



THE IMPACT OF FINANCIAL TURMOIL ON THE WORLD COTTON AND TEXTILE MARKET

Presented by

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The dominant world economic development over the last two years has been the Asian financial crisis and its global repercussions. The crisis started in a limited number of Asian economies in the second half of 1997, but spread throughout the Asian region and into other parts of the world. The combination of the direct impact on the economies concerned and the flow through to other economies caused a significant slowing in the growth of world income.

For a commodity like cotton, which is dependent on growth in textile demand, which in turn linked closely to world economic performance, the impact has been significant. As explained in this paper, the financial crisis is the primary reason for the close to zero growth in textile demand in 1998, and the decline in world cotton consumption of 2 per cent in that year. The impact on prices has been even more significant – with a large part of the 25 per cent decline in cotton prices over the past two years being a direct consequence of the decline in demand. Overall, the crisis is estimated to have substantially affected the consumption and price prospects for cotton in both the short and medium terms.

The aims in this paper are to briefly examine the changes that have occurred in the world cotton market as a result of the Asian financial crisis and to look at how cotton consumption and prices might recover in the future.

Effects on World Economic Growth

The financial crisis can be linked to the deregulation of the financial system worldwide during the late 1980s and early 1990s, which generated an increasing and unchecked flow of short-term capital used to finance medium and long term investment in developing countries. In Asia, continuous over-investment in specific markets for a number of years resulted in overexposure by financial institutions. The infrastructure regulating such exposure in developed countries was simply not present in many of the Asian developing countries. As several financial institutions went into bankruptcy, investors began a rapid repatriation of their capital creating pressures on exchange markets and drying up national

reserves. Devaluation became the only policy instrument available and as currencies slid dramatically, the debt contracted in foreign currency by financial institutions increased to unsustainable levels and the system simply collapsed. The initial crisis in Asia originated an outflow of financial capital from Eastern Europe and the former Soviet Union, as well as from developing countries.

The rapid withdrawal of investment capital sent the economies affected into almost immediate recession. The consequences on world economic growth were similarly rapid. World GDP increased at around 4 per cent a year between 1994 and 1997. In contrast, a substantial deterioration of the world economy was experienced during 1998. In addition to the financial crisis initiated in Asia, and, in part, as a result of it, unstable economic conditions in Russia were registered, Latin American economies plunged into recession, and the Japanese economic recession deepened.

In October 1997 the International Monetary Fund estimated that the world economy would increase by 4.3 per cent in 1998. As a result of the financial crisis, world GDP increased by only 2.5 per cent in 1998. The most important adjustments to GDP growth took place in developing countries and in Eastern Europe and the former Soviet Union. GDP growth in developing countries is estimated to have increased by 3.3 per cent in 1998, the lowest rate of growth in over two decades. This lower GDP growth in developing countries was mainly the result of a deep recession in Indonesia, the Republic of Korea, and Thailand, the main economies in Asia at the center of the financial crisis. However, the financial crisis also negatively affected neighboring economies and economies of developing countries in other regions. GDP growth in 1998 in Latin America and the Caribbean, which in October 1997 was expected to be 4.5 per cent, is now estimated to have been 2.3 per cent.

For Eastern Europe and the former Soviet Union, the economic outlook has changed fundamentally. Growth of GDP for 1998 in Eastern Europe and the former Soviet Union was expected to be 3 per cent. Now, it has been revised downward to -0.2 per cent.

In industrial countries, with the exception of the Japanese economy, the impact of the crisis on economic performance was modest. In fact, estimates of GDP growth have been revised upward for the United States and the European Union since October 1997. Exports to Asia from these industrial countries fell sharply, while exports to other developing country regions slowed or experienced small declines. However, the decline in bond yields and the shifting of capital from developing and emerging economies, had offsetting effects on economic growth – most notably through increases in domestic investment expenditures. In contrast, the Japanese economy, which is the industrial economy that is most exposed to the crisis because it is the main holder of Asian debt, experienced the deepest recession of the postwar era. GDP growth in Japan, which in October 1997 was expected by the IMF to be 2 per cent, was -2.8 per cent in 1998.

Another source of the deceleration of GDP growth in developing countries was the rapid decline of commodity prices, which was exacerbated by the crisis. As the crisis has reduced effective demand worldwide, prices of non-oil commodities have also declined.

The IMF Non-Fuel Commodity Price Index suggests that commodity prices fell 12 per cent between October 1997 and June 1998. Commodity prices have fallen further since the summer of 1998. Between July 1998 and May 1999 the IMF Non-Fuel Commodity Price Index fell 4 per cent. Non-fuel commodity prices had already fallen 8 per cent between January and October 1997.

Impact on Textile Demand

The impact on world textile demand is driven by a number of factors. Most importantly the decline in world income created by the crisis reduced world demand for textiles - particularly in developing countries. Between 1993 and 1997, above average world economic performance translated into a 3.7 per cent average annual rate of growth of textile consumption – with growth of 6.5 per cent in 1997. In just four years, the world consumed an additional 6 million tons of textile fibres.

The financial crisis changed dramatically the economic climate around the world and the textile and cotton markets were not an exception. As a result of the crisis, world textile consumption estimates and projections have been lowered by 730,000 tons for 1998, 1.3 million tons for 1999, and 1.5 million tons for 2000 (see table 1). The largest adjustment took place in developing countries where textile consumption growth was adjusted from a 2.5 per cent increase to a decline of 0.5 per cent in 1998. Declines occurred in all developing country regions. Textile consumption in Asia declined 0.3 per cent in 1998, the first decline in the region since 1982. In the absence of the crisis, increases of about 100,000 tons would have been expected in developing countries in the Middle East and Europe region and in the Latin America and the Caribbean region in 1998. Current estimates suggest that textile consumption declined in both regions in that year.

With the exception of Japan, the impact of the crisis on textile consumption in industrial countries has been modest. Textile consumption in industrial countries is estimated to have increased by about 0.9 per cent in 1998, just about as expected.

The fact that most of the reduction in economic growth occurred in developing countries could have been important. Continued growth in most of the developed countries might have offset, at least in part, the negative impact of poor growth in developing countries. In particular, with the significant depreciation in the exchange rates of many Asian economies, their exports of textiles and apparel should have been more competitive in the world market – particularly in developed countries. However, as mentioned above, the growth in consumption in developed countries remained about where it had been expected. Two factors are likely to have been important in restricting this offsetting effect. First, many of the countries affected, while exporters of textiles and apparel, are also importers of raw cotton. Depreciation of the currencies of these countries combined with difficulties in obtaining commercial credit, served to have a negative impact on export growth prospects. Second, market access barriers in developed countries served to impede more significant increases in exports from developing countries.

As a consequence, most of the impact of the financial crisis has been felt through an adjustment in fibre prices. The ICAC Textile Price Index declined 15 per cent in 1998 and is expected to decline 15 per cent again in 1999. While part of these declines are due to longer term trends which saw substantial, but smaller declines in the previous two years, the decline in textile demand in 1998 is estimated to have contributed to at least three quarters of the decline in prices in 1998 and 1999. It should be noted that prices affect textile consumption with a lag of about one year, due to the period of time that occurs between consumption of fibers at the mill level and consumption of fibers by the final users. However, a decline in demand affects prices more rapidly, as unsold stocks accumulate.

Impact on Cotton Consumption

The effect of the financial crisis in Asia has been more significant on cotton than for other textile fibres. After world end-use cotton consumption increasing 2 per cent to a record 19.3 million tons in 1997, current estimates suggest that world cotton consumption declined by about 2 per cent in 1998. This is around 700,000 tons lower than would have been the case without the financial crisis (table 2). Similarly, world cotton consumption is expected to be 900,000 tons lower for 1999 and 2000 than would otherwise have been the case. Virtually all of the adjustment has taken place in developing countries, where consumption fell by 5.7 per cent in 1998. In Eastern Europe and the former Soviet Union, the crisis took cotton consumption to new lows. The ICAC estimates that cotton consumption in that region declined 8.6 per cent to 1.1 million tons in 1998. Another 7 per cent decline is expected to take place in 1999.

In industrial countries, other than Japan, the financial crisis has actually resulted in increased consumption of cotton products. As a result of the crisis, cotton consumption in North America increased an additional 1 per cent in 1998. Cotton consumption in both North America and Western Europe is forecast to increase an additional 1 per cent in 1999 as a result of the crisis. It is expected that the gains in North America and Western Europe have been mainly the result of increases in imports of cotton products. However, these gains have been offset by reductions in consumption of cotton in Japan, amounting to 5 per cent in 1998 and a forecast 1 per cent in 1999. The consumption increases in developed countries has largely been a result of price reductions of imported products due to the devaluation of exchange rates in many developing countries in Asia.

The decline in demand for cotton has also had a significant impact on the price of cotton fibre. The price of cotton (as represented by the Cotlook A Index) has declined by 25 per cent over the past two years. The ICAC estimates that around a fifth of this can be directly accounted for by the financial crisis in Asia. In addition, at least half of the decline in prices can be accounted for by bearish expectations about demand for cotton, which are also related to the crisis. In the face of significant reductions in cotton prices, which should lower the price of cotton textiles and apparel, the increases in consumption of cotton products in Europe and North America have been modest. As mentioned earlier, this is, at least in part, accounted for by barriers to trade (such as the Multifibre Arrangement) which impede growth in imports, particularly from low-cost producing developing countries.

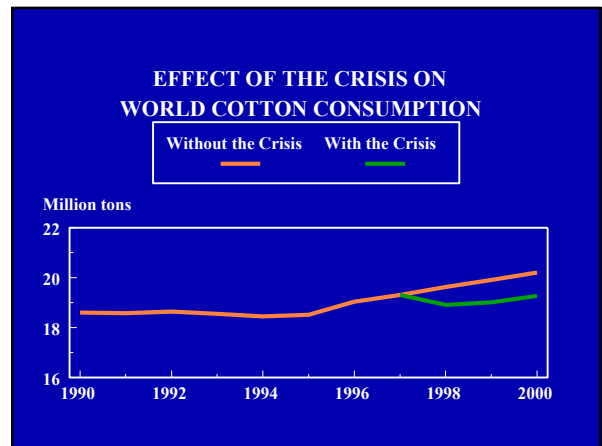
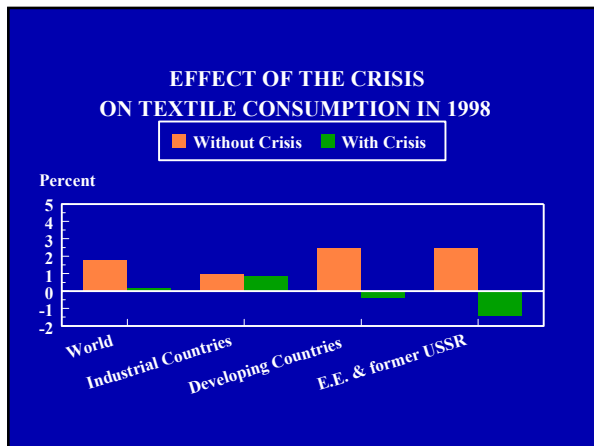
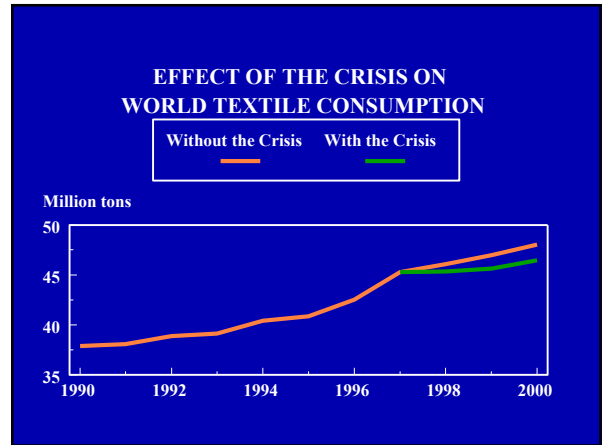
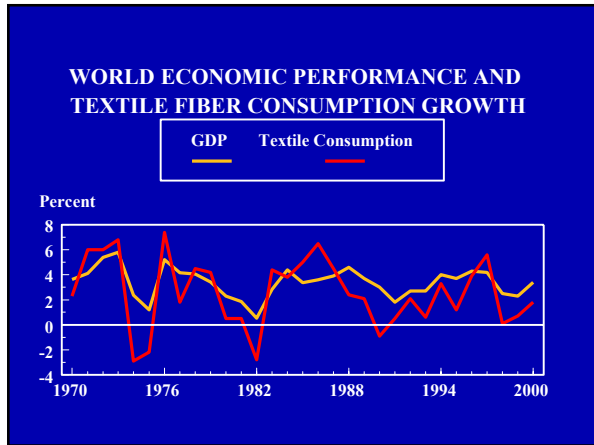
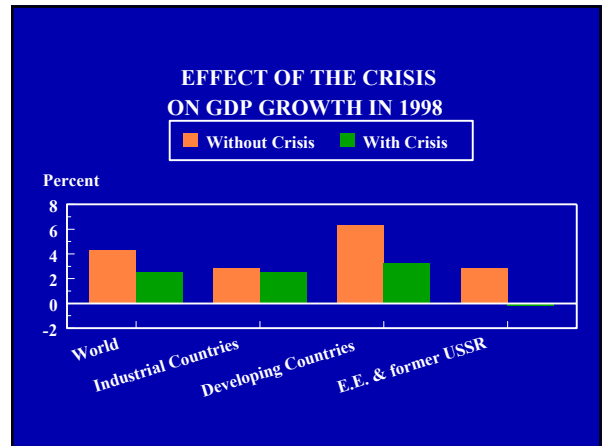
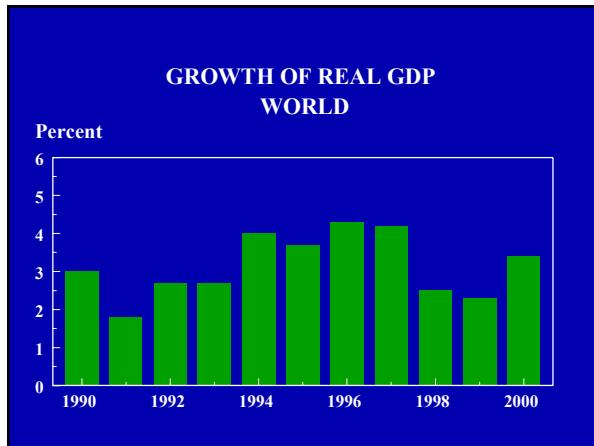
Outlook for cotton consumption and prices

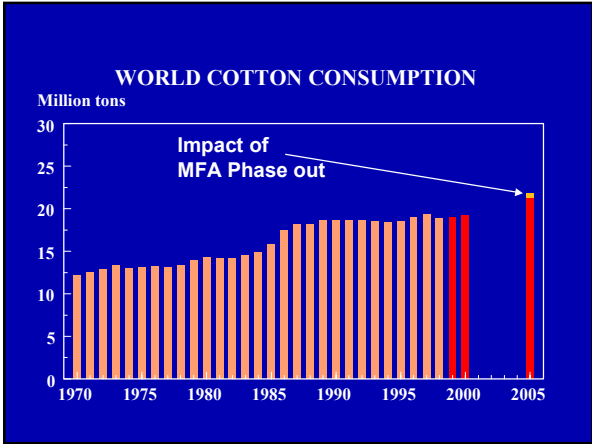
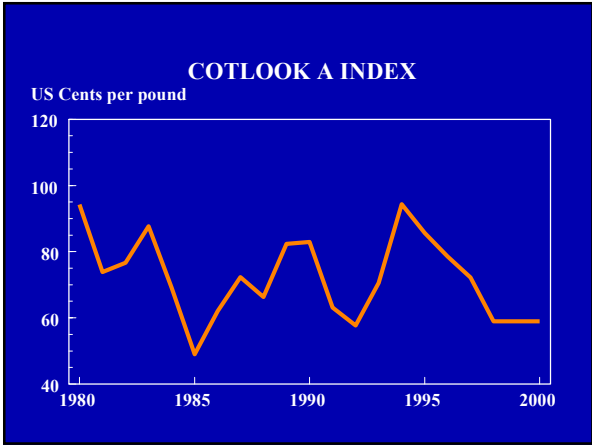
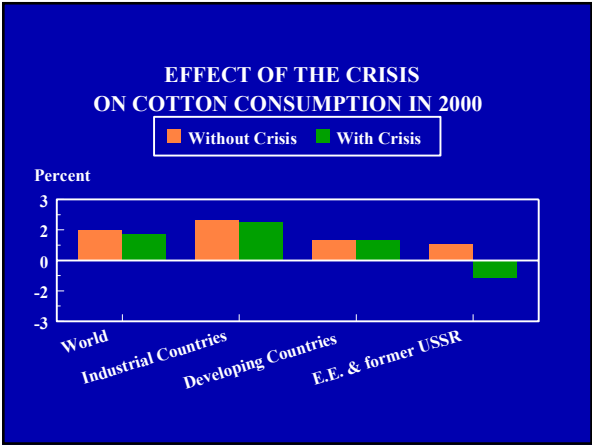
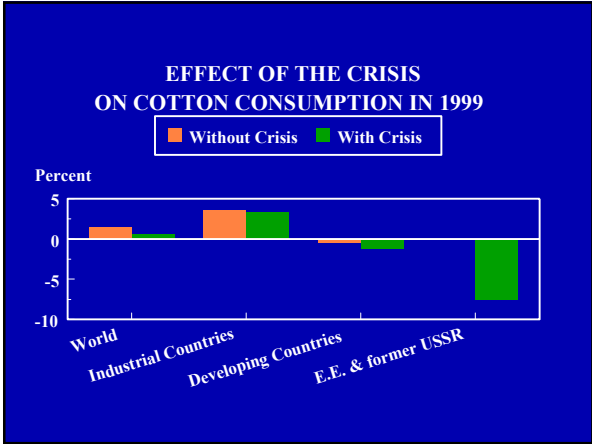
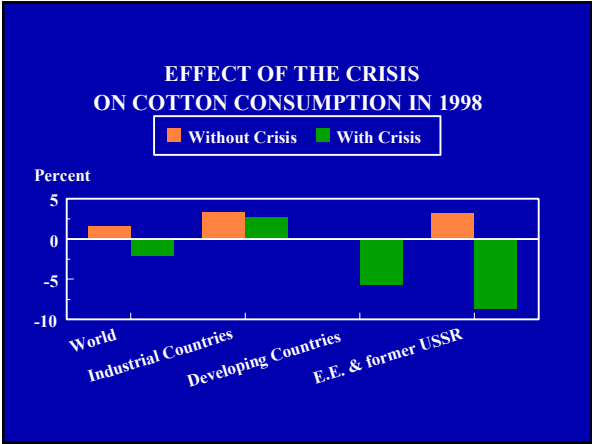
Despite the fact that the world textile market has been thrown off course, textile and cotton consumption are expected to resume growth in the next few years. The new projections by FAO and ICAC presented at this conference suggest that textile consumption could increase to 50.5 million tons in 2005, an average of 800,000 tons of additional consumption a year. Similarly, cotton consumption could increase to 21.8 million tons by 2005, an average of 400,000 tons of additional consumption a year. With this demand potential, many countries will be able to benefit from the textile and cotton market in the next six years.

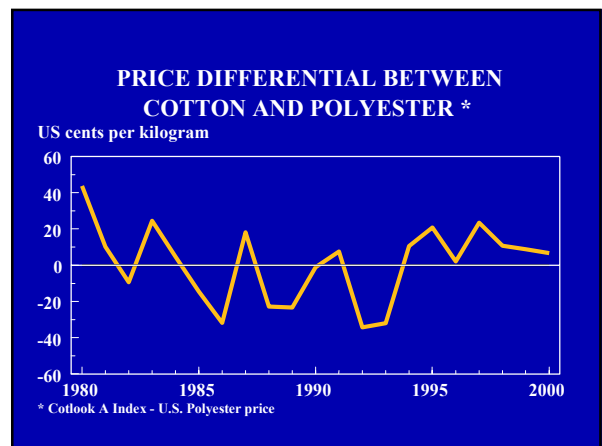
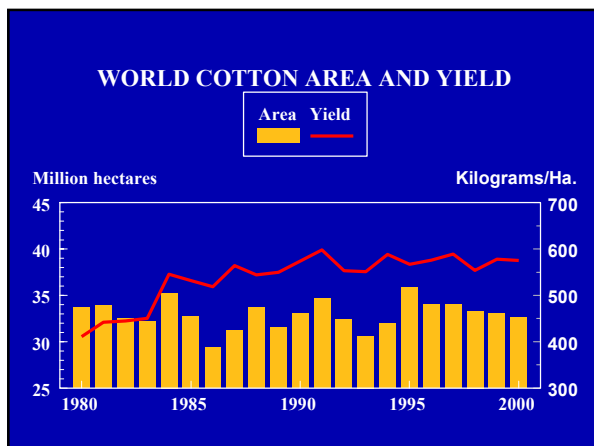
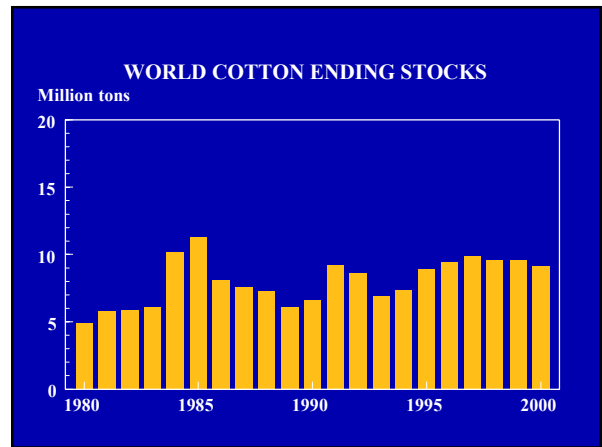
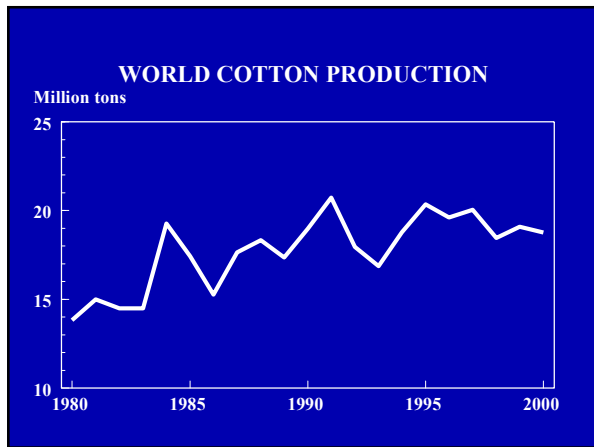
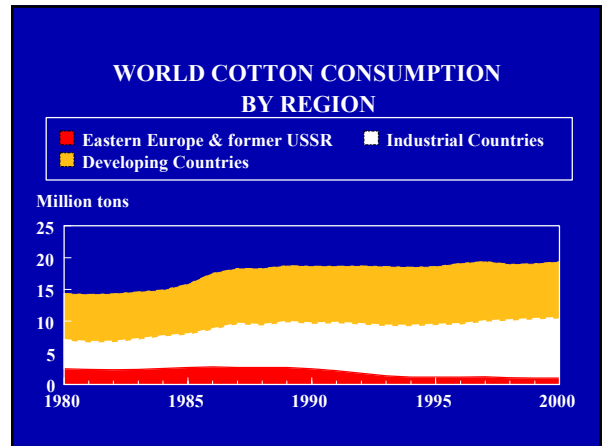
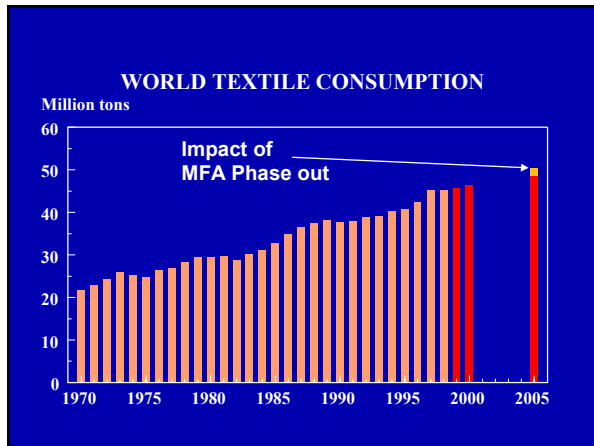
A factor that is likely to drive cotton consumption during the next few years is prices. Cotton prices averaged 59 cents per pound in 1998/99, about 13 cents below what is considered the equilibrium price. The ICAC expects cotton prices to continue to average 59 cents per pound in 1999/2000 and 2000/2001. A recovery of prices is not likely to start until 2001/2002.

Conclusion

In conclusion, the impact of the Asian financial crisis on the world cotton market has been substantial, with the effects likely to carry on for a number of years. While growth in cotton consumption is expected to resume as early as this year, growth is likely to be lower than otherwise and consequently cotton prices are expected to remain at relatively low levels for some time to come. While the economic crisis in Asia has had effects on regions throughout the world, developed countries, other than Japan, have managed to continue their economic growth. Despite this, and despite low prices for cotton, cotton consumption has only increased modestly in these countries. Textile and apparel imports in North America and Western Europe have increased, but the existence of trade barriers in the textile and apparel market is likely to have been a factor in the modest response of consumption. As these barriers are fully liberalized in the future, markets will be better able to respond to disturbances in the market and are likely to much better absorb the impacts without the significant price effects we have seen for cotton in the past two years.

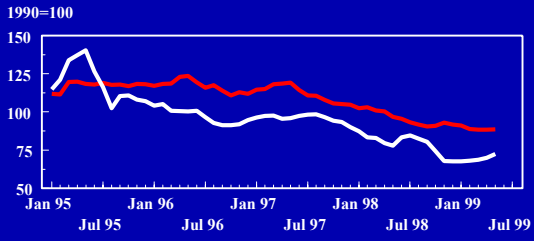






COMMODITY PRICES

Non-fuel Commodities Cotton



SUPPLY AND DISTRIBUTION OF COTTON

23-August-99

Years Beginning August 1

	1995	1996	1997	1998 Est.	1999 Proj.	2000 Proj.
Million Metric Tons						
BEGINNING STOCKS						
WORLD TOTAL	7.374	8.928	9.401	9.89	9.60	9.61
CHINA (MAINLAND)	2.788	3.715	4.002	4.30	4.12	3.47
USA	0.577	0.568	0.865	0.85	0.73	0.98
NET EXPORTERS	2.954	3.609	3.908	4.05	3.85	4.31
NET IMPORTERS 1/	4.420	5.319	5.494	5.84	5.75	5.30
PRODUCTION						
WORLD TOTAL	20.352	19.607	20.030	18.53	19.08	18.77
CHINA (MAINLAND)	4.768	4.203	4.602	4.50	4.00	3.80
USA	3.897	4.124	4.092	3.03	4.00	3.90
INDIA	2.885	3.024	2.686	2.75	2.85	2.86
PAKISTAN	1.801	1.594	1.561	1.48	1.50	1.50
UZBEKISTAN	1.254	1.062	1.139	1.00	1.05	1.10
TURKEY	0.851	0.784	0.838	0.87	0.82	0.79
OTHERS	4.895	4.816	5.113	4.90	4.86	4.82
CONSUMPTION						
WORLD TOTAL	18.580	19.378	19.269	18.84	19.06	19.23
CHINA (MAINLAND)	4.500	4.700	4.700	4.60	4.40	4.30
INDIA	2.576	2.864	2.684	2.68	2.85	2.95
EU, C. EUR. & TURKEY	2.351	2.513	2.597	2.36	2.44	2.45
USA	2.318	2.422	2.471	2.30	2.25	2.10
EAST ASIA & AUSTRALIA	2.160	2.086	1.922	1.97	2.04	2.00
PAKISTAN	1.540	1.524	1.543	1.53	1.56	1.60
BRAZIL	0.817	0.830	0.750	0.74	0.78	0.85
CIS	0.441	0.406	0.445	0.43	0.48	0.50
OTHERS	1.878	2.034	2.157	2.24	2.27	2.47
EXPORTS						
WORLD TOTAL	5.972	6.051	5.913	5.29	5.71	5.90
USA	1.671	1.495	1.633	0.93	1.50	1.70
UZBEKISTAN	0.940	1.042	1.050	0.90	0.88	0.96
FRANCOPHONE AFRICA	0.608	0.721	0.826	0.84	0.89	0.93
AUSTRALIA	0.308	0.519	0.575	0.65	0.58	0.58
GREECE	0.275	0.195	0.187	0.23	0.24	0.20
ARGENTINA	0.266	0.290	0.220	0.17	0.09	0.06
CHINA (MAINLAND)	0.005	0.002	0.006	0.15	0.30	0.30
IMPORTS						
WORLD TOTAL	5.809	6.137	5.742	5.34	5.71	5.90
EAST ASIA & AUSTRALIA	2.137	1.992	1.786	1.92	2.04	1.94
EU, C. EUR. & TURKEY	1.443	1.640	1.702	1.51	1.61	1.51
SOUTH AMERICA	0.510	0.633	0.581	0.49	0.52	0.71
CIS	0.224	0.206	0.273	0.24	0.29	0.29
CHINA (MAINLAND)	0.663	0.787	0.399	0.07	0.05	0.05
TRADE IMBALANCE 2/	-0.163	0.086	-0.170	0.05	0.00	0.00
STOCKS ADJUSTMENT 3/	-0.055	0.159	-0.100	-0.03	-0.01	0.03
ENDING STOCKS						
WORLD TOTAL	8.928	9.401	9.892	9.60	9.61	9.18
CHINA (MAINLAND)	3.715	4.002	4.297	4.12	3.47	2.72
USA	0.568	0.865	0.846	0.73	0.98	1.09
NET EXPORTERS	3.609	3.908	4.054	3.85	4.31	4.60
NET IMPORTERS 1/	5.319	5.494	5.839	5.75	5.30	4.58
ENDING STOCKS/USE 4/	0.42	0.42	0.41	0.38	0.40	0.41
COTLOOK A INDEX 5/	85.61	78.60	72.20	58.90	59*	59*

1/ Includes Brazil, China (Mainland), Colombia, Greece, Mexico, Turkey and traditional importers

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

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

4/ World-less-China (Mainland) ending stocks minus China net exports, quantity divided by world-less-China consumption

5/ U.S. Cents per pound. The estimates for 1998/99 and 1999/00 are based on net China (Mainland) trade and world-less-China (Mainland) ending stocks to use, corrected for the overall error.

*/ 95% confidence interval extends 15 cents above and below the point estimate

**THE FINANCIAL CRISIS
IMPACT ON TEXTILE FIBER CONSUMPTION (END-USE)**

	World	Eastern Europe and former USSR	Industrial Countries	Developing Countries				
				All	Africa	Asia	Middle East & Europe	Latin America & Caribbean
1,000 Metric Tons								
Current Base Estimates and Projections								
1997	45,271.5	3,149.8	21,123.5	20,998.2	1,432.5	14,635.6	1,905.3	3,024.8
1998	45,331.5	3,104.4	21,301.8	20,925.3	1,443.4	14,596.3	1,901.7	2,983.9
1999	45,652.5	2,991.0	21,576.0	21,085.6	1,449.8	14,615.4	2,062.0	2,958.4
2000	46,466.7	2,988.5	21,922.5	21,555.6	1,681.3	14,845.5	2,133.3	2,895.5
Estimates and Projections Without the Crisis								
1998	46,063.6	3,226.0	21,319.1	21,518.4	1,510.2	14,660.0	2,165.7	3,182.6
1999	46,987.9	3,210.8	21,632.6	22,144.5	1,569.4	15,042.7	2,251.9	3,280.7
2000	48,020.0	3,231.2	21,960.4	22,828.4	1,634.8	15,454.2	2,342.2	3,397.3
Difference								
1998	-732.08	-121.61	-17.36	-593.11	-66.83	-263.64	-124.01	-138.67
1999	-1335.39	-219.80	-56.60	-1058.99	-119.58	-627.21	-49.91	-262.23
2000	-1553.35	-242.69	-37.88	-1272.78	46.47	-808.64	-68.85	-441.76

Source: ICAC

**THE FINANCIAL CRISIS
IMPACT ON COTTON TEXTILE FIBER CONSUMPTION (END-USE)**

	Eastern Europe and former USSR		Industrial Countries				Developing Countries
	World	USSR	All	North America	Western Europe	Japan, Australia & N. Zealand	
1,000 MetricTons							
Current Base Estimates and Projections							
1997	19,308.0	1,218.2	8,813.6	4,552.9	2,869.1	1,391.6	9,276.3
1998	18,908.0	1,113.6	9,047.5	4,735.6	2,976.4	1,335.5	8,746.7
1999	19,014.6	1,029.8	9,344.6	4,899.3	3,123.8	1,321.5	8,640.1
2000	19,264.9	1,020.1	9,518.0	5,020.4	3,166.6	1,331.0	8,726.3
Estimates and Projections without the Crisis							
1998	19,622.6	1,256.9	9,102.3	4,704.7	2,973.9	1,423.6	9,263.5
1999	19,905.5	1,255.2	9,421.9	4,873.8	3,079.0	1,469.0	9,228.5
2000	20,196.4	1,265.5	9,614.0	5,032.8	3,102.4	1,478.8	9,316.9
Difference							
1998	-714.63	-143.22	-54.74	30.89	2.48	-88.10	-516.88
1999	-890.99	-225.34	-77.21	25.46	44.80	-147.48	-588.48
2000	-931.50	-245.39	-95.94	-12.33	64.19	-147.80	-590.62