THE U.S. AND WORLD COTTON OUTLOOK

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Abstract

The world cotton situation for 1998/99 is characterized by much lower production and consumption. U.S. production is down sharply due to lower planted acreage, higher abandonment and lower yields relative to last year. Weak global demand, substantial foreign stocks outside China, and the prospect of large exports by China have reduced current U.S. prices to their lowest level in more than 5 years, despite the short U.S. crop. Prospects for 1999/2000 include a modest recovery in world demand, intense competition for world trade, higher production in the U.S. and higher U.S. ending stocks.

Introduction

U.S. production fell more than 5.0 million bales this year, the smallest crop since 1989 and a drop of nearly 30 percent, the largest year-to-year decline since the PIK program of 1983, as disaster struck all four major cotton-producing regions. Lower U.S. production is a primary factor contributing to much lower world production for the 1998/99 marketing year. However, a sharp decline in world consumption will partially offset lower world production, with the result that world stocks are expected to decline by about 2.0 million bales. Despite the extremely short U.S. crop, domestic prices have fallen to their lowest level in five years.

Before proceeding with forecasts for next season, I'd like to review the situation that brought prices to their current low. Following this review, I will discuss USDA's preliminary outlook on next season for both the U.S. and the world. Since USDA is prohibited by law from making public price projections, I will leave that to the next speaker, Mr. Jernigan, and focus on the more fundamental developments in production, consumption and trade. This situation and outlook reflects the collective thinking of USDA's Interagency Cotton Estimates Committee and I want to thank committee members for providing insights, analysis and review for this paper.

World Situation, 1998/99

World production for 1998/99 is projected 8 percent lower, due mainly to reductions in the U.S., China, Uzbekistan and Egypt. Most of these decreases are due to adverse weather. Partially offsetting these reductions are increases in India, Pakistan and Australia, which are primarily the result of higher area. India's area has increased an estimated 3.5 percent, due to shifts from other crops, and Australia's planted acreage, especially of dryland cotton, has responded to both a favorable price situation and good weather.

This year's U.S. production decline results from lower planted area, harvested area and yield. Planted area of 12.9 million acres was nearly 1.0 million below the preceding year due to more attractive alternative crop options and to adverse weather at planting time--unseasonably cool, wet conditions reduced area in the far West while dry conditions hindered planting in the Southwest. Estimated harvested acres of 10.4 million reflect a record abandonment of 42 percent in Texas, due to continued excessive heat and drought. And despite the loss of lower-yielding dryland cotton, the national estimated yield of 621 pounds per harvested acre is nearly 9 percent lower as yields were down in nearly every state in the Southeast, Delta and far West regions. The drought which began in Texas extended east as far as the Carolinas by the end of the season, and a cool, wet finish prevented California from recovering from its very late start.

Falling world consumption is expected to absorb much of the fall in production. China, the world's largest cotton spinner, is expected to use about 5 percent less cotton this year. The government of China has instituted a program to close inefficient mills by destroying spindles; in addition, textile exports have suffered from the relative strength of China's currency.

Last year's Asian currency crisis drastically reduced incomes in countries which previously accounted for about 4-5 percent of world end-use consumption, based on estimates by the ICAC. Very inexpensive manmade fiber prices exacerbated the impact on cotton, since many of the countries affected by the Asian crisis have a surplus capacity for synthetic fiber production. With lower demand at home, major cotton spinners like Indonesia, Thailand and South Korea have produced a higher proportion of textiles for export; as a result, cotton mill use in these countries has stabilized. However, the increased competition for markets has adversely affected mill use in the U.S., Turkey and India. More recently, economic collapse in Russia is estimated to cut this year's consumption by about 20 percent and financial instability in Brazil is likely to reduce consumption by 4.5 percent. Taken together, these factors have generated the largest annual percentage decrease in world cotton consumption since 1980/81.

A review of projected world, China and other foreign stocks offers an important clue to the depressed state of the current world cotton market. World stocks are estimated to fall over 4 percent, or 1.8 million bales, at the end of this season. However, the combined expected reduction in stocks for China and the U.S. is 3.0 million bales. This means that foreign stocks outside China, that is, the stocks

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of nearly all of the U.S.'s major competitors and some of its customers, are projected to rise collectively by more than 5 percent. Moreover, these stocks were already at a burdensome level at the end of last season, the highest in five years.

Recent developments in China are also important to understanding the current world situation. China's government-run cotton industry has supported production at prices above market-clearing levels for several years. At the same time, imports by joint venture mills made China the world's leading importer. This combination of oversupply and imports led to a build-up in stocks to an estimated 17 million bales at the end of 1997/98, over 40 percent of world's total stocks. Over the past year and a half, China has sent a number of signals that these policies will be reversed. The government took steps to promote the use of cotton from Xinjiang province, China's largest and most remote cotton-producing area, beginning in the fall of 1997. At the same time, prices to mills became negotiable within specified price bands. Procurement prices to farmers were reduced for the 1998 crop and prices to mills were allowed to fluctuate without limit. Procurement prices are likely to be liberalized completely in the spring of 1999 and purchase by a variety of government entities will be permitted, in lieu of monopoly by a single agency. Imports were severely restricted at the beginning of calendar 1998. And large quantities of stocks were offered for sale to the international trade in the late spring of 1998; approximately 1.1 million bales of mostly old-crop cotton was sold. The purposes of these reforms are to reduce the government's cost of buying and storing cotton and to improve the cost-effectiveness of China's domestic mills.

USDA is currently projecting China's exports at 1.5 million bales for the year. This estimate includes cotton from the announced sale of approximately 1.0 million bales to the international trade in a tender last April, plus shipments from further sales likely to occur before the end of the marketing year. Shipment of the cotton reported to have been sold has been very slow, probably due to weak global demand and difficulty finding buyers. Since further sales depend on decisions in China's State Council, rather than market forces, the China export projection is one of the most speculative estimates in USDA's world balance sheet. On the one hand, the government of China may be reluctant to subsidize exports to the degree necessary to move them in today's very competitive market; on the other hand, further sales may be forthcoming this spring as confirmation of 1998-crop production and the implications for stock-building become more apparent.

Implications for U.S. 1998/99 Supply, Trade, Stocks and Income

With production estimated at 13.5 million bales and imports of 400,000, the U.S. total supply will be 17.7 million bales this year, the lowest in over 10 years. Significant imports are projected under the Step 3 quotas, now expected to trigger in late February, due to abundant supplies of cotton in the world and a critical domestic shortage of certain qualities required by U.S. mills.

U.S. consumers are expected to purchase the equivalent of about 20 million bales of cotton this marketing year, which indicates a rise in the per capita consumption of cotton to about 35 pounds. However, slower growth in the U.S. economy and rising textile imports will keep mill use from reaching last season's 50-year high. U.S. domestic mill use is projected at 10.6 million bales, which is 7 percent below last year. Cotton textile imports, which have risen at an annual rate of 20 percent on average since the beginning of calendar 1997, are rising faster than consumer demand.

With respect to exports, a total of 4.3 million bales is currently projected, or 17.5 percent of world trade, which is the lowest share since 1985/86. Limited supplies, weak demand, intense competition, and quality problems will affect U.S. exports this year. Of the total, an estimated 2.3 million bales were shipped under the Step 2 program before the spending cap was reached in mid-December. Approximately 1.6 million bales in outstanding sales remain on the books, but some cancellations are likely for sales which were made with the expectation of a Step 2 payment.

The combination of the current low prices and low yields will reduce market revenue to producers to its lowest level in over 10 years, but government payments (including contract payments) will provide an average of about $100 per acre planted. Government outlays for the cotton program, which tend to rise as prices fall, may exceed $1.5 billion for the current fiscal year. With the marketing loan differential running at about 10 cents per pound, most of this year's production is likely either to enter the loan or receive a loan deficiency payment (LDP). As of mid-December, just over 3.0 million bales had entered the loan and a similar quantity had earned an LDP.

Early Predictions for 1999/2000

The U.S. and world projections for 1999/2000, always tentative at this early stage, are even more uncertain than usual this year. In addition to the customary variation around production associated with weather and growing conditions, world demand has fallen off its short-run growth curve, making it more difficult to estimate its path, and world trade will be significantly impacted by somewhat arbitrary decisions by the government of China.

USDA currently predicts that world demand will rise next marketing year, with an increase in the range of 1-2 percent; this recovery, while positive, will be insufficient to bring consumption back to the level pre-dating the Asian financial crisis. Projections of real GDP growth for the world are relatively flat for calendar 1999 at less than 2 percent, but reflect a return to a more robust 2.8 percent in 2000.

Recession is expected to continue one more year in Southeast Asia, Japan, Brazil and Russia, but projections for all other countries, including developed economies that account for over 40 percent of world retail cotton consumption, are positive. The exhaustion of excess inventories now in the pipeline, combined with the current low level of cotton prices, will raise demand for cotton next marketing year by a modest amount.

World production is also expected to rise and may roughly equal consumption, mainly because U.S. production will return to normal under assumptions of average weather conditions. Foreign production overall is likely to fall, but by less than the probable increase for the U.S. Under a normal weather scenario, we look for production to decrease in China, India and Australia. Area will be down in China due to anticipated lower procurement prices; however, area shifts away from cotton will be limited because of farmers' recent difficulties with grain procurement. India's 1999 planted area is likely to decline due to this year's surplus of production over consumption. And dryland area in Australia, which in 1998 was supported by unusually wet conditions at planting time, is likely to fall. Partially offsetting these decreases in foreign production is a projected increase for Uzbekistan, based on a return to normal weather.

China will continue as a net exporter, as the government maintains policy initiatives designed to draw down stocks. We believe that China will be a significant exporter next year whether or not the rate of exports increases in the current marketing year; however, if exports this year fall short of the projected 1.5 million bales, then the shortfall will weigh on next year's world trade. Foreign stocks outside China may also fall, but will remain historically high. An increase in U.S. stocks will about offset the decrease in foreign stocks and world stocks may continue at just under 40.0 million bales.

USDA's survey of U.S. planting intentions will reported on March 31. Our preliminary subjective estimate is for a marginal increase in acres planted to cotton for the 1999 cropyear. About 12.9 million acres were planted in 1998; but producers planted less than originally intended because of weather problems. We now expect that 1999 acres planted will range from 13.0-13.5 million. A study of supply response developed by USDA's Economic Research Service indicates that while some area will be lost due to depressed cotton prices, the decrease will be about offset by shifts from other crops such as corn and soybeans. A comparison of 1999 futures prices for these crops indicates that, relatively speaking, corn and soybean prices have fallen more than cotton prices in the past year. Thus, we would expect to see small net increases in area, especially in the Southeast and Delta, where multiple cropping patterns provide more planting flexibility. With average abandonment and weather conditions, a crop of 17.0-18.0 million bales is indicated.

U.S. GDP is expected to grow more slowly in both 1999 and 2000 than it has in recent years; this, in turn, will generate slower growth in retail consumption of cotton. Textile imports will also continue to increase, but at a slower rate than the recent annual average of approximately 20 percent, due to a strengthening of foreign currencies against the dollar. These factors indicate that mill use may show a marginal decline in 1999/2000, averaging somewhere between 10.0 and 10.5 million bales.

With higher production, the U.S. is potentially a larger exporter; however, relatively weak world demand, limited foreign imports, increased export competition from China, and continued large stocks in foreign countries outside China are major factors that will limit U.S. share. Exports approaching 1996/97's 7.5 million bales would be needed to completely offset the anticipated increase in U.S. supplies; however, a range that encompasses 6.0 million bales is more consistent with the world projections outlined previously. This estimate would place the U.S. at about 23 percent of world trade, well above the current year but slightly below the average of the early 1990's.

USDA is currently developing baseline projections to the year 2008. These projections include macroeconomic assumptions, discussions of likely developments in important countries and regions, especially with respect to trade, and supply-demand estimates for the U.S. for all major commodities. The USDA baseline will be made available at our annual outlook conference, scheduled for February 22 and 23, in Washington, D.C. and will be one topic for discussion at the conference.

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