



# INTERNATIONAL COTTON ADVISORY COMMITTEE

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## WORLD EXTRA-FINE COTTON OUTLOOK\*

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### Overview

The world cotton industry is finally emerging from a five-year period of falling prices caused by weak demand, economic disruptions and policy changes in China (Mainland). World demand for all cotton is rising an estimated 4% this season and is forecast record high in 2000/01, and the Cotlook A Index is expected to rise modestly during the remainder of 1999/00 and through next season as well. However, despite this strong news for cotton as a whole, the outlook for extra-fine cotton is troublesome. World consumption of extra-fine cotton, measured as consumption in the producing countries plus exports, is falling 10% to an estimated 2.6 million bales in 1999/00. Even with an increase in use of extra-fine cotton next season, world consumption will probably still be no higher than it was in 1994/95 at about 2.8 million bales.

Cotlook quotes for American Pima have increased since December and further gains may occur. Lower production in 2000/01, combined with rising prices for upland cotton, may lead to modestly higher quotes for extra-fine cotton in the coming season. Nevertheless, the underlying fundamentals of world demand for cotton of superior quality and premium prices appear weak. Economic growth in Japan and Europe, major retail markets for products made from extra-fine cotton, remains uncertain, with Japan actually still in recession. Consequently, those consumers most disposed toward the consumption of prestige items, may have less disposable income and less economic confidence than in earlier periods. As a consequence, there has been a decline in world exports of extra-fine cotton since 1994/95, even though prices have declined. In fact, world trade in extra-fine cotton has trended lower over the last two decades.

World production of extra-fine cotton is forecast at 2.5 million bales next season, down 150,000 bales from this season. But consumption in producing countries is dropping 15% to just 1.6 million bales this season, the lowest level of consumption in the producing countries since at least the start of the 1980s, and little gain in consumption in producing countries is expected next season. World exports of extra-fine cotton are estimated at 1.1 million bales next season, up just 40,000 bales from this season and level with exports in 1994/95. Ending stocks of extra-fine cotton are estimated at 1.1 million bales both this season and next. Extra-fine cotton now accounts for about 3% of the world cotton supply, down from 5% in the 1980s.

### Structural Change in Producing Countries

The structure of the world market for extra-fine cotton is completing an historic decade-long period of adjustment following the breakup of the USSR and with the increased international acceptance of market-oriented economic policies. World consumption of extra-fine cotton was supported for decades by government policies in producing countries that either ignored costs or drowned their impacts in subsidies. In contrast, competitive pressures have winnowed consumption of relatively expensive cotton in producing

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\* Paper presented to the 4<sup>th</sup> U.S. Pima Industry Seminar, February 24-25, 2000, San Diego, California. The International Cotton Advisory Committee is an association of 43 governments of cotton producing and consuming countries. The Secretariat of the Committee publishes information related to world cotton production, supply, demand and prices, and provides technical information on cotton production technology. Detailed statistics are found bimonthly in *COTTON: Review of the World Situation*, \$150 per year. A monthly outlook by fax is also available for \$250 per year or on the Internet for \$200 per year. Access to the latest estimates of world cotton supply and use by the Secretariat is also available on the Internet for \$1,500 per year.

## SUPPLY OF EXTRA-FINE COTTON\*

### 22 February 2000

Years Beginning August 1

	1995	1996	1997	1998	1999 Est.	2000 Proj.	2001 Proj
Thousand 480-Lb. Bales							
<b>BEGINNING STOCKS*</b>							
CHINA (MAINLAND)	93	38	24	20	21	136	122
EGYPT, ELS	73	72	181	284	215	101	76
EGYPT, L. STPL.	164	281	700	467	122	229	308
INDIA	156	190	78	64	64	64	64
AUSTRALIA, ISRAEL & PERU	34	40	99	88	66	61	56
SUDAN	80	108	169	167	143	143	152
TAJIKISTAN	26	26	26	20	20	20	20
TURKMENISTAN	12	12	7	22	22	22	22
UNITED STATES	62	66	51	65	114	277	260
UZBEKISTAN	23	64	41	41	16	7	7
OTHER PRODUCERS	17	15	13	13	13	12	12
<b>TOTAL</b>	<b>738</b>	<b>912</b>	<b>1389</b>	<b>1251</b>	<b>815</b>	<b>1069</b>	<b>1097</b>
<b>PRODUCTION</b>							
CHINA (MAINLAND)	37	69	69	139	253	253	
EGYPT, ELS	172	253	335	257	138	161	
EGYPT, L. STPL.	922	1315	1218	770	896	896	
INDIA	563	291	175	373	322	316	
AUSTRALIA, ISRAEL & PERU	165	230	118	63	113	142	
SUDAN	84	109	82	56	64	92	
TAJIKISTAN	96	87	60	47	28	28	
TURKMENISTAN	43	9	78	55	46	46	
UNITED STATES	368	529	548	443	689	459	
UZBEKISTAN	92	83	115	41	46	55	
OTHERS	25	22	21	20	20	20	
<b>TOTAL</b>	<b>2567</b>	<b>2997</b>	<b>2818</b>	<b>2266</b>	<b>2613</b>	<b>2467</b>	
<b>CONSUMPTION*</b>							
CHINA (MAINLAND)	101	92	83	101	92	184	
EGYPT, ELS	87	70	69	230	115	69	
EGYPT, L. STPL.	857	822	993	748	559	564	
INDIA	522	565	493	509	533	542	
AUSTRALIA, ISRAEL & PERU	67	69	59	58	51	51	
SUDAN	6	7	6	12	13	14	
TAJIKISTAN	24	24	32	18	14	14	
TURKMENISTAN	23	12	18	18	18	18	
UNITED STATES	109	106	115	149	147	142	
UZBEKISTAN	32	46	55	32	32	32	
OTHER PRODUCERS	20	16	16	16	16	15	
<b>TOTAL</b>	<b>1848</b>	<b>1830</b>	<b>1938</b>	<b>1891</b>	<b>1589</b>	<b>1645</b>	
<b>EXPORTS</b>							
CHINA (MAINLAND)	0	0	0	46	55	92	
EGYPT, ELS	86	83	89	92	138	115	
EGYPT, L. STPL.	0	130	230	367	230	253	
INDIA	21	40	10	2	5	7	
AUSTRALIA, ISRAEL & PERU	97	112	105	61	81	110	
SUDAN	49	42	78	69	52	69	
TAJIKISTAN	72	63	34	28	14	14	
TURKMENISTAN	20	2	45	37	28	28	
UNITED STATES	300	466	440	289	413	367	
UZBEKISTAN	60	60	60	34	23	23	
OTHER PRODUCERS	11	10	6	6	6	6	
<b>TOTAL</b>	<b>717</b>	<b>1008</b>	<b>1097</b>	<b>1032</b>	<b>1043</b>	<b>1083</b>	
TOTAL IMPORTS 1/	38	49	385	195	249	267	
STOCKS ADJUSTMENT 2/	134	269	(306)	25	24	22	
<b>ENDSTOCKS/USE, EGYPT</b>	<b>0.34</b>	<b>0.80</b>	<b>0.54</b>	<b>0.23</b>	<b>0.32</b>	<b>0.38</b>	
<b>ENDSTOCKS/USE, USA</b>	<b>0.16</b>	<b>0.09</b>	<b>0.12</b>	<b>0.26</b>	<b>0.49</b>	<b>0.51</b>	
<b>ENDSTOCKS/USE, TOTAL</b>	<b>0.36</b>	<b>0.49</b>	<b>0.41</b>	<b>0.28</b>	<b>0.41</b>	<b>0.40</b>	
<b>COTLOOK QUOTE, AM. PIMA</b>	<b>169.92</b>	<b>122.55</b>	<b>115.46</b>	<b>108</b>	<b>94</b>		
<b>COTLOOK QUOTE, GIZA 75</b>		<b>120.42</b>	<b>105.47</b>	<b>99</b>	<b>96</b>		
<b>RATIO: AM. PIMA/GIZA 75</b>		<b>1.02</b>	<b>1.09</b>	<b>1.09</b>	<b>0.99</b>		
<b>RATIO: AM. PIMA/A INDEX</b>	<b>1.98</b>	<b>1.56</b>	<b>1.60</b>	<b>1.84</b>	<b>1.97</b>		

\* Producing countries only

1999/2000 Cotlook quotes through 10 February 2000

1/ Imports of extra-fine cotton by producing countries

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

countries during the past decade. The process of accommodation to cost pressures may even yet not be complete as many mills in Egypt remain inefficiently structured. Nevertheless, because so much mill use has already been lost, there is less to lose in the future, and the remaining production facilities are more efficient than the facilities that have already been idled. Therefore, the use of extra-fine cotton in producing countries as a group is forecast to rise in 2000/01 and later.

During the last half of the 1980s, mill use of extra-fine cotton in the producing countries amounted to between 3.5 and four million bales per year. Consumption dropped by more than one million bales in 1991/92 with the breakup of the USSR, and consumption continued lower during the 1990s and is estimated at 1.6 million bales this season.

Consumption of extra-fine cotton in the USSR rose to 1.5 million bales per year in the 1980s but has dropped to just 110,000 bales per year in the successor countries. Imports of extra-fine cotton by Russia were 219,000 tons in the first year after the breakup of the USSR but fell to 14,000 tons last season and are estimated at 9,000 tons, or 40,000 bales this season. Consumption of extra-fine cotton in Central Asia is estimated at about 60,000 bales this season, with little prospect for increase.

Consumption of extra-fine cotton in Egypt averaged about 1.3 million bales during the 1980s but dropped by one-fourth just in 1994/95 in response to changes in government policies that reduced subsidies and relaxed employment requirements. Mill use of extra-fine cotton in Egypt is continuing down and is estimated at less than 700,000 bales this season and modestly lower yet again next season. To put the decline in Egyptian mill use of extra-fine cotton in perspective, the rate of decline has been about the same as the rate of decline in Japanese cotton mill use during the 1990s.

In other producing countries mill use of extra-fine cotton has been stable or rising slightly in recent years. Extra-fine cotton consumption in India dropped from 1.1 million bales in the mid-1980s to 430,000 bales in 1994/95 because of reduced domestic production. Even though Indian production has remained lower than consumption in the 1990s, mill use of extra-fine cotton has increased to more than 500,000 bales, with imports needed to bridge the difference.

Consumption of Pima cotton in the USA is now approximately 150,000 bales, double the level of use in the early 1990s. Consumption of extra-fine varieties in China (Mainland) has been about 90,000 bales per year but is estimated double that in 2000/01 because of increased production.

## Exports

World exports of extra-fine cotton were about 1.5 million bales in the mid 1980s and 1.8 million bales immediately after the breakup of the USSR, but world trade in extra-fine cotton has fallen to about one million bales, and only modest growth to 1.1 million bales is forecast for next season. It is clear from two decades of export data that the world market for products made from extra-fine cotton has not been growing, although exports from the USA have expanded because of gains in market share.

Three-fourths of the year-to-year variation in world exports of extra-fine cotton is accounted for by changes in available supply, defined as beginning stocks plus production less consumption in the producing countries. World ending stocks are rising an estimated 250,000 bales this season because of increased production in the USA and reduced mill use in Egypt. However, production in 2000/01 is likely to fall because of reduced area in the USA. On balance, the supply available for export in 2000/01 is estimated about 50,000 bales larger than this season, suggesting that exports may rise some 40,000 bales to 1.1 million bales.

Exports of Pima from the USA are estimated at 410,000 bales this season and 370,000 next season because of lower production. Shipments from Egypt are estimated at 370,000 bales both this season and next. Exports from Uzbekistan are now only about 20,000 bales per year, and even with Turkmenistan and Tajikistan, extra-fine cotton exports from Central Asia only amount to an estimated 55,000 bales. Exports from all other countries are estimated at 325,000 bales in 2000/01, up from 240,000 bales this season. Exports of extra-fine cotton from China (Mainland) are expected to nearly double to 90,000 bales because of increased production in Xinjiang, and shipments from Australia and Israel may rise a combined 25,000

bales with increased production. Shipments from Sudan may rise to about 70,000 bales, and exports from India, Peru, and the minor producers such as Morocco amount to less than 20,000 bales.

The U.S. Pima cotton loan rate is reducing exports. Historically, about 90% of the variation in U.S. Pima exports was determined by changes in the U.S. Pima available supply. The ratio of prices for U.S. Pima and Egyptian cotton has also affected U.S. shipments. The U.S. supply net of mill use of Pima rose by 300,000 bales in 1999/00, and Cotlook quotes for American Pima have declined relative to quotes for Giza varieties since 1996. Nevertheless, U.S. exports are climbing only 120,000 bales this season, less than half the expected increase in exports if market forces were free to adjust.

The U.S. Pima loan rate is approximately 80 cents per pound, and farm prices are apparently just a few cents above that level. 9,000 bales of 1998-crop Pima and 306,000 bales of current-crop Pima are still being held as collateral against loans from the government, and 64,000 bales of 1998-crop Pima have already been forfeited to the government and sold at auction. The remainder of the 1998-crop Pima held in the loan will also likely be forfeited. U.S. ending stocks this season are estimated at 280,000 bales. Assuming that the U.S. industry needs about 50,000 bales of "free stocks" of cotton on July 31, inventory carried over to 2000/01 while still held as collateral against loans is estimated at 230,000 bales. Consequently, another 75,000 bales of 1999-crop Pima will need to be redeemed from the loan rather than being forfeited. That need to redeem cotton from the loan will work to keep farm prices from dropping any further. The operation of the loan program will continue to inhibit shipments of U.S. cotton next season, and with lower production, U.S. Pima exports are likely to fall.

Step 2 payments to facilitate the consumption and export of U.S. Pima have been authorized by Congress, but the administrative procedures for implementation have not been determined. Until those procedures are determined, it is difficult to know what the impact on exports would be. Obviously, the implementation of Step 2 payment rates could not reduce U.S. exports.

As with the USA, exports from Egypt are largely determined by the available supply (beginning stocks plus production less mill use), and government policies also play a significant role. The Egyptian surplus fell about 100,000 bales to 700,000 bales in the current season, and exports are falling by an estimated 90,000 bales. At this stage, little change in the Egyptian surplus supply is expected in 2000/01.

About two-thirds of world extra-fine cotton exports go to nine countries, with Italy and Japan the largest destinations. Switzerland, Korea, Indonesia and India together account for one-fourth of world exports, and Germany, China (Taiwan), Turkey and Bangladesh together account for another one-fifth of shipments.

## Production

Egypt remains the largest extra-fine cotton producing country. Production in 1999/00 is a little more than one million bales, about the same as last season, and production in 2000/01 is again expected a bit more than one million bales. Egyptian cotton farmers have been buffeted by policy changes that allowed domestic prices to fall from 500 Egyptian pounds per Kentar for the base variety and grade to market-determined prices that are about one-third lower now, and other reforms have allowed land rents and other input costs to rise. Consequently, production fell by one-third in 1998/99, but seems not to be falling further.

U.S. planted area for Pima is estimated at 220,000 acres in 2000, including 180,000 acres in California, a decline in the U.S. total of about 30%. The likely fall in U.S. Pima area in 2000 is another distortion caused by the U.S. government program. Pima yields in California over the last three years have averaged just 2% less than upland yields in California, but the price premium for Pima over SJV is actually rising in 1999/00 and is now about 40%. Based on price relationships alone, even accounting for differences in production costs per acre, land ought to be shifting from upland to Pima, not the reverse. But, upland cotton farmers in the USA received marketing loan payments (or POP payments) of up to 20 cents per pound this season, on top of contract transition payments and disaster payments of about 12 cents per pound. As a result, the income relationships are reversed, and income from growing upland cotton, including government benefits, is higher than the income from growing Pima. Of course, if it weren't for the Pima loan rate, Pima prices would be much lower than they are, and it is difficult to estimate what the income relationship would be in the absence of government programs. But it is clear that U.S. Pima plantings and production will decline in 2000/01. The estimate of U.S. production is 460,000 bales, down from 690,000 this season.

Area and production of Barakat in Sudan and Pima in Australia are expected to rise. Little is known about policies affecting extra-fine cotton production in China, and so we tend to assume each season will be the same as before. Production of the Valaraxmi and DCH-32 varieties in South India are estimated as a proportion of total production in India and are not expected to change much in 2000/01. Uzbekistan is placing more emphasis on improving yields, and extra-fine cotton production may increase.

#### Prices

Season average Cotlook quotes for American Pima fell from \$1.70 per pound in 1995/96 to \$1.08 last season, and the average through mid-February this season was 94 cents. Quotes for Giza 70 have also fallen, dropping from \$1.95 in 1995/96 to \$1.08 so far this season.

World ending stocks of extra-fine cotton are forecast to remain equal to 40% of disappearance during 2000/01, suggesting little room for upward movement in prices. Nevertheless, increases in prices of upland cotton next season, fueled by stronger demand and renewed imports by China (Mainland), could push the entire complex of cotton prices higher. Assuming an increase in the Cotlook A Index from an average of 50 cents in 1999/00 to between 55 cents and 60 cents per pound next season, the average Cotlook quote for American Pima could rise to between \$1 and \$1.10, and the average for Giza 70 could be between \$1.10 and \$1.20 per pound. The premium for American Pima over the A Index this season is averaging nearly 100%, or double the A Index, compared with an average Pima premium during the 1990s of 70%. The premium for American Pima is likely to drop next season as upland prices rise. The margin between American Pima and Giza 70 is averaging 13 cents per pound this season, and will depend on decisions by ALCOTEXA next season.

#### National Promotion Programs Needed

The President of Cotton Incorporated, the largest cotton marketing organization in the world, observes that the world economy is in the midst of significant structural change fueled by a revolution in communications technology and aging populations in major consuming countries. He notes that these structural shifts are leading to changes in consumer behavior, including more casual lifestyles, increased environmental and safety awareness, and greater concern for financial security. He concludes that the impact of these changes on the cotton industry is to confirm the dominance of the consumer as the driving economic factor determining success or failure, and that successful industries are those that respond to consumer demands. He adds that improvements in product quality are quickly internalized by consumers as standard product features. An example is wrinkle-resistant cotton pants that commanded a price premium of \$6 per pair when first introduced but now are demanded by consumers as standard with no premium.

An increased consumer emphasis on product quality would seem to work in favor of producers of extra-fine cotton and products made from extra-fine cotton. However, consumers are also demanding that increased quality be provided without a rise in retail prices. Twenty years of data on extra-fine cotton consumption and exports suggest that extra-fine cotton, as a world industry, has not been meeting the challenges posed by consumer dominance. World consumption of extra-fine cotton, including use in the producing countries and exports, has fallen since the mid-1980s, even as world cotton use has grown about 15%. World production of extra-fine cotton now represents about 3% of world cotton production, only about half the share held in the mid-1980s. While much of the loss of world extra-fine cotton production can be attributed to the breakup of the USSR and changes in government policies in producing countries, it must also be noted that even exports to market economies did not rise in the 1990s.

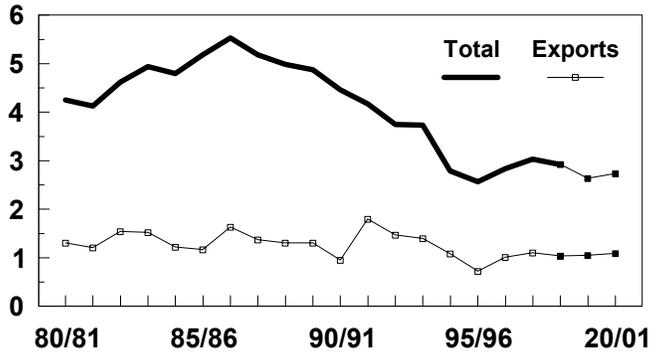
Possible explanations for the lack of growth in extra-fine cotton consumption include new spinning machinery that permits the substitution of fine and high-medium cotton for extra-fine cotton in the production of quality products, competition with chemical fibers and weak economic performance in Japan and other consumer markets during the 1990s. But a failure to communicate to consumers the advantages of extra-fine cotton and to convince consumers of the justification of the price premiums associated with products made from extra-fine cotton might also be contributing to the lack of growth in this industry over the past two decades.

Demand enhancement was one of the themes of the most recent ICAC plenary meeting last year in South Carolina. The meeting highlighted the need for national cotton organizations in producing countries to promote cotton to their own consumers. Representatives from Cotton Australia, Cotton South Africa, and Cotton Incorporated and Cotton Council International in the USA presented examples of successful national promotion programs. The success of Supima at boosting mill use of extra-fine cotton in the USA serves as evidence that promotion matters. Among the major extra-fine cotton producing countries, mill use rose in the 1980s and 1990s only in the USA. The reasons for increased mill use in the USA are many, but increased consumer awareness of the properties of cotton, including Pima cotton, are among those reasons. Promotion alone is not a sufficient condition for increased demand, but promotion is a necessary investment for growth by national cotton industry organizations.

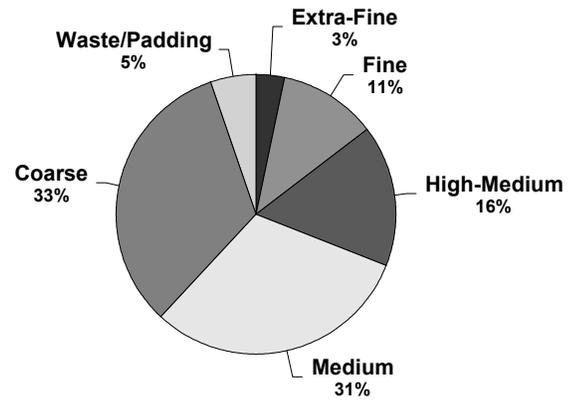
The world cotton market is turning upward again after five years of declining prices, and prices of extra-fine cotton may rise in 2000/01. But exports have been steady and domestic use in producing countries of extra-fine cotton has slumped the last five years, even as average prices have fallen. The quantity of extra-fine cotton used in the world is not likely to grow in this decade either, unless the industry is better able to meet the challenges posed by a consumer-driven cost and quality conscious economy. Given that major structural changes in producing countries since the breakup of the USSR have mostly been undertaken, the industry may now be better positioned for growth. But real industry growth, meaning higher prices and increased quantities over the long term, will only happen with better communication to consumers.

## EXTRA-FINE COTTON USE WORLD

Million Bales

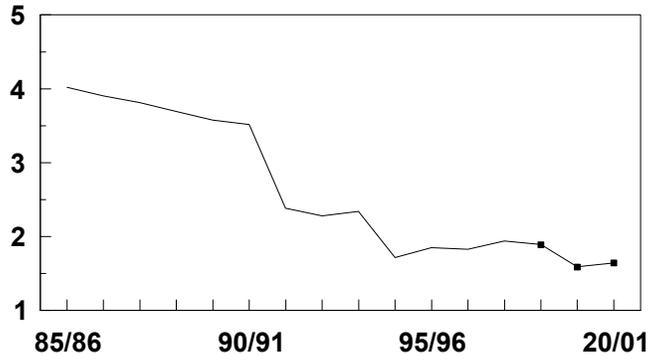


## WORLD COTTON SUPPLY 1999/00



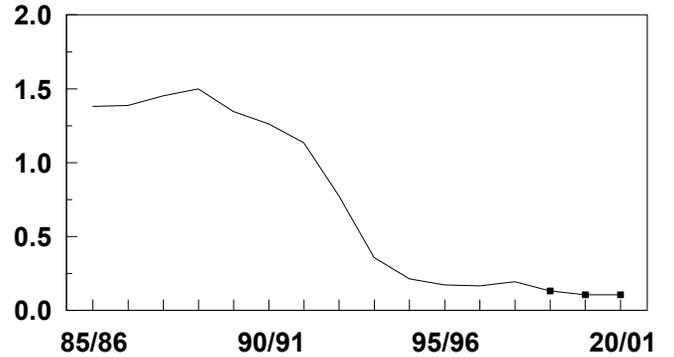
## EXTRA-FINE COTTON USE PRODUCING COUNTRIES

Million Bales



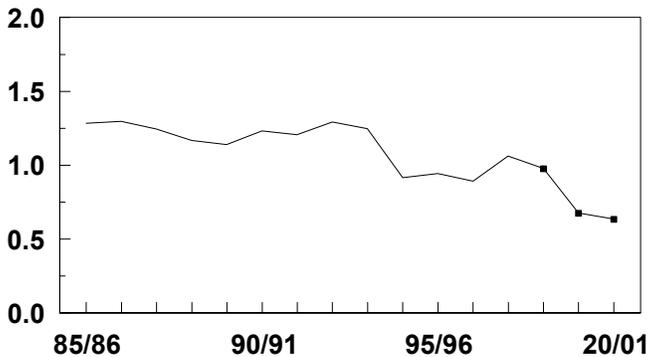
## EXTRA-FINE COTTON USE USSR / FORMER USSR

Million Bales



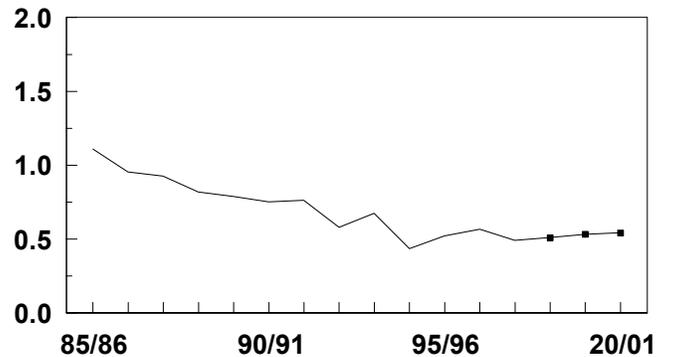
## EXTRA-FINE COTTON USE EGYPT

Million Bales



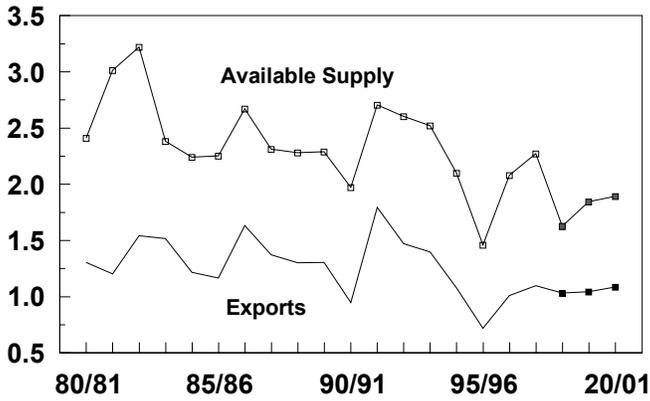
## EXTRA-FINE COTTON USE INDIA

Million Bales



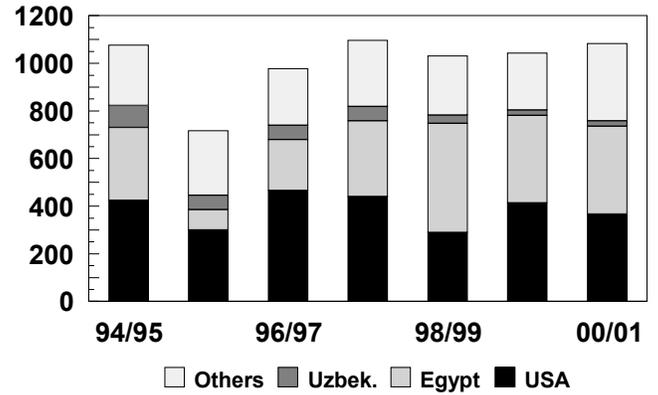
## WORLD EXTRA-FINE COTTON

Million Bales



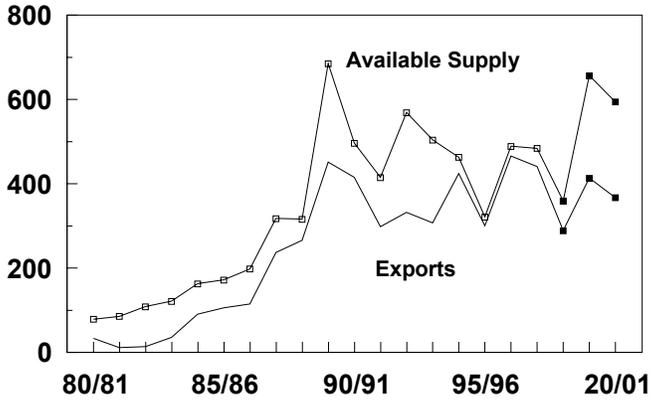
## EXTRA-FINE COTTON EXPORTS

Thousand Tons



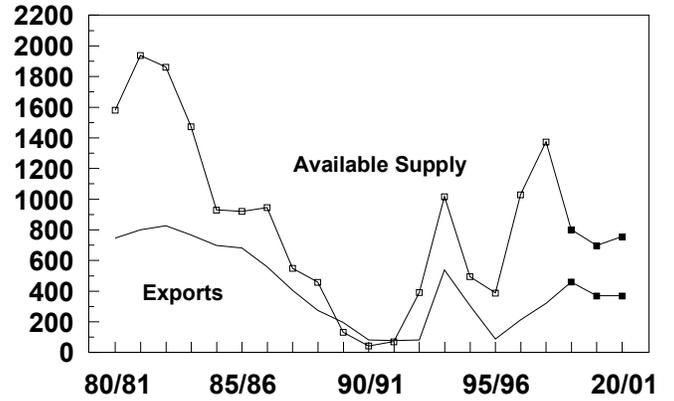
## USA EXTRA-FINE COTTON

Thousand Bales

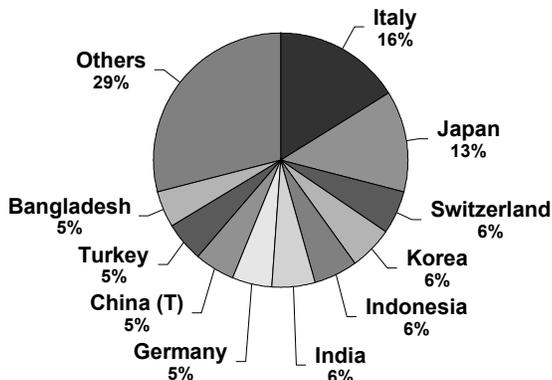


## EGYPT EXTRA-FINE COTTON

Thousand Bales

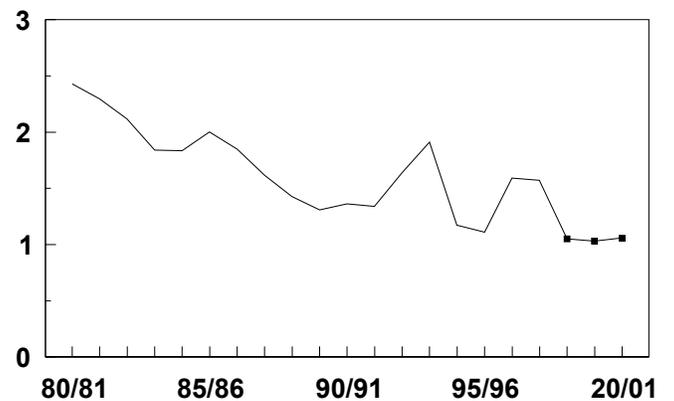


## EXTRA-FINE COTTON EXPORTS BY DESTINATION: 1999/00



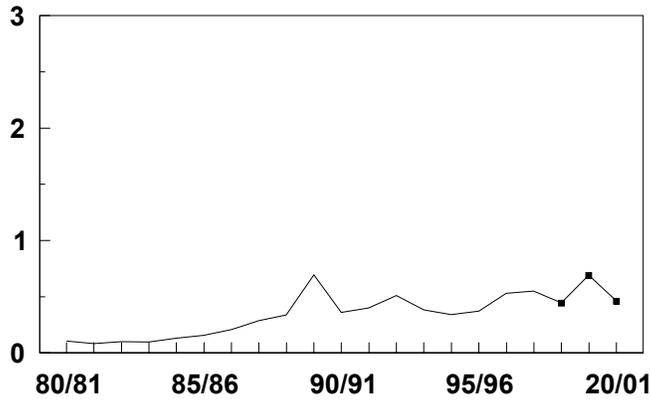
## EGYPT PRODUCTION:

Million Bales



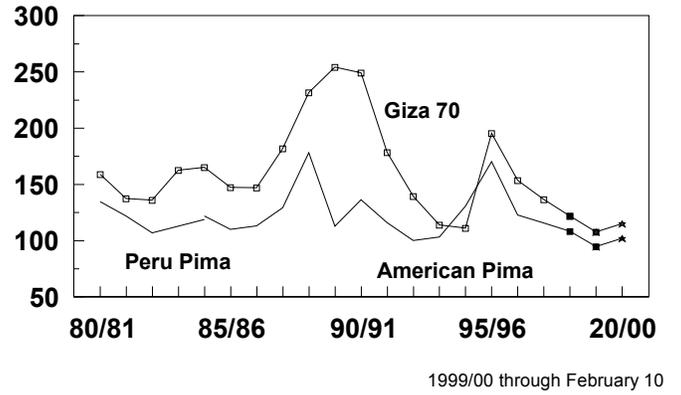
## USA PIMA PRODUCTION:

Million Bales



## EXTRA-FINE PRICES

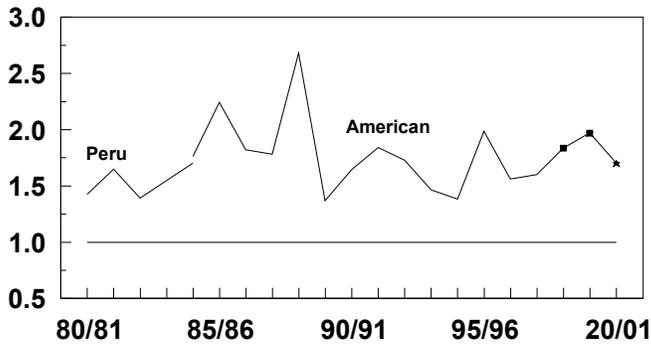
Cents per Pound



1999/00 through February 10

## PIMA PRICES

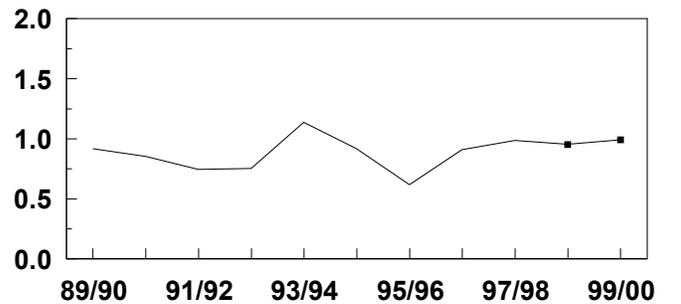
Ratio to the Cotlook A Index



1999/00 through February 10

## EXTRA-FINE EXPORTS TO NON-COMECON COUNTRIES

Million Bales



COMECON refers to the former USSR and its trading partners

## USA EXTRA-FINE USE

Thousand Bales

