

COTTON ECONOMIC UPDATE

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Introduction

Good morning. Thank you, Mr. Chairman, for the opportunity to address the 2010 Beltwide Cotton Conferences regarding cotton's economic landscape. Over the next few minutes, I will give a broad overview of the current cotton market. As we head into 2010, it appears that we've weathered the worst of the economic downturn.

Cotton Prices

Prices have been on an upward trend during 2009, gaining between 20 and 25 cents over the course of the year. There are several factors supporting prices: an improved general economy, the weaker U.S. \$, and improving fundamentals through a tighter balance sheet.

World Balance Sheet

To start, we will review USDA's latest numbers for the current 09/10 marketing year, which runs from August to July. World production is estimated at 102.7 million bales, down almost 5 million bales from 2008, due in large part to China's decline of 5.2 million bales. The crop in Central Asia is also smaller. Changes in other countries largely offset each other.

Mill use is expected to recover to 114.5 million bales, after a sharp drop in 08/09. The current 09/10 estimate is still well below the 07/08 level. The combined effect of reduced production and increased mill use is a significant drop in stocks by the end of the current marketing year. If realized, it would be the first time for such a drop since the '02 marketing year.

2010 Economic Recovery?

For cotton demand, a big question will be the extent to which the economy continues to improve. The latest projections from the International Monetary Fund call for the global economy to expand by 3% in 2010, after a contraction of just over 1% in 2009. As 2009 ended, the economy continued to exhibit positive signals, but there are concerns that economic expansion will be slow. Consumer spending will likely be restrained as confidence remains low, unemployment remains high, and the housing market struggles.

Economic Recovery and Mill Use

Over the past decade, there has been a discernible correlation between economic growth and the change in mill use. During the years when the global economy expanded by 3 to 5% per year, we saw mill use grow at annual rates between 5 and 10%.

U.S. Balance Sheet

Turning our attention to the U.S. balance sheet, growers planted 9.1 million acres in 2009, down 3.5% from 2008. With abandonment of 15% and an average yield of 782 pounds per acre, the total U.S. crop is estimated at 12.6 million bales. The U.S. crop has been reduced as we've gone through the fall due to excessive rainfall in the Mid-South and Southeast. A significant drought in south Texas further lowered the potential of the 2009 crop. After a delayed harvest, cotton classing is progressing with 10.9 million 480-lb bales classed as of December 31.

The U.S. textile industry is expected to consume 3.4 million bales in 09/10, down 200 thousand bales from 08/09. Recent monthly mill use numbers are consistent with the marketing year estimate.

Cotton exports will again be critical to determining total offtake. It is evident that 09/10 exports will be down from the previous 2 years, in part due to lower exportable supplies. USDA's current estimate of 11 million bales is

attainable, but based on sales-to-date, there is still work to do to attain the total. As of late December, sales stood at 6.3 million bales and shipments totaled 3.5 million bales.

As with the world balance sheet, U.S. cotton stocks are projected to decline by the end of the current marketing year. The current estimate off 4.5 million bales is less than half the total stocks of just two years prior.

U.S. Cotton Export Markets

A quick review of the top international markets for U.S. cotton will reiterate the importance of exports. Based on average export shares for the 2006-2008 period, the top 7 international markets account for almost 75% of total U.S. exports. In fact, the top 3 markets of China, Turkey and Mexico receive more than half of all U.S. cotton exports. China is largest export customer at 30%.

China Mill Use and Imports

As mentioned earlier, China's cotton production is down from 2008. USDA estimates the crop at 31.5 million bales, but some estimates are even lower. Mill use in China suffered the effects of the downturn in the global economy, but current estimates call for a recovery in 09/10. The result should be additional imports by China, but we have to remember how closely China manages their market through the issuance of import quotas and the sale of stock reserves. Typically, internal Chinese prices are supported at levels well above the world market. For calendar 2010, China has announced their WTO-mandated tariff rate quota (TRQ) of approximately 4 million bales TRQ and another 4.59 million bales of imports that are subject to a sliding scale duty. It is anticipated that further quotas will issued as needed.

India's Export Competition

While China is important on the buying side, India has emerged as a significant exporter and competitor to U.S. cotton. Their recent growth in production has outpaced the demands of their textile industry. In 2008, India increased their support prices for cotton to a level that made them uncompetitive in world markets. As a result, their exports were sharply lower in 08/09, but they appear poised to expand their exports in the current marketing year as world prices have improved.

Export Trade Shares

India's increased exports create a more challenging market for U.S. cotton. Over the past 5 years, export shares of the U.S. and India are virtually mirror images of each other. An increase in India's trade share generally means a reduction in U.S. trade share. Such will be the case for 09/10.

Looking at 2010

To quickly recap key points for 2010, maintaining mill demand at current prices is critical. Manmade fibers will continue to pose serious competition for U.S. cotton, further emphasizing the importance of the promotion efforts of Cotton Incorporated and Cotton Council International.

It is becoming more apparent that cotton stocks will decline, offering support to cotton prices. As we move through 2010, we will soon turn our attention to the competition for acres in the U.S. and abroad. The recent rise in prices has placed cotton in a more competitive position than anytime in the past three years. Historically, when world prices have approached current levels, growers in other countries responded with increased area. In the United States, the NCC's acreage survey will give the industry an early-season look at expected plantings. The survey was distributed to cotton farmers across the Cotton Belt in mid-December, and we encourage all growers to respond.