

**COTTON CONSUMPTION
AND THE FINANCIAL CRISIS IN ASIA**
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Abstract

The global financial crisis that initiated in Asia in mid-1997 caused world economic growth to decelerate from 4% in 1997 to 2% in 1998. The crisis interrupted a four-year period of rapid expansion of world end-use consumption of textiles. World end-use cotton consumption, which was expected to increase by 1% in 1998, instead declined by 1% as a result of the crisis. In addition, exports of cotton textile manufactures from developing countries, essentially from Asia, to industrial countries increased about 9% in 1997 and 1998, compared to an average rate of 4% during the 1990s.

Introduction

The dominant economic development over the last year and a half has been the Asian financial crisis and its repercussions. Once again, the world is at a critical juncture. During the 1990s we have witnessed both the benefits and the risks associated with globalization. Taking advantage of the increasing international flow of investment resources, the world economy managed to grow at above-average rates for four years. However, once again, as in Mexico in 1995 or during the debt crisis of the early 1980s, financial instability, now on a larger scale, is affecting the world economy.

The crisis is the result of deregulation of the financial system worldwide during the late 1980s and early 1990s which generated an increasing and unchecked flow of short term capital that has been used to finance medium and long term investment in developing countries. In Asia, continuous overinvestment in specific markets for a number of years resulted in overexposure by financial institutions. As several financial institutions went into bankruptcy, investors began a rapid repatriation of their capital creating pressures on exchange markets and drying up national reserves. Devaluation became the only policy instrument available and as currencies slid dramatically, the debt contracted in foreign currency by financial institutions increased to unsustainable levels and the system simply collapsed.

Effects on World Economic Growth

World GDP increased by 4% in 1996 and 1997 and by more than 3.5% during the previous two years. In contrast, substantial deterioration of the world economy was

experienced during 1998. In addition to the financial crisis initiated in Asia, which today affects every corner of the world, and in part as a result of it, there are new unstable economic conditions in Russia and neighboring countries and a deepening of economic recession in Japan.

In October 1997 the International Monetary Fund estimated that the world economy would increase by 4.3% in 1998. As a result of the crisis in Asia, the IMF lowered its estimate to 3% in May 1998 and to 2% in September. The most important adjustments to GDP growth have taken place in developing countries and in Eastern Europe and the former USSR. GDP growth in developing countries is estimated now to only increase by 2% in 1998, the lowest rate of growth in two decades. This lower GDP growth in developing countries is mainly the result of the deep recession in Indonesia, the Republic of Korea, and Thailand, the main economies in Asia at the center of the financial crisis. However, the financial crisis is also negatively affecting neighboring economies and economies of developing countries in other regions. GDP growth in 1998 in Latin America and the Caribbean, which in October 1997 was expected to be 4.5%, is now estimated to be 1.8%.

Spillover effects of the crisis are more dramatic in Eastern Europe and the former USSR. The economic outlook for the region has changed fundamentally. Growth of GDP for 1998 in Eastern Europe and the former USSR was expected to be 3% in October 1997. Now, it has been revised downward to -0.2%.

In industrial countries, with the exception of the Japanese economy, the impact of the crisis on economic performance is still estimated to be modest for 1998. In fact, projections of GDP growth have been revised upward for the United States and the European Union since October 1997. Exports to Asia from these industrial countries are expected to fall sharply, while exports to other developing country regions are expected to slow down or experience small declines. However, the decline in bond yields and the shifting of capital from developing and emerging economies, are expected to have offsetting effects on economic growth. In contrast, the Japanese economy, which is the industrial economy that is most exposed to the crisis because it is the main holder of Asian debt, is at this moment in the deepest recession of the postwar era. GDP growth in Japan which in October 1997 was expected by the IMF to be 2% has been revised downward to -2.5%.

Another source of the deceleration of GDP growth in developing countries is the rapid decline of commodity prices, which has been exacerbated by the crisis. Average crude oil prices declined from US\$20 per barrel in October 1997 to US\$12.5 per barrel in June 1998 and have remained at that level since then. As the crisis has reduced effective demand worldwide, prices of non-oil commodities have also declined. The IMF Non-Fuel Commodity Price Index suggests that commodity prices fell 12% between October

1997 and June 1998. Similar declines were registered for agricultural commodity prices during the same period. Non-fuel commodity prices had already fallen 8% between January and October 1997, and agricultural commodity prices fell 20% during that period.

Impact on Textile Demand

In 1997, strong expansion of world textile demand was fostered by strong world economic performance. In fact, world textile consumption at the end-use level increased 5.6% in 1997, the highest increase in 12 years. Similarly, new estimates indicate that world textile consumption increased about 4% in 1996, almost 1 percentage point more than previous estimates. Between 1993 and 1997, above average world economic performance translated into a 3.5% average annual rate of growth of textile consumption. In just four years, the world consumed an additional 5.8 million tons of textile fibers.

The financial crisis has dramatically changed the economic climate around the world and the textile and cotton markets are not an exception. The effects of the crisis upon the world textile market depend mainly on the impact on economic growth, which in turn determines income growth. Lower GDP growth translates into lower textile consumption. With world GDP growing 4.3%, textile demand would have increased 2.5% in 1998. Current estimates of 2% world GDP growth suggest that world textile demand increased less than 1% in 1998. A better performance of world textile demand is not expected for 1999. Only by the year 2000 is textile demand expected to recover with a growth rate of 2%.

Another element that affects textile consumption is prices. Lower prices of textile products translate into increased consumption of textile products. Declines in fiber prices have been reinforced by the crisis and are expected to mitigate the effect of lower GDP growth. The ICAC Textile Price Index declined 14% in 1996, 7% in 1997 and declined 14% again in 1998. It should be noted that prices affect textile consumption with a lag of about one year, due to the period of time that occurs between consumption of fibers at the mill level and consumption of fibers by the final users.

World textile consumption reached 44.9 million tons in 1997, an increase of 2.4 million tons. About one third of the increase, or 800,000 tons, was consumed in developing countries. Another 60% of additional textile consumption took place in industrial countries and the remaining 10% in Eastern Europe and the former USSR. Textile consumption is estimated to have increased an additional 400,000 tons in 1998, and is expected to increase 300,000 tons in 1999. That is one-sixth and one-eighth of additional consumption in 1997.

As a result of the crisis, world textile consumption estimates and projections have been lowered by 740,000 tons for

1998 and 1.4 million tons for 1999 and 2000. The largest adjustment took place in developing countries where textile consumption growth was adjusted from a 2% increase to a decline of 1% in 1998. In other words, as a result of the crisis, consumption went from a potential increase of 500,000 tons to an expected decline of 200,000 tons. Similarly, it is now estimated that textile consumption in Eastern Europe and the former USSR will decline 1%. With the exception of Japan, the impact of the crisis on textile consumption in industrial countries is modest but positive. Textile consumption in industrial countries is estimated to have increased by about 3% in 1998.

Textile consumption in developing countries has been adjusted downward in all regions. It is obvious that the largest adjustments have been made for Asia. It is now estimated that textile consumption in Asia declined 2% in 1998, or about 250,000 tons. The growth initially expected in other regions has disappeared due to the crisis. In absence of the crisis, increases of about 100,000 tons would be expected in the Middle East and Europe and Latin America and the Caribbean. These increases have now been virtually reduced to zero.

Impact on Cotton Consumption

World end-use cotton consumption increased 2% reaching a record 19.4 million tons in 1997. However, the growth of noncotton fiber consumption was four times higher and, as a result, the trend of cotton's declining market share has been accentuated. Cotton's market share declined 1.5 percentage points, reaching 43.3% in 1997. Current estimates suggest that world cotton consumption declined by about 140,000 tons in 1998 and that the level of 19.3 million tons will be maintained in 1999. Similarly, it is estimated that growth of noncotton consumption decelerated to 2% in 1998 and will continue to decelerate to 1% in 1999. As a result, cotton's market share is expected to continue to decline to 42.4% in 1999.

As a result of the crisis, estimates and projections of world cotton consumption have been reduced by 300,000 tons for 1998 and 600,000 tons for 1999 and 2000. Virtually all of the adjustment took place in developing countries, where the growth of consumption fell from -1% to -5% in 1998. Even in the absence of the crisis, the rapid increase of chemical fiber production in developing countries has deepened the decline of cotton's competitiveness.

In Eastern Europe and the former USSR, it is estimated that the crisis has had a larger impact upon chemical fiber consumption and that in 1998 it only affected cotton consumption by a reduction of growth from 2.5% to 2%. Chemical fiber consumption is mainly consumption of domestic production in the region, while cotton products are the main component of textile imports.

In industrial countries, the crisis has improved consumption of cotton products. It is expected that the positive effects of additional growth of income due to the crisis will be reinforced by price reductions of imported products due to devaluation in export countries.

As a result of the crisis, cotton consumption in North America and Western Europe will increase an additional 1%. However, it is expected that these gains will be partially offset by a reduction of 0.5% in Japan, Australia and New Zealand. It is expected that the gains in North America and Western Europe will be mainly the result of increases in imports of cotton products.

Impact on Trade of Cotton Manufactures

The crisis has compromised the short and medium term growth of the textile industry in developing countries, in particular Asia. However, the expected declines of mill consumption of cotton in developing countries do not imply that developing-country exports of cotton textile products will decline. On the contrary, given that the crisis has had a dramatic impact on domestic demand through reductions in income per capita and an equally dramatic effect on the price competitiveness of cotton products from several Asian countries in international markets through devaluation, it is estimated that declines of mill consumption will only be a fraction of declines of end-use consumption and that exports from Asian countries will surge. In fact, international agencies such as the International Monetary Fund, which are involved in the managing of the crisis, suggest that countries should "export their way out of the crisis". The cotton textile trade deficit in industrial countries increased 4% in 1996. In 1997, the deficit increased a further 9.6% and it is estimated to have continued to expand at similar rates in 1998. In 1999, the cotton textile trade deficit might increase above 10%.

References

International Cotton Advisory Committee. October 1998. World Textile Demand. Available in print and on the internet at www.icac.org.

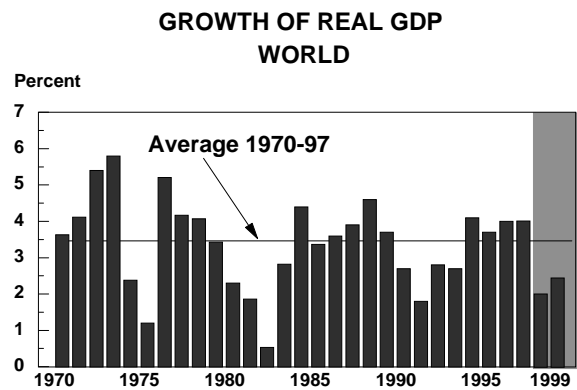


Figure 1

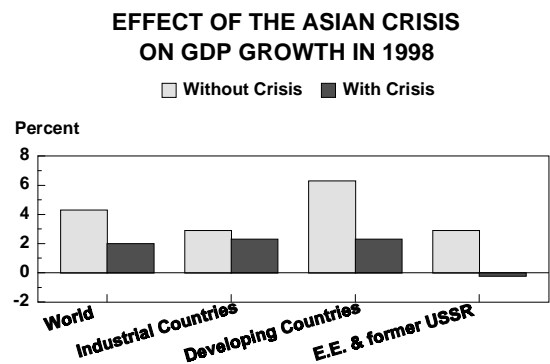


Figure 2

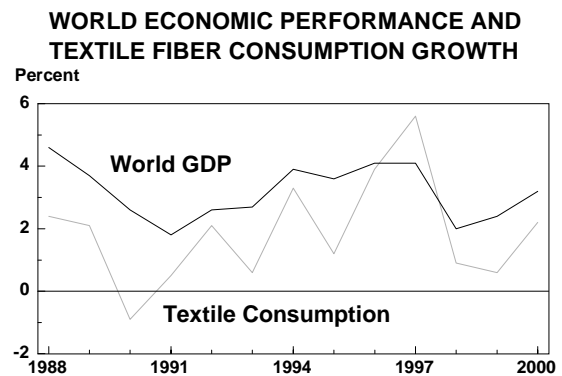


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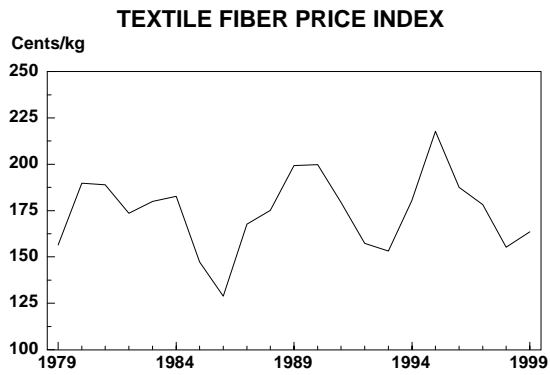


Figure 4

EFFECT OF THE ASIAN CRISIS ON COTTON CONSUMPTION IN 1998

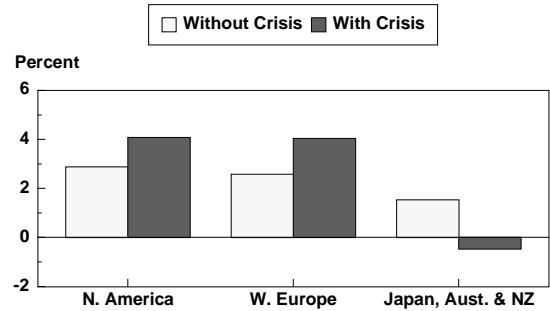


Figure 7

EFFECT OF THE ASIAN CRISIS ON TEXTILE CONSUMPTION IN 1998

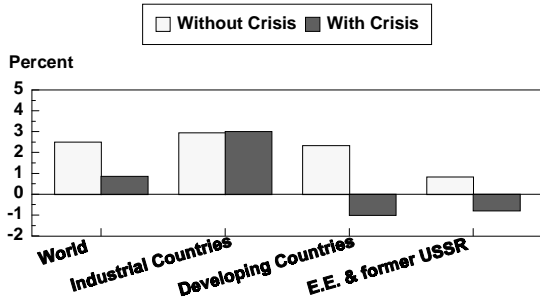


Figure 5

Table 1. Impact of the Financial Crisis on World End-Use Textile Fiber Consumption

	All Textiles	Cotton	Non Cotton
	1,000 Metric Tons		
Current Base Estimates and Projections			
1997	44,938.4	19,448.9	25,489.5
1998	45,327.3	19,309.0	26,018.3
1999	45,601.1	19,318.0	26,283.1
2000	46,611.3	19,603.9	27,007.4
Simulation of Projections Without the Crisis			
1998	46,063.6	19,622.6	26,440.9
1999	46,987.9	19,905.5	27,082.4
2000	48,020.0	20,196.4	27,823.6
Difference			
1998	-736.3	-313.7	-422.7
1999	-1386.8	-587.5	-799.3
2000	-1408.6	-592.5	-816.2

EFFECT OF THE ASIAN CRISIS ON COTTON CONSUMPTION IN 1998

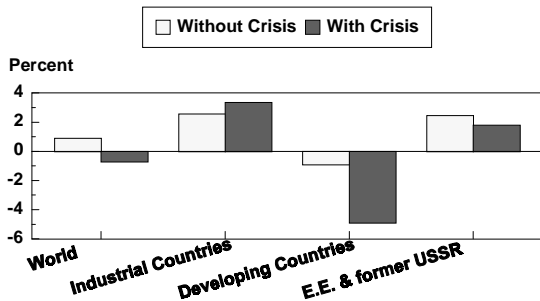


Figure 6