The Economic Outlook
For U.S. Cotton 2013

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Summary

For the coming year, there are significant uncertainties and questions that will shape the economic health of the U.S. cotton industry. With this outlook, NCC staff hopes to provide some perspective and insights on the economic landscape. Before summarizing the projections for the global cotton market, it is important to review the underlying assumptions for the general economy and government policies that are assumed to be in place for 2013.

The International Monetary Fund (IMF) calls for growth to continue for the next two years at slightly improved rates than observed in 2012. But, their forecast also notes that much of the growth is policy-dependent and that downside risks remain significant. Recovery in the Euro Zone is expected to be further delayed, and the outlook for the U.S. economy is contingent on fiscal policies. It is also worth noting that preliminary estimates for the 4th quarter of 2012 showed a modest contraction in the U.S. economy – the first quarter with a downturn in economic activity since the recession. In summary, economies are expected to grow, but the continued recovery is not robust.

No major changes in government policies are assumed relative to the policies applied to the 2012 crop. For the United States, the extension of 2008 farm bill, as in place for the 2012 crop, will apply to the coming marketing year. India is expected to maintain a minimum support price for cotton. Likewise, China is expected to continue their policy of supporting prices by purchasing their domestic cotton production into government reserves. The key uncertainty, which will be discussed later in the report, will be the extent to which China makes the reserve cotton available to the market.

Turning attention to the cotton market, one of the key questions is the expected change in cotton acreage given current market prices. Each year, the National Cotton Council surveys U.S. cotton farmers as to their acreage intentions for the coming year. Both regular mail and email are used in an effort to reach all cotton farmers, asking the number of acres devoted to cotton and other crops in 2012 and the acres planned for the coming season. Surveys were distributed on December 18th and responses were collected through January 23rd.

Cotton farmers are responsive to market signals. Relative prices of cotton and major competing crops, as measured by the harvest-time futures contracts, have been the primary factor influencing U.S. acreage. During the survey period, the December 2013 cotton contract averaged 79 cents per pound, as compared to 92 cents in the weeks prior to planting the 2012 crop. In contrast, corn and soybean futures are trading above year-ago levels. Price ratios of cotton-to-corn and cotton-to-soybeans are comparable to 2009, the year of the most recent low in cotton acreage. Projections by market watchers have been consistent in calling for reduced acreage in 2013, and the NCC survey agrees with those expectations. For the U.S. as a whole, the survey indicates total cotton acreage of 9.01 million acres, down 27% from 2012 and the lowest since 1983.

Survey results vary by production region. For the 6-state Southeast region, respondents indicated a decline of 18%, lowering the regional total to 2.24 million acres. For additional insight into the survey, responses can be categorized one of three ways: increasing cotton acreage, maintaining cotton acreage unchanged, or reducing cotton acreage. Based on the number of

responses for the region, two-thirds indicated a decrease in area, with the remaining one-third of responses equally split between those maintaining acreage and those increasing acreage. Respondents indicating a decline in acreage are shifting to corn and soybeans, with soybeans more heavily favored as the alternative. Respondents planning more acres of cotton indicated fewer acres in the 'Other Crops' category, which is peanuts in this region.

Collectively, the five states in the Mid-South will plant 1.00 million acres, which is half of last year's total. The significant reduction underscores the ability of farmers in the region to move between cotton, corn and soybeans. The decline in cotton acres is also consistent with relative returns for cotton and competing crops based on current futures markets. Using USDA costs of production and trend yields, the shortfall between cotton net returns and returns for corn and soybeans is substantially larger than in 2009 – the most recent low in acreage. More than 85% of survey respondents said their cotton acreage will decline in 2013, with corn accounting for slightly more than half of the decline. Soybeans account for the remainder of the decline in acres, with many of the soybeans being double-cropped with wheat.

Results for the Southwest indicate total upland acres of 5.23 million, down 24% from last year. For the region as a whole, 2013 acreage is very similar to the years 2007 through 2009. The respondents planting less cotton, which was the case in approximately 65% of responses, said they intended to move those acres into grain sorghum, wheat and corn, in that order. Between 10 and 15% of the responses are intending to plant more cotton, with some of those acres coming from grains, but the larger reason underlying the increase appears to be weather. More specifically, additional cotton acres will come from growers that were unable to plant in 2012 due to drought conditions.

In the West, a 12% reduction is expected with the regional total at 341 thousand acres. Approximately 50% of the responses indicated reduced acres, with the vast majority of those acres moving into the 'Other Crops' category. In 30% of the responses, growers plan to maintain acreage at the same level as last year, while the remaining 20% said they intend to plant more cotton, largely at the expense of wheat.

For extra-long staple cotton, U.S. acreage is pegged at 203 thousand acres, down 15%. As in the case of upland cotton, Pima prices down from year-earlier levels are inducing a shift to other crops.

The NCC survey captures the intentions of producers at the time of the survey. Changes in markets and weather will affect final planting decisions. Since the time of the survey, cotton prices have strengthened somewhat relative to corn and soybeans. As a result, the survey could err to the low side when compared to current expectations, but unless there is further strengthening in the cotton futures, the view is that the overall acreage situation for 2013 is not fundamentally changed from the survey.

Planted acreage is just one variable determining production. Weather is often a more significant determinant of the final crop. The standard approach to the Council's projections is to assume abandonment rates for each state in line with historical averages and state-level yields consistent with recent trends. However, past experience tells us that actual production can deviate greatly based on variation in yields and abandonment. Applying deviations from the past 25 years to planting intentions for each state produces a distribution for the U.S. crop ranging from a low of 9.5 million bales to a high of 17.2 million bales, with a

mid-point of 13.3 million bales. In this outlook, slightly above-average abandonment rates and yields marginally below trend are assumed in the Southwest region due to the dry conditions. Those assumptions, coupled with average conditions for the remaining regions of the Cotton Belt, generate a U.S. cotton crop of 12.9 million bales.

Staying in the U.S. market, let's turn our attention to cotton demand. Consumption of cotton can be measured at different points along the textile supply chain. Initial demand occurs at the mill that produces yarn from cotton fiber. Final demand occurs with the consumer's purchase of finished apparel and textile products. Although purchases of finished consumer goods are generally measured in units, it is useful to convert the products into an equivalent pounds of fiber based on product weight and fiber blend.

Recent data for the U.S. consumer market clearly demonstrates the challenges the industry faces in terms of competition from synthetic fibers. Based on 11 months of data, calendar 2012 net domestic consumption of cotton fiber by U.S. consumers is estimated at 17.0 million bales. The proxy of the retail market equals the sum of the amount of cotton consumed by U.S. mills and the fiber equivalence of textile net imports into the United States. Since 2005, net domestic consumption in the U.S. is down by 10 pounds per person. The 2012 U.S. retail cotton market fell to the lowest level since 1996, amid a 4th consecutive year of declining market share on a volume basis. In part, the loss in market share is the result of cotton prices that have been uncompetitive with polyester. As raw fiber prices have moderated in recent months, prices of cotton textile products have also become more competitive with manmade fiber products. Assuming these relative prices continue as levels comparable to current values, market share is projected to stabilize, leading to a modest growth in cotton net domestic consumption for 2013. However, cotton is unlikely to reclaim market share unless cotton prices trade at levels below polyester.

Cotton consumed by U.S. textile mills has presented a more stable appearance over the past several months. Monthly consumption is currently running at 3.5 million bales on an annualized basis. This compares with 2.7 million bales at this time last year. For the current 2012 marketing year, U.S. mills are estimated to use 3.4 million bales. For the 2013 marketing year, a modest increase is projected with a total of 3.5 million bales used by U.S. mills.

For more than a decade, international markets have comprised the largest outlet for U.S. cotton production. Over the past five years, exports have consistently accounted for 75 to 80% of total offtake. Exports not only depend on available supplies of U.S. cotton, but also on changes in production and mill use in other countries. To understand the Council's outlook for U.S. exports, it is necessary to review projections for the international market. Detailed projections for selected countries and regions are presented in Table 1 on pages 7 and 8. For purposes of this summary, a separate focus will be given to China, while other countries will be addressed in a more collective manner. The distinction between China and all other countries is justified by the large disparity in price signals brought about by China's current stocks policy.

In 2012, 61.8 million acres of cotton were harvested outside of the United States and China, with India accounting for almost half of those acres. Last year's area was down almost three million acres from the 2011 season, which was a record high. The Council expects another modest drop in area for 2013 in response to lower cotton prices,

and in some countries, the lower price of cotton relative to grains and oilseeds. Although cotton prices are down from year-ago levels, the expected decline in acreage is modest as cotton remains the most attractive alternative in many countries.

Turning our attention to international mill demand, we will first focus on countries outside of China. A shift is underway in terms of where cotton is spun into yarn. For the current 2012 marketing year, mill demand outside of China is estimated at 67.2 million bales, up 5.4 million bales from the previous year. India and Pakistan together account for 33 million of the 67 million bales. After the detrimental effects of the recession followed by the loss of demand in the aftermath of $2 cotton, cotton spinning has regained its footing and is showing solid growth. For the coming year, NCC economists expect mill use to grow by almost 4 million bales, approaching 71 million bales. India and Pakistan account for slightly more than half the growth.

Continued growth in mill use is being supported by the relatively stable price pattern of recent months, more competitive prices when compared to polyester and more favorable spreads between yarn values and fiber prices. For India and Pakistan, the differential between yarn export values and fiber spot prices has been much improved in recent months.

The other factor supporting mill use in these countries is China's current policy of buying cotton for their strategic reserves. While the spread between yarn values and local prices is attractive to spinners in other countries, the same relationship does not hold for China. By purchasing their domestic production at prices 40 to 50 cents above world prices, China is insuring that their internal prices are well above world prices, and causing their cotton spinning to be uncompetitive. For China, differentials between yarn values and fiber prices are only one-third of those in India and Pakistan. Fabric manufacturers in China are increasingly looking to fill their yarn demand with imported product. If China continues to import at the current pace, China will import cotton yarn equivalent to 7.5 million bales of fiber in the current marketing year. This compares to 5.0 million bales in the 2011 marketing year.

China's current policy, while supporting prices received by farmers, acts as a tax on textile mills and has furthered the shift to manmade fiber. Over the 2009 through 2012 marketing years, mill use in China declined by almost 15 million bales. Over that same period, China's use of manmade fiber grew by 40 million bales, dropping cotton's market share from 30% to 19%. Although no official announcement has been made regarding the 2013 policy, this outlook assumes that the government support price remains at a level comparable to 2012. Continuing to operate the program in a manner similar to the past year will maintain pressure on cotton spinning mills. As a result, mill use for the 2013 marketing year is expected to decline further, falling to 34.3 million bales.

With the support price well above world market prices, the vast majority of China's domestic production will enter government reserves. From the 2012 production of 33.5 million bales, current information suggests that more than 28 million bales will be purchased by the reserves. A similar scenario is assumed for the 2013 crop. Despite the high support levels, cotton acreage in 2013 is expected to decline by 4% due to strong competition from food crops. Assuming average yields, China's 2013 cotton crop is projected at 30.7 million bales. It is assumed that as much as 26 million bales of the 2013 crop will enter government reserves.

Both in the current marketing year and the year to come, the most important unknown is the extent to which China releases cotton from the reserves. If China's textile mills are to continue to consume between 34 and 35 million bales of cotton, then there will be either significant sales from government reserves or significant imports from the world market. In the 2011 marketing year, it was the case that the Chinese government was only a buyer and not a seller. As a result, 20 million bales from the 2011 crop were placed in reserves and the shortfall in domestic supplies was satisfied with imports of 24.5 million bales.

In the current marketing year, the government has commenced sales from the reserves. For the marketing year as a whole, it is assumed that 3.5 million tons, or 16.1 million bales, are sold from reserves. Even with significant sales, total imports by China are estimated at 12.5 million bales. Cotton in government reserves on July 31, 2013 would stand at 33.8 million bales, which is 95% of mill use. For the 2013 marketing year, China's decision regarding sales from the reserves and the allocation of import quotas/licenses is the key uncertainty.

In this outlook, China is assumed to sell 21 million bales of cotton during the course of the 2013 marketing year. When coupled with purchases of 26.1 million bales from this year's crop, China will continue to build government reserves, holding 38.8 million bales on July 31, 2014. In order to supply projected mill use of 34.3 million bales, China would import 6.8 million bales, which includes the WTO-required quota of 4.1 million bales. Under this scenario, total imports for the 2013 marketing year are slightly more than half the import level for the current marketing year.

Reduced imports by China are only partially offset by increased imports in other countries, leading to a decline in world trade from 38.9 million bales to 36.0 million bales. With a reduction in exportable supplies, the United States is projected to see a decline in exports for the 2013 marketing year, down 1.6 million to 10.6 million bales. When combined with mill use of 3.5 million bales, total use of 14.1 million bales exceeds the U.S. crop by 1.2 million bales. Ending stocks for the 2013 marketing year fall to 3.6 million bales, giving a stocks-to-use ratio of 25%.

Summing individual country projections gives a 2013 world crop of 110.1 million bales, down 8.7 million bales from 2012. World mill use is projected to increase to 108.7 million bales, 2.6 million bales higher than 2012. The relative balance between production and use causes world stocks to grow to 83.1 million bales by the end of the 2013 marketing year. Although the projections initially appear bearish, that is not necessarily the case as increases in China's government reserves more than offset a decline in "available" cotton stocks.

The potential impact of China's management of their reserves must be reiterated. Should they choose to be a more active seller in the coming year, China's imports could fall to the required WTO quota of 4.1 million bales. That would be 2.7 million bales less than the 6.8 million bales projected in this outlook. Given current U.S market share of China's cotton imports, a 2.7 million bale decline in imports translates into almost one million fewer bales of U.S. exports. China could also go to the other extreme and choose to sell very little of their reserves. Under that scenario, imports could increase to levels comparable to the current marketing year. Such an outcome is more bullish for U.S. exports in the short term, but the scenario only delays the inevitable outcome of working the cotton reserves back onto the market.

The coming year is shaping up to be a challenging year where uncertainties regarding the market are magnified by the 40-million bale gorilla that is China's government reserves. The expected decline in U.S. acreage and production will present problems for businesses that are largely volume-dependent. But, as we have seen in the past, commodity markets are cyclical, and producers must be prepared to respond to markets that can quickly change.

After consecutive declines, cotton demand has stabilized and is expected to grow in the coming year. However, the battle for market share with manmade fibers has never been fiercer. With a recovering global economy, there is excellent potential for growth in cotton demand. However, that full potential will not be realized as long as China continues to operate their current policy in a manner that stifles cotton demand.

Table 1 - Balance Sheet for Selected Countries & Regions

World	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	81,116	75,534	74,459	82,662	87,775	84,078	79,412
Yield (Pounds/Acre)	708	682	659	676	679	678	665
Production (Thou Bales)	119,580	107,244	102,158	116,331	124,134	118,831	110,064
Trade (Thou Bales)	39,321	30,477	36,350	35,666	44,700	38,874	35,950
Mill Use (Thou Bales)	123,496	110,032	118,650	114,061	103,091	106,087	108,728
Ending Stocks (Thou Bales)	61,843	61,400	46,495	48,779	68,851	81,690	83,102

United States	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	10,489	7,569	7,529	10,699	9,461	9,427	7,649
Yield (Pounds/Acre)	879	813	777	812	790	866	807
Production (Thou Bales)	19,207	12,815	12,188	18,104	15,573	17,010	12,860
Net Exports (Thou Bales)	13,622	13,261	12,037	14,367	11,695	12,195	10,608
Mill Use (Thou Bales)	4,584	3,541	3,550	3,900	3,300	3,426	3,481
Ending Stocks (Thou Bales)	10,051	6,337	2,947	2,600	3,350	4,774	3,545

Australia	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	161	405	494	1,344	1,433	1,100	1,070
Yield (Pounds/Acre)	1,913	1,777	1,724	1,500	1,842	1,833	1,775
Production (Thou Bales)	640	1,500	1,775	4,200	5,500	4,200	3,957
Net Exports (Thou Bales)	1,219	1,201	2,115	2,509	4,642	4,300	4,252
Mill Use (Thou Bales)	50	45	40	40	40	40	40
Ending Stocks (Thou Bales)	625	979	749	2,575	3,568	3,603	3,444

Bangladesh	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	72	82	79	86	89	99	99
Yield (Pounds/Acre)	234	247	304	355	405	437	390
Production (Thou Bales)	35	42	50	64	75	90	80
Net Imports (Thou Bales)	3,600	3,800	3,900	3,700	3,150	3,650	3,775
Mill Use (Thou Bales)	3,500	3,800	3,900	3,700	3,200	3,600	3,861
Ending Stocks (Thou Bales)	716	748	788	842	857	987	971

Brazil	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	2,661	2,083	2,066	3,459	3,459	2,471	2,330
Yield (Pounds/Acre)	1,327	1,263	1,266	1,249	1,207	1,263	1,260
Production (Thou Bales)	7,360	5,480	5,450	9,000	8,700	6,500	6,116
Net Exports (Thou Bales)	2,067	2,689	1,839	1,297	4,763	4,350	2,381
Mill Use (Thou Bales)	4,600	4,200	4,400	4,300	4,000	4,100	4,145
Ending Stocks (Thou Bales)	6,251	4,992	4,353	7,906	7,993	6,193	5,933

China	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	15,320	14,950	13,096	12,973	13,343	12,849	12,396
Yield (Pounds/Acre)	1,159	1,178	1,173	1,129	1,191	1,251	1,188
Production (Thou Bales)	37,000	36,700	32,000	30,500	33,100	33,500	30,681
Net Imports (Thou Bales)	11,468	6,912	10,880	11,857	24,478	12,425	6,828
Mill Use (Thou Bales)	51,000	44,000	50,000	46,000	38,000	35,500	34,286
Ending Stocks (Thou Bales)	20,504	21,366	14,246	10,603	30,181	40,606	43,829

India	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	23,324	23,242	25,476	27,527	30,146	28,911	28,403
Yield (Pounds/Acre)	494	467	448	460	438	423	448
Production (Thou Bales)	24,000	22,600	23,800	26,400	27,500	25,500	26,510
Net Exports (Thou Bales)	6,900	1,560	6,070	4,550	10,480	3,000	3,672
Mill Use (Thou Bales)	18,600	17,750	19,750	20,550	19,950	21,500	22,799
Ending Stocks (Thou Bales)	6,704	10,644	9,374	10,674	7,744	8,744	8,783

Table 1 – Selected Countries and Regions (Continued)

Indonesia	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	25	22	25	22	22	25	25
Yield (Pounds/Acre)	622	648	583	540	648	583	600
Production (Thou Bales)	32	30	30	25	30	30	31
Net Imports (Thou Bales)	2,580	2,280	2,185	2,080	1,955	2,280	2,395
Mill Use (Thou Bales)	2,500	2,250	2,150	2,050	1,900	2,200	2,407
Ending Stocks (Thou Bales)	414	424	439	444	479	539	508

Mexico	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	272	250	190	274	474	378	330
Yield (Pounds/Acre)	1,095	1,091	1,198	1,281	1,194	1,199	1,205
Production (Thou Bales)	620	567	475	732	1,180	944	829
Net Imports (Thou Bales)	1,310	1,140	1,303	971	660	925	1,023
Mill Use (Thou Bales)	2,000	1,850	1,900	1,700	1,700	1,800	1,855
Ending Stocks (Thou Bales)	932	764	617	595	710	754	726

Pakistan	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	7,413	7,166	7,413	6,919	7,413	7,413	7,310
Yield (Pounds/Acre)	554	572	598	599	686	648	640
Production (Thou Bales)	8,550	8,540	9,240	8,640	10,600	10,000	9,746
Net Imports (Thou Bales)	3,638	1,560	849	825	-350	1,900	2,772
Mill Use (Thou Bales)	12,000	11,100	10,400	9,900	10,000	11,500	12,477
Ending Stocks (Thou Bales)	4,403	3,378	3,042	2,582	2,807	3,182	3,198

Turkey	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	1,285	840	692	791	1,211	988	828
Yield (Pounds/Acre)	1,158	1,103	1,214	1,281	1,364	1,335	1,300
Production (Thou Bales)	3,100	1,930	1,750	2,110	3,440	2,750	2,241
Net Imports (Thou Bales)	2,897	2,783	4,244	3,204	2,082	3,315	4,164
Mill Use (Thou Bales)	6,100	4,950	5,900	5,600	5,600	6,000	6,233
Ending Stocks (Thou Bales)	1,748	1,511	1,605	1,319	1,241	1,306	1,478

Uzbekistan	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	3,534	3,509	3,212	3,286	3,237	3,175	3,042
Yield (Pounds/Acre)	727	629	583	599	623	650	635
Production (Thou Bales)	5,350	4,600	3,900	4,100	4,200	4,300	4,024
Net Exports (Thou Bales)	4,200	3,000	3,800	2,650	2,500	2,700	2,574
Mill Use (Thou Bales)	1,000	1,000	1,100	1,250	1,350	1,450	1,499
Ending Stocks (Thou Bales)	1,348	1,948	948	1,148	1,498	1,648	1,599

Vietnam	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	32	12	20	22	25	25	25
Yield (Pounds/Acre)	389	466	413	475	447	447	455
Production (Thou Bales)	26	12	17	22	23	23	23
Net Imports (Thou Bales)	1,208	1,251	1,695	1,569	1,625	2,100	2,278
Mill Use (Thou Bales)	1,200	1,250	1,600	1,625	1,650	2,050	2,338
Ending Stocks (Thou Bales)	250	263	375	341	339	412	375

West Africa	**07/08**	**08/09**	**09/10**	**10/11**	**11/12**	**12/13**	**13/14**
Harvested Area (Thou Acres)	3,897	3,731	3,447	3,452	4,527	5,374	5,001
Yield (Pounds/Acre)	303	310	312	317	324	367	344
Production (Thou Bales)	2,462	2,412	2,242	2,280	3,051	4,105	3,586
Net Exports (Thou Bales)	2,661	2,146	2,191	2,130	2,361	3,316	3,458
Mill Use (Thou Bales)	191	188	208	188	188	188	188
Ending Stocks (Thou Bales)	673	751	594	556	1,058	1,659	1,599

U.S. and World Economy

In the early weeks of 2013, the mood among macroeconomists can be better characterized as slightly less pessimistic, rather than labeling their disposition as actually being optimistic. Though four years have passed since the onset of the financial crisis, the world economy continues to struggle and near-term growth is projected to remain below the long-term trend. However, Wells Fargo Securities noted in their January 2013 *Monthly Outlook* that the outlook for the first time in several months has brightened a bit. Likewise, the World Bank's recent *Global Economic Prospects* report concluded that risks are less skewed to the downside than in previous years. Regions of the world that have been a significant drag on global growth should be less so in 2013, and in some cases, will make a positive contribution to overall growth.

The U.S economy is expected to continue modest growth in 2013, but uncertainties surrounding the so-called fiscal cliff remain. With passage of the American Taxpayer Relief Act, Congress and the Administration simply delayed key decisions that must be made regarding the debt ceiling, sequestration and longer-term funding for the federal government. Amidst the uncertainty surrounding the federal budget situation, equity markets have remained surprisingly resilient, but consumer confidence has been shaky.

The concerned mood of U.S. consumers is evident in the latest results from the Thomas Reuters/University of Michigan's Consumer Sentiment Index. The index is designed to gauge the attitudes of the American consumer with regards to the economy.

In October and November 2012, the index reached its highest level in five years, reflecting optimism about the overall economy and an improving jobs market (Figure 1). However, by December, the uncertainty surrounding the fiscal situation became front and center in the minds of consumers and the index fell by more than 10% from the previous month. The relatively cautious mood appears to be continuing into January as the preliminary index fell to 71.3, the lowest level since late 2011. The decline is in part being attributed to the increased payroll taxes that were not addressed by the year-end fiscal cliff package.

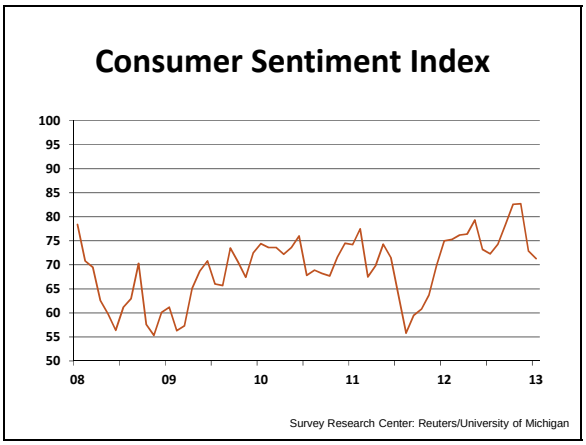

Figure 1 - Consumer Sentiment Index

U.S. Gross Domestic Product

As determined by the Bureau of Economic Analysis (BEA), the U.S. 2012 third quarter real Gross Domestic Product (GDP) expanded by 3.1% (Figure 2) from the second quarter, following on gains of 2.0% and 1.3% in the first and second quarters, respectively. Increases in personal consumer expenditures, private inventory investment, federal government spending, residential fixed investment, and exports were partly offset by a negative contribution from nonresidential fixed investment.

BEA's advance estimate for the U.S. 2012 fourth quarter GDP shows a decline of 0.1% from the third quarter. The decrease primarily reflected negative contributions

from private inventory investment, federal government spending and exports that were partially offset by positive contributions from personal consumption expenditures, nonresidential and residential fixed investment. The biggest contributor to the decline was a large cut in defense spending, which decreased at a 22% annual rate.

Despite the fourth quarter decline in GDP, many economists still see signs for growth in the upcoming quarters. Some pointed out that defense spending tends to be a volatile number in the GDP report and probably declined in the fourth quarter due to the looming sequestration deadline and therefore is unlikely to decline so dramatically next quarter. Another major contributor to the decline was from decreased business inventories. When that happens, it often indicates businesses will have to increase inventories in the upcoming quarter which could lead to stronger growth in the first quarter of 2013.

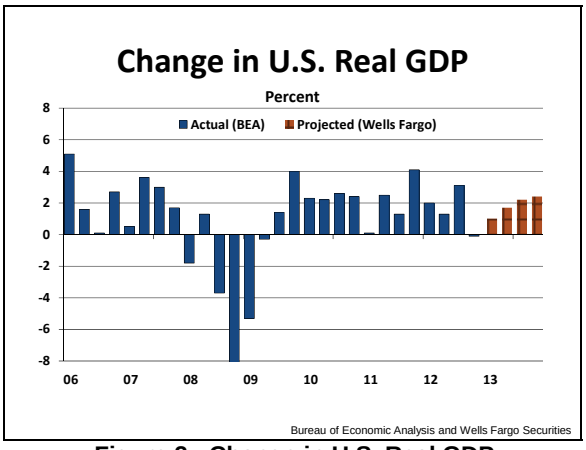

Figure 2 - Change in U.S. Real GDP

The latest projections by the Wells Fargo Economics Group call for modest economic growth to continue into 2013. Economic expansion in the first half of the year is particularly conservative as uncertainties over the fiscal cliff lead to a pullback in business decisions. Performance in the latter half of 2013 is expected to improve as households and businesses adjust to the new fiscal environment and residential construction steadily improves.

U.S. real personal consumption expenditures (PCEs) expanded in the third quarter of 2012 (Figure 3), albeit at rates similar to those observed in the previous quarter. For the third quarter of 2012, real PCEs grew by 1.6%, up from 1.5% in the third quarter. Following six consecutive quarters of contraction in 2008 and 2009, the growth in the third quarter of 2012 resulted in 13 quarters of expansion.

Spending on durable goods rebounded in the third quarter with growth of 8.9%. This comes on the heels of a second quarter contraction of -0.2%.

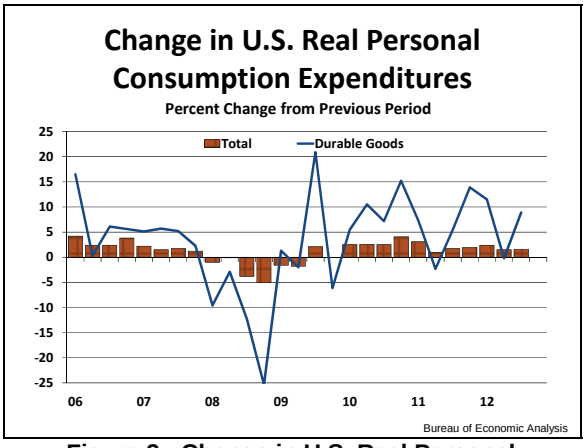

Figure 3 - Change in U.S. Real Personal Consumption Expenditures

Private investment in the United States continued to expand during the first three quarters of 2012. When combined with the final three quarters of 2011, real fixed and residential investment has expanded for six consecutive quarters (Figure 4).

The sustained improvement in investments comes on the heels of extraordinary contraction in 2008 and 2009, followed by mixed performance in 2010. In the third quarter of 2012, fixed investment expanded by 0.9%, while residential investment was up by 13.5%.

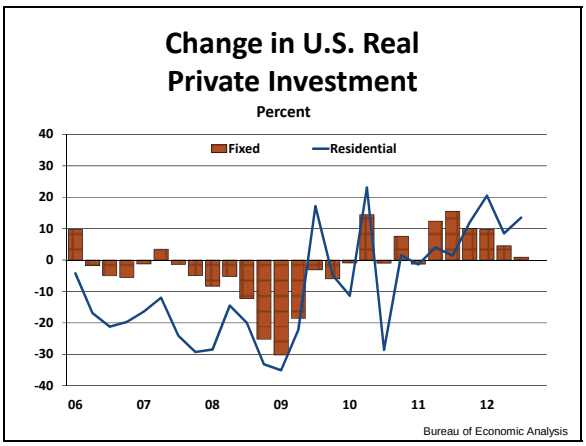

Figure 4 - Change in U.S. Real Private Investment

U.S. Employment

After contracting through much of 2008 and 2009, the U.S. work force has since stabilized with some very modest improvement since the second half of 2011. By the end of 2013, civilian employment stood at 58.6% of the population (Figure 5). However, it is important to keep in mind that current values are only slightly better than the post-recession low of 58.2%, observed at various times in 2009, 2010 and 2011. When compared to the pre-recession levels of 63.0%, it is readily evident why the past four years of economic growth are often referred to as a jobless recovery.

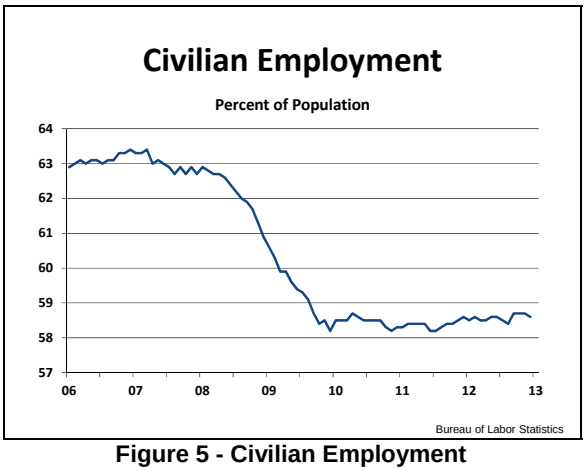

Figure 5 - Civilian Employment

Overall, a very similar picture prevailed for manufacturing employment. After reaching a low in 2010, manufacturing employment in 2013 built on the very modest gains observed since 2011. Overall, net employment grew by 180 thousand jobs during the past year (Figure 6). A significant portion of the annual increase in jobs occurred in the first quarter of 2012.

As with the civilian employment rate, the modest gains in manufacturing jobs observed since 2009 pale in comparison to the job losses experienced during the recession. Unfortunately, long-term projections by the Bureau of Labor Statistics call for manufacturing jobs to remain very near current levels through 2020.

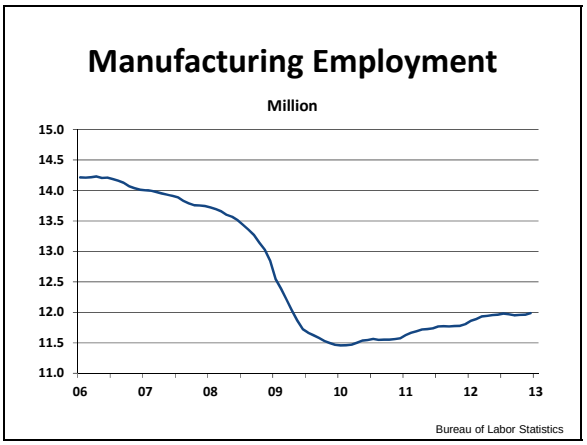

Figure 6 - Manufacturing Employment

According to the latest government estimates, nonfarm payroll employment rose by 155,000 in December 2012, and the unemployment rate was unchanged at 7.8% (Figure 7). Employment increased in health care, food services and drinking places, construction, and manufacturing. Although unchanged from November, the jobs market, as represented by the unemployment rate, generally improved during the past year.

At 7.8%, the current unemployment rate is down from the post-recession high of 10.0%, but still well above the 4.5 to 5.0% levels observed in early 2008.

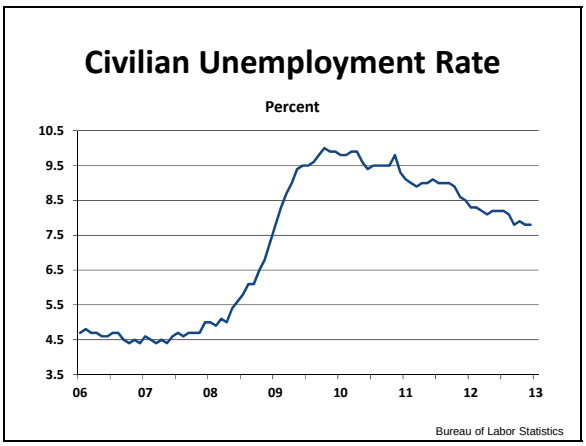

Figure 7 - Civilian Unemployment Rate

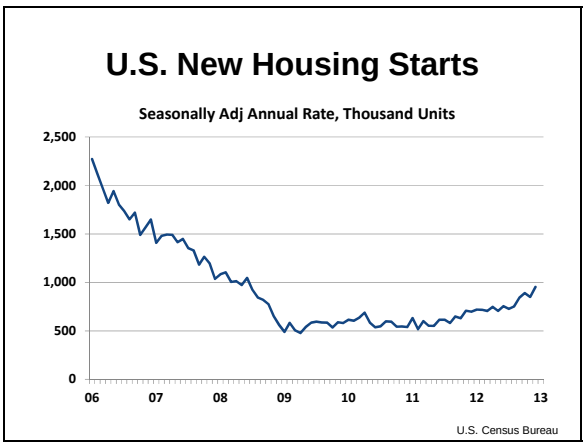

Figure 8 - U.S. New Housing Starts

Looking forward, economists caution not to read too much optimism into the recent data regarding the labor market. Although weekly jobless claims have declined, one reason contributing to lower unemployment rates has been the fact that more people are ending their search for employment. Projections for 2013 call for unemployment to remain stable at 7.8%, with only modest improvements expected by the latter half of 2014.

U.S. Housing Market

The housing industry is a key barometer of the well-being of the economy. As with employment indicators, a modest improvement in the housing market became evident during 2012. For December 2012, U.S. housing starts registered a seasonally adjusted annual rate of 954 thousand units (Figure 8). The December estimate represents a 100 thousand unit increase from November and is the highest level since June 2008.

According to Freddie Mac's *U.S. Economic and Housing Market Outlook*, the expectations for 2013 are dependent on an improving economy and growing consumer confidence. By the fourth quarter of 2013, housing starts are expected to top a seasonally adjusted annual rate of 1 million units.

For much of 2012, 30-year mortgage rates continued to drift lower, with a survey by Freddie Mac putting the December average at 3.35% (Figure 9). The latest decline in rates sets all-time lows for the 30-year lending rate.

Low mortgage rates have been a contributing factor to the recovery in the housing market experienced in 2012. For 2013, little change in mortgage rates is expected with Freddie Mac projections showing an average rate of 3.7% by the end of the year. Stable rates should contribute to a continued recovery of the housing market in 2013.

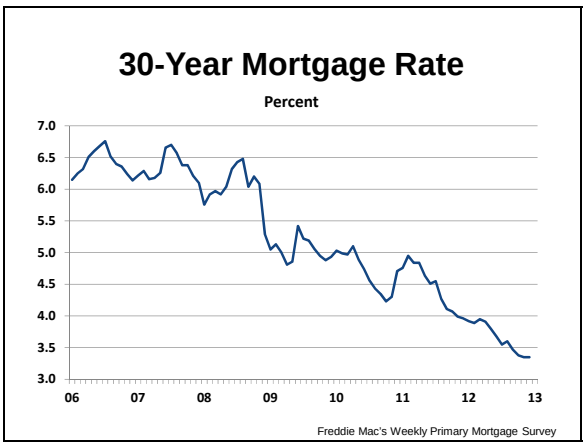

Figure 9 - 30-Year Mortgage Rate

Federal Reserve Board

The Federal Reserve controls the three tools of monetary policy -- open market operations, the discount rate, and reserve requirements. The Board of Governors of the Federal Reserve System is responsible for the discount rate and reserve requirements, and the Federal Open Market Committee is responsible for open market operations. Primarily, the federal fund rate is the tool for influencing the economy – the interest rate that banks charge each other for overnight loans.

As economic conditions deteriorated in 2008, the Federal Reserve quickly lowered the fund rate into the range of 0% to 0.25% (Figure 10), and the rate remained in that range for 2009 through 2012. In December, the Federal Reserve announced that they consider a target range of 0% to 0.25% to be appropriate at least as long as the unemployment rate remains above 6.5% and inflation is projected to be no more than 2.5%.

The Fed remains concerned that, without sufficient policy accommodation, economic growth might not be strong enough to generate sustained improvement in labor market conditions. Furthermore, strains in global financial markets continue to pose significant downside risks to the economic outlook. To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Fed will continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month.

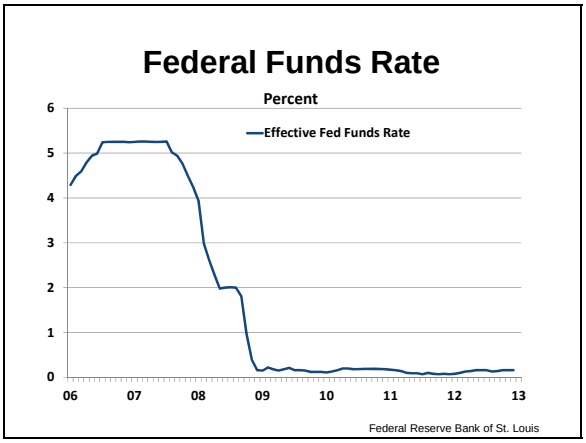

Figure 10 - Federal Funds Rate

Federal Budget Situation

The severe economic downturn and nearly unprecedented turmoil in the financial systems over the past two years, combined with federal policies implemented in response to those conditions, have caused deficits to climb dramatically.

The Congressional Budget Office (CBO) estimates for fiscal year 2012 that federal spending totaled $3.6 trillion and revenue only reached $2.4 trillion (Figure 11), resulting in a deficit in excess of $1.1 trillion.

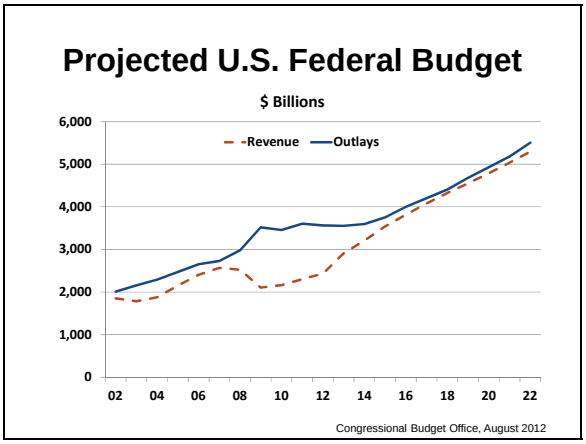

Figure 11 - Projected U.S. Federal Budget

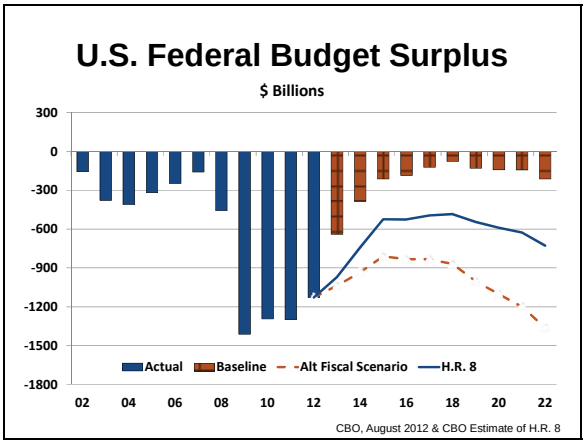

Figure 12 - U.S. Federal Budget Surplus

The 2012 deficit comes on the heels of 3 years with annual deficits exceeding $1.0 trillion. According to the Congressional Budget Office, the United States is facing profound budgetary and economic challenges. At 7.0% of GDP, the budget deficits stem in part from the long shadow cast on the U.S. economy by the financial crisis and subsequent recession. Although economic output began to expand again three years ago, the pace of the recovery has been slow.

In large part because of the significant changes to tax and spending policies that were scheduled to take effect on January 1, 2013, CBO's baseline projections called for sharply smaller deficits, eventually falling to less than 1% of GDP. However, given the uncertainty surrounding the fiscal cliff, CBO developed projections for an alternative scenario in which all tax breaks in effect for 2012 are extended into the future. Under that scenario, deficits were not projected to decline but instead remain in the range of $900 billion to $1.3 trillion (Figure 12).

According to CBO, the American Taxpayer Relief Act (H.R. 8) provides a middle ground with budget deficits projected to be between $450 billion and $800 billion for fiscal years 2014 and beyond.

Consumer and Producer Price Indices

Inflation acts as a tax on investment by increasing the cost of equity-financed investment and reducing corporate equity values. U.S. inflation is commonly measured by the Consumer Price Index (CPI) and the Producer Price Index (PPI).

Measured by the December-to-December change, the CPI rose 1.7% in 2012, according to Labor Department figures, well below the 3.0% gain in 2011 (Figure 13). The index for all items less food and energy rose 1.9% over the last 12 months. The food index has risen 1.8% over the last 12 months, and the energy index has risen 0.5%. On an annual average basis, the CPI increased by 2.1%, which followed an increase of 3.2% in 2011.

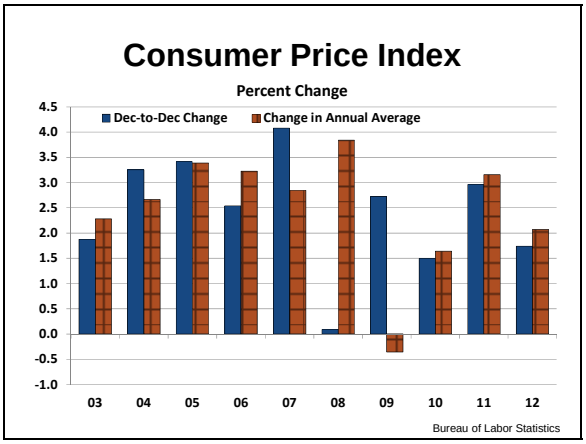

Figure 13 - Consumer Price Index

On a December-to-December basis, the PPI for finished goods rose in 2012 by just 1.3%, well below the 4.7% reported in December 2011 (Figure 14) and the lowest value since 2008. For the year as a whole, the PPI for finished goods increased by 1.9%, also well below the 2011 value of 6.0%.

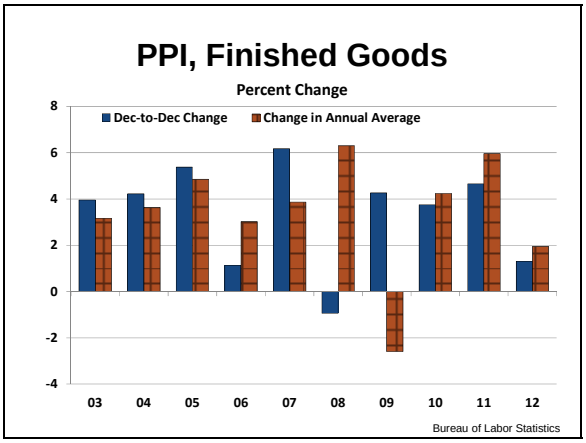

Figure 14 - Producer Price Index, Finished Goods

Energy Prices and Supply

According to the latest projections by the Department of Energy's Energy Information Administration (EIA), oil markets are expected to loosen in 2013 and 2014 as increasing global supply more than offsets higher global consumption. Projected world supply increases by 1.0 million bbl/day in 2013 and 1.7 million bbl/day in 2014, with most of the growth coming from outside the OPEC countries. North America will account for much of this growth. Projected world liquid fuels consumption grows by an annual average of 0.9 million barrels per day (bbl/d) in 2013 and 1.3 million bbl/d in 2014. As a result, the EIA expects the price of West Texas Intermediate (WTI) crude oil to average about $90 per barrel in 2013, $4 per barrel lower than the 2012 average price (Figure 15).

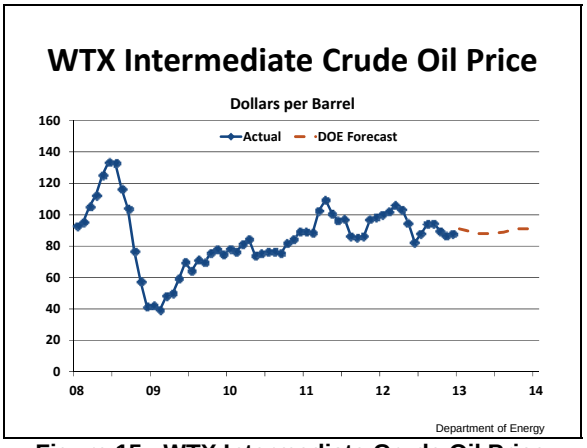

Figure 15 - WTX Intermediate Crude Oil Price

The EIA outlook cautions that energy price forecasts are highly uncertain. Implied market volatility is averaging approximately 26%, establishing the lower and upper limits of the 95% confidence interval for the market's expectations of nearby monthly average prices at $74 per barrel and $117 per barrel, respectively.

Retail diesel fuel prices (Figure 16), which track closely with crude oil prices, averaged $3.96 per gallon in December 2012, up $0.10 per gallon from year-earlier levels amid continued tight market conditions and strong demand for exports. The EIA projects diesel prices to average $3.93 per gallon for January 2013, and decline modestly to $3.78 per gallon by December 2013.

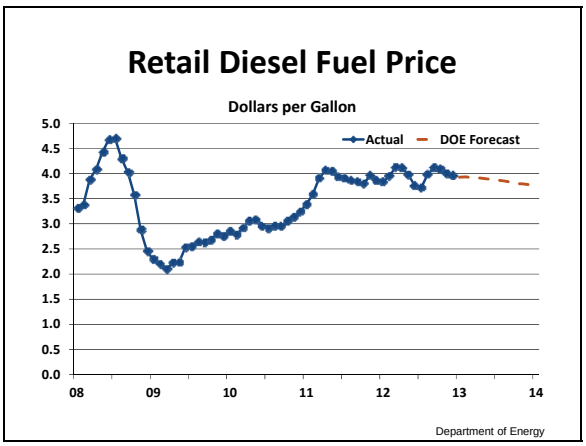

Figure 16 - Retail Diesel Fuel Price

The Henry Hub spot price averaged $3.44 per thousand cubic foot (Mcf) in December 2012 (Figure 17), an increase of more than $1 since April. The current forecast for 2013 natural gas prices calls for stronger prices, reaching $4.00 per Mcf by the end of the year. Though increasing through 2013, natural gas prices remain below historical averages as inventories are expected to remain at high levels.

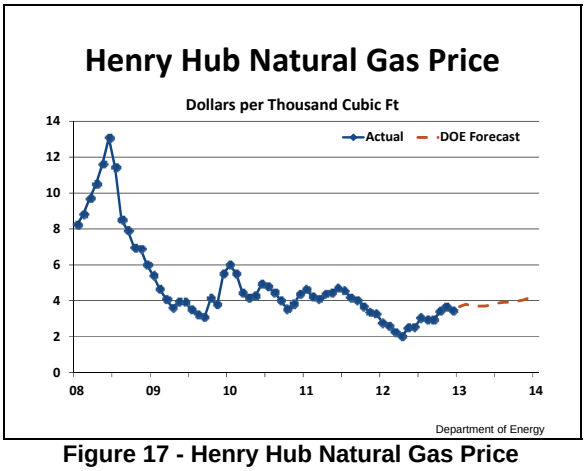

Figure 17 - Henry Hub Natural Gas Price

U.S. Equity Markets

Despite uncertainties surrounding the federal government's fiscal health and generally sluggish economic growth, U.S. equity markets showed tremendous resiliency in 2012. After closing 2011 at 12,218, the Dow Jones Industrials Average (Dow) moved to 13,400 by the end of September 2012 (Figure 18). By the end of the year, the market had given up some the gains achieved through September, but still managed to post a 3.7% increase since December 31, 2011.

Following passage of the fiscal package, the equity markets have started 2013 with somewhat surprising strength. By late January, the Dow Jones average was approaching the all-time high set in 2007. With so much uncertainty surrounding the economic outlook, some macroeconomists wonder if the markets are setting up for a correction.

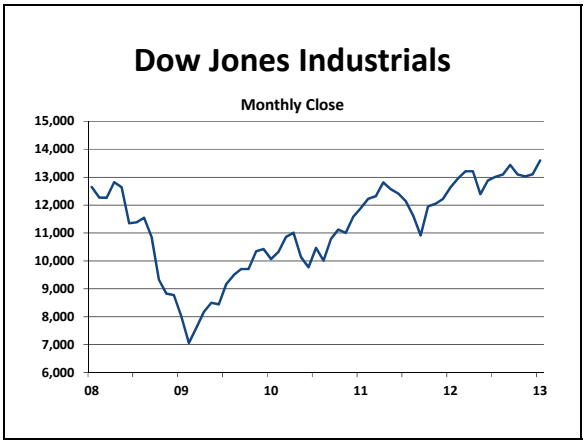

Figure 18 - Dow Jones Industrials

World Economies

The world economy continued its recovery in 2012, but at a slower pace than observed in either of the previous two years. According to the latest projections by the International Monetary Fund, the world economy grew by 3.2% in 2012, down from 3.9% in 2011 (Figure 19).

IMF projections call for the world economy to grow by 3.5% in 2013, which is slightly better than the World Bank's projected growth of 3.4%. According to the report, policies have lowered risks in the Eurozone and the U.S. Japan's stimulus plans boost growth in the near term, pulling the country out of a short-lived recession. Effective policies have also helped support a modest

growth pickup in some emerging market and developing economies.

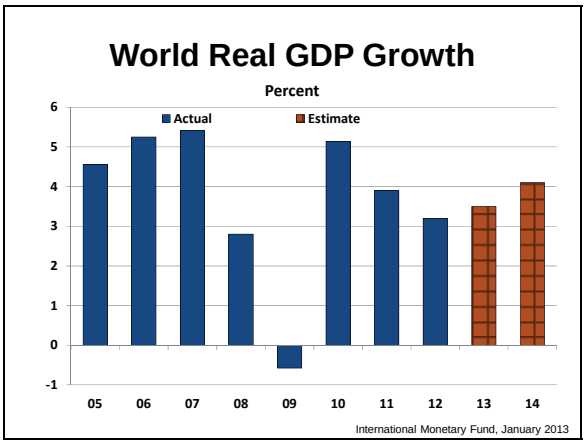

Figure 19 - World Real GDP Growth

If additional "risks do not materialize and financial conditions continue to improve, global growth could even be stronger than forecast", the report said. However, downside risks remain significant, including prolonged stagnation in Europe and the possibility of excessive short-term fiscal tightening in the U.S.

The IMF projects that output of emerging and developing economies will expand at 5.5% in 2013 and 5.9% in 2014. In advanced economies, growth is projected at 1.4% in 2013 and 2.2% in 2014.

Looking across key countries and regions, the economy in the Euro Area is projected to contract by 0.2% in 2013 before showing modest growth in 2014 (Table 2). Building on the growth in 2012, Japan's economy is projected to expand by 1.2% in 2013. However, the IMF expects Japan's growth to slow to just 0.7% in 2014. A more favorable picture is unfolding for developing countries. China is expected to continue to lead the way with growth above 8% in 2013 and 2014. After growth of just 4.5% in 2012, India's economy is also expected to recover momentum and grow by almost 6% in 2013. Growth in Russia and key Latin American countries ranges between 3.5 and 4.0%.

Table 2 - Selected Economies: Real GDP

Year-Over-Year % Changes				
	2011	2012e	2013f	2014f
World	3.9	3.2	3.5	4.1
U.S.	1.8	2.3	2.0	3.0
Euro Area	1.4	-0.4	-0.2	1.0
Japan	-0.6	2.0	1.2	0.7
China	9.3	7.8	8.2	8.5
India	7.9	4.5	5.9	6.4
Russia	4.3	3.6	3.7	3.8
Brazil	2.7	1.0	3.5	4.0
Mexico	3.9	3.8	3.5	3.5

Source: International Monetary Fund, January 2013

During 2012, Asia's equity markets experienced a more positive performance, regaining much of the ground lost in 2011. Japan's Nikkei gained 23% during 2012, ending the year at 10,395 (Figure 20). The Hong Kong Hang Sang market also posted a 23% gain in 2012. Despite the strong performance, both markets remain below pre-recession levels.

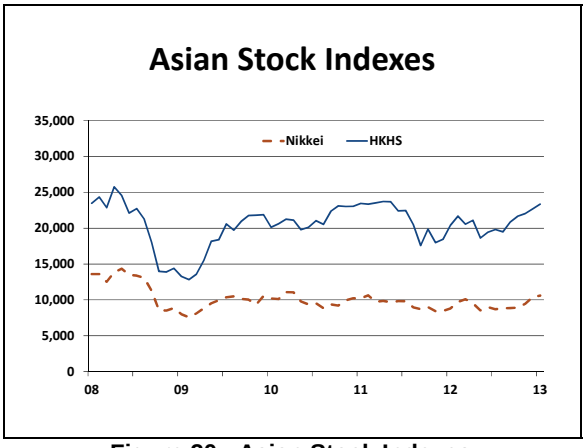

Figure 20 - Asian Stock Indexes

Exchange Rates

During periods of market uncertainty, traders sell currencies that are perceived riskier and place their bets in safe havens. One sign that stability is returning to the global economy is an easing of the volatility in major currency pairs. Now, many traders turn to a carry-trade strategy as they seek to

profit from the interest rate differential between currencies.

Relative to the dollar, the euro ended 2012 at a value very similar to the beginning of the year. For December, the euro averaged 0.76 per dollar, which is the same value as December 2011. However, in between, the euro saw its relative value decline against the dollar, reaching 0.81 in July. The July value represented a two-year low against the dollar as investors continue to seek safety in the dollar given the uncertainty of the Eurozone. Improved prospects for the Euro economy in the latter half of 2012 allowed the currency to strengthen relative to the dollar.

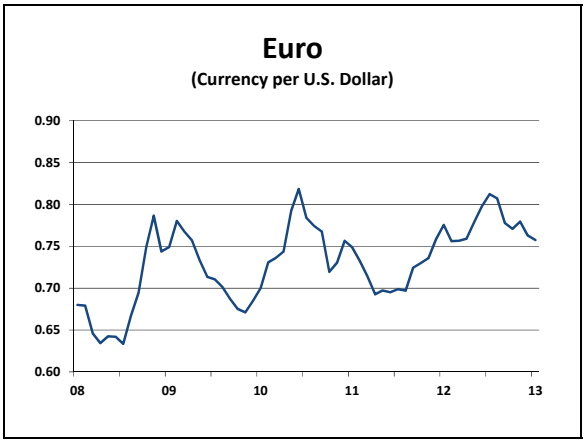

Figure 21 – Euro

During 2012, the yen became about 7% weaker compared to the U.S. dollar (Figure 22), with most of the weakening occurring in the final two months of the year. The yen began 2013 in a similar manner, and by late January, had weakened to levels not observed since 2010. The recent movements in the value of the yen largely reflect the expectation of new monetary stimulus policies in Japan.

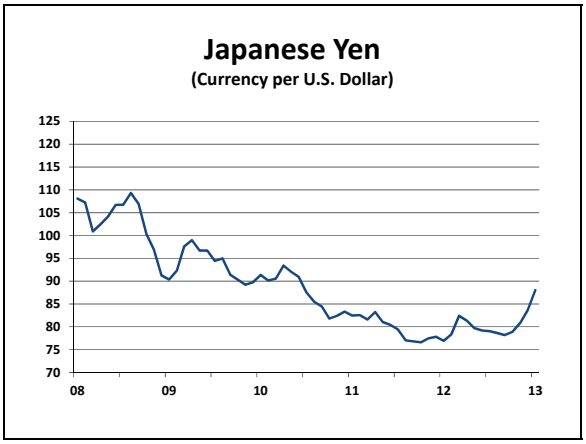

Figure 22 - Japanese Yen

An overriding trend across many currency markets played out this past year with the dollar generally strengthening in the latter half of 2012. This held true for the Brazilian Real, Indian Rupee, Indonesian Rupiah and the Pakistani Rupee (Figures 23 and 25-27). Only in South Korea and China did the local currency continue to strengthen against the dollar (Figures 24 and 28).

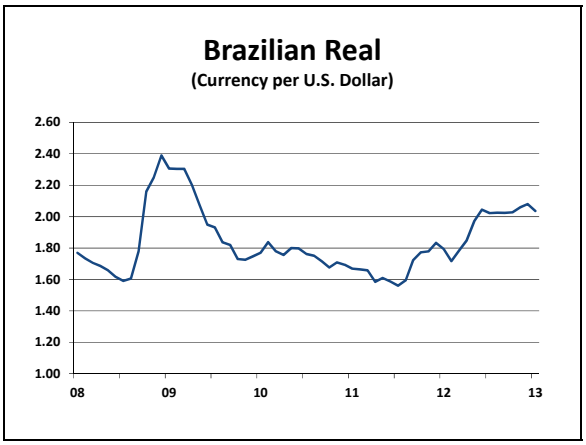

Figure 23 - Brazilian Real

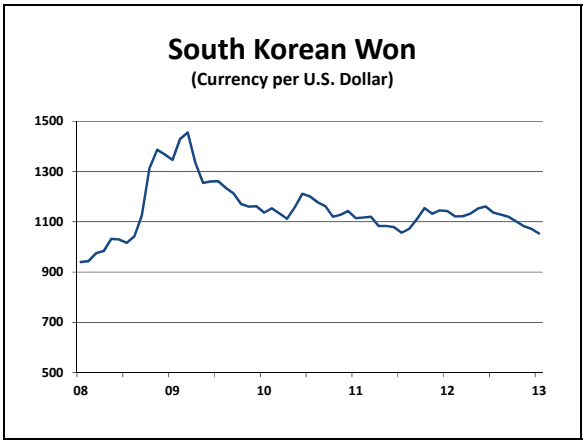

Figure 24 - South Korean Won

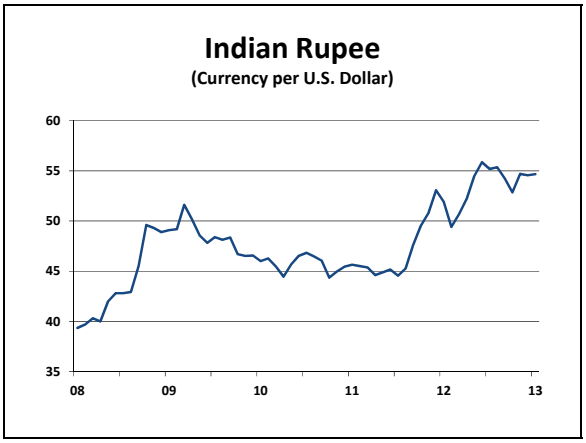

Figure 25 - Indian Rupee

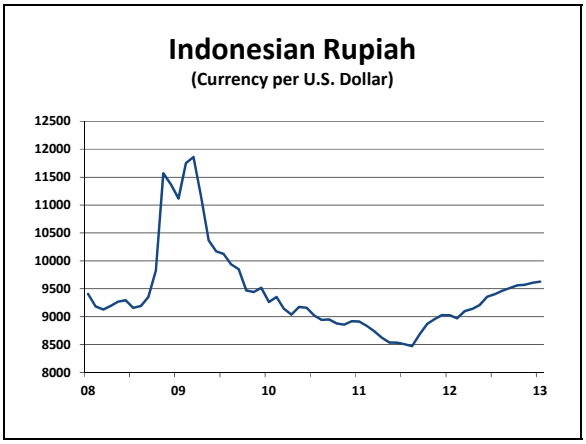

Figure 26 - Indonesian Rupiah

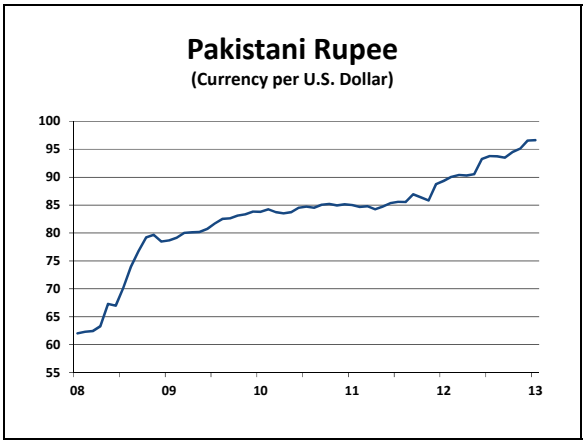

Figure 27 - Pakistani Rupee

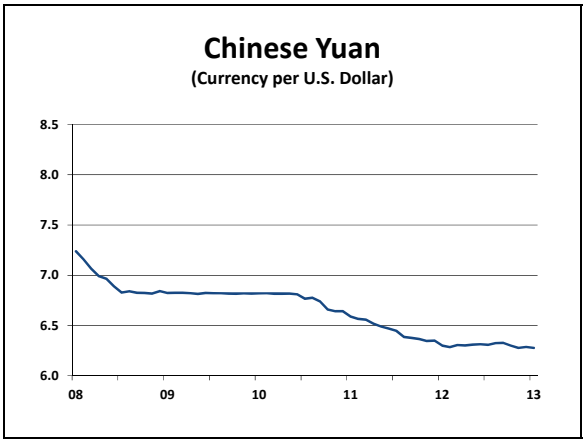

Figure 28 - Chinese Yuan

The Federal Reserve Board publishes a real exchange rate index comparing the dollar to a weighted average of currencies of important trading partners, excluding major developed economies. Between early 2009 and mid-2011, the trade weighted index fell by almost 15 percentage points (Figure 29). However, the trend reversed course during the latter half of 2011 and maintained a relatively stable appearance throughout 2012.

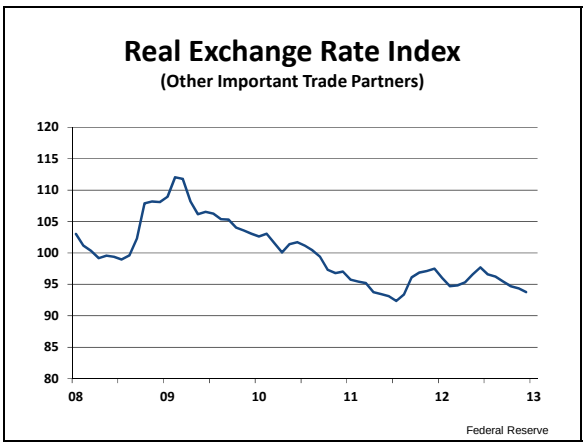

Figure 29 - Real Exchange Rate Index

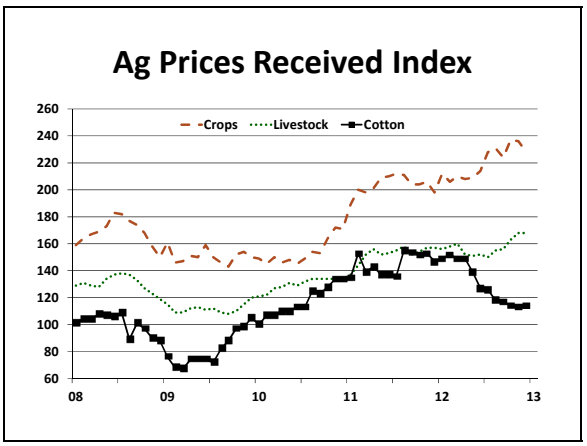

Figure 30 - Ag Prices Received Index

Commodity Prices

The U.S. Department of Agriculture (USDA) publishes monthly indices of prices received by farmers. Despite the December index of 228 representing a 3.4% decline from November, the crop price index remained 15% above December 2011 (Figure 30). The gains in 2012 crop prices were broadly reflected in food grains, feed grains, oilseeds and fruits and vegetables. In the case of grains and oilseeds, the stronger prices reflected reduced production due to severe drought condition in the Midwestern United States.

Unlike crop prices, gains in livestock prices were less pronounced, ending the year up 7%. Compared with a year ago, prices are higher for broilers, milk, cattle, and calves. Prices for eggs, turkeys, and hogs are down from last year.

During 2012, cotton prices were not able to sustain the high levels achieved in 2011. The cotton price index ended the year down 23% from year-earlier levels. Cotton demand continued to struggle in the wake of the high prices and increased volatility of 2011. Despite the decline, prices remained above 2010 levels, largely due to strong imports by China as they rebuilt their reserves of cotton.

USDA also publishes monthly indices of prices paid by farmers for various production inputs. Of particular interest are the indices for energy related inputs such as diesel and nitrogen fertilizer. After tremendous volatility between 2008 and 2010, prices in 2012 continued to move largely in a sideways pattern, continuing in a manner similar to the latter part of 2011. Unfortunately, the sideways movement meant that prices sustained themselves at relatively high levels. The index of diesel prices paid closed the year at 409, which is below the 2008 peak but still double the levels observed in 2009 (Figure 31).

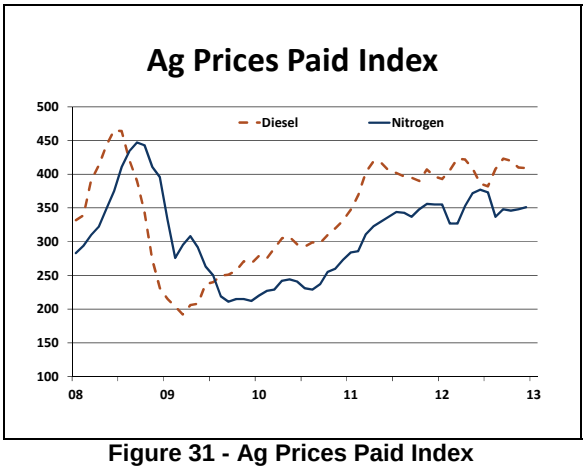

Figure 31 - Ag Prices Paid Index

Nitrogen fertilizer prices also maintained a firm appearance in 2012, ranging between 350 and 375. If these prices hold through

2013, producers will continue to face higher production costs than in either 2010 or 2011.

U.S. Net Farm Income

The latest USDA estimates place U.S. net farm income at $114.0 billion in 2012, down 3% from 2011 (Figure 32), but still the second highest on record. Net cash income is forecast at $132.8 billion, down 1.4% from 2011. Despite gains in almost all sources of farm income, large increases in farm expenditures, especially for purchased feed, have more than wiped out those price-led gains to farm income. Nevertheless, after adjusting for inflation, both income measures are high by historical standards.

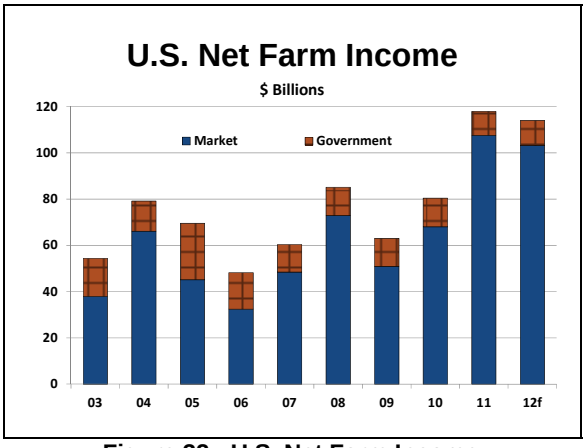

Figure 32 - U.S. Net Farm Income

According to USDA's Economic Research Service, an increase in the value of crop production is expected in 2012, reflecting increases in receipts from food grains, feed crops, and especially oil crops. The increase in corn receipts reflects USDA expectations that the 2012 calendar-year price will increase almost $1 per bushel from 2011, despite a projected decline in the quantity of corn sold. While the quantity of soybeans sold in 2012 is forecast to decline, a forecast price increase of $2 per bushel will push soybean receipts up.

The value of livestock production is projected to rise in 2012 with gains predicted in all livestock categories except hogs and milk. Gains and losses in receipts predicted for this year depend on the direction of predicted price changes rather than shifts in quantities marketed.

Total production expenses in 2012 are forecast to increase $23.5 billion. Total expenses in 2012 fall into a string of large year-to-year movements that have taken place since 2002, and would reach another record-high level in nominal dollars. Since 2002, nominal total production expenses have increased $143 billion. In inflation-adjusted dollars, 2012 production expenses will eclipse the previous peak reached in 1979.

U.S. Farm and Trade Policy

Extension of the 2008 Farm Bill

For the 2013 crop, the American Taxpayer Relief Act extended the provisions of the Food, Conservation, and Energy Act of 2008, hereafter referred to as the 2008 Farm Bill. Based on congressional action to date, the provisions of the 2008 legislation as structured for the 2012 crop will apply to the 2013 crop. According to USDA, sign-up for the 2013 programs will occur from February 19th through August 2nd.

However, it is important to keep in mind that direct payments for the 2013 crop will not be issued until October 1. Prior to that date, Congress must address a number of fiscal issues that will present opportunities for budget cuts that could apply to the 2013 crop. While that uncertainty exists, for purposes of this outlook, the provisions are assumed to be implemented as passed. The following provides a review of the provisions of the legislation.

The 2008 Farm Bill continued the marketing loan, direct payments, and counter-cyclical payments. Certain marketing loan provisions for upland cotton were modified to reflect changes advocated by the cotton industry. Much-needed support was also introduced for the U.S. textile industry. Another new provision was an optional revenue-based counter-cyclical program that producers can choose as an alternative to the target price counter-cyclical program. The bill also made significant changes to payment limits and program eligibility requirements.

Base Loan Rates, Marketing Loans and LDP's

The 2008 Farm Bill maintained the upland cotton base loan rate at 52.00 cents/lb (See Table 3 on page 26). The duration of the loan is maintained at nine months from the first day of the month following entry.

The following provisions of the upland cotton marketing loan are:

- Elimination of warehouse location differentials.
- A loan schedule with premiums and discounts based on a 3-year moving average of spot market information, weighted by region's share of U.S. production.
- Elimination of the split in the micronaire schedule between staple lengths 32 and 33.
- For qualities of cotton in which the leaf grade is more than one grade above the color factor, a premium/discount equal to the premium/discount of the quality with the same color factor but with a leaf grade that is one better than the color factor.
- An Adjusted World Price (AWP), based on the 5 lowest Far East quotes, which
  - Incorporates a seamless transition between marketing years such that current-crop quotes are used through the end of the marketing year, if available.
  - Adjusts to U.S. location by using the average costs to market, including average transportation costs.
  - Institutes the Fine Count Adjustment, which can lower the AWP for qualities better than 31-3-35 based on differences in premiums in the U.S. and international markets.

Storage credits to upland cotton loan repayment values are maintained, but reduced by 10% from the 2006 maximum rate for the 2008 through 2011 marketing years and reduced by 20% from the 2006 maximum rate beginning with the 2012 marketing year. Storage is credited when the AWP is less than the total of the loan rate plus interest plus storage.

Marketing loan gains (MLG) continue to be payable as the difference between the base loan rate and AWP when the former exceeds the latter. For eligible producers that agree to forego placing upland cotton in CCC loan, the marketing loan gain is available as a loan deficiency payment (LDP).

The loan rate for ELS cotton is maintained at 79.77 cents/lb.

Base Acres and Payment Yields

In general, the upland cotton base acres and payment yields established by the 2002 Farm Bill that were effective September 30, 2007, constitute the base acres and payment yields under the 2008 Farm Bill. However, the 2008 law requires adjustments to base acres under various circumstances. These include, but are not limited to, adjustments based on the likelihood that land returns to agricultural use, and changes in the status of a Conservation Reserve Program (CRP) contract.

For 2011, USDA indicates that 17.88 million acres of upland cotton base enrolled in the Direct and Counter-cyclical Program (DCP).

Direct Payments

For upland cotton, the direct payment is 6.67 cents/lb (See Table 3 on page 26). There is no direct payment available for ELS cotton. For the 2009-11 crops, direct payments were paid on 83.3% of an eligible producer's base acres multiplied by payment yield. In 2012, the percentage of base acres receiving direct payments increased to 85%. Direct payments remain decoupled from current production decisions.

Target Price

For upland cotton, the 2008 Farm Bill authorized a target price of 71.25 cents/lb for the life of the legislation (See Table 3 on page 26). The farm bill makes no provision for a target price for ELS cotton.

Target prices are used in the calculation of counter-cyclical payments (CCP). The CCP rate is determined as: (target price) minus (direct payment) minus (greater of 12-month marketing year average price or loan rate). When the sum of the direct payment and the marketing year average price exceeds the target price, the corresponding counter-cyclical payment is zero. Counter-cyclical payments are decoupled from production, as are the direct payments. Counter-cyclical payments are made on 85% of base acres and payment yields.

Average Crop Revenue Election Program

As an alternative to the price-based counter-cyclical program, producers have the option to elect a revenue-based program. In return for accepting a 20% reduction in direct payments and 30% reduction in loan rate, producers could make an irrevocable election to enroll all covered commodities and peanuts in a state-level revenue counter-cyclical program, known as the Average Crop Revenue Election, or ACRE, program.

For producers with qualifying losses, the program makes payments on a portion of planted acres based on the difference between 90% of the product of a state average yield factor times the national seasonal average price for the previous 2 years for the commodity and the actual state revenue for the commodity.

Producers who choose not to participate in the ACRE program beginning in 2009 had the ability to choose the program in each subsequent year. However, once an affirmative ACRE decision is made, the producer may not return the farm to the target price counter-cyclical program. For 2013, producers once again have the option to opt in to the ACRE program. For those producers, previously enrolled in ACRE, they may also opt for the DCP program for the 2013 crop.

For 2011, just over 83,000 acres of upland cotton base enrolled in the ACRE program. Texas accounts for almost 60,000 of those acres, with another 20,900 in Oklahoma.

Producer Agreement Requirements for Payments

For a producer to be eligible for payments, they must:

1. Comply with conservation requirements;
2. Comply with planting flexibility requirements;
3. Maintain land in an agricultural or conserving use;
4. Submit annual acreage reports.

Payment Limitations and Eligibility Requirements

Taking effect with the 2009 crop, the 2008 Farm Bill included a number of changes in both limits and eligibility.

The farm bill eliminated the limit on marketing loan gains and LDP's, which was $75,000 prior to 2009. The limits on direct payments and counter-cyclical payments are $40,000 and $65,000, respectively. For producers with some or all of their farms enrolled in the ACRE program, the limit on direct payments is reduced from $40,000 by an amount equal to the 20% reduction in direct payments. The limit on revenue-based ACRE payments is increased from $65,000 by the amount of the reduction in the direct payment (DP) limit.

The 2008 Farm Bill eliminates the 3-entity rule, and direct attribution is applied to all commodity program payments. The rules for spouse eligibility were enhanced such that an actively engaged spouse is automatically credited with making a significant contribution of labor and management.

While the farm bill statute included no changes in the determination of those "actively engaged in farming," USDA, through the rule-making process, instituted significant new restrictions that all members of a farming entity make a regular, identifiable, documentable, separate and distinct contribution of active personal labor or active personal management.

Income means tests for commodity and conservation payment eligibility are more restrictive under the 2008 Farm Bill. If an entity or individual earns an average of more than $500,000 in adjusted non-farm income during the 3 years prior to the year proceeding the applicable year, the individual or entity is ineligible for any commodity program payments for the year (example: for 2009 crop, use average of 2005, 2006 and 2007).

If an individual or entity earns an average of more than $750,000 in adjusted farm income during the 3 years prior to year preceding the applicable year, the individual or entity is ineligible for direct payments for the year. The definition of farm income is also expanded to include other sources of income derived from a farming or agricultural enterprise.

For the 2012 crop, a legislative change implements an additional $1 million means test. This means test includes all income, farm and non-farm, and is applicable only to direct payments.

For conservation payments, if during 3 years prior to the year preceding the applicable year, an individual or entity earned an average of more than $1.0 million in adjusted non-farm income or more than $1.0 million in adjusted gross income (if less than 66⅔'s is from farming, ranching or forestry), that individual or entity is ineligible for conservation program payments for the year (but does not apply to easement programs).

In addition, USDA placed unnecessary payment limits on the Conservation

Stewardship Program (CSP). The 2008 Farm Law clearly establishes a five-year payment limit of $200,000 per "person or legal entity" for "all contracts" entered into during any "five-year period." Without basis, USDA instituted an overly-restrictive limit of $40,000 per year on CSP participants and a five-year limit of $200,000 per contract, regardless of the number of participants associated with the contract.

Cotton Import Provisions

When the average U.S. quote in the international market exceeds the prevailing world market price for 4 consecutive weeks, a Special Import Quota equal to 1 week's mill use is triggered. Cotton imported under this quota must be purchased within 3 months and enter the U.S. within 6 months. Imports under this quota cannot exceed 10 weeks of mill use in a marketing year.

Authority for Global Import Quotas is also extended by the current farm law. Whenever the base quality spot price for a month exceeds 130% of the average for the previous 36 months, a limited global import quota equal to 3 weeks of mill use must be opened for a 3-month period. Limited global quota periods cannot overlap, nor can a limited global quota be established if a special import quota is already in effect.

ELS Cotton Competitiveness Provisions

Competitiveness payments for eligible domestic users and exporters of American Pima cotton are continued for the 2008-12 crops. The payment rate reflects the difference between the American Pima quote in the Far Eastern market (APFE) and the lowest foreign quote in the Far East (LFQ), adjusted for quality. If the APFE quote exceeds the LFQ for 4 consecutive weeks and the LFQ is less than 134% of the base loan rate, then the payment rate equals the difference between the APFE and the LFQ in the fourth week of the 4-week period.

Economic Assistance to Users of Upland Cotton

From August 1, 2008 through July 31, 2012, the Secretary made a payment to domestic users of 4 cents/lb for all upland cotton consumed by U.S. textile mills. Beginning August 1, 2012, the rate adjusted to 3 cents/lb.

Payments must be used for purposes specified in the 2008 Farm Bill and include acquisition, construction, installation, modernization, development, conversion, or expansion of land, plant buildings, equipment, facilities, or machinery; such capital expenditures must be directly attributable and certified by the user for the purpose of manufacturing eligible upland cotton into eligible cotton products in the United States.

Export Programs

Title III of the 2008 Farm Bill makes a number of changes to trade promotion and facilitation programs important to the U.S. cotton industry. Specifically, the law repeals the Intermediate Export Credit Guarantee Program (GSM-103) and the Supplier Credit Guarantee Program. The Export Credit Guarantee Program (GSM-102) is authorized with $4 billion in credit guarantees and $40 million in budget authority.

The Market Access Program (MAP) and the Foreign Market Development (FMD) Program are funded at annual amounts of $200 million and $34.5 million, respectively.

Table 3 - Support Rates in the 2008 Farm Bill

	Loan Rate		Target Price		Direct Payment
	’08-09	’10-13	’08-09	’10-13	’08-13
Upland Cotton (lb)	0.5200	0.5200	0.7125	0.7125	0.0667
ELS Cotton (lb)	0.7977	0.7977	NA	NA	NA
Rice (cwt)	6.50	6.50	10.50	10.50	2.35
Wheat (bu)	2.75	2.94	3.92	4.17	0.52
Barley (bu)	1.85	1.95	2.24	2.63	0.24
Oats (bu)	1.33	1.39	1.44	1.79	0.024
Corn (bu)	1.95	1.95	2.63	2.63	0.28
Sorghum (bu)	1.95	1.95	2.57	2.63	0.35
Soybeans (bu)	5.00	5.00	5.80	6.00	0.44
Peanuts (ton)	355.00	355.00	495.00	495.00	36.00
Other Oilseeds (cwt)	9.30	10.09	10.10	12.68	0.80

Trade Negotiations & Disputes

Trade issues continue to command the attention of the U.S. cotton industry. Within the purview of the World Trade Organization (WTO), 2012 saw no progress in the ongoing Doha trade negotiations. However, the stalled negotiations will likely receive new momentum in the coming year with a ministerial scheduled for December in Indonesia. During the past year, little changed in the trade dispute with Brazil as provisions of the Framework Agreement are being implemented. However, the U.S. cotton industry is faced with a new counter-veiling duty (CVD) investigation launched by the Peruvian government.

Brazil Trade Dispute

In August 2009, a WTO Arbitration Panel ruled that Brazil could seek retaliation for the U.S.'s failure to comply with an earlier panel regarding the export credit guarantee programs and certain provisions of the upland cotton farm program.

Brazil claimed retaliation authority of $829 million for 2010. On March 8, 2010, Brazil published a list of 102 products that were scheduled for increased tariffs to go into effect on April 7. Brazil's announcement indicated that tariffs will be increased on $591 million worth of imports from the U.S., while it plans to retaliate against U.S. goods valued at $238 million in the services or intellectual property sector.

On March 15, 2010, Brazil published a list of 21 items under consideration for cross-retaliation through the suspension of patent and intellectual property rights. With sanctions estimated at $238 million, the list included agricultural chemicals and biotechnology products, veterinary medicines, software, books, music and films.

Before any retaliation was actually implemented, the United States and Brazil concluded a June 2010 Framework Agreement that delays trade retaliation by Brazil through the development of the new farm bill and further indicates that a mutually agreed outcome in the next farm bill would provide a long-term settlement of the dispute.

Regarding U.S. upland cotton policy, the Framework calls for an annual limit on trade-distorting cotton subsidies that would be "significantly lower" than the average for the marketing years '99-05 (the years covered by the WTO dispute). Furthermore, the actual level of the limit and the extent to which support counts against the limit would depend on the types of trade-distorting domestic support provided. Finally, Green Box, or non-trade-distorting, support does not count toward the limit.

The Framework also provides benchmarks for changes to the U.S. export credit guarantee program that would affect all participating U.S. commodities. Allocations for the program will be announced in two equal installments at the beginning and mid-point of the fiscal year. The export credit guarantee changes call for a reduction in the length of the guarantees by October 2012 to a weighted-average length of no more than 16 months. In addition, fee increases will be based on the use of the program in the previous 6-month period. Program usage greater than $1.5 billion results in a fee increase not less than 15%. Program usage between $1.3 billion and $1.5 billion will result in an 11% fee increase.

The Framework also calls for quarterly meetings between the two countries to discuss progress in the 2012 farm bill debate. As long as the Framework is in place, Brazil agreed not to impose trade sanctions. However, Brazil reserved its

rights to terminate the Framework Agreement at any time with a 21-day notice.

Brazil has not offered an official response to the 1-year extension of programs for the 2013 crop. For purposes of this outlook, it is assumed that retaliation is withheld while Congress continues debate on long-term farm legislation.

Doha Trade Negotiations

The U.S. cotton industry has consistently delivered the message that a Doha agreement must balance gains in market access with the reductions imposed on domestic support. Unfortunately, the current text, which was originally tabled by WTO Director General Pascal Lamy in July 2008, does not contain the necessary balance between domestic support and market access. The NCC continues to convey this message to U.S. negotiators and have been encouraged that U.S. officials are carrying that message to other countries.

From the broader perspective of the Doha trade talks, there continues to be serious concerns regarding the ability to advance the talks along the lines that have brought them to this point. A significant imbalance exists between the contributions of developed and developing countries. In many cases, proposed exemptions in the draft text for developing countries would offer no gains in market access.

Looking ahead to 2013, efforts are underway to revive the negotiations in advance of the ministerial scheduled for December in Indonesia. As part of those efforts, there are proposals to insist on modifications to U.S. cotton policy as an "early harvest" to entice developing countries to agree to make concessions on market access, intellectual property rights and services.

Peru CVD Investigation

In 2012, the independent Peruvian commission, National Institute for the Defense of Competition and the Protection of Intellectual Property (INDECOPI), launched an investigation of U.S. upland cotton programs. Specifically, INDECOPI is investigating Direct Payments, Counter-cyclical Payments, marketing loan benefits, and the ACRE program to determine if a causal link exists through the importation of U.S. cotton between those support programs and the economic health of Peruvian cotton producers. This is not INDECOPI's first time to investigate U.S. cotton programs. In fact, the most recent investigation was finalized in 2009 and found no causal link between U.S. programs and the economic well-being of Peru's cotton farmers.

As background, the June 2nd launch of the current investigation began an initial six-month fact-finding phase, during which INDECOPI has continued to gather and evaluate information. The U.S. government, U.S. cotton merchandising firms, Peruvian textile interests and Peruvian cotton producers received extensive questionnaires that were subsequently completed and returned to INDECOPI in July and August. The National Cotton Council retained the law firm Estudio Muniz in Lima, Peru, to represent the NCC as an interested party in the INDECOPI proceedings. As an interested party, the NCC is able to review the public docket of the investigation, as well as submit analysis for consideration by INDECOPI.

In late November, INDECOPI extended their fact-finding phase by three months, which is not uncommon in CVD investigations. The NCC, along with other interested parties, participated in a hearing held by INDECOPI in Lima on December 6. In summary, the NCC stressed the following points to INDECOPI: U.S. cotton program spending is sharply lower in recent years;

cotton markets have changed dramatically in recent years; U.S. cotton farmers based planting decisions on market signals and not the program; U.S. upland cotton has substantially different quality characteristics from Peruvian tanguis; and a CVD is not warranted and would only harm Peru's textile industry without aiding their cotton farmers.

The fact-finding phase of this investigation will continue until early March, at which point INDECOPI will issue an "Essential Facts" report. This report will serve as the basis for either a determination that no causal link exists (which is the outcome we are working for) or for a finding of damage and with some indication of a possible CVD, if one is to be imposed. Once the "Essential Facts" report is released, parties will have the opportunity to respond to the findings and there will likely be another hearing before a preliminary CVD determination is made.

The NCC continues to follow this investigation closely, and is working all levels to achieve a final determination of no causation and therefore no CVD.

Textile Trade Issues

Textile trade policy continues to have a substantial impact on the U.S. textile industry, both in terms of opportunities to export textiles and the pressures brought to bear by imported textiles and apparel. 2012 brought relatively few changes for U.S. textile trade policy, with the exception of agreements with Panama, Colombia and South Korea being implemented.

AGOA

The African Growth and Opportunity Act (AGOA) provides preferential access of textile and apparel products to the U.S. market for qualifying countries in Africa. AGOA is currently set to expire in 2015.

The AGOA legislation requires an annual determination to determine which countries are eligible to receive benefits under the trade act. Countries must make continued progress toward a market-based economy, rule of law, free trade, and economic policies that will reduce poverty, and protect workers' rights. There are now 40 countries that are eligible for economic and trade benefits under AGOA. Of those 40 Sub-Saharan countries, 27 of them are eligible to receive AGOA's apparel benefits. Twenty-seven countries also qualify for the LDC special rule for apparel (third-country fabric). In August of 2012, the AGOA third-country fabric provision was extended through September 30, 2015. Eighteen countries also qualify for AGOA's provisions for handloomed and handmade articles. Six countries qualify for AGOA's ethnic printed fabric benefits.

CAFTA-DR

The Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) includes the participating countries of Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua.

According to the provisions of the CAFTA-DR agreement, textiles and apparel are duty-free and quota-free if they meet the agreement's yarn-forward rule of origin. This means that only apparel using yarn and fabric from the U.S., Central America and the Dominican Republic qualifies for duty-free benefits.

The textile provisions also include a number of avenues for 3rd-country participation, including 'cumulation', Tariff Preference Levels (TPLs) which authorize the use of a specified quantity of 3rd country components, a fabric-forward rule of origin for certain products and allowances for 'single transformation' for a number of others.

The signatories of CAFTA-DR agreed to cumulation with Mexico and Canada for woven apparel. This allows a limited amount of inputs from Mexico and Canada to be used in Central American/Dominican apparel that will still qualify for duty-free benefits in the U.S. Cumulation under CAFTA-DR is subject to an annual cap of 100 million SME. This cap can grow to 200 million SME, but the growth is tied to an increase in CAFTA-DR trade. Mexico and Canada must provide reciprocal benefits to U.S. and Central American textile and apparel exports. On March 1 2012, the Dominican Republic lost cumulation eligibility. The Dominican Republic was only granted cumulation eligibility in regards to inputs from Mexico. In order to keep this eligibility the Dominican Republic had to conclude a free trade agreement with Mexico and provide written notification to all parties of the CAFTA-DR that the Dominican Republic and Mexico have taken actions necessary to provide reciprocal application of the rule. This had to be completed within 5 years from the date CAFTA-DR entered into force. The 5-year period expired on March 1, 2012 and the Dominican Republic had not concluded a free trade agreement with Mexico.

The TPLs for CAFTA-DR cumulation for the period of January 1, 2012 through December 31, 2012 was 100,000,000 SME. During that time, imports applied to this preference level equaled 21,116,853 SME, implying a 21.1% fill rate. The TPLs for CAFTA-DR cumulation for the period of January 1, 2013 through December 31, 2013 is 100,000,000 SME.

An amendment regarding pocketing material became effective in August 2008. Under this CAFTA-DR amendment, material for pockets going into apparel made in the CAFTA region have to be made in the U.S. or CAFTA countries for the product to enter the U.S. duty free.

CAFTA-DR provides Nicaragua with a TPL of 100 million SME which phases out over 10 years. CAFTA-DR does not contain TPLs for El Salvador, Honduras or Guatemala. Nicaragua agreed that for each SME of exports of cotton and man-made fiber woven trousers entered under the TPL, Nicaragua would export to the U.S. an equal amount of cotton and man-made fiber woven trousers made of U.S. formed fabric of U.S. formed yarn. Any shortfall in meeting this commitment that was not rectified by April 1 of the succeeding year would be applied against the TPL for the succeeding year. For 2011, the shortfall in meeting the one-to-one commitment was 3,470,941 SME. This amount was deducted from the 2012 TPL, resulting in a new 2012 TPL level of 96,529,059 SME. During the 2012 preference period, 96,529,059 SME of imports were applied to this TPL, implying a 100% fill rate.

CAFTA-DR provides Costa Rica with TPLs for certain apparel of wool fabric, tailored wool apparel, and certain women's swimwear. Combined, these TPLs were 1,119,102 SME for the 2012 preference period. During this period, 174,654 SME of imports were applied to these TPLs, implying a 15.6% fill rate.

CAFTA-DR contains a special textile safeguard which allows the U.S. to impose tariffs on certain goods when injury occurs due to import surges. A safeguard cannot last more than 3 years for a specific good.

The agreement also contains a revised short supply process that includes tighter timelines than in earlier short supply processes, allows items to be deemed in partial short supply, and provides for items to be added to and removed from the short supply list.

Andean Countries

The U.S. – Peru TPA entered into force on February 1, 2009. Under the U.S. – Peruvian agreement, textile and apparel provisions are based on the yarn-forward rule of origin. There are no provisions for TPLs or exceptions to the requirement that qualifying products contain components manufactured in the U.S. or Peru. As in NAFTA, a list of components not manufactured in either country has been developed and only those products may be sourced from a third country.

On November 22, 2006, the U.S. – Colombia Trade Promotion Agreement was signed. On June 28, 2007, the United States and Colombia signed a Protocol of Amendment revising the Agreement to reflect the bipartisan consensus on trade of May 10, 2007. The U.S. – Colombia TPA was ratified by the U.S. Congress on October 12, 2011, and signed by President Obama on October 21, 2011. The agreement was implemented on May 15, 2012.

Under the U.S. – Colombia agreement, over 80% of U.S. exports of consumer and industrial products to Colombia were duty-free immediately, and an additional 7% will be duty free within five years. All remaining tariffs will be eliminated within ten years. The textile and apparel provisions are generally based on the yarn-forward rule of origin. Exceptions to the rules of origin will be handled through an expedited "short supply" determination process. The U.S. and Colombia agreed on 20 "short supply" items as part of the agreement. The agreement does not make use of TPLs. A "de minimis" provision will allow limited amounts of specified third-country content to go into U.S. and Colombian apparel. Also, a special textile safeguard will provide for temporary tariff relief if imports under the agreement prove to be damaging to domestic producers.

Colombia, Peru, Ecuador, and Bolivia received duty-free benefits under the Andean Trade Preference Act (ATPA). As part of the Trade Act of 2002, Congress renewed and enhanced the trade preferences for all four countries under the Andean Trade Promotion and Drug Eradication Act (ATPDEA), which was scheduled to expire on December 31, 2006, but has been extended several times. The most recent extension was enacted on November 5, 2011. It extended tariff preference programs for Colombia and Ecuador through July 31, 2013. Peru was not included because it has a free trade agreement with the U.S. that has already been implemented. As of May 15, 2012, only Ecuador is eligible for ATPDEA benefits because the U.S.-Columbia agreement has been implemented.

Haiti

The Haitian Hemispheric Opportunity through Partnership for Encouragement Act (HOPE) provides expanded duty-free, quota-free access to certain apparel products assembled in Haiti. To qualify, Haitian products are required to have 50% of the value of the finished product be provided by the U.S., Haiti, any U.S. Free Trade Agreement partner or any country in AGOA, Andean and CAFTA regions.

HOPE provides that the annual quantity of goods eligible for duty-free benefits will be recalculated for each subsequent 12-month period. HOPE also provides that the annual limit for qualifying apparel imported from Haiti under this provision for the 12-month period beginning on December 20, 2007 will not exceed 1.3% of the total SME of all apparel articles imported into the U.S. from Haiti in the most recent 12-month period for which data are available. The 12-month limit on duty-free benefits for the one-year period beginning on December 20, 2011 and extending through December 19, 2012 was 326,752,739 SME. During that time period,

17,676,749 SME were attributed to the limit, implying a fill rate of 5.4%.

The 2008 Farm Bill included amendments to rules enacted by the HOPE Act. These amendments are referred to as the Haitian Hemispheric Opportunity through Partnership Encouragement Act of 2008 (HOPE II). HOPE II extends tariff preferences for 10 years and relaxes rules of origin for textile and apparel products from Haiti. It creates a benefit for apparel wholly assembled or knit-to-shape in Haiti that meets a "3 for 1" earned import allowance. The amendment requires the Secretary of Commerce to establish a program to provide earned import allowance certificates to any producer or entity controlling production of apparel in Haiti, such that apparel wholly assembled or knit-to-shape in Haiti from any combination of fabrics, fabric components, components knit-to-shape, or yarns, regardless of their source, and imported directly from Haiti or the Dominican Republic may enter the United States duty-free, pursuant to the satisfaction of the terms governing issuance of the earned import allowance certificate by the producer or entity controlling production of apparel in Haiti.
In May 2010, President Obama signed into law the Haiti Economic Lift Program Act (HELP). HELP was designed to help Haiti's economy recover from the devastating earthquake which occurred there in January 2010. HELP expanded existing preferences for apparel and established new preferences for certain non-apparel textile goods. With the exception of the Value-Added TRQ, which expires in December 2018, HELP extended existing trade preference programs for Haiti through September 2020. Key HELP act provisions increase current TPLs for certain knit and woven apparel products.

Panama

The U.S. – Panama Free Trade Agreement was signed on June 28, 2007. It was ratified by the U.S. Congress on October 12, 2011, and signed by President Obama on October 21, 2011. The U.S. – Panama TPA was implemented on October 31, 2012.

The U.S.-Panama FTA adheres to a yarn-forward rule of origin, meaning that qualifying textile and apparel products must be made using U.S. or Panamanian yarns and fabrics. Goods that meet the rule of origin qualify for immediate duty-free market access upon entry into force of the Agreement.

Consistent with other free trade agreements, elastomeric yarns, narrow elastic fabrics, pocketing fabric, thread, and visible linings must be sourced from the region for use in textile and apparel products that qualify for duty free entry.

Similar to CAFTA-DR, a streamlined commercial availability (short supply) determination process will allow yarns or fabrics that are deemed not commercially available in the region to be used in the production of apparel. Also, a textile-specific safeguard mechanism allows for temporary Most Favored Nation tariffs if a surge in imports threatens to cause serious damage to the domestic industry.

Korea

On April 1, 2007, the final day for Congressional notification under Trade Promotion Authority (TPA), the United States concluded a Free Trade Agreement with South Korea. This agreement was signed on June 30, 2007, the last day it could be signed and still be considered under TPA which expired on the same day. The agreement (referred to as the KORUS FTA) was ratified by Congress on October 12, 2011 and signed by President Obama on October 21, 2011. The KORUS FTA entered into force on March 15, 2012.

Under the KORUS FTA, all qualifying U.S. footwear and non-textile travel goods entering into Korea were duty-free immediately. Duties on the majority of qualifying U.S. textile and apparel products exported to Korea were eliminated upon entry into force of the agreement. The remainder will be eliminated in three or five year stages. Qualifying footwear and non-textile travel goods from Korea will be duty-free into the United States under KORUS, except for a few rubber/fabric and plastic/protective footwear items. Duties on these items will remain at base rates during years one through eight. Beginning on January 1 of year nine, duties will be reduced in four equal annual stages, and then will be duty-free, effective January 1 of year 12.

The KORUS adopts a “yarn forward” rule of origin, which requires that the yarn production and all operation forward occur in either South Korea or the United States, but the fiber may be from anywhere. However, there are some exceptions in the rules requiring "fiber forward," and some requiring "fabric forward". Also, there are consultative processes to amend the rules of origin should any fiber, yarn or fabric not be commercially available in the U.S. or South Korea. If a good does not meet the rule of origin requirements, a textile or apparel product might be considered originating if all non-originating fibers and yarns make up less than a "de minimis" seven percent of the total weight of the product.

The KORUS FTA includes a special textile safeguard mechanism which provides for temporary re-application of MFN tariffs, if imports under the agreement increase either absolutely or relative to the domestic market, and are shown to be causing or threatening to cause serious damage to the domestic industry. The safeguard can only be implemented for two years, with the possibility of extension for an additional two years, up to ten years.

Looking Ahead

Trade Promotion Authority (TPA) expired on June 30, 2007. Under TPA, trade agreements are subject to an up-or-down vote, but not amendment, in Congress. President Obama has said he would seek an extension of TPA but, as of late January 2013, has not done so. According to press reports, leaders of the House and Senate committees with jurisdiction over trade have made it clear that renewal of TPA is a key legislative priority for them in 2013. Reports also indicate that the Obama administration prefers to wait until the Trans-Pacific Partnership (TPP) talks are closer to conclusion before pursuing TPA. The administration has indicated that it will need TPA to finish talks on the Trans-Pacific Partnership and to pursue other possible initiatives.

In mid-December 2009, the USTR announced that the U.S. will negotiate a trade agreement with the Trans-Pacific Partnership (TPP). The initial TPP negotiation partners included Australia, Brunei Darussalam, Chile, New Zealand, Peru, Singapore, and Vietnam. Malaysia joined the negotiations in October 2010. In addition, Canada, Mexico, Japan and Thailand expressed interest in joining the talks. In June of 2012, the U.S. and the other eight countries negotiating the TPP extended an invitation to Mexico and Canada to join the TPP negotiations, pending successful conclusion of their domestic procedures.

Fifteen rounds of negotiations have already occurred. The next round of negotiations is scheduled for early March 2013 in Singapore. During the last round of negotiations, which occurred in December 2012 in New Zealand, Canada and Mexico participated in the negotiations for the first time. In that round of negotiations, the U.S.

offered a new approach for negotiating market access for textiles and apparel that would allow for more exceptions to the yarn-forward rule of origin it has proposed. Under the new proposal, the general rule for apparel in the TPP would be a yarn-forward rule of origin, but there would be two short supply lists – a permanent list and a temporary one. The permanent list would include textile inputs that are never expected to be produced in the TPP region. The temporary list would last for three years and would include textile inputs that are currently not produced in the region but are expected to be in the future. Apparel made from items on either list would be subject to a cut-and-sew rule of origin instead of a yarn-forward rule.

Trade associations representing the U.S. textile industry have opposed certain aspects of the TPP. NCTO has opposed the inclusion of Vietnam in the TPP due to unfair and anti-competitive subsidies, labor and environmental rules. In 2011, Rep. Gowdy (R-SC) organized a letter co-signed by 51 members to the USTR urging the inclusion of strong rules of origin for textiles in the TPP negotiations to reduce the risk to the U.S. textile and apparel industry from Vietnam's inclusion. The co-signers included three specific recommendations: 1) establish special market access rules, given Vietnam's non-market economy status and inherent advantages provided to its textile and apparel sectors; 2) adopt the basic yarn-forward rule of origin for textiles and apparel with no loopholes; and 3) strengthen customs rules. The House members also encouraged USTR to handle textiles and apparel in a separate negotiating group.

In February 2012, the Textile and Apparel Alliance for TPP (TAAT) coalition, which includes trade groups from 30 countries, was formed to show support for the U.S. negotiation position on textiles after Vietnam proposed country-of-origin rules for textiles and apparel that are much weaker than those in current U.S. FTAs and preference programs. Instead of the yarn-forward rule that is a part of many U.S. trade agreements, Vietnam is insisting on “single transformation” in TPP. Under the “single transformation” rule goods only have to be assembled in Vietnam but the textile components can come from non-TPP participating countries, such as China, and the finished product could still be exported to TPP countries duty free. According to TAAT, “single transformation” would allow Vietnam’s state-owned enterprises (SOEs) to export textiles and apparel made from subsidized inputs produced by China’s massive textile SOEs duty free to other TPP countries. Also, the competitive advantage gained by Vietnam’s SOEs would shift business to them at the expense of privately-owned and financed textile and apparel producers in the United States and elsewhere in the NAFTA, CAFTA and AGOA trade blocs, thereby harming potential for new textile and apparel export markets for U.S. producers and those of FTA partners. Moreover, China, the largest textile and apparel exporter in the world and a country not participating in the TPP, would gain substantial new access to the U.S. market without having to make trade concessions in return.

In May 2012, seventy-six U.S. representatives sent a letter to USTR Ambassador Kirk stressing the need for job-creating textile rules in the TPP. The letter stated that the TPP negotiations are particularly important because they include Vietnam which has experienced dramatic growth in their textile and apparel exports to the U.S. in recent years fueled by Vietnam’s large state-owned, state-subsidized apparel sector. According to the letter, without strong textile rules in TPP, Vietnams’ state-subsidized companies could damage the U.S. domestic textile industry and those in countries with which the U.S. currently has

free trade agreements and trade preference programs. Three objectives mentioned in the letter involved a yarn-forward rule of origin, market access rules which take into account Vietnam's non-market economy status and anti-competitive advantages provided to their state-owned textile and apparel sector, and strong customs enforcement rules.

U.S. Supply

Planted Acreage

U.S. farmers planted 12.1 million acres of upland cotton in 2012, a decrease of 16% from the previous year (Figure 33). Each of the four production regions contributed to the drop in U.S. acreage. Weaker cotton prices relative to primary competing crops such as corn and soybeans explained the acreage decline. In the weeks prior to planting the 2012 crop, cotton-to-corn and cotton-to-soybean price ratios were less favorable than in either 2010 or 2011.

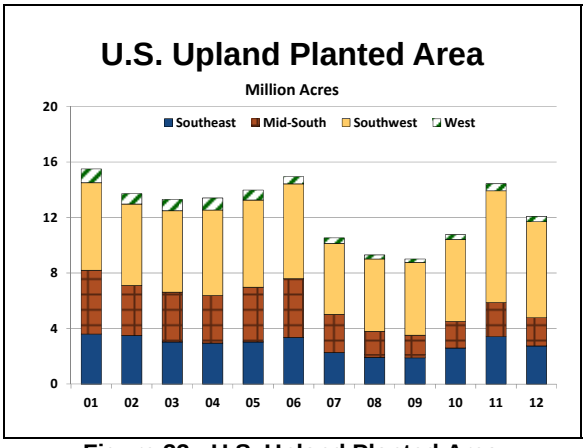

Figure 33 - U.S. Upland Planted Area

With a decrease of approximately 650 thousand acres, cotton acreage in the Southeast fell to just more than 2.7 million acres (Figure 34). Although down 19% from 2011, the region's cotton acreage was 45% higher than 2009's low. Across the region, all states reported declines with the largest percentage losses of 27% and 26% occurring in North Carolina and Virginia, respectively. Georgia followed with a 19% decrease, while Alabama and Florida registered losses of 17% and 11%, respectively. South Carolina showed the smallest decline with acreage off just 1% from 2011. Across the region, the decrease in cotton area came as acres were shifted to soybeans and peanuts.

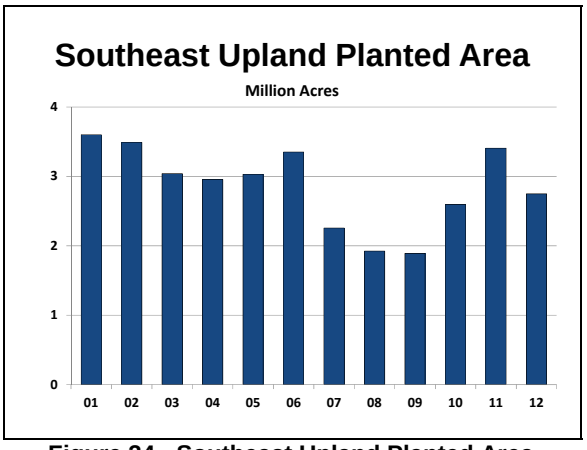

Figure 34 - Southeast Upland Planted Area

In 2012, plantings of 2.0 million acres in the Mid-South represented an 18% decrease (Figure 35). In recent years, Mid-South farmers have demonstrated their ability and willingness to adjust their crop mix based on market signals. The decline in 2012 continued that pattern as growers sought alternative crops offering a higher expected return.

As in the Southeast, all states experienced decreased acreage in 2012 due to the improved relative price signals. With area reduced by 155 thousand acres, Mississippi's 25% decrease was the largest in the region. Growers in Tennessee and Louisiana responded in a similar manner with reductions of 23% and 22%, respectively. Producers in Arkansas lowered their cotton plantings by 13%, while Missouri exhibited the smallest decline of 7%. Across the region, the acres shifted away from cotton generally moved to either corn or soybeans.

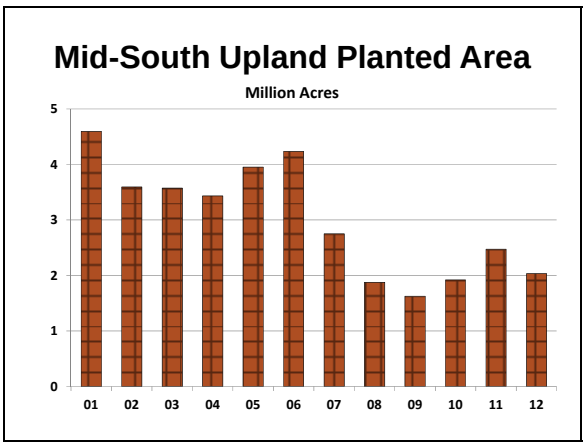

Figure 35 - Mid-South Upland Planted Area

In the Southwest, upland cotton area fell 14% to 6.9 million acres (Figure 36). Though down from 2011, the 3-state total for the region was 900 thousand acres above the 10-year average. Weaker cotton relative to wheat and sorghum contributed to the decline in cotton acres. In Texas, cotton acres fell by 1.0 million acres, which equated to a 13% decline. In Kansas and Oklahoma, acreage decline by 30% and 27%, respectively.

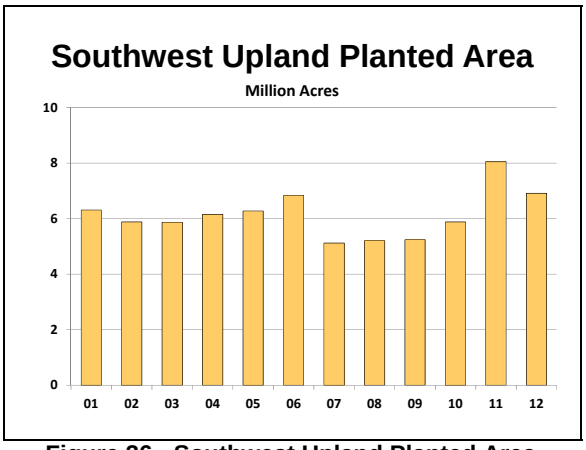

Figure 36 - Southwest Upland Planted Area

Upland acres in the West stood at 388 thousand acres, down 23% from 2011 (Figure 37). Each of the 3 states contributed to the drop in acres. In percentage terms, New Mexico's 34% decline was the largest among the three states. Declines were comparable in California and Arizona, coming in at 22% and 20%, respectively.

For each state, the declines in area gave total acreage comparable to the 2010 total.

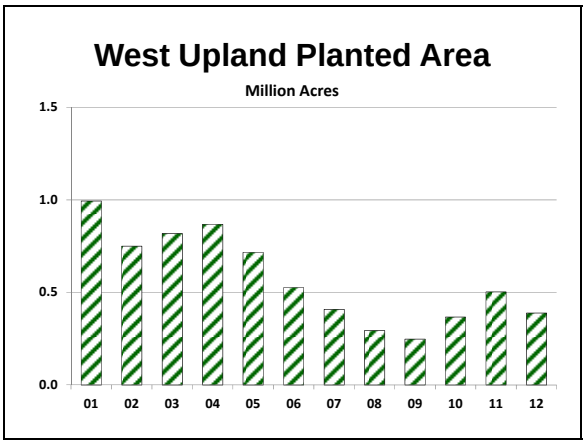

Figure 37 - West Upland Planted Area

In 2012, adjustments in ELS area mirrored those of upland cotton as growers responded to lower prices. For the U.S. as a whole, ELS acres fell 22%, leaving planted area at 238 thousand acres (Figure 38). California, down 18%, accounted for 225 thousand acres. Texas followed with just 8 thousand acres, a decrease of 60% from 2011. Arizona growers planted 3 thousand acres of ELS cotton, down from 10,500 acres in 2011. In New Mexico, growers devoted 2,400 acres to ELS, down 1,000 from 2011.

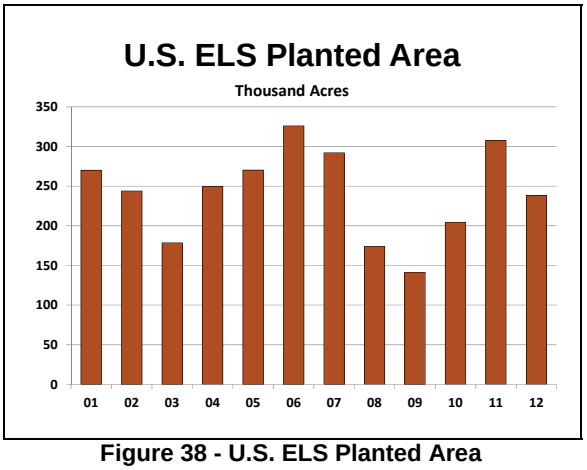

Figure 38 - U.S. ELS Planted Area

Harvested Acreage

Weather issues continue to plague portions of the Cotton Belt, through generally not to the devastating extent as in 2011. As a

result, national abandonment stood at 23% (Figure 39). While much improved from the 2011 abandonment of 36%, the portion of acres un-harvested in 2012 was the second highest in recent history. By comparison, the 5-year average abandonment is 17%.

On a regional basis, the Southwest was the hardest hit, with 41% of planted acres not harvested due to the adverse weather conditions. Despite localized weather concerns, abandonment in the Southeast and Mid-South was below the 5-year average. In fact, for the Southeast, an abandonment rate of 0.6% was the smallest on record.

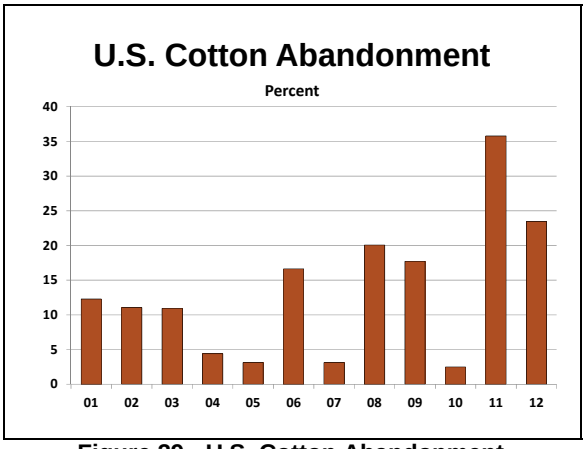

Figure 39 - U.S. Cotton Abandonment

Yields

Given the weather challenges facing cotton farmers during the 2012 growing season, it is somewhat amazing that the national average yield per harvested acre of 866 pounds stands as the 2nd highest on record (Figure 40). The 2012 yield is only surpassed by 2007's yield of 879 pounds. In addition, last year's yield came in 49 pounds above the 5-year average. However, looking at the numbers in more detail provides a better understanding of the national estimate. Record yields in some regions of the Belt were partially offset by below-average yields in the Southwest. It is also important to remember that the yields are measured per harvested acre and do not reflect the zero yields on abandoned acres.

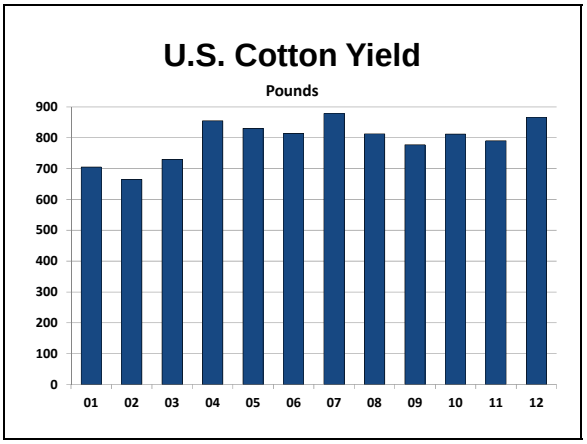

Figure 40 - U.S. Cotton Yield

Across the 6-state Southeast region, USDA production data reveal exceptional yields. For the region as a whole, the 2012 yield of 996 pounds was more than 200 pounds above the 5-year average (Figure 41). The region's 2012 yield also eclipsed the previous record by more than 100 pounds. Virginia led the way with a record average yield of 1,129 pounds, more than 300 pounds above the 5-year average. Georgia was 2nd in the region with an average yield of 1,027 pounds, marking the first time that the state average exceeded 1,000 pounds. North Carolina was not far behind with an average yield of 993 pounds, a substantial gain from the 5-year average of 780 pounds. Alabama and South Carolina also produced yields above 900 pounds, with averages of 952 and 918, respectively. Only Florida fell short of the 900-mark, and even then, by just 3 pounds. At 897 pounds, Florida's yield fell short of the record but exceeded the 5-year average by more than 130 pounds.

Southeast Upland Yields
Pounds per Harvested Acre

	2011	2012	5-Year Average
Alabama	742	952	676
Florida	744	897	760
Georgia	791	1,027	826
North Carolina	616	993	780
South Carolina	828	918	797
Virginia	676	1,129	811
SOUTHEAST	739	996	789

Figure 41 - Southeast Upland Yields

Average yields for the Mid-South region also set a record high of 1,011 pounds per harvested acre (Figure 42). The 2012 harvest surpassed the previous record set in 2004 by 2 pounds. Last year's result also bested the 5-year average by almost 100 pounds. Across the 5-state region, Arkansas recorded the highest average yield of 1,083 pounds, almost 100 pounds above the 5-year average. Missouri's average yield of 1,033 pounds was approximately 25 pounds better than the 5-year average. With an average yield of 1,003 pounds, Louisiana surpassed their 5-year average by 180 pounds. Mississippi, at 970 pounds, and Tennessee, with 934 pounds, also came in above average.

Mid-South Upland Yields
Pounds per Harvested Acre

	2011	2012	5-Year Average
Arkansas	929	1,083	985
Louisiana	846	1,003	823
Mississippi	952	970	924
Missouri	969	1,033	1,006
Tennessee	796	934	768
MID-SOUTH	904	1,011	913

Figure 42 - Mid-South Upland Yields

As previously discussed, the Southwest region continued to face drought conditions but not to the extent seen in 2011. For the region as a whole, average yields reflected the modestly better growing conditions. For the region as a whole, the average yield of 610 pounds per acre was a 22-pound improvement from 2011 but still more than 90 pounds below the 5-year average (Figure 43). State-by-state results present a more mixed picture as average yields in Texas and Kansas improved from 2011, while yields in Oklahoma not only fell short of 2011 but was the lowest since 1999.

Southwest Upland Yields
Pounds per Harvested Acre

	2011	2012	5-Year Average
Kansas	510	578	653
Oklahoma	597	480	770
Texas	589	615	700
SOUTHWEST	588	610	702

Figure 43 - Southwest Upland Yields

The average upland yield in the West is estimated at 1,517 pounds, 50 pounds above the 5-year average (Figure 44) and 17 pounds better than the previous record. California led the way with a record average yield of 1,651 pounds, which surpasses the 5-year average by 114 pounds. Arizona's average yield of 1,511 pounds was in line with the 5-year average of 1,502 pounds. Yields in New Mexico improved from 2011 but fell short of their 5-year average by 14 pounds.

West Upland Yields
Pounds per Harvested Acre

	2011	2012	5-Year Average
Arizona	1,548	1,511	1,502
California	1,474	1,651	1,537
New Mexico	1,059	1,080	1,094
WEST	1,463	1,517	1,467

Figure 44 - West Upland Yields

The national average ELS yield is estimated at a record 1,540 pounds, almost 100 pounds higher than the previous record and more than 200 pounds above the 5-year average (Figure 45). With the majority of ELS acres, California heavily influences the U.S. average. With an average yield of 1,575 pounds, California surpassed their 5-year average by 196 pounds. Yields in Arizona, were also more than 200 pounds above their 5-year average. New Mexico's yield of 981 pounds bettered their 5-year average more than 160 pounds. Unfortunately, ELS producers in Texas did not enjoy the same outcome as their yields fell short of the 5-year average.

ELS Yields
Pounds per Harvested Acre

	2011	2012	5-Year Average
Arizona	960	1,152	930
California	1,380	1,575	1,379
New Mexico	875	981	814
Texas	1,038	832	899
U.S.	1,340	1,540	1,324

Figure 45 - ELS Yields

Production

USDA's latest estimate places the 2012 U.S. cotton crop at 17.0 million bales (Figure 46), up 1.4 million bales from 2011. The 9% increase in production can be attributed to increased yields and reduced abandonment more than offsetting lower plantings. The upland crop is estimated just under 16.3 million bales, and ELS farmers harvested 760 thousand bales.

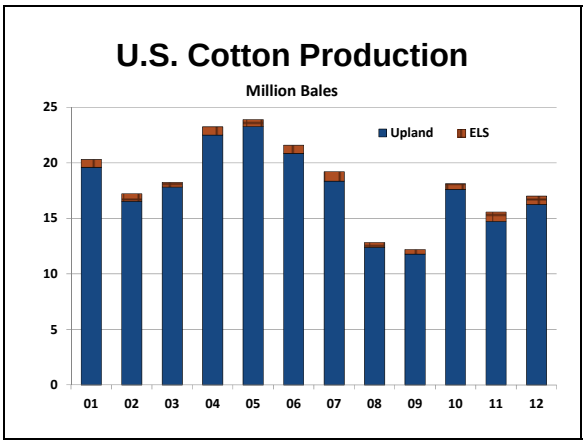

Figure 46 - U.S. Cotton Production

In 2012, the Southeast was the largest production region, with a crop of 5.7 million bales, accounting for 35% of the total upland crop (Figure 47). This is more than 600 thousand bales above 2011 and 1.8 million bales better than the 5-year average.

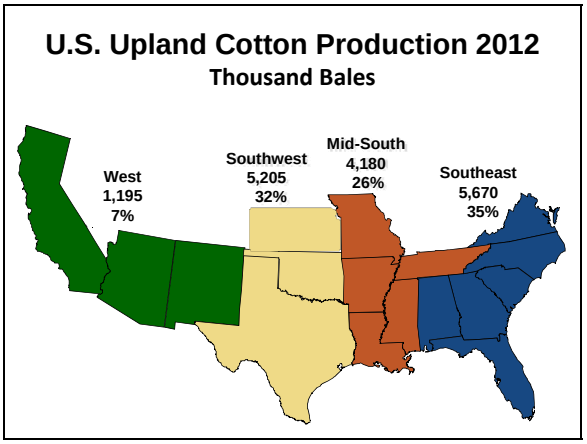

Figure 47 - U.S. Upland Cotton Production 2012

For 2012, the Mid-South accounted for 26% of the total U.S. upland crop. At 4.2 million bales, the 2012 crop was 362 thousand bales lower than 2011 but still more than 200 thousand bales above the 5-year average.

Compared to year-earlier results, the smaller crop can be attributed to reduced area not being fully offset by increased yields.

At 5.2 million bales, production in the Southwest accounted for 32% of the U.S. upland crop. Though still well below the 5-year average of 6.1 million bales, the Southwest's crop was a dramatic improvement over the 3.7 million bales harvested in 2011.

The West produced 1.2 million bales of upland cotton in 2012, down almost 300 thousand bales from the region's 2011 crop. The region accounted for 7% of U.S. production. While smaller than 2011, the upland crop in the West exceeded their 5-year average by more than 100 thousand bales.

The 2012 ELS crop of 760 thousand bales was 91 thousand bales lower than 2011. At 735 thousand bales, the California ELS crop was down 50 thousand bales from 2011, but still exceeded their 5-year average almost 175 thousand bales (Figure 48). The state accounted for 97% of the total 2012 U.S. ELS crop. In 2012, ELS production declined in all states.

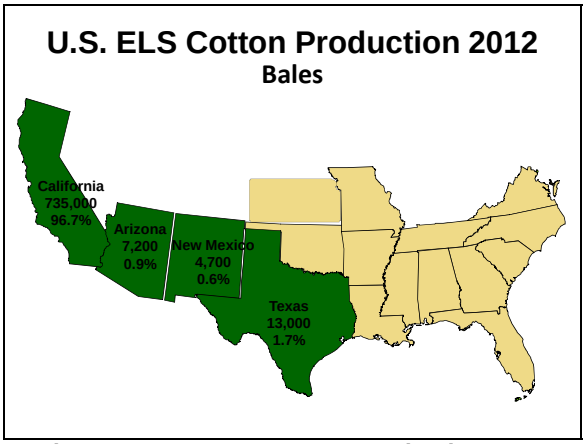

Figure 48 - U.S. ELS Cotton Production 2012

Stock Levels

With U.S. cotton production exceeding total demand for the 2011 marketing year, cotton stocks bounced back from the previous year, but still remained at relatively low levels. The resulting carryout from the 2011 marketing year, and equivalent carry-in or beginning stocks for the 2012 marketing year, stood at 3.4 million bales (Figure 49). That represented a 750 thousand bale increase from the stocks that were brought into the 2011 marketing year. However, beginning stocks remained well below the levels observed for the 2005 though 2009 marketing years. Upland stocks increased by 500 thousand bales, while ELS stocks grew by 240 thousand bales.

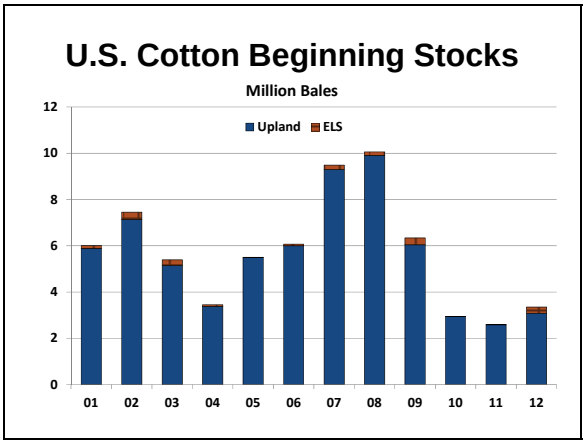

Figure 49 - U.S. Cotton Beginning Stocks

For the 2010 and 2011 crops, total bales of upland cotton placed under the CCC loan peaked at approximately 4 million bales, which is sharply lower than previous crops. With cotton prices well above the loan rate, a smaller proportion of the crop has entered the CCC loan.

Midway through the 2012 marketing year, larger production combined with lower prices relative to 2011 has allowed the CCC loan stocks to marginally exceed the 2011 total. As of December 31, 2012, outstanding CCC loan stocks were 4.4 million bales (Figure 50), up from 4.0 million bales in 2011. The Mid-South accounts for approximately 40% of cotton placed under loan.

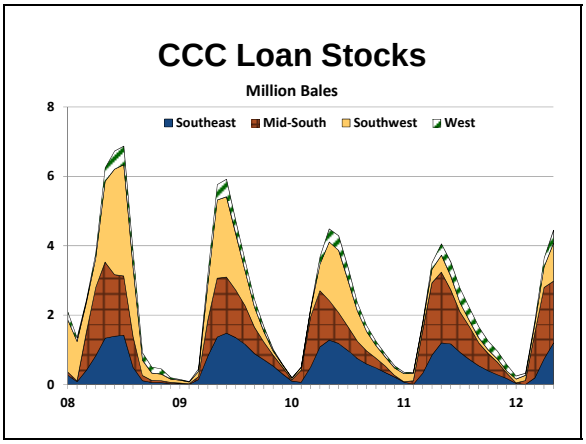

Figure 50 - CCC Loan Stocks

Total Supply

Total supply for the 2012 marketing year is estimated to be 20.4 million bales, up from 18.2 million bales the previous year (Figure 51). Increased supplies are the combined result of larger production and increased beginning stocks. Total supplies for the 2012 marketing year remain substantially below the levels observed in 2001 through 2007.

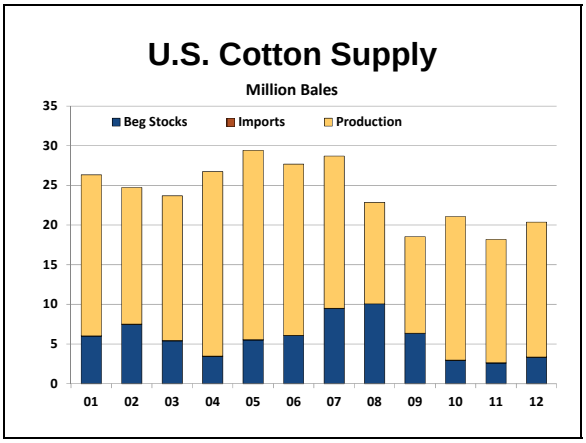

Figure 51 - U.S. Cotton Supply

Upland Cotton Quality

With 15.6 million running bales classed through January 24, the national average staple length (measured in 32nd of an inch) is 35.7, up from a 5-year average of 35.5 (Figure 52). The Southeast staple length of 36.0 is 1.1 32nd of an inch better than their 5-year average, and if sustained for the remainder of the crop, the 2012 staple length would be an all-time best for the region. In the Mid-South, the average staple length of 35.9 exceeds the 5-year average by 0.6 thirty-second's. The Southwest's average staple length of 35.0 will fall short of the 5-year average of 35.7, but that is not unexpected given the drought conditions. The West reports the longest staple, with an average of 36.7, down 0.2 from the 5-year average.

2012 Crop Staple and Strength

	Staple		Strength	
	2012	5-Year	2012	5-Year
Southeast	36.0	34.9	29.1	29.0
Mid-South	35.9	35.3	30.5	29.7
Southwest	35.0	35.7	29.8	29.6
West	36.7	36.9	31.6	31.2
U.S.	35.7	35.5	29.9	29.6

Figure 52 - 2012 Crop Staple and Strength

The strength of the 2012 upland crop, averaging 29.9 grams/tex, is substantially better than the 5-year average of 29.6. All regions are exceeding their 5-year average, and in the West, the average of 31.6 grams/tex would be a record if sustained for the remainder of the crop.

In total for the Cotton Belt, 90.2% of the 2012 crop is grading 41 or better, which compares to a 5-year average of 87.8% (Figure 53). The U.S. average is being bolstered by color grades in the Southeast and Mid-South that are substantially above their 5-year averages. Color grades for the West are also exceeding their 5-year average.

2012 Crop Color and Mike

	%SLM+		Micronaire	
	2012	5-Year	2012	5-Year
Southeast	91.9	83.4	45.6	46.2
Mid-South	93.8	84.4	48.9	45.7
Southwest	84.1	91.5	41.6	42.3
West	96.1	95.4	44.0	44.0
U.S.	90.2	87.8	45.1	44.3

Figure 53 - 2012 Crop Color and Mike

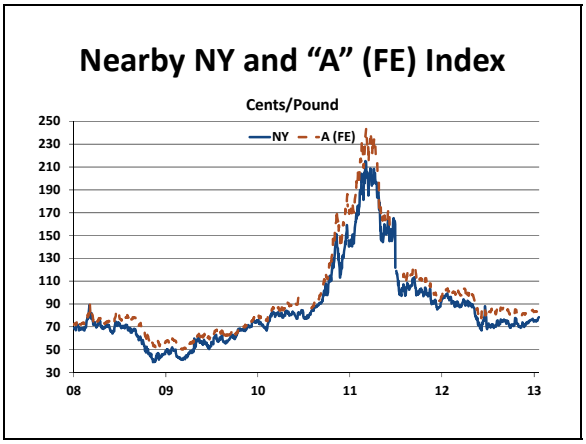

Figure 54 - Nearby NY and "A" (FE) Index

The average micronaire of the 2012 upland cotton crop is 45.1, up from the 5-year average of 44.3. The national result is due to the Mid-South, where the average micronaire of 48.9 not only exceeds the 5-year average, but also would be the highest on record if sustained. All other regions are coming in below or equal to their 5-year averages.

Cotton Prices

Upland Cotton Prices

When compared to the previous year, upland cotton prices presented a much less volatile appearance during 2012. After starting the year at $0.96 per pound, nearby New York futures drifted lower through May before settling into a sideways trading range for the remainder of the year (Figure 54). After July 1, the nearby contract generally closed in the narrow range of $0.69 to $0.76 per pound.

Early in calendar 2012, prices were coming under pressure as demand continued to struggle in the aftermath of $2 cotton. Market participants were also working through the rash of contract defaults brought about by the price volatility of the previous year.

Increasing global stocks measured on July 31, 2012 were also keeping pressure on prices. However, downside movements were limited with the demand responding when prices moved lower. As futures prices moved into the lower 70's, cotton became more competitive with comparably-priced manmade fibers. In addition, with the high internal prices in China, textile mills in that country found it advantageous to import cotton even after applying the 40% above-quota tariff.

As harvest of the Northern Hemisphere's 2012 crop advanced, little changed with the global balance sheet. There were no major production problems to generate price increases, and China continued to build their reserves and maintain a relatively strong presence in the import market.

The "A" Far East (FE) Index exhibited a similar pattern to futures prices. Prices drifted lower in the first half of the year before moving in a sideways pattern in the latter months. During the year, the spread between the "A" Index and the nearby futures ranged between 8 and 12 cents, which is somewhat larger than the historical range of 5 to 8 cents.

Thus far into the 2012 marketing year, spot 4134 values have averaged $0.69/lb.; the average spot 4134 value for the 2011 crop

cotton was $0.88 cents/lb (Figure 55). During 2012, spot market prices generally followed the trend in futures. After starting calendar 2012 at $0.91, prices closed the year at $0.71, with the decline in prices being observed in the first five months of the year.

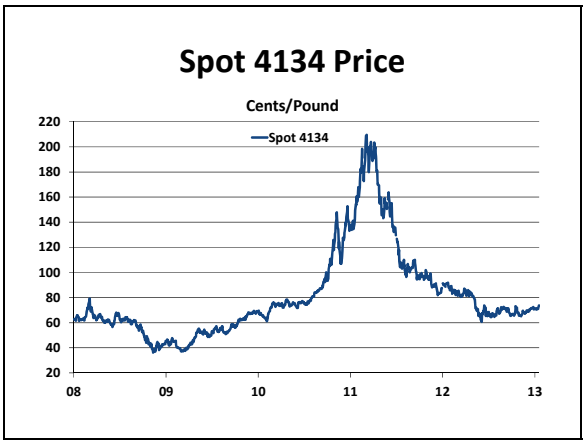

Figure 55 - Spot 4134 Price

ELS Prices

Movements in market prices for extra-long staple cotton generally mirrored those in the upland market. ELS cotton prices began 2012 at $1.76 per pound, after having peaked at $2.60 in 2011 (Figure 56). Prices generally drifted lower through June, before finding support between $1.15 and $1.20 per pound. Prices maintained that narrow range through the end of 2012, closing the year at $1.20.

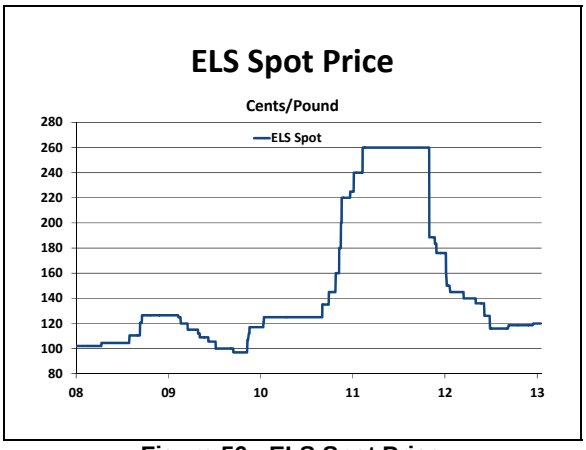

Figure 56 - ELS Spot Price

Cottonseed Situation

Cottonseed Supply

USDA estimates 2012 cottonseed production at 5.8 million tons, up 389 thousand tons from the previous year (Figure 57). The changes in cottonseed production mirror the movements in cotton lint production as average seed-to-lint ratios have remained relatively stable in recent years. For 2012, USDA's latest estimates indicated an average ratio of 1.4 pounds of seed per pound of lint.

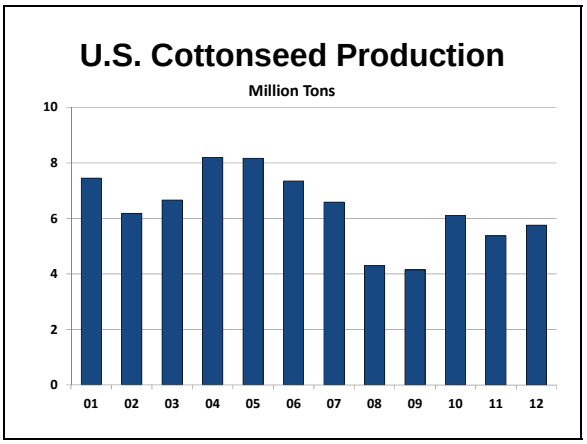

Figure 57 - U.S. Cottonseed Production

For the 2012 crop, a regional breakdown of production shows that the Southwest produced 1.8 million tons or 31% of the total, the largest of any region (Figure 58). They were closely followed by the Southeast with estimated production of 1.7 million tons for a 30% share. The Mid-South produced 1.4 million tons, or 25% of total production, and the West accounted for 773 thousand tons, 13% of the total.

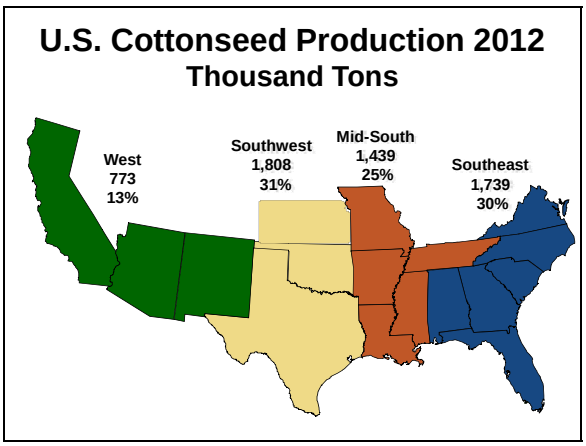

Figure 58 - U.S. Cottonseed Production 2012

Supplementing U.S. production, beginning stocks of 430 thousand tons and imports of 100 thousand tons bring total cottonseed supply for the 2012 marketing year to 6.3 million tons (Figure 59). Total supplies for 2012 are up 230 thousand tons from the previous year and more than 400 thousand tons above the 5-year average.

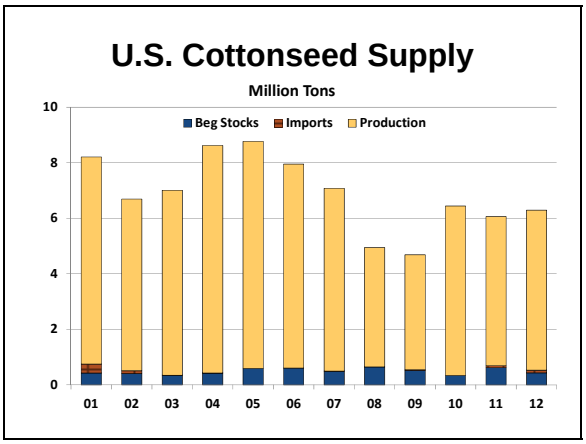

Figure 59 - U.S. Cottonseed Supply

Disappearance and Stock Levels

USDA's latest estimate places 2012 cottonseed disappearance at 5.8 million tons, up 168 thousand tons from the previous year (Figure 60). Crush is estimated at 2.5 million tons, up 100 thousand tons from 2011. Whole seed feeding for the 2012 marketing year is estimated at 3.0 million tons, down 100 thousand tons from the 2011 level. Estimated exports of 300 thousand tons are up almost 170 thousand tons from the previous year.

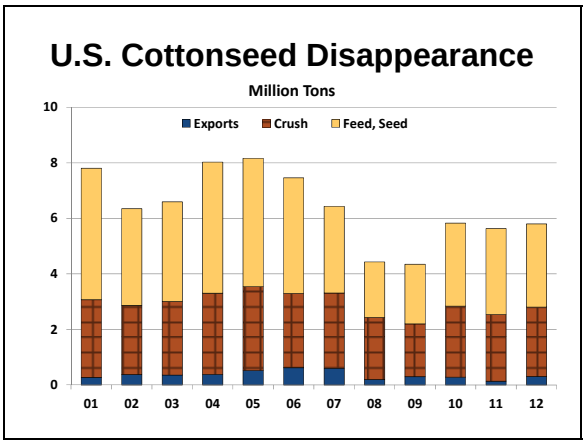

Figure 60 - U.S. Cottonseed Disappearance

However, increased demand is not enough to offset the larger supplies, and cottonseed stocks are projected to increase to 492 thousand tons for the 2012 marketing year (Figure 61).

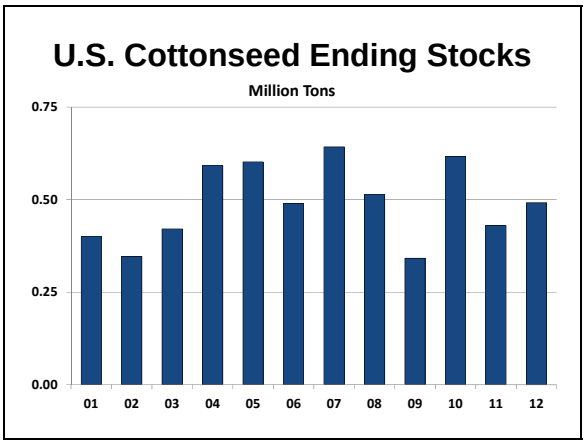

Figure 61 - U.S. Cottonseed Ending Stocks

Cottonseed Prices

The movement in cottonseed prices generally mirrors the changes in competing feed prices more so than the movements in cotton lint prices. During 2012, cottonseed prices remained firm as grain and protein prices were supported by the drought in the Midwest. The U.S. average spot price began 2012 at $278 per ton before advancing to a monthly average high of $328 in August (Figure 62). However, prices moderated thereafter, but still closed the year at $295.

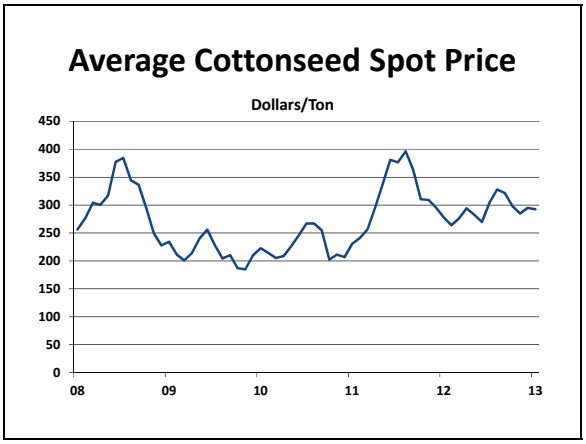

Figure 62 - Average Cottonseed Spot Price

2013 Planting Intentions

Price Prospects

Cotton growers are approaching the 2013 planting season with the December contract trading 10-15 cents below last year's level. As of late January, the December 2013 contract was trading just below $0.80 per pound (Figure 63). At this time last year, the December 2012 contract was between $0.90 and $0.95. Since mid-2012, cotton prices, as measured by the December 2013 contract, have settled into a narrow sideways range between $0.75 and $0.80 cents. Harvest progress and largely-hand-to-mouth purchases are keeping a lid on the upside, while China's reserve purchases are lending support to the downside.

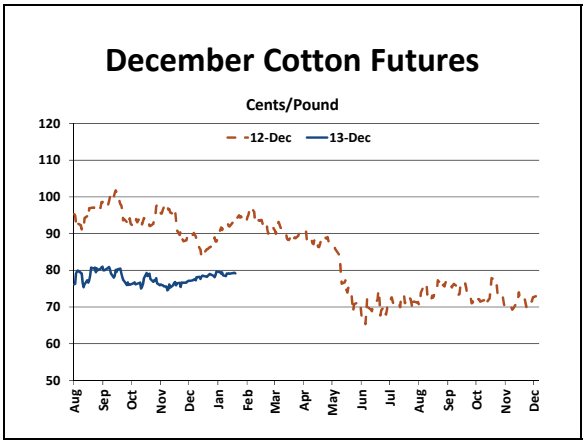

Figure 63 - December Cotton Futures

While cotton prices are lagging slightly behind last year's level, the corn market is trading at slightly higher values when compared to the 2012 contract. As of late January, the December 2013 contract was trading between $5.90 and $6.00 per bushel, as compared to $5.60 for a comparable time for the 2012 contract (Figure 64). The December 2013 contract is also trading at a substantial discount relative to the nearby contracts, which are being supported by the reduced production caused by significant drought conditions in the Midwest in 2012.

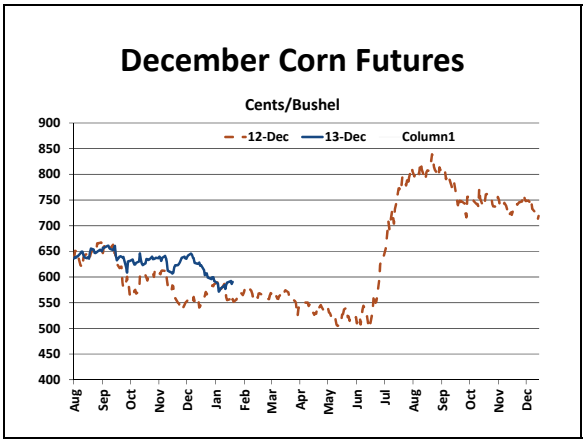

Figure 64 - December Corn Futures

Relative soybean prices present an appearance similar to corn with the November 2013 soybean contract trading at higher levels than the previous year. By late January 2012, the November 2013 contract traded just over $13.00 per bushel, approximately $1.00 higher than the November 2012 contract was trading a year earlier (Figure 65). Since August 2012, the November 2013 contract has ranged between $13.00 and $14.00 per bushel. It is also worth noting that unlike the corn contract, which has declined since November, the 2012 harvest-time soybean contract has moved in more of a sideways range. Soybean prices have also been supported by the reduced production due to the drought in the Midwest. In the near-term, the market will be closely following crop developments in South America. For the coming year, with lower production costs, soybeans are expected to continue to

offer formidable competition for area as diesel and nitrogen prices increase.

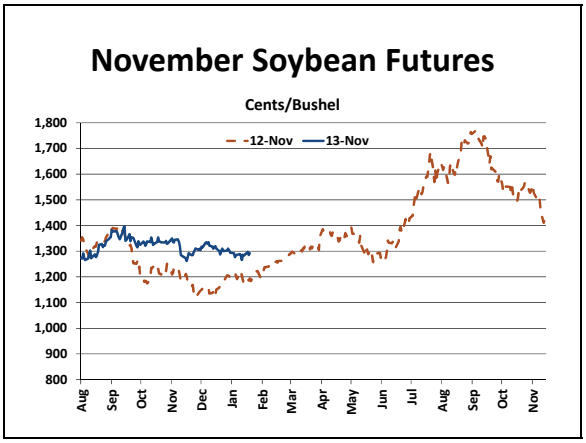

Figure 65 - November Soybean Futures

As growers consider their 2013 planting decisions, they are comparing prices for cotton, corn, soybeans and other regional crops. Growers will also be influenced by production costs, which are lower than the 2008 spike, but will likely increase relative to both 2011 and 2012. While final acreage decisions are influenced by expected returns of cotton and competing crops, farmers will also take into account weather and agronomic considerations such as crop rotation. Continued dry conditions in the Southwest could play a significant role in plantings.

2013 U.S. Cotton Acreage Intentions

In mid-December 2012, the NCC distributed the annual early season planting intentions survey. Respondents are asked to give their plantings of cotton, corn, soybeans, wheat, and other crops for 2012 and intended acreage for 2013. As always, the survey results should be viewed as a measure of grower intentions prevailing at the time the survey was conducted. Changing climate and market conditions could cause actual plantings to be significantly different from growers' stated intentions.

Beginning with the Southeast, survey results indicate a 18.5% decrease in the region's upland area to 2.24 million acres (See Table 4 on page 50), with all states indicating reduced area. Across the 6-state region, North Carolina shows the largest decline at 32.0% with cotton acres moving to soybeans and corn. Virginia follows with a 28.3% decline as survey results indicated a shift to corn and soybeans. Acreage in Alabama and Georgia are expected to be down by 15.7% and 15.3%, respectively. In Alabama, the decline is cotton acreage is due to stronger competition from a double-crop of wheat and soybeans. In Georgia, cotton acreage is primarily moving to corn. Growers in South Carolina indicate a decline of 11.4%, with soybeans being the primary beneficiary of the reduced acreage. Survey results for Florida show the smallest anticipated reduction in acreage at 4.5%. Total 2013 acreage for each of the states is as follows: Alabama at 320 thousand acres, Florida at 103 thousand, Georgia at 1.09 million, North Carolina at 398 thousand, South Carolina at 265 thousand, and Virginia at 62 thousand.

In the Mid-South, survey results show that growers intend to plant 1.00 million acres, a decrease of 50.6% from the previous year. All states indicate fewer acres of cotton relative to 2012, with the largest percentage decline in Arkansas with a reduction of 62.9%. In Arkansas, the shift to soybeans was slightly larger than the shift to corn. Results for Mississippi were similar with a decline of 58.1%, but with corn being the primary recipient of the reduced cotton acres, while soybeans also attracted some acres. Of the remaining states, Tennessee is showing the largest decline at 47.6%. Survey results indicate a move to both corn and soybeans. With a decline of 37.3%, Louisiana shows the next largest drop, with the shift equally split between corn and soybeans. Missouri's expected decline is 31.6%. Total 2013 acreage for each of the states is as follows: Arkansas at 221 thousand acres, Louisiana at 144 thousand,

Mississippi at 199 thousand, Missouri at 239 thousand, and Tennessee at 199 thousand.

Growers in the Southwest are indicating a decline of 24.4%, lowering the regional total to 5.23 million acres. Among the states, Kansas growers intend to plant 50 thousand acres, a 10.4% reduction from the 2012 total of 56 thousand. Acreage in Oklahoma is showing a 12.3% decline as acres are moving to wheat. With the decline in acres, Oklahoma's 2013 cotton acreage is expected to be 267 thousand acres. For Texas, survey respondents intend to reduce area by 25.0%, bringing the state total down to 4.91 million acres. In south Texas, respondents indicated a shift into grain sorghum and corn. Similar shifts were observed in Blacklands, with wheat also picking up cotton area. In west Texas, the acres shifting out of cotton are moving to grain sorghum and wheat.

All states in the West region show decreases in upland plantings, with the region as a whole down 12.2%. In Arizona, intended area of 193 thousand acres represents a 3.6% decrease from the previous year. The expected decrease in acreage is coming in response to reduced price expectations and a shift into the 'Other Crops' category. At the time of the survey, California farmers intend to plant 112 thousand acres (-21.4%), with the decrease due to a shift into grains. California's actual plantings could ultimately be dictated by water costs and availability. New Mexico is reporting intentions of 36 thousand acres, down 21.0% from 2012.

Summing across the 4 regions gives intended 2013 upland cotton area of 8.81 million acres, 27.0% lower than 2012.

With ELS prices down from year-ago levels, survey results indicate that U.S. cotton growers intend to decrease ELS plantings 15.0% to 203 thousand acres in 2013. The results across the four ELS-producing states are mixed as Texas indicated a modest increase of 3.9%, bringing the state's acreage up to 8,300 acres. The remaining states are expecting to reduce area relative to the previous year. Results are as follows: Arizona planting 2,500 acres (-16.0%); California planting 190 thousand acres (-15.6%); and New Mexico planting 1,800 acres (-26.0%).

Summing together the upland and ELS cotton intentions shows U.S. all-cotton plantings in 2013 of 9.02 million acres, 26.8% lower than 2012. (See Table 4 on page 50 and Figure 66)

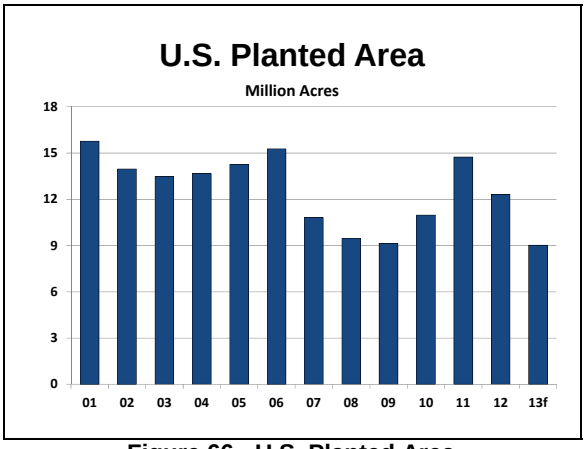

Figure 66 - U.S. Planted Area

2013 U.S. Cotton and Cottonseed Supply

Planted acreage is just one of the factors that will determine supplies of cotton and cottonseed. Ultimately, weather, insect pressures, and agronomic conditions play a large role in determining crop size. Since the NCC economic outlook does not attempt to forecast weather patterns, the standard convention is to assume yields in line with recent trends and abandonment consistent with historical averages. However, early in 2013, portions of the Southwest region continue to be plagued by drought conditions. As a result, abandonment rates slightly above the historical averages are assumed for Texas and Oklahoma. In

addition, yields per harvested acre are adjusted to modestly below trend.

With abandonment in Texas and Oklahoma assumed at 25% (which is only slightly higher than recent averages) and all other states set at historical averages, Cotton Belt harvested area totals 7.65 million acres (Figure 67), which is 15.2% below planted area. Weighting individual state yields by 2013 area generates a U.S. average yield of 807 pounds. This compares to a 2012 yield of 866 pounds and a 2006-10 average yield of 814 pounds. Applying each state's yield to its 2013 projected harvested acres generates a cotton crop of 12.86 million bales, with 12.29 million bales of upland and 570 thousand bales of ELS.

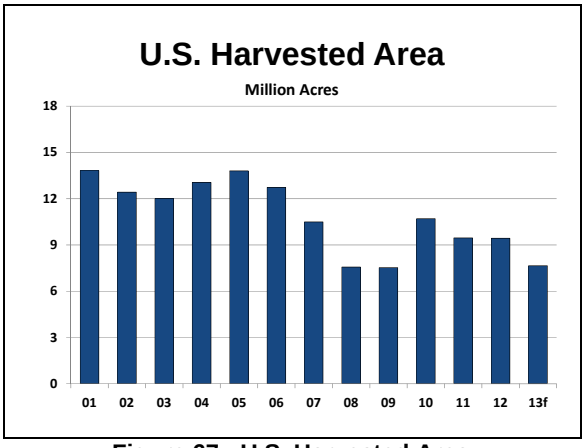

Figure 67 - U.S. Harvested Area

Combining projected production with expected beginning stocks of 4.77 million bales gives a total U.S. supply of 17.64 million bales (Figure 68). This is a decrease of 2.73 million bales from the 2012 level.

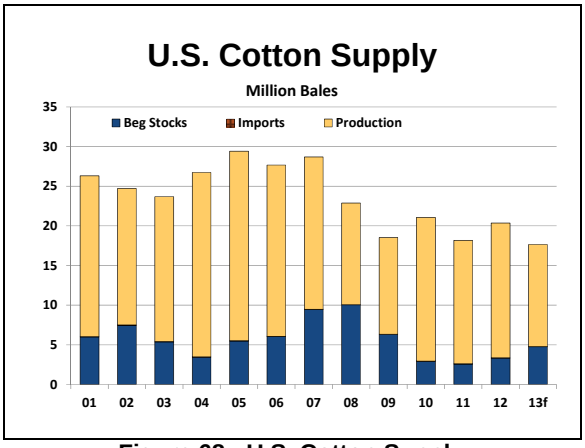

Figure 68 - U.S. Cotton Supply

For cottonseed, multiplying the point estimate of lint production by an average lint-seed ratio generates expected production of 4.38 million tons. With 492 thousand tons of beginning stocks and 100 thousand tons of imports, 2013 cottonseed supply totals 4.97 million tons (Figure 69).

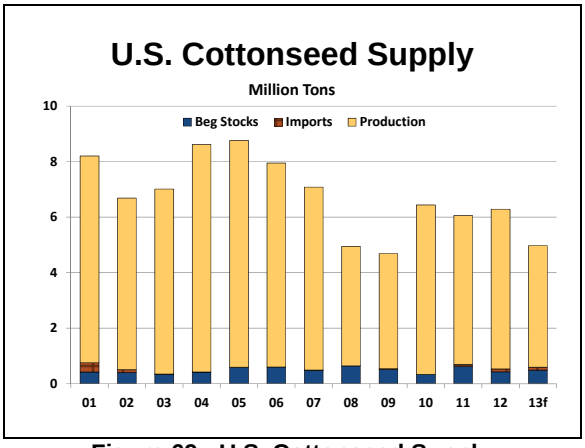

Figure 69 - U.S. Cottonseed Supply

Table 4 - Prospective 2013 U.S. Cotton Area

	2012 Actual (Thou.) 1/	2013 Intended (Thou.) 2/	Percent Change
SOUTHEAST	**2,748**	**2,241**	**-18.5%**
Alabama	380	320	-15.7%
Florida	108	103	-4.5%
Georgia	1,290	1,093	-15.3%
North Carolina	585	398	-32.0%
South Carolina	299	265	-11.4%
Virginia	86	62	-28.3%
MID-SOUTH	**2,030**	**1,003**	**-50.6%**
Arkansas	595	221	-62.9%
Louisiana	230	144	-37.3%
Mississippi	475	199	-58.1%
Missouri	350	239	-31.6%
Tennessee	380	199	-47.6%
SOUTHWEST	**6,911**	**5,228**	**-24.4%**
Kansas	56	50	-10.4%
Oklahoma	305	267	-12.3%
Texas	6,550	4,910	-25.0%
WEST	**388**	**341**	**-12.2%**
Arizona	200	193	-3.6%
California	142	112	-21.4%
New Mexico	46	36	-21.0%
TOTAL UPLAND	**12,077**	**8,812**	**-27.0%**
TOTAL ELS	**238**	**203**	**-15.0%**
Arizona	3	3	-16.0%
California	225	190	-15.6%
New Mexico	2	2	-26.0%
Texas	8	8	3.9%
ALL COTTON	**12,315**	**9,015**	**-26.8%**

1/ USDA-NASS

2/ National Cotton Council

U.S. Market

U.S. Textile Industry

While the U.S. textile industry experienced more job losses in 2012, the rate of losses was lower than in previous years. Preliminary data from the U.S. Bureau of Labor Statistics indicate that textile industry employment in 2012 fell by approximately 2,300 workers. These figures represent employment in all three sectors of the U.S. textile industry - textile mills, textile product mills, and apparel mills.

Mill Use

Mill use of cotton decreased from the previous year and is estimated at 3.39 million bales in calendar 2012, 2.2% below 2011 (Figure 70). For calendar 2013, NCC forecasts domestic mill use of cotton at 3.50 million bales and estimates the 2012 marketing year at 3.43 million bales (Figure 71). NCC projects domestic mill use of cotton at 3.48 million bales for the 2013 marketing year.

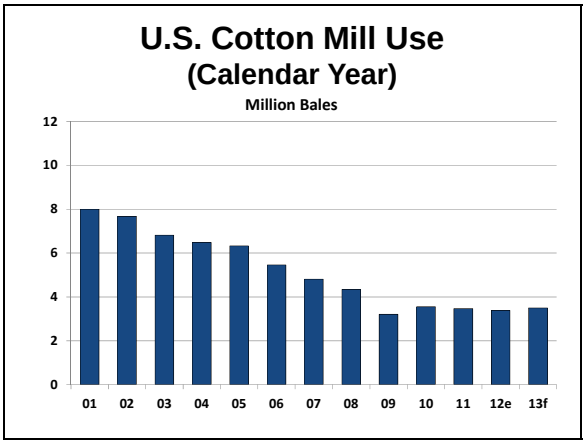

Figure 70 - U.S. Cotton Mill Use (Calendar Year)

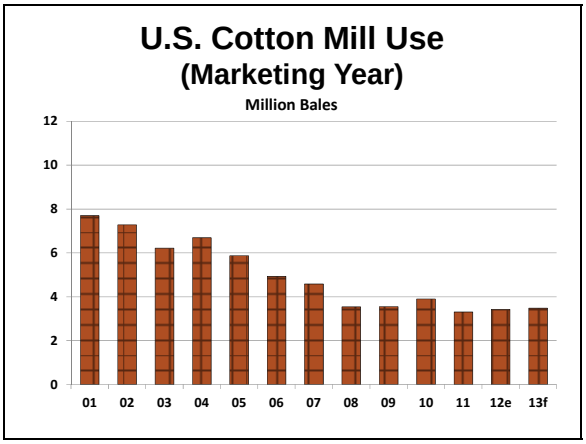

Figure 71 - U.S. Cotton Mill Use (Marketing Year)

While cotton experienced a decrease in mill use in 2012; U.S. mill consumption of manmade fibers increased. NCC estimates mill use of manmade fibers at 15.7 million bales for 2012, an increase of 8.4% from 2011 (Figure 72). Manmade fiber mill use is projected to increase to 16.3 million bales in calendar 2013.

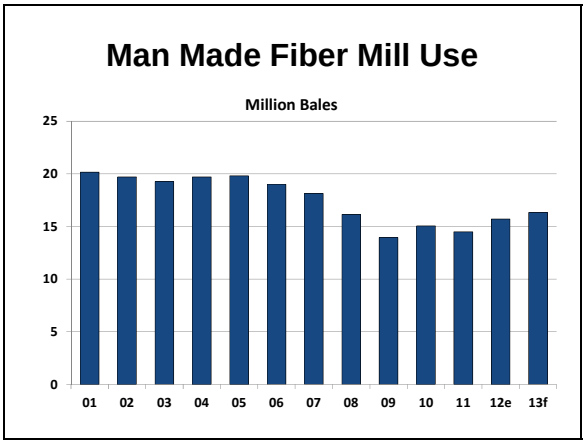

Figure 72 - Man Made Fiber Mill Use

Upland Cotton Economic Adjustment Assistance Program

The Upland Cotton Economic Adjustment Assistance Program (EAAP), authorized in the 2008 Farm Bill, has provided U.S. cotton textile manufacturers with much-needed assistance for capital investments and improvements.

Under the EAAP, from August 1, 2008 through July 31, 2012, domestic users received 4 cents /lb. for all upland cotton consumed. Beginning August 1, 2012 the rate was adjusted to 3 cents/lb. Recipients must agree to invest the EAAP proceeds in plants and equipment. In fiscal year 2012, almost 50 U.S. companies received payments under the EAAP.

Net Domestic Consumption

Net domestic consumption is a measure of the U.S. retail market's size. It measures both cotton spun in the U.S. (mill use) and cotton consumed through textile imports. Total fiber consumption in 2012 is estimated to be 45.1 million bale equivalents (Figure 73). Cotton's share of net domestic consumption decreased 1.8% this past year to 37.7%, which translates to 17.0 million bales. For 2013, NCC projects net domestic consumption of all fibers to increase to 46.9 million bales. With a projected share of 38.0%, cotton's net domestic consumption is projected to be 17.8 million bales.

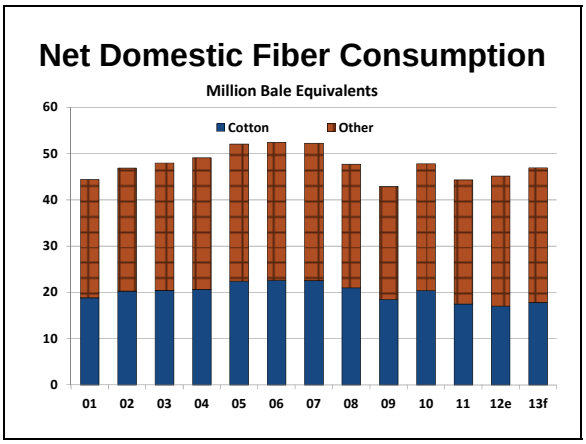

Figure 73 - Net Domestic Fiber Consumption

Imported goods make up the largest portion of U.S. net domestic consumption. Imported cotton textiles decreased from 17.8 million bale equivalents in 2011 to an estimated 17.0 million in 2012 (Figure 74).

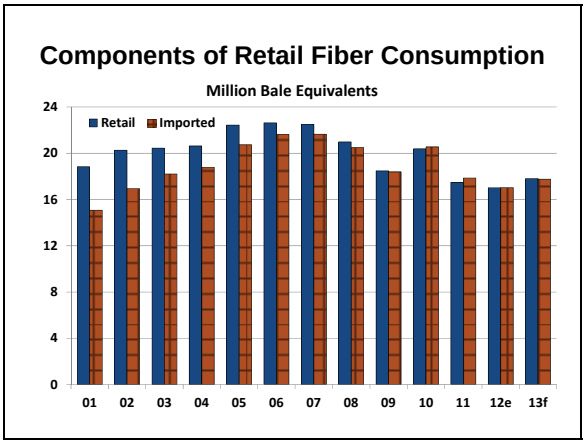

Figure 74 - Components of Retail Cotton Consumption

Textile Trade

Imports of cotton goods in calendar 2012 were estimated to have decreased by 4.6% to 17.0 million bale equivalents (Figure 75). In calendar 2013, NCC projects cotton textile imports to increase to 17.8 million bales.

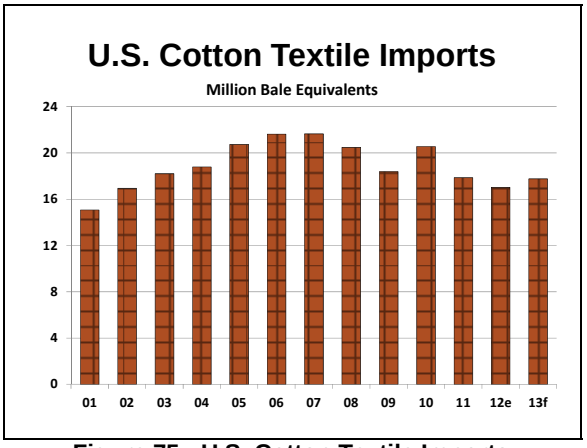

Figure 75 - U.S. Cotton Textile Imports

For imports, it is important to consider that a significant portion of imported goods contain U.S. cotton. Since much of what the U.S. exports to the NAFTA (North American Free Trade Agreement) and the CBI (Caribbean Basin Initiative) countries is in the form of fabric and piece goods that come back in the form of finished goods, the trade gap is not as wide as implied by gross imports and exports. NCC analysts estimate that 27.4% of all cotton goods imported in 2012 contained U.S. cotton. This is a 0.9%

decrease over the previous year. In bale equivalents, these imported cotton goods contained 4.7 million bales of U.S. cotton (Figure 76). This is due, in large part, to our trading partners in NAFTA and the CBI.

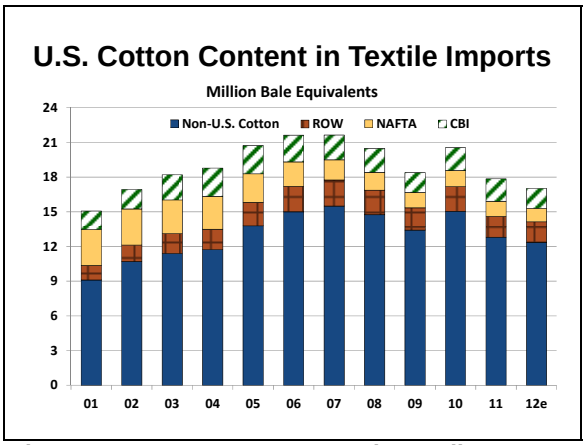

Figure 76 - U.S. Cotton Content in Textile Imports

U.S. Cotton Product Imports

Apparel was once again the largest category of imported cotton goods when compared to yarn, thread and fabric, and home furnishings (Figure 77). Cotton apparel imports were estimated at 12.6 million bale equivalents for 2012, down 5.3% from 2011. Imports of cotton home furnishings (including floor coverings) increased 0.8% in 2012 to an estimated 3.1 million bale equivalents. Cotton yarn, thread and fabric imports decreased 2.9% in 2012 to an estimated 1.3 million bales.

Once again, countries in NAFTA and CBI represented significant sources of imported cotton goods in 2012 (Figure 78). Imports from Mexico in 2012 were estimated at 1.1 million bales, down approximately 9.3% from the previous year (Figure 79). Imports of cotton goods from Canada fell to an estimated 73 thousand bales in 2012, sliding 10.9% from the previous year (Figure 80). Imported cotton goods from CBI for the year were estimated at 2.3 million bale equivalents (Figure 81), down 10.0% from the previous year. The CAFTA-DR countries of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic are all part of the CBI region. Imports of cotton goods from CAFTA-DR in 2012 were 2.0 million, or 87.3% of the cotton textile imports from CBI. Combined, imports from NAFTA and CBI countries decreased 9.8% and accounted for 20.3% of total U.S. cotton product imports in 2012.

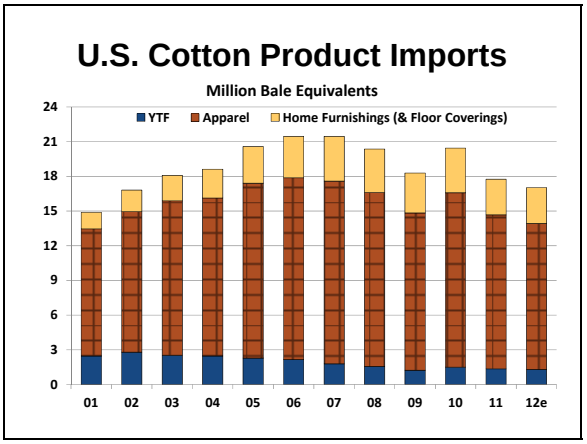

Figure 77 - U.S. Cotton Product Imports

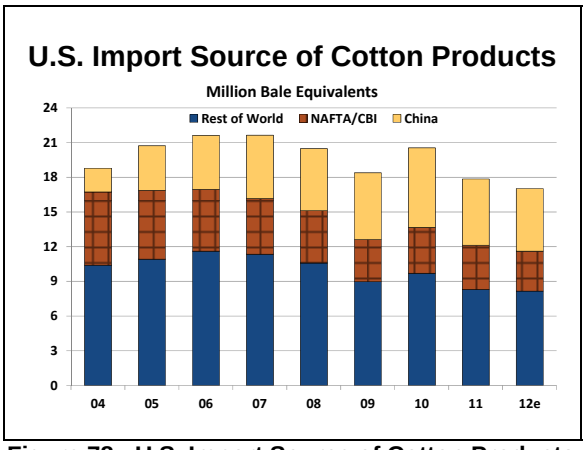

Figure 78 - U.S. Import Source of Cotton Products

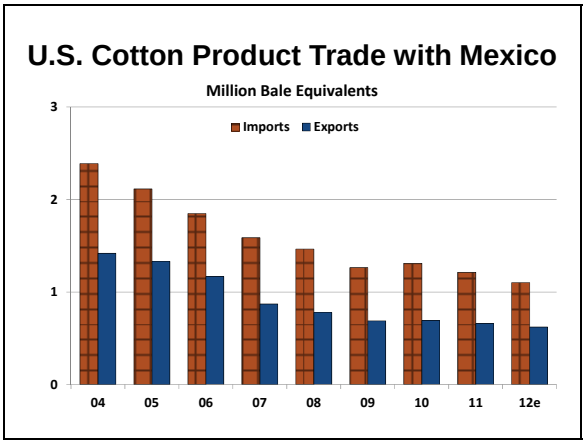

Figure 79 - U.S. Cotton Product Trade with Mexico

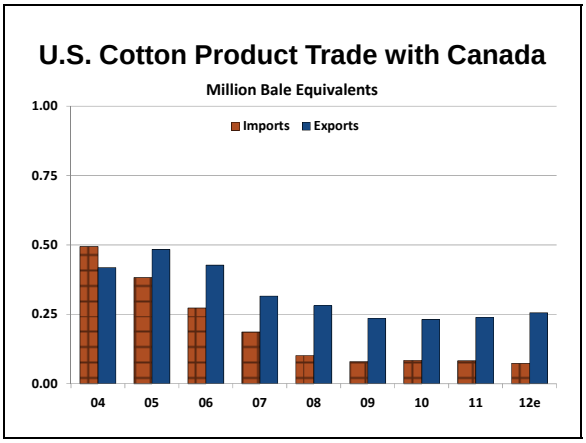

Figure 80 - U.S. Cotton Product Trade with Canada

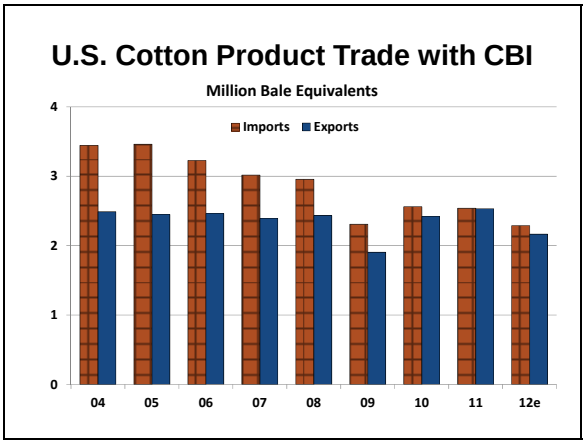

Figure 81 - U.S. Cotton Product Trade with CBI

Other top sources of imported cotton goods in 2012 were China, Pakistan, India, Hong Kong, Bangladesh, Vietnam, South Korea, and Turkey. For the eighth consecutive year, China was the largest supplier of cotton textile imports into the U.S. (Figure 82). However, total cotton product imports from China decreased to an estimated 5.4 million bale equivalents in 2012, down 5.6% from 2011 but up by approximately 558% from 2001 when China entered the WTO. China's share of imported cotton goods in the U.S. market accelerated from 10.9% in 2004 to an estimated 31.8% in 2012.

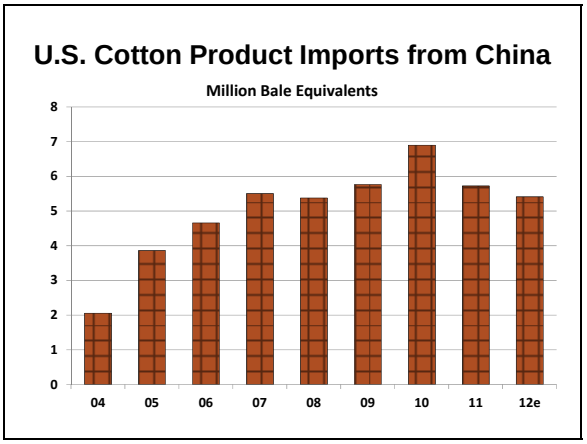

Figure 82 - U.S. Cotton Product Imports from China

Imports of cotton products from Pakistan are estimated at 1.5 million bale equivalents in 2012, a decrease of 104 thousand bales. Since 1997, Pakistan imports have increased 124%. Pakistan slightly lowered its share of imported cotton goods in the U.S. market last year to 8.8%.

Imports from India stood at 1.5 million bale equivalents for 2012. This was a 5.1% increase from last year but a 110% increase from 1997. India now accounts for 8.9% of all U.S. cotton product imports.

Imports from Hong Kong in 2012 were 19 thousand bale equivalents, down 28.9% from 2011. Hong Kong's share of imported cotton goods in the U.S. declined to 0.1% in 2012.

Bangladesh showed an increase in cotton product imports into the U.S. when compared to the previous year. Imports from

Bangladesh in 2012 were up 0.5% from 2011 to 1.1 million bale equivalents. Bangladesh accounted for an estimated 6.6% of all cotton goods imported into the U.S. in 2012.

Vietnam showed a decrease in cotton product imports into the U.S. when compared to the previous year. Total cotton product imports from Vietnam decreased to an estimated 986 thousand bale equivalents in 2011, down 0.3% from 2011. However, Vietnam's share of cotton goods imported into the U.S. in 2012 increased to 5.8%, up 0.3% from the previous year. Cotton product imports from South Korea decreased 0.5% from 2011 to 143 thousand bale equivalents in 2012.

It is important to note in the following discussion that the most reliable data on imports by product category and by country is in the form of square meter equivalents (SME), rather than pounds or bales. Since different products have different weights per square meter, total imports reported in bale equivalents will not necessarily show the same trend as total imports expressed in SME. NCC expresses imports in bale equivalents whenever possible, but the measurement of SME best represents product categories imported from individual countries.

Mexico

Although declining relative to other countries, Mexico remained a large shipper of cotton goods to the U.S. in 2012. Cotton trousers remained the largest category of imported cotton goods from Mexico. Trousers accounted for 34.1% of all cotton product imports from Mexico based on SME (Figure 83). Knit cotton shirts were the next largest category of imports, accounting for 17.9%, followed by cotton hosiery (9.7%) and "other cotton apparel" (8.6%). The U.S. Customs Service category "other cotton apparel" includes items such as waistcoats, swimwear, bodysuits and scarves.

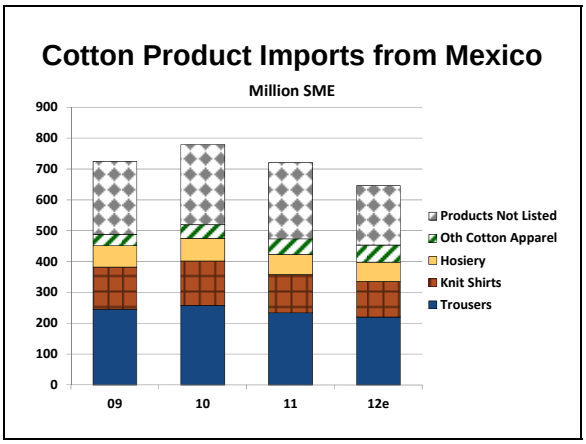

Figure 83 - Cotton Product Imports from Mexico

Canada

U.S. cotton imports from Canada decreased again in 2012. The largest category of imports from Canada in 2012 was "other cotton manufactures", which accounted for 34.3% of total SME of cotton product imports from Canada (Figure 84). The U.S. Customs Service category "other cotton manufactures" includes items such as tablecloths, napkins, dishtowels and pillow covers. The next largest category was "other cotton apparel" with 7.6% of total imports, followed by coats at 4.5% and terry towels at 3.4%.

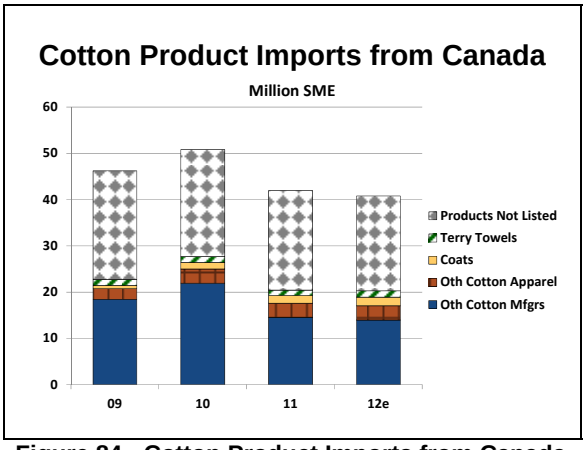

Figure 84 - Cotton Product Imports from Canada

Caribbean Basin Initiative (CBI)

Continuing the recent trend, CBI countries shipped more cotton goods to the U.S. than

did NAFTA countries in 2012. The largest category of imported cotton goods from the region was knit shirts, accounting for 37.5% of total imports, based on SME (Figure 85). Approximately 84.8% of the cotton knit shirt imports from CBI came from the CAFTA-DR countries. The second largest category, underwear, accounted for 34.5% of imports, followed by cotton hosiery (12.8%) and trousers (8.7%). Of these imports, 90.4% of the underwear, almost 100.0% of the cotton hosiery and 91.2% of the cotton trousers were from the CAFTA-DR countries.

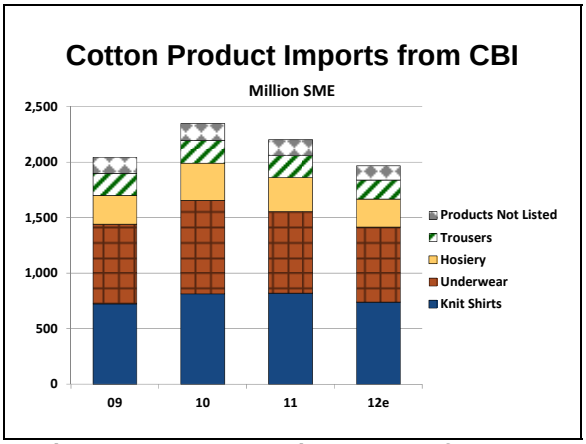

Figure 85 - Cotton Product Imports from CBI

African Growth & Opportunity Act (AGOA)

Over the past year, total cotton apparel product imports from the AGOA region decreased by 5.9% to an estimated 121.4 million SMEs (Figure 86). Also, during the past year, the percentage of U.S. cotton apparel imports from the AGOA region receiving preferential treatment under the act decreased from 94.1% to 92.7%.

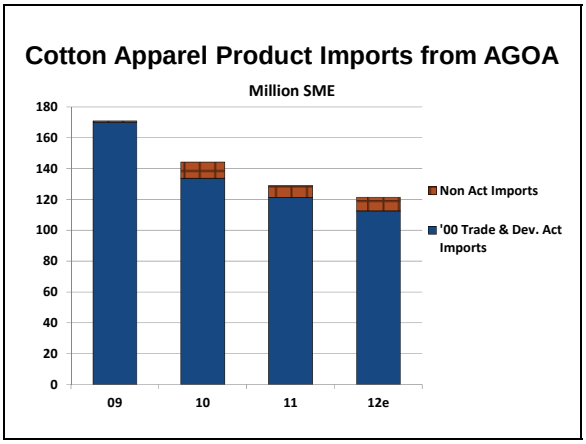

Figure 86 - Cotton Apparel Product Imports from AGOA

Pakistan

The largest category of imported goods from Pakistan in 2012 was "other cotton manufactures" (Figure 87). This category accounted for 40.3% of all cotton product imports from Pakistan based on SME. The second largest category imported from Pakistan was cotton sheets with 13.6% of total imports, followed by bedspreads and quilts (6.7%) and cotton hosiery (4.8%).

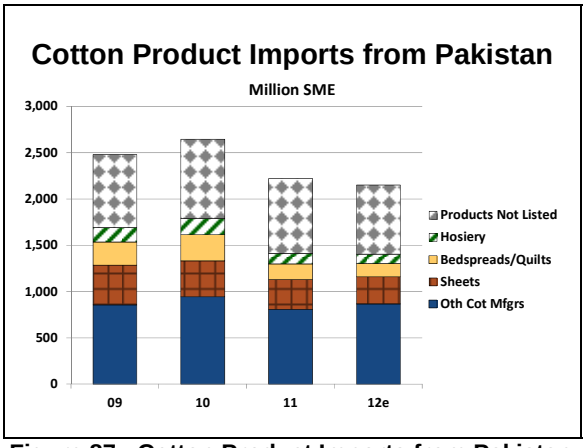

Figure 87 - Cotton Product Imports from Pakistan

China

Again last year, the single largest supplier of imported cotton goods into the U.S. market was China. On a SME basis, the largest category of cotton product imports from China in 2012 was "other cotton manufactures", which accounted for 23.4% of all cotton product imports from that country (Figure 88). Trousers was the

second largest category of cotton imports from China in 2012, comprising 13.2% of total cotton product imports from that country. Knit shirts accounted for 6.0% of U.S. cotton textile and apparel imports from China in 2012. Nightwear was the fourth largest category and accounted for 5.4% of cotton product imports.

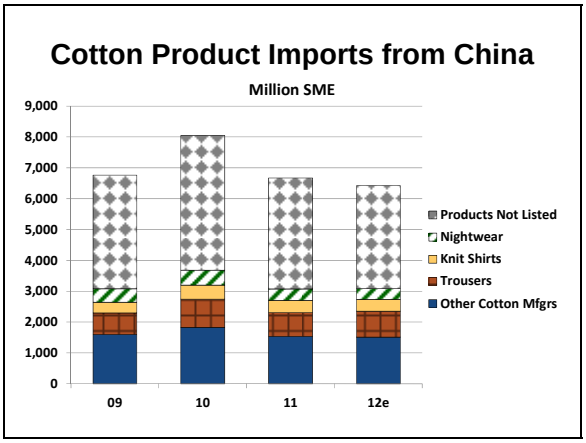

Figure 88 - Cotton Product Imports from China

India

As was the case with Pakistan and China, the largest category of imported cotton goods from India in 2012 was the category of "other cotton manufactures" (Figure 89). When based on SMEs, this category represented 29.5% of all cotton goods imported from India. The next largest category was cotton sheets (16.3%), followed by underwear (6.5%) and knit shirts (5.3%).

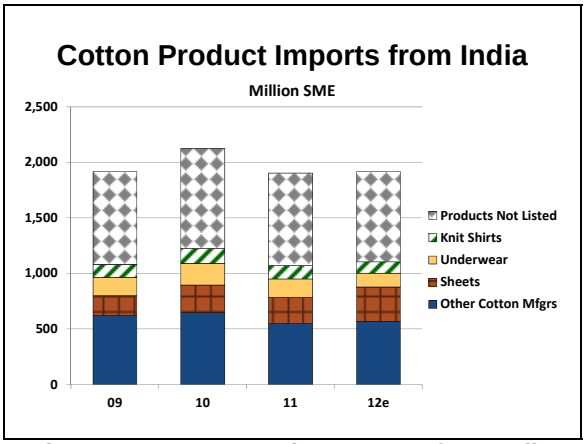

Figure 89 - Cotton Product Imports from India

Hong Kong

Hong Kong's share of U.S. imports has been declining over the past several years. The largest category of imported cotton goods from Hong Kong in 2012 was trousers (Figure 90). When looking at SMEs, trousers accounted for 30.7% of all cotton products imported. The second largest category was "other cotton manufactures" with 14.7% of imports, followed by woven shirts (8.6%) and knit shirts (8.2%).

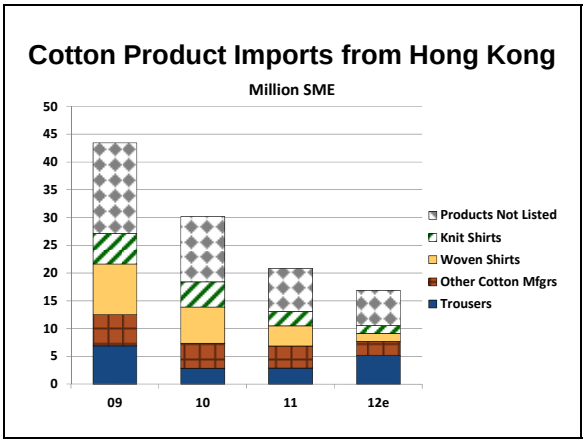

Figure 90 - Cotton Product Imports from Hong Kong

Bangladesh

Based on SMEs, the largest category of cotton goods imported from Bangladesh in 2012 (32.4%) was trousers (Figure 91). The second largest category in 2012 was underwear (16.1%). Cotton woven shirts was the third largest category in 2012, representing 15.6% of total cotton goods imported from Bangladesh, followed by knit shirts at 7.3%.

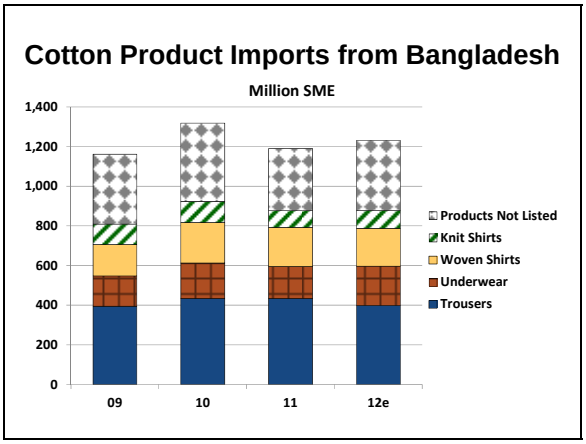

Figure 91 - Cotton Product Imports from Bangladesh

Vietnam

Vietnam continues to be a more significant supplier of cotton product imports (Figure 92). U.S. cotton product imports from Vietnam have increased by over 4,500% based on SME since 2001. In 2001, the U.S. imported 24.3 million SME of cotton goods from Vietnam. This number increased to an estimated 1.1 billion SME in 2012. The largest category of imported cotton goods from Vietnam in 2012 was underwear. Based on SMEs, this category represented 21.5% of all cotton goods imported from Vietnam. The next largest category was trousers (21.0%), followed by knit shirts (19.8%) and cotton dresses (5.8%).

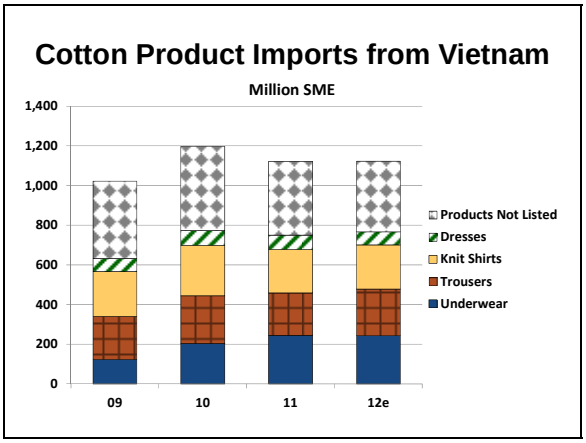

Figure 92 - Cotton Product Imports from Vietnam

South Korea

Based on SMEs, the largest category of cotton goods imported from South Korea in 2012 was cotton sheeting fabric, which accounted for 36.6% (Figure 93). The second largest category in 2012 was combed cotton yarn (32.1%), cotton hosiery (13.4%) and cotton nightwear (2.4%).

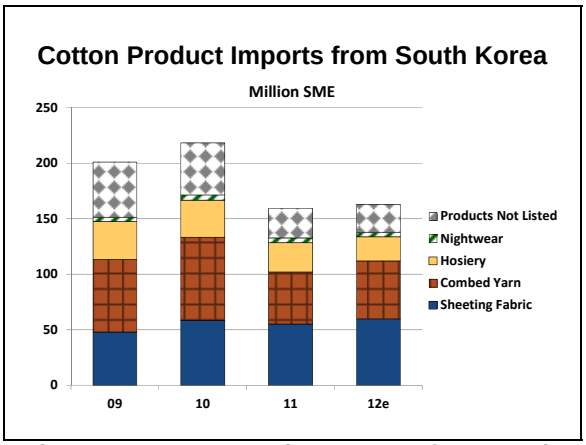

Figure 93 - Cotton Product Imports from South Korea

Turkey

Based on SMEs, the largest category of cotton goods imported from Turkey in 2012 was cotton sheets, which accounted for 29.3% (Figure 94). The second largest category in 2012 was "other cotton manufactures" (18.2%), followed by bedspreads and quilts (6.7%) and cotton trousers (5.3%).

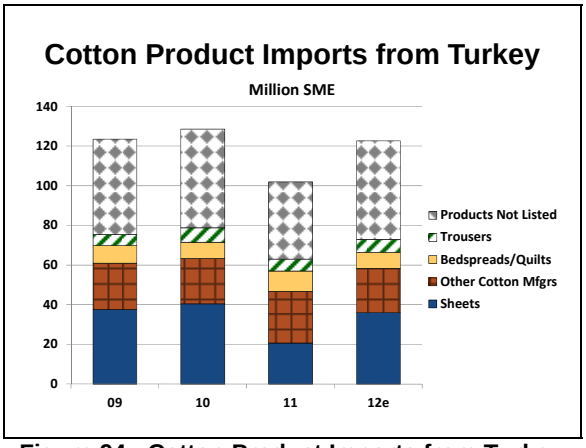

Figure 94 - Cotton Product Imports from Turkey

U.S. Cotton Product Exports

Exports of U.S. cotton textile and apparel products experienced a decrease in 2012 (Figure 95). Exports decreased by 11.5% in

2012 to an estimated 3.4 million bale equivalents. This decrease was due to a decrease in the export category of cotton yarn, thread and fabric (Figure 96). Exports of cotton yarn, thread, and fabric declined by 13.7% to 3.0 million bale equivalents in 2012. Exports of cotton apparel increased by 5.7% in 2012 to 272 thousand bale equivalents. Exports of home furnishings (including floor coverings) rose by 23.6% over the previous year to an estimated 117 thousand bale equivalents. For 2013, NCC projects U.S. cotton textile exports to increase 68 thousand bales to 3.45 million bale equivalents.

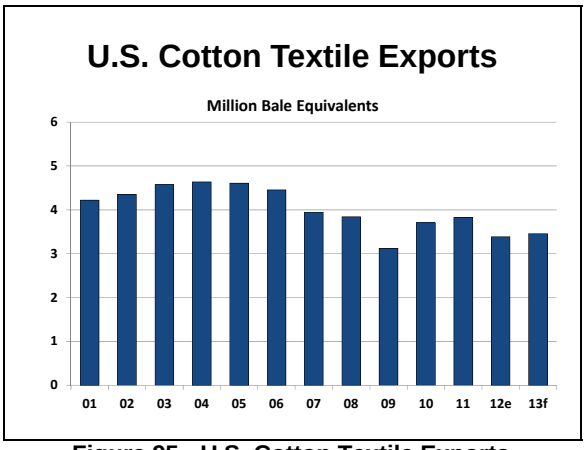

Figure 95 - U.S. Cotton Textile Exports

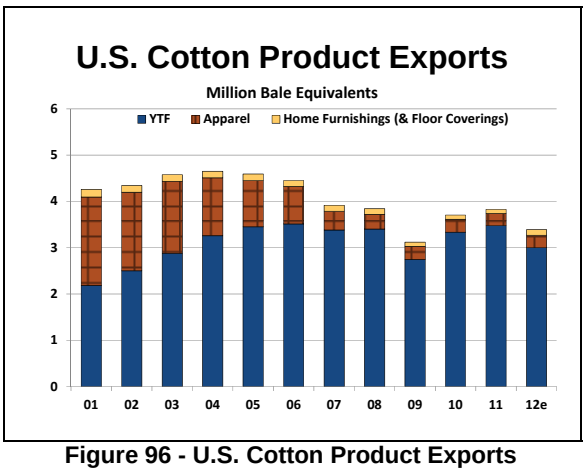

Figure 96 - U.S. Cotton Product Exports

The top customers of exported U.S. cotton textiles and apparel in 2012 were once again the NAFTA and CBI countries (Figure 97). Exports to the NAFTA countries last year totaled an estimated 877 thousand bale equivalents, down 2.3% from the previous year. Exports to the region accounted for 25.9% of all U.S. cotton product exports. Exports to Mexico decreased to an estimated 621 thousand bale equivalents from 658 thousand in 2011. Cotton product exports to Canada grew by an estimated 6.9% to 256 thousand bale equivalents for 2012.

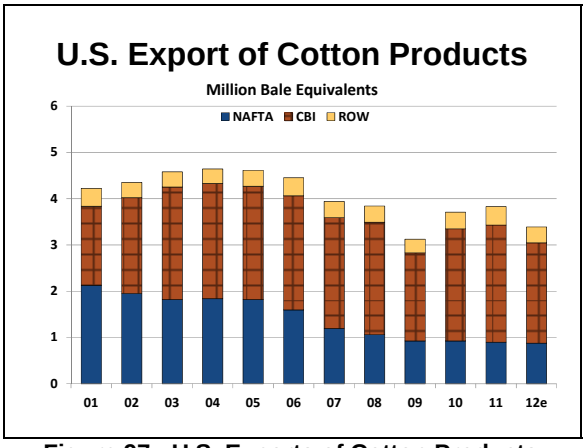

Figure 97 - U.S. Exports of Cotton Products

U.S. exports to the CBI countries declined last year. In 2012, exports decreased 14.4%, totaling 2.2 million bale equivalents or 64.0% of all U.S. cotton exports. Approximately 98.3% of the cotton products exported to CBI went to the CAFTA-DR countries.

World Market Situation

World cotton prices, as measured by Cotlook Ltd.'s "A" Index, ranged between 77.65 and 104.00 cents per pound during the course of calendar 2012 (Figure 98). For the current marketing year-to-date, the "A" Index has averaged 85.08 cents per pound, more than 16.00 cents lower than this time last year.

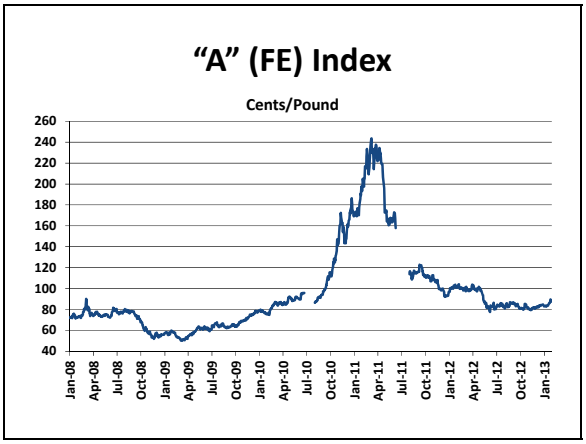

Figure 98 - "A" (FE) Index

World

The 2012 marketing year saw a drop off in terms of cotton production with an estimated world crop of 118.8 million bales (Figure 99). The smaller cotton crop was in part due to fewer harvested acres. China remains the leading producer while India and Pakistan continue to be significant producers. The United States produced a crop of 17.0 million bales, 1.4 million bales higher than the 2011 crop.

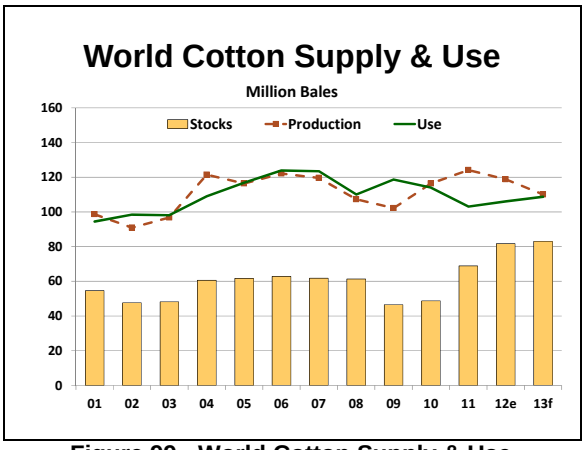

Figure 99 - World Cotton Supply & Use

After falling short of world mill use in the 2008 and 2009 marketing years, world production bounced back above mill use in 2010. This trend continues with the most recent 2011 and 2012 marketing year estimates placing world consumption at 103.1 million bales for the 2011 marketing year and 106.1 for 2012 while production is estimated to be 124.1 million bales for 2011 and 118.8 million bales for the 2012 marketing year.

Production is projected to drop in the 2013 marketing year to 110.1 million bales with an increase in consumption to 108.7 million. Ending stocks will climb to 83.1 million bales resulting in a stock-to-use ratio of roughly 76.4%.

China

China remained the largest cotton producer with a 2012 crop of 33.5 million bales (Figure 100). The crop was 400,000 bales larger than the 2011 crop. The increase was based largely on slightly higher yields.

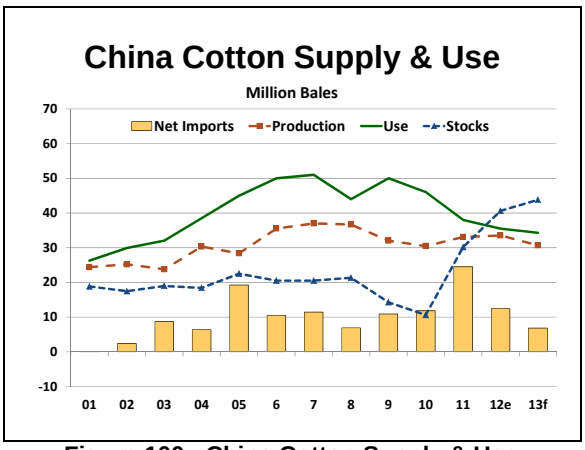

Figure 100 - China Cotton Supply & Use

The Government of China's (GOC) seed subsidy program continued this past crop year. The seed subsidy policy is aimed at stabilizing planted cotton area. It is also expected that cotton quality will be more uniform because selected "high quality varieties", seeds eligible to be subsidized, are likely to increase in use. Given the large cotton production-consumption gap and the importance placed on maintaining a stable planting area, the policy is assumed to remain in place for the foreseeable future.

In general, China's average cotton yield by individual province varies significantly. For the 2011 crop year, the average yield was estimated to be roughly 1,191 pounds per planted acre. For the 2012 crop year, yields are expected to increase slightly to 1,251 pounds per planted acre. Overall, technology advancements in recent years have improved cotton yields in China. Yields are expected to remain generally stable over the next few years. Biotechnology (Bt) cotton use remained constant in 2012, supported by the cottonseed subsidy program. Some experts believe that Bt variety coverage reached 100 percent in Henan, Hebei, Shandong, and Anhui Provinces. Additionally, China's Ministry of Agriculture (MOA) plans to encourage increased usage of the domestically developed "3-line Cross-bred Bt Cotton Varieties" which reportedly increases yield by 25% compared to conventional varieties. According to the China Academy of Agricultural Science (CAAS), this domestic variety was planted on 300,000 hectares during the 2011 crop year and an even greater number of cotton acres in 2012.

However, Bt may not be the answer for all Chinese producers. In Xinjiang, Bt varieties are reportedly not planted due to fewer outbreaks of diseases and pests. The development of conventional varieties with specific traits such as dwarf plant size and early maturity are expected to continue boosting yields. Expanded application of advanced techniques including high density sowing, plastic sheet covering and drip irrigation technology will contribute to additional yield gains. These advancements are particularly significant for Xinjiang Production Construction Corporation (PCC) farms due to their organized farming on larger scale farms. However, some advances don't always result in an increase in yields. An increased use of mechanized harvesting equipment, in an attempt to reduce growing labor costs, reportedly reduced overall cotton yield in Xinjiang. The mechanized harvesting created more loss than the traditional hand picking.

China's MOA has set an annual production target for the 2011-2015 crop years of roughly 32.0 million bales on planted area of approximately 13.0 million acres. However, producers face rising input costs and intensive labor demands, making it one of the most difficult and least profitable crops in China. To offset plunging competiveness with other crops and influence farmers toward cotton production, the government provides income subsidies in the form of a minimum purchase price for classified, quality cotton and controls imports. In recent years, this domestic floor price has exceeded world price which has enticed the majority of the domestic cotton crop to flow into government inventory. China's high

reserves introduce a large source of uncertainty into the market as to how and when China will release the cotton.

Despite the continued support of the Chinese government, a drop in cotton production is expected in 2013. China's 2013 harvested cotton area is projected at 12.4 million acres, down more than 450,000 acres from 2012. Assuming trend yields, China is projected to remain the world's largest cotton producer with a projected 2013 crop of 30.7 million bales.

Along with being the world leader in cotton production, China is also the largest consumer of raw cotton. China's textile industry remains one of China's "pillar industries". According to China's 12th Five Year (2011-2015) Plan, the textile industry employs over 23 million people and will focus on restructuring and upgrading its infrastructure. According to China's National Statistics Bureau (NSB), fixed asset investment in the textile industry in 2011 stood at $56.4 billion, up 30.9% over 2010.

While the current government policy has supported prices received by farmers, the policy acts as a tax on textile mills and has furthered the shift to manmade fiber. Over the 2009 through 2012 marketing years, mill use in China declined by almost 15 million bales. Over that same period, China's use of manmade fiber grew by 40 million bales, dropping cotton's market share from 30% to 19%. Although no official announcement has been made regarding the policy for 2013, this outlook assumes that the government support price remains at a level comparable to 2012. Continuing to operate the program in a manner similar to the past year will maintain the pressure on cotton spinning mills. As a result, mill use for the 2013 marketing year is expected to decline further falling to 34.3 million bales.

With the support price well above world market prices, the vast majority of China's domestic production will enter government reserves. From the 2012 production of 33.5 million bales, current information suggests that more than 28 million bales will be purchased by the reserves. A similar scenario is assumed for the 2013 crop.

As is the case for the current marketing year, the most important unknown is the extent to which China releases cotton from the reserves. If China's textile mills are to continue to consume between 34 and 35 million bales of cotton, then there will be either significant sales from government reserves or significant imports from the world market. In the 2011 marketing year, it was the case that the Chinese government was only a buyer and not a seller. As a result, 20 million bales from the 2011 crop were placed in reserves and the shortfall in domestic supplies was satisfied with imports of 24.5 million bales.

In the current marketing year, the government has commenced sales from the reserves. For the marketing year as a whole, it is assumed that 3.5 million tons, or 16.1 million bales, are released from reserves. Even with significant sales, total imports by China are estimated at 12.5 million bales. Total cotton in government reserves on July 31, 2013 would stand at 33.8 million bales, which is 95% of mill use. For the 2013 marketing year, China's decision regarding sales from the reserves and the allocation of import quotas/licenses is the key uncertainty in outlook.

In this outlook, China is expected to sell 21 million bales of cotton during the course of the 2013 marketing year. When coupled with purchases of 26.1 million bales from this year's crop, China will continue to build government reserves, holding 38.8 million bales on July 31, 2014. In order to supply projected mill use of 34.3 million bales,

China must import 6.8 million bales, which includes the WTO-required cotton of 4.1 million bales. Under this scenario, total imports for the 2013 marketing year are slightly more than half the import level for the current marketing year.

India

The latest estimates have India producing 25.5 million bales for the 2012 marketing year (Figure 101). If these estimates hold, the 2012 crop will be 2.0 million bales lower than the 2011 crop.

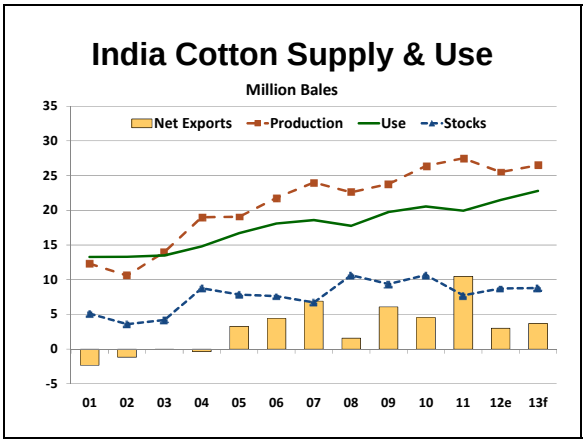

Figure 101 - India Cotton Supply & Use

Cotton production has been a major success story in Indian agriculture as production more than doubled from 10.6 million bales in the 2002 marketing year to a then record 24.0 million bales in 2007. Since 2007, cotton production in India has averaged over 25.0 million bales per year. India now accounts for about a third of global cotton area. Within India, two-thirds of the cotton crop is produced in the central cotton growing zone in the states of Maharashtra, Madhya Pradesh, Gujarat and Odisha where much of the crop is rain fed. The Northern zone, which consists of the states of Punjab, Haryana and Rajasthan, produces cotton under irrigated conditions and accounts for about 15 percent of production. The Central and Southern zones typically grow long duration cotton that allows farmers to reap multiple pickings or harvests. While the number of pickings has declined as traditional varieties have been replaced by biotech hybrids, producers can still get up to five pickings per plant depending on weather conditions. In contrast, the irrigated cotton in the northern zone is mostly a short duration crop that fits into a cotton-wheat rotation. The production growth in recent years has been largely fueled by rapid gains in productivity. Cotton yields have gone from 269 pounds per acre in 2002 to 423 pounds per acre in 2012. The rapid growth in yields can be attributed to the introduction and expansion of Bt cotton and improved hybrid cotton varieties, improved crop management practices and overall favorable weather conditions.

However, it should be noted that the upward trend in yields has slowed since 2008. With the area under Bt cotton and improved varieties reaching an estimated 92% of total area and over 95% of India's cotton production, prospects for future productivity growth is limited as most cotton is grown under rain-fed conditions and on small size land holdings. Although potential exists for a further increase in yields, cotton farmers will have to invest more in production technologies to improve management of irrigation, usage of fertilizers and micro nutrients, and control of pests and diseases. If prices remain firm and cotton area expands, industry sources suggest that India's cotton production could peak at somewhere over 30.0 million bales within in the next few years.

Assuming normal weather and a slight bump in yields, India's cotton production is forecast at 26.5 million bales in 2013. This is over 1.0 million bales higher than the 2012 crop.

India's mill consumption is estimated to reach 21.5 million bales in the 2012 marketing year, up 1.6 million bales from the previous year.

On a macro level, India's economy continues to expand which bodes well for domestic demand for textiles. If this trend continues to hold true, then India's mill use should grow to 22.8 million bales in the 2013 marketing year.

India is expected to continue as a net exporter. Most exports are expected to be medium-to-long staple cotton to China, Bangladesh and East Asian countries. However, India will likely continue to import ELS and quality long staple cotton, with occasional imports of short staple cotton when international prices are favorable. The United States has been the leading supplier of cotton to India over the past few years. Indian mills importing U.S. Pima and upland cotton recognize its quality and consistency, and are ready to pay some premium over competing origins. However, U.S. cotton faces competition from neighboring suppliers like Egypt, West Africa, the Commonwealth of Independent States (CIS), and Australia due to their freight advantage and shorter delivery periods.

In terms of overall trade, for the 2013 marketing year, India is expected to export 5.3 million bales of cotton, 770,000 bales more than the previous crop year. Imports will grow to 1.6 million bales, 100,000 bales higher than the 2012 crop year.

Uzbekistan

Current estimates put Uzbek cotton production at 4.3 million bales for 2012 (Figure 102), up 100,000 bales from the previous year. Cotton has been the cash crop in Uzbekistan for generations and a significant source of employment and foreign exchange. Currently, all state farms have been privatized and reorganized into private farms. In spite of implementing structural reforms in the agricultural sector, the government still maintains tight control over all aspects of production including planted area, production targets, prices, inputs, procurement and marketing of nearly all of the cotton in Uzbekistan.

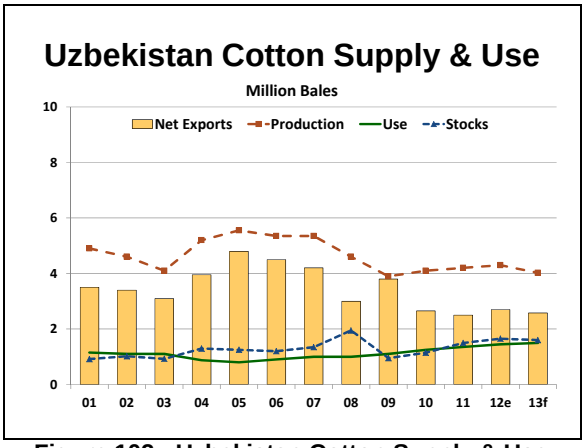

Figure 102 - Uzbekistan Cotton Supply & Use

The government's overall cotton policy is still aimed at maintaining stable production, improving quality and fiber characteristics.

For the 2013 marketing year, Uzbek cotton production is projected to fall by roughly 309,000 bales to an estimated 4.0 million bales.

In terms of Uzbekistan's domestic lint consumption, the government has often stated that it would like Uzbekistan to process more of its cotton domestically. The spinning and weaving industries continue to invest heavily in new equipment as well as to renovate existing equipment due to improving profitability over the past few years. Domestic demand increased marginally over the last two years, and so did export demand, especially for cotton yarn and textile garments. The main player in this industry is "Uzbekengilsanoat", a State Joint Stock (SJS) Company which unites 265 textile, sewing and knitting enterprises most of which are joint ventures. The total annual capacity of these companies is 373,000 tons of cotton yarn, 282 million square meters of cotton fabric, 82,000 tons of knitted fabric, and 168 million pieces of

garments. Within the recently approved Government decree, "Uzbekengilsanoat" SJS Company plans implementation of 55 new investment projects for the amount of 1.7 billion USD, including the creation of vertically integrated textile complexes with finished outputs. As a result, Uzbek domestic cotton consumption is estimated at 1.5 million bales in the 2012 marketing year. For 2013, Uzbekistan's mill use is projected to remain relatively unchanged at 1.5 million bales.

According to government policy for the next few years, exports of cotton are projected to decrease to fifty percent of total production, which is planned to be achieved by considerably increasing domestic consumption. However, independent experts believe that this will be a slower process than the Uzbek government anticipates. Currently, a well-established local system of logistics, consisting of 21 specialized cotton terminals with a storage capacity of 410,000 tons and a good transportation infrastructure and shipment corridors facilitate timely deliveries of Uzbek cotton to buyers. Asia, with Bangladesh, China, South Korea and Russia, is still the major market for Uzbek cotton. With those markets, Uzbekistan will remain a net exporter of cotton for the foreseeable future exporting an estimated 2.6 million bales of cotton in the 2013 marketing year.

Pakistan

Pakistan is the world's 4th largest producer and 3rd largest consumer of cotton and also one of the largest exporters of cotton yarn in the world. Cotton is the country's most important non-food cash crop and is considered the backbone of the national economy and the lifeline of Pakistan's textile industry. It contributes 1.4 percent to GDP and 6.9 percent to the total value addition in agriculture. The textile and clothing industry remains the main driver of the economy in terms of revenue generation and job creation. Cotton production supports Pakistan's largest industrial sector, comprised of over 400 textile mills, 1,000 cotton gins, and 300 cotton seed oil crushers and refiners.

Pakistan's cotton crop is traditionally planted from late April through June and is harvested in the fall. Planting area and production strategy is influenced by a number of factors including international and domestic market trends, relative prices of competing crops, input availability, weather forecasts, and government policy. In most of Pakistan's cotton growing areas, early sowing of cotton, especially with biotech seeds, is steadily increasing. It is expected that during the current crop year, early sowing covered 15 percent of the total area under cotton. Almost all of this early sowing was planted with Bt varieties. Farmers have adopted this technology because early-sown cotton has a better chance of resisting Cotton Leaf Curl Virus (CLCV) and other pest attacks. Also, plants attain enough strength to endure heavy monsoon rains and heat stress. This change in cropping pattern, however, does have repercussions as it is likely to impact wheat and sunflower planted area.

In 2012, cotton production was estimated at 10.0 million bales. A slight decline in production is expected for the upcoming marketing year as planted area declines. Assuming normal weather conditions, low pest infestation and good prices, production is projected to be roughly 9.7 million bales in 2013 (Figure 103).

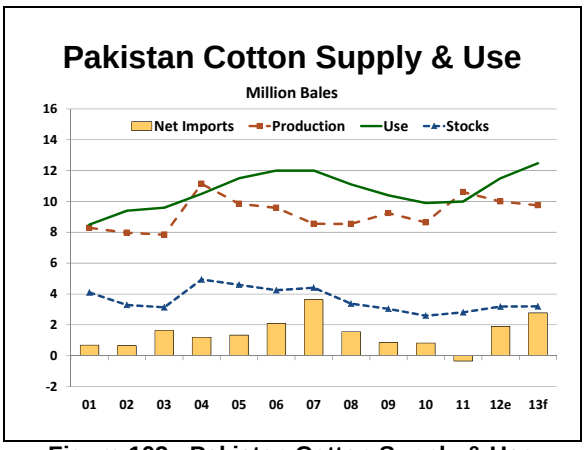

Figure 103 - Pakistan Cotton Supply & Use

Little growth was seen in Pakistan's consumption numbers between 1991 and 1998, averaging 6.9 million bales. However, cotton mill use increased sharply in 1999 in response to aggressive export pricing of cotton yarn. After nearly a decade of growth, consumption fell to 11.1 million bales in 2008, down roughly 900,000 from the previous year. Since that time, mill use has ranged between 9.9 million bales and 11.5 million bales.

Synthetic and artificial silk yarn continues to gain acceptance among consumers seeking less-expensive blended products. The future growth in cotton versus synthetic fiber will be determined by the relative prices of the products. Share of synthetics is gradually increasing. Cotton-synthetic blends are popular due to their durability and ease in washing and maintenance. Despite these obstacles, Pakistan's mill consumption is projected to grow to roughly 12.5 million bales for the 2013 marketing year.

Pakistan is a net importer of cotton due to strong domestic demand for better grades of cotton. Pakistan remained a net importer of cotton with 1.9 million more bales of cotton imported than exported during the 2012 marketing year. With growing demand for better quality fabrics for the export market and specialized products for the domestic market, Pakistan's textile industry is expected to increasingly rely on imported U.S. Pima cotton and contamination-free upland cotton for the production of higher quality textile products. Pakistan is one of the largest importers of U.S. Pima cotton, particularly for its specialized export industry.

Pakistani firms often import upland cotton for their export programs due to contamination problems in local cotton, particularly with alien fibers, mainly polypropylene and jute. The problem occurs during harvesting and handling. The inclusion of these fibers wreaks havoc in the industry by creating yarn with differential strength and differential dye uptake. Estimates are that contamination increases a mills' cost by 10% or more. Some mills have standardized their blend for export markets, with a predefined origin and percentage of imported cotton in the product. Importers of long staple cotton prefer U.S. origin cotton due to high quality standards. These practices should keep Pakistan a net cotton importer in 2013. Cotton net imports for the 2013 marketing year are expected to be 2.8 million bales.

Turkey

Most of Turkey's cotton is planted between mid-March and mid-May and harvested from mid-August through November. The crop is grown in three main areas: the Aegean region, Cukurova, and Southeastern Anatollia. Small amounts of cotton also are produced around Antalya.

For the 2008 marketing year, Turkey produced an estimated 1.9 million bales (Figure 104). The 2008 marketing year was a difficult year for Turkish cotton growers due to a lack of water and price increases for all agricultural inputs including petroleum, fertilizer, and electricity. In addition to higher input prices, better returns for wheat and corn production, a lack of irrigation

water, and lower than expected government payments for cotton also contributed to the drop in cotton production.

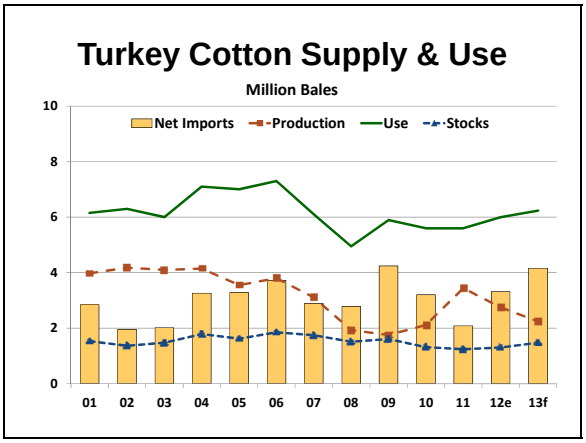

Figure 104 - Turkey Cotton Supply & Use

Turkish cotton area and production declined for the third consecutive year in 2009 to an estimated 692,000 acres harvested with 1.8 million bales of production. The continued decline in cotton area and production was the result of low farmer returns on cotton and expectations of better returns on wheat and corn or wheat and corn rotations. In contrast to 2008, when lack of irrigation water was a source of concern, all cotton growing regions received adequate precipitation, and reservoirs had sufficient water for irrigation for the 2009 growing season. In spite of the favorable weather, farmers planted less cotton because of high input costs, low local prices and no effective production support system.

For the 2010 marketing year, with increased acres and improved yields due to improved planting techniques and increased utilization of certified seeds, cotton production increased to 2.1 million bales. Estimates for 2011 show production increased 1.3 million bales due in large part to increased cotton acreage. Production is estimated to decline to 2.8 million bales in 2012, due in part to a decline in acreage. For 2013, production continues to follow this trend of lower production with an estimated 2.2 million bales, and fewer acres, an estimated 828,000 harvested acres, down roughly 160,000 acres.

The textile and garment industries continue to be crucial to the Turkish economy. Investments by the Turkish textile industry since 1985 are estimated at about $90 billion USD. When the new investments are finalized, production capacity is estimated to reach 6.5 million spindles and 650,000 rotors in Turkey. Domestic cotton is mainly sold directly to mills and the remainder is traded on a spot basis at the exchange in Izmir. Mill use for the 2013 marketing year should increase modestly to 6.2 million bales, while imports increase to 4.4 million bales.

Australia

Australia's crop was 640,000 bales in 2007, the smallest crop in over 20 years. Production in 2008 rose to 1.5 million bales of cotton, an increase of 860,000 (Figure 105). Much needed rainfall in key regions greatly improved the irrigation water supplies leading up to the 2008 marketing year. The increase in harvested area accounts for the increase in production.

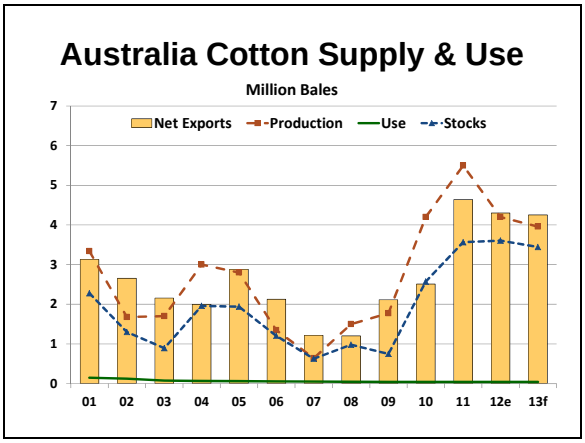

Figure 105 - Australia Cotton Supply & Use

With timely rains, Australia continued to improve production with a 2009 crop estimated at 1.8 million bales. Australia appears to have fully recovered from the

long and severe drought which began in 2002.

A return to more normal weather conditions in the lead-up to the 2012 crop year played a role in the decline in the area planted to dry-land cotton, down sharply from what is considered a record year in terms of area planted. Irrigated cotton planting, however, was believed to increase. The increase was thought to be driven by new growers who have never grown cotton before or who have grown only small areas of cotton and are now growing larger areas. Many of these new cotton growers would previously have grown rice. A growing number of farmers have shifted to cotton production, as the introduction of biotech cotton has rendered the crop "easier" to grow than was the case for conventional cotton which typically required six to eight herbicide applications throughout the growing season.

Current estimates put Australia's cotton production at 4.2 million bales for the 2012 marketing year. A return to a more normal weather pattern puts Australia's cotton production at roughly 4.0 million bales in 2013.

Australia exports virtually all of their cotton production. For the 2012 marketing year, exports are estimated to reach 4.3 million bales. With production hovering around the 4.0 million bale mark during the 2013 marketing year, exports are expected to remain virtually unchanged at 4.3 million bales.

Brazil

According to USDA's GAIN reports, Brazil's National Technical Commission of Biosafety (CTNBio) has approved nine biotech cotton events for commercial use. The single event varieties include: Bollgard (Bt1), Roundup Ready (RR1), Liberty Link (LL) and Widestrike. However, these single-event genetically-engineered varieties do not provide broad protection against regionally specific pests and disease. There were also limited quantities of the only approved double-stacked trait variety Roundup Ready Bollgard cotton (RR1XBt1). Sources confirm biotechnology adoption for cotton in Brazil should reach 40% in 2012, mostly Liberty Link, compared to 60-80% in most other cotton producing countries. It is estimated that the use of genetically engineered cotton only reached 25 percent of total planted area in 2011. Liberty Link has had the most success as it has been utilized in a crop rotation to combat build-up of Roundup resistant weed pressure. However, it appears a one-time rotation has been common practice as some producers deem continued yearly use too expensive given the combined cost of the seed technology fee and of the herbicide "Finale." In addition, there have been concerns related to the quality of the seed and its performance. Robust research and development of region-specific seed varieties, a two year process, promise improved yields and crop management in the near future. Producers also anticipate in 2 to 3 years the benefits of second generation double-stacked trait seed varieties, such as, insect resistant (Bt2) and herbicide tolerant (RR2). Adoption of genetically engineered (GE) cotton varieties are expected to spike and surpass 80% once the desired traits are made available to producers.

Despite the adoption of new biotech cottonseed varieties and continued support in the form of government programs, the 2012 crop saw reduced cotton acreage as cotton prices were not as competitive with soybean prices. Current estimates place production for the 2012 marketing year at 6.5 million bales (Figure 106). For the 2013 marketing year, harvested area is estimated at 2.3 million acres, down 216,000 acres from 2012. Lower area will result in a

production estimate of 6.1 million bales in 2013.

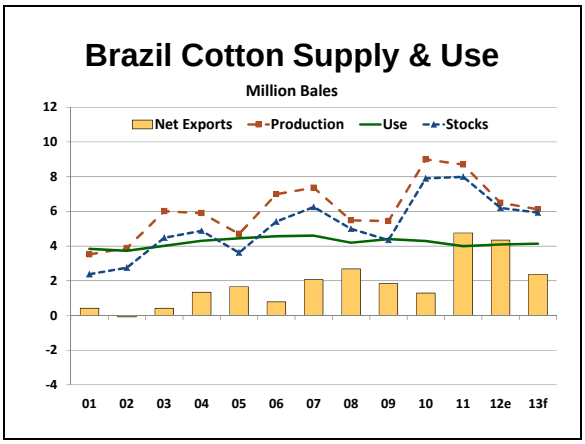

Figure 106 - Brazil Cotton Supply & Use

Brazilian mill use for the 2012 marketing year was up 100,000 bales to 4.1 million bales. Brazilian cotton consumption will remain stable in the 2013 marketing year with mill use estimated at 4.1 million bales.

In terms of trade, Brazil is expected to export 4.4 million bales of cotton in the 2012 marketing year. For the 2013 marketing year, exports are expected to drop 2.0 million bales to 2.4 million bales.

West Africa

In the West African cotton-producing countries, cotton production continues to play an important role in the economy. A farmer's decision to grow cotton depends on several factors, including payment received for last year's crop, procurement and distribution of inputs, access to input credits and national pricing policy. Government policies and farmers' associations are pushing aggressive seed cotton production goals by addressing these factors. As a result, cotton production in 2012 increased over 1.0 million bales to 4.1 million bales.

There are a few developments on current activities in the cotton sector in Burkina Faso. During a meeting that took place in early April 2012, the following issues were addressed: organizational and institutional arrangements in the cotton sector; seed cotton farm gate price fixing mechanism and smoothing mechanism; and inputs supply procedures, pricing and credit. This event assembled more than 450 partners involved in the cotton sector including the Government of Burkina Faso, donors and the private sector.

In Mali, The Compagnie Malienne pour le Developpement des Textiles (CMDT), a state-owned company for the development of textiles, monopolizes the country's cotton production. Since 2008, the government of Mali has tried to privatize CMDT. CMDT has not completed the privatization process of its four subsidiaries. The bidding process started in 2010 and the Chinese company, Yue Mei, was selected last year to buy two subsidiaries located in the west (Kita region) and south (Sikasso and Bougouni regions). This had been slated to be completed by the end of 2012, but this is uncertain. The two other subsidiaries located in the center (Fana region) and northeast (Koutiala and San regions) are not privatized. The government was planning to have a new tender and complete sales by the end of 2012 for either two subsidiaries or all four (if the negotiations with Yue Mei do not succeed).

Given the current political and security situation in Mali, it is worth noting that cotton production lies in the government controlled portion of the country, and there is little foreseeable impact on the next marketing campaign. However, over the coming months, the situation could change and estimates revised accordingly.

In Benin, devastating floods came at a time when the government of Benin was trying to revitalize the cotton sector in several ways including making sure that farmers are fully paid for the previous year's crop, consolidating farmer's organizations, creating village cooperatives, educating small producers and fortifying input

committees. Time will tell what kind of impact the weather had on the government's efforts.

In Cote d'Ivoire, the cotton sector has rebounded significantly. Since May 2011, government officials in Cote d'Ivoire have been working to reform the cotton sector. In June 2011, the farm gate cotton price was increased 26 percent compared to the previous year, the highest price in the region. Input prices were reduced by 25 percent for marketing year 2011, representing government subsidies of $14 million. Subsidies of $20 million were paid to cotton companies during marketing years 2008 and 2009. These measures motivated farmers to return to cotton (70,000 to 73,000 farmers), increase area planted and seed cotton production for marketing year 2011.

The future of cotton remains uncertain in Chad. However, there have been some encouraging signs in the past few years. Since the creation of the new state-owned cotton company, Cotontchad SN, farmers have planted more cotton with the increase of the farm gate price which had been fixed for many years since marketing year 2009. As an indication of the efforts to plant more cotton, marketing year 2012 area planted increased 57% from marketing year 2011 (170,000 ha to 267,000 ha).

Despite all the obstacles facing cotton producers in this region, cotton remains an important cash crop in most of Francophone West Africa, Cote d'Ivoire and Senegal. The current projections have West Africa producing 3.6 million bales in 2013 (Figure 107), down 519,000 bales from 2012. With this size crop, West Africa continues to measurably affect the cotton export market, since virtually all of its production is sold abroad. The region exports between 95 and 98% of its cotton production. For the 2012 marketing year, it is estimated that the region will export over 3.3 million bales.

For 2013, West Africa is expected to increase their exports to 3.5 million bales.

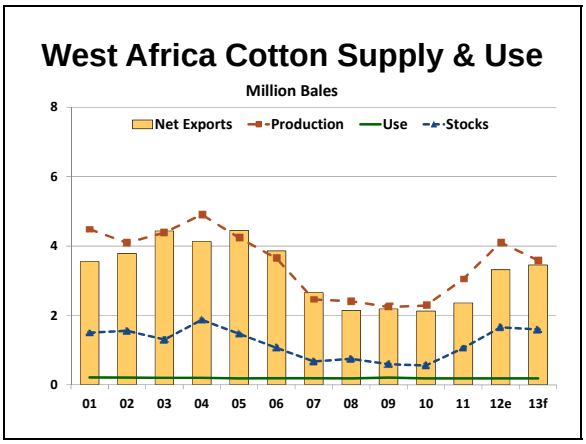

Figure 107 - West Africa Cotton Supply & Use

Longer term, West Africa's potential for growth and stability depends on whether or not they can address a number of internal issues related to their production, ginning, price discovery, and distribution systems.

Mexico

Mexican cotton production for marketing year 2012 dropped 236,000 bales, to 944,000 bales.

Cotton yields vary significantly among the major-producing areas in Mexico. The highest yielding area is La Laguna, while the lowest yielding area is expected to be South Sonora. Although cotton growers in northern Mexico have adopted the use of genetically-modified (GM) seed varieties, other factors, such as weather and use of technology, can explain differences in production levels. For example, in South Sonora and Tamaulipas cotton production is in non-irrigated areas, which significantly reduces yields. On the other hand, different pests affect the regions in a different way, for example, cotton fields of Tamaulipas have been declared free of pink bollworm, which still can have an impact in other states. With continued use of these improved varieties, a crop of roughly 829,000 bales in the 2013 marketing year is expected (Figure 108). The lower production

estimate is due mainly to fewer acres being planted to cotton.

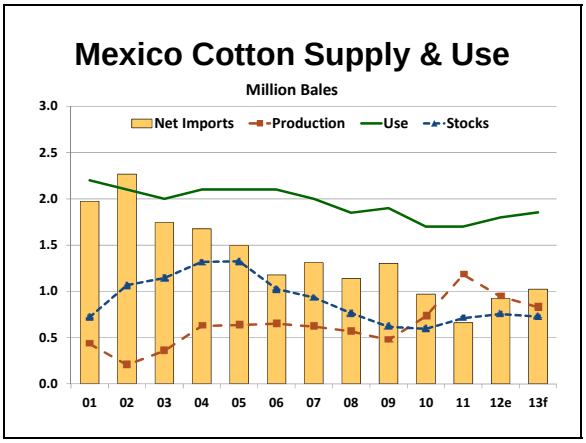

Figure 108 - Mexico Cotton Supply & Use

In terms of consumption, Mexico's outlook remains basically unchanged. Marketing year 2012 mill use is estimated at 1.8 million bales. For the 2013 marketing year, Mexican mill consumption is projected to remain stable at 1.9 million bales.

Cotton imports climbed to 1.3 million bales during the 2012 marketing year. The U.S. should continue to be the main supplier, accounting for practically 100% of cotton imports. Mexico's imports are expected to remain unchanged at 1.3 million bales for the 2013 marketing year.

Indonesia

Indonesian cotton production was estimated to reach 30,000 bales in the 2012 marketing year (Figure 109). Current projections show this number basically unchanged for 2013, 31,000 bales.

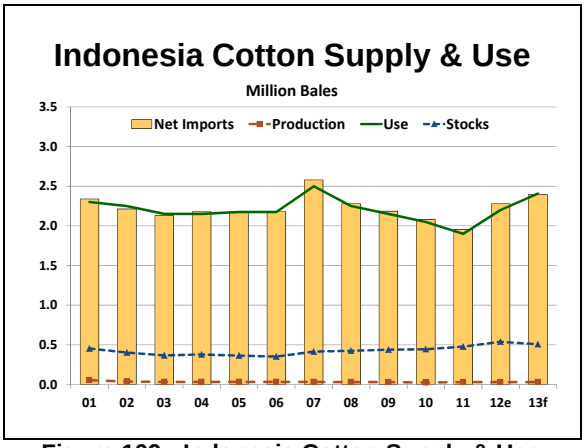

Figure 109 - Indonesia Cotton Supply & Use

As the main contributor to Indonesian export revenue and a labor intensive industry absorbing approximately 1.4 million workers (which equated to just over 10 percent of the total Indonesian manufacturing workforce in 2011), the textile industry continues to receive attention from the Indonesian government. With 7.9 million spindles and 110,000 rotors, Indonesian textile mills have been running at 70-80% of capacity during past marketing years. Several fundamental problems have hampered the growth of the industry. Most of the textile machines are more than 20 years old. The industry revitalization program launched by the government of Indonesia in 2007 has updated only 6 percent of the textile machines. Furthermore, higher interest rates have made it more difficult for the industry to get commercial bank loans. Despite these struggles, Indonesian cotton consumption in marketing year 2013 is estimated to improve modestly to 2.4 million bales. The same holds true for imports, estimated at 2.4 million bales for the 2013 marketing year.

Vietnam

Vietnam produces a relatively small amount of cotton and must compete with corn for available area. In addition, cotton production in Vietnam is highly susceptible to weather conditions and can fluctuate widely year-to-year. More than 90 percent of the cotton

production area in Vietnam is rain-fed, with planting initiated in the rainy season (May/June – August) and harvesting taking place from October - December. In areas where irrigation is possible, cotton may be planted in the dry season (November/December), thereby allowing for harvesting from March through May. For the 2012 marketing year, production stands at 23,000 bales with no change expected for the 2013 crop (Figure 110).

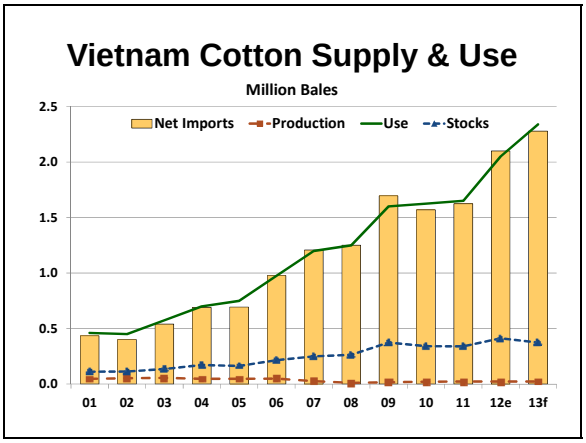

Figure 110 - Vietnam Cotton Supply & Use

Vietnam's domestic consumption continues to increase to meet strong demand from the expanding textile industry. Demand for textiles is strong for both the export and domestic markets. Vietnam is now ranked among the world's top textile, garment, and apparel-exporting countries. Despite the global economic downturn, Vietnam's 2011 textile, garment, and apparel exports were well over the government's target reaching a value of $15.8 billion, an increase of 26 percent over 2010. This growth is mainly due to the sector maintaining its traditional export markets (USA, EU, Japan), while also expanding to new export markets (Korea, Taiwan, the Middle East, Singapore, China, Turkey, etc.). Vietnam has set ambitious targets for the textile industry, with exports projected by Vietnam Textile and Apparel Association (VITAS) to reach $20 billion by 2020. The Trans-Pacific Partnership Agreement (TPP), if finalized, would help Vietnam achieve this target.

Vietnam is one of a very few countries in Asia that has expanded its yarn spinning sector in recent years. Not only foreign investors like Texthong Group (Hong Kong), Kyung Bang Vietnam (Korea); Itochu (Japan) etc., but also local businesses (Vinatex, Dai Cuong, Phu Bai, Thien Nam etc.) have increased investments in yarn spinning in Vietnam. Currently, Vietnam is home to 100 spinning factories belonging to over 80 enterprises. From only 2 million spindles in 2000, Vietnam spindle capacity reached over 5 million spindles (equivalent) in 2011 creating the potential for voracious demand for imported cotton.

Estimates place 2012 marketing year mill use at 2.1 million bales. Growth continues into the 2013 marketing year with consumption climbing to 2.3 million bales.

In order to keep pace with this rising cotton demand, Vietnam will remain a net importer for the foreseeable future, with the U.S. being a significant supplier. For the 2012 marketing year, Vietnam will import 2.1 million bales and estimates are slightly higher for the 2013 marketing year at 2.3 million bales.

Bangladesh

Marketing year 2012 cotton production in Bangladesh totaled 90,000 bales (Figure 111). Cotton production is vulnerable to excessive rainfalls/floods and pest infestations which are common in Bangladesh. With that in mind, production for the 2013 marketing year is set at 80,000 bales.

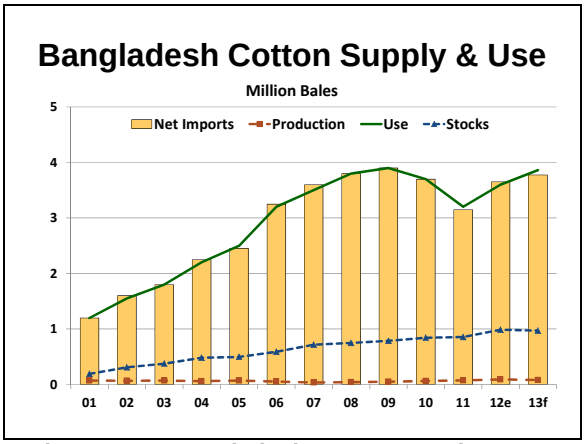

Figure 111 - Bangladesh Cotton Supply & Use

The Bangladesh textile industry, the largest manufacturing sub-sector of the industrial sector, provides employment to 5.5 million people. It contributes 12% to the country's GDP, 40% of manufacturing value and 77% of export earnings. During the last three decades, the Bangladesh textile sector has received the highest level of investment. Increasing demand from the rapidly growing private sector spinning mills and steady growth in domestic demand and strong growth in export demand for cotton textiles and ready-made garments are contributing to the escalation in cotton consumption. Marketing year 2012 mill use was estimated at 3.6 million bales and an increase is expected in the 2013 marketing year with estimates approaching 3.9 million bales.

As a result of increasing demand, raw cotton imports have steadily grown. A decade ago, Bangladesh imported 1.0 million bales of cotton. Since that time, imports have increased to an estimated 3.7 million for the 2012 marketing year and further expand in 2013 to roughly 3.8 million.

United States Trade

For the 2012 marketing year, U.S. exports of raw cotton are estimated at 12.2 million bales (Figure 112), up 490,000 bales from 2011. Exports fall in the 2013 marketing year with projections of 10.6 million bales. The reliance of the U.S. cotton market on exports has increased dramatically over the past decade as the domestic textile industry has contracted. It is estimated that exports will constitute over 78% of total use for the 2012 marketing year.

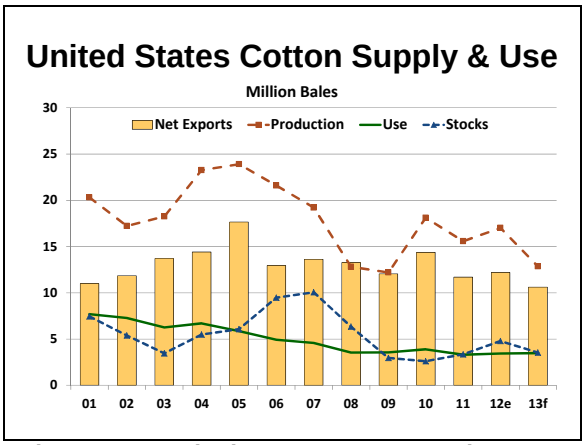

Figure 112 - United States Cotton Supply & Use

Customers of U.S. exports have changed in recent years. While Mexico remains one of the top customers, China, Turkey, Pakistan, Vietnam, and Indonesia have emerged as significant buyers (Figure 113).

Top U.S. Raw Cotton Export Destinations

2000		2012YTD	
Country	(000 480-Lb. Bales)	Country	(000 480-Lb. Bales)
Mexico	1,819	China	4,309
Turkey	613	Turkey	1,442
Indonesia	541	Mexico	997
Taiwan	407	Pakistan	509
Japan	383	Vietnam	463
Hong Kong	297	Indonesia	336

Figure 113 - Top U.S. Raw Cotton Export Destinations

World Trade

In the 2012 marketing year, world cotton trade declined over 7.0 million bales to 38.9 million bales (Figure 114). Current estimates put 2013 marketing year world cotton exports at 36.0 million bales. As previously discussed, U.S. exports are projected to fall to 10.6 million bales in the 2013 marketing

year. Brazil, Uzbekistan and Australia are also expected to see a drop in exports.

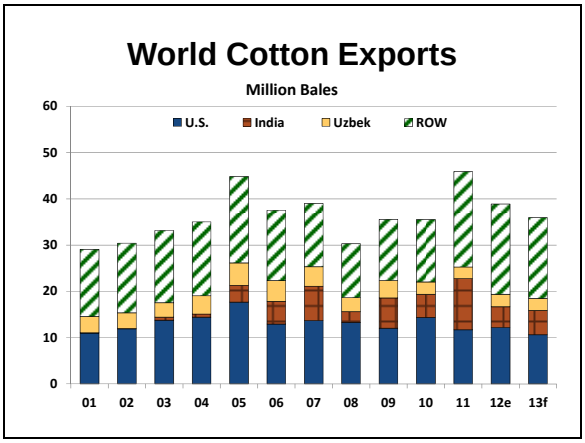

Figure 114 - World Cotton Exports

China has the greatest drop in imports with an estimated 6.9 million bales, 5.6 million bales fewer than the previous year (Figure 115).

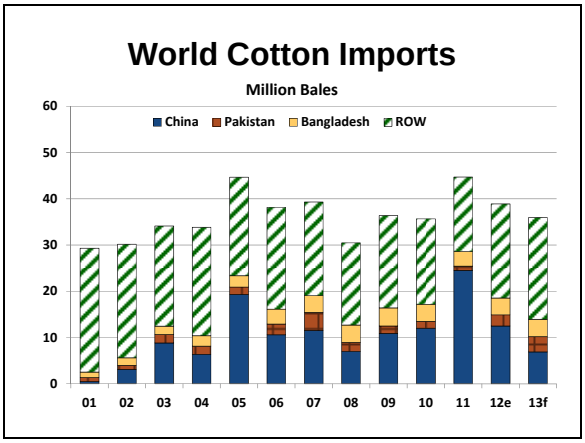

Figure 115 - World Cotton Imports

Examining the world trade-to-mill use ratio for the 2012 marketing year shows a drop to 37% from 43% in 2011 (Figure 116). For 2013 the ratio is expected to continue to fall to 33%.

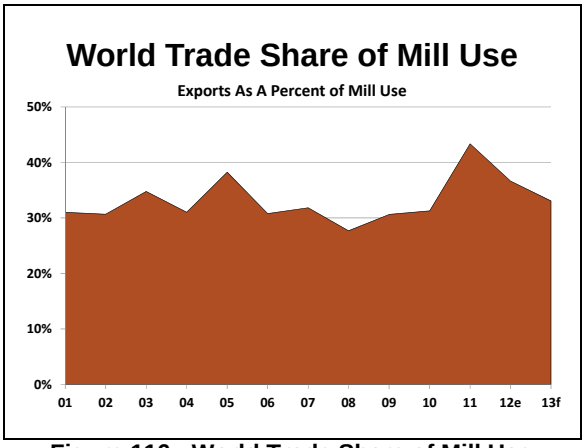

Figure 116 - World Trade Share of Mill Use

World Ending Stocks

For the 2013 marketing year, ending stocks are estimated to increase by 1.4 million bales while the stocks-to-use ratio is estimated at 76% (Figure 117). The 3 largest producers – China, India, and the U.S. – are also significant holders of cotton stocks. In the case of China and India, various government programs can play a major role in overall stock levels.

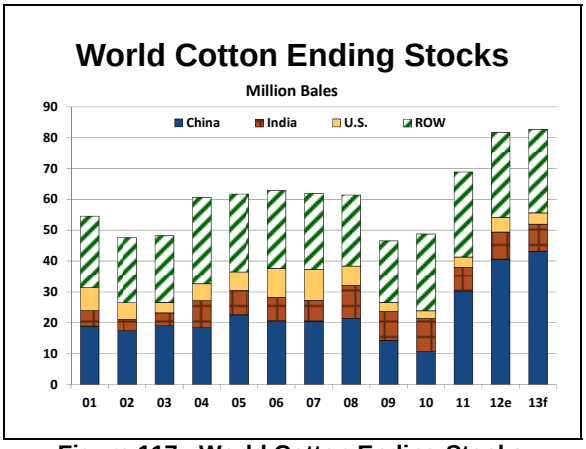

Figure 117 - World Cotton Ending Stocks

The overall balance sheet would normally indicate continued pressure on prices as the projected world stocks-to-use ratio climbs to 76% for the 2012 marketing year (Figure 118). However, traditional relationships between prices and stocks-to-use ratios do not hold in the current environment since almost half of world stocks are being held in government reserves.

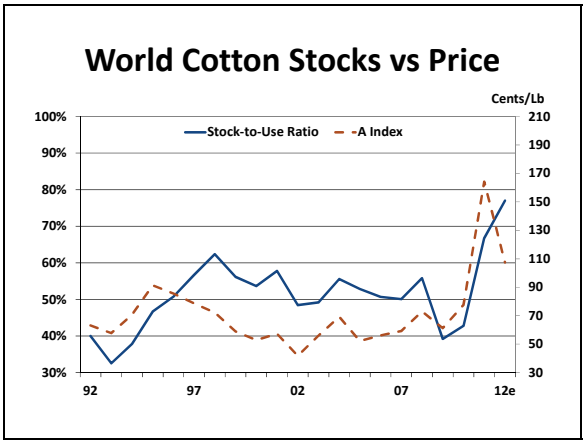

Figure 118 - World Cotton Stocks vs Price