INTERNATIONAL COTTON ADVISORY COMMITTEE
1629 K Street NW, Suite 702, Washington, DC 20006 USA
Telephone (202) 463-6660 • Fax (202) 463-6950 • e-mail secretariat@icac.org

COTTON SUPPLIES EXPANDING*

Terry Townsend
Executive Director

Prices at 6-year High in 2003/04

Despite distortions in the world market caused by government measures, cotton supply and demand are price-responsive. Historically low prices in 2001 led to reduced production and record consumption in 2002/03. Prices rose in 2002, and world production increased by 7% in 2003/04, while consumption was up slightly to another record and world ending stocks shrank to a 9-year-low of 7.8 million tons by July 31, 2004. However, during 2003/04 the stocks-to-use ratio outside China (Mainland) jumped from 51% to 60%, the highest since 1974/75. Net imports by China (Mainland) skyrocketed to a record of 1.9 million tons, and as a result, the Cotlook A Index averaged 68 cents per pound in 2003/04, 13 cents (24%) above the average in 2002/03 and the highest in six seasons. Nonetheless, from the perspective or recognizing structural change, prices remained below the 30-year average of 70 cents per pound despite record imports by China (Mainland).

Higher prices are boosting world production to a record in 2004/05, exceeding consumption and leading to an increase in world ending stocks. Expectations of rising stocks and of lower imports by China (Mainland) in 2004/05 caused the Cotlook A Index to fall from 75 cents per pound in January 2004 to 52 cents per pound in August 2004, the lowest monthly average since October 2002. The average Cotlook A index is expected to fall to 51 cents per pound in 2004/05.

2004/05 Record Production on Track

During the first five months of 2004, international prices were at their highest level at that period of the year since 1997, up 23% from the same period in 2003. Even though, cotton prices were less attractive than they were a year ago compared to soybeans, the rise in prices stimulated plantings in 2004. Many producers can make a profit at current prices. The U.S. dollar has weakened against the currencies of most developed countries since February 2002, but it remains strong against the currencies of many cotton-producing developing countries, keeping cotton prices in many domestic currencies attractive. As a result, world cotton area is climbing by 8% to an estimated 35 million hectares in 2004/05, the highest since 1995/96.

Weather has been favorable to the development of cotton crops in most areas of the Northern Hemisphere in 2004, and the harvest has begun without major incident. Plantings in the Northern Hemisphere account for 90% of world production. Therefore, the world yield is forecast to climb to a record of 678 kilograms per hectare in 2004/05, up 36 kilograms (6%) from last season. Yields stagnated below the 600-kilogram per-hectare mark during the nineties but progress made in China (Mainland), Brazil and Turkey pushed the world yield to a record of 644 kilograms per hectare in 2002/03. Year-to-year fluctuations in yields have been a significant factor in the volatility of cotton prices during recent seasons, and yields in China (Mainland) will again be critical to world production this season.

In addition to higher prices, structural factors are stimulating cotton production. New cotton areas in high-yielding Xinjiang (China), Mato Grosso (Brazil), and Southeast Anatolia (Turkey) are being expanded, contributing significantly to the increase in world production since the mid-1990s. With advances in technology, including genetic engineering, costs of production for the most efficient producers are coming down, sustaining

---

* Presentation at the Liverpool Cotton Conference, October 8, 2004.

world supply. It is estimated that 24% of world cotton area was planted to biotech varieties in 2004/05, up from just 2% in 1996/97, contributing about 34% to world production and 31% to world exports.

World production is forecast up 2.9 million tons (14%) in 2004/05, climbing to 23.5 million tons, 2 million tons above the 2001/02 record. This would be the largest year-to-year increase in absolute terms since 1984/85. Half of the increase is expected to occur in China (Mainland), where production is forecast to reach a record of 6.3 million tons, up 29%. The U.S. is expecting a record crop of 4.55 million tons, up 575,000 tons (14%). Production in India is expected to remain near a record level of 3 million tons. Increases of about 180,000 tons are expected in Pakistan and Uzbekistan, to 1.9 million tons and nearly 1.1 million tons, respectively. Production in the African franc zone is forecast up 50,000 tons to reach 980,000 tons. Turkey is expecting a record crop of 950,000 tons. Adverse weather can still have a negative impact on volume and the quality in 2004/05, but record production is definitely on track.

Plantings in the Southern Hemisphere are about to start, responding to price signals. Brazil is expected to remain the fifth largest producer this season, with a record of 1.3 million tons. Production in Australia is forecast to rebound to 500,000 tons, up 170,000 tons (50%).

World production of extra-fine cotton is expected to reach 750,000 tons in 2004/05, up 34% from last season and the highest since 1994/95.

Over the last 16 years, ICAC estimates of world production made each September for the same season have been too low 7 times, too high 4 times, and correct five times, and the average error is zero. For the season ahead, forecasts of world production made in September are also nearly equally distributed above and below the final correct figure, and the average forecast error is 2%.

Impacts of Government Measures on Production

The current pace of negotiations on agriculture under the Doha Round can best be understood in historical context. The modern era of international trade agreements began in 1948 with the creation of the General Agreement on Tariffs and Trade (GATT). From the beginning of GATT, the agriculture sector was exempted from broad trade liberalization initiatives. However, that exemption began to end in the mid-1980s, when, at the insistence of the U.S. and other governments, agriculture was included in the agenda of the Uruguay Round of GATT negotiations. The Uruguay Round ended successfully in 1995 and included an Agreement on Agriculture that became part of the multilateral trade rules of the World Trade Organization (WTO) that was created to replace GATT. The three pillars of liberalization of trade in agricultural products: 1) improved market access, 2) reduced subsidies that distort production and trade, and 3) elimination of export subsidies, were enumerated in the Uruguay Round, but the quantitative commitments were sufficiently generous that few domestic policy changes were required in the United States, the European Union, Japan, Korea and other major subsidizing countries.

Member governments of the WTO decided to launch the Doha Round of trade negotiations under the auspices of the WTO in November 2001. The Doha Ministerial Declaration established a mandate to liberalize trade in agriculture by making progress on the three pillars of market access, production subsidies and export subsidies first identified during the GATT talks.

The Doha Round is proceeding along a tortuous path. Countries have argued over proposals since 2001 without coming to agreement. Efforts were made to achieve a consensus on agriculture prior to the Ministerial meeting in Cancun, Mexico in September 2003. Negotiations are complex and easy summary is difficult, but generally the developing countries and the U.S. support aggressive reductions in subsidies, while Europe, Japan and Korea favor a more conservative approach. Developing countries argue that they should receive “special and differential” treatment to keep protective trade barriers in place. Draft ministerial texts were circulated prior to Cancun that were rejected by developing countries and the Cairns Group. The Cancun Ministerial meeting collapsed without agreement, and countries are still pointing fingers to affix blame.

An unusual element of the agenda in Cancun was specific reference to cotton under the General Initiative on Cotton. The initiative was a request by four African countries, Burkina Faso, Cote d’Ivoire, Chad and Mali to negotiate a separate commodity agreement covering only cotton that would phase out subsidies in three years and provide compensation to developing countries for the harm caused by subsidies prior to the phase out. Several countries in Europe, none of whom produce cotton and none of whom have volunteered to reduce subsidies paid to their farmers, financed the General Initiative on Cotton. Even though the General Initiative on Cotton was not accepted in Cancun, the initiative served to raise the profile of cotton in this round of trade talks and to focus dispirit attention on the U.S. as a subsidizing country. The effects of the initiative carry on in the form of a new commitment by the EU to provide development assistance to the African cotton sector and in specific recognition of cotton in the most recent WTO framework document.

Framework Document

During 2004, the talks on agriculture in the WTO continued in Geneva. On August 1, 2004 the General Council of the WTO reaffirmed the Doha Ministerial Declaration and approved a framework agreement that is designed to facilitate the successful conclusion of the Doha Round by the end of 2005. The agreement refers to significant reforms in agricultural policies and addresses specifically the cotton sector. The framework agreement reached in the WTO at the end of July is a masterful example of diplomatic language identifying high purpose but avoiding specific commitments. There is nothing in the framework agreement that will obligate the U.S. or the EU to specific cuts in subsidies.

Nevertheless, the tide of history is moving in the direction of reductions in direct support for agriculture and in favor of decoupled payments linked to broad objectives of rural development and environmental protection. Already under the 2002 farm bill, approximately half of all payments to U.S. cotton producers are no longer linked directly to current production. Benefits are received either through fixed payments or payments based on historical production. The EU recently agreed to shift 65% of benefits paid to cotton growers to decoupled payments based on historical production beginning in 2006. This process of changing the formulas used to calculate benefits for individual producers from payments based on production to payments based on other calculations will continue in the next U.S. farm bill to be implemented probably in 2007. Changes in U.S. agriculture policies and programs prior to 2007 are not likely. Accordingly, the Secretariat expects that production in the U.S. will continue at average levels for the foreseeable future, while modest declines may occur in Greece and Spain as a result of the decoupled payments.

Cotton Consumption Rising

Cotton consumption is affected by world economic growth and by relative fiber prices. IMF projections released in April suggest that world GDP will grow about 4.5% in 2004 and next year, up from 3.9% in 2002 and 3% in 2001. China (Mainland)’s economy is forecast to grow 8.5% in 2004 and 8% next year.

World cotton consumption in 2004/05 will be stimulated by lower cotton prices. Cotton is currently price competitive with polyester, and as a result, world cotton mill use is expected to grow by about 2.3% in 2004/05 to reach a record of 21.8 million tons, up half a million tons.

World cotton use will benefit from the elimination of the remaining quotas on textile and apparel trade among WTO members on January 1, 2005. The phase out of quotas on textile and apparel trade was part of the agreement under the Uruguay Round of the GATT trade negotiations that ended in 1994. The first three phases of the elimination of quotas have proceeded without delay by member governments of the WTO, and the completion of the final phase of quota elimination represents a sovereign agreement by governments and will not be delayed.

The approaching deadline is putting downward pressure on wholesale prices of cotton products. By some measures, the existence of quotas has increased wholesale costs of affected products by between 20% and 38% in some countries, and the elimination of quotas will result in declines in wholesale costs of similar magnitudes. The Secretariat estimates that the elimination of quotas will account for about 100,000 tons, or 20%, of the increase in world mill use this season.

For the fifth consecutive season, China (Mainland) will capture most of the increase in world mill use. Cotton mill use in China (Mainland) is projected to increase to 7.6 millions tons in 2004/05, up 500,000 tons (7%) from last season. Mill use in the rest of the world is projected unchanged at 14.2 million tons, the same as in 1998/99, when consumption in China (Mainland) was 4.3 million tons.

Continuing declines in developed countries will offset increases expected in South Asia. Mill consumption in India is expected to reach 2.96 million tons, up 60,000 tons (2%). Mill use is forecast up by 80,000 tons (4%) in Pakistan. The decline of the spinning industry in developed countries and Central and Eastern Europe is continuing. Mill use in these regions is expected to fall to 2.7 million tons in 2004/05, down from 4.2 million tons in 1998/99 and 3.6 million tons less than in 1989/90. U.S. mill use is forecast down to 1.3 million tons in 2004/05, the same as in Turkey. Developing countries will account for an estimated 88% of world mill use this season, up from 77% in 1998/99 and 66% in 1988/89. China (Mainland)'s share of world mill use is expected to reach 35% in 2004/05, up from 23% in 1998/99.

International Trade Shrinking in 2004/05

The 13-cent increase in average cotton prices in 2003/04 was due to surging imports of cotton by China (Mainland). The shortfall between production and consumption in China (Mainland) is expected to shrink from an estimated 2.2 million tons in 2003/04 to 1.3 million tons this season. However, depleted stocks, including government reserves, need to be replenished. As a result, Chinese (Mainland)'s imports are expected to decline to 1.6 million tons in 2004/05, down 300,000 tons from last season. Indonesia and Turkey are expected to remain the second and third largest cotton importing countries, with 480,000 tons and 420,000 tons, respectively.

World cotton exports are expected to decline from a record of 7.3 million tons last season to 6.7 million tons in 2004/05. Net imports by China (Mainland) are projected to decline to 1.55 million tons in 2004/05, down 350,000 tons. The gap between mill use and production outside China (Mainland) and the U.S. is forecast to drop to an estimated 300,000 tons this season, down from 1.2 million tons in 2003/04 and 2.5 million tons in 2002/03. U.S. exports are expected to fall from a record of 3 million tons in 2003/04 (41% of world exports) to 2.45 million tons this season (37% of world exports).

Uzbekistan is forecast to export 770,000 tons in 2004/05, and Brazil is likely to become the third largest cotton exporting country, with 450,000 tons, surpassing Australia. Export shipments from the African franc zone are forecast to decline to about 900,000 tons, down from a record of over one million tons last season.

Secretariat forecasts of world consumption are usually pretty accurate. The average forecast error in September for the same season is 1%, and the average error for the season ahead is 2%.

Stocks Rising in 2004/05

With production expected to outpace mill use in 2004/05, world ending stocks are projected up by some 1.7 million tons, climbing to 9.5 million tons, still lower than from 1996/97 through 2001/02. China (Mainland) is expected to replenish stocks to an estimated 1.5 million tons by July 31st 2005. World ending stocks outside China (Mainland) are projected up 1.4 million tons, climbing to 8 million tons for the first time. As a result, the non-China (Mainland) stocks-to-use ratio is expected to rise from 60% to 67%, the highest since 1965/66. U.S. ending stocks are forecast to double to 1.6 million tons in 2004/05, the same as in 2001/02, with the stocks-to-use ratio climbing from 18% in 2003/04 to 42%.

Prices Down in 2004/05

Over the last two decades, the most important single variable affecting year-to-year changes in the Cotlook A Index was net exports by China (Mainland). On average, an increase in China (Mainland)'s net imports (imports minus exports) of 100,000 tons leads to an increase in the season average Cotlook A Index of about two cents per pound. Net imports by China (Mainland) are projected to decline to 1.55 million tons in 2004/05, down 350,000 tons, while the stocks-to-use ratio outside China (Mainland) is projected up by 7 percentage points.

Market fundamentals suggest that the Cotlook A Index will decline to 51 cents per pound in 2004/05, down 17 cents (25%) from the average last season. ICAC forecasts of the average Cotlook A Index made in September for the current season were too low by 4 cents for 2003/04, and by 2 cents for 2002/03. Forecasts were too high by about 5 cents for 1999/00 through 2001/02.

Initial supply and demand projections for 2005/06 suggest that world production will decline to 22.3 million tons, while mill use is expected to rise to about the same level. Net imports by China (Mainland) are projected up 250,000 tons from the projection for 2004/05. As a result, the forecast for the season average Cotlook A Index in 2005/06 is 54 cents per pound, up three cents from the projection for 2004/05. Barring extreme weather in major producing countries, the average Cotlook A Index is expected to remain between 45 and 55 cents per pound during the next decade, much lower than the average of 70 cents during the previous three decades.

SUPPLY AND DISTRIBUTION OF COTTON

September 23, 2004

Years Beginning August 1

	2000	2001	2002	2003 Est.	2004 Proj.	2005 Proj.
	Million Metric Tons					
BEGINNING STOCKS						
WORLD TOTAL	**10.111**	**9.699**	**10.575**	**8.561**	**7.80**	**9.49**
CHINA (MAINLAND)	3.812	2.984	2.631	1.566	1.23	1.48
USA	0.852	1.307	1.622	1.172	0.79	1.59
NET EXPORTERS	3.119	3.617	4.212	3.650	3.25	4.62
NET IMPORTERS 1/	6.993	6.081	6.363	4.911	4.55	4.88
PRODUCTION						
WORLD TOTAL	**19.439**	**21.475**	**19.297**	**20.602**	**23.53**	**22.30**
CHINA (MAINLAND)	4.417	5.324	4.916	4.870	6.30	6.19
USA	3.742	4.420	3.747	3.975	4.55	3.80
INDIA	2.380	2.686	2.312	3.000	3.00	2.90
PAKISTAN	1.816	1.783	1.736	1.734	1.91	1.90
BRAZIL	0.939	0.766	0.848	1.273	1.30	1.37
UZBEKISTAN	0.975	1.055	1.022	0.893	1.07	0.99
OTHERS	5.171	5.440	4.717	4.858	5.39	5.15
CONSUMPTION						
WORLD TOTAL	**19.842**	**20.298**	**21.194**	**21.304**	**21.83**	**22.25**
CHINA (MAINLAND)	5.200	5.700	6.500	7.100	7.60	7.98
INDIA	2.924	2.910	2.914	2.900	2.96	3.02
EU, C. EUR. & TURKEY	2.361	2.430	2.399	2.208	2.13	2.11
PAKISTAN	1.764	1.855	2.042	2.100	2.18	2.25
EAST ASIA & AUSTRALIA	2.075	2.127	2.075	1.889	1.84	1.80
USA	1.929	1.676	1.583	1.369	1.30	1.24
BRAZIL	0.873	0.830	0.760	0.800	0.84	0.87
CIS	0.657	0.671	0.674	0.685	0.69	0.72
OTHERS	2.059	2.099	2.248	2.253	2.29	2.27
EXPORTS						
WORLD TOTAL	**5.883**	**6.444**	**6.647**	**7.343**	**6.69**	**7.06**
USA	1.472	2.395	2.591	3.000	2.45	2.57
CFA ZONE	0.755	0.756	0.815	1.040	0.88	0.97
UZBEKISTAN	0.800	0.810	0.798	0.644	0.77	0.70
AUSTRALIA	0.849	0.662	0.575	0.470	0.34	0.48
GREECE	0.270	0.250	0.280	0.250	0.21	0.24
BRAZIL	0.068	0.147	0.107	0.210	0.45	0.50
CHINA (MAINLAND)	0.097	0.074	0.164	0.038	0.05	0.05
IMPORTS						
WORLD TOTAL	**5.743**	**6.246**	**6.541**	**7.280**	**6.69**	**7.06**
EAST ASIA & AUSTRALIA	1.995	2.143	2.029	1.733	1.78	1.75
EU, C. EUR. & TURKEY	1.449	1.597	1.396	1.181	1.12	1.12
CIS	0.412	0.328	0.348	0.314	0.32	0.32
SOUTH AMERICA	0.309	0.226	0.318	0.315	0.23	0.25
CHINA (MAINLAND)	0.052	0.098	0.682	1.929	1.60	1.85
TRADE IMBALANCE 2/	**-0.140**	**-0.199**	**-0.106**	**-0.063**	**0.00**	**0.00**
STOCKS ADJUSTMENT 3/	**0.130**	**-0.103**	**-0.011**	**0.000**	**0.00**	**0.00**
ENDING STOCKS						
WORLD TOTAL	**9.699**	**10.575**	**8.561**	**7.796**	**9.49**	**9.54**
CHINA (MAINLAND)	2.984	2.631	1.566	1.227	1.48	1.49
USA	1.307	1.622	1.172	0.788	1.59	1.59
NET EXPORTERS	3.617	4.212	3.650	3.245	4.62	4.69
NET IMPORTERS 1/	6.081	6.363	4.911	4.551	4.88	4.86
ENDING STOCKS/USE 4/	**0.46**	**0.55**	**0.51**	**0.596**	**0.67**	**0.69**
COTLOOK A INDEX 5/	**57.20**	**41.80**	**55.40**	**68**	**51***	**54***

[1] Includes Argentina, China (Mainland), Colombia, India, Mexico, Pakistan, Turkey and traditional importers. [2] 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. [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 projections for 2004/05 and 2005/06 are based on net China (Mainland) trade and world-less-China (M) ending stocks-to-use ratio.

* 95% confidence interval extends 12 cents above and below the point estimate.