



OUTLOOK FOR WORLD COTTON SUPPLY AND USE: CONTINUED RISE OF ASIA*

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Summary

Growth in world cotton production and the extraordinary expansion in mill consumption in recent years have gone hand in hand. Asia has been the main driver of these increases in production and mill use. As world cotton mill consumption is forecast to increase by 3% in 2007/08 but world cotton production is projected slightly down, world cotton stocks could decline. An expected significant decline in the stocks-to-mill use ratio in the World-less-China (Mainland) is expected to result in an increase in international cotton prices in 2007/08. World cotton imports are expected to rebound in 2007/08, driven by forecast higher Chinese imports.

World Cotton Production Slightly Down in 2007/08, but record in Asia

World cotton production followed an almost regular upward trend over the last half century, staying on the same general trend as global cotton mill use. Production expanded from 6.6 million tons in 1950/51 to 27.1 million tons in 2004/05, before declining slightly in following seasons. A zoom on the last 25 seasons shows that production stagnated around 20 million tons between 1994/95 and 2003/04, before jumping to 27.1 million tons in 2004/05. Production has since remained above 25 million tons. The higher production levels since 2004/05 are primarily the result of much higher yields, but also benefited from larger cotton area.

The world average yield rose by 105 kilograms per hectare (16%) in 2004/05 and has not declined since. Cotton yields in many countries are benefiting from the expanded use of existing techniques, such as integrated pest management, better water management, minimum tillage, crop rotations and improved use of fertilizers, as well as new technologies. The most visible of these new technologies is biotech cotton. Biotech cotton is primarily risk and cost reducing, but in some countries it can contribute to increasing yield. It is estimated that 41% of world cotton area will be planted to authorized biotech cotton in 2007/08, up from 37% in 2006/07, contributing to 48% of world cotton production. In India, yields have increased sharply from 302 kilograms per hectare in 2002/03 to a record of 520 kilograms per hectare in 2006/07. This 72% yield increase over four seasons is in large part attributed to the expansion of biotech cotton area. In the rest of the world, the average yield increased by 12% over the same period. These recent yield increases in India, where one quarter of world cotton is planted, significantly contributed to the rise in the world average yield.

Until the end of September, weather in most regions of the northern hemisphere has been favorable to cotton plant growth. A significant increase in biotech cotton area in India is expected to continue to support increases in yields. The world yield is forecast stable in 2007/08 at 772 kilograms per hectare.

Since 2004/05, world cotton area has remained between 34 and 36 million hectares, in the upper range of the historical interval of 28 to 36 million hectares maintained since the beginning of the 1950s, despite lower prices than in the past. Several factors are responsible for the higher levels of world cotton area, but the most visible and also possibly the most important is the significant increase

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in cotton yields in some large producing countries over the last few seasons. Nevertheless, since 2006/07 world cotton area has not increased despite the gradual rise in cotton prices.

Despite the small gain in prices in 2006/07, cotton area is estimated slightly down in 2007/08 to 34.0 million hectares. Area is estimated up in Asia, including in particular India (+4%) and Pakistan (+6%). However, it declined sharply in the United States (-17%), Turkey (-11%), and the CFA zone (-26%). In the United States and in Turkey, corn was a more attractive alternative to cotton at planting time. In addition, Turkish growers experienced low cotton yields in 2006/07, which discouraged some of them from planting cotton this season. In the African Franc Zone, several seasons of low producers' prices combined with declining yields have reduced the incentive for many farmers to plant cotton. As a result, world cotton production is expected to decline slightly to 26.2 million tons in 2007/08.

Production is expected to decline in many countries in 2007/08. In particular, significant production declines are expected in the United States (-16%), in Turkey (-9%) and in the African Franc Zone (-21%) due mainly to drops in cotton area. However, production in Asia is expected to increase again in 2007/08 to a record of 15.5 million tons. This would represent 59% of projected world production, compared to 56% in 2006/07 and 51% in 2005/06. Most Asian cotton production is located in China (Mainland), India and Pakistan. Projected area and yield increases in India and Pakistan explain most of the forecast production increase in Asia in 2007/08. In particular, both area and yield are expected to reach record levels in India, which will remain the second largest producer for the second consecutive season.

Estimates of Production in China (Mainland) Revised

The lack of accurate information on major elements of the Chinese balance sheet forces the Secretariat to adjust its estimates from time to time to better reflect the market situation or additional information.

The Secretariat raised its estimates of Chinese cotton production three times in 2007: in June, in August and in October. There appears to be a consensus in the Chinese cotton industry that production statistics published by the National Bureau of Statistics generally underestimate actual production. In addition, the amount of cotton imported by China (Mainland) during 2006/07 (2.3 million tons) was much smaller than expected. In September 2007, the China Cotton Association (CCA) and the National Development Reform Committee (NDRC) estimated 2006/07 Chinese production at 7.7 million tons, based on a higher production estimate for Xinjiang. The Secretariat took into account this higher production estimate in Xinjiang and assumed that production in provinces other than Xinjiang is also underestimated by NBS statistics, although to a much smaller extent. The Secretariat's revised production estimate for 2006/07 in China (Mainland) is 8.0 million tons, and the projection for 2007/08 is 7.8 million tons.

World Cotton Mill Consumption Increasingly Driven by Asia

World textile fiber consumption is driven by three major factors: income, population and fiber prices. It is also affected by trade rules and consumer preferences. World cotton mill use increased at an impressive pace from 18.9 million tons in 1998/99 to 26.3 million tons in 2006/07, averaging annual growth of 4% compared to 1% in the previous two decades. This considerable expansion in mill use has been fueled by strong global economic growth, increases in population, lower prices of cotton relative to other fibers (in particular polyester), and the popularity and greater availability of cotton products vis-à-vis products made of other fibers. In addition, the removal of textile trade quotas agreed under the Multi Fiber Arrangement was completed at the end of 2004. This encouraged further geographical redistribution of textile production to countries with lower production costs, with the effect of lowering textile prices and boosting retail consumption. China (Mainland) has been the main driver of world cotton mill use since 1998/99, thanks in part to its accession to the WTO in 2001. Despite the

safeguard mechanisms implemented against imports of Chinese textile products by the United States, Turkey and the European Union since 2005/06, these imports have continued to rise.

Global cotton mill use is expected to continue to increase in 2007/08, supported by economic and population growth, but the increase is expected to be smaller than in recent seasons owing in part to the expected increase in cotton prices. World cotton mill use is projected to increase by 3% to 27.2 million tons in 2007/08, compared to an annual growth of 6% in 2006/07 and 9% in 2004/05.

Asian cotton mill use is expected to continue to increase by 5% in 2007/08 to a record of 20.5 million tons. This would represent 75% of world cotton mill use, up from 74% in 2006/07 and 57% in 1998/99. Once again, most of this increase will be driven by China (Mainland), where mill use is forecast at 11.1 million tons, up 6% from 2006/07 and accounting for 41% of world cotton mill use. Mill consumption of cotton is also expected to increase in India to 4.3 million tons (+8%) and in Pakistan to 2.7 million tons (+3%). Mill use in other Asian countries is forecast stable at 2.4 million tons: increases forecast in Bangladesh, Vietnam and Indonesia are expected to offset projected declines elsewhere. Cotton mill use is expected to increase in Central Asia, Turkey and South America but to continue declining in the United States and the European Union. The end of the safeguard mechanisms against Chinese imports in the European Union at the end of 2007 could increase pressure for the local textile industry, but it is not yet clear if this will accelerate the current decline in European cotton mill use.

Despite the significant increase in world cotton mill use since 1998/99, cotton's share of the world textile market has declined by 10% from 1986 to 2000. Afterwards, due to more competitive cotton prices and to the rapid expansion of cotton mill use in China after its incorporation to the WTO in 2000, cotton's share of the world textile market has stabilized at around 40%.

Projected Increase in World Cotton Trade, driven by Chinese Imports

World cotton trade expanded for five consecutive seasons, from 5.9 million tons in 2000/01 (30% of world production) to a record 9.8 million tons in 2005/06 (38% of world production). Chinese imports were the main driver of this expansion: they grew from 58,000 tons in 2000/01 (1% of world cotton imports) to 4.2 million tons in 2005/06 (43% of world imports), fueled by increasing domestic mill use. However, in 2006/07, world imports dropped by 15% to 8.2 million tons. Despite continued growth in Chinese cotton mill use, Chinese imports fell by almost half to 2.3 million tons. A record crop, an increase in the duty rates for low-priced cotton under the sliding-scale duty system, a reduced gap between Chinese and international cotton prices, the fact that apparently no cotton was imported for the national cotton reserve (as was the case in 2005/06), and the auction of national reserve stocks in the last two weeks of the season led to reduced Chinese imports in 2006/07. In 2007/08, world cotton trade is expected to rebound by 8% to 8.9 million tons due to larger forecast Chinese imports (3.5 million tons). Chinese mill use is projected to increase faster than production in 2007/08, and mills will need to import more cotton so as not to deplete their stocks. Imports by the rest of the world are forecast down by 8% to 5.4 million tons.

U.S. exports dropped from 3.9 million tons in 2005/06 to 2.8 million tons in 2006/07, mainly due to the decline in Chinese demand, as well as increased competition from Indian exports. The share of the United States in world exports dropped from 40% in 2005/06 to a six-year low of 35% in 2006/07, whereas the share of India increased from 8% to 12%. U.S. exports, boosted by large domestic stocks accumulated during 2006/07, are projected to rebound to 3.7 million tons in 2007/08. Brazilian exports could more than double to a record of 685,000 tons, as a result of the record 2006/07 crop. Indian exports are also expected to increase to a record of 1.1 million tons, as domestic supplies are forecast to continue to grow faster than domestic mill use. However, exports from Uzbekistan, the CFA zone and Australia are expected to decline. The share of the United States in world exports is expected to rebound to 41% in 2007/08.

Cotton Prices Rising, but not as Fast as Prices of Competing Commodities

International cotton prices, as measured by the Cotlook A Index, averaged 59 cents per pound in 2006/07, or 3 cents higher than in the previous season and 7 cents higher than in 2004/05. However, international cotton prices remain much lower than in previous decades. The Cotlook A Index averaged about 74 cents per pound between 1973/74 and 1997/98 compared to 56 cents per pound between 1998/99 and 2006/07.

Since 1988 the Secretariat has used a statistical model to forecast the season average Cotlook A Index. This model was adjusted from time to time to reflect structural changes in the world cotton market, and functioned relatively well until 2003/04. The main variables used by the model were the stocks-to-use ratio in the world-less-China (Mainland) and the net imports by China (Mainland) as a share of non-China mill use. However, this price model did not function as well starting in 2004/05, and the model functioned very poorly in 2005/06 and 2006/07.

The Secretariat recently developed a new model to forecast the season-average Cotlook A Index. The first published forecast of this model is dated August 1, 2007. The new model includes two main variables: the stocks-to-mill use ratio in the World-less-China (Mainland) and the stocks-to-mill use ratio in China (Mainland). The most important variable is the stocks-to-mill use ratio in the World-less-China (Mainland):

- A 10% increase in the stocks-to-mill use ratio in the World-less-China (Mainland) in the current season causes a 10% decline in the Cotlook A Index this season;
- A 10% increase in the stocks-to-mill use ratio in the World-less-China (Mainland) in the previous season causes a 4% decline in the Cotlook A Index in the current season;
- A 10% increase in the stocks-to-mill use ratio in China (Mainland) in the previous season causes a 1% decline in the Cotlook A Index in the current season.

The first forecast of the season-average Cotlook A Index for 2008/09 will be published on April, 1, 2008, or four months before the beginning of the season. Also, price forecasts are now adjusted each month depending on the actual values of the Cotlook A Index to that date.

As of October 16, 2007, the new ICAC price model 2007 predicts a season-average Cotlook A Index of 68 cents per pound for 2007/08, with a 95% confidence interval ranging from 61 to 76 cents per pound. The main reason for this projected price increase from 59 cents per pound in 2006/07 is the expected decline in the stocks-to-mill use ratio in the World-less-China (Mainland) from 59% in 2006/07 to 51% in 2007/08. This would be the lowest ratio since 2003/04, but the ratio would remain higher than the 25-year average of 45%.

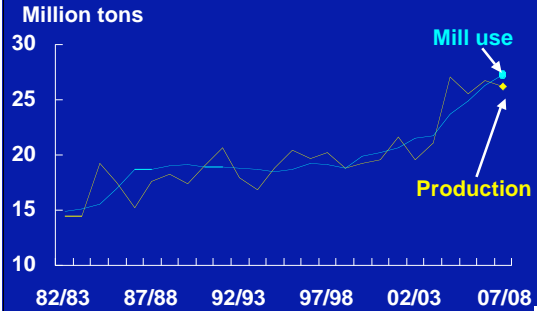
Cotton prices are rising, but not as fast as prices for corn, soybean and wheat. Increasing demand for ethanol pushed corn prices upwards in the past year; prices of soybean, a major competing crop, were affected by the decrease in supply and higher demand. Wheat prices are also increasing this season due to production shortfalls. As a result, in coming months cotton prices are expected to remain less attractive than prices of corn, soybean and wheat. This suggests that despite the expected significant rise in cotton prices this season, plantings in many countries may not increase much in 2008/09. The Secretariat currently projects world cotton area to increase by only 1% in 2008/09. In particular, cotton area is expected to decline further in the United States.

Outlook for World Cotton Supply and Use



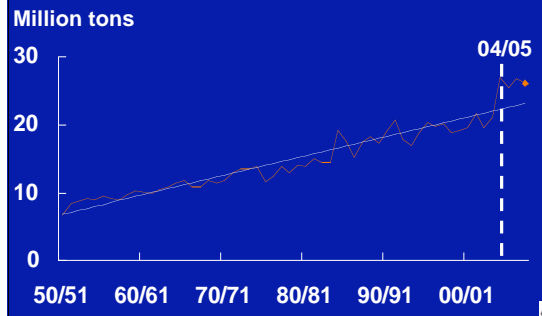
Alejandro Plastina, ICAC
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World Production & Mill Use

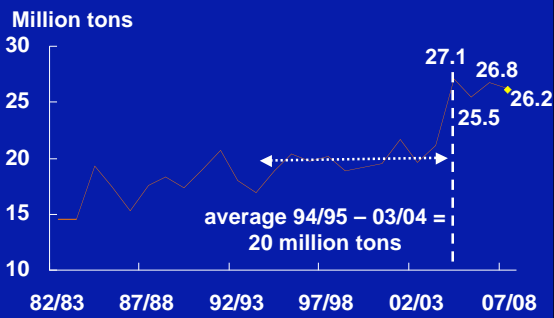


WORLD COTTON PRODUCTION

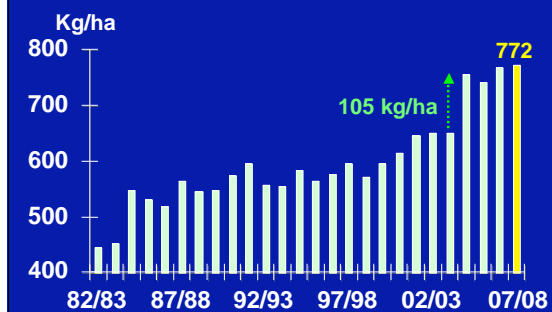
Long-term Trends in World Cotton Production

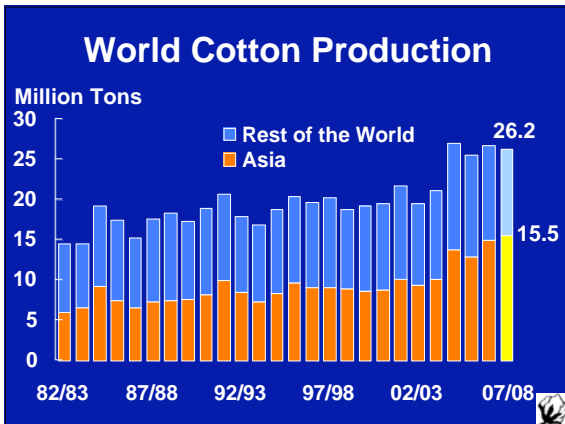
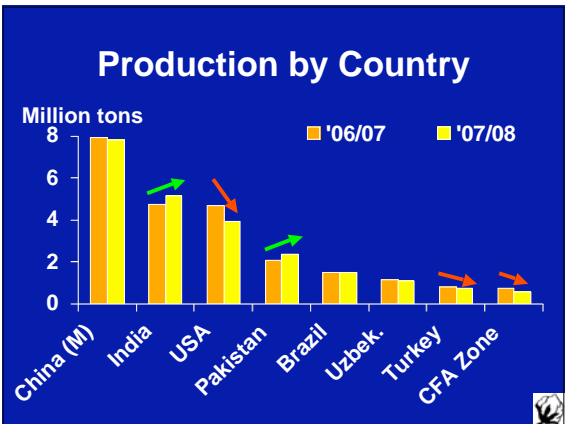
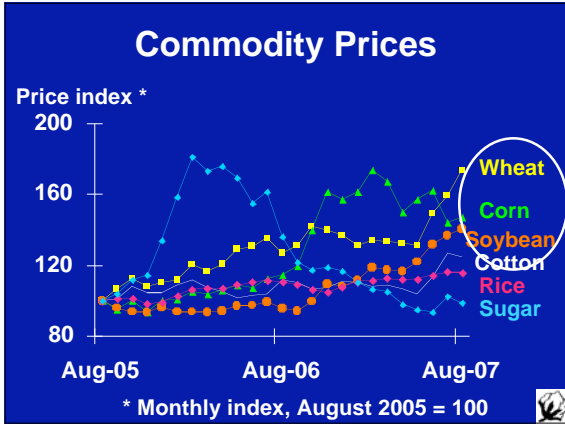
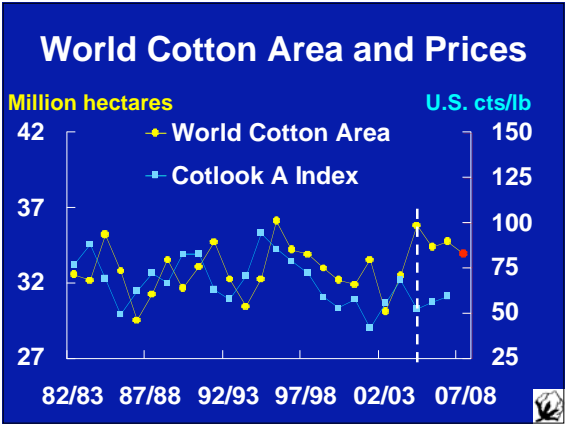


World Production

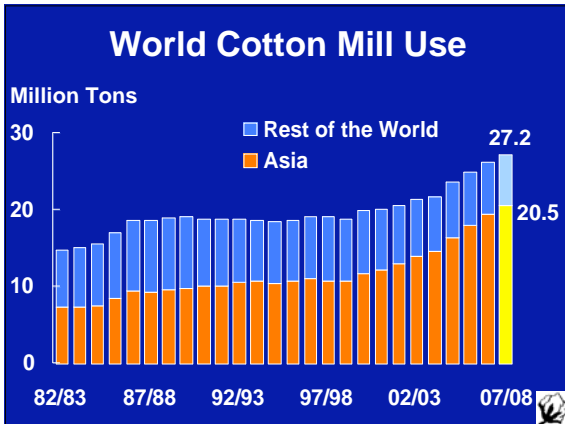


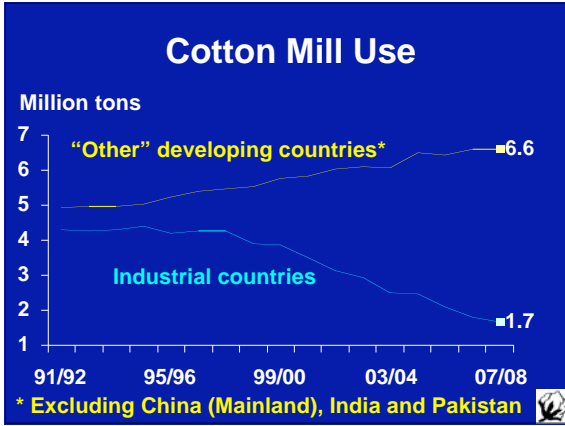
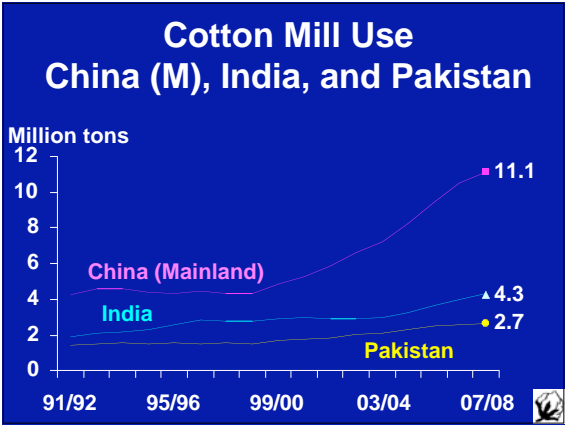
World Cotton Yield



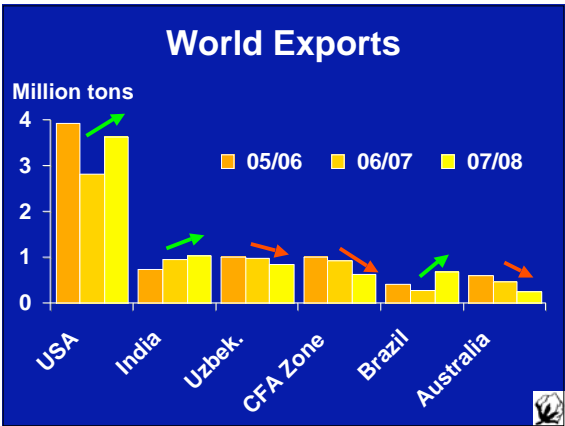
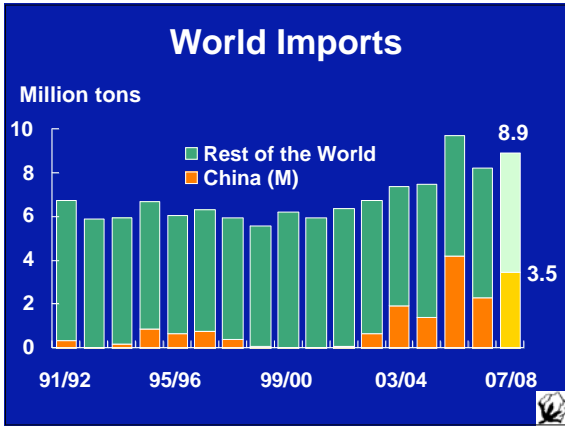


WORLD COTTON MILL USE

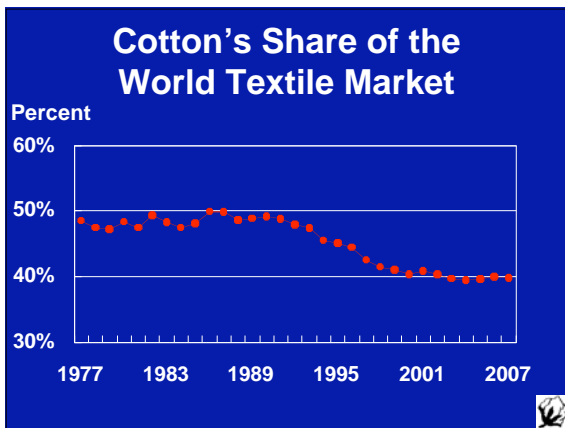
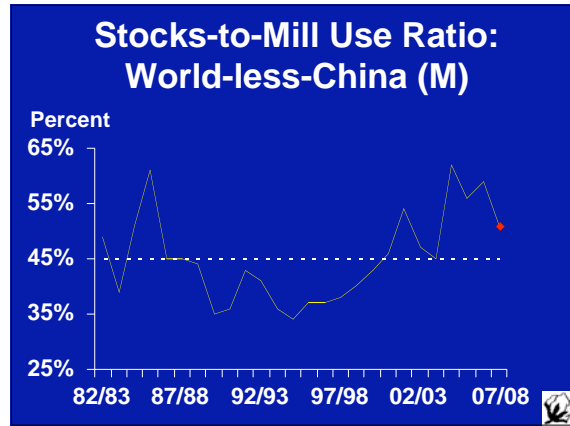
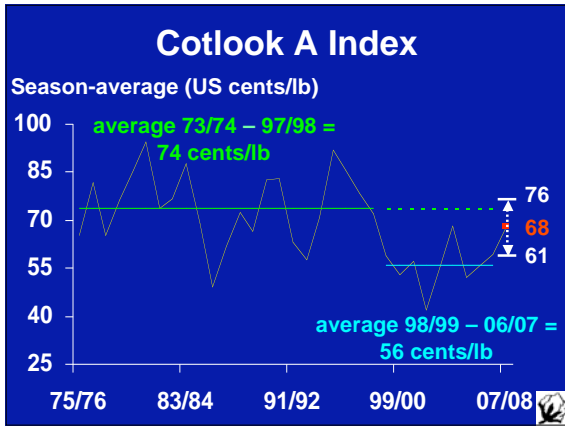




WORLD COTTON TRADE



WORLD COTTON PRICES



- ### Concluding Remarks
- Yields remain high
 - Rise of Asia in both production and mill use
 - Rebound in world cotton trade
 - Projected rise in cotton mill use, slight decline in production → decline of stocks in 2007/08
 - Rising cotton price
 - Rising prices of competing commodities could limit expansion of cotton area in 08/09



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