



WORLD COTTON SITUATION

Huge Decline in World Cotton Mill Use in 2008/09

World cotton mill use is forecast at 24.1 million tons in 2008/09, down by 9% from 2007/08. The fall in industrial cotton consumption is due mainly to a drop in end-use consumption of cotton products caused by a slow-down in world economic growth, as well as a loss of competitiveness of cotton prices compared to polyester prices, and tightening credit conditions for textile mills. One of the most startling developments is the expected retrenchment in cotton mill use in China (Mainland), which accounts for around 40% of world cotton industrial consumption. Mill use in China rose by an average annual rate of nearly 11% between 1998/99 and 2007/08. However, 2008/09 mill use in China is projected at 9.6 million tons, a decline of 12% from the 2007/08 level. Likewise, the decline in cotton mill use in India that is occurring this season was unexpected in early 2008. 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. Declines in cotton mill use are also expected in Pakistan and other major cotton consuming countries.

World cotton production is also estimated down by 9% in 2008/09, to 23.8 million tons, the lowest since 2003/04. The decline in production results principally from a decline in world cotton area for the second consecutive season. Significant portions of cotton area were diverted to grains and oilseed production, for which prices were more attractive than for cotton. The world yield is also estimated down by 3% due mainly to unfavorable weather. The decline in world production is driven by a fall of 1.3 million tons in the United States. Production is also estimated lower in China, India, Uzbekistan, Brazil, and Turkey, but slightly larger in Pakistan.

Along with the drops in consumption and production, world cotton trade is falling by 1.5 million tons (18%) to 6.8 million tons, the lowest level in six seasons. In past seasons, world trade averaged about 32% of world mill use. However, during 2008/09, the ratio of world imports to world mill use is falling to 28%, reflecting tighter credit conditions, tighter operating margins for textile mills and caution on the part of textile mill operators. The decline in world trade relative to mill use also indicates that even though world ending stocks are forecast to decrease slightly during 2008/09 to 12 million tons, exporters are being forced to carry larger stocks than desired.

Increased Government Interventions in the Cotton Sector in 2008/09

The decline in cotton prices in the first half of 2008/09 has triggered government interventions in the largest cotton producing countries to support producers' prices. In particular, the government of China (Mainland) bought 1.8 million tons between October 2008 and January 2009, accounting for almost one quarter of the estimated 2008/09 Chinese crop. In India, government agencies bought around 1 million tons of the 2008/09 crop, representing a little over 40% of arrivals up to date. In the United States, about half of the estimated 2008/09 crop was placed in the government loan program as of December 31, 2008. In Pakistan, the Trading Corporation of Pakistan purchased around 93,000 tons of cotton, or 5% of the estimated 2008/09 crop.

Cotton Prices Lower in 2008/09

Secretariat research indicates that the main variable affecting international cotton prices is the stocks-to-mill use ratio (SMU) in the World-less-China (Mainland).¹ Over the past three decades, an increase in the SMU in the World-less-China (M) was generally accompanied by a decline in the season-average Cotlook A Index, and vice-versa. Another variable, whose impact on cotton prices is much less significant, is the SMU in China (M) (during the previous season).

¹ See "The New ICAC Cotton Price Forecasting Model", in Cotton: Review of the World Situation, Vol. 60 No. 6, July-August 2007.

International cotton prices remained lower than the historical average between 1998/99 and 2006/07. Over this period, the season-average Cotlook A Index was 56 U.S. cts/lb, compared to an average of 74 U.S. cts/lb between 1973/74 and 1997/98. This phase of lower-than-average cotton prices coincided with a period of mostly increasing stocks in the world-less-China (M), but a period of mostly declining stocks in China (Mainland).

In 2007/08, the SMU in the World-less-China (M) increased slightly, which should have translated into slightly lower cotton prices. However, the season-average Cotlook A Index increased by 24% to 73 cts/lb, the highest in more than ten seasons. Factors other than fundamental changes in cotton supply and use appear to have contributed to this significant increase in cotton prices. In particular, an increased interest from the financial sector in agricultural commodities as an asset class (including cotton) placed upward pressure on nearby cotton futures prices and damaged the hedging mechanism for deliverable cotton. Cotton prices have also been influenced by rising prices of competing commodities, including corn, wheat, soybeans and rice. The U.S. dollar continued to weaken against major currencies in 2007/08, which might have had a small strengthening effect on cotton prices, expressed in U.S. dollars.

The main variable of the ICAC Price Model 2007, the SMU in the World-less-China (M), is expected to increase from 58% to 60% in 2008/09 due to an expected larger decline in mill use than in stocks. In addition, the accumulation of considerable stocks by the Chinese government this season is expected to affect trade and prices.² As a result, the model is forecasting a decline in the season-average Cotlook A Index in 2008/09, to 61 cts/lb, with a 95% confidence interval between 55 and 67 cts/lb.³

World Cotton Production Expected to Decline Further in 2009/10

Despite some governments' attempts to support cotton prices in 2008/09, world cotton area is projected to continue to decline in 2009/10 due to a decline in cotton returns, more attractive prices for competing crops, and expected difficulties to finance 2009/10 production inputs. World cotton area is forecast down by 3% to 30.1 million hectares, the smallest cotton area in seven years. Assuming an average yield of 780 kg/ha, slightly higher than in 2008/09, world cotton production is expected down by 1% to 23.5 million tons. This would be the smallest world cotton crop in six seasons. Production is expected to decline in China (M) and the United States, but to increase in India and to remain stable in Pakistan.

² Given that (1) states reserves in China (M) as of January 14 amounted to 1,815,650 and represented 23% of the projected domestic production and 19% of the projected domestic consumption in 2008/09, and that (2) the current procurement target is 2,720,000 tons, then there is credible indication that the magnitude of the Chinese government intervention in the cotton market is substantial. The situation resembles that of the period 1991/92 to 1998/99, when the Chinese government was purposefully building the national stockpile. This government intervention is captured through a dummy variable in the ICAC Price Model. The effect of the dummy variable is to include into the 2008/09 price forecast the effect of the projected change in Chinese net imports in 2008/09.

³ Price forecast as of January 21, 2009. This price forecast does not take into account expected trends in competing commodity prices, speculation, and exchange rates.

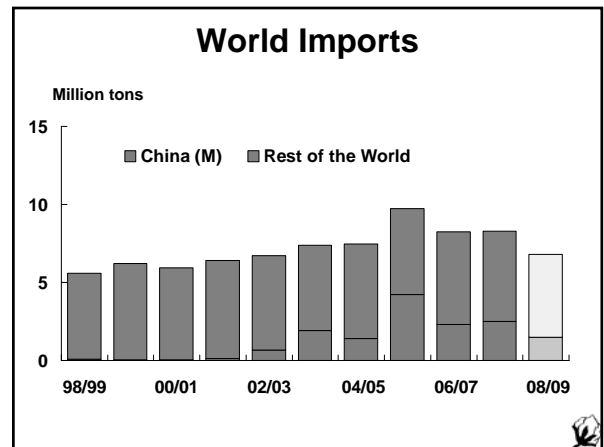
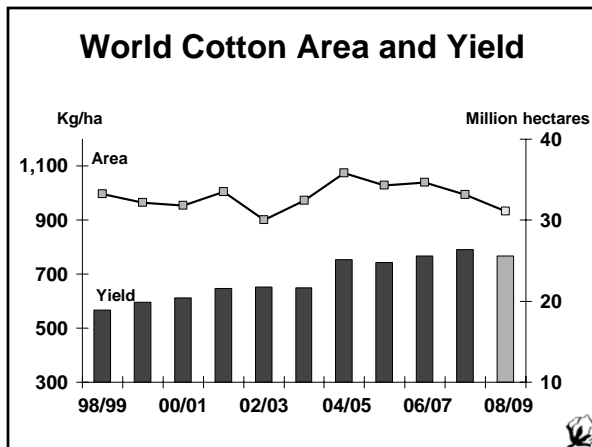
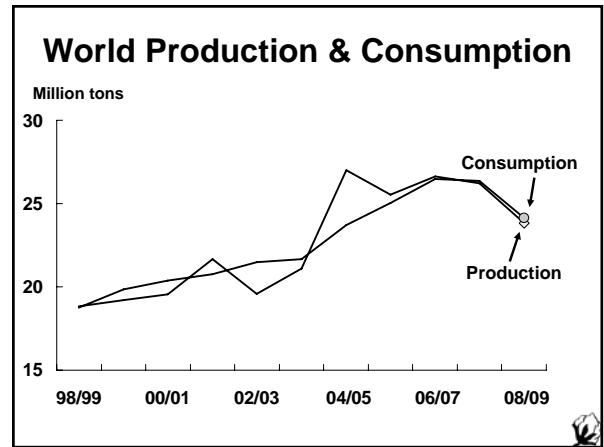
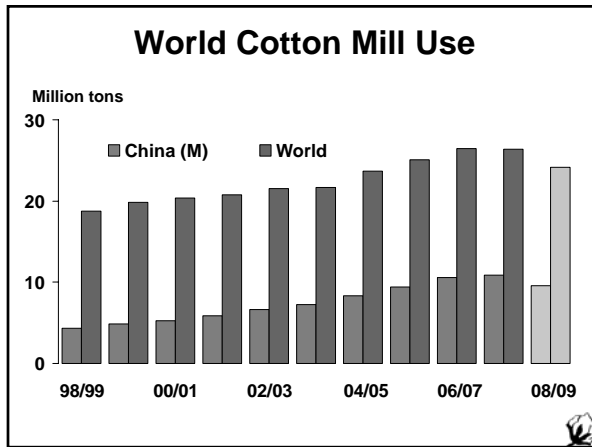
Outlook on World Cotton Supply and Use



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SCM 496
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Huge Decline in World Cotton Mill Use in 2008/09

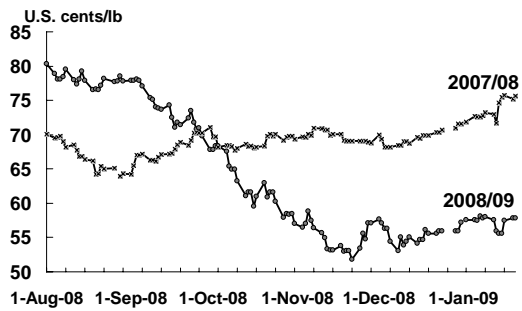


Government Support in 2008/09

- China (M)
- India
- USA
- Pakistan

Cotton Prices Lower in 2008/09

Cotlook A Index

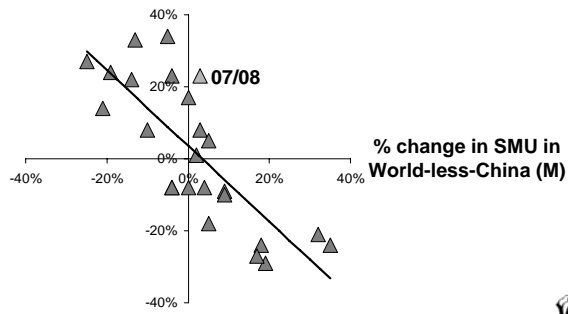


Variables Affecting Cotton Prices

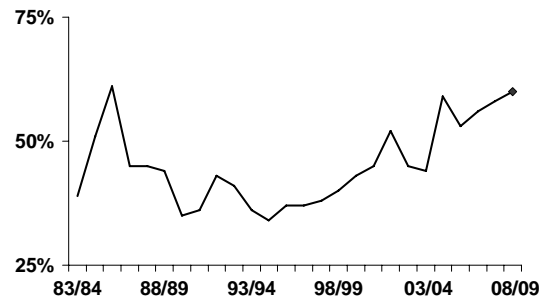
- Main variable = Stocks-to-mill use ratio (SMU) = Ending Stocks/Mill Use in World-less-China (M)
- + Dummy variable to account for stockpiling by Chinese government in 2008/09

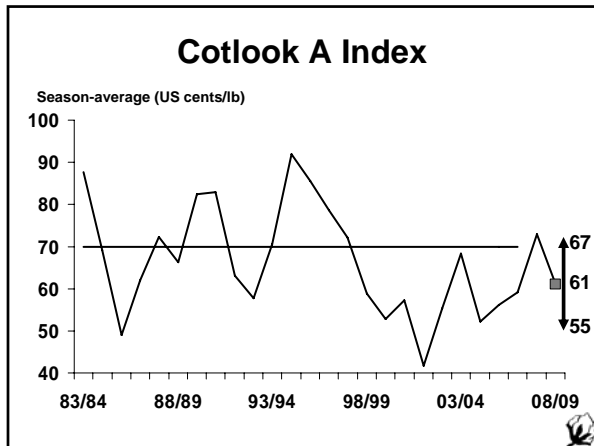
% Change in Cotlook A Index

From 1981/82 to 2007/08

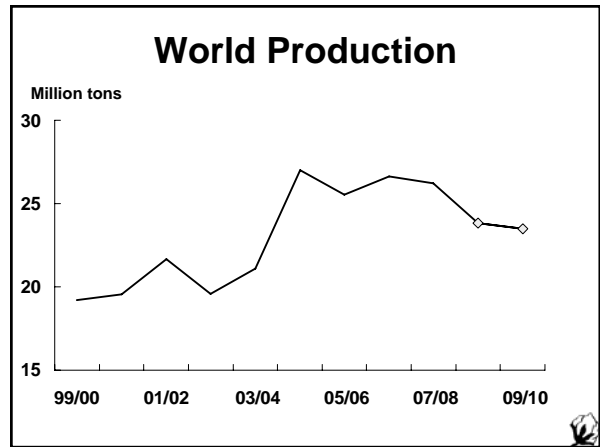
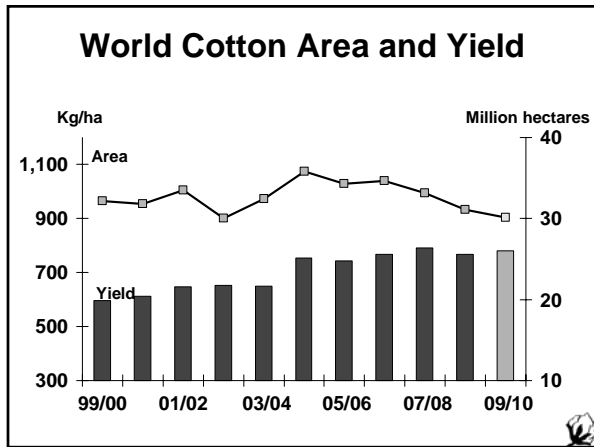


SMU in World-less-China (M)





Production Expected to Decline Further in 2009/10



SUPPLY AND DISTRIBUTION OF COTTON

January 21, 2008

Years Beginning August 1

	2004	2005	2006	2007 Est.	2008 Proj.	2009 Proj.
Million Metric Tons						
BEGINNING STOCKS						
WORLD TOTAL	8.751	11.675	12.255	12.519	12.25	11.96
CHINA (MAINLAND)	2.449	2.622	3.991	3.653	3.32	3.22
USA	0.751	1.196	1.321	2.064	2.19	1.50
PRODUCTION						
WORLD TOTAL	27.011	25.529	26.635	26.222	23.82	23.48
CHINA (MAINLAND)	7.085	6.616	7.975	8.071	8.03	7.39
INDIA	4.131	4.097	4.760	5.355	5.00	5.31
USA	5.062	5.201	4.700	4.182	2.84	2.78
PAKISTAN	2.439	2.089	2.070	1.845	1.91	1.92
BRAZIL	1.299	1.038	1.524	1.603	1.26	1.28
UZBEKISTAN	1.134	1.210	1.171	1.206	1.09	1.09
OTHERS	5.861	5.278	4.435	3.961	3.70	3.72
CONSUMPTION						
WORLD TOTAL	23.709	25.045	26.485	26.358	24.11	24.06
CHINA (MAINLAND)	8.300	9.439	10.600	10.900	9.60	9.67
INDIA	3.265	3.655	3.932	4.011	3.79	3.82
PAKISTAN	2.326	2.532	2.654	2.574	2.48	2.48
EU, C. EUR. & TURKEY	2.333	2.134	2.104	1.800	1.51	1.44
EAST ASIA & AUSTRALIA	1.988	1.885	1.872	1.823	1.74	1.72
USA	1.457	1.278	1.074	1.003	0.87	0.85
BRAZIL	0.938	0.969	0.996	0.996	0.98	0.93
CIS	0.613	0.633	0.682	0.664	0.63	0.64
OTHERS	2.490	2.519	2.572	2.586	2.52	2.53
EXPORTS						
WORLD TOTAL	7.764	9.745	8.121	8.350	6.78	7.43
USA	3.143	3.821	2.833	2.973	2.66	2.23
INDIA	0.136	0.751	0.960	1.500	0.85	1.67
UZBEKISTAN	0.850	1.020	0.980	0.887	0.72	0.81
CFA ZONE	0.934	1.010	0.931	0.601	0.51	0.57
BRAZIL	0.339	0.429	0.283	0.486	0.44	0.42
AUSTRALIA	0.435	0.628	0.465	0.265	0.20	0.28
IMPORTS						
WORLD TOTAL	7.474	9.720	8.229	8.297	6.78	7.43
CHINA (MAINLAND)	1.394	4.200	2.306	2.511	1.49	2.03
EAST ASIA & AUSTRALIA	2.072	1.776	1.902	1.839	1.73	1.73
EU, C. EUR. & TURKEY	1.471	1.310	1.379	1.126	0.93	1.00
PAKISTAN	0.383	0.352	0.502	0.795	0.64	0.63
CIS	0.347	0.333	0.322	0.271	0.23	0.23
TRADE IMBALANCE 1/	-0.290	-0.025	0.108	-0.053	0.00	0.00
STOCKS ADJUSTMENT 2/	-0.088	0.122	0.006	-0.081	0.00	0.00
ENDING STOCKS						
WORLD TOTAL	11.675	12.255	12.519	12.250	11.96	11.37
CHINA (MAINLAND)	2.622	3.991	3.653	3.321	3.22	2.96
USA	1.196	1.321	2.064	2.187	1.50	1.20
ENDING STOCKS/MILL USE (%)						
WORLD-LESS-CHINA (M) 3/	59	53	56	58	60	58
CHINA (MAINLAND) 4/	32	42	34	30	34	31
COTLOOK A INDEX 5/	52.20	56.15	59.15	72.90	61*	

1/ The inclusion of linters and waste, changes in weight during transit, differences in reporting periods and measurement error account for differences between world imports and exports.

2/ Difference between calculated stocks and actual; amounts for forward seasons are anticipated.

3/ World-less-China (Mainland) ending stocks divided by World-less-China (Mainland)'s mill use, multiplied by 100.

4/ China (Mainland)'s ending stocks divided by China (Mainland)'s mill use, multiplied by 100.

5/ U.S. cents per pound.

* The price projection for 2008/09 is based on the ending stocks/consumption ratio in the world-less-China (Mainland) in 2006/07, in 2007/08 (estimate), and in 2008/09 (projection), and on the ending stocks/consumption ratio in China (Mainland) in 2006/07 and in 2007/08 (estimate).

95% confidence interval: 55 to 67 cents per pound.