The Economic Outlook
For U.S. Cotton 2009

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Summary

As 2009 begins, the U.S. cotton industry is facing a host of economic challenges. With this economic outlook report, NCC economists strive to provide information and analyses that will equip the industry to meet these challenges. An overview of key issues follows in this section with a summary of supply and demand estimates for selected countries in Table 1 on page 5. Detailed discussions and data are more thoroughly presented in the subsequent sections.

The intricate linkages between the cotton market, other commodity markets, and the general economy have never been more evident. Pessimism over faltering fiber demand and reduced trade is overriding lower production, resulting in weak cotton prices. One indication of the growing concern is the steady lowering of the 2008 marketing year global mill use estimate of more than 10% by most sources. The combination of lower production, use, and price defining the 2008 marketing year is an uncommon occurrence, with only one previous instance during the last three decades. Perhaps, not surprisingly, that prior time was the 1998 marketing year. Similar to the current environment, financial turmoil, at that time in the form of the Asian currency devaluations, played a large role in all commodity markets.

Before looking in detail at the year ahead, it is important to briefly recap 2008 – a year where uncertainty and volatility have been the rule rather than the exception. The cotton industry experienced financial strain due to the uncertainty and unpredictable risk caused by a dysfunctional futures market. Calendar year 2008 also brought sharply higher fuel and fertilizer costs as oil surpassed $140 per barrel. As mentioned earlier, deteriorating financial conditions and a faltering economy raised doubts about the consumer's willingness and ability to buy textile and apparel products.

Cotton's economic outlook is extremely dependent on the underlying macroeconomic assumptions. A recap and timeline of the financial situation is included in the "U.S. and World Economy" section. While information and opinions are collected from a number of sources, the latest projections by the International Monetary Fund (IMF), developed in January, play a key role in shaping the projections. The IMF outlook calls for economic contraction in developed economies and a slowdown in developing economies for 2009. World real GDP growth is estimated at 0.5% in 2009. Recovery is projected in 2010 with the global economy expanding at 3.0%. The severity and duration of the economic downturn remains an important wild card in the outlook.

Despite higher cotton prices in the spring of 2008, U.S. cotton acres experienced a second consecutive decline due to competing crop prices and higher input costs. Lower acreage and weather problems in certain growing regions produced a crop of 13.0 million bales, as compared to 19.2 million in 2007. Despite the smaller crop, higher stocks from the previous marketing year have maintained total cotton supplies at a level that the market deems sufficient to satisfy current demand.

Domestic mill use and exports of U.S. cotton fiber are estimated at 15.6 million bales for the 2008 marketing year. The 3.0 million bale decline from the previous year underscores the difficult climate facing demand.

Not unlike a number of industries affected by the economic downturn, the U.S. textile industry experienced plant closings and job losses. According to the National Council of Textile Organizations, an additional 32 textile mills closed in 2008, and preliminary data from the U.S. Bureau of Labor Statistics indicate that textile industry employment fell by 57,000 workers. Weaker consumer spending exacerbates the effects of continued competition from imported textile products. Unfortunately, competition intensifies in 2009 with the expiration of the U.S.-China textile agreement. The effects of the loss of quotas may not be evident in total imports given the downturn in the retail market. However, if past history is any indication, China is expected to gain market share in the categories previously limited by safeguards.

As a result of current pressures, U.S. textile mills are estimated to use 4.1 million bales in the 2008 marketing year. With projected mill use of 3.9 million bales in the 2009 marketing year, further losses are tempered due to an improved macroeconomic environment in 2010 and the beneficial impacts of the economic assistance program in the 2008 Farm Bill.

International markets will remain the primary destination for U.S. cotton. For the 2008 marketing year, exports are estimated at 11.5 million bales, down 2.2 million bales from the previous year. As with U.S. mill use, the slowdown in the general economy is a primary reason behind the lower exports. In addition, some international mills have restricted their cotton purchases in response to higher input costs and tighter credit conditions.

Globally, mill use in the 2008 marketing year is estimated at 112.4 million bales. The 8.4% decline from 2007 is the largest year-on-year decline in the post-World War II era. Few textile industries have proven immune from the current slowdown. China's spinning industry, which accounts for more than 40.0% of world mill use, is expected to contract for the first time since 1998. China's estimated mill use of 46.3 million bales is the lowest since 2005. India, Pakistan, and Turkey are also reporting a downturn in mill use. Bangladesh and Vietnam are examples of the few countries that will see a slight expansion in mill use in the current marketing year.

Considering that China's cotton balance sheet, and hence the world balance sheet, incorporates an 'Unaccounted' term of -2.5 million bales, lower mill use suggests that global stocks will largely be maintained at current levels despite the lower 2008 production of 109.8 million bales.

Weaker demand and declining farm-gate prices prompted government action in key countries in the latter half of 2008. For example, in an effort to support slumping seed cotton prices, China announced their intentions to procure for their state reserves as much as 12.5 million bales of 2008 production. As a result, China is estimated to end the 2008 marketing year with 19.4 million bales of cotton stocks, with the vast majority in government reserves. If the Chinese government decides to aggressively liquidate those reserves in the

coming months, it could dramatically alter their import requirements.

In 2008, the Indian government announced an increase in cotton's Minimum Support Price of 35 to 40%. While there is an ongoing debate between the various segments of India's cotton industry as to the appropriateness of the higher support price, this outlook assumes that support is maintained for 2009. India's export prospects are complicated by the current support price. With support levels above current market prices, the Indian government has authorization to purchase up to 11.7 million 480 lb. bale equivalents. Current reports indicate that cotton is being sold from their stocks to Indian mills. A decision to be more aggressive with stock release into export channels could boost their presence in the world market, but at current prices, would carry a high cost.

The overview of the 2009 outlook begins with the expectations for U.S. cotton production. As in past years, the National Cotton Council's economic outlook incorporates the results of the annual planting intentions survey, mailed in mid-December 2008. Results, collected through mid-January, indicate that growers will plant 8.1 million acres, or 14.4% fewer than in 2008. Lower cotton prices and strong competition from soybeans are the primary reasons behind the shift. For upland cotton, all regions are expected to see declines with the largest percentage declines in the West and Mid-South, respectively. Lesser declines are expected in the Southeast and West. U.S. ELS acres are also expected to fall, primarily due to reductions in California. (State-level estimates available in Table 3 on page 45.) Assuming average abandonment and yields gives a 2009 crop of 12.8 million bales, as compared to 13.0 in 2008.

Reduced cotton area is not limited to the United States. For 2009, most major-cotton producing countries are expected to reduce area as relative commodity prices favor alternative crops. In China, a projected 10% decline in area produces a crop of 32.6 million bales. Pakistan, Turkey, and West Africa are also expected to reduce cotton production. Slightly larger crops in Australia, India, and Uzbekistan are the result of yield assumptions offsetting declines in area. The summation across all countries is a world crop of 105.6 million bales, the smallest since 2003.

With expected recovery in the overall macroeconomic situation, global mill demand in the 2009 marketing year is projected to show a modest recovery of 1.2%. The growth is largely isolated to countries in Asia as further declines are projected in Brazil, the European Union, Mexico, and Turkey.

World mill use of 113.8 million bales for the 2009 marketing year is projected to foster increased trade relative to the current year. However, because of adjustments in other cotton-exporting countries, larger total trade may not translate into increased U.S. exports. With larger beginning stocks and slightly higher production, India is positioned to assume a larger presence in the world cotton market for 2009. Australia and Uzbekistan could also be positioned to increase exports. As a result, U.S. exports are projected at 11.2 million bales, down from 11.5 million in the 2008 marketing year.

The combined effects of the supply and demand projections result in declining

stocks, both in the U.S. and globally. The U.S. is expected to end the 2009 marketing year with stocks of 5.2 million bales, which would be the lowest since the 2003 marketing year and stand in stark contrast to the 10.0 million bales in 2007.

Globally, ending stocks are expected to fall by 5.7 million bales, giving a 49.7% stock-to-use ratio. This would represent the first year since 2003 with a stocks-to-use ratio below 50%, and paints a scenario more supportive of prices going into 2010.

Table 1. Balance Sheet for Selected Countries & Regions

	08/09	09/10
	(Million Bales)	
World		
Production	109.84	105.65
Mill Use	112.44	113.79
Trade	30.40	33.91
Ending Stocks	62.19	56.52
United States		
Production	13.04	12.76
Mill Use	4.10	3.90
Net Exports	11.49	11.17
Ending Stocks	7.50	5.19
Mexico		
Production	0.65	0.56
Mill Use	1.81	1.76
Net Exports	-1.16	-1.15
Ending Stocks	0.91	0.82
Brazil		
Production	5.80	5.80
Mill Use	4.43	4.40
Net Exports	2.02	1.77
Ending Stocks	5.75	5.53
Turkey		
Production	2.30	2.13
Mill Use	4.97	4.96
Net Exports	-2.34	-2.77
Ending Stocks	1.61	1.56
West Africa		
Production	2.53	2.32
Mill Use	0.19	0.19
Net Exports	2.23	2.15
Ending Stocks	0.95	0.93
Uzbekistan		
Production	5.00	5.17
Mill Use	1.03	1.04
Net Exports	3.59	4.07
Ending Stocks	1.68	1.73

	08/09	09/10
	(Million Bales)	
China *		
Production	36.50	32.56
Mill Use	46.31	47.17
Net Exports	-6.70	-9.61
Ending Stocks	19.40	16.88
India		
Production	23.00	23.45
Mill Use	17.14	17.49
Net Exports	3.51	6.52
Ending Stocks	9.73	9.16
Pakistan		
Production	9.40	9.09
Mill Use	11.52	11.86
Net Exports	-2.24	-2.78
Ending Stocks	4.58	4.56
Indonesia		
Production	0.03	0.03
Mill Use	2.13	2.22
Net Exports	-2.14	-2.24
Ending Stocks	0.38	0.38
Vietnam		
Production	0.03	0.03
Mill Use	1.02	1.12
Net Exports	-1.02	-1.09
Ending Stocks	0.27	0.27
Bangladesh		
Production	0.06	0.06
Mill Use	2.90	3.03
Net Exports	-2.87	-3.00
Ending Stocks	0.61	0.62
Australia		
Production	1.35	1.45
Mill Use	0.05	0.05
Net Exports	0.90	1.43
Ending Stocks	0.98	1.00

* Balance sheet assumes Unaccounted of -2.5 million bales in 08/09 and 09/10.

U.S. and World Economy

Since the second half of 2007, the U.S. economy has been on the defensive, and during 2008, economic troubles spread across global markets. Current trends show a continuing deterioration into 2009, with indications of recovery in 2010. However, growth will be hindered as households respond to depreciating assets and a tightening financial situation.

Future economic growth in the U.S. and abroad will depend on an array of components, one of those being a sound and stable financial system. Early in 2008, after the collapse of the credit boom that encompassed both the mortgage lending and other credit markets, a number of industrialized countries came under severe strain. Banks and financial institutions experienced depleting capital and poorly performing and hard-to-sell assets on their balance sheets. Trust between banks was in question as credit spreads widened dramatically. This past fall, an intensifying financial meltdown led to concerns regarding the stability of the global financial system. Multiple relief programs instituted by countries' central banks restored some stability to the financial system, allowing the return to more-normal credit conditions. However, further fiscal stimulus and monetary policy is needed to limit the decline in world growth.

The Consumer Sentiment Index is a tool designed by the University of Michigan's Survey Research Center to gauge the mood of the American consumer with regards to the economy. According to this index, the American consumer's confidence fell sharply in 2008 (Exhibit 1). Further erosion is expected as job losses mount.

Under current market forces, 2009 economic growth is expected to contract through the first half of the year with some recovery during the last quarters and early part of 2010. High unemployment rates, loss of wealth through equity markets and a strained financial and credit system, coupled with low consumer confidence does not bode well starting out 2009. However, there are some positive factors for consumers, including lower fuel and commodity prices along with recent actions by the Federal Reserve that lowered mortgage rates and provided liquidity into the credit market.

U.S. Gross Domestic Product

As determined by the Bureau of Economic Analysis, the U.S. 2008 real Gross Domestic Product (GDP) expanded by 1.3% (Exhibit 2). After experiencing growth in the first two quarters, the annual number was reduced by a dismal second half. Reviewing GPD fourth quarter of 2008 relative to the same period in 2007 reveals a decline of 0.2%. Contributors to the recent decline were lower personal consumption expenditures, residential fixed investments, and equipment and software. Positive factors partially offsetting the decline were an expansion in federal, state and local government spending, private inventory investments, exports and nonresidential structures.

Expectations for the first two quarters of 2009 are grim, with some economist expecting the U.S. to endure the worst recession since 1981-82. Rationale behind these conclusions includes weak consumer confidence, mounting job losses, continued tightening of credit, restricting investment spending, declining wealth, and lower new

construction. The January projections by the International Monetary Fund (IMF) for annual GDP growth shows the U.S. economy contracting by 1.6% in 2009 with a recovery in 2010 of 1.6%. A slightly more pessimistic stance by Congressional Budget Office (CBO) anticipates the 2009 GDP will diminish by 2.2%, slowly recovering in the second half and expanding by 1.5% in 2010.

Falling equity markets, declining home values, and rising unemployment weighed heavily on consumers' minds, despite lower costs for energy, healthcare, and food. As a result, consumer spending fell sharply in the last two quarters of 2008 (Exhibit 3), specifically for durable goods. The outlook for 2009 is not expected to improve. A great deal hinges on unemployment as it has a direct effect on real disposable incomes. It must be noted that unemployment is a lagging factor and most likely will not decline until well after economic recovery is underway. Consumer spending is further limited by restricted credit availability stemming from the current financial turmoil.

U.S. private investment has been on the defensive since 2006, tied to a soft residential housing market and restricting credit lines. A slight recovery occurred in the last half of 2008 due to nonresidential structures (Exhibit 4).

U.S. Employment

The U.S. job force steadily contracted over the last year as businesses reacted to economic uncertainty and declining revenue (Exhibit 5). By December 2008, employment fell to 61% of the U.S. civilian population. Employment in manufacturing jobs steadily declined throughout the past year settling at a new low of 13.0 million in December (Exhibit 6). Since December 2007, a total of 791,000 manufacturing jobs were lost, with nearly half that total coming in the fourth quarter of 2008. At the same time, manufacturing hours and overtime declined as well. The long-resilient service sector also showed considerable weakness. On a more optimistic note, education and health services continued to add jobs.

The unemployment rate surged to 7.2% in December 2008, as reported by the Labor Department, the highest level since January 1993 (Exhibit 7). While the before-mentioned is the official rate, an alternative measure that includes discouraged workers who have dropped out of the labor force and those working part-time climbed to 13.5%, up from 8.7% at the end of 2007. Recent announcements suggest that companies are still assessing the full impact of the economic crisis and further job losses are expected. Most sources show a rise in unemployment for 2009 and a mixed review for 2010. Respondents to the Livingston Survey in December projects the unemployment rate for June 2009 at 7.6% and further increasing to 7.8% by December 2009. Estimates by CBO put 2009 at 8.3% and 2010 at 9%.

U.S. Housing Market

The housing industry is a key barometer of the well-being of the economy. Unfortunately, that sector of the economy offers little positive news. New housing starts tumbled to a record low in December at 550,000 units, down 45% compared to year ago (Exhibit 8). New building permits fell to a historical low at 549,000 units, down 51% from the 2007 time period. The National Association of Home Builders noted that the trough will continue through

mid-year, but should come out of 2009 on an upswing. However, the recovery will be slow with the large number of unsold homes on the market.

Home prices are down 10.5% through November from their April 2007 peak, according to the Federal Housing Finance Agency. The agency tracks prices on homes purchased with loans backed by Fannie Mae and Freddie Mac, excluding many bought with riskier financing, thus reflecting a leaner decline than other gauges.

Hindering the housing sector is the level of foreclosures – having reached more than 2.3 million homeowners in 2008, an increase of 81% from 2007. Foreclosure rates are likely to remain high while housing prices continue to fall; many homeowners are holding negative equity in their homes and will not be able to refinance unless lending policy changes.

In early January, relief came as the Federal Reserve started a campaign to buy back up to $500 billion in mortgage-backed securities, inciting lenders to lower the average U.S. 30-year mortgage rate to record low 4.96% (Exhibit 9), giving some hope to the sector. Mortgage applications subsequently hit a 5-year high, with over 80% of applicants refinancing. It should be noted that the purchase volume did rise by 1.4% from the prior month. While limited stability came back to the credit industry, only individuals with solid credit and plentiful home equity have access. Those individuals in danger of foreclosure, out of a job or little credit history are sidelined.

According to Freddie Mac's chief economist, rising unemployment in 2009 will lead to more mortgage defaults. However, the housing market should show signs of improvement in the second half of 2009 as government efforts to stimulate the economy kick in.

Federal Reserve Board

The Federal Reserve Board retains a number of tools at its discretion to deploy against the current crisis. Primarily, the federal fund rate is the tool for influencing the economy – the interest rate that banks charge each other for overnight loans. Aggressive action was taken by the Fed starting back in 2007 by initially reducing the rate by 50 basis points. As indications of economic weakness proliferated in the spring of 2008, the Fed responded by reducing the rate a cumulative 325 basis points. The measures through this point in time were to both cushion the direct effect of the financial turbulence and reduce the virulence of the adverse feed-back loop, in which economic weakness and financial stress become mutually reinforcing. Positive signals were noted as relief for employment and incomes stabilized for a short period.

Unfortunately, the situation deteriorated further in the fall, prompting additional reductions in October by 100 basis points and another 25 in December (Exhibit 10). Lending rates declined at varying levels in response to the federal fund rate that is now close to zero, especially short-term rates. However, the offsets were stifling, as widening credit spreads, more restrictive lending standards, and credit market dysfunction worked against the monetary easing. In particular, funding sources for financial institutions and markets dried up, and banks and other lenders found their ability to securitize mortgages, auto loans, credit card receivables, student loans, and other forms of credit greatly curtailed.

Thus, the Federal Reserve now must implement additional tools to support credit markets and revitalize the economy.

One directive initiated by the Federal Reserve involved making use of its balance sheet by extending credit directly to the private sector or purchase high-risk securities. Two recently announced plans included the purchase of $100 billion in government-sponsored enterprises debt and up to $500 billion in mortgage securities. Some observers expressed concern that expanding the Federal Reserve balance sheet and effectively printing money will ultimately be inflationary. However, banks are choosing to leave the bulk of their reserves idle and in most cases on deposit with the Fed. Consequently, the growth rates of broader monetary aggregates have been lower than that of the monetary base. Chairman Ben Bernanke recently stated, "At this point, with global economic activity weak and commodity prices at low levels, we see little risk of inflation in the near term; indeed, we expect inflation to continue to moderate."

Agricultural Finance

The Board of Governors of the Federal Reserve conducts a quarterly survey of commercial banks and financial institutions involved in agriculture. Survey results, as reported in the Agricultural Finance Databook, show a relatively healthy picture with the volume of farm loans up, interest rates down, longer maturity levels, and rates of return on equity for agricultural banks exceeding other small banks.

Escalating annual operating cost in 2008 is evident as the amount borrowed rose 24% to $40.2 billion, whereas purchases of equipment fell 31% to $3.8 billion. On an annual basis, the average effective interest rate for non-real-estate loans made to producers fell in 2008 to 5.6% versus 2007 at 8.3% (Exhibit 11). Further reductions are expected in 2009.

Examining selected measures of financial performance reveals agricultural banks average rate of return on equity modestly exceeds other small banks over the last decade. However, that trend widened in 2007 to 10.6% versus 7.7%, respectively. Agricultural banks stability looks to be holding through this financially turbulent time as the average capital ratio at 10.7% (Exhibit 12) continues to hold at its current trend of the last three years.

Federal Budget Situation

Ongoing turmoil in the housing and financial markets has taken a major toll on the federal budget this year. Final appropriations and additional funding for operations in Iraq and Afghanistan may increase outlays for 2009 and beyond, and any new economic stimulus package may raise discretionary spending further.

The Congressional Budget Office (CBO) estimates that total federal revenues for fiscal year 2009 will decline to $2.4 trillion (Exhibit 13). The sharp drop in the value of assets, most significantly in publicly traded stock, will lead to lower individual and corporate income taxes.

While revenues have declined, efforts to combat the faltering economy have led to sharply higher outlays. For the current fiscal year, outlays are estimated at $3.5 trillion. Unemployment compensation is projected to nearly double to $79 billion as a result of increased levels and legislation to date extending such benefits. Outlays

for nutrition assistance are expected to expand by 27% to $50 billion, primarily because of increased caseloads and benefits, resulting from higher food prices.

CBO projects that federal spending for the three largest mandatory programs-Social Security, Medicare and Medicaid are all anticipated to record growth of at least 8% this year. These increases stem from a relatively high rate of inflation recorded early in 2008, which boosted cost of living adjustments for retirees and the cost of health care. In addition, rising unemployment will add to Medicaid spending by increasing the number of beneficiaries.

The result is a deficit for fiscal year 2009 of $1.2 trillion, more than two and a half times the size of 2008 (Exhibit 14). CBO's latest projections indicate that budget deficits will persist through its entire baseline out to 2019. The outlook shows the deficit steadily declining as revenue rebounds and outlays hold a steady growth. However, significant uncertainty surrounds long-term projections, especially in these ambiguous times. In the absence of significant changes in policy, rising costs for health care and the aging of the U.S. population will continue to weigh on federal spending.

CBO projects that federal spending for mandatory programs this year is to grow by almost $570 billion or 36%. Nearly three-quarters of the growth in the 2009 budget results from the activities of the Trouble Asset Relieve Program (TARP) and CBO's treatment of Fannie Mae and Freddie Mac as federal entities. TARP authorizes the Treasury Department to enter into agreements to purchase assets totaling up to $700 billion outstanding at any one time.

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 grew by just 0.1% in 2008, according to Labor Department figures, the smallest gain in over 50 years and well below the 4.1% gain in 2007 (Exhibit 15). However, on an annual average basis, the CPI advanced by 3.8% in 2008. The contrasting measures for 2008 reflect the sharp variability in prices, most notably energy-related prices.

Consumer prices declined in the last quarter at a 12.7% seasonally adjusted annualized rate, led mainly by the drop in energy of 76.6%. However, consumers did not benefit from falling agricultural commodity price as the food index rose for the year at 5.8%, the largest since 1980. Among the grocery store food groups ranged from an increase of 2.7% for dairy products to a high of 11.7% for cereals and bakery products. Excluding food and energy, core consumer annual inflation was moderate at 1.8%, down to level not experienced since 2003, although fourth quarter rates were lower than the high rates experienced early in the year.

On a December-to-December basis, the PPI for all commodities fell in 2008 by 4.1%, which was the largest December-on-December decline since 2001. For the year as a whole, the PPI for all commodities advanced by 9.9%. Volatility in

commodity and energy prices dictated the movement in the PPI. This pattern reflected a deceleration in the energy and materials for both manufacturing of durable and nondurable goods; while materials and components for a wide variety of construction materials increased. Concerns of deflation in 2009 are growing with the sharp declines in the forth quarter prices in energy and commodities.

Energy Prices and Supply

The downward trend in oil prices continued in December as the worsening global economy weakened oil demand, and the Organization of Petroleum Exporting Countries (OPEC) agreement for substantial production cuts has failed, thus far, to support prices. The global economic downturn points to declining oil consumption in 2009, while additional production capacity from both OPEC and non-OPEC nations should boost surplus production capacity, reducing the likelihood of a renewed strong upward pressure on prices. Going forward, oil prices will be driven mainly by the depth and duration of the global economic downturn, the pace and timing of the recovery, and actual OPEC production.

OPEC's latest two announcement of cuts in crude oil production has not yet led to a substantial increase in prices. In part, due to the fact the market is not presently convinced that OPEC members will willingly curtail output enough to lead to much higher prices. Adherence to these reductions will be challenging, as several countries are motivated to maintain production to generate revenue needed to finance their government programs amid falling prices. The Department of Energy Information Administration (EIA) projects that total OPEC crude oil production will fall by more than 2 million barrels per day, from 31.4 in September 2008 to 29.3 for the first quarter of 2009, implying a compliance rate of a less than 50%, but rebounding to average 30.0 for all of 2009 and 30.7 for 2010.

The combination of lower demand for OPEC crude oil and the capacity expansions in several countries means that surplus production capacity could increase to roughly 4.0 million barrels per day in 2009 and 4.7 by the end of 2010, compared with the 1 to 2 million available over the past several years.

Non-OPEC supply is projected by EIA to rise modestly over the next 2 years. After falling in 2008 because of project delays and disruptions in Central Asia and the Gulf of Mexico, growth in the U.S., Brazil, and Azerbaijan is expected to more than compensate. Lower oil prices bring into doubt the viability of some high-cost projects. The credit crunch can also make it difficult to acquire financing for new projects or even finance the investment required to prevent declines at producing fields. If conditions in global financial markets lead to delayed investment in existing and new oil fields, then even a short-lived economic downturn could have longer-term ramifications for world oil supply. This would heighten the risk of a return to a tight supply situation once the world economy and oil demand recover.

In 2008, the West Texas Intermediate (WTI) crude oil price fell from record highs in the summer to approximately $40 per barrel by the end of the year. Assuming under current economic conditions and no major crude oil supply disruptions, EAI projects WTI prices are to average $43.25

per barrel in 2009 and $54.50 in 2010 (Exhibit 17).

Retail diesel fuel prices (Exhibit 18), which averaged $3.79 per gallon in 2008, are projected by EIA to average $2.27 and $2.54 per gallon in 2009 and 2010, respectively. The projected continuation of the decline in diesel fuel consumption in the United States as well as a slowing of the growth in distillate fuel usage outside the United States are expected to result in a weakening of refining margins.

Weak natural gas demand associated with poor economic conditions together with strong domestic production contributed to the recent decrease in prices, and the decline is expected to persist in 2009. The Henry Hub spot price averaged $9.13 per thousand cubic foot (Mcf) in 2008 (Exhibit 19), but ended the year averaging $5.99 in December. The spot price is expected to average $5.78 in 2009 and $6.63 in 2010.

Total U.S. natural gas 2008 production expanded 5.9%, led by the development of unconventional reserves in the Lower-48 States. Simultaneously, consumption increased by just 0.7%, driven by a 5.8% increase in heating degree-days year-over-year. As consumption reacts to worsening economic factors, natural gas prices may need to fall further than forecasted in order to restrain production and balance the market during the second half of 2009, particularly as inventory nears storage capacity. Current U.S. inventories are now above the 5-year average (2004-2008).

U.S. Equity Markets

As the U.S. economy fell first into a capital spending recession and then a consumer recession, Wall Street experienced its most volatile days in its history. The Dow Jones Industrials Average (Dow) ended 2008 at 8,776 (Exhibit 20), a fall of 33.8% for the year, the worst drop in percentage terms since 1931 and the year's 4,488 point drop is the worst ever. Collapse in the NASDAQ was slightly larger, down 40.5% or 1,075 points to 1,577 (Exhibit 21). The severity of the S&P 500 was just as bad, settling at 903, down 565 points or 38.5% (Exhibit 22).

2008 Timeline

The year began on a down note with the Dow falling 1.7% on the first trading day and oil reached $100 a barrel for the first time. Later in January, Bank of America agrees to buy the U.S.'s largest mortgage lender, protecting a casualty of a possible mortgage collapse. Citigroup and Merrill Lynch write off assets of $18.1 and $15 billion, respectively, with each also reporting quarterly losses of roughly $10 billion.

Surprisingly a week before its meeting in January, the Fed lowers its interest rates by 75 basis points to only lower it again by 50 the day of its meeting. Impacts of these adjustments were minimal as the Dow continued to fall. By the first of February, Congress approves a $168 billion stimulus plan to cut rebate checks of $300 to $1,200 per taxpayer.

In mid-March, the Fed announces a $200 billion loan to Wall Street taking over hard-to-trade securities and lowers its short-term rates by 75 basis points. By the end of the first quarter the Dow had fallen 7.6%.

At the end of the first quarter, the Federal deficit hits a record $311 billion for the first half of fiscal 2008. New home sales for March collapse by 8.5%, lowest level

since 1991. Negative earnings were posted by financial institutions, and yet again, the Fed cuts the rate by 25 basis points to 2%, the seventh cut in eight months. Consumer sentiment about the economy hits a 28 year low as home prices fall in 43 states.

In June, Congress passes a $3.1 trillion fiscal 2009 budget. The following day markets reacts as crude oil notches its largest one day advancement of $11 to $138.54 a barrel and the Dow retrenches 395 points. The May jobless rate is announced at 5.5%, up from 5% for April – it is it's the largest one month gain in 20 years. The U.S. price of gasoline hits $4 a gallon, up 29% from the previous year. Markets around the world start to feel the ramifications of the economic downturn as China's stock market tumbles 7.7% in one day and the dollar has its best week in more than three years against the yen and euro.

As the third quarter begins, markets are hit by news that U.S. auto sales fell 18% for June, gasoline use drops to a five year low, IndyMac is seized by Federal regulators, and the Treasury and Fed announces a plan to place the government behind Fannie Mae and Freddie Mac. This sent financial stocks plummeting, which sparked the SEC to curb short selling for 19 financial firms. Ford and GM both report their largest quarterly losses at $8.7 and $15.5 billion, respectively.

In an effort to stabilize markets and reestablish confidence, Japan, at the end of August, unveils a $106 billion stimulus package. The U.S. Treasury decides backing-up the two mortgage giants are not enough as they seize Fannie Mae and Freddie Mac in September, with plans to replace the CEO and buy $1 billion in preferred shares. A week later over a weekend, Lehman faces liquidation and Merrill Lynch agrees to be sold to Bank of America. That Monday the markets panicked with both the Dow closing down 4.4% and oil falling by 5.4%.

Things start to unwind as the U.S. government seizes control of AIG, the SEC temporarily bans short selling on stocks, and the Fed's convert the last two major investment banks, Morgan Stanley and Goldman Sachs, into traditional bank-holding companies under close supervision of bank regulators. Federal regulators seize Washington Mutual, striking a deal to sell a bulk of its operations to J.P. Morgan.

To end the quarter, the U.S. House defeats Bush's $700 billion rescue plan, and with fears of additional bank failures, the Dow plummets 778 points in one day and oil drops more than $10 per barrel.

On October 3, President Bush signs a revised $700 billion rescue plan for the financial system. Market participants responded by continuing to pressure the Dow the following week, capping the worst week in the Dow's history. Central banks around the world launch a coordinated attack against the global financial crisis, lowering short-term rates in unison by half-percentage point and announce plans to rescue banks through direct capital injections. This excited the market as the Dow surged 11% or 936 points to 9,388. By mid-October, crude is under $75. OPEC announces to slash output by 1.5 million barrels a day, the largest reduction in almost eight years, which had no effect on the market as oil topples the same day by $3.69 to $64.15. The Dows sees another big surge by 889

points to 9,065, but to a level less than the previous rally.

Reports of the economy contracting by 0.3% the third quarter and consumer spending falling for the first time in 17 years by 3.1% sparked the Fed to reduce rates by a half a point to 1%.

The November election of Barack Obama as President did not inspire a rally on Wall Street as in the past. Stocks fell 9.7% in the two days following the election. The U.S. jobless rate jumps to a 14 year high at 6.5%, while GM and Ford post combined losses of $14.6 billion for the third quarter. The U.S. government reaches a deal to bailout AIG for $150 billion. Later that month, China announces a $586 billion stimulus package to revive dependent economies, and Japan's economy slips into recession.

U.S. consumer prices for October register their largest monthly decline since World Word II, adding to deflationary concerns. Once again, the government takes unprecedented steps to stabilize Citigroup, guaranteeing over $300 billion in trouble assets and injecting $20 billion of capital into the company. The U.S. Fed pledges to pump another $800 billion into the credit market, and plans to buy up to $600 billion of debt issued or backed by mortgage-finance firms, with additional support from the Treasury of $200 billion in financing to boost consumer spending.

Surprisingly, the first of December reports note Thanksgiving holiday shopping is up by an estimated 7.2%, but only due to the fact that retailers offered deep discounts.

On December 2, the National Bureau of Economic Research officially announces that the U.S. recession began December 2007. Job losses mount, pushing unemployment to 6.7%, a 15 year high. Crude oil sinks 25% for the week to close at $40.81. The Fed reduces its target interest rate to historic lows between zero and a quarter percentage point. Central banks around the world reduce their rates the following day. OPEC once again states its reducing production by 2.2 million barrels a day and NYMEX crude slides by $3.54, to $40.06. The benchmark 30-year fixed-rate home mortgage falls to a national average of 5.17% the lowest since records have been kept back to 1971. In the end, price cutting fails to rescue the holiday season; retail sales excluding automobiles dropped 5.5% in November and 8% for December through Christmas Eve.

In summary, the roller coaster ride of the 2008 equity markets will be a year for the record books and one that will evoke sour memories for many years to come. Hopefully it taught consumers, banks, businesses, and government regulators valuable lessons that we can build a stronger U.S. and global economy.

World Economies

After consecutive years of growth, global stock markets could not escape the financial crisis started in the U.S. as investors withdrew money in search of a safe haven (Exhibit 23). According to the IMF, world real GDP grew 3.4% in 2008, compared to 5.2% a year earlier, with a forecast for 2009 of only 0.5% (Exhibit 24) and a gradual recovery in 2010 to 3%. Activity on an annual basis in the advanced economies is expected to contract by 2% for 2009, down from a positive 1% growth in 2008, marking the first annual contraction in the postwar

period. Downward revisions in emerging and developing economies will be larger, but their growth rate remains at an annual average rate of 3.3%.

China's double digit growth since 2003 was broken in 2008 at 9% (Exhibit 25). Decelerating exports appear to have been a major slowdown to its economy. Early in 2008, the China's CPI inflation rate spiked due largely to rising food prices causing the government to tighten economic policies. Since mid-summer actions have been to loosen policy due to the drop in the CPI. IMF estimates indicates China's 2009 GDP growth rate will be 6.7%.

Projections are for India's 2009 growth to subside to 5.1%, down from 7.3% a year earlier. Russia's economy is expected to fall from 5.4% to 0.3% due to the effects of lower crude prices. In addition, other emerging market and developing countries are showing modest positive growth for 2009. For example, the ASEAN-5 is pegged at 2.7% and Brazil at 1.9%, while Mexico tumbles to a negative 0.3%.

Investors in Asian markets acted aggressively in liquidating their equity positions (Exhibit 26). Japan's Nikkei had its worst-ever showing at a loss of 39.6% for the year. The Hong Kong Hang Seng fell 46.1% from the start of the year, giving-up its gain of the prior two years.

An outlook for equities is based on the return of consumers' confidence in their own finances and the economy. Currently, U.S. companies' fourth quarter earnings are being reported at daunting levels, coupled with additional layoffs with over 200,000 jobs lost in the first three weeks of 2009. This puts the economy in a vicious cycle as earning weakness begets layoffs, which begets more spending weakness. Some economists believe the rapid fall in equities in 2008 could have been overstated, allowing for a slight correctional recovery during the middle of 2009. That just might give consumers back their confidence.

Exchange Rates

During periods of market uncertainty, traders sell currencies that are perceived riskier and place their bets in safe havens. The U.S. dollar enjoyed a broad based rally in mid-2008 reversing a four year declining trend against the Euro (Exhibit 27). Support came to the dollar not on the fact the U.S. economy was expanding, but rather that many other economies were deteriorating at faster paces.

In the dawn of a global recession, the Japanese yen was seen as a safe haven in Asia, appreciating against the dollar and reaching a 13-year high in October 2008 (Exhibit 28). It has remained strong at present due to risk aversion, but may lose some of its strength in 2009 as investors look to the U.S. dollar and other markets for higher returns. In the current trading pattern, the dollar has fallen against the yen when it is up against the euro, and the dollar has risen against the yen when it is down against the euro. Traders tend to borrow the yen to fund investments in higher-yielding currencies, but when those currencies weaken, investors reverse their positions and are forced to buy back the yen, raising its value.

The U.S. dollar has dropped precipitously against the Brazilian real since 2004 to a 9-year low in July (Exhibit 29). What had supported the Real in past years was the very factor hurting it during the slowdown in the global economy; that being their

status as a major exporter of commodities. Local consumer and investment spending going into fourth quarter looked to be holding strong. Also, its central bank has not cut rates in fear of inflation.

The value of the U.S. dollar against the South Korean won surged to a 10-year high in November (Exhibit 30) after experiencing two years of stable rates. Korean banks had borrowed significant amounts from foreign banks and were caught short as they rushed to lock in dollar funding during the last quarter of 2008.

Growth in India, Asia's third-largest economy, is expected to slow to 7% this year, down from 9% in each of the last three years. The U.S. dollar gained against the Indian rupee, hitting a lifetime high in November, amid a broad scramble to buy dollars as the pipeline of foreign money sputtered (Exhibit 31). Authorities have responded with several measures to bolster the domestic economy and attract capital, but as the world recession mounts, it will fall victim as money is pulled out of emerging markets. The rupee is likely to stay under further pressure as India's balance of payments deteriorates.

To varying degrees, the U.S. dollar gained value against Asian markets in 2008. In the fall, the selloff in Asian stocks helped push currencies to fresh lows, touching levels last seen in the Asian financial crisis a decade ago. Indonesian's central bank, after raising its key interest rate six times during 2008 by a total of 150 basis points to 9.5%, cut its rate by 25 basis points in December to protect the economy from a severe global downturn. The Indonesian rupiah had weakened against the U.S. dollar to a lesser degree than other markets (Exhibit 32). Pakistan experienced a rougher year than some as it was rocked by political instability and the Karachi Stock Exchange imposed a floor on stock prices for four months. The value of the Pakistani rupee largely continued to depreciate against the U.S. dollar (Exhibit 33).

The Chinese government took strong measures in the first half of the year to constrain inflation by allowing the renminbi to continue its strengthening pattern of the last couple of years against the dollar. Since mid-year, it has been unchanged as inflation waned and growth dwindled (Exhibit 34). China's aggressive stimuli measures, coupled with flexibility to lower interest rates, make it a candidate for an early turnaround.

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. From a high in February 2002 to March 2008, the trade weighted index fell 40% (Exhibit 35).

The dollar became a safe haven as the global recession began in mid-July and then spiked against several currencies reflecting a scramble for dollar liquidity. No one doubts the financial crisis started in the U.S., however, even after that, the recent strength in the dollar demonstrates that individuals around the world still have confidence in the U.S. economy.

Commodity Prices

The Commodity Research Bureau (CRB) maintains an index of commodity price movements. The commodities included in the index range from traditional U.S. agricultural commodities to heavily traded international products such as cocoa,

coffee and sugar to metals and energy commodities. The Index is a combination of arithmetic and geometric averaging which means its absolute value at any one time is not particularly informative. However, the movement in the index from any base point can be revealing.

Commodities started 2008 on a strong note and advanced through the first half of the year. Stocks prices were weighed down by uncertainties that led to commodities gaining favor among investors as an asset class they believed would help their portfolios weather the financial storm. It was also believed that emerging markets such as China and India, the primary driver of commodity demand, could decouple themselves from the U.S. mortgage crisis. These philosophies held through mid-year as the CRB started in January 2008 averaging 369, rose to 463 in June, before collapsing and ending the year at 230 (Exhibit 36). The plummet wiped out gains commodities had accumulated since 2002.

The U.S. Department of Agriculture (USDA) publishes monthly indices of prices received by farmers. The index of crop prices received was 157 in January and eventually fell to 145 in December after a mid-year rise to 183 (Exhibit 37). This hefty decline from mid-year of 20.7% resulted from a combination of weak demand and speculators exiting the futures markets. Livestock prices followed the same pattern in 2008 for similar reasons. Starting the year at 129, livestock prices rose to 138 before falling back to an index value of 120 in December.

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. The index of diesel prices paid was 332 back in January 2008, surging to 475 in July, only to drop to 254 in December (Exhibit 38). Starting the year at 283, nitrogen fertilizer prices rose by August to 414, before declining to 325 at the end of the year. These indices imply that producers will face fuel and nitrogen fertilizer costs in 2009 similar to the 2007 crop, barring no major disruptions.

U.S. Net Farm Income

The latest USDA estimates place U.S. net farm income at $86.9 billion for 2008 (Exhibit 39). This represents a very modest increase of $95 million relative to 2007, but 42% above the 10-year average of $61.1 billion.

The story for 2008 is twofold, with a large increase in the value of the crop that is largely offset by rising production costs for the farm sector. Total crop values of $181 billion are forecast to exceed the 2007 record by $30 billion, or 20%. Income performance will not be the same across all farms. In 2008, commodity and input forecasts indicate that incomes will likely be lower for cotton, specialty crop, and livestock operations. Unlike the situation for grains and oilseeds, receipts on these farms are not expected to rise enough from 2007 levels to offset increases in expenses.

USDA estimates that 2008 government payments will increase to a total $12.5 billion; direct payments and counter-cyclical payments are expected to amount to $5.9 billion, dropping from last year's $6.2.

U.S. Farm and Trade Policy

2008 Farm Bill

The Food, Conservation, and Energy Act of 2008, hereafter referred to as the 2008 Farm Bill, legislates the provisions of the cotton farm program for the 2008 through 2012 crops. After a lengthy debate, the bill became law in June, 2008, but as of early 2009, implementing rules for certain provisions were still being developed by the Department of Agriculture.

The new farm law maintains the basic structure of previous farm programs by continuing 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. The 2008 Farm Bill establishes a permanent disaster program designed to partially cover weather-related losses at the whole-farm level. Another new provision is an optional revenue-based counter-cyclical program that producers can choose as an alternative to the target price counter-cyclical program. The new bill also makes significant changes to payment limits and program eligibility requirements.

Base Loan Rates, Marketing Loans and LDP's

The 2008 Farm Bill maintains the upland cotton base loan rate at 52.00 cents/lb (See Table 2 on page 23). 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 effective for the 2008-12 crops:

- Eliminate warehouse location differentials.
- Develop loan schedule premiums and discounts on a 3-year moving average of spot market information, weighted by region's share of U.S. production.
- Eliminate 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, the premium/discount will be set 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.
- In the calculation of the Adjusted World Price (AWP), which is based on the 5 lowest Far East quotes due to a regulatory change by USDA prior to enactment of the farm bill,
  - establish a seamless transition between crop years such that current-crop quotes are used through the end of the marketing year, if available.
  - adjust to U.S. location by using the average costs to market, including average transportation costs.
  - institute 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 for the 2008 through 2012 crop years, but reduced by 10.0% from the 2006 maximum rate for the 2008 through 2011 crop years and reduced by 20.0% from the 2006 maximum rate beginning with the 2012 crop year. Storage is credited when AWP

is less than the total of the loan rate plus interest plus storage.

Marketing loan gains (MLG) will 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, will constitute the base acres and payment yields for the 2008-12 crops. However, the new 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.

In addition to the changes required by the 2008 Farm Bill, a final rule published in December 2008 terminates crop base acreage on lands owned by Federal agencies for the 2009 and subsequent crops. An exception to the rule is given for land that was entered into a lease agreement before December 23, 2008. In that case, the base will be terminated upon expiration of the lease.

Beginning with the 2009 crop, the 2008 Farm Bill, as amended by a subsequent law, precludes payments to farms that have 10 or less total base acres, with exceptions for socially disadvantaged and limited resource farmers.

Direct Payments

For upland cotton, the direct payment is maintained at 6.67 cents/lb (See Table 2 on page 23). There is no direct payment available for ELS cotton. For the 2009-11 crops, direct payments are 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 is increased to 85%. Direct payments remain decoupled from current production decisions.

Target Price

The 2008 Farm Bill continues target prices with adjustments from the levels established in 2002. For upland cotton, the target price is set at 71.25 cents/lb (See Table 2 on page 23). The modest reduction from the 2007 target price of 72.40 cents/lb was necessary to offset the costs of adjustments in other provisions of the cotton program. Also, as in current law, the new farm bill makes no provision for a target price for ELS cotton. Target prices for wheat, soybeans and some minor feed grains are increased from current levels for the 2010-12 crops.

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 will continue to be 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 beginning with the 2009 crop.

In return for accepting a 20% reduction in direct payments and 30% reduction in loan rate, producers may 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 have 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.

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

As expected, payment limits and eligibility requirements were a focal point throughout the farm bill debate. The 2008 Farm Bill includes a number of changes in both limits and eligibility. These changes take effect with the 2009 crop.

The new legislation eliminates the limit on marketing loan gains and LDP's, which was $75,000 in previous years. The limits on direct payments and counter-cyclical payments are maintained at $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 DP limit.

The new law also 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," an interim rule issued by the Department of Agriculture in December 2008 sets forth new restrictions that all shareholders must contribute labor or management. NCC staff submitted comments in late January expressing concerns about this and other changes included in the rule.

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 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).

Cotton Import Provisions

Special Import Quotas are retained in the 2008 Farm Bill. 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 week's 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.

By administrative action, effective January 16, 2009, the Department of Agriculture updated the foreign quotes and their respective quality adjustments used to determine payment rates under the program.

Economic Assistance to Users of Upland Cotton

Beginning August 1, 2008 through July 31, 2012, the Secretary is required to make 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 is 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 2. Support Rates in the 2008 Farm Bill

	Loan Rate		Target Price		Direct Payment
	’08-09	’10-12	’08-09	’10-12	’08-12
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

ACRE Program Provisions	
ACRE State Program Guarantee	90% * (5-yr Olympic rolling avg state yield per planted acre) * (2-yr rolling avg of national average market price); Starting in 2010, the ACRE guarantee shall not increase or decrease by more than 10% from the preceding crop year. Provisions to allow separate guarantees for irrigated and non-irrigated land under certain conditions.
Actual State Revenue	Actual state yield per planted acre * higher of national avg. market price and 70% of marketing loan rate.
Actual Farm Revenue	Actual farm yield * higher of national MYA price and 70% of marketing loan rate.
Farm ACRE Benchmark Revenue	(5-yr Olympic rolling avg farm yield) * (2-yr rolling avg national market price) + per-acre crop insurance premium
Payment Rate per Acre	Lesser of (ACRE State Program Guarantee – Actual State Revenue) or 25% of ACRE State Program Guarantee
Individual Farmer Payments	Payment Rate * Payment Acres * (5-yr Olympic rolling avg farm yield / 5-yr Olympic rolling avg state yield)

World Trade Organization

2008 was a busy year in the ongoing Doha trade negotiations within the World Trade Organization (WTO), but no resolution was reached. 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. In July 2008, WTO Director General Pascal Lamy convened a mini-ministerial in an effort to bring the 7-year old negotiations to a conclusion. Lamy tabled a paper calling for a 70% reduction in allowed levels of U.S. domestic support. However, exemptions from full tariff reductions for special and sensitive products would negate the vast majority of any potential gains in market access.

In December 2008, revised negotiating texts were released which incorporated much of the failed Lamy paper. However, after serious concerns were raised with both the agriculture and non-agricultural texts, efforts to convene another ministerial were abandoned. Schedules for 2009 remain uncertain, but it is expected that there will be efforts to restart the negotiations. Efforts continue by 4 West African cotton-producing countries to single out cotton for inequitable treatment.

Textile Trade Issues

Regional trade preference agreements continue to be vital to the U.S. textile industry's ability to compete, especially since the removal of quotas for all WTO member countries on January 1, 2005. While in office, the Bush Administration worked to open markets globally in the Doha WTO negotiations, through regional trade negotiations, and bilaterally with free trade agreements (FTAs). Since 2001, FTAs with Australia, Bahrain, Chile, Jordan, Morocco, Oman, Peru, Singapore, and the countries of the CAFTA-DR – Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua -have entered into force. The Bush Administration also completed free trade agreements with numerous countries including Colombia, Panama and South Korea. Furthermore, the administration signed a broad agreement with China on Chinese textile imports into the United States.

Only time will tell what happens regarding free trade agreements under the Obama Administration. President Obama seems to generally support free trade policies, but he has expressed concern about free trade agreements that do not include labor and environmental protections. Obama has called NAFTA a bad trade deal and has mentioned trying to amend NAFTA. He has also criticized the U.S.- South Korea FTA, saying it is "bad for American workers". President Obama also opposed CAFTA. However, President Obama supported the FTAs with Peru and Oman. He has also criticized China for manipulating its currency and urged former U.S. Treasury Secretary Henry Paulson to take action against China. He also praised the passage of the Consumer Product Safety Commission (CPSC) Reform Act. This act requires that the Government Accountability Office examine the CPSC's monitoring of goods imported to the U.S. and make recommendations to improve safety and regulation.

China

In late 2001, China officially became a member of the WTO. The textile portion of the China agreement subjected the U.S. textile industry to increase competition

from imported textiles, as it called for quotas on Chinese textile imports to be phased out within 5 years. China has made full use of WTO provisions to increase their textile imports to the U.S.

A China-specific safeguard allows the U.S. and other WTO member countries that believe imports of Chinese-origin textile and apparel products are, due to market disruption, threatening to impede the orderly development of trade in these products to request consultations with China with a view to easing or avoiding such market disruption. Upon receipt of the request, imports from China may be restricted to a level no greater than 7.5% (6% for wool product categories) above the amount entered during the first 12 months of the most recent 14 months preceding the request for consultations. The import quotas may last up to one year. China-specific safeguard petitions are filed with the Committee for the Implementation of Textile Agreements (CITA). Due to the tremendous rise in Chinese textile exports to the U.S., safeguards have been enacted numerous times since 2003.

On November 8, 2005, the U.S. and China signed a broad agreement on Chinese textile imports into the U.S. The agreement went into effect on January 1, 2006 and ended on December 31, 2008 and placed quotas on a broader range of textile and apparel product categories (34) than were subjected to safeguard action (19). The quotas established under the agreement compared favorably to quotas that would have been imposed if China textile safeguards were invoked. Over the life of the agreement, China could export 3.2% more of the covered products to the U.S. than if the safeguards were invoked on all of the covered products for all three years.

In general, U.S. imports of Chinese goods covered by the agreement were allowed to grow by 10 to 12.5% in 2006, 12.5% in 2007, and 15 to 16% in 2008, depending on the item. Furthermore, in 2006, the agreement imposed tighter limits on U.S. imports from China's "core" apparel products. The "core" apparel products are cotton knit shirts, MMF knit shirts, woven shirts, cotton trousers, MMF trousers, brassieres and underwear. Other items covered by the agreement included combed cotton yarn, cotton towels, glass fiber fabric, knit fabric, polyester filament fabric, special purpose fabric, synthetic filament fabric and thread, sweaters, socks/baby socks, swimwear and blinds.

As part of the agreement, the U.S. promised to exercise restraint in the future use of safeguards on products that are not covered by the agreement. The agreement also contained mechanisms to allow U.S. importers and the Chinese government to manage quotas to avoid overshipments. For example, China managed its exports with a visa system and could borrow small amounts of quota from future years to cover overshipments.

Imports from China for the agreement categories were approximately 1.8 billion SME in calendar 2006 and approximately 2.2 billion SME in 2007. NCC estimates that imports from China for the categories covered in the agreement were approximately 2.4 billion SME in calendar 2008 (Exhibit 40). Imports from China for the categories not covered in the agreement were approximately 16.8 billion SME for calendar 2006 and increased to approximately 19.2 billion SME for calendar 2007. For calendar 2008, NCC estimates that imports from China for the

categories not covered in the agreement were approximately 18.3 billion SME.

It is difficult to quantify precisely how much U.S. textile imports from China will increase due to the expiration of the U.S.-China textile agreement. Data for U.S. imports from China for the month of January will be the first data available since the expiration of the China textile agreement. Unfortunately, as of the writing of this report, that data was not yet available. However, in order to attempt to determine the impact of the expiration of the agreement, we can look at the percentage change of European imports from China after their textile agreement expired at the end of 2007. We can also look at China's U.S. market share of U.S. textile imports for categories included in the U.S.-China agreement compared to those categories not included in the agreement.

The loss of the quotas included in the agreement is coming at a time when the U.S. is experiencing a large downturn in our retail market due to the recession. Therefore, the impact of the expiration of the agreement on the U.S. will not be as apparent as it would have been if quotas were removed at a time when the retail market wasn't experiencing such a downturn, since this decline has caused a decrease in total U.S. textile imports. Even with the decline in the U.S. retail market and subsequent decline in U.S. textile and apparel imports from China, China is still the largest single importer of textile and apparel products into the U.S. with a total market share of 41% based on data through November 2008. Looking at U.S. market share for agreement versus non-agreement categories, China's market share of U.S. imports for the categories that were covered by the agreement was just 14% while Western Hemisphere countries (such as the countries of NAFTA, CAFTA, and the Andean) totaled 29% of the U.S. market share (Exhibit 41). However, China's market share for those textile and apparel products that were not covered by the agreement was 55% while the market share of the Western Hemisphere countries was only 9%. This leads to the conclusion that China's market share for all U.S. textile and apparel imports will increase even more after the removal of the quotas at the expense of many of the countries with which we have free trade agreements that encourage the use of U.S. cotton.

The EU-China textile agreement covered ten different product categories. The agreement expired on December 31, 2007. However, eight of the categories covered by the agreement were monitored in calendar year 2008 to ensure a 'smooth transition' after the agreement expired. Data on European imports from China show that in the year after the expiration of the EU-China textile agreement, imports in the eight monitored categories increased in a range of 22 to 300%.

Like the European Union, the U.S. began monitoring certain U.S. textile and apparel imports from China. Representative Rangel (D-NY), chairman of the House Committee on Ways and Means, formally asked the U.S. International Trade Commission (ITC) to initiate an investigation to monitor certain U.S. textile and apparel imports from China beginning in 2009. His request was designed to help prevent a repeat of the disruptive surge of Chinese textile and apparel exports to the U.S. following the discontinuation of quotas in January 2005. The Committee will use the data to evaluate whether the

imposition of safeguards are appropriate with the removal of the remaining quotas since the U.S.-China textile agreement has expired. The reports will be released biweekly by the ITC. The first report was released December 1, 2008 and provided volume, value, unit value and market share of imports from China for the categories included in the agreement.

AGOA

On July 13, 2004, President Bush signed legislation which extended AGOA from its planned expiration date of 2008 to 2015. Other key provisions of the legislation included the extension of authority for the use of third country fabrics from September 2004 to September 2007. Rules-of-origin provisions were amended to allow non-AGOA produced collars and cuffs for apparel import categories. The "folklore" provision was expanded to allow ethnic fabrics that are made on machines to qualify for AGOA duty-free treatment. The legislation also included provisions for the development of sustainable infrastructure and technical assistance, including the assignment of 20 people to sub-Saharan Africa to assist and advise them on sanitary and phyto-sanitary standards to meet requirements for the U.S. market. In 2006, legislation was passed by Congress and signed by President Bush to extend provisions of AGOA which provide for use of non-US, non-AGOA components to September 2008. However, beginning October 2008, 50% of the fabric used in apparel qualifying for preferential access must be manufactured in AGOA countries. The legislation also established tax credits for companies with facilities in AGOA countries or that conduct business in AGOA countries.

The AGOA legislation requires an annual determination to see 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. On January 1, 2009, Mauritania was once again removed from the list of eligible countries after being removed in 2006 and added back in 2007. In 2008, Togo and Comoros were both designated as AGOA eligible. There are now 40 countries that are eligible for economic and trade benefits under AGOA. Of those 40 Sub-Saharan countries, 25 of them are eligible to receive AGOA's apparel benefits. Seventeen of those countries also qualify for AGOA's provisions for handloomed and handmade articles. One country, Nigeria, qualifies for AGOA's ethnic printed fabric benefits.

CAFTA-DR

In the spring of 2004, the Central America Free Trade Agreement (CAFTA) was signed. At that time, the Central American countries included in the agreement were Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. By August 2004, the Dominican Republic was included in the agreement and the agreement became known as the Central America – Dominican Republic Free Trade Agreement (CAFTA-DR). The U.S. Senate passed implementing legislation for CAFTA-DR in June 2005. The House of Representatives passed the legislation in July 2005 and it was signed by President Bush in August 2005. The initial target date agreed to by all signatories for the agreement to go into force was January 1, 2006. In December 2005, U.S. officials announced that implementation would begin on a rolling basis as soon as the

participating countries meet their internal approvals. Under the rolling admissions process, entry into force would occur on the first day of the month with a country that the U.S. Trade Representative determines is ready by the middle of the preceding month. The CAFTA-DR entered into force for El Salvador on March 1, 2006, for Honduras and Nicaragua on April 1, 2006, for Guatemala on July 1, 2006, for the Dominican Republic on March 1, 2007 and for Costa Rica on January 1, 2009.

According to the provisions of the CAFTA agreement, textiles and apparel are duty-free and quota-free immediately 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 agreement's benefits for textiles and apparel are retroactive to January 1, 2004.

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. 'Single transformation' means only one manufacturing step has to be taken in a country in order for products made from components sourced from anywhere to qualify for benefits.

Cumulation is a concept that brings countries that are not signatories to an agreement into the agreement provided they are signatories to another trade agreement. 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. Under the overall cap of 100 million SME, there is a 1 million SME cap on wool, 20 million SME cap on blue denim, and 45 million SME cap on cotton and man-made bottom weights. Mexico and Canada must provide reciprocal benefits to U.S. and Central American textile and apparel exports. Canada and Mexico must also agree to strengthen Customs enforcement measures. The CAFTA-DR Cumulation provision became effective on August 15, 2008. The TPLs for CAFTA-DR cumulation for the period of August 15, 2008 through December 31, 2008 was 41,666,667 SME. During that time, imports applied to this preference level equaled 2,026,541 SME, implying a 4.9% fill rate.

CAFTA-DR provides Nicaragua with a TPL of 100 million SME which phases out over 10 years. CAFTA-DR does not contain TPLs for Costa Rica, El Salvador, Honduras or Guatemala. The TPL was 87,897,046 SME for the 2008 preference period. During this period, 84,219,025 SME of imports were applied to this TPL, implying a 95.8% fill rate. This is up slightly from the 2007 fill rate of 94.2%.

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 can not last more than 3 years for a specific good. On January 18, 2008, the CITA announced

that it had voted to notify Honduras of its intent to apply a textile safeguard measure on cotton socks imported into the U.S. This safeguard was only for cotton socks and does not include wool and man-made fiber socks. CITA determined this safeguard was warranted based on the substantial growth in imports of cotton socks from Honduras. Imports of cotton socks from Honduras were 30.4 million dozen pairs in 2007, an increase of 108% from the same period the previous year. In accordance with the CAFTA-DR agreement, Honduras requested consultations following the receipt of written notice of the intent to apply the safeguard measure. Consultations between the Governments of Honduras and the U.S. were held for 60 days, and by agreement of both parties, were continued for an additional 30 day period. CITA announced on April 23, 2008 they had determined to apply a textile safeguard measure on imports of cotton socks from Honduras. This safeguard applied a duty in the amount of 5% ad valorem to all CAFTA-DR originating socks of Honduras classifiable in subheading 6115.95 of the Harmonized Tariffs Schedule of the United States that were entered, or withdrawn from warehouse, for consumption from July 1, 2008 through December 31, 2008. The 5% ad valorem duty was applicable on the full value of the entered goods, regardless of the value of any U.S. content of the goods.

The agreement also contains a new 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.

Under legislation passed by Congress and signed by President Bush in the summer of 2006, material for pockets going into apparel made in the CAFTA region will have to be made in the U.S. or CAFTA countries for the product to enter the U.S. duty free. As of December 2006, all five of the Central American signatories to the CAFTA-DR and the Dominican Republic had concluded agreements on pocketing fabric with the U.S. The next step was for all of the CAFTA-DR parties to complete their domestic legislative procedures required to implement the amendments that have been agreed upon. As of October 1, 2007, all CAFTA-DR countries had signed the official "working party" letter agreeing to the pocketing change but none had made the administration or legislative changes needed to actually implement the agreement. The U.S. government expected the CAFTA-DR countries to complete these changes during the month of October 2007. The changes had to be made by January 1, 2008 or new legislation would have had to be introduced in the U.S. Congress which again authorized the President to make the pocketing changes since the current authority under existing legislation expired on December 31, 2007. On December 21, 2007, President Bush issued a proclamation to implement amendments to the CAFTA-DR agreement granting additional textile and apparel concessions to our CAFTA-DR in return for a new rule of origin for pocketing. The CAFTA-DR pocketing amendment became effective on August 15, 2008.

Andean

Negotiations on a trade agreement between the U.S., Colombia, Ecuador, and Peru (Bolivia was participating as an observer) continued throughout 2005. The last round of talks occurred in November 2005, but

failed to develop a comprehensive agreement. However, Peru decided to continue negotiations and a free trade agreement was concluded between the U.S. and Peru in December 2005. Negotiations with Columbia were concluded on February 27, 2006. Negotiations with Ecuador are ongoing.

The U.S. - Peru Trade Promotion Agreement was signed on April 12, 2006. On May 10, 2007, the Democratic Leadership of the U.S. House of Representatives and the Bush Administration announced they had reached a conceptual agreement regarding labor, environmental and intellectual property provisions of the pending FTAs with Peru, Colombia, Panama, and South Korea. At the end of June 2007, the U.S. Trade Representative announced that it had reached agreements with each of the pending FTA countries to incorporate these changes into the legal text of the FTAs. In November 2007, legislation to implement the Peru Free Trade Agreement was approved by the U.S. House of Representatives. The U.S. Senate approved legislation to implement the U.S. – Peru free trade agreement in early December 2007 and the agreement was signed by President Bush on December 14, 2007. The U.S. – Peru free trade agreement entered into force on February 1, 2009.

Under the U.S. – Peruvian agreement, 80% of U.S. consumer and industrial product exports and two-thirds of U.S. agricultural exports to Peru will be duty-free immediately. The 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. As mentioned previously, 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. As of mid-January 2009, the U.S. – Colombia Trade Promotion Agreement was still pending Congressional approval.

Under the U.S. – Colombia agreement, over 80% of U.S. export of consumer and industrial products to Colombia will be 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 after entry into force, or through a similar process under the Andean Trade Preference Act before entry into force. 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. Since it was not possible for Congress to approve legislation implementing the FTAs with Peru and Colombia before the ATPDEA expired, U.S. textile and apparel groups urged Congress to act to ensure that preferential access for products produced in the Andean region containing U.S. cotton, yarn, and fabric was not interrupted. Before adjourning in December 2006, Congress passed legislation to extend the ATPDEA. President Bush signed the legislation on December 20, 2006. In June 2007, the U.S. House and Senate approved legislation and President Bush singed into law another extension of the ATPDEA. This extension lasted until February 29, 2008. In February 2008, the U.S. House and Senate approved a 10-month extension of the ATPDEA. This extension was scheduled to expire on December 31, 2008. In October 2008, the House and Senate approved legislation to extend provisions of the ATPDEA again. The legislation provides a one-year extension for Colombia, but limits the extension to six months – subject to further review – for Ecuador and Bolivia because of their actions against U.S. investors. USTR has taken separate action to strip Bolivia of ATPDEA benefits.

Haiti

In September 2006, legislation – the Haitian Hemispheric Opportunity Through Partnership for Encouragement Act (HOPE) - was introduced that would provide 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 or CAFTA. Congress passed the legislation in December 2006 and it was signed by President Bush on December 20, 2006.

U.S. textile industry organizations expressed strong objections to this legislation due to the very loose rule-of-origin. These organizations argued that the rule-of-origin is unenforceable according to customs and would result in transshipment of Chinese products displacing US exports and disrupting mutually beneficial trade with neighboring CAFTA countries.

HOPE provided that the annual quantity of goods eligible for duty-free benefits will be recalculated for each subsequent 12-month period. HOPE also provided 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, 2007 and extending through December 19, 2008 was 313,000,534 SME. During that time period, 14,922,358 SME were attributed to the limit, implying a fill rate of 4.8%.

The 2008 Farm Bill included amendments to rules enacted in 2006 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.

Vietnam

The comprehensive trade legislation that was passed by Congress and signed by President Bush in December 2006 included provisions granting Permanent Normal Trade Relations (PNTR) to Vietnam. PNTR permits the U.S. to enter into the reciprocal "most favored nation" relationship – a relationship necessary for the U.S. and Vietnam to make use of the benefits of Vietnam's membership in the World Trade Organization (WTO). Vietnam's commitments in joining the WTO included wide-ranging reforms to its economy and substantial reduction in tariffs. Vietnam became the 150th member of the WTO on January 11, 2007.

In November 2006, the Bush Administration agreed to institute a Vietnam anti-dumping program at the Department of Commerce. As part of the program, the government agreed to monitor imports of textiles and apparel from Vietnam and to institute dumping investigations if dumping occurs. On January 11, 2007, the Department of Commerce began monitoring imports of textile and apparel products from Vietnam, concurrent with Vietnam's accession to the WTO and the subsequent removal of quotas on Vietnamese imports. This monitoring program was in effect until the end of the Bush Administration. The Department of Commerce initially monitored five sensitive product categories – trousers, shirts, sweaters, underwear, and swimwear – however, products could be added or removed from monitoring based on Commerce's analysis and/or input received from its outreach efforts. In November 2008, the Department of Commerce announced, after reviewing the third series of six months of data from the monitoring program, there was insufficient evidence to warrant self-initiating an antidumping investigation. This was the final review under the import monitoring program that concluded at the end of the Bush Administration. The Department of Commerce continued to post import data for these product groups on the Vietnam Textile and Apparel Import Monitoring Program Web site until January 20, 2009. In January 2007, Vietnam announced that it would require export licenses for the product categories being monitored by the U.S. and that it would not allow unduly low priced goods to be exported.

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. As of January 2009, the agreement (referred to as the KORUS FTA) is still pending approval by Congress.

The KORUS FTA should have the largest economic impact on the U.S. of any free trade agreement since NAFTA. Korea's agricultural sector is heavily protected from imports and will open significantly under the agreement. However, rice was excluded from coverage and high beef tariffs will phase out over a 15-year period. The US Trade Representative's office reported that more than $1 billion worth of US farm exports to Korea will become duty-free immediately. Trade in cotton fiber is slated to be liberalized quickly under the agreement. The agreement maintained the use of a "yarn-forward" rule of origin for textiles, no tariff preference levels, no cumulation, and no immediate concessions for the Kaesong Industrial Zones. The agreement also includes a textile safeguard and strong customs enforcement language. The KORUS FTA also allows for immediate duty-free access for Korea for most textile and apparel lines (87% of all tariff lines and over 50% of 2006 trade).

Miscellaneous Trade Agreements

In September 2006, President Bush signed into law the U.S. – Oman Free Trade Agreement. The agreement provides full reciprocal market access for U.S. textile and apparel producers. The agreement contains a yarn-forward rule of origin which requires textile and apparel products to contain U.S. or Omani yarn and fabric in order to qualify for duty-free treatment. However, the agreement also provides, on a temporary basis, duty-free treatment for limited quantities of textile and apparel products that do not meet this requirement. This tariff preference level is 50,000,000 SME annually for ten years for knit or woven apparel of cotton or man-made fiber. The U.S. – Oman Free Trade Agreement entered into force on January 1, 2009.

On December 19, 2006, the U.S. and Panama announced they completed negotiations on a free trade agreement with the understanding that it is subject to further discussions regarding labor. A conceptual agreement between the Democratic Leadership of the U.S. House of Representatives and the Bush Administration regarding labor, environmental and intellectual property provisions of the pending FTAs including the FTA with Panama was reached in May 2007. At the end of June 2007, the U.S. Trade Representative announced that it had reached agreements with each of the pending FTA countries to incorporate these changes into the legal text of the FTAs. As of January 2009, the U.S. – Panama Free Trade Agreement is still pending Congressional Approval.

Looking Ahead

As mentioned previously, 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. When TPA expired, the Administration effectively lost its authority to enter into new FTA negotiations. Therefore, Doha and FTA negotiations are likely to remain at a standstill until TPA is extended.

Before TPA expired, negotiations were under way or about to begin with other countries including Malaysia, Ecuador, Thailand, the five nations of the Southern

African Customs Union (Botswana, Lesotho, Namibia, South Africa and Swaziland) and the United Arab Emirates. In late 2008, the USTR announced that the U.S. intends to initiate negotiations on a Trans-Pacific Partnership free trade agreement with Singapore, Chile, New Zealand, Brunei Darussalam, Australia, Peru and Vietnam. The first round of negotiations for the free trade agreement are tentatively scheduled for early in 2009.

U.S. Supply

Planted Acreage

U.S. farmers planted 9.3million acres of upland cotton in 2008, a decline of 12% from the previous year (Exhibit 42). The decline in upland acres was consistent with early-season expectations with all regions except the Southwest planting less than in 2007. The drop in acreage comes on the heels of a 30% decline in 2007. The continuing decline in acres was in response to a combination of strong competition from grain and soybeans and increased production costs reducing the attractiveness of cotton.

Upland area in the Southeast fell by 15%, and at 1.9 million acres, was the lowest since 1993 (Exhibit 43). Only Virginia, with 61 thousand acres, increased from the 2007 level. The remaining states exhibited declines between 9% and 27%. Georgia, which accounts for almost one-half of the region's cotton area, planted 940 thousand acres, a drop of 9%. With 14% fewer acres in 2008, growers in North Carolina planted 430 thousand acres. Alabama planted just 290 thousand acres in 2008, down 27% from 2007. South Carolina followed with acreage of 135 thousand acres, down 25% from the previous year. Finally, a 21% reduction in Florida left the state with 67 thousand acres. Looking across the states, USDA data indicate that growers expanded acreage of soybeans and peanuts at the expense of cotton.

In 2008, plantings in the Mid-South fell by 32%, which follows a 35% decline in 2007. Acreage across the 5-state region now totaled 1.9 million acres, the lowest since 1983 (Exhibit 44). Declines were evident in all states with Mississippi and Tennessee's decline of 45% being the largest in percentage terms. With 620 thousand acres, Arkansas reduced acreage by 28%. Growers in Missouri lowered acreage by 19%, bringing their total area to 306 thousand acres. In Louisiana, cotton area fell by 10% to 300 thousand acres. Across the region, growers shifted land away from cotton in favor of double-cropping wheat and soybeans.

In the Southwest, growers planted 5.2 million acres, an increase of 2% from 2007 (Exhibit 45). Across the region, state-level results varied with Kansas planting 26% fewer acres in 2008, while Oklahoma reduced area by just 3%. In contrast, growers in Texas planted 5.0 million acres, or 2% more than in 2007.

In the West, the recent trend of declining cotton area continued as growers planted 292 thousand acres, down 28% from 2007 (Exhibit 46). The 2008 total is the lowest upland plantings in the West region in recent history. Declines occurred in all Western states, with California leading the way both in actual and percentage declines. Competition from specialty crops and reduced water availability lowered California upland acreage to 120 thousand acres, down 38% from the previous year. Growers in Arizona planted 135 thousand acres, a 21% drop from 2007. With 37 thousand acres, New Mexico fell 14% below their 2007 level.

ELS area is facing some of the same pressures and constraints as upland acres in the West. In 2008, competition from specialty crops and reduced water contributed to a 40% reduction in ELS plantings (Exhibit 47). In California, 155 thousand acres of ELS cotton were planted

in 2008, down 40% from the previous year. Acreage in Arizona was down 68% to 800 acres. In New Mexico, ELS area fell 43%, while Texas planted 15.5 thousand acres of ELS, a decline of 38% from 2007.

Harvested Acreage

Although some parts of the Cotton Belt experienced better growing conditions in the 2008 season, the net result across the belt was decidedly a poorer year in terms of weather. For the Southeast, 2008 was clearly a much better year than the drought-ravaged results of 2007. However, portions of the Mid-South suffered severe crop losses due to late-season hurricanes, with Louisiana receiving the brunt of the damage. In the Southwest, portions of Texas also suffered crop losses due to hurricanes, while other parts of the region experienced higher abandonment and lower yields due to drought conditions. Across all cotton acres, abandonment rose to 18.4%, the highest since 1998 (Exhibit 48). By comparison, the average abandonment in the prior 5 years was 7.6%.

Yields

The effects of the weather problems that plagued the Mid-South and Southwest are evident in the latest USDA 2008 crop estimates. The U.S. average cotton yield is estimated at 810 pounds, down sharply from the 2007 record yield of 879 pounds (Exhibit 49). The 2008 yield is the lowest since 2003. The 2008 upland yield is estimated to be 799 pounds, 13 pounds below the 5-year average. ELS yields averaged 1,265 pounds, which is also below the 2007 level. However, the 2008 ELS yields surpassed the recent 5-year average by 6 pounds.

The Southeast achieved a record yield of 853 pounds in 2008, surpassing the previous mark of 823 pounds set in 2005. The regional average yield is almost 100 pounds above the 5-year average (Exhibit 50). Yields in each of the 6 states recovered from 2007, with South Carolina, Alabama, and Florida seeing the greatest rebound. With an average yield of 896 pounds, South Carolina set a new record and surpassed their 5-year average by more than 400 pounds. With a record yield of 836 pounds, 2008 marked the first time that Alabama has surpassed the 800-pound mark for a state average. In a similar manner, Florida set a state record of 901 pounds. While Georgia, North Carolina, and Virginia did not set yield records, their 2008 results exceeded both 2007 and the 5-year average.

Across the Mid-South, the 2008 average yield of 930 pounds equaled the 2007 result and fell just 9 pounds below the 5-year average (Exhibit 51). However, the results across the 5-state region were dramatically different. Growers in Missouri achieved a record yield of 1,061 pounds, surpassing the 5-year average by more than 100 pounds. Although not a state record, Tennessee benefitted from much-improved growing conditions and harvested 917 pounds per acre, which is approximately 350 pounds better than the previous year. While Arkansas and Mississippi fell short of their 2007 yield, average yields of 1,022 and 920 pounds, respectively, were in line with 5-year averages. State averages were reduced due to localized hurricane damage. In general, the devastating effects of the hurricanes are evident in Louisiana's sharply-reduced yield of 560 pounds. By contrast, the 5-year average for the state is 928 pounds. To better understand the severity of the

losses in Louisiana, the 2008 yield is the lowest since 1981.

A series of weather events, primarily affecting parts of Texas, did not allow Southwest yields to match either 2007 or the 5-year average. Across the region, the 2008 yield averaged 656 pounds per acre, 183 pounds below 2007 and 30 pounds short of the 5-year average (Exhibit 52). However, results were mixed across the region as growers in Kansas and Oklahoma generally fared better than their counterparts in Texas. In fact, Oklahoma's 2008 average yield of 805 pounds was the second highest on record, falling short of the 817-pound record set in 2007. With an average yield of 686 pounds, growers in Kansas achieved a record, surpassing the previous record by almost 50 pounds. For Kansas, the 2008 yield is 151 pounds better than their 5-year average. Unfortunately, favorable yields were not recorded in most parts of Texas. For the state, the 2008 yield averaged 649 pounds, down from a 5-year average of 688 pounds. As previously noted, southern regions of the state suffered losses from hurricanes, while West Texas faced early season losses due to high winds and then suffered further losses due to drought conditions.

The average upland yield in the West is estimated at 1,420 pounds, 73 pounds above the 5-year average (Exhibit 53). California led the way with an average yield of 1,518 pounds, which falls short of the 2007 record but surpasses the 5-year average by 136 pounds. In Arizona, an average yield of 1,444 pounds is 73 pounds above the 5-year average. Growers in New Mexico harvested 988 pounds, which is the third highest on record and 42 pounds better than their 5-year average.

The national average ELS yield is estimated at 1,265 pounds, just 6 pounds above the 5-year average (Exhibit 54). With the majority of ELS acres, California heavily influences the U.S. average. With an average yield of 1,319 pounds, California fell short of 2007 and was generally in line with the 5-year average. New Mexico was the success story of 2008 with a state-record ELS yield of 1,108 pounds, exceeding the 5-year average by 231 pounds. With an average yield of 960 pounds, Arizona also exceeded 2007 results and the 5-year average. In Texas, the average yield of 768 pounds was more than 100 pounds below their 5-year average.

Production

USDA's latest estimate places the 2008 U.S. cotton crop at 13.0 million bales (Exhibit 55), which is down more than 6 million from 2007. The sharp drop in production is the result of reduced acreage and lower yields. Relative to 2007, higher yields allowed the Southeast to be the only region to register an increase in production. Cotton crops in the other three regions fell by more than one-third. The upland crop, estimated at 12.6 million bales, was 31% below the 2007 level. After a record production of 852 thousand bales in 2007, ELS production in 2008 declined by 48% to 447 thousand bales.

The Southeast produced 3.4 million bales of upland cotton in 2008, accounting for 27% of the total upland crop (Exhibit 56). This is more than 100 thousand bales above 2007 but still down 1.2 million bales from the 5-year average. Across the region, better yields more than offset the decline in cotton area.

For 2008, the Mid-South accounted for 28% of the total U.S. upland crop. With lower acreage, upland production in the Mid-South fell to its lowest level since 1986 and one-half of the 5-year average. All states in the region reported smaller crops with Louisiana and Mississippi showing the largest percentage declines.

Production in the Southwest fell by more than 3.5 million bales as reduced yields due to unfavorable weather in Texas more than offset a slight increase in area. Upland production of 4.9 million bales accounts for 39% of the U.S. crop.

The West produced 840 thousand bales of upland cotton in 2008, down more than 400 thousand bales from the region's 2007 crop. The region accounts for 7% of U.S. production. All states in the region declined as the regional total fell to the lowest level in recent decades.

The 2008 ELS crop of 447 thousand bales is the smallest since 2003 and 405 thousand bales below 2007. At 415 thousand bales, the California ELS crop was 203 thousand bales smaller than the 5-year average (Exhibit 57). The state accounted for 93% of the total 2008 U.S. ELS crop. Production also declined in Arizona, New Mexico, and Texas.

Stock Levels

With mill use and exports for the 2007 marketing year falling below early-season expectations, cotton stocks rose for the fourth consecutive year. As a result, total stocks grew to an estimated 10.0 million bales at the beginning of the 2008 marketing year (Exhibit 58). This is more than 500 thousand bales above the 2007 level and the highest amount in recent history. Upland stocks accounted for all of the increase of total cotton stocks with 9.9 million bales. At 139 thousand bales, stocks of ELS cotton fell slightly during the 2007 marketing year.

With smaller production in 2008, cotton placed under CCC loan during the first half of the 2008 marketing year is down from year-earlier levels. As of December 31, 2008, outstanding CCC loan stocks were 6.2 million bales (Exhibit 59). This is approximately 3.5 million bales below the same point in the 2007 marketing year. While loan entries are down across the Cotton Belt, the Mid-South and Southwest account for more than three-fourths of the reduction. Roughly 80% of the cotton under loan was Form G (cooperative) while the remaining 20% was Form A (producer).

Total Supply

Total supply for the 2008 marketing year is estimated to be 23.1 million bales, down from 28.7 million the previous year (Exhibit 60). Lower supplies came about as reduced production more than offset higher beginning stocks. For the 2008 marketing year, imports of raw cotton are expected to be 10 thousand bales. The 2008 supply represents the lowest total for cotton supply since 2000.

Upland Cotton Quality

As a whole, the quality of the 2008 crop is exceeding the recent 5-year averages for staple and strength. With 11.8 million running bales classed through January 22, the national average staple length (measured in 32^{nd} of an inch) is 35.7, up from a 5-year average of 35.0 (Exhibit 61). The Southeast matched their 5-year average staple length of 34.6. In the Mid-South, the average staple length of 35.7 exceeds the 5-year average by 0.9 thirty-

second's. The Southwest continues a trend of increasing length with an average staple of 36.2, exceeding their 5-year average by 1.1 thirty-second's. The West reports the longest staple, with an average of 37.3. The 2008 average represents the first time that the average staple in the West has exceeded 37.0.

The 2008 upland crop is showing excellent strength characteristics with a national average of 29.7 grams/tex, up 0.7 grams/tex from the 5-year average. Strength is exceeding the 5-year averages in all regions with the Mid-South and the West showing the largest gains. At 30.2, the average strength in the Mid-South is 1.4 grams/tex better than the 5-year average. 2008 also marks the first time for the Mid-South to average above 30.0. The average strength of 31.9 in the West is 1.3 grams/tex better than the 5-year average. In the Southwest, the average strength is 29.6 grams/tex, up from 29.1. The crop in the Southeast has an average strength of 28.7 grams/tex, which is 0.1 better than the 5-year average.

Color grades for the 2008 crop exceed the 5-year average for all regions (Exhibit 62). For the U.S., 91.2% of the crop is grading 41 or better, which compares to the 5-year average of 84.4%. In the West, color grades were higher than the 5-year average as 97.2% had a grade of 41 or better. The Mid-South followed with 93.9% of the crop grading 41 or better, which is more than 10 percentage points better than their 5-year average. In the Southeast, 89.8% of the bales classed had a color grade of 41 or better. The Southwest followed with 89.1%, as compared to a 5-year average of 84%.

The average micronaire of the 2008 upland cotton crop is 42.9, down from the 5-year average of 43.8. The Mid-South, with an average of 46.2, reports the highest micronaire. The Southeast follows with an average of 45.5. Both regions exceeded their 5-year averages. With an average micronaire of 43.1, the West region comes in below their 5-year average of 44.3. The Southwest reports the lowest micronaire, with an average of 38.7.

Cotton Prices

Upland Cotton Prices

Upland cotton prices traded in a relatively narrow range between July 2004 and June 2007 with the "A" Far East (FE) Index generally ranging between 50 and 60 cents per pound (Exhibit 63). New York futures tracked closely with the "A" (FE) Index, but typically traded about 5 cents below the "A". In the latter half of 2007, cotton prices strengthened, largely in sympathy with other commodity prices. As 2008 began, the "A" Index traded in the low 70's and the nearby futures contract was in the upper 60's. However, 2008 brought a new environment, and volatility and uncertainty defined cotton prices during the year.

In the first week of March, cotton futures traded on the InterContinenetal Exchange (ICE) unexpectedly spiked higher. While the Commodities Futures Trading Commission (CFTC) has an ongoing investigation of the events surrounding the surge in prices, it is worth noting that the spike came on the heels of a move to all electronic trading of cotton futures. The electronic move was accompanied by an influx of new money from investors such as pension funds and mutual funds.

While daily trading limits kept increases in futures prices in check, margin requirements were determined based on the synthetic close calculated using options trading. The result was tremendous financial pressure placed on cotton industry firms due to the larger-than-expected margin calls.

Almost as quickly as prices increased, they moved lower, and by mid-March, were trading in the 70's. The nearby futures contract and the "A" Index traded between the upper 60's and upper 70's until mid-August. By the fall, concerns about the general economy and an exodus of investment funds in commodity markets contributed to a sharp fall in upland cotton prices. By mid-November, the December 2008 futures closed below 40 cents, and the "A" Index briefly dipped below 52 cents. The move from 90 cents to 40 cents in the December '08 contract in such a short span of time is unprecedented.

By the end of January 2009, the "A" had risen into the upper 50's. Thus far through the 2008 marketing season, the "A" (FE) Index has averaged about 64 cents/lb., down from 73 cents/lb. during the 2007 marketing year. The nearby NY contract has averaged 53 cents, which is also down from year-ago levels.

Thus far into the 2008 crop year, spot 4134 values have averaged 49 cents/lb.; the average spot 4134 value for the 2007 crop cotton was about 61 cents/lb (Exhibit 64). During 2008, spot market prices generally followed the trend in futures. However, while spot prices increased in early March, the rise was not to the extent observed in the futures market. As a result, the basis widened to 10 cents and remained above average levels through mid-August.

ELS Prices

In early 2008, ELS prices began to move marginally higher from the low prices of 2007 (Exhibit 65). With sharply lower production, prices continued to strengthen during the second half of 2008. As of the end of January 2009, the average ELS spot price was just over $1.25 per pound.

Cottonseed Situation

Cottonseed Supply

USDA estimates 2008 cottonseed production at 4.4 million tons, down from 6.6 million the previous year (Exhibit 66). A regional breakdown of production shows that the Southwest produced 1.7 million tons or about 39% of the total, the largest of any region (Exhibit 67). This was followed by the Mid-South with estimated production of 1.2 million tons for a 27% share. The Southeast produced 1.1 million tons, or 24% of total production, and the West accounted for 462 thousand tons, 10% of the total.

Supplementing the 2008 crops, beginning stocks of 643 thousand tons and 50 thousand tons of imports give total cottonseed supply for 2008 of 5.1 million tons (Exhibit 68). The 2008 supplies represent the lowest levels in recent history.

Disappearance and Stock Levels

USDA's latest estimate places 2008 cottonseed disappearance at 4.8 million tons, down 1.6 million tons from the previous year (Exhibit 69). Crush is estimated at 2.4 million tons, down 300 thousand tons from 2007. With lower supplies, use of the whole seed for feed purposes is expected to fall sharply in the current marketing year. USDA estimates that 2.0 million tons of cottonseed will be used for feed. As a result, this will be the

first year since 1997 that crush of cottonseed has exceeded the amount used for feed. Estimated exports of 351 thousand tons are only 60% of the 2007 level. Reduced supplies and stronger cottonseed prices are contributing to the lower exports.

With sharply smaller production, stocks of cottonseed are estimated to decline during the 2008 marketing year (Exhibit 70). With projected ending stocks of 330 thousand tons, 2008 carryover will be the lowest since the 1999 marketing year.

Cottonseed Prices

Strength in competing feed prices and reduced cottonseed supplies fueled a rise in cottonseed prices that peaked at almost $400/ton in July 2008 (Exhibit 71). As corn and soybean prices fell, cottonseed prices followed suit, despite the sharply lower supplies for the 2008 marketing year. By December, average cottonseed spot prices had fallen below $250 and remained near that level in early 2009. While down from the 2008 level, current prices are above historical averages.

2009 Planting Intentions

Price Prospects

As growers approach the 2009 planting season, cotton prices are approximately 20 cents below year-ago levels (Exhibit 72). As of the end of January, December 2009 futures are trading in the mid 50's. At this time last year, the December 2008 contract was above 75 cents per pound. Like most commodity markets, cotton prices weakened in the second half of 2008. In addition to growing pessimism about global demand, cotton prices are pressured by plentiful stocks.

Driven by the increased demand for corn to produce ethanol, corn prices continue to trade at high levels relative to historical averages. However, with weaker oil and gasoline prices, corn prices have retreated from the peak levels achieved in summer 2008. On the Chicago Board of Trade, the December 2009 contract traded around $4.25 per bushel at the end of January (Exhibit 73). This is down from year-earlier levels by approximately $0.85 per bushel. Despite the smaller 2008 corn crop, prices have moved lower as ethanol plants have come under increasing financial strain due to lower gasoline prices. In addition, weakening export demand has contributed to the lower prices relative to year-earlier levels. Heading into the 2009 planting season, corn and soybeans continue to jockey for available acres.

Throughout 2008, soybean prices generally followed a similar path to corn, strengthening during the first half of the year and then declining through the end of the year. In fact, in mid-summer 2008, the November '08 contract closed above $16 per bushel before expiring below $9 in November (Exhibit 74). As of the end of January 2009, the November '09 contract traded around $9.50 per bushel. This is more than $2 per bushel below year-earlier levels of the '08 contract. However, it is important to note that the November '09 contract has strengthened from lows registered in December due to dry weather and concerns about production in South America. The recent price rally, coupled with the lower input costs required for soybean production, are expected to provide stiff competition to cotton for available acres.

As growers consider their 2009 planting decisions, they are comparing prices for

cotton, corn, soybeans and other regional crops. Growers will also be influenced by production costs, which have declined from the 2008 peak, but will likely remain higher than 2006 and 2007. 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.

2009 U.S. Cotton Acreage Intentions

In mid-December 2008, the NCC mailed out its annual early season planting intentions survey. Respondents are asked to give their plantings of cotton, corn, soybeans, wheat, and other crops for 2008 and intended acreage for 2009. The response rate on the latest survey was about 10%, comparable to the typical return rate. 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 17.8% decrease in the region's upland area to 1.6 million acres (See Table 3 on page 45). All states except Florida indicate declining cotton acreage. In Florida, growers report a planned 2.5% increase coming at the expense of peanuts. Survey results for Georgia, North Carolina, and South Carolina indicate declines ranging between 11% and 19%. Alabama and Virginia will have the largest cutbacks in percentage terms. Total 2009 acreage for each of the states is as follows: Alabama at 193 thousand acres (-33.3%), Florida at 69 thousand (+2.5%), Georgia at 782 thousand (-16.8%), North Carolina at 379 thousand (-11.9%), South Carolina at 110 thousand (-18.4%), and Virginia at 47 thousand (-22.8%). In Alabama, Georgia, and Virginia, the survey indicates that growers are shifting to corn and soybeans. In the Carolinas, soybeans are the primary beneficiary of the intended drop in cotton area.

In the Mid-South, survey results show that all states intend to reduce cotton area for 2009. Growers in the region intend to plant 1.4 million acres, a decline of 23.4% from the previous year. All states in the region indicate a shift out of cotton and into soybeans, while Mississippi respondents also plan to increase corn area. Coming on the heels of a sharp decline in 2008, the 2009 intentions put Mid-South cotton area at the lowest level since 1983. The largest decrease is in Arkansas (-28.8%) with plantings of 441 thousand acres. Mississippi (-26.5%) and Louisiana (-26%) also show sizable declines with plantings of 268 thousand acres and 222 thousand, respectively. Missouri is expected to plant 234 thousand acres, a decline of 23.6%. With only a 4.4% decline, Tennessee's cotton is expected to total 272 thousand acres.

Survey results indicate the smallest percentage drop will occur in the Southwest with intentions off 8.8% from 2008, bringing planted area for the region down to 4.7 million acres. The decline in the Southwest is the result of Texas indicating a 9.2% decline to 4.5 million acres. Within Texas, respondents from South Texas and the Blacklands regions indicate larger reductions in 2009 cotton acres relative to West Texas. Growers in South Texas indicate a shift to the 'Other Crops' category, which is likely grain sorghum. In West Texas, the shift from cotton is to wheat and the 'Other Crops'

category. Moving to the north, a planned reduction of 1.7% by growers in Oklahoma will give the state 167 thousand acres. Kansas is planning to increase cotton area by 7.2%. However, with intended plantings of 38 thousand acres, the 2009 level is well below their historical peak.

All states in the West region show declines in upland plantings, with the region as a whole down 31% to 202 thousand acres. In California, intended area of 54 thousand acres represents a 55.4% decrease from the previous year. The expected decline in acreage is the result of serious concerns over water availability and competition from specialty crops. Growers in New Mexico intend to decrease upland area by 39.7% to 22 thousand acres. Arizona growers indicate a drop of 6.9% to 126 thousand acres.

Summing across the 4 regions gives intended 2009 upland cotton area of 8.0 million acres, 14.3% lower than 2008. If realized, U.S. upland area would be the lowest since 1983 – the year of the Payment-in-Kind (PIK) program.

Survey results indicate that U.S. cotton growers intend to decrease ELS plantings 18.6% to 142 thousand acres in 2009. Results across the 4 ELS-producing states are mixed. In New Mexico, a 27.1% reduction brings acreage down to 2 thousand acres. A decrease of 23% is indicated by California growers, bringing acreage to 119 thousand acres. Producers in Arizona (1,000 acres) and Texas (19 thousand acres) indicate increases of 25% and 24.3%, respectively.

Summing together the upland and ELS cotton intentions shows U.S. all-cotton plantings in 2009 of 8.1 million acres, 14.4% lower than the previous year. (See Table 3 on page 45 and Exhibit 75)

2009 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. However, for the economic outlook, normal or average weather conditions are assumed. In addition, it is assumed that abandonment returns to levels consistent with historical averages.

Assuming an average abandonment across the Cotton Belt of 9.4%, harvested area would be 7.3 million acres (Exhibit 76). For all states, expected yields are aligned with recent trends. Weighting by 2009 area generates a U.S. average yield of 834 pounds. This compares to a 2008 yield of 810 pounds and a 2003-07 average of yield of 821 pounds. Applying each state's yield to its 2009 projected harvested acres generates a cotton crop of 12.8 million bales, with 12.4 million bales of upland and 372 thousand bales of ELS.

Based on the estimate of projected yields, upland production by region is: Southeast = 2.7 million bales; Mid-South = 2.9 million; Southwest = 6.2 million; and West = 580 thousand.

Combining projected production with expected beginning stocks of 7.5 million bales gives a total U.S. supply of 20.3 million (Exhibit 77). This is a decrease of approximately 3 million bales from the 2008 level and the lowest since 1998.

For cottonseed, multiplying the point estimate of lint production by an average

lint-seed ratio generates expected production of 4.4 million tons. With 330 thousand tons of beginning stocks and expected imports of 40 thousand tons, 2009 cottonseed supply totals 4.7 million tons (Exhibit 78).

Obviously, weather will have a dramatic impact on the final crop size, particularly in light of the fact that Texas is expected to account for 57% of U.S. cotton area. Under ideal conditions, 14 million bales would not be out of the question, while weather problems could also push the crop to 10 million bales.

Table 3. Prospective 2009 U.S. Cotton Area

	2008 Actual (Thou.) 1/	2009 Intended (Thou.) 2/	Percent Change
SOUTHEAST	**1,923**	**1,580**	**-17.8%**
Alabama	290	193	-33.3%
Florida	67	69	2.5%
Georgia	940	782	-16.8%
North Carolina	430	379	-11.9%
South Carolina	135	110	-18.4%
Virginia	61	47	-22.8%
MID-SOUTH	**1,876**	**1,438**	**-23.4%**
Arkansas	620	441	-28.8%
Louisiana	300	222	-26.0%
Mississippi	365	268	-26.5%
Missouri	306	234	-23.6%
Tennessee	285	272	-4.4%
SOUTHWEST	**5,205**	**4,746**	**-8.8%**
Kansas	35	38	7.2%
Oklahoma	170	167	-1.7%
Texas	5,000	4,542	-9.2%
WEST	**292**	**202**	**-31.0%**
Arizona	135	126	-6.9%
California	120	54	-55.4%
New Mexico	37	22	-39.7%
TOTAL UPLAND	**9,296**	**7,965**	**-14.3%**
TOTAL ELS	**174**	**142**	**-18.6%**
Arizona	1	1	25.0%
California	155	119	-23.0%
New Mexico	3	2	-27.1%
Texas	16	19	24.3%
ALL COTTON	**9,470**	**8,107**	**-14.4%**

U.S. Market

U.S. Textile Industry

Like many other segments of the economy affected by the recession in 2008, the U.S. textile industry experienced more plant closings and job losses. According to the National Council of Textile Organizations (NCTO), an additional 32 textile mills closed in 2008. Approximately 610 textile mills have closed since 1997. Preliminary data from the U.S. Bureau of Labor Statistics indicate that textile industry employment in 2008 fell by approximately 57,000 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 declined for the eleventh consecutive year in calendar 2008 and is estimated at 4.4 million bales, 9.5% below the amount consumed in 2007 and 20.1% below the 5.5 million bales consumed in 2006 (Exhibit 79). For calendar 2009, NCC forecasts domestic mill use of cotton at 4.0 million bales and estimates the 2008 crop year at 4.1 million bales (Exhibit 80). NCC projects domestic mill use of cotton at 3.9 million bales for the 2009 crop year. The economic assistance program enacted in the 2008 Farm Bill should provide much-needed help to the sector.

By Department of Commerce accounting methods, there are generally 261 effective working days in a calendar year. Hence, a 1,000 bale reduction in daily mill use equates to a reduction of 261 thousand bales in annual mill use (Exhibit 81). By extension, a 4,000 bale reduction in daily mill use implies annual reductions greater than 1 million bales.

Average daily mill use continued its decline throughout 2008. In January 2008, average daily mill use was 17,527 bales. By December 2008, average daily mill use had declined 7,816 bales to 9,711.

Cotton is not the only fiber that experienced a decline in mill use in 2008; U.S. mill consumption of manmade fibers decreased as well. NCC estimates mill use of manmade fibers at 16.5 million bales for 2008, a decrease of 8.9% from 2007 (Exhibit 82). Manmade fiber mill use is projected to decrease to 15.9 million bales in calendar 2009.

While reliable mill use and trade data are available for 2008, the most recent annual data for U.S. production of apparel and home furnishings are obtained from NCC's annual publication *Cotton Counts Its Customers.* The latest edition contains production data through 2007. The 2009 edition, containing annual data for 2006, 2007 and 2008, is scheduled to be released in late 2009.

The 2008 edition of *Cotton Counts Its Customers* shows that the apparel industry continues to be hard hit by imports. Total apparel production in 2007 fell to 2.1 million bale equivalents, 29.7% below the 2006 production figure of 3.0 million bales (Exhibit 83). While all apparel segments experienced a decline in production, men's and boys' apparel experienced the largest decline, dropping 35.4% in 2007. Children's apparel saw the second largest decline (-24.9%) followed by women's, misses', and juniors' with a 24% drop in 2007. Cotton's share of apparel production experienced a decrease from the previous year, falling 15.4% to 45.1% in 2007.

Production of cotton apparel fell 47.6% in 2007 to 942 thousand bales (Exhibit 84).

U.S. production of home furnishings, excluding carpeting, also decreased in 2007. Most recent estimates indicate that total production, excluding carpeting, was down 15.6% to 2.4 million bales, from 2.8 million bales in 2006 (Exhibit 85). The share of cotton in home furnishings, excluding carpeting, decreased slightly in 2007 to 51.1%. Total cotton consumed in home furnishings, excluding carpeting, for 2007 was 1.2 million bales.

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 2008 is estimated to be 48.9 million bale equivalents (Exhibit 86). Cotton's share of net domestic consumption increased 0.4% this past year to 44.6%, which translates to 21.8 million bales. As for 2009, NCC projects net domestic consumption of all fibers to decrease to 48.2 million bales. With a projected share of 44.4%, cotton's net domestic consumption is projected 21.4 million bales.

Imported goods make up the largest portion of U.S. net domestic consumption. However, for the second time since 2001, imported cotton textiles declined slightly from 22.8 million bale equivalents in 2007 to an estimated 21.6 million in 2008 (Exhibit 87).

Textile Trade

Increasing imports over the past several years have devastated the U.S. textile and apparel industries. While cotton textile imports did not increase in calendar 2008, they still made up almost 99% of U.S. net domestic consumption of cotton. Imports of cotton goods in 2008 are estimated to have diminished by 5.4% to 21.6 million bale equivalents (Exhibit 88). In calendar 2009, NCC projects cotton textile imports to shrink slightly to 21.5 million bales.

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 28.2% of all cotton goods imported in 2008 contained U.S. cotton. This is a 0.2% decrease over the previous year. In bale equivalents, these imported cotton goods contained 6.1 million bales of U.S. cotton (Exhibit 89). This is due, in large part, to our trading partners in NAFTA and the CBI.

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 (Exhibit 90). Cotton apparel imports are estimated at 15.9 million bale equivalents for 2008, down 4.9% from 2007. Imports of cotton home furnishings (including floor coverings) decreased 2% in 2008 to an estimated 4.0 million bale equivalents. Cotton yarn, thread and fabric imports decreased 9.2% in 2008 to an estimated 1.7 million bales.

Once again, countries in NAFTA and CBI represented significant sources of imported cotton goods in 2008 (Exhibit 91). Imports from Mexico in 2008 are estimated at 1.5

million bales, down approximately 7.3% from the previous year (Exhibit 92). This marks the eighth straight year in which imports from Mexico have declined. Imports of cotton goods from Canada also fell to an estimated 107 thousand bales in 2008, sliding 46.5% from the previous year (Exhibit 93). Imported cotton goods from CBI for the year are estimated at 3.2 million bale equivalents (Exhibit 94), down 0.5% 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 2008 were 2.8 million, or 88.6% of the cotton textile imports from CBI. Combined, imports from NAFTA and CBI countries reduced 4.6% and accounted for 22.3% of total U.S. cotton product imports in 2008.

Other top sources of imported cotton goods in 2008 were China, Pakistan, India, Hong Kong, Bangladesh, Vietnam, and Turkey. For the fourth consecutive year, China was the largest supplier of cotton textile imports into the U.S. (Exhibit 95). However, total cotton product imports from China slowed slightly to an estimated 5.6 million bale equivalents in 2008, down 3.4% from 2007 but up 553.7% 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, 20.5% in 2005, 21.6% in 2006, and 25.5% in 2007 to 26% in 2008. Imports of cotton products from Pakistan are estimated at 2.0 million bale equivalents in 2008, a decrease of 146 thousand bales. Although imports from Pakistan decreased in 2008, since 1997, Pakistan imports have increased 200.5%. Pakistan lowered its share of imported cotton goods in the U.S. market last year to 9.4%. Imports from India are estimated at 1.7 million bale equivalents for 2008. This is a 0.7% decrease from last year but a 128% increase from 1997. India now accounts for 7.7% of all U.S. cotton product imports. Imports from Hong Kong in 2008 are estimated at 357 thousand bale equivalents, down 16.7% from 2007. Hong Kong's share of imported goods in the U.S. declined to 1.7% in 2008. One of the few countries to show a boost in cotton product imports into the U.S. when compared to the previous year was Bangladesh. Imports from Bangladesh in 2008 were up 9.2% from 2007 to 1.2 million bale equivalents. Bangladesh accounted for an estimated 5.7% of all cotton goods imported into the U.S. in 2008.

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 among individual countries, Mexico was still a large shipper of cotton goods to the U.S. in 2008. Cotton trousers remained the largest category of imported cotton goods from Mexico. Trousers accounted for 34.3% of all cotton product imports from Mexico based on SME (Exhibit 96). Knit cotton shirts were the next largest category of imports,

accounting for 21%, followed by cotton hosiery (8%) and "other cotton manufactures" (5.7%). The U.S. Customs Service category "other cotton manufactures" includes items such as tablecloths, napkins, dishtowels and pillow covers.

Canada

U.S. cotton imports from Canada decreased for the sixth consecutive year in 2008. The largest category of imports from Canada in 2008 was "other cotton manufacturers", which accounted for 18.1% of total SME of cotton product imports from Canada (Exhibit 97). The next largest category was underwear with 14.6% of total imports, followed by carded yarn at 12.3% and knit cotton shirts at 7.2%.

CBI

Continuing the trend seen over the past several years, CBI countries shipped more cotton goods to the U.S. than did NAFTA countries in 2008. The largest category of imported cotton goods from the region was underwear, accounting for 37.5% of total imports, based on SME (Exhibit 98). Approximately 93% of the cotton underwear imports from CBI came from the CAFTA-DR countries. The second largest category, knit shirts, accounted for 30.8% of imports, followed by trousers (8.8%) and cotton hosiery (8.6%). Of these imports, 88.4% of the cotton knit shirts, 96.8% of the cotton trousers and almost 100% of the cotton hosiery were from the CAFTA-DR countries.

AGOA

Over the past year, total cotton apparel product imports from the AGOA (African Growth and Opportunity Act) region have decreased by 12.9% to an estimated 210.2 million SMEs (Exhibit 99). However during the past year, the percentage of U.S. cotton apparel imports from the AGOA region receiving preferential treatment under the act increased from 98.7% to 99%.

Pakistan

The largest category of imported goods from Pakistan in 2008 was "other cotton manufactures" (Exhibit 100). This category accounted for 35% of all cotton product imports from Pakistan based on SME. The second largest category imported from Pakistan was cotton sheets with 16.3% of total imports, followed by bedspreads and quilts (10.3%) and cotton hosiery (5.6%).

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 2008 was "other cotton manufactures", which accounted for 26.4% of all cotton product imports from that country (Exhibit 101). Coats was the second largest category of cotton imports from China in 2008, comprising 8.6% of total cotton product imports from that country. Nightwear accounted for 7.7% of U.S. cotton textile and apparel imports from China in 2008. Cotton sheets were the fourth largest category and accounted for 7.2% of cotton product imports.

India

As was the case with Pakistan and China, the largest category of imported cotton goods from India in 2008 was the category of "other cotton manufactures" (Exhibit 102). When based on SMEs, this category represented 30.6% of all cotton goods imported from India. The next largest

category was cotton sheets (8.9%), followed by underwear (8.1%) and knit shirts (6.1%).

Hong Kong

While still a significant source of imported cotton goods, 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 2008 was trousers (Exhibit 103). When looking at SMEs, cotton trousers accounted for 34.3% of all cotton products imported. The second largest category was sweaters with 28.6% of imports, followed by knit shirts (13.8%) and woven shirts (8.5%).

Bangladesh

Based on SMEs, the largest category of cotton goods imported from Bangladesh in 2008 (32%) was trousers (Exhibit 104). The second largest category in 2008 was underwear (15.2%). Cotton woven shirts was the third largest category in 2008, representing 14.1% of total cotton goods imported from Bangladesh, followed by knit shirts at 8.5%.

Vietnam

Another country which has emerged as a more significant supplier of cotton product imports is Vietnam (Exhibit 105). U.S. cotton product imports from Vietnam have increased by 3,821.9% 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 954.9 million SME in 2008. The largest category of imported cotton goods from Vietnam in 2008 was trousers. Based on SMEs, this category represented 24.2% of all cotton goods imported from Vietnam. The next largest category was knit shirts (24%), followed by coats (7.6%) and cotton dresses (6.5%).

Turkey

Cotton product imports from Turkey continued their recent downward trend. Based on SMEs, the largest category of cotton goods imported from Turkey in 2008 was cotton sheets, which accounted for 25% (Exhibit 106). The second largest category in 2008 was "other cotton manufactures" (21.5%), followed by cotton trousers (5.1%) and cotton towels (4.9%).

U.S. Cotton Product Exports

For the fourth consecutive year, exports of U.S. cotton textile and apparel products experienced a decrease in 2008 (Exhibit 107). Exports declined by 0.9% in 2008 to an estimated 4.1 million bale equivalents. This reduction is due to a drop in the export categories of cotton home furnishings (including floor coverings) and cotton apparel (Exhibit 108). Cotton apparel exports are estimated to have faded by 24.4% in 2008 to 326 thousand bale equivalents. Exports of home furnishings (including floor coverings) weakened by 2.3% over the previous year to an estimated 130 thousand bale equivalents. Exports of cotton yarn, thread, and fabric increased by 2.6% to 3.7 million bales equivalents over the previous year. For 2009, NCC projects U.S. cotton textile exports to decrease 70 thousand bales.

The top customers of exported U.S. cotton textiles and apparel in 2008 were once again the NAFTA and CBI countries (Exhibit 109). Exports to the NAFTA countries last year totaled an estimated 1.1 million bale equivalents, down 10.1% from the previous year. Exports to the region accounted for 27.2% of all U.S. cotton product exports. Exports to Mexico

decreased to an estimated 817 thousand bale equivalents from 920 thousand in 2007. Cotton product exports to Canada shrunk by an estimated 7% to 306 thousand bale equivalents for 2008.

U.S. exports to the CBI countries strengthened last year. In 2008, exports increased 4.5%, totaling 2.6 million bale equivalents or 64.2% of all U.S. cotton exports. This is 22.1% higher than 2002 exports and 48.3% higher than 2001 cotton product exports to CBI. Approximately 98.7% of the cotton products exported to CBI went to the CAFTA-DR countries.

Estimated exports to China, Colombia, Japan, and the U.K were 30,000 bale equivalents, each. Exports to Germany and Venezuela were 20,000 bale equivalents, each. Exports to Belgium and Hong Kong were 10,000 bale equivalents, each. The remaining 4.3%, or 180 thousand bales, of U.S. cotton textile and apparel exports were shipped to all other customers of U.S. cotton goods.

World Market Situation

As of August 1, 2008, Cotlook Ltd. discontinued the "A" (NE) Index. In 2004, Cotlook began publishing an "A" Index for the Far Eastern (FE) markets alongside the Northern Europe Index and continues to publish the Far East "A" Index. The index is considered to be an objective and representative measure of offering prices in the international cotton market**.**

World cotton prices, as measured by Cotlook Ltd.'s "A" Index, fluctuated between 51.80 and 90.00 cents per pound during the course of calendar 2008 (Exhibit 110). Last year was one of the most volatile years in terms of cotton prices. Between March 5, 2008 and December 31, 2008, the "A" dropped 32.80 cents per pound to 57.20 cents. The "A" Index continues to slowly inch its way up and currently hovers around 60.00 cents per pound. For the current marketing year to date, the "A" Index has averaged 63.69 cents per pound.

World

The 2008 marketing year will mark the second consecutive year of declining world cotton production with a crop of 109.8 million bales (Exhibit 111). The smaller cotton crops are a direct result of lower relative commodity prices and less global demand for cotton. China remains a leading producer while India has enjoyed improved yields. The United States is estimated to produce a crop of 13.0 million bales, 6.2 million below 2007 and the smallest since 1989.

In 2006, world production was slightly behind the pace of world consumption. That gap grew to 2.2 million bales during the 2007 marketing year. The most recent estimates place world consumption at 112.4 million bales and production at 109.8, with a crop-to-use deficit of more than 2.6 million.

Production is projected to fall again in the 2009 crop year to 105.6 million bales with a slight rebound in consumption to 113.8 million. This implies reductions in ending stocks, with a stock-to-use ratio just under 50%.

China

According to the latest estimates, China remains the largest cotton producer with a 2008 crop of 36.5 million bales (Exhibit 112). This year's crop is roughly 500,000 bales smaller than 2007. The decrease is based on a slightly smaller planted area with yields remaining similar to the previous year. China's cotton acreage increased in 2006 and remained stable in 2007 mainly due to cotton's competitive revenue when compared to competing crops. However, in response to stronger prices for competing grain and oilseed crops in some cotton-producing regions, the area planted to cotton in some provinces is expected to decline. Another factor affecting the 2008 cotton area is the fact that the Government of China's (GOC) 2008 agricultural policies favored grain crops for food security and to safeguard against the sudden increase in grain prices.

The GOC's subsidy to grain crops increased in 2008 and is much higher than that of cotton. Grain farmers received a direct subsidy, an agriculture input subsidy of $137 U.S. dollars per hectare and subsidies for purchasing large agricultural machinery. Despite the GOC's favorable

grain policies, cotton planting seed subsidies are expected to continue.

In 2007, the Chinese government (GOC) began to subsidize cotton production through a multi-year "seed subsidy" program. In March 2007, the Chinese Ministry of Agriculture (MOA) appropriated a total of 500 million Yuan ($72 million U.S. dollars) to cotton seed producers/traders to subsidize "high quality seed varieties" at $32 U.S. dollars per hectare. Based on industry sources, this subsidy remained in place in 2008 covering the same area, more than 2.2 million hectares. Initiated by MOA and supported by the China Textile Industry Association (CTIA), the seed subsidy policy is aimed at stabilizing planted area. It is also expected that cotton quality will be more uniform because the selected "high quality varieties" (seeds eligible to be subsidized) are likely to increase in area coverage. Given the increasing cotton supply deficit and the importance placed on maintaining a stable planting area, this policy is likely to remain in place for the foreseeable future.

Taking into account current government policy and relative prices, cotton acres in China will continue to decline in 2009. This economic outlook estimates China's 2009 harvested cotton area at 13.3 million acres, down 1.5 million from 2008. Assuming trend yields, China is projected to remain the world's largest cotton producer with a projected 2009 crop of 32.6 million bales.

Along with being the world leader in terms of cotton production, China is also the largest consumer of raw cotton. China's cotton mill use was estimated at 51.5 million bales in 2007, up 1.5 from the previous year and accounting for roughly 42% of the world's mill use. Between 1980 and 1998, China's share of world cotton consumption fluctuated between 22.0 and 25%. Starting in 1999, China's mill use began surging while the rest of the world grew only slightly. However, for the 2008 crop year, increased financial pressures and declining global demand are forcing reductions by China's textile industry. As a result, China's mill use is expected to fall to 46.3 million bales.

For the 2009 marketing year, China's consumption is projected to rebound to 47.2 million bales. However, the recovery is dependent on projections of an improved global economy in calendar 2010, growing consumption by the Chinese consumer, and a financial boost from recently-announced stimulus packages by the Chinese government.

Despite the slowdown in their textile sector, China remains a net importer of cotton fiber, but at lower levels than in recent years. For 2008 crop year, imports are estimated at 6.8 million bales, down from 11.5 million in 2007. For 2009, imports are expected to recover to 9.7 million bales, based on the smaller production and slight improvement in mill demand. However, the increased imports are also highly dependent on China's stock policy.

As the 2008 harvest progressed, China announced their intentions to procure for their state reserves as much as 12.5 million bales and has already purchased over 8 million to date. The move was an effort to support slumping seed cotton prices. As a result, it is estimated that China will end the 2008 crop year with 19.4 million bales, with the vast majority in government

reserves. If the Chinese government decides to aggressively liquidate those reserves in the coming months, it could dramatically alter their import requirements.

India

The latest estimates have India producing 23.0 million bales for the 2008 crop year (Exhibit 113). If these estimates hold, the 2008 crop will be slightly lower than (1.6 million bales) than the 2007 crop. One factor playing a role in the poorer production could be the delayed planting (30-45 days) that occurred. Such a delay could have adversely impacted yield due to shorter crop duration. There were also reports of farmers shifting from higher yielding hybrid staple cotton varieties to lower yielding short staple conventional varieties. Reports also indicate that the cotton crop in the central states of Maharashtra and Gujarat have been slightly impacted by erratic rains in September and October with less than favorable weather compared to last year.

Indian cotton production has almost doubled in the last ten years. The growth has been fueled by the rapid gains in productivity as there is limited scope for expansion in area. The most obvious benefit to productivity can be attributed to the rapid adoption of Bt cotton hybrids, which is expected to peak in the next few years. With a limited cotton planting area, production growth is expected to decelerate in the next few years. However, Indian cotton yields are still well below the world average yield, indicating room for future growth. Although potential exists for a further increase in yields, cotton farmers will have to invest more in production technologies for improved management of irrigation, nutrient, pests and cotton disease.

In the fall of 2008, the Indian government announced an increase in cotton's Minimum Support Price (MSP) of 35 to 40%. While there is an ongoing debate between the various segments of India's cotton industry as to the appropriateness of the higher MSP, this outlook assumes that the MSP is maintained for 2009, allowing cotton to remain competitive and tempering the acreage reduction. Assuming continued yield improvements, India's cotton production is forecast at 23.4 million bales in 2009. This is roughly 450,000 bales above 2008 and well above their 5-year average of 21.5 million.

As with most major cotton-consuming countries, India's mill consumption is estimated to fall in the 2008 marketing year to 17.1 million bales. This is down 1.2 million bales from the 2007 estimate. There will only be slight improvement in India's cotton consumption for the 2009 marketing year. Due to the global slowdown, industry sources report that most of the mills are scaling back consumption due to weak demand for textile products, both globally and domestically. The global recession should keep India at 17.5 million bales of consumption in the 2009 crop year.

The economy is also putting pressure on India's trade environment. India's export prospects have weakened along with lower international prices. During the 2008 marketing year, India's exports fell by more than 3.0 million bales to 4.0 million. However, India remains a major player in terms of cotton trade. Since the 2006 crop year, India has been the second largest exporter of cotton behind the United States

and should remain in the cotton export market for at least the next four to five years, until domestic consumption catches up with production. Most exports are expected to be of medium-to-long staple cotton (25-32 mm length) to neighboring countries, China and Far East countries. For the 2009 marketing year, India is expected to rebound to near 2007 marketing year levels with exports of 7.0 million bales.

India's export prospects are complicated by their decision to increase the MSP. With the MSP above current market prices, the Indian government has authorization to purchase up to 11.7 million 480 lb. bale equivalents. As of July 31, 2009, total stocks are estimated at 9.7 million bales. The uncertainty centers on the extent to which India's government releases those stocks into the marketing channels. Current reports indicate that cotton is currently being sold from their stocks to Indian mills. A decision to be more aggressive with stock release into export channels could boost their presence in the world market, but at current prices, would carry a high cost.

Uzbekistan

Current estimates put Uzbek cotton production at 5.0 million bales for 2008 (Exhibit 114), down 500,000 bales from the previous year. Analysts believe weather was the main issue. Producers had to cope with challenging weather conditions throughout the 2008 growing season. Last winter was unusually cold with above normal snowfall. In addition, spring came early and was very hot and dry, resulting in the quick evaporation of ground moisture. In several regions, considerable shortages of irrigation water were experienced during pivotal points in the growing season. Uzbekistan was not the only Central Asian region affected by irrigation problems this year. The governments of Uzbekistan, Kazakhstan and Tajikistan continue discussions on how the region's water and energy supplies might be shared in a fair manner.

Cotton traditionally has been the primary cash crop in Uzbekistan and a significant source of employment and foreign exchange. To ensure hard currency revenues and support the growing textile sector, maintaining the stability of cotton production remains one of the government's primary objectives. However, on October 21, the government adopted a decree called "On Measures of Optimizing Sown Area And Increasing Production Of Food Crops." As officially stated, the decree was adopted because of continuing irrigation water shortages and rising food prices. One goal of the program is to increase production and variety of food crops in order to meet domestic demand. According to the decree, for the 2009 crop year, area planted to cotton will be decreased by 75,000 hectares to 1.3 million, and accordingly, the official seed cotton production target will be lowered to 3.4 MMT. The freed land will be used to produce grains and vegetables. Even with these new programs in place, 2009 Uzbek cotton production is estimated to improve to 5.2 million bales based on better yields.

A slight increase is also expected in Uzbek mill use. The Fourth International Uzbek Cotton Fair and Textile Conference took place in Tashkent on October 14-16, 2008. The conference and exhibition once again highlighted Uzbekistan's position as a leading producer and exporter of cotton. It also exuded a level of confidence that seemed unfazed by the boycott of Uzbek

cotton declared by Wal-Mart and other European and American companies last August. During the conference, Uzbek Minister of Foreign Economic Relations, Investments and Trade (MFERIT) declared that last year, Uzbekistan's domestic cotton consumption was over 1.2 million bales and 2009 would reach 1.25 million. Current estimates place 2008 consumption at 1.0 million bales with a slight increase of 14,000 bales in 2009.

Over 70% of Uzbek cotton is exported. For 2008, Uzbekistan is projected to export 3.6 million bales of cotton. Uzbek cotton is exported primarily to Asian countries, including China, the Republic of Korea, and Bangladesh. In addition to selling cotton through MFERIT trading companies and the Uzbek Commodity Exchange, the Dubai Cotton Center (DCC) began marketing Uzbek cotton in 2007. DCC, which is capable of handling a volume of 200,000 tons annually, aims by its activity to simplify the purchase of Uzbek cotton for those customers who do not wish to travel to Uzbekistan. Uzbekistan will remain a net exporter of cotton for the foreseeable future exporting an estimated 4.1 million bales of cotton in 2009.

Pakistan

Pakistan's economy is heavily dependent on the cotton and textile sector which accounts for 8.2% of the value-added in agriculture and about 2% to GDP. The country's gross exports in 2006-07 were valued at about $17 billion U.S. dollars, of which $9.98 (59%) were accrued through raw cotton and textile products. Hence, growth in the national economy is essentially linked with the volume and value of cotton produced in the country.

Major components of the strategy to increase cotton production includes increased area, enhanced tonnage of certified seed of approved varieties, use of higher seed rates, discouragement of late cotton sowing, increased plantings, subsidizing fertilizers, assured availability of quality and insect-specific pesticides, particularly for mealy bug and whitefly, and a focused media campaign. For the past two years, good returns on cotton production have encouraged farmers to use their resources efficiently and adopt better management practices. Current estimates project Pakistan production at 9.4 million bales for 2008, up 500,000 from the 2007 estimate (Exhibit 115).

Production is forecast to fall to 9.1 million bales in 2009. Serious energy and electricity crises in the country are bound to take their toll on cotton production. Growers in far-flung areas have limited access to alternative sources of energy. The high cost of inputs combined with escalating operating costs will impact productivity. A rising concern is the reduced availability of canal water during the peak of the growing season.

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 is projected to fall to 11.5 million bales in 2008, down almost 880,000 from the previous year. Again, the growing concerns over the energy crisis will factor into Pakistan's mill use. Sensing the critical situation, the large textile houses have invested in back-up generators to limit the overall impact. The bearish trend

in world yarn and textile prices is also negatively affecting consumption. Vertically integrated textile plants are faring better as they move activities upstream and import the cheap yarn. To remain competitive in international markets, the ginning, spinning and weaving industries must invest heavily in new equipment, as well as renovate existing mills. However, investment in the textile sector is on the decline. Imports of textile machinery from July 2007 to February 2008, as compared to the same period a year ago, dropped by 21%. Looking forward, the textile industry knows to remain competitive in the global market, it must aggressively pursue quality improvements and product diversification to include more value-added products, rather than rely on low value yarn-based exports.

Synthetic fiber continues to gain acceptance among consumers who increasingly seek less expensive blended products to compensate for their shrinking buying power. The future growth in cotton versus synthetic fiber will be determined by the relative price of these items. The long-term trend is for synthetics to comprise an increasing share of domestic consumption. Cotton-synthetic blends are popular due to their durability, ease in washing and maintenance under tropical conditions. The growth in synthetic fiber use has shown an increase.

With these obstacles along with a weak global economy, Pakistan's mill consumption will likely remain around 11.9 million bales for the 2009 season.

In terms of cotton trade, Pakistan is forecast to remain a net importer of 2.2 million bales during 2008. 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 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.

Pakistan is one of the largest importers of U.S. Pima cotton for its specialized export industry. Given the need for higher-count yarns and better quality fabrics for the export market and specialized products demanded by the domestic market, Pakistan's textile industry is expected to increasingly rely on U.S. Pima cotton and contamination-free upland cotton.

This year, Pakistan has made significant purchases of short to medium staple cotton from India. Opening of land-trade routes are more cost-effective than the sea, helping the domestic industry stay competitive. Buyers are focused on non-U.S. suppliers for medium grade cotton due to the significant price differential; however, importers of long staple cotton look to the U.S. due to the high quality standards. These practices should keep Pakistan a net cotton importer in 2009. Cotton imports for the 2009 crop year are expected to increase to 3.2 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 (GAP). Small amounts of cotton also are produced around Antalya and Antakya. The most popular varieties in the Aegean region are "Nazilli 84" and "Nazilli 88"; in Cukurova "Carolina Queen", "Delta Pine", and "BA 119", "Stone Mill"; and "Diyarbakir Gold" is the most popular variety in the Southeast. Aegean cotton generally is considered to be the best quality and is preferred by the local textile industry. Aegean cotton is longer (1 1/8") than cotton from Cukurova (1 3/32") and GAP (1 5/32) regions. Quality and properties of cotton have improved significantly in the GAP region due to the improved quality of seeds

Between 2004 and 2007, Turkey's production averaged 3.7 million bales. For 2008, Turkey is estimated to produce 2.3 million bales (Exhibit 116). The 2008 crop 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 all contributed to the drop in cotton production. Ecological problems in Southeastern Anatollia (GAP) region are also a factor in the decline.

In the Hatay region, which is part of Cukurova, the lack of irrigation water due to lower than usual precipitation during the winter was the main reason fewer acres of cotton were planted in 2008. In the Aegean region, even though precipitation was better than last year, producers planted corn rather than cotton due to better returns. Despite fewer acres, yields improved because the farmers that continued to plant cotton were experienced, well equipped and are larger producers overall. Therefore, better planting techniques and economies of scale will help them to achieve higher yields. An increase in the use of certified seed also helped increase yields. The increase in certified seed use is driven by a 10% higher production bonus for certified seed users.

About one third of the Turkish population lives in rural areas and earns its living primarily from farming. Therefore, agriculture and rural development are still top priorities for the Turkish government. The aim of the government, along with the farmers' cooperatives, is to keep cotton and cotton products within the economy and support production. For 2009, yields are expected to increase slightly to 1,179 pounds per acre. However, fewer acres will result in production of 2.1 million bales, down 166,000 from 2008.

Much of the growth in Turkish mill use has been to supply a textile export business to Europe that expanded rapidly throughout the 1990's due to a strong Euro. However, in 2007, Turkish mill use dropped off slightly to 6.0 million bales.

The Turkish textile industry is struggling in the current crop year with estimated mill use pegged at 5.0 million bales. A strong Turkish Lira versus the Euro hurt textile exports and facilitated imports of low cost yarn and fabric from competing countries such as India, Pakistan and China. However, the Lira has been weaker against the U.S. dollar making U.S. cotton more expensive. A slow down in the economies of Turkish textile export markets and the removal of Chinese textile export quotas in 2008 were other negative factors. The high

cost of labor, electricity and transportation in Turkey has caused many mills to suspend operation. Furthermore, some mills moved to low cost countries such as Egypt and others sold their machinery. About 1 million spindles have reportedly been moved out of Turkey during the recent economic crisis. Despite the recent downturn, the textile industry continues to be one of the most important and dynamic sectors in the Turkish economy, accounting for 8% of the GNP, 16% of the industrial employment and 22% of total exports. Investments by the Turkish textile industry since 1985 are estimated at about $85 billion U.S. dollars. There are an estimated 6 million spindles and 800,000 rotors in Turkey. Total textile sales are approximately $50 billion U.S. dollars, of which one half are exports. Even with the downturn in the global economy, Turkey has tremendous investment in their textile industry. With that in mind, mill use for 2009 should remain decrease by roughly 10,000 bales while their imports grow slightly to 3.0 million.

Australia

Australia's crop was 620,000 bales in 2007, the smallest crop in roughly 25 years. Production in 2008 is estimated at 1.4 million bales of cotton, an increase of 750,000 (Exhibit 117). Much needed rainfall in key regions greatly improved the irrigation water supplies leading up to the 2008 crop year. The increase in harvested area accounts for all the increase in production. With timely rains, Australia should continue to improve production with 2009 estimated at 1.5 million bales.

Australia exports virtually all of their total cotton production. Total exports of cotton have fallen significantly since the beginning of the drought in 2002/03. However, despite this decline, exports to China over the past five years have increased. China went from Australia's fifth largest export market to the largest in less than three years. Most anticipate that this market will continue to take a greater share of Australian cotton and will likely absorb increases in production for the foreseeable future. For 2008, exports are estimated to drop further to 901,000 bales. However, with the increase in production in 2009, exports are expected to rise to 1.4 million bales.

Brazil

Cotton continues to receive support from the Brazilian government. This support was provided almost exclusively through the use of the Equalization Premium Paid to the Producer (PEPRO) program. PEPRO is a subsidy paid to the producer or cooperative to help market cotton. The amount paid is the difference between the reference price (based on the minimum guaranteed price) and the highest bid at the government auction. The recipient then has until a specified date to sell the product and provide proof to the government, with the required documentation determined by whether the product is sold within the state, sold outside of the state, or exported. This program is very popular with the cotton industry, which considers it to be critical due to the current strong Real that is making Brazilian cotton increasingly expensive in the international market.

Despite the continued support, cotton continues to face strong competition from soybeans. Current estimates place production for the 2008 marketing year at 5.8 million bales (Exhibit 118), down from the 2007 level by 1.6 million bales. For 2009, harvested area is estimated at 2.2 million acres, an increase of almost

40,000. Despite this increase in acres, production decreases slightly by 1,000 bales.

Brazilian mill use for the 2008 marketing year is estimated at 4.4 million bales, slightly down from 2007. Brazilian industrial cotton use has remained relatively stable over the last 15 years with an average annual growth around 1%. In comparison, industrial use of artificial and synthetic fibers has increased an average of nearly 5% over the last 15 years, evening out slightly in recent years with a 5-year annual growth rate of 1.5%. With these trends likely to continue in the near future, Brazilian cotton consumption is projected to fall slightly to 4.4 million bales in 2009.

In terms of trade, Brazil exported 2.2 million bales of cotton in 2008, 9,000 bales less that what was exported in 2007. Since most of the 2007/08 production will be harvested towards the end of the trade year, exports from this crop were made during the 2008 crop year. More than 60% of the cotton crop was sold in advance in exchange for seed, fertilizer and other inputs. For 2009, exports are expected to fall to 2.0 million bales.

West Africa

In the four cotton-producing countries of Mali, Burkina Faso, Benin and Chad (C-4), cotton production makes up the largest share of non-oil export earnings. Cotton production and market reform were mixed across the region for the 2008/09 despite relatively good rains and higher prices. Some countries experienced a late onset of rains, and most countries encountered the annual delay in the distribution of fertilizers and pesticides. While input prices expanded significantly, there was also increased competition for inputs from food crops, which don't benefit from the same credit and distribution system afforded to many cotton producers. High cereal prices also encouraged many farmers to increase cereal area. Burkina Faso is the only country that will definitively increase production year to year and by just enough to offset declines in other countries. Cotton production in Mali remained at historic lows in the midst the financial difficulties of *Compagnie Malien Pour le Developpement des Textiles* (CMDT), the State cotton company. Meanwhile, Benin has further privatized ownership of the state-run cotton gin, the National Society for Agricultural Promotion (SONAPRA), and is expected to harvest an average size crop. Burkina Faso remains the largest producer in the region, increasing area and yields despite strong competition from cereal crops. In Chad, the government has reinitiated funding to agricultural research and extension in support of the cotton sector, however, farmers continue to record low yields and returns. Cotton remains an important cash crop in most of Francophone West Africa and Cote d'Ivoire and Senegal. The latest estimates have West Africa producing 2.5 million bales in 2008 and 2.3 in 2009 (Exhibit 119). 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 2008 marketing year, it is estimated that the region will export 2.2 million bales. For 2009, West Africa is expected to decrease their exports by 80,000 bales.

The world cotton industry is well aware of West Africa's claims of economic injury caused by the presence of the U.S. cotton

program. However, their potential for growth and stability is not determined by the U.S. cotton program, but instead 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 2008 is forecast to reach 650,000 bales, 30,000 higher than the previous year. The slight increase in production is a result of additional acreage. According to the Confederation of Mexican Cotton Associations (CMCA), many growers considered planting other higher-priced commodities (corn, wheat and other regional crops) for 2008. However, despite the attraction of strong wheat and corn prices, cotton acres grew slightly due to a significant increase in input costs, particularly fuel and fertilizers, associated with other crops. Plus, most cotton producing areas are best equipped to grow only cotton. However, a recent announcement by the Mexican government will realign support prices for 2009. Grain support prices will increase, while cotton support prices are declining. Both area and production are expected to fall in 2009, with production estimated at 559,000 bales (Exhibit 120).

In terms of consumption, Mexico's outlook for 2008 is less favorable than the previous year due to the recession in the U.S. economy. Marketing year 2008 mill use is projected to be 1.8 million bales, down 189,000 from 2007. The lower consumption number reflects the sluggish demand from the Mexican textile industry, which in turn reflects the impact of an economic slowdown and a relatively lower level of consumer purchasing power for apparel spending. Moreover, the textile industry has been under pressure from foreign suppliers; thus growth in consumption within this sector has been somewhat stagnant. Industry sources estimate this trend will likely continue into the next marketing year. Current estimates put Mexican mill consumption at 1.8 million bales for the 2009 marketing year. Despite the fact that Mexico's apparel and textile industry expanded as a result of NAFTA, it has been declining in recent years. The Mexican market share of cotton apparel peaked in 2000, and in the past eight years, Mexican shipments have been declining. This decline is almost exclusively attributed to the fact that Mexico's apparel and textile industry is losing domestic and U.S. market share to low cost production countries such as China.

Cotton imports fell 219,000 bales to 1.3 million during 2008. Despite this decline, the U.S. should continue to be the main supplier, accounting for practically 100% of cotton imports. Due to the poor economic outlook, imports are expected to fall another 16,000 bales to 1.3 million during the 2009 season.

Indonesia

Indonesian cotton production fell to 30,000 bales in 2008 (Exhibit 121). Current estimates show this number unchanged for 2009 due to fierce competition with other crops giving higher revenue to farmers such as corn or rice.

As the main contributor to Indonesian export revenue with an 11.6% share in 2007 and a labor intensive industry absorbing approximately 3.0 million workers, the textile industry continues to receive attention from the Indonesian

government. With a total capacity of 7.8 million spindles and 110,000 rotors, Indonesian textile mills are running at around 70% of capacity. Antiquated machines tend to use power inefficiently and operate at lower productivity levels than newer machines in competing countries. Therefore, the government of Indonesia launched the Machinery Restructuring for Textile and Textile Products Industry Program, expecting to increase the industry productivity by 10%-15% and to absorb 4,400 new workers. The Ministry of Industry launched this program during the 2007 crop year with a total allocated fund of Rp. 255 billion ($27.6 million U.S. dollars). Approximately 92 textile and textile products companies have taken advantage of Rp. 160 billion ($17 million U.S. dollars) from the fund. A relatively low usage of the fund is mainly due to the lack of confidence from the industry. This stems from the lack of confidence from banks and other financial institutions serving the textile industry, multi-financial resources system used by the industry, the perceived difficult requirements by the industry to join the program, and time constraints to ship the machinery to Indonesia before the end of the program.

These are not the only issues affecting the successfulness of the program. Around 70% of total energy demands from the textile industry are fulfilled by the National Electricity Company (PLN). Currently, PLN imposes a premium tariff during the peak hours of 5:00 PM to 10:00 PM which increases production costs by 10 to 15%. The soaring price of natural gas prices is also increasing the production cost. The increasing price of raw material such as cotton, polyester, and viscose in the international market has lowered the competitiveness of the finished product since the price raw materials account for 60% of total production cost. Moreover, the higher wages and lower productivity of the Indonesian textile workers compared to other Asian countries added more burden to the industry. Fierce competition with lower priced imported textile products from China and other neighboring countries have lowered the total sales of Indonesian textile and textile products. This has impacted the mills liquidity, further straining their capacity. Given this situation, the Indonesian cotton consumption in marketing year 2008 is estimated to fall 5% to 2.1 million bales.

If Indonesia's political and economic situation can remain stable, mill use should increase slightly to 2.2 million bales for the 2009 marketing year. Along with the increase in mill use will be an increase in imports of cotton from 2.2 million bales in 2008 to 2.3 million in the 2009.

Vietnam

Vietnam's commercial cotton production is concentrated in the Central Tay Nguyen Highlands and the southeast of the country. About 40 to 50% of Vietnam's cotton production is grown in Dak Lak, Dak Nong and Gia Lai provinces in the Central Highlands. The second largest growing areas are in the southeast in Dong Nai, Binh Thuan, Binh Phous, Ba Ria and Vung Tau provinces. Cotton production in Vietnam is highly susceptible to weather as more than 80% of the cotton area is rain fed. Planting is initiated in the rainy season, June through August and harvested in November through January. In areas with irrigation, cotton can be planted in the dry season (November and December) allowing for harvesting from April through June. Irrigated cotton areas continue to

decline in the face of strong competition from the more lucrative corn, beans and vegetable crops. For 2008, production stands at 28,000 bales with a slight increase expected for the 2009 crop year to 31,000 (Exhibit 122).

Vietnam's domestic consumption continues to increase to meet strong demand from the expanding textile industry. Demand for textiles is robust both for domestic use and for export. Vietnam has focused on curtailing their lead times, which has played to their favor during these tight credit periods. Local cotton consumption continues to increase at an average rate of 10 to 15% per year. Estimates place 2008 mill use at 1.0 million bales, up 70,000 from 2007. This trend continues into 2009 with consumption climbing 102,000 bales to 1.1 million.

In order to keep pace with this rising cotton demand, Vietnam will remain a net importer for the foreseeable future. The United States, for the first time, was the largest single supplier of cotton to Vietnam in calendar 2007 with over 66 tmt, which accounted for almost one third of Vietnam's total cotton imports. For the previous four years, West Africa had been the largest single supplier, but in 2007, cotton imports from West Africa totaled 54 tmt or 25.8%, making it the second largest supplier. India ranked third with a market share of 12.7%. For 2008, Vietnam will import 1.0 million bales and estimates grow to 1.1 million for the 2009 crop year.

Bangladesh

Assuming a normal monsoon and minimum pest infestation, marketing year 2008 cotton production in Bangladesh is forecast at 60,000 bales (Exhibit 123). Cotton is a relatively less desirable crop in terms of profitability vis-à-vis competing crops. Cotton production is vulnerable to excessive rainfalls/floods and pest infestations which are common in Bangladesh. With that in mind, production estimates for 2009 remain unchanged at 60,000 bales.

The Bangladesh textile industry, the largest manufacturing sub-sector of the industrial sector, provides employment to about 5.0 million people (including over 2.0 million in the ready-made garment (RMG) units). It contributes 13% of the country's GDP, 40% manufacturing value and 78% of export earnings. In 2008, it is estimated an additional 43 new spinning business accounting for roughly 950,000 spindles began operating. Increasing demand from the rapidly growing private sector spinning mills and large imports are contributing to the escalation in cotton consumption. Crop year 2008 mill use is estimated at 2.9 million bales and continued growth is seen in 2009 with estimates topping 3.0 million.

As a result of increasing demand, raw cotton imports have steadily grown. In marketing year 2000, Bangladesh imported 1.0 million bales of cotton. Since that time, imports have increased 1.9 million bales to an estimated 2.9 for the 2008 crop year and further expand in 2009 to roughly 3.0 million.

United States Trade

For the 2008 marketing year, U.S. exports of raw cotton are estimated at 11.5 million bales (Exhibit 124), down 2.2 million from 2007. Exports will continue to decline into the 2009 crop with estimates pegged at 11.2 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. The shift to the export market became evident in 2001 as contributions of exports exceeded domestic mill use. While exports contributed over 73% of total use in the 2007 marketing year, it is estimated that exports will constitute roughly 74% of total use for 2008. Customers for U.S. exports have changed in recent years. While Mexico remains one of the top customers, China, Turkey, and Indonesia have emerged as significant buyers (Exhibit 125).

U.S. imports are relatively small in size, focused on specialty cotton including Egyptian long staple and organic. Current estimates for 2009 of 10,000 bales are modestly down from 12,000 in 2008. This decline reflects a lower crop in Egypt and a decrease in demand for these high-priced raw materials.

World Trade

In 2008/09 marketing year, world cotton trade is estimated to tumble over 8 million bales to 30.4 from the previous season. Tight credit issues started weighing on the international spinning mills in the spring of 2008. Then mills were faced with the dramatic drop in prices coupled with a slow down of retail orders. This forced mills into further liquidity issues for they now held high-priced stocks in both raw cotton and cotton yarn. Three large importing countries account for a bulk of the drop in demand including China down 4.4 million to 6.7, Pakistan -1.3 to 2.2, and Turkey -0.6 to 2.3 (Exhibit 126). At the same time, major exporting markets were forced to reduce their 2008 shipments such as India -2.8 from 2007 to 4.3 million bales, the U.S. down -2.1 to 11.6, and Uzbekistan -0.8 to 3.6 (Exhibit 127).

Current estimates put 2009 marketing year world cotton exports at 33.9 million bales, up 3.5 from the previous year. China's imports should grow, but with carrying large stocks, they will most likely not return to the high levels seen earlier in the last 5 years. At the same time, some of the other traditional Asian consuming and importing markets should rise. Despite a smaller world crop, availability of all grades of cotton should not be a major concern.

Examining the world trade-to-mill use ratio for 2008/09 shows a fall to 27% from 31% last year (Exhibit 128), reflecting a larger percentage drop in trade versus consumption.

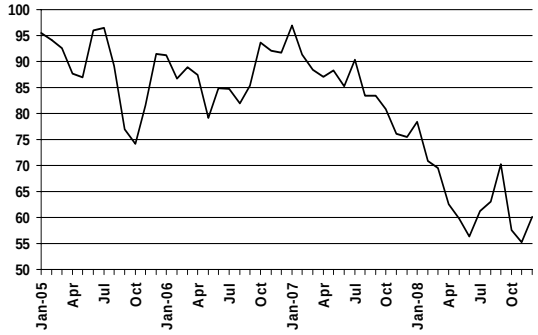
World Ending Stocks

Global 2008/09 supply and demand enters its fifth year of being fairly balanced (Exhibit 129). Ending stocks are estimated to decline by only 100,000 bales; however, the stocks-to-use ratio increased by 4 percentage points to 55% or 6.5 months of consumption. The large holders of stocks are the three largest producers including the largest exporters, the U.S. and India, and the largest importer China. The timing and release of these stocks from the various government programs holding them will play a major role on trade and international prices in 2009/10.

Based on individual supply and demand projections for the 2009/10 season, ending stocks would fall by 5.7 million bales with a stock-to-use ratio of 49.7% (Exhibit 130). At a stock-to-use ratio tighter than this level, prices should start to see support towards the end of the 2009 season going into the 2010 crop year.

Exhibit 1

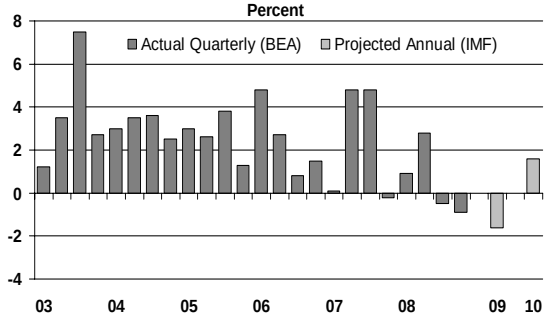
Consumer Sentiment Index



Survey Research Center: University of Michigan

Exhibit 2

Change in U.S. Real GDP



Bureau of Economic Analysis and International Monetary Fund

Exhibit 3

Change in U.S. Real Personal Consumption Expenditures

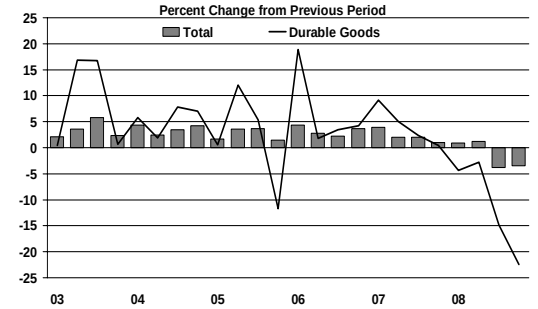


Exhibit 4

Change in U.S. Real Private Investment

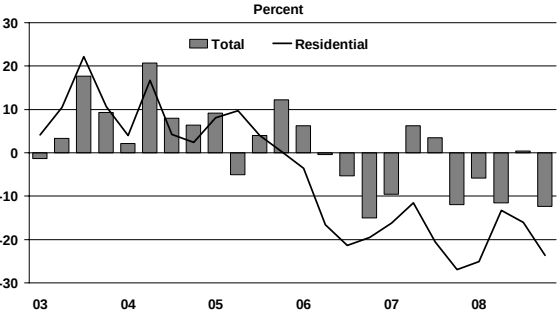


Exhibit 5

Civilian Employment

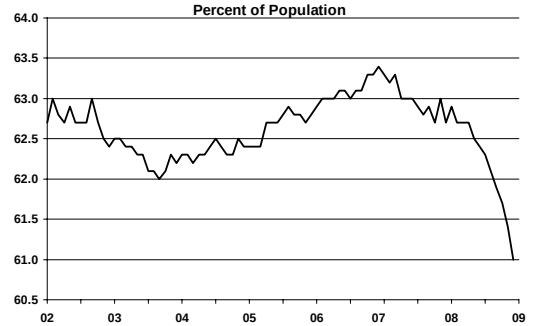


Exhibit 6

Manufacturing Employment

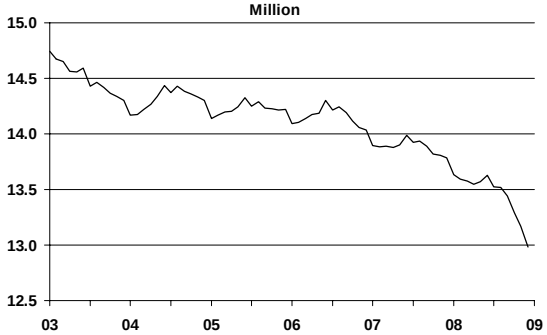


Exhibit 7

Civilian Unemployment Rate

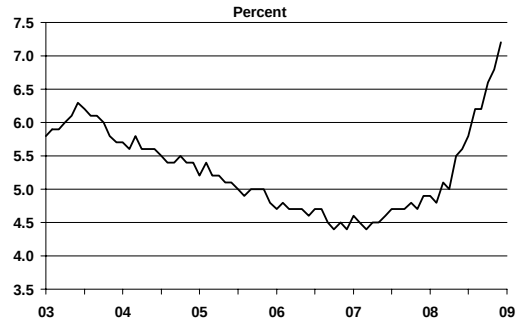
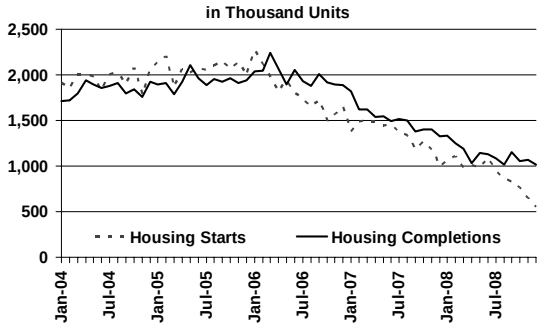


Exhibit 8

U.S. New Residential Construction



U.S. Census Bureau News, January 2009

Exhibit 9

30-Year Mortgage Rate

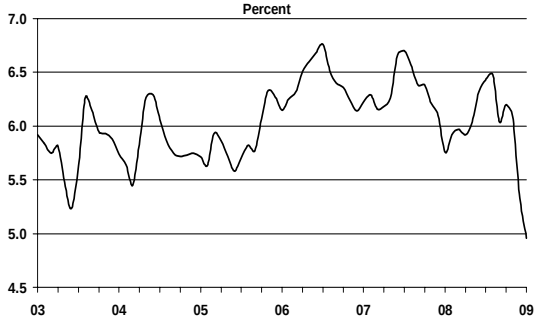


Exhibit 10

Federal Funds Rate

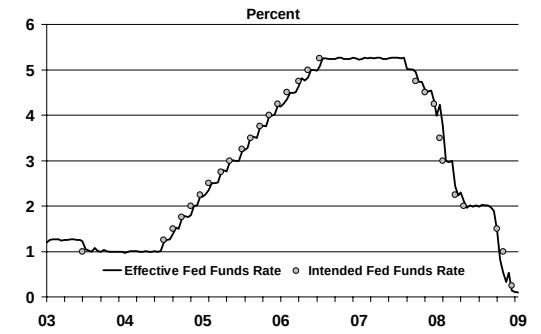
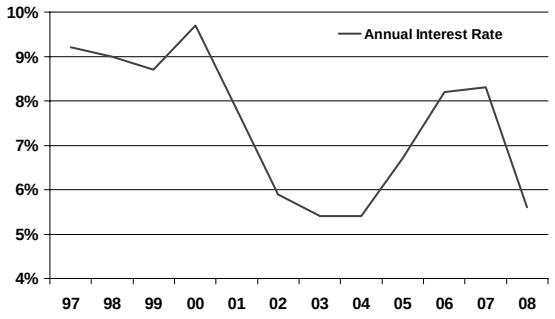


Exhibit 11

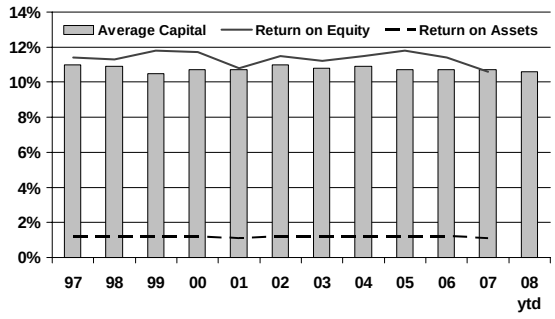
Non-Real Estate Loans for Farmers



Federal Reserve Board – The Agricultural Finance Databook, December 2008

Exhibit 12

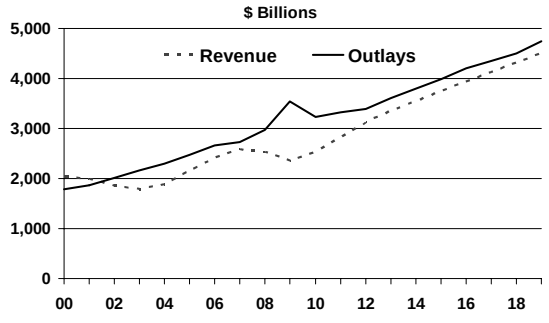
Financial Performance of Ag Banks



Federal Reserve Board – The Agricultural Finance Databook, December 2009

Exhibit 13

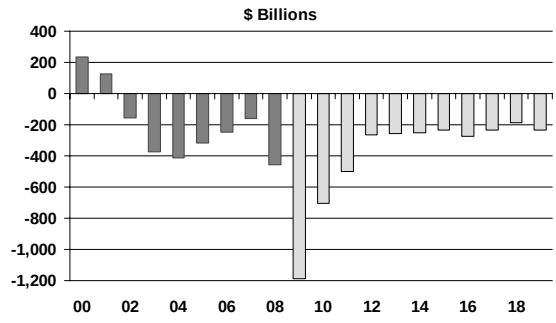
Projected US Federal Budget



Congressional Budget Office, January 2009

Exhibit 14

US Federal Budget Surplus



Congressional Budget Office, January 2009

Exhibit 15

Consumer Price Index

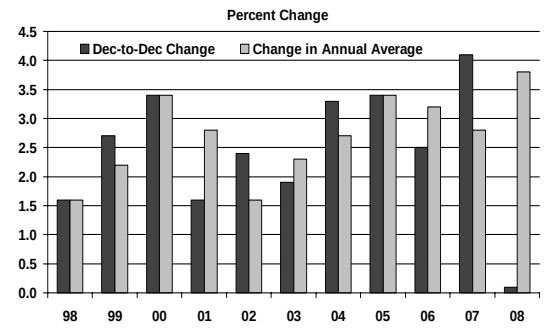


Exhibit 16

Producer Price Index

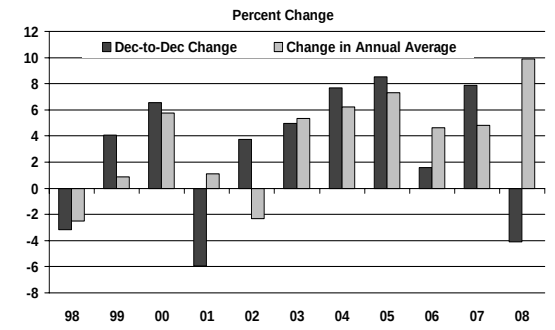


Exhibit 17

WTX Intermediate Crude Oil Price

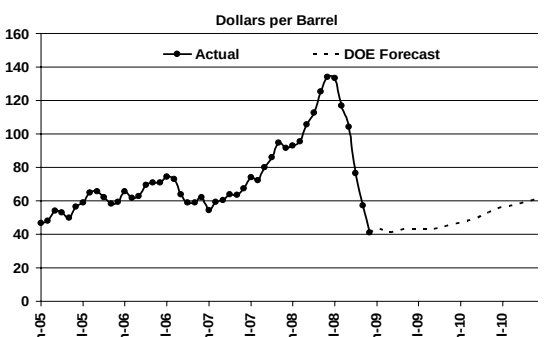


Exhibit 18

Retail Diesel Fuel Price

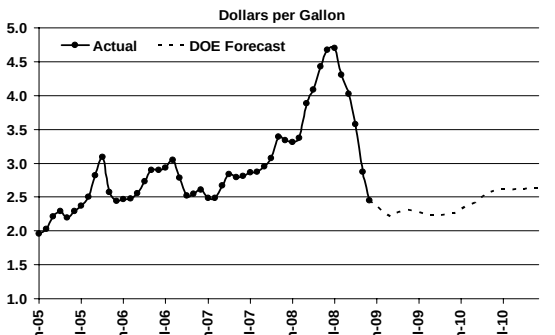


Exhibit 19

Henry Hub Natural Gas Price

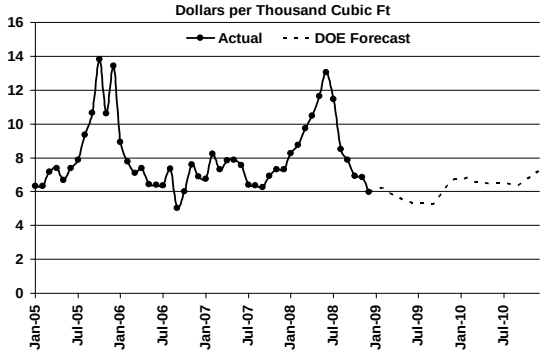


Exhibit 20

Dow Jones Industrials

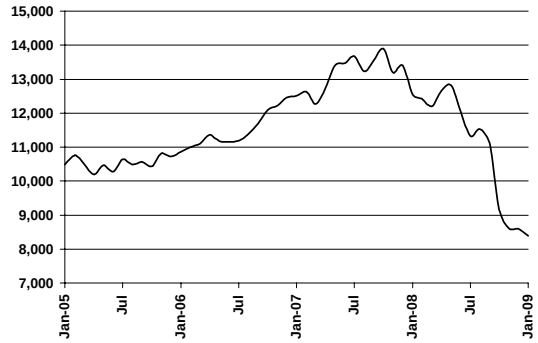


Exhibit 21

NASDAQ

Exhibit 22

S&P 500

Exhibit 23

Stock Markets Percent Change

(Dec 2007 to Dec 2008)

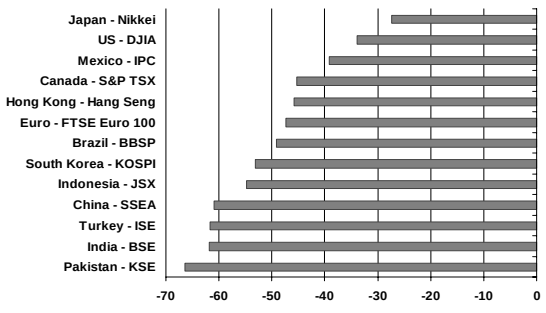
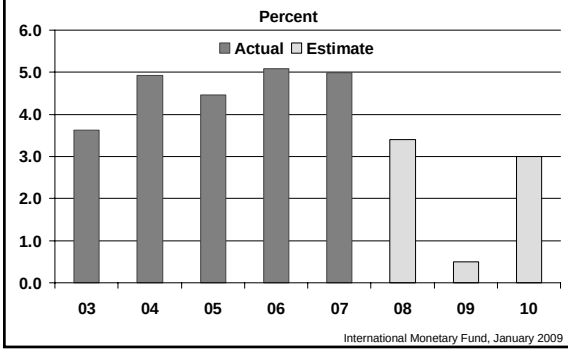


Exhibit 24

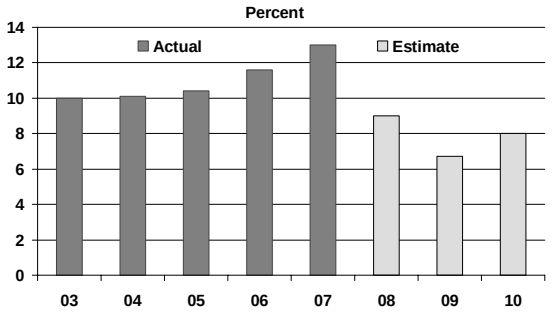
World Real GDP Growth



International Monetary Fund, January 2009

Exhibit 25

China Real GDP Growth



International Monetary Fund, January 2009

Exhibit 26

Asian Stock Indexes

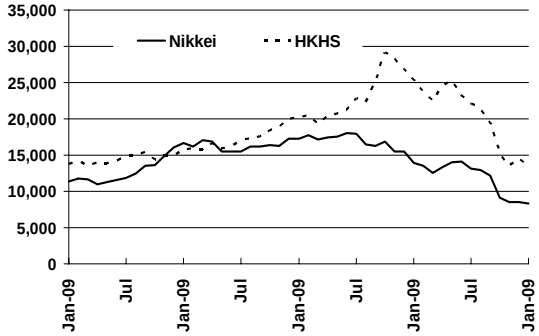


Exhibit 27

Euro

(Currency per U.S. Dollar)

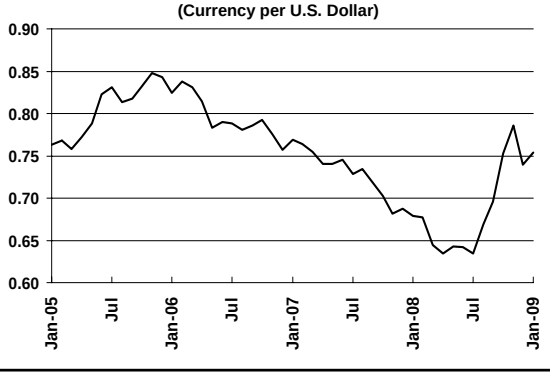


Exhibit 28

Japanese Yen

(Currency per U.S. Dollar)

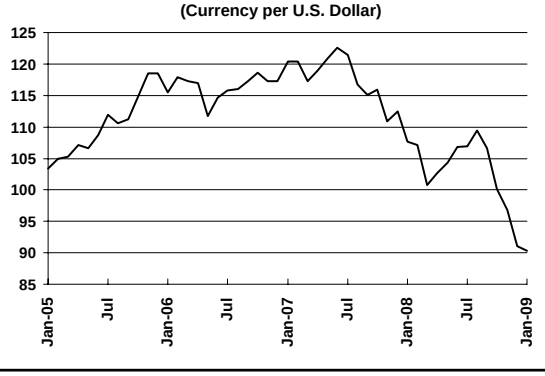


Exhibit 29

Brazilian Real

(Currency per U.S. Dollar)

Exhibit 30

South Korean Won

(Currency per U.S. Dollar)

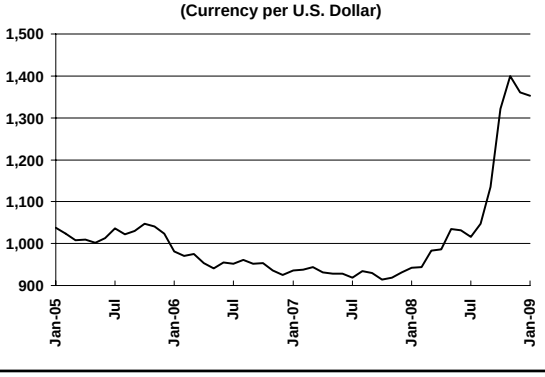


Exhibit 31

Indian Rupee

(Currency per U.S. Dollar)

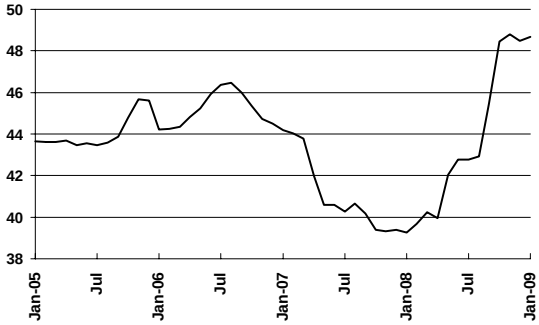


Exhibit 32

Indonesian Rupiah

(Currency per U.S. Dollar)

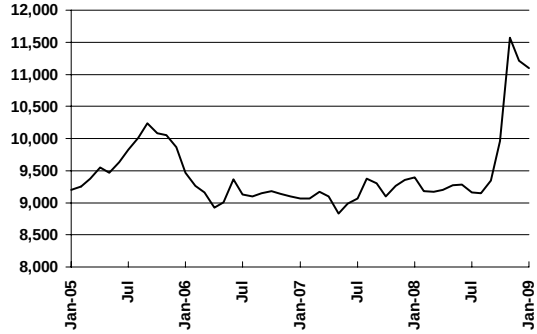


Exhibit 33

Pakistani Rupee

(Currency per U.S. Dollar)

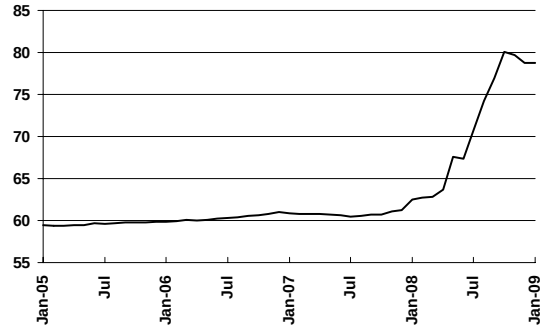


Exhibit 34

Chinese Renminbi

(Currency per U.S. Dollar)

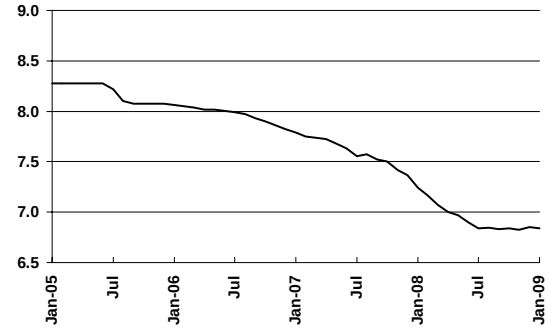


Exhibit 35

Real Exchange Rate Index

(Other Important Trade Partners, Source - Federal Reserve)

Exhibit 36

Reuters/CRB Futures Index

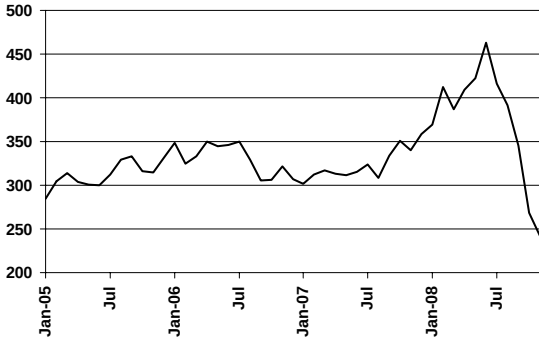


Exhibit 37

Ag Prices Received Index

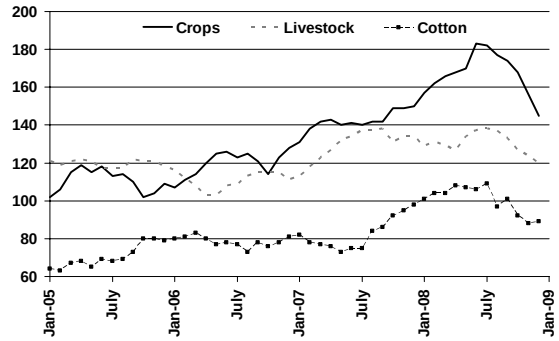


Exhibit 38

Ag Prices Paid Index

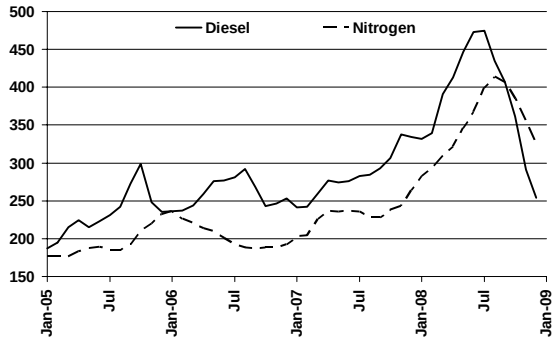


Exhibit 39

U.S. Net Farm Income

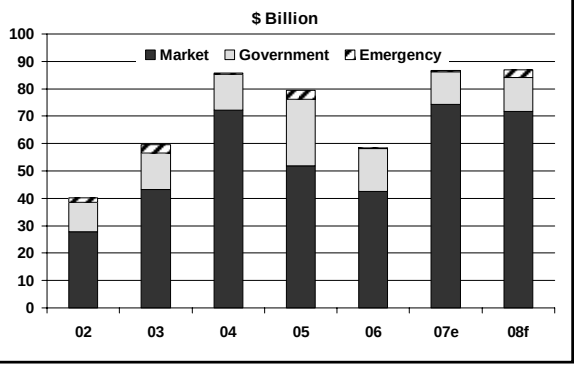


Exhibit 40

U.S. Textile and Apparel Imports from China (All Fibers)

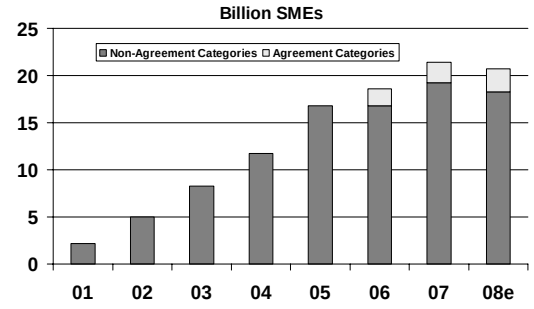


Exhibit 41

Market Share of US Textile Imports (2008 YTD)

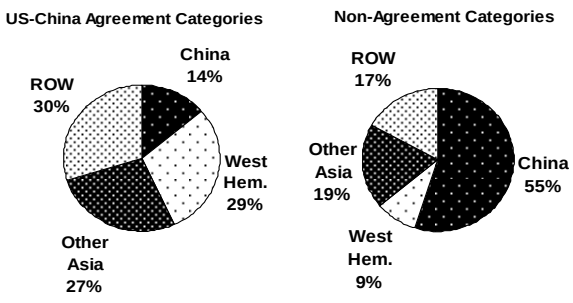


Exhibit 42

U.S. Upland Planted Area

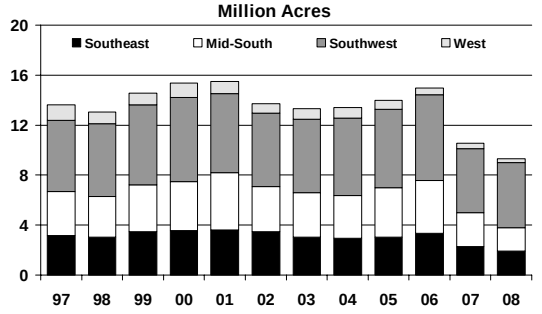


Exhibit 43

Southeast Upland Planted Area

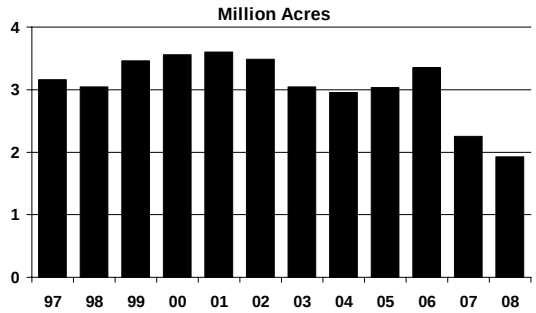


Exhibit 44

Mid-South Upland Planted Area

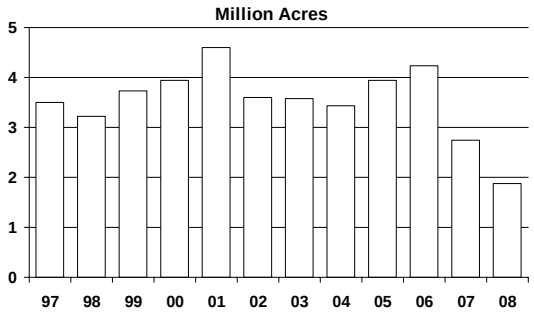


Exhibit 45

Southwest Upland Planted Area

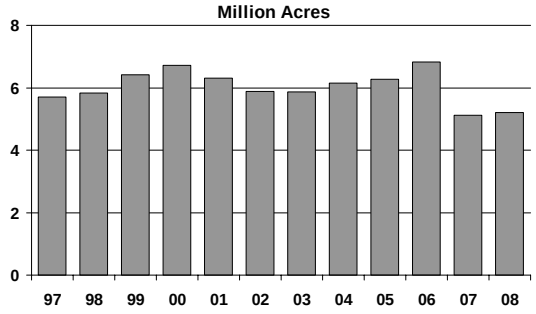


Exhibit 46

West Upland Planted Area

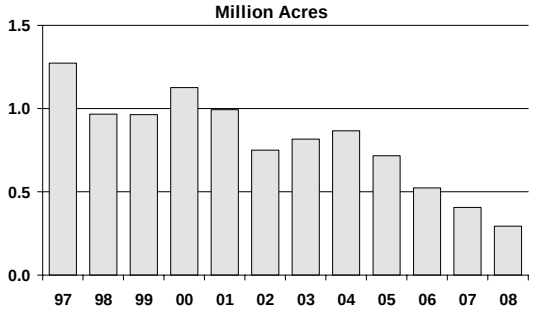


Exhibit 47

U.S. ELS Planted Area

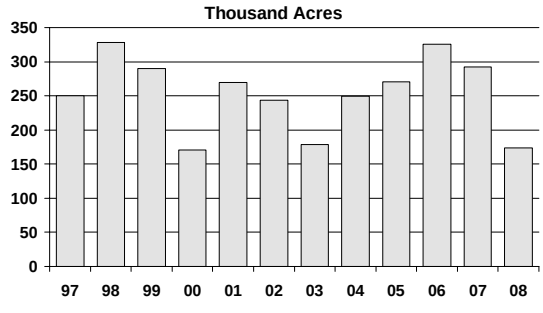


Exhibit 48

U.S. Cotton Abandonment

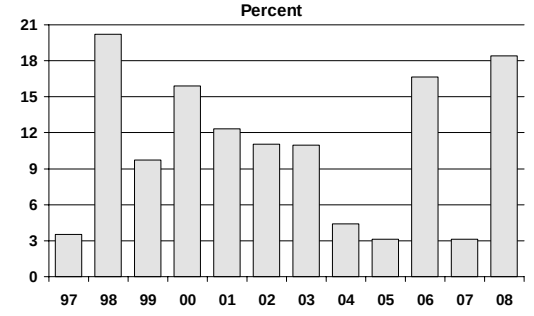


Exhibit 49

U.S. Cotton Yield

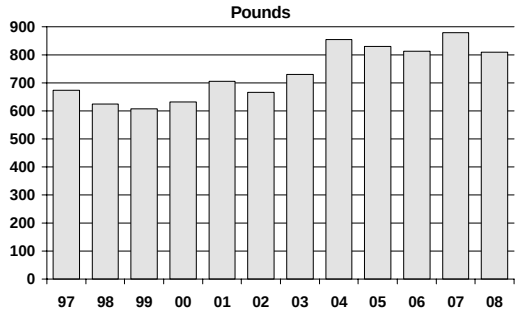


Exhibit 50

Southeast Upland Yields

Pounds per Harvested Acre

	2007	2008	5-Year Average
Alabama	519	836	675
Florida	687	901	692
Georgia	801	840	784
North Carolina	767	864	774
South Carolina	486	896	716
Virginia	829	896	822
SOUTHEAST	717	853	755

Exhibit 51

Mid-South Upland Yields

Pounds per Harvested Acre

	2007	2008	5-Year Average
Arkansas	1,071	1,022	1,031
Louisiana	1,017	560	928
Mississippi	966	920	915
Missouri	968	1,061	956
Tennessee	565	917	823
MID-SOUTH	930	930	939

Exhibit 52

Southwest Upland Yields

Pounds per Harvested Acre

	2007	2008	5-Year Average
Kansas	639	686	535
Oklahoma	817	805	685
Texas	843	649	688
SOUTHWEST	840	656	686

Exhibit 53

West Upland Yields

Pounds per Harvested Acre

	2007	2008	5-Year Average
Arizona	1,469	1,444	1,371
California	1,608	1,518	1,382
New Mexico	1,095	988	946
WEST	1,500	1,420	1,347

Exhibit 54

ELS Yields

Pounds per Harvested Acre

	2007	2008	5-Year Average
Arizona	883	960	889
California	1,481	1,319	1,321
New Mexico	856	1,108	877
Texas	920	768	877
U.S.	1,419	1,265	1,259

Exhibit 55

U.S. Cotton Production

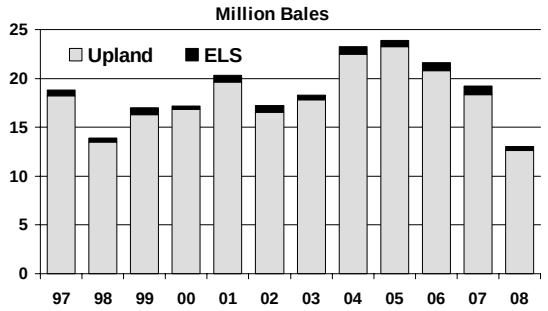


Exhibit 56

U.S. Upland Cotton Production 2008

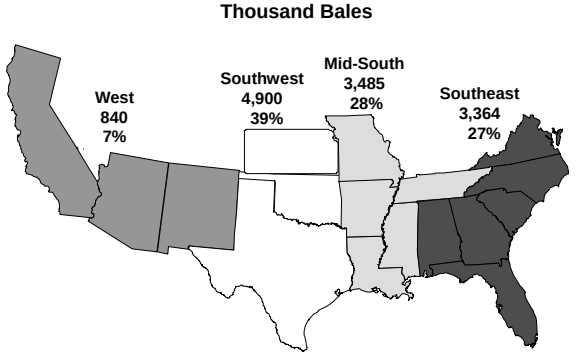


Exhibit 57

U.S. ELS Cotton Production 2008

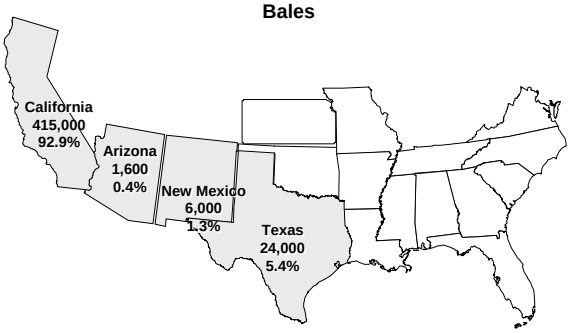


Exhibit 58

U.S. Cotton Beginning Stocks

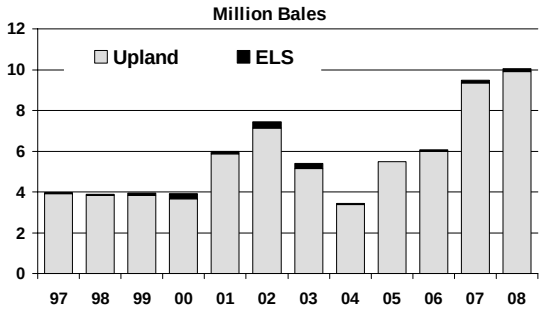


Exhibit 59

CCC Loan Stocks

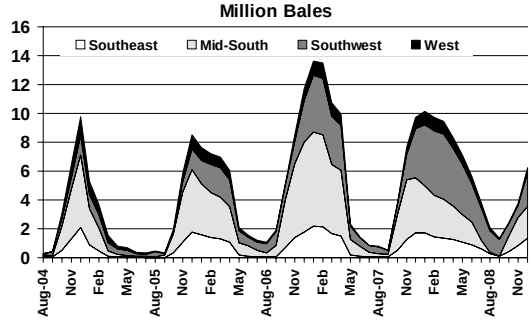


Exhibit 60

U.S. Cotton Supply

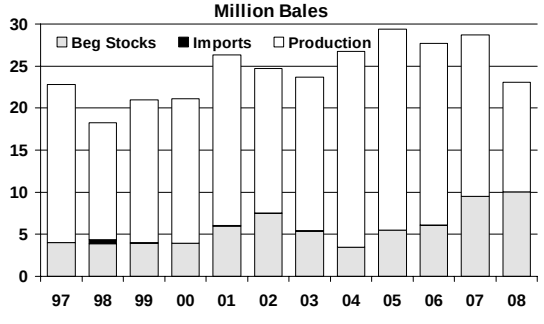


Exhibit 61

2008 Crop Staple and Strength

	Staple		Strength	
	2008	5-Yr.	2008	5-Yr.
Southeast	34.6	34.6	28.7	28.6
Mid-South	35.7	34.8	30.2	28.8
Southwest	36.2	35.1	29.6	29.1
West	37.3	36.5	31.9	30.6
U.S.	35.7	35.0	29.7	29.0

Exhibit 62

2008 Crop Color and Mike

	%SLM+		Micronaire	
	2008	5-Yr.	2008	5-Yr.
Southeast	89.8	81.9	45.5	44.9
Mid-South	93.9	83.6	46.2	45.6
Southwest	89.1	84.0	38.7	41.2
West	97.2	94.3	43.1	44.3
U.S.	91.2	84.4	42.9	43.8

Exhibit 63

Nearby NY and "A" (FE) Index

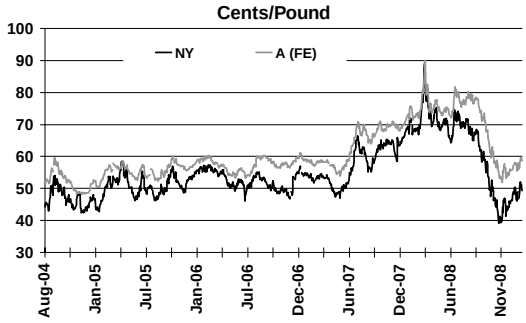


Exhibit 64

Spot 4134 Price

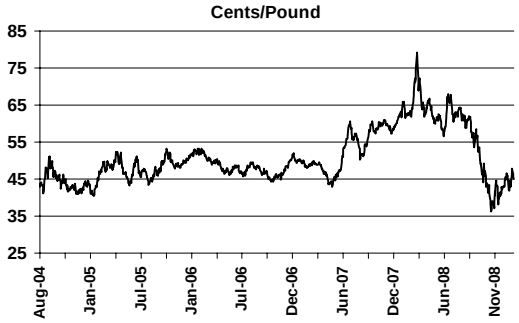


Exhibit 65

ELS Spot Price

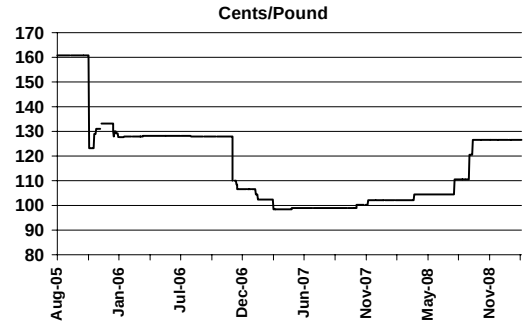


Exhibit 66

U.S. Cottonseed Production

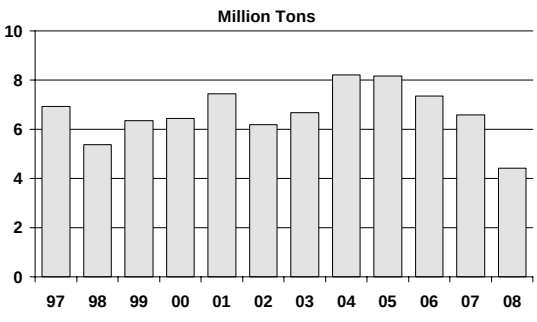


Exhibit 67

U.S. Cottonseed Production 2008

Thousand Tons

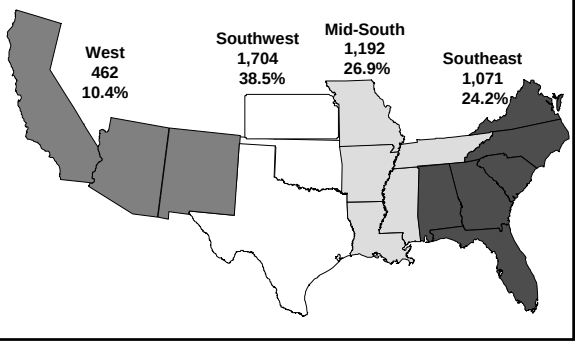


Exhibit 68

U.S. Cottonseed Supply

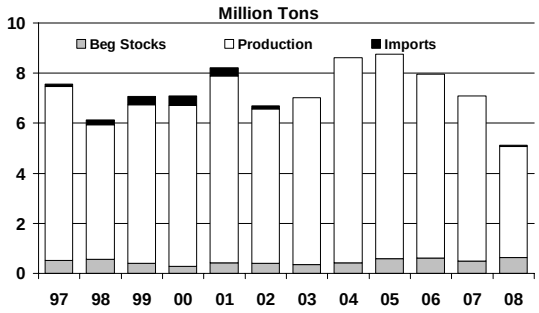


Exhibit 69

U.S. Cottonseed Disappearance

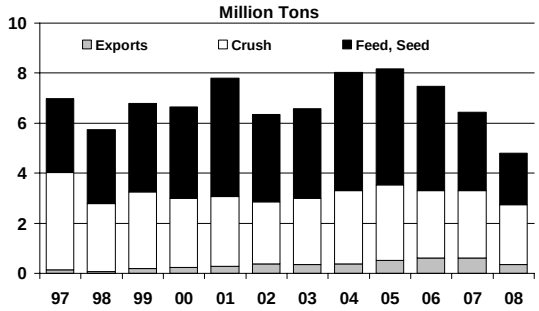


Exhibit 70

U.S. Cottonseed Ending Stocks

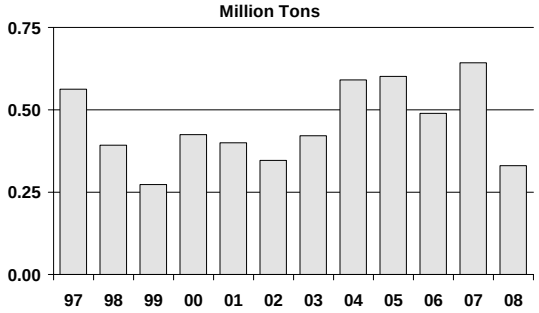


Exhibit 71

Average Cottonseed Spot Price

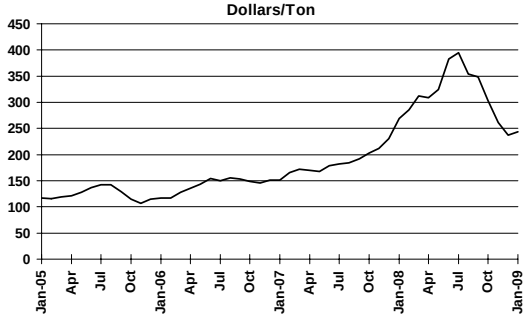


Exhibit 72

December Cotton Futures

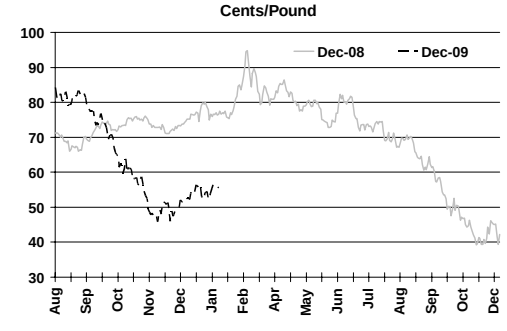


Exhibit 73

December Corn Futures

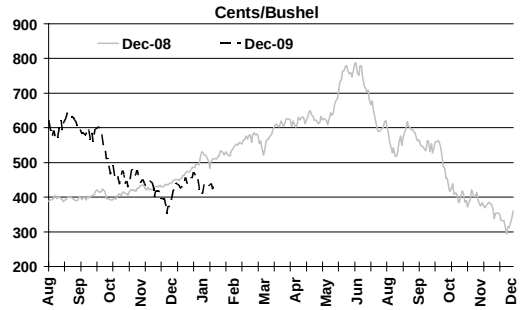


Exhibit 74

November Soybean Futures

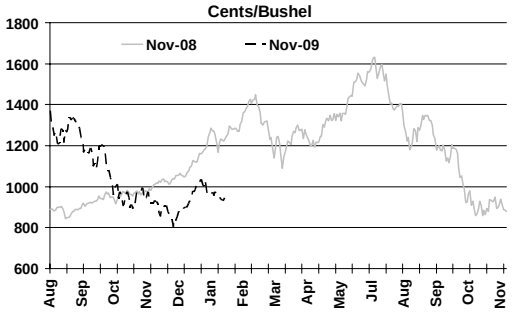


Exhibit 75

U.S. Planted Area

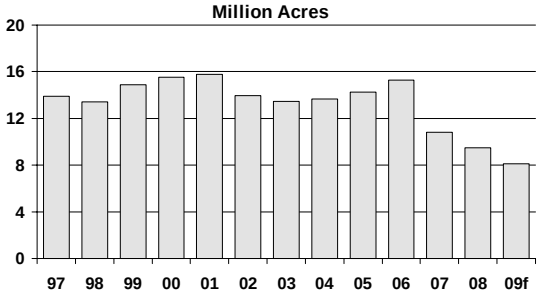


Exhibit 76

U.S. Harvested Area

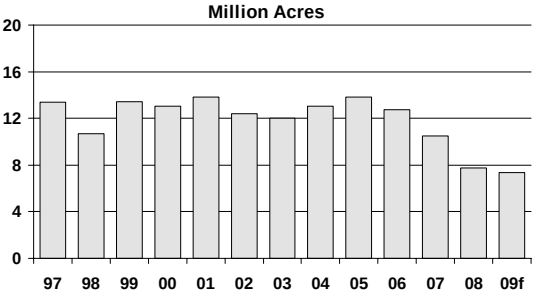


Exhibit 77

U.S. Cotton Supply

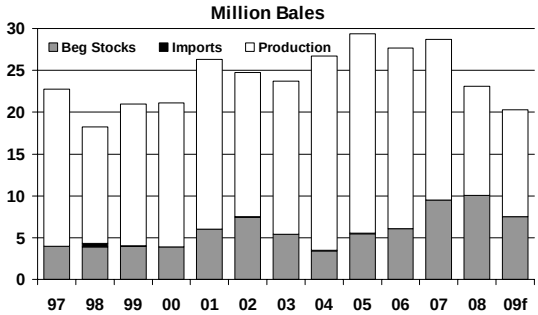


Exhibit 78

U.S. Cottonseed Supply

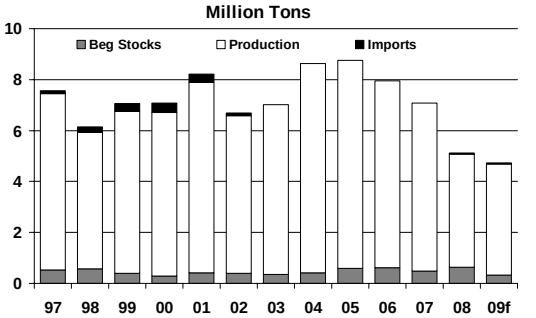


Exhibit 79

U.S. Cotton Mill Use
(Calendar Year)

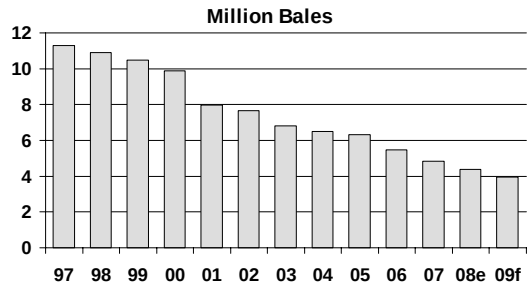


Exhibit 80

U.S. Cotton Mill Use
(Crop Year)

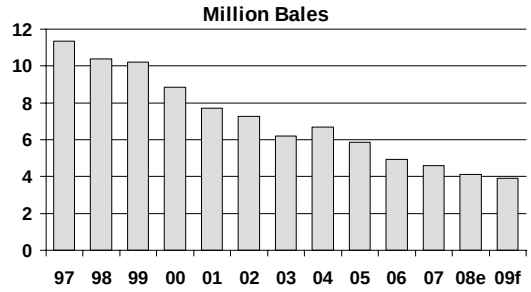


Exhibit 81

Daily Avg. U.S. Cotton Mill Use

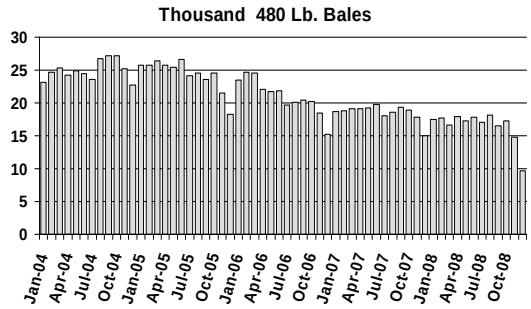


Exhibit 82

Man Made Fiber Mill Use

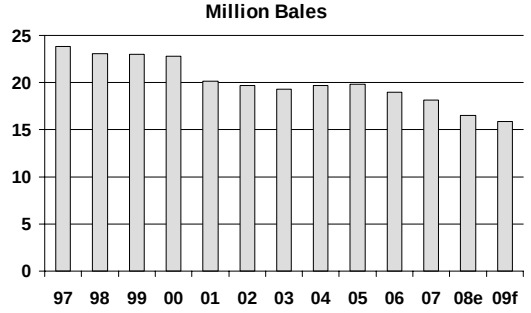


Exhibit 83

U.S. Apparel Production

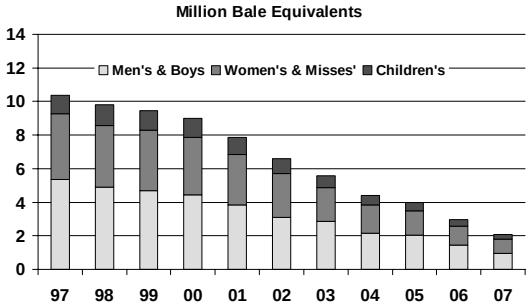


Exhibit 84

Fiber in U.S. Made Apparel

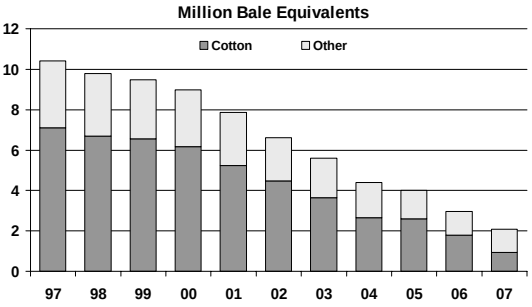


Exhibit 85

Fiber in U.S. Made Home Furnishings
(excludes carpeting)

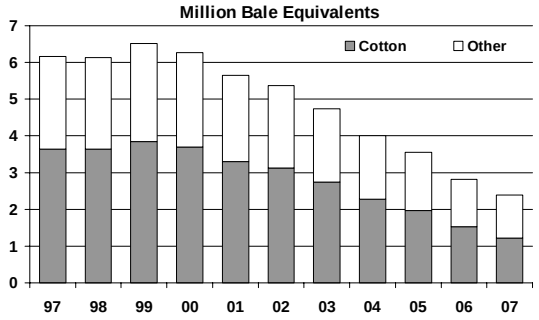


Exhibit 86

Net Domestic Fiber Consumption

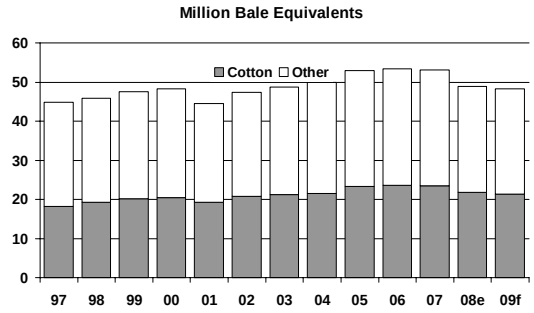


Exhibit 87

Components of Retail Cotton Consumption

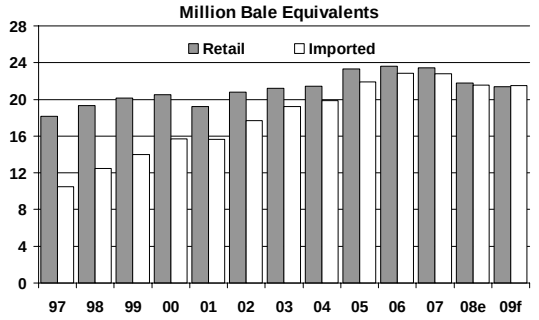


Exhibit 88

U.S. Cotton Textile Imports

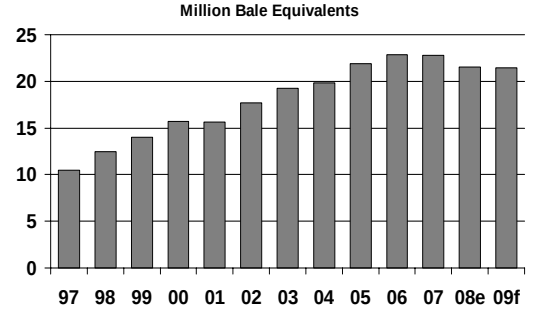


Exhibit 89

U.S. Cotton Content in Textile Imports

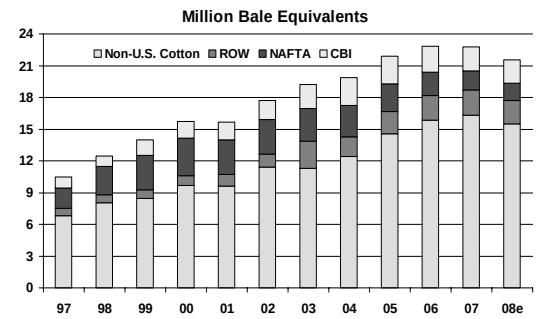


Exhibit 90

U.S. Cotton Product Imports

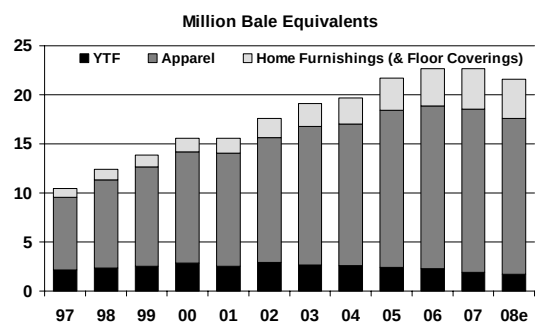


Exhibit 91

U.S. Import Source of Cotton Products

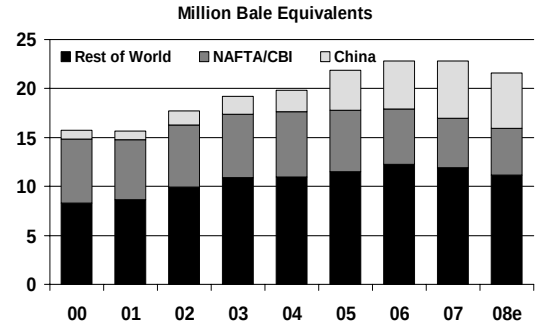


Exhibit 92

U.S. Cotton Product Trade With Mexico

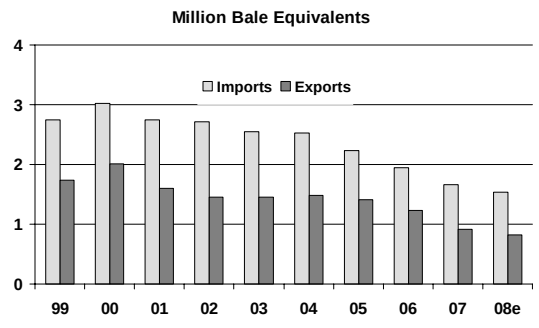


Exhibit 93

U.S. Cotton Product Trade With Canada

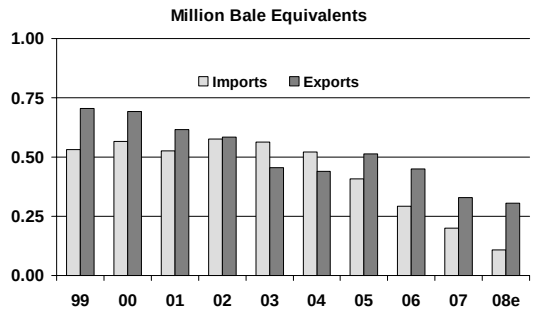


Exhibit 94

U.S. Cotton Product Trade with CBI

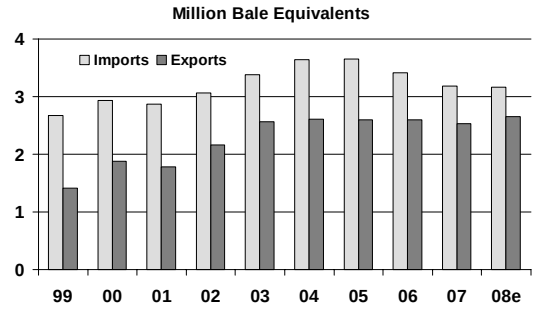


Exhibit 95

U.S. Cotton Product Imports from China

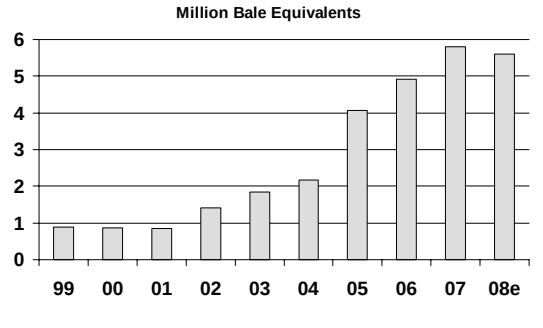


Exhibit 96

Cotton Product Imports from Mexico

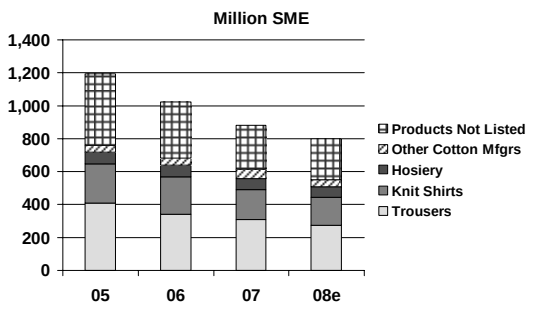


Exhibit 97

Cotton Product Imports from Canada

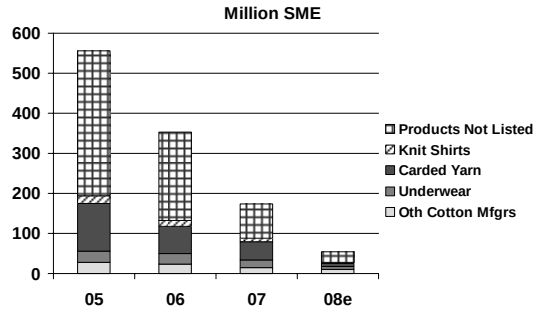


Exhibit 98

Cotton Product Imports from CBI

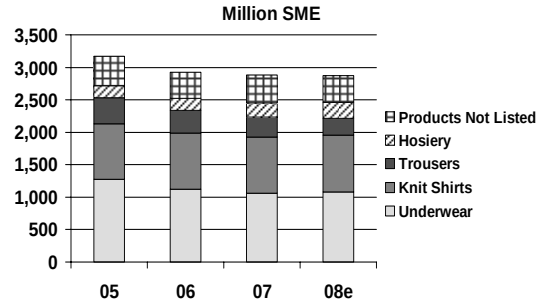


Exhibit 99

Cotton Apparel Product Imports from AGOA

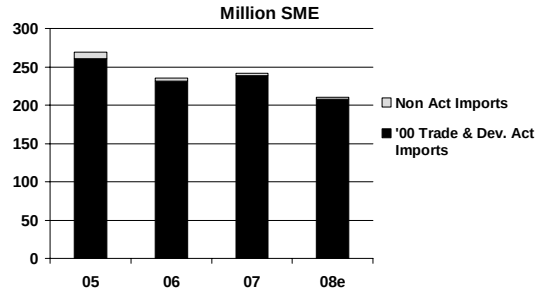


Exhibit 100

Cotton Product Imports from Pakistan

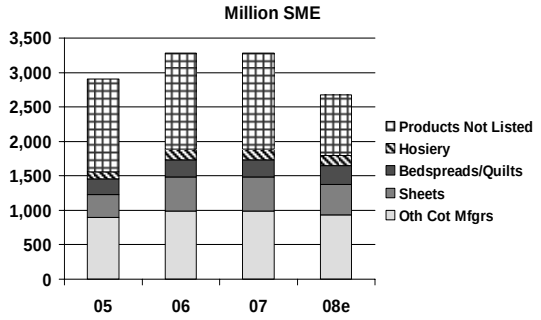


Exhibit 101

Cotton Product Imports from China

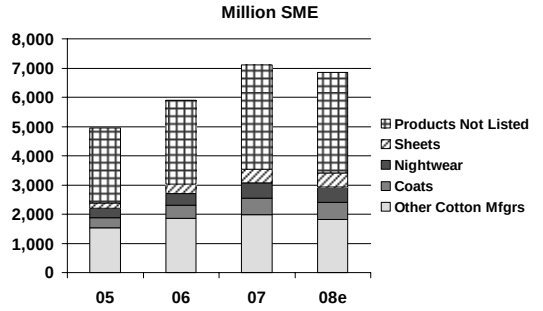


Exhibit 102

Cotton Product Imports from India

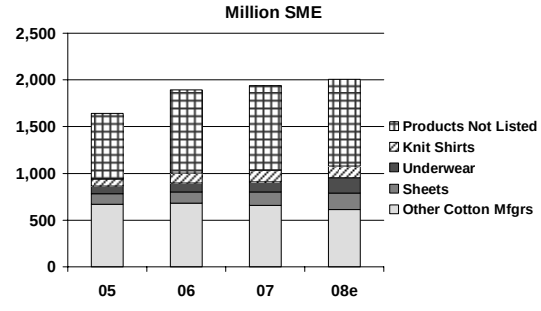


Exhibit 103

Cotton Product Imports from Hong Kong

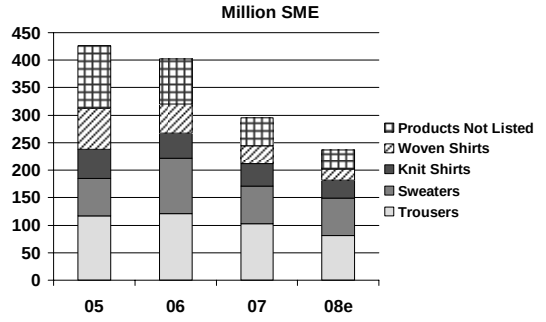


Exhibit 104

Cotton Product Imports from Bangladesh

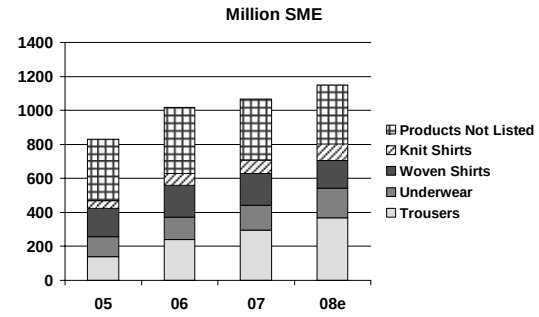


Exhibit 105

Cotton Product Imports from Vietnam

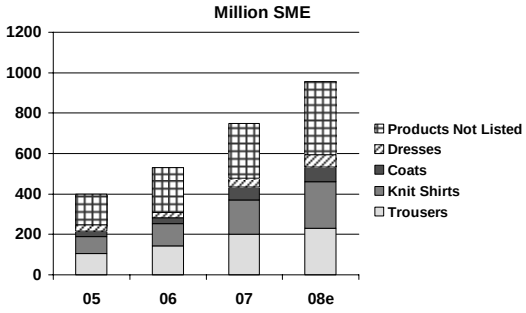


Exhibit 106

Cotton Product Imports from Turkey

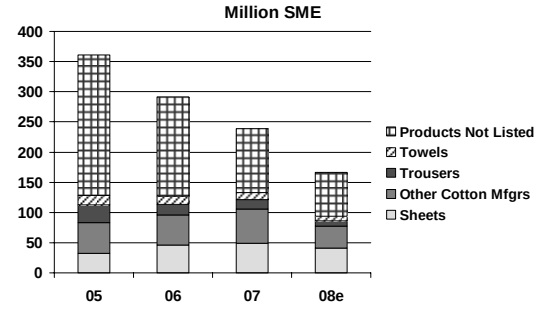


Exhibit 107

U.S. Cotton Textile Exports

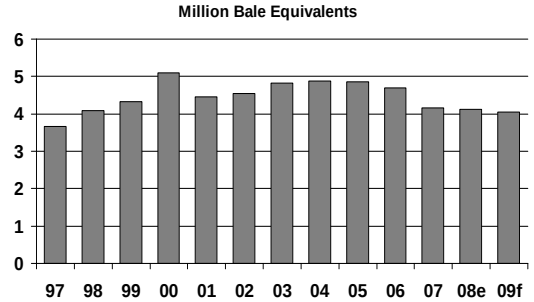


Exhibit 108

U.S. Cotton Product Exports

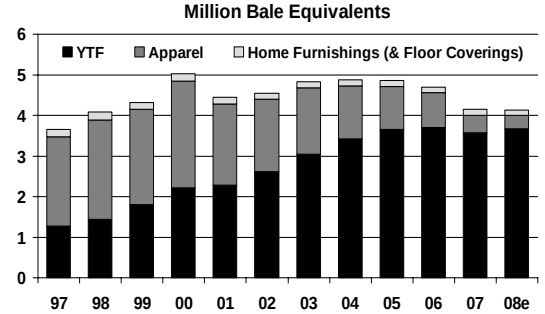


Exhibit 109

U.S. Exports of Cotton Products

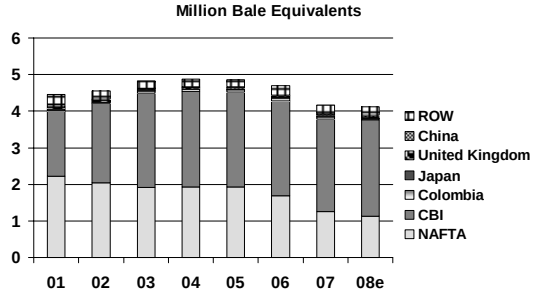


Exhibit 110

"A" (FE) Index

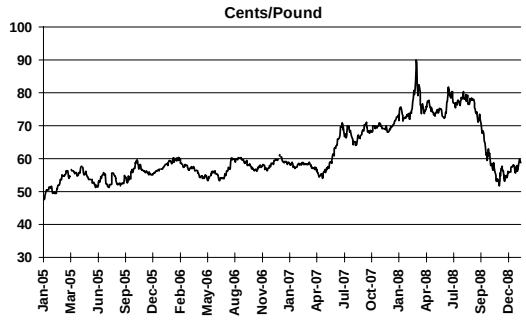


Exhibit 111

World Cotton Supply & Use

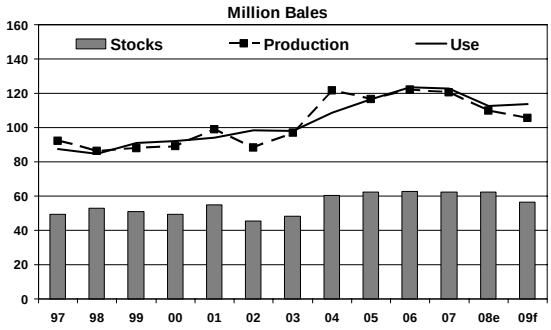


Exhibit 112

China Cotton Supply & Use

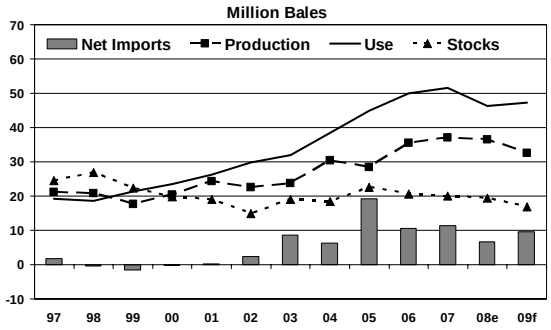


Exhibit 113

India Cotton Supply & Use

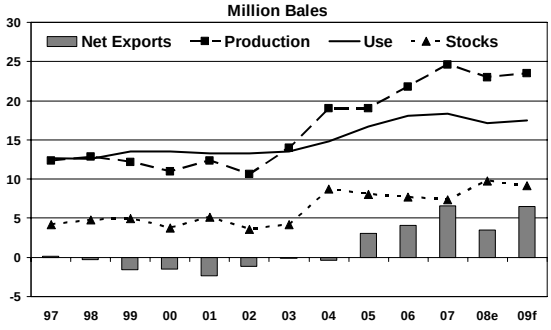


Exhibit 114

Uzbekistan Cotton Supply & Use

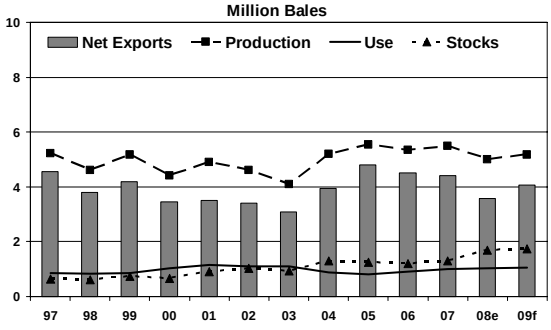


Exhibit 115

Pakistan Cotton Supply & Use

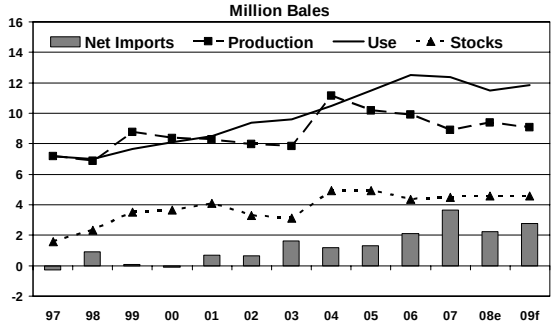


Exhibit 116

Turkey Cotton Supply & Use

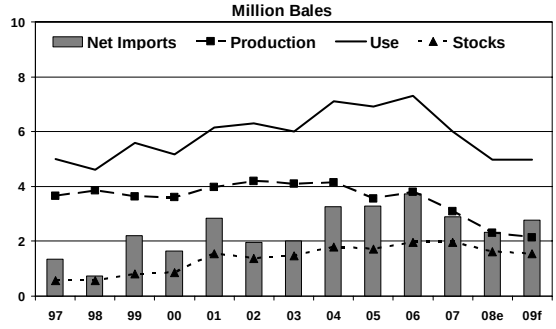


Exhibit 117

Australia Cotton Supply & Use

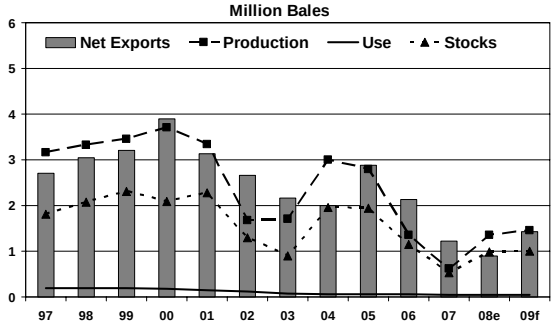


Exhibit 118

Brazil Cotton Supply & Use

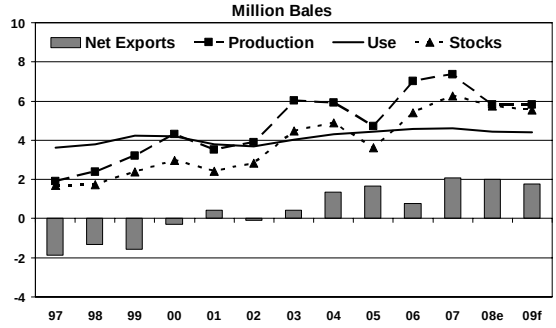


Exhibit 119

West Africa Cotton Supply & Use

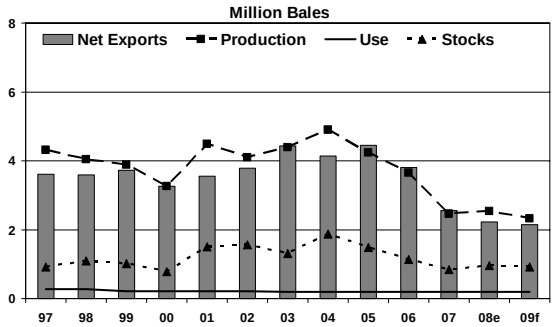


Exhibit 120

Mexico Cotton Supply & Use

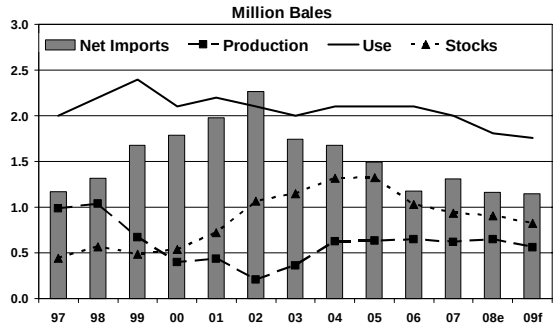


Exhibit 121

Indonesia Cotton Supply & Use

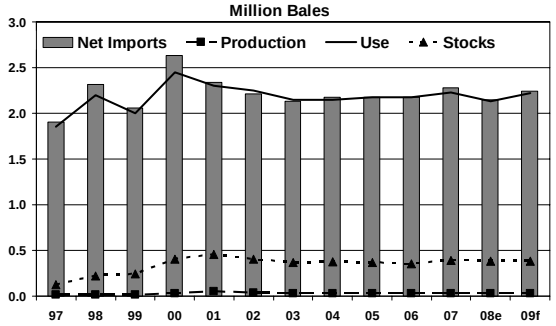


Exhibit 122

Vietnam Cotton Supply & Use

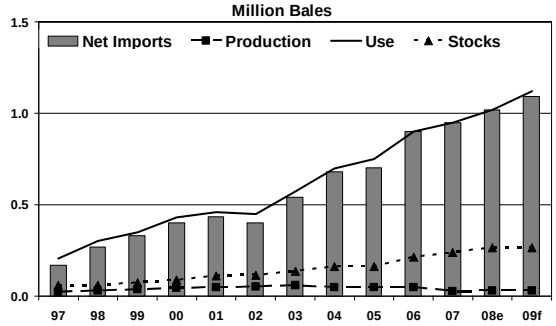


Exhibit 123

Bangladesh Cotton Supply & Use

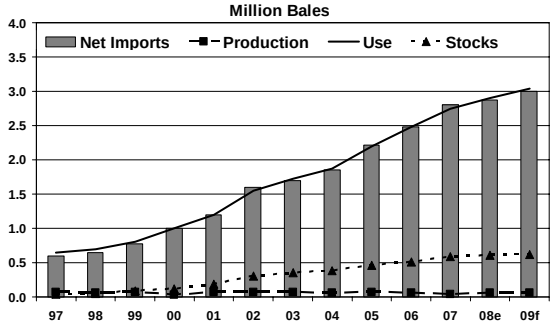


Exhibit 124

United States Cotton Supply & Use

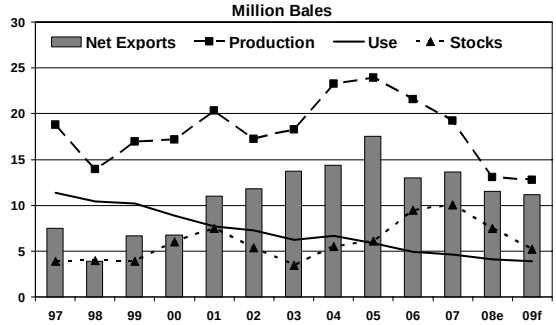


Exhibit 125

Top U.S. Raw Cotton Export Destinations

2000		2008YTD	
Country	(000 480-Lb. Bales)	Country	(000 480-Lb. Bales)
Mexico	1,819	China	2,691
Turkey	613	Mexico	1,227
Indonesia	541	Turkey	1,055
Taiwan	407	Indonesia	769
Japan	383	Vietnam	474
Hong Kong	297	Thailand	397

Exhibit 126

World Trade Share of Mill Use

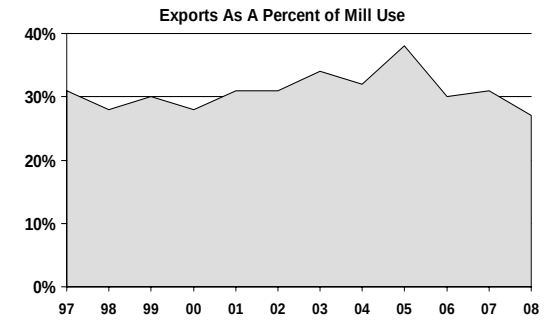


Exhibit 127

World Cotton Imports

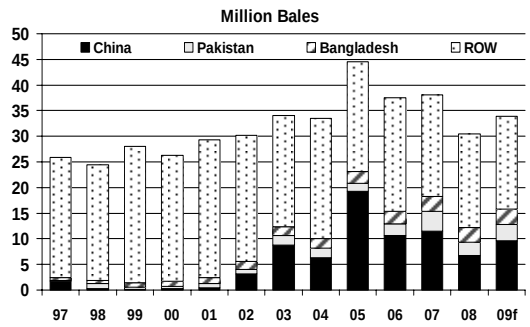


Exhibit 128

World Cotton Exports

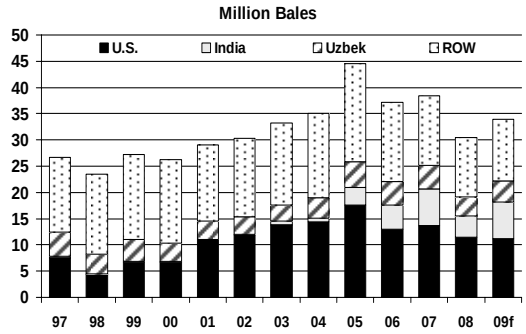


Exhibit 129

World Cotton Ending Stocks

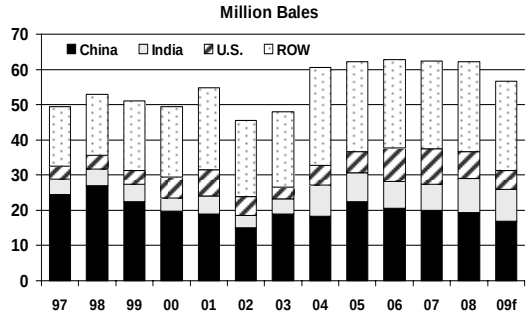


Exhibit 130

World Cotton Stocks vs Price