



THE WORLD COTTON MARKET SITUATION

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Introduction

World cotton prices, as measured by the Cotlook A Index, have fluctuated this crop year between 95 and 82 cents per pound describing a continuing relative tight supply situation in the world market. Cotton prices have been above average since 1993/94 and reached historic highs in 1994/95. However, the response of production to higher prices has been less than normal due to adverse weather and pests in major producing countries and to the bankruptcy of many cotton sectors in developing countries as a result of the last period of low prices between 1991 and 1993. This is particularly the case of Latin America where the cotton sector enjoys a free market with no government subsidy programs.

World production increased from 16.9 million tons in 1993/94 to 18.7 million in 1994/95 and is expected to reach 19.3 million in 1995/96. With world cotton consumption expected to reach 18.6 million tons in 1995/96, world cotton stocks are expected to increase by 800,000 tons to reach 8.5 million at the end of 1995/96. World stocks have increased sufficiently to move world prices 8 cents below the average 94 cents registered in 1994/95. However, prices have not experienced further downward pressures because most of the increase in stocks is taking place in China (Mainland) while stocks outside China (Mainland), estimated at 4.7 million tons in August 1, 1995, are at the lowest level since 1984/85. With one month remaining in the current crop year, the Cotlook A Index is already averaging 86 cents per pound, the expected level for 1995/96.

Current price levels are expected to maintain world production growing above consumption during the next two years and ending stocks are expected to increase to 9 million tons in 1996/97 and to 9.4 million tons in 1997/98. As a result, the Cotlook A Index will likely decline 12 cents to average 74 cents per pound in 1996/97 and remain at that level in 1997/98.

Demand

World cotton consumption is increasing at lower than expected rates. While the world textile market fully recovered from the 1991-93 recession, world cotton consumption declined 0.3% in 1994/95 and is expected to increase by 1% to reach 18.6 million tons in 1995/96. As a result, it is estimated that the market share of cotton declined 2.6 percentage points from 48.2% in 1993 to 45.6% in 1995. Such decline has been mainly the result of high prices of

cotton relative to other textile fibers and a gradual reduction in investment dedicated to cotton promotion activities in a good number of countries.

Despite the recent loss of market share, world cotton consumption is bound to resume long term growth during the next four years as major obstacles to increases of cotton consumption have dissipated. Distinctive features of the world cotton market this year are a halt of the declines in mill consumption of cotton experienced since 1989 in Eastern Europe and the former USSR, a temporary decline in mill consumption of cotton in industrial countries and continued growth in developing countries.

Dramatic declines in consumption since 1989 in Eastern Europe and the former USSR prevented world cotton and textile consumption in the 1990s from achieving greater growth. Consumption of cotton in this group of countries in 1994/95 was about 1 million tons, a third of the level of consumption in 1989/90. Had mill consumption of cotton in Eastern Europe and the former USSR remained at the level of 1989/90, the world would be consuming now 20.2 million tons of cotton. Mill consumption of cotton in Eastern Europe and the former USSR is expected to experience a slight increase in 1995/96, the first increase since 1989. Therefore, consumption in Eastern Europe and the former USSR will not offset increased consumption elsewhere in the world this year, as it did between 1989/90 and 1994/95.

Mill consumption in industrial countries is expected to decline from 4.1 million tons in 1994/95 to 3.9 million tons in 1995/96. The most important decline is that of US mill consumption of cotton, but other smaller declines are expected to take place in the European Union and in Japan. As cotton prices become more competitive and supplies increase, mill consumption of cotton in industrial countries is expected to resume growth in 1996/97. Mill consumption of cotton in developing countries is expected to continue to increase at 3%, about the average annual rate of growth during the last 15 years.

With expected increases in world income during the next two years, consumption in Eastern Europe and the former USSR no longer declining, and prices close to the average price of the last 20 years (a measure of long term prices), cotton consumption is expected to increase to 19.1 million tons in 1996/97 and 19.5 million tons in 1997/98.

United States

Mill consumption of cotton in the US increased at an average annual rate of 4.7% during the last 15 years reaching 2.4 million tons in 1994/95, the fifth year of continuous growth. This crop year, however, limited supplies and lower economic growth are causing a temporary decline and US mill consumption of cotton is expected to be 150,000 tons less than in 1994/95.

Ten years ago almost every analyst in the United States agreed with US cotton projections for 1994 showing stable or declining mill consumption, but none envisioned the 100% increase that took place between 1985/86 and 1994/95. Such success is the result of several factors. The US industry managed to lower costs and improve quality by investing in new technologies and, more important, US consumer preferences for cotton have grown stronger. In fact, according to research by the ICAC the US has been the only country where

the market share of cotton has not been greatly affected by relative high prices and is expected to continue to increase over the next ten years. While cotton promotion programs in other countries have been greatly reduced or discontinued since 1990, investment in cotton promotion in the US more than doubled between 1986 and 1994.

Investment in new technologies has continued to take place and textile mills in the USA are adding capacity; denim production capacity alone may be higher in 1995 by as much as 40,000 tons. In a survey conducted by the International Textile Manufacturers Federation (ITMF), machinery manufacturers reported 1994 shipments to USA spinning mills of 118,000 open-end rotors and 30,000 spindles. At average rates of use of one ton of fiber per rotor per year and 200 kilograms of fiber per spindle per year, the rotors and spindles installed in 1994 could account for about 125,000 tons of increased USA mill use. Machinery shipment statistics for 1995 are not available yet, but the estimate of 1995 capital spending by USA companies in the textile mill, apparel and finished textiles category is 14% greater than 1994 capital expenditures by the same group.

The major obstacle to mill consumption in the US is the limited availability of cotton and the resulting impact on prices. Although prices have declined since last year and spinning margins have recovered, stocks in the US cotton market relative to consumption are at the lowest level of the last 15 years. As a result, prices are still relatively high and spinning margins are about half of the 56 cent average spinning margin registered between January 1986 and April 1996.

The average spot market price of cotton in the US dropped from \$1.08 per pound in mid June 1995 to 86 cents in early May 1996 and the calculated spinning margin for open-end 10s yarn in the USA increased from 19 cents per pound to 26 cents over the same period.

Stocks in the US are expected to recover in the next two years. Ending Stocks in 1994/95 were 577,000 tons, and are expected to increase to 677,000 tons in 1995/96 and to 794,000 tons in 1996/97. As a result, the US stocks to use ratio will recover from 13% in 1994/95 to 20% in 1996/97.

China (Mainland)

Consumption in China (Mainland) is expected to rise during 1995/96, but in 1996/97 and 1997/98 mill consumption of cotton in the world's largest consuming country will probably be at the level of 1986/87. Under the influence of tight supplies, which caused high cotton prices and government policies to reduce subsidies to unprofitable textile enterprises, consumption in China (Mainland) dropped to 4.3 million tons in 1994/95. Production of cotton yarn dropped from 5 million tons in 1993 to 4.6 million in 1994, and cotton's share of fiber used in blended cotton yarn fell from 74% to an estimated 73%. Both, the decline in yarn production and the shift toward chemical fibers were mandated by the National Textile Council, a government organization that oversees the textile industry. Since 1986/87, consumption in China (Mainland) has ranged between 4.2 and 4.5 million tons. Because of the accumulation of stocks of cotton by the government during the 1994/95 crop year, greater supplies will probably be made available to textile mills in China (Mainland) during

1995, 1996 and 1997, even if cotton production declines. Therefore, a rise in consumption toward the upper half of the range recorded during the last nine years may be allowed.

India and Pakistan

Cotton consumption in India rose by 120,000 tons to reach 2.3 million tons in 1994/95 and is expected to increase to 2.4 million tons in 1995/96 and continue the same pace of increases during the next two years. Strong growth in textile exports and strong economic growth, leading to increased domestic demand, are encouraging increased mill consumption of cotton in India. Proximity to cotton production is an advantage for textile mills in India; cotton prices in Bombay for medium cotton were 16% less than the Cotlook A Index in early May, 1996 and were between 12% and 14% below the Cotlook A Index in 1994/95.

GDP in Pakistan rose by 4.1% in 1994, compared with 2.5% in 1993. Increased cotton production in 1994 contributed to the rise in economic growth. Even though cotton supplies remained relatively tight in Pakistan during the 1994/95 crop year, textile production increased because of continued investment in new technology and increased capacity. In 1994, yarn production increased by 5% and production of cotton cloth increased by 4.6%. Prices for cotton fiber of the type NIAB-78 averaged 16% lower than the Cotlook B Index during 1994/95 but the differential has narrowed to 2.5% below the Cotlook B Index in early May, 1996. With the recovery of cotton production in Pakistan this crop year, supplies will be available for continued increases in mill consumption. However, because mills no longer enjoy domestic prices at levels substantially lower than international prices, mill consumption is not expected to increase at the rates of growth registered during the 1980's.

Turkey

Mill consumption of cotton in Turkey is projected to reach 909,000 tons in 1997/98, 60,000 tons more than in 1994/95. Turkey joined the European Union customs system in January 1996 and now has greater access to European textile markets. Economic policies are enhancing the competitiveness of Turkish exports by reducing the value of the lira, and cotton production in Turkey is rising, providing a supply for domestic spinners.

Supply

Despite prices having reached historic highs during 1994/95, world cotton production is expected to increase only 3.5% to reach 19.3 million tons in 1995/96. High prices caused world area dedicated to cotton to expand to 35.5 million hectares, the highest area registered since 1952/53. However, a combination of adverse weather conditions and increasing difficulties in containing pests in many countries is causing world yields to decrease 6% to 545 kilograms per hectare in 1995/96. Production in 1995/96 is lower than previously expected in the US, Pakistan and Brazil, but higher than expected in China (Mainland). Because of higher than anticipated production, imports of cotton by China (Mainland), which reached 900,000 tons in 1994/95 and played a key role in the price increase of 1994/95, are expected to decline to 600,000 tons in 1995/96. Accordingly, it is the decline in imports by China (Mainland) and not an increase in supplies in the rest of the world that explains most of the decline in average cotton prices in 1995/96.

With current cotton prices above 80 cents and likely to remain above the long term average of 73 cents during the next two crop years, production is expected to continue to expand but will not be near the record level of 20.7 million tons established in 1991/92. World production is expected to reach 19.6 million tons in 1996/97 and nearly 20 million tons in 1997/98. Higher-than-average cotton prices are expected to keep area near 35 million hectares, near the top of the range for world harvested area established since the 1950s. However, problems with disease and insect resistance to pesticides will probably continue to affect yields in many countries through the rest of the 1990s, keeping production from expanding by enough to lower the season average Cotlook A Index to less than 70 cents per pound.

United States

At the beginning of the 1995/96 crop year production in the USA was expected to increase to a new record of 4.4 million tons. However, despite an increase of 1 million hectares dedicated to cotton in 1995/96, adverse weather in some cotton producing states and pests in other states lowered yields from 794 kilograms per hectare in 1994/95 to 602 kilograms in 1995/96. Production is now expected to reach 3.9 million tons in 1995/96, some 400,000 tons less than in 1994/95. Higher-than-average cotton prices will keep most land in production, and yields may rise as producers who started growing cotton in the 1990s gain experience. However, the decoupling of cotton benefits from cotton production will reduce the incentive to plant cotton, and US production may be lower than it would have been otherwise. As a result of lower area and a recovery of yields, US cotton production is expected to increase to 4.1 million tons in 1996/97 and to remain at that level in 1997/98.

Between 1988/89 and 1995/96, ending-stocks-to-use ratios in the USA have varied between 0.13 and 0.23, except for 1992/93 when exports were affected by unusually strong competition from China (Mainland) and Central Asia. The ratio of ending stocks-to-use in the US is forecast to rise to 0.19 in 1997/98 as a result of slower growth of both production and consumption.

China (Mainland)

Cotton production in China (Mainland) is expected to increase 150,000 tons to 4.5 million tons in 1995/96. With normal weather conditions and the implementation by Chinese authorities of an early management of the pests that affected the crop during the last three years, yields are expected to be above 800 kilograms per hectare for the first time since 1991/92. Production in China (Mainland) is estimated at 4.1 million tons in 1996/97 and 1997/98, 10% less than in 1995/96 and about 400,000 tons less than consumption. Grain prices have risen in China (Mainland) but prices for cotton have not, suggesting that planted area will decline. Furthermore, the fact that many farmers were paid with IOUs for cotton in 1995/96 rather than being paid in cash is another reason why planted area could decline in 1996/97. A survey of farmers' planting intentions conducted in February indicated a possible decline of less than 1% in cotton area in 1996/97. However, domestic grain prices have since risen thereby encouraging farmers to dedicate less area to cotton. The national average cotton yield in China was the highest in four seasons in 1995/96 and was 5% above the five-season average. Resistance to pesticides among populations of boll worm continues to be a problem in the eastern and central cotton producing regions. Consequently, there is

limited scope for substantial increases in the Chinese average cotton yield to offset likely declines in area the next two seasons. China (Mainland) is expected to remain a net importer of cotton in most years, although large stocks carried over from 1994/95 and 1995/96 will still mitigate the need for imports in 1997/98.

Pakistan

Production in Pakistan is expected to reach 1.7 million tons in 1995/96, the highest in four years, and rising domestic prices more in line to international prices are likely to keep area dedicated to cotton in Pakistan increasing by 2% to 3% a year; a change in government policy in Pakistan reducing the barriers to exports of cotton will probably lead to higher farm prices over a period of years. Nevertheless, a continued problem with the leaf curl virus is expected to keep production in Pakistan below the 1991/92 record of 2.2 million tons, and Pakistan may export and import cotton routinely.

India

High prices caused area in India to expand 9% to reach 8.4 million hectares and, therefore, production reached 2.5 million tons in 1995/96. Expanding cotton consumption in India will maintain upward pressure on Indian market prices and will encourage increased production. However, low yields and competition with other crops for planted area may keep production close to consumption in most years; as with Pakistan, Brazil, Turkey and other producing countries, India may need to import cotton in many seasons. Production in India is expected to remain at 2.5 million tons in 1996/97 and 1997/98.

Uzbekistan

Uzbekistan's production was 1.26 million tons in 1995/96 and a crop of similar size is expected in the next two years. The Government of Uzbekistan hopes to stabilize cotton area at 1.5 million hectares and yields are likely to remain just above 800 kilograms per hectare. Economic difficulties in other countries in Central Asia may lead to reduced production and exports from the region.

Turkey

Production in Turkey is expected to increase by 33% to reach 837,000 tons in 1995/96 as a result of expanded area and higher yields. Area is not expected to continue to increase substantially during the next two years and less than the optimal weather conditions experienced in 1995/96 will likely result in somewhat lower yields. As a result, production is expected to be between 750,000 tons and 800,000 tons during the next two years. Turkey, however, will likely increase again cotton production substantially by the end of the 1990's as the GAP dam project is completed and over 1 million additional hectares will be available for irrigation.

Other Countries

Production in countries other than the largest six producer countries is gradually adjusting to high prices and production is expected to increase by 275,000 tons to reach 4.6 million tons in 1995/96. The most important increases in 1995/96 took place in Australia and in Francophone African countries and additional increases are expected in those countries during the next two years.

Prices

The main factor determining prices is available supplies on the market relative to demand, which is measured by stocks as a ratio of mill consumption. A simple equation that explains prices as a function of stocks-to-use ratio is known in economics as an inverted supply and demand function. This type of equation explained cotton prices very well before the mid 1970's. That was before China (Mainland) integrated its economy into the economy of the rest of the world and Chinese cotton trade began affecting the world market. China (Mainland) represents about a quarter of the world cotton market and decisions regarding production and consumption are large in world terms. For this reason the model devised by the ICAC to project cotton prices, as measured by the Cotlook A Index, isolates the impact of China (Mainland) from the stocks-to-use ratio of the rest of the world.

Furthermore, the model includes a barter variable that reflects the impact of barter transactions of Central Asian cotton, a factor affecting cotton prices since the disintegration of the Soviet Union in 1990. Finally the model also adds price expectations measured by changes of the December contract in New York between February and November in the current and previous year.

Given that production is expected to exceed consumption, stocks are expected to increase. Stocks outside China (Mainland) are expected to increase from 4.9 million tons in 1995/96 to 5.6 million tons in 1996/97 and 6 million tons in 1997/98. The stocks-to-use ratio is expected to increase from 0.39 in 1995/96 to 0.40 in 1996/97 and 0.43 in 1997/98. Other things being equal, the expected increase in non-China (Mainland) ending stocks are likely to reduce the average Cotlook A Index by 1 cent per pound in 1996/97 and by 3 additional cents in 1997/98.

Net imports by China (Mainland) are expected to decline from 520,000 tons in 1995/96 to 150,000 tons in 1996/97. Such decline in imports by China (Mainland) will likely reduce the average Cotlook A Index by 7 cents in 1996/97. However, expected increased imports by China (Mainland) in 1997/98 will likely prevent the Cotlook A Index from declining further. Net Chinese imports are expected to increase to 400,000 tons in 1997/98, balancing the expected downward pressures on prices from increased stocks outside China (Mainland).

Barter sales of Central Asian cotton rose from 9% of total exports from the region in the late 1980's to 60 in 1993/94 contributing to the decline of cotton prices in the early 1990's. During the last two years barter sales have declined substantially maintaining upward pressures on prices. Barter sales are estimated to be 35% of total Central Asian cotton exports in 1995/96

and are expected to decline further to 28% in 1996/97 and 22% in 1997/98. The decline in barter sales is expected to prevent the average Cotlook A Index from declining 3 additional cents in 1997/98.

SUPPLY AND DISTRIBUTION OF COTTON

6 June 1996

Years Beginning August 1

	1992	1993	1994	1995 Est.	1996 Proj.	1997 Proj.
Million 480-Lb. Bales						
BEGINNING STOCKS						
WORLD TOTAL	42.3	39.5	31.9	35.5	38.9	41.141
CHINA (MAINLAND)	14.7	13.6	9.8	14.0	16.4	15.218
USA	3.7	4.7	3.5	2.7	2.8	3.647
NET EXPORTERS	18.4	18.0	15.0	14.5	15.2	17.792
NET IMPORTERS 1/	23.9	21.5	16.9	21.0	23.7	23.349
PRODUCTION						
WORLD TOTAL	82.6	77.6	85.9	88.8	90.1	91.4
CHINA (MAINLAND)	20.7	17.2	19.9	20.7	18.8	18.8
USA	16.2	16.1	19.7	17.9	18.8	18.6
INDIA	10.9	9.6	10.8	11.4	11.3	11.5
PAKISTAN	7.1	6.3	6.8	8.0	8.1	8.3
UZBEKISTAN	6.0	6.2	5.8	5.8	5.6	5.6
TURKEY	2.6	2.8	2.9	3.8	3.4	3.6
OTHERS	19.0	19.3	20.0	21.2	24.0	25.0
CONSUMPTION						
WORLD TOTAL	86.1	84.8	84.5	85.5	87.8	89.5
CHINA (MAINLAND)	21.1	21.1	19.6	20.7	20.7	20.7
USA	10.3	10.4	11.2	10.5	11.1	11.5
INDIA	9.7	9.9	10.5	10.9	11.4	11.8
EAST ASIA & AUSTRALIA	10.9	10.6	10.2	9.9	9.9	9.9
EU & TURKEY	8.2	8.7	9.5	9.4	9.5	9.5
PAKISTAN	7.0	6.9	6.9	7.0	7.2	7.3
E. EUR. & FORMER USSR	6.7	5.0	4.4	4.6	4.8	4.9
BRAZIL	3.6	3.8	3.9	4.0	4.1	4.2
OTHERS	8.7	8.3	8.4	8.6	9.2	9.7
EXPORTS						
WORLD TOTAL	25.3	27.1	28.4	29.2	26.3	27.5
USA	5.2	6.9	9.4	7.7	7.1	7.3
UZBEKISTAN	6.0	5.9	5.3	4.7	4.5	4.7
FRANCOPHONE AFRICA	2.3	2.4	2.7	2.8	3.1	3.2
TURKMENISTAN	1.6	1.8	1.4	1.0	0.9	0.9
ARGENTINA	0.2	0.3	0.9	1.2	1.2	0.9
AUSTRALIA	1.7	1.7	1.3	1.4	1.9	1.9
CHINA (MAINLAND)	0.7	0.8	0.2	0.4	0.2	0.2
IMPORTS						
WORLD TOTAL	26.6	26.5	30.6	29.3	26.3	27.4
EAST ASIA & AUSTRALIA	10.3	10.2	9.8	10.0	9.7	10.0
EU & TURKEY	5.5	5.7	5.9	5.3	5.8	6.1
E. EUR. & FORMER USSR	5.0	3.9	4.2	4.1	4.2	4.2
CHINA (MAINLAND)	0.2	0.8	4.1	2.8	0.9	2.1
SOUTH AMERICA	2.3	2.5	2.2	3.1	2.4	1.5
TRADE IMBALANCE 3/						
STOCKS ADJUSTMENT 4/	1.3	-0.5	2.1	0.0	-0.0	-0.0
	-0.7	0.2	0.1	-0.0	-0.0	-0.0
ENDING STOCKS						
WORLD TOTAL	39.5	31.9	35.5	38.9	41.1	43.1
CHINA (MAINLAND)	13.6	9.8	14.0	16.4	15.2	15.2
USA	4.7	3.5	2.7	2.8	3.6	3.6
NET EXPORTERS	18.0	15.0	14.5	15.2	17.8	18.9
NET IMPORTERS 1/	21.5	16.9	21.0	23.7	23.3	24.1
ENDING STOCKS/USE 5/						
COTLOOK A INDEX 6/	0.39	0.35	0.39	0.38	0.40	0.43
	57.70	70.60	94.30	86*	74*	75*

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

2/ Cuba, East Europe, former USSR; Vietnam is included in East Asia

3/ 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.

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

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

6/ U.S. Cents per pound. Model results for 1995/96, 1996/97 and 1997/98 are based on net China (Mainland) trade, ratios of world-less-China (Mainland) ending stocks to use, barter sales from Central Asia, and futures prices. The estimate for 1994/95 is adjusted for quotes during June and July.

*/ 95% confidence intervals extend 9 cents per pound above and below each point estimate