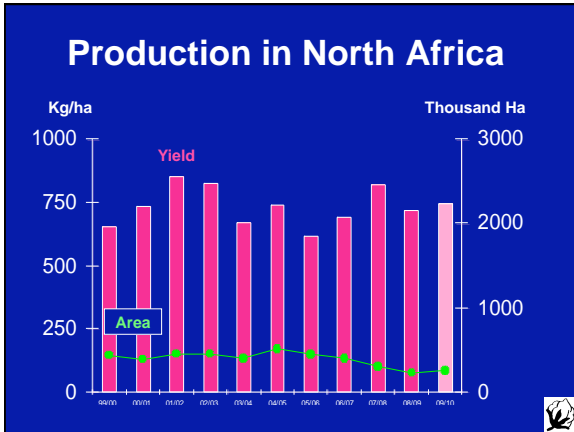
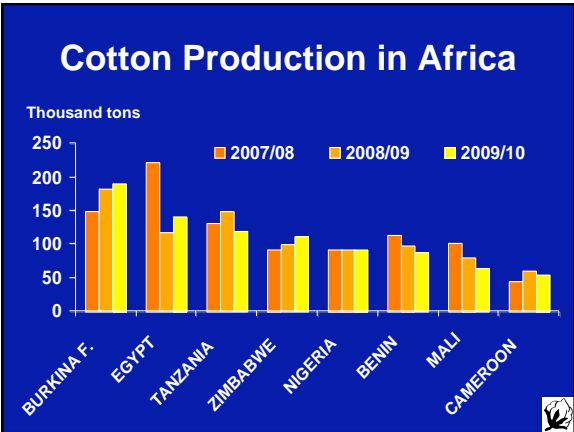
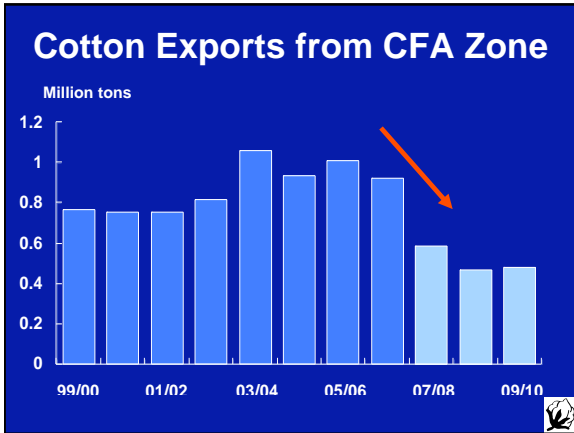
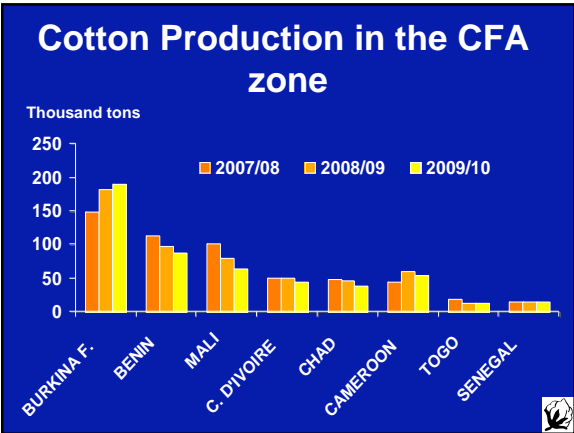
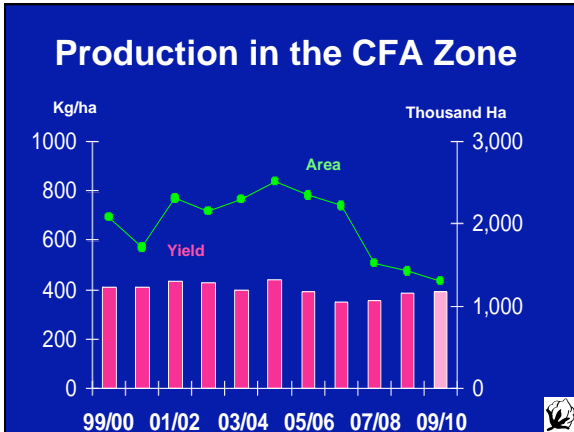
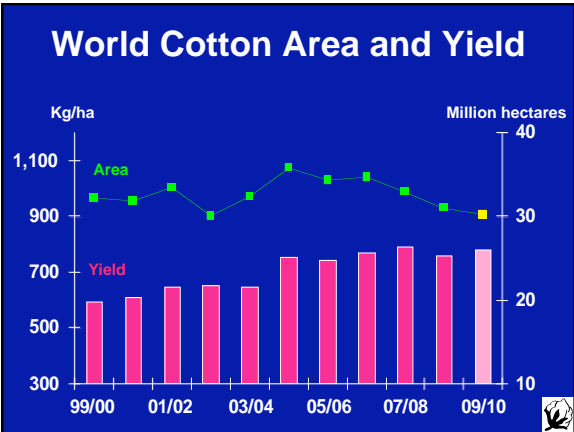
Fertilizer Prices

August 2006 = 100









Production in East and Southern Africa

