The ICAC Recorder

The Impact of COVID-19 on the Global Textile Industry

Andrei Guitchounts, International Cotton Advisory Committee, 1629, K Street NW, Washington DC 20006
and **Terry Townsend**, Cotton Analytics, 1013 Autrey St., #2 Houston, TX 77006

Andrei Guitchounts: Director of Trade Analyses of the International Cotton Advisory Committee (ICAC). He worked for the Soviet state cotton trading company "Exportlljon/Novoexport" from 1978 to 1990 before joining the ICAC in 1990. Andrei analyses trade data and trade policies, structure of world trade and works on risk management issues. He co-authored a book "Cotton Facts" (2003), published by the ICAC Secretariat. He also authored numerous publications on world cotton trade, supply and use, prices, risk management, structure and subsidies.

Terry Townsend.: Worked as Executive Director of the international Cotton Advisory Committee (ICAC) from January 1999 to December 2013; Statistician (ICAC) from August 1987 to December 1998; Economics Research Service (ERS) at the United States Agricultural Department (USDA) as Economics Editor, Agricultural Outlook, January 1986 to July 1987 and Cotton & Wool Outlook and Situation Coordinator, March 1983 to December 1985.

COVID-19's impact on the world textile chain has been devastating. From retail to brands, textile mills, trade, producers and all associated industries, monetary and job losses are mounting. Estimates by the International Labour Organization (ILO) indicate that full or partial lockdown has affected 2.7 billion workers, or 81% of the world's workforce. The ILO estimates that the majority of the hardest-hit workers — about 1.25 billion, 38% of the global workforce — are in retail trade, accommodation, food services and manufacturing. Retail and manufacturing, including textiles, are facing the closure of retail stores, cancelled orders, job losses and reduced salaries, as well as suppressed demand for textiles, and clothing, especially fast fashion. There are several estimates of the number of workers employed in the global textile and cotton industry, ranging from 150 million to 200 million, and almost all of them are affected and face losses. The value of textiles produced in 2019 is estimated by the Grand View Research company at $962 billion. Production in 2020 could be reduced by approximately one-third, or around $300 billion in lost economic activity.

Order Cancellations Damage Demand for Textiles and Cotton

Textile demand contraction accelerated at the retail level in March and April and continued during May in every region of the world, as most of the stores and markets around the world have been closed for weeks, and retailers were faced with growing losses, large inventories and no in-store customers. At the same time, consumers are faced with sharply reduced income and substantially less ability to spend on non-essential items. Unemployment in the United States is estimated at one-third of the work force as of May 2020, a level not seen since the Great Depression.

Consumer spending priorities include food, sanitary items and utilities, rather than clothing and textiles. Major retailers have suffered significant losses and had to close stores. Macy's, Kohls, Gap, Bed Bath & Beyond, JC Penny, Levi Strauss and others have seen their sales decline by up to 90% during the shutdown. In Germany, the largest department store, Galeria Karstadt Kaufhof, filed for administrative insolvency, the equivalent of bankruptcy in the USA, as it was losing 80 million euros per week. The Galeria was a retailer for major brands such as Adidas, Calvin Klein, Ralph Lauren, Scotch & Soda and more. In the United States, J. Crew and Neiman Marcus filed for bankruptcy recently, and more retailers are likely to follow.

Major brands such Primark, C&A, Inditex, Matalan, JC Penny, Kiabi, Kohls, Marks & Spencer, H&M, Mothercase, Target, Tesco, Walmart and others have cancelled billions of dollars' worth of contracts with textile mills in major textile-dependent economies. Bangladesh has suffered the brunt of those cancellations. According to the Bangladesh Garment Manufacturers and Exporters Association (BGMEA), $3.11 billion worth of textile exports — 967 million pieces — were cancelled by the major brands, affecting 1,123 factories and 2.23 million workers. Some of the brands pledged to accept and pay for the orders already completed and even to create a wage fund for the workers who lost their jobs, but that represents only a small portion of the pre-COVID-19 business. In Pakistan, textile order cancelations are estimated at $1.3 billion, affecting hundreds of mills and millions of workers. The Indian Clothing Manufacturing Association estimates that the Indian industry has suffered losses of $13 billion as a result of the shutdown and cancelled orders. Textile mills in China are returning to operations but indications are that they are only operating at about 30% of capacity. The Chinese textile industry is valued at $250 billion. Vietnam, Indonesia, Myanmar and other countries face similar cancellations. Spinners in all markets report a significant build-up in yarn stocks, order cancellations and contraction in operations.

Figure 1. Garments factory in China

The ITMF in March-April conducted a couple of surveys on the Covid-19 impact on the global textile industry. The survey reached 700 companies and indicates that in 2020, cancellations of orders could reach 31% and the employee turnover could reach 28%. That could mean total losses for the global textile industry of about $300 billion.

Figure 2. A warehouse under lockdown

World cotton mill use will decline during the last five months of the 2019/20 season because of the cancellations of orders in China and other major textile economies. It is estimated that if the loss in spinning capacity between February and July 2020 averages 30%, mill use of cotton could decline from 26 million tonnes in 2018/19 to about 23 million tonnes in 2019/20. Based on the loss of this volume in demand, losses for the global cotton industry are estimated at $5 billion.

Contract Defaults and Losses will Damage Cotton Merchandising

Plummeting demand from major cotton-consuming countries will mean a reduction of about 2 million tonnes in the world cotton trade, bringing the total closer to 7 million tonnes. The cancellation of orders from brands and retailers forced the closure of spinning mills and led to an explosion in contract defaults on a very large scale. This is a major crisis and many of the cotton merchants are suffering very large losses that can reach hundreds of millions of dollars. Many companies, especially smaller family-owned firms, will be forced out of business, similar to the crises in 2008 and 2011. Total losses suffered by the cotton merchants could range from $1 billion to $2 billion. It will mean further consolidation in the cotton merchandising industry, where multinational, multicommodity companies have a better chance of survival. The recovery will happen, but it will take several seasons before we return to pre-COVID-19 levels.

The decline in mill use is resulting in declines in exports and imports of cotton, and the ICAC estimate of global cotton trade in 2019/20 has been reduced by 10% to 8.3 million tons since the start of March, with further revisions in the estimate of trade possible. In addition to the decline in the volume of trade, prices have fallen. Cotton futures on the ICE contract fell from 70 cents in early January when reports of COVID-19 began surfacing in China to 56 cents as of mid-May. The changes in volume and price amount to a reduction in the value of cotton trade during 2019/20 of approximately $4 billion. There will be additional losses to the cotton industry representing the value of lost domestic sales.

The steepest declines in imports during 2019/20 as a result of the disruptions to trade caused by COVID-19 are in Bangladesh, down about 400,000 tons, China, down 300,000 tons, and Vietnam, Turkey and Indonesia, each down about 100,000 tons. Imports will be declining in almost every country during 2019/20.

Cotton merchants will bear much of the brunt of this decline in the value of trade because of contract cancellations and market losses. When merchants sell cotton to buyers, both domestic and international, they must procure the cotton and ensure it is in an accessible warehouse and ready to be shipped. For export contracts, merchants must arrange freight and insurance and ensure that phytosanitary certificates are issued. In normal times, documents are prepared, letters of credit are opened, and cotton moves from origin to destination according to schedule.

However, in the current situation, the movement of cotton has slowed dramatically, leaving merchants with stocks in warehouses accumulating storage charges, which include insurance, warehouse charges and interest and average 0.8 cents per pound per month. These storage charges may seem small, but when added over 900,000 tons of reduced world trade, they represent costs of about $16 million per month.

The International Cotton Association (ICA), headquartered in Liverpool, is encouraging market participants to avoid contract cancellations and instead extend contracts for delivery later in 2020, without charge for carrying costs. Contract extensions, compared to contract cancellations, would enable merchants to salvage some of the losses they will otherwise experience.

Merchants are also facing losses on their hedges caused by contract cancellations. When merchants sell physical cotton to a buyer, they usually offset that risk by buying futures contracts. The decline in the value of futures from 70 cents in early January to 56 cents in mid-May represents additional losses to merchants.

In March 2008, ICE cotton futures changed from a century-old system of open outcry to fully electronic trading. Under open outcry, representatives of buyers and sellers stood in a circle on the trading floor in New York and screamed bids and offers at each other. The system was chaotic to observers but was understood by market participants. With fully electronic trading, all bids and offers were entered from computer terminals around the world, and while the system is efficient, participants were not used to it. During the first week of fully electronic trading in 2008, prices for cotton shot upward by about 40 cents a pound and then collapsed to their starting point. The gyration caught several major merchants without enough money in their trading accounts to meet margin calls, and several either went bankrupt or decided that the risk inherent in cotton trading was too great relative to the potential reward, and they chose to leave the industry.

Figure 3. A closed textile factory

Figure 4. Some garment factories have resumed activity

As a result of the market gyrations in 2008, the merchant sector became more concentrated with fewer but larger firms. Decades ago, cotton was traded mostly by family-owned merchant firms that specialised in cotton and were named after the family patriarch. Today, most of the surviving firms are diversified with operations across many commodities, including grains, oilseeds and animal products, with cotton being just one component or division in a large corporation. The losses to the merchant sector caused by the contract cancellations linked to COVID-19 will likely cause more firms to exit the cotton trading industry.

Lesser Effect on Production

At this time, cotton plantings for 2020/21 in the Northern Hemisphere, accounting for 90% of world production, are underway. Losses in cotton plantings and production are expected to be much smaller than in cotton demand despite a decline in cotton prices from 80 cents per pound in December 2019 to below 60 cents per pound today (per the Cotlook A Index). In some producing countries like Brazil, a switch from cotton to more attractively priced corn, soybeans and grain is expected. However, in other major producing countries, government programs guaranteeing target prices (like the USA), minimum support price (MSP) programs (like India and Pakistan) or direct subsidies (like China), will limit the extent of the decline in cotton plantings. Many producers have already made planting decisions but could change them at the last minute. For example, US prospective plantings for 2020/21 indicate only 1% decrease in planted area. However, many analysts expect a larger decline, as the surveys were taken before the major impacts of the COVID-19 became more obvious. Government economic relief/stimulus programs could also provide additional aid to cotton producers. However, in India and Pakistan, the lockdown has delayed seed processing, which could negatively affect plantings. In West Africa, the stronger US dollar benefits producers so cotton plantings might actually increase in 2020/21. Overall, global production could decline by 0.5-1 million tons, bringing the total closer to 25 million tons. That would mean an increase of about 2 million tonnes in world stocks, which will apply downward pressure on cotton prices.