THE U.S. AND WORLD COTTON OUTLOOK

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Abstract

World production is estimated to rise more than 3 percent in 1999/2000, with mostly in the U.S. World cotton consumption is also projected to rise significantly, by an estimated 3.3 percent, well. A significant portion of this year's larger U.S. supply will flow into world export markets; however, larger exports are insufficient to offset the effects of both higher production and lower domestic use and, ending stocks are likely to rise. USDA's early projections show lower foreign, but higher U.S. production for 2000/01. World consumption is likely to continue to rise, and there is potential for the U.S. to capture a very competitive share of the world export market. This scenario, based on normal weather and crop conditions, results in lower world ending stocks, with U.S. stocks rising.

Introduction

At last year's Beltwide conference, this outlook presentation consisted mainly of exploring the many factors contributing to low cotton prices. Some of those factors, such as weak world cotton consumption resulting from the Asian financial crisis, have eased over the past year. Other influences, such as China's shift in policy and the existence of surplus world stocks, still apply today and account for the dismal performance of U.S. and world prices over the past year. As we turn to the upcoming season, 2000/01, we find a mixture of both positive and negative influences at work. USDA is prohibited by law from making public price forecasts, which may disappoint those in the audience who are looking for a single, definitive answer to the question of market direction. But cotton prices are extremely volatile and can turn around quickly based on changes in weather or economic conditions. Given the particular complexity of next season's outlook, it may be more constructive to define the issues that are likely to shape price behavior.

Before proceeding with our forecasts for next season, I will review our estimates for the current year. 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.

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World Situation, 1999/2000

World production is estimated to rise more than 3 percent in 1999/2000, with most of the increase accounted for by the U.S. Despite a number of weather problems, U.S. production is currently placed at 16.9 million bales, 3.0 million above the drought-stricken 1998 crop, due to larger planted and harvested area. U.S. planted acreage rose nearly 6 percent from 1998, with the largest increases in the Southeast and Delta as producers shifted area back into cotton from corn and soybeans. Approximately 8 percent of planted area was abandoned, most of it in Texas due to drought, and the expected national yield of 604 pounds per harvested acre is the lowest since 1995.

This season's foreign production is virtually unchanged from last year, as expected smaller crops in China, Mexico, Argentina, Brazil and Australia offset increases in Pakistan, Central Asia and India. China's crop is projected 1.7 million bales lower, as producers reduced planted area in response to lower expected procurement prices under the new government policy. Drought and financial difficulties stemming from low prices reduced plantings in Mexico, and adverse planting weather has dimmed crop prospects in Argentina and, to a lesser extent, Brazil. Less favorable soil moisture conditions has reduced dryland area in Australia to a more normal level. Production in Uzbekistan more than recovered from the poor weather conditions experienced the previous year, and favorable weather and low pest pressure are raising output in Pakistan and India.

World cotton consumption is also projected to rise significantly this season, by an estimated 3.3 percent, well above the long-run average growth rate of about 1.3 percent. Several factors support the rise in consumption. First, continued recovery in the world's economies from the after-effects of the Asian financial crisis is boosting world economic growth above earlier expectations. The surge in demand is also supported by falling world cotton prices, which have reached their lowest level since 1986. In addition, the benefits of reforms in China, which have both improved the efficiency of textile mills and provided a much cheaper supply of raw material, are raising use by the world's largest cotton processor by an estimated 3.5 percent. Total world cotton consumption this year is now expected to approach 88.0 million bales, near the level of two years ago.

World trade is also expected to rise commensurate with world consumption, and larger exports by the U.S. and China currently dominate the world trade picture. China's transformation, beginning in April 1998, from net importer to net exporter is the single most significant factor underlying the decline in world prices. This change came about as the result of a government decision to stop supporting internal cotton prices above world market-clearing levels, a practice which had resulted in an extremely burdensome accumulation of surplus stocks. With the new floating procurement prices in place for the 1999 crop and partial government subsidies available to help dispose of higher-priced 1998 crop, USDA currently projects China's exports at 1.2 million bales this season–most of this cotton has already been sold and shipments are occurring at a steady pace. The combination of lower Chinese production, higher consumption and exports, is expected to reduce China's stocks by a hefty 2.4 million bales during 1999/2000.

The drawdown in China's stocks has negative ramifications for other foreign countries that affect both the current and upcoming seasons. As a result of the Asian financial crisis and its spillover effects on consumption in countries like Turkey, Russia and Brazil, ending stocks in many countries rose in 1998/99. Total foreign stocks rose to a record level of 38.0 million bales by the end of 1998/99, including an estimated 17.4 million bales held in China. With stable production and higher consumption, foreign stocks are expected to decline by about 1.3 million bales at the end of 1999/2000; however, China's stocks are likely to decline by nearly double this amount. This means that foreign stocks held outside of China will rise again in 1999/2000, despite the salutary effects of larger world consumption. Outside the U.S., countries where stock increases are likely to be most significant include Pakistan and Uzbekistan.

1999/2000 U.S. Supply, Demand, Stocks and Farm Income

A significant portion of this year's larger U.S. supply will flow into world export markets; however, larger exports are insufficient to offset the effects of both higher production and lower domestic use and, therefore, ending stocks are likely to rise. Current estimates place stocks on July 31, 2000 at 4.5 million bales, up 14 percent from the beginning level.

U.S. consumers are expected to purchase the equivalent of just over 20 million bales of cotton this marketing year, which indicates a per capita cotton consumption of over 35 pounds, up roughly one pound from last year. However, rising textile imports will reduce U.S. mills' share of retail demand. U.S. domestic mill use is projected at 10.2 million bales, marginally below last year. While the growth in cotton textile imports has slowed to 8.0 percent in the third quarter of 1999, the textile trade deficit, defined as the amount by which textile imports exceed textile exports, continues to rise. The result of the textile trade deficit is that U.S. mill use as a share of the total cotton purchased by U.S. consumers continues to fall.

U.S. exports are expected to reach 6.2 million bales this year, constituting a much improved 23.7 percent of world trade. A number of factors account for the higher trade share, the first and most obvious being the recovery in U.S. production. The ability of the U.S. to compete at very low world prices in the early part of the season was also significant; this early season edge is attributable to the government cotton program, as well as some hesitation by major competitors, notably Uzbekistan, to sell at low prices. And the production of a significant quantity of shorter-staple export type qualities has also contributed to the larger export volume expectations.

Two U.S. government programs–the marketing loan and the Step 2 payments–have supported U.S. export competitiveness. Merchants' expectation of Step 2 reauthorization, which occurred in mid-October but was retroactive to October 1, permitted them to compete as world prices fell in the first half of the season under pressure from China's sales. At the same time, the marketing loan program, for which differentials have reached a record of nearly 22 cents per pound, has encouraged producers to actively market their cotton, rather than delay in the hope of a turn-around in prices.

Government payments are also instrumental in supporting farm income this season. At the October average farm price of 46 cents per pound, gross farm receipts from market sources would reach only $4.2 billion, the lowest in ten years. However, when government payments are added, including contract payments and marketing loan benefits (but excluding Step 2 payments), gross cotton farm income rises to $7.0 billion, above last season and slightly below the 1997/98 level.

Preliminary Projections for 2000/01

USDA's early projections show lower foreign, but higher U.S. production for next season. World consumption is likely to continue to rise, and there is potential for the U.S. to capture a very competitive share of the world export market. The scenario we envision, which is based on normal weather and crop conditions, results in lower world stocks at the end of the season, with U.S. stocks rising.

The current world price level, which is the lowest in 13 years, is likely to cause reductions in foreign production predicated on lower area in 2000/01. The largest reduction, in terms of both percentage and quantity, is projected to occur in China, where area and production are expected to fall 8 percent, the equivalent of 1.5 million bales, as producers adjust to significantly lower prices under the cotton reforms. Most of the world's other major cotton producers are also likely to plant less cotton, with reductions projected to average about 2.5 percent. A return to normal weather would also contribute to lower foreign production, since India and Pakistan, the world's third- and fourth-largest cotton producers, have experienced favorable conditions in 1999/2000, and very high yields were realized in Central

Asia. Overall, foreign production next season is expected to fall 5 percent to just below 67.0 million bales.

In sharp contrast to the foreign situation, U.S. production is likely to rise by roughly 8 percent in 2000/01. We currently project that planted area will remain at about this year's level. This projection is based on a supply response study by USDA's Economic Research Service, which quantifies shifts in acreage based on a comparison of the prices producers expect for cotton and alternative crops. These effective prices are based on the current values of 2000-crop futures prices plus any expected marketing loan benefits. To summarize the results, the study shows that, relative to last year's intended plantings, cotton is likely to gain about 600,000 acres because the expected prices for wheat, corn and sorghum (based on futures prices) are not rising commensurate with the effective price that producers anticipate for cotton, which includes a marketing loan differential of about 15 cents per pound. Soybean prices attract the only year-to-year shift away from cotton. The model indicates total additional cotton acreage of about 600,000, but last year's planted area of 14.6 million acres benefitted from favorable soil moisture conditions in Texas which would not recur under an assumption of normal weather. Offsetting the model's additional acres against a normal-weather base for last year results in a subjective estimate of 14.5-15.0 million acres for the 2000/01 season. USDA's survey of producers' planting intentions will be published on March 31. With an average abandonment of about 7.5 percent and an average yield of 645 pounds per harvested acre, production of 18.0-18.5 million bales is indicated.

World consumption is projected to rise about 1.5 percent in 2000/01, above the long-run growth rate of about 1.3 percent due to the lagged effect of very low prices. This would bring consumption back to about the peak achieved in the pre-Asian crisis year of 1996/97. Stronger projected world GDP supports the rise in consumption, as does a more favorable relationship of cotton prices to those of manmade fibers.

U.S. consumption is likely to remain nearly flat next season at a projected level of about 10.0-10.5 million bales. The growth rate in cotton textile imports, which was about 11.5 percent for the first 3 quarters of 1999, is likely to decline slightly as last year's depreciation of the dollar against Asian currencies continues to have an impact. The projected rise in the textile trade deficit would about offset increases in consumer use of cotton, leaving mill use relatively unchanged.

China's net trade position will continue to play a pivotal role in the world cotton situation, as it has the past several seasons, and uncertainties about China's policies and statistics cloud the outlook. We project that consumption will exceed production for the second consecutive year–with China's cotton mill use rising, 2000/01 consumption is anticipated to exceed production by more than 3.0 million bales. China has sufficient surplus stocks to support this level of consumption, as well as potential exports; however, the quantity of exports will be determined by two main factors: (1) the government's willingness to subsidize losses on cotton procured at prices much higher than the current world-competitive level; and (2) the desirability of the available cotton to the world's cotton importers. No data are available about the cotton qualities in China's stockpile, but anecdotal evidence suggests that a significant percentage may not be very marketable. USDA's current baseline estimates show slightly larger imports and slightly smaller exports for China next season. It is important to note that if the government does not subsidize the release of cotton from stocks, or if the stocks have major quality issues, then imports may be higher and exports lower than projected here. We will explore the China outlook further during this afternoon's panel discussion on the state of the U.S. cotton industry.

U.S. exports for 2000/01 are currently projected to range from 7.0-7.5 million bales, about 1.0 million more than the estimate for the current season and a very competitive 26.7 percent of world trade. Larger exports are expected to result from the effects of higher U.S. production in the context of lower foreign production, in combination with competitive pricing under the marketing loan and Step 2 programs.

Despite stable mill use and significantly larger exports, U.S. ending stocks are likely to rise under the scenario presented here. At the same time, world stocks are expected to fall, due mainly to a reduction in China's stocks that could exceed 3.0 million bales. Foreign stocks outside China are also expected to fall, but the projected decrease of 7 percent is less significant, percentage-wise, than the China change.

In closing, I want to emphasize again the large uncertainties associated with this analysis. In addition to the usual difficulties of predicting weather and crop conditions, China's policies, especially those directed at surplus disposal, will have a fundamental impact upon the world outlook. In examining income prospects, producers need to keep in mind that while the U.S. futures market provides a measure of expected market prices, as well as a hedging instrument, the level of the world price A-index will determine the marketing loan differential, or LDP payment. Thus, it is important to focus on both U.S. and world developments in planning for the 2000 crop.

References

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