XINJIANG 2020 CROP HAS QUALITY PROBLEM

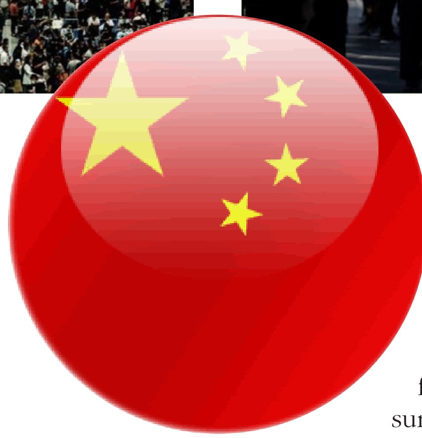
CHINA AGGRESSIVE BUYER OF IMPORTED COTTON FIBER & YARN

AUSTRALIAN COTTON BASIS UNDER PRESSURE

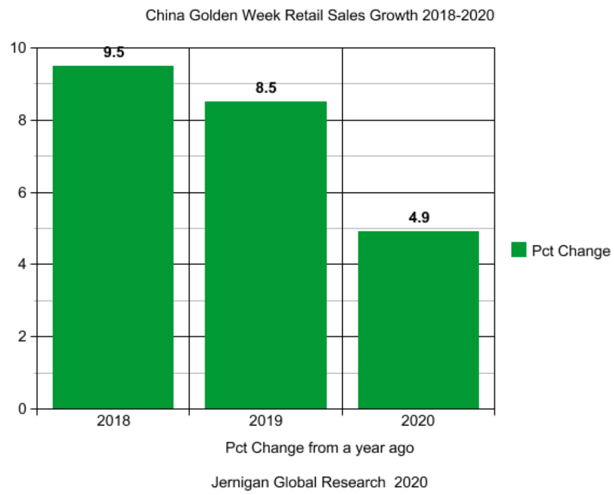
INDIAN PRICES CONTINUE TO MOVE HIGHER

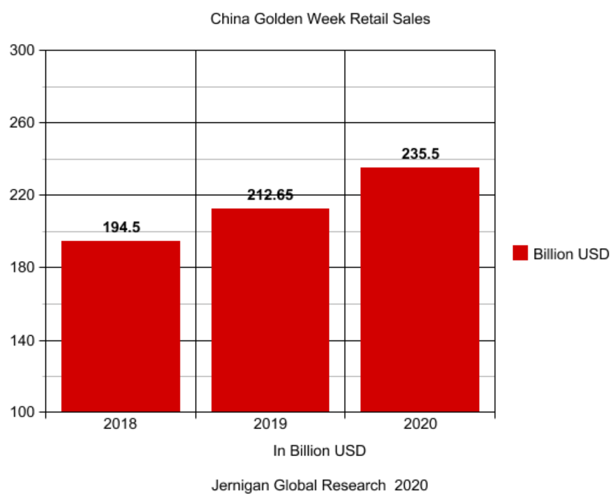
JERNIGAN GLOBAL
KNOWLEDGE IS THE NEW CAPITAL

CHINA FIBER/TEXTILE MARKETS SURGE IN POST HOLIDAY PERIOD MOVING GLOBAL PRICES HIGHER



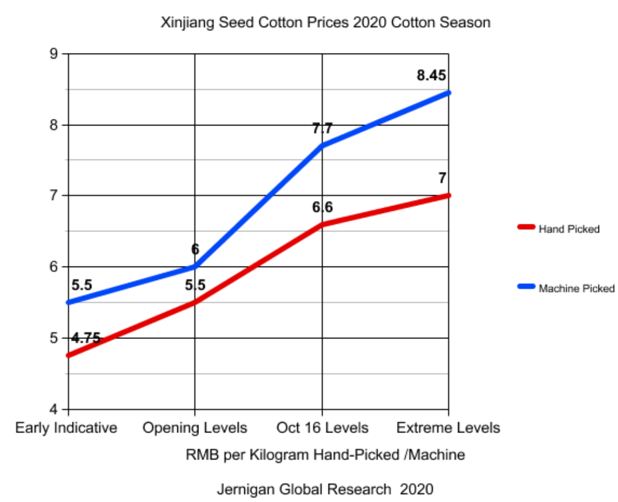
Chinese cotton and agriculture markets have reopened to very bullish excitement following a successful October holiday that appeared to allow the country a near normal travel holiday that helped to boost national consumer confidence. The data shows the Chinese consumer is now leading the world in spending. One major consequence of the virus has been the fact that the normally active traveling Chinese consumer, which spent 127.5 billion USD abroad last year from January to June 2019, have now turned their attention to the domestic market, where their spending is having a very positive economic impact. The average spending during the October 1st-8th holiday rose 4.9% from a year ago, reaching 1.6 trillion RMB or 238.805 billion USD. For example, in Hainan, which is designated a free trade duty free zone for domestic buyers, duty free sales surged 148.7% from a year ago during the holiday period. On the Tmall Global Ecommerce platform used by foreign brands to sell in China, sales in the period increased 79% from a year ago.





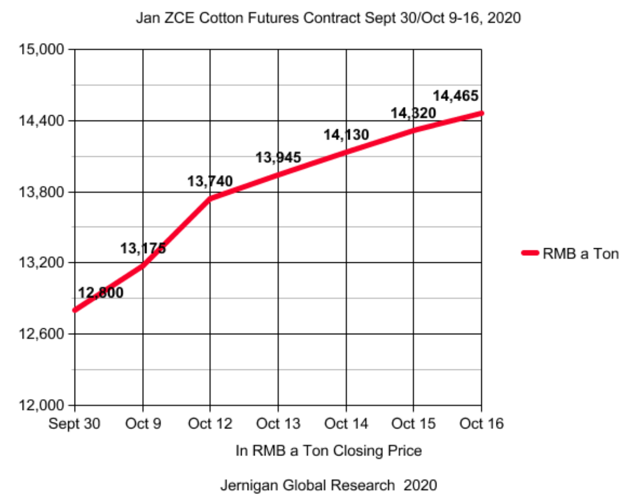
Sharp gains have occurred in the domestic soybean, corn, and wheat markets, along with cotton fiber, yarn and other textile products. Physical cotton prices have led the advance in the sector as ginners aggressively bid for new crop seed cotton in Xinjiang. When a business makes money in China it is soon followed by massive new investment and a surge in the opening of new companies, which has been true for cotton ginning in Xinjiang. The 2019/2020 season was a success for Xinjiang cotton ginners, with average margins overall quite good. One reason for this was the increased sophistication of the sector in hedging. The group used ZCE futures successfully to manage price risk and lock in margins. This resulted in a record volume of Xinjiang cotton being certificated for delivery on the ZCE, reaching over six million bales at one point. This profitability resulted in a healthy ginning sector, which increased the number of new gins in 2020 and also increased investments in new seed cotton dryers and seed cleaning equipment which has raised hopes of improved ginning outturns. The improved financial structure also has allowed better flow of crop finance for the 2020 season.

Thus, the 2020/2021 cotton season opened to a record number of gins, more than 800, operating and competing for the purchase of seed cotton. The season began with seed cotton prices expected at 4.5-5.0 RMB a kilogram for machine-picked and 5.0-5.8 for handpicked. Movement of some volume appeared to begin September 10th-11Th, with a price being paid of 6.0 RMB for handpicked cotton and with a ginning outturn of 40%-41%, which was higher than expected and below the needed lint price ex-warehouse to produce a profit for the gin. Prices have been steadily advancing, and by October 14th after the holiday, prices had reached 7.0-7.6 RMB for handpicked and 6.0-6.6 RMB for machine picked at the extreme level of prices. As of Friday, the excitement and rush by ginners had continued to push seed cotton prices higher. The national average seed cotton price on October 15th hit 6.81 RMB per kilogram and 6.86 in Xinjiang. However, in the Yuepu Lake region of Xinjiang, excited ginners are reported to have paid up to 8.0-8.45 RMB a kilogram for handpicked seed cotton. Seed cotton price volatility at the gin level is extreme, with some gins reported to be changing prices paid to growers two or three times a day. The bull market in proteins led by soybeans has boosted the cottonseed price ginners are receiving to 2.42 RMB a kilo, which is up sharply from 1.8-2.0 a year ago.



The opening of new gins and the excitement of ginners to acquire seed cotton, both machine-picked and handpicked, created a bull market in seed cotton never experienced before since the market reform occurred. The Agriculture Development Bank of China's local branch appears to have been aggressive and provided ginners with crop finance loans early and had the ginners equipped to allow them to pay growers for seed cotton on the day the cotton was delivered and sold, with payment showing up on their mobile phones. This has made the bull market in seed cotton exciting and quite profitable for growers who will likely see a record profit this season. The stage has been set, however, for the ginners to suffer losses, with the seed cotton prices paid pushing breakeven lint prices to levels which cannot be achieved. In addition, ginners have not adjusted seed cotton prices for the lower quality lint that is occurring on a widespread basis because of weather, defoliation practices, and the seed varieties planted. A much smaller portion of the 2020/2021 Xinjiang crop will meet the quality requirements for certification for delivery on the ZCE contract, which will make hedging and risk management much more difficult than last season. As mentioned earlier, in 2019 ginners successfully purchased seed cotton, certificated, and hedged on the ZCE, doing an excellent job of managing risk.

The ZCE cotton futures have been in a raging bull market since reopening on October 9th after closing at 12,800 RMB a ton or 86.66 cents in the last day of September trading. Since then, prices have closed sharply higher for six consecutive sessions, ending last week at 14,465 RMB a ton or 97.93 cents, gaining 11.27 cents a lb. in that short period of time. This equals the Cash Cotton Index close Friday of 14,421 RMB or 97.63 cents. However, while the gains appear excessive, the price of the ZCE futures contract for January delivery is still at a discount to the breakeven prices of the ginners buying machine picked cotton at the extremes. As the seed cotton price paid for machine picked moved to 6.5-6.7 RMB a kilogram, which it has in much of the trade at the end of last week, the breakeven lint price advances to 14,500 to 15,000 RMB or 98.17 to 101.55 cents a lb. Handpicked has a premium of 6.77 to 8.0 cents a lb. depending on location and region.



The ZCE price reflects the price of machine picked cotton with a normal basis of about 800-1000 RMB a ton on for handpicked. Handpicked cotton in China sells at a premium due to the better quality and less contamination. The crop is being increasingly machine picked, with a surge in imported John Deere pickers noted ahead of the season. The industry still struggles with such issues as the pickers picking up the plastic film used for planting that in turn has to be cleaned out at the gin. The much higher seed cotton cleaning reduces fiber length and creates other issues. The problems with machine picked have been reduced over the last few years by increased use of biodegradable film, adjustments in picker heights, and new seed varieties better suited for machine picking. A shortage of labor has made handpicking more expensive, which has also increased its premium.

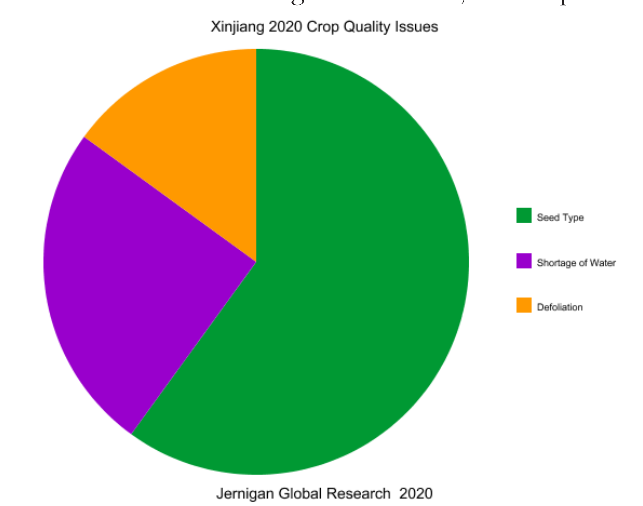
2020/2021 XINJIANG CROP HAS MAJOR QUALITY PROBLEM

Adding to the market volatility is a concern that the quality of the 2020/2021 crop will be lower than last year. The concern is not the color grade in Xinjiang but its fiber length, micronaire, and strength. The target price scheme in Xinjiang has been a major success for cotton growers. It has boosted profits while allowing a market-based system to develop and has fostered active hedging on the ZCE futures by ginners. The target price along with increased yield has allowed growers to post annual profits that exceed all other crops, with cotton acreage steadily expanding. The target price is 18,600 RMB a ton or about 125.00 cents a lb. at today's exchange rate. This has made China's cotton crop grown at subsidies that exceed 4 billion USD or more most seasons and violates all WTO guidelines. Despite this, no case has been taken to the WTO, for all the exporting countries fear the wrath of Beijing which would result in the banning of cotton imports. US and Brazil stand out for their silence. China has a very expensive cost basis for growing cotton despite the yield achievements. The true cost, if the water infrastructure and subsidies for the textile and apparel industry were included, the subsidy would likely double. The high target price has made it profitable for the Han Chinese growers and has allowed them to expand acreage and added to the economic stability of Xinjiang. The scheme will provide growers with record profits in 2020/2021.

Plastic mulch used in Xinjiang

Hand-picking in Xinjiang

The target price scheme does not reward growers for quality, and the system of buying seed cotton makes quality not the top focus of growers; it is yields. Ginners will pay a small premium for high ginning outturn, but it is minor compared to a 1.25 per lb. lint price. There are limits on growers and other restrictions to halt abuse and cheating. Nonetheless, for the past five years growers have chosen the seed variety that produced the best yields, which can be seen in the steady increase in yields during the period. The average yield for all of China (Xinjiang is higher) in 2010/2011 was 1265 kilograms per hectare or 5.81 bales, but by the 2020/2021 season it had improved to 1826 kilograms or 8.386 bales per hectare. This has meant serious increases in income in Xinjiang. The September BCO estimate places the Xinjiang average yield at 9.30 bales per hectare. Thus, it is all about yields.

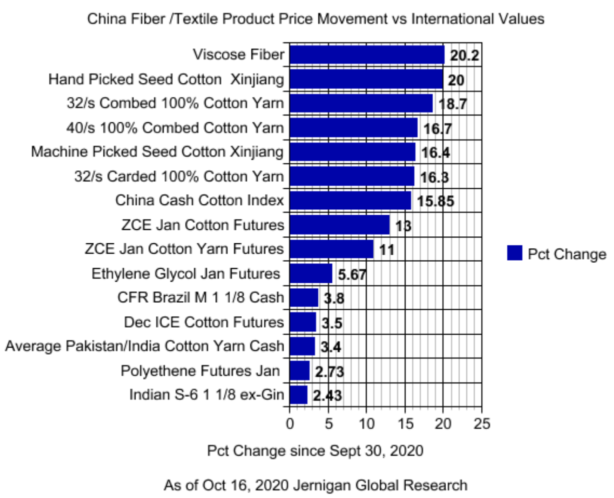


Spraying by drone

This season, staple length is running shorter than normal and the pride of the quality produced in Xinjiang is what translates in English as “Double 29,” a Strict Middling 1 1/8 type or longer staple. “Double 28” or a SM 1 3/32 is in high demand. This season both appear to be in very short supply. Classing volume is nearing about one-fifth the crop, but the trend is too widespread not to likely hold true for the total crop. The Production and Construction Corp farmers are the best managed in Xinjiang and China, and their farms normally produced the highest quality cotton. PCC ginned cotton in many seasons will command a premium for this reason. In one large block of its farms this season, the volume of cotton that is reaching the “Double 28” or better quality has fallen to 30%-40% of the crop compared to this group normally producing over 80% of the crop in this quality. Non-PCC farms are reporting a very small volume of cotton reaching 1 3/32. In many areas, the staple length has fallen to average 27 mm. The second issue is strength, which is running lower than desired, and third, high micronaire is an issue. In addition to the issues with the seed varieties used, which we discussed, the 2020 season was marked by a shortage of irrigation supplies that denied crops either the total water needed or the timely application of the water. This would appear to have been a key reason for the higher mike. The quality also appears to be affected by issues concerning defoliation of the crop. Growers this season used drones in many cases to apply the harvest aids, and, as a result, they were applied incorrectly. In addition, some farmers appeared to apply them about a week too early.

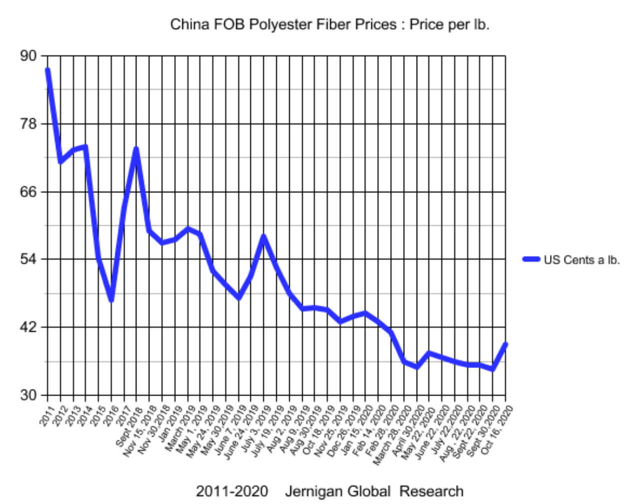
These quality issues have not yet been reflected in the movement of domestic prices, and they also mean ginners could face sizeable losses. The ZCE basis should also strengthen as a tightness in cotton that can be certificated for delivery occurs. Last season, as we discussed earlier, ginners aggressively hedged on the ZCE and certificated their stocks for delivery. At one point, certificated stocks reached a record of over 6.8 million bales or about a third of the entire Xinjiang crop. This kept the ZCE cotton futures trading either at a discount to cash or near the cash price all season. Certificated stocks have been rapidly falling over the last 120 days and ended the week near only 1.246 million bales, a 20% drop last week alone. This suggests that the ZCE may begin to trade at a premium to the Cash Index price later in the season.

CHINESE COTTON YARN PRICES ADVANCED SHAPLY



In a very rare occurrence, the usually lethargic world of yarn prices has seen cotton yarn prices appreciate at a faster pace than ZCE futures or cash cotton prices. Normally, when cotton prices advance, there is a time lag in the price movement of yarn that results in the squeezing of spinners' margins. However, cash cotton yarn prices in China have advanced rapidly since the October holidays with price gains exceeding those of cotton fiber. The January ZCE cotton futures contract gained 13% since the holiday reopening, while the January ZCE cotton yarn contract, which draws much smaller volume, gained 11% in the same period. However, the average cash price of the 100% cotton 32s carded & combed and the 40s combed yarns have gained from 16.3% to 18.7% during the same period. This has had a significant impact on downstream fabric prices and has also given the cotton price gains major support.

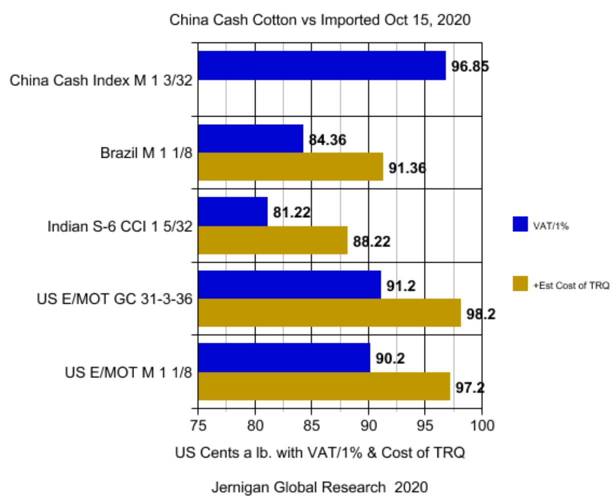
Polyester staple fiber prices have also rallied, along with poly and poly/cotton yarns. The standard polyester staple quote is now back to near 39 cents. The ZCE has launched a polyester staple futures contract which opened on October 12th and moved quickly to limit up after just 20 minutes of trading. On Thursday, the lead May 2021 contract closed at 6,144 RMB a ton or 41.60 cents a lb. and advanced further to close the week at 6,342 RMB a ton or 42.94 US cents a lb. Traders are therefore bullish on the price outlook. China now has a suite of petrochemical futures, including PTA, which has also posted strong gains since the holidays. The ZCE and Dalian Exchange also have several plastic futures that followed with strong post-holiday gains, including Ethylene Glycol, which a base petrochemical. The gains in polyester staple are near those of cotton at 11%, which is very unusual movement in such a short period for polyester. The gains in polyester also far outpaced those of the other plastic futures. The Dalian Polyethylene Jan futures gained only 2.73%, and the feedstock Ethylene Glycol Jan contract gained 5.67%.



Viscose fiber cash prices have been depressed for some time, but they rallied over 10 cents a lb. off its lows to stand near 67 cents, still a major discount to cotton. The gain has been the largest percentage increase of any major fiber at 20.2% since the holiday period.

China returned from the holiday with renewed business confidence and a feeling that economic growth has returned. This is showing up in the data, which, even after adjustments for errors, makes it clear that growth has returned. September imports surged 13.2% to 203 billion USD, which was a record. Large increases in tech imports boosted trade with South Korea, Taiwan, and Japan. Agriculture imports also increased sharply. Iron ore imports increased 9.2% in volume. The BCO (China Cotlook) PMI for textiles has now returned to growth. New IMF data forecast China's economy will lead the world in 2020, posting 1.9% growth while the US will shrink 4.3% and the EU will suffer an 8.3% decline, and the UK a 9.8% economic contraction. The *Financial Times* reported that by Wednesday October 14th the value of the Chinese stock markets had reached a new record of 10. 08 trillion USD, with the market attracting 26.5 billion USD in global funds. China issued a new 6 billion USD bond, which drew demand for 27 billion of debt. Wall Street took 15% despite the current issues.

CHINA'S PRICE SURGE TRIGGERS WIDESPREAD OFFTAKE OF BONDED WAREHOUSE STOCKS & IMPORTED COTTON YARNS



Three driving factors have resulted in widespread demand for imported cotton and imported yarn during the last week since China reopened from the holiday. First, China's return to growth has produced an appreciation of the RMB against the USD. The RMB since May had appreciated 6.3% against the USD before the Central Bank appeared to stop the rise on Monday when it intervened, resulting in a weakening in the RMB back to 6.75. This appeared to signal to the business sector that the appreciation was over, and they should increase imports. Importers had already been doing that with September's record imports. Second, there is the increase in business confidence and orders both domestic and foreign. Third, the sharp gains in cotton lint and cotton yarn also made imported cotton and yarns very attractive. International physical cotton prices as well as ICE cotton futures have been a major laggard to the gains in China, creating major import demand from Chinese mills for imported cotton fiber and yarns.

This set off a flurry of activity which made Qingdao and other ports the center of activity. Offers of imported Vietnamese, Pakistani, Indian, and Central Asian yarns were aggressively taken up. The average offering price of the imported yarns was only up near 3.5%-5.0%, while cash cotton domestic yarns have gained 16.3% to 18.7%. Heavy volume is believed to have sold both from port warehouse stocks and new sales from origin. Vietnamese yarns are a bargain using imported cotton because of the value of the TRQ quota. The quality of the Vietnamese yarns is also reported to be superior to most domestic yarns in the same counts since they are made with high quality US and Brazilian cotton. Concerns over the quality of Xinjiang new crop at the sky-high prices has only added to the attraction of the Vietnamese yarns. Cotton yarn imports, despite the impact of the virus, are now likely to show 5%-10% growth year on year and increase further in 2021. This will have a very positive impact on Vietnam's cotton use.

Cotton yarn imports are also quota fee, thus much cheaper than cotton allowing widespread offtake. Many are duty free or carry only a small tax. Also, the use of imported cotton yarns has increased as weavers and knitters want to protect against any ban on Xinjiang yarn or meet the demand of brands and retailers. Pakistani, Indian, Uzbekistan, Vietnamese, and other cotton yarns sold in volume last week. In the single count yarns, increased offtake of Pakistani yarns made with imported cotton is also occurring.
Imported cotton prices only gained 2.5%-4.0% during the same period as compared to the near 16% gain in cash cotton prices. Offtake of imported US, Brazilian, Indian, West African, and Uzbekistan cotton from bonded warehouses has been noted, with a major destocking underway after two years of a build in stocks to record levels. Brazilian cotton appeared to attract the largest volume of offtake due to its discount to US cotton. The main drawback to larger offtake is

the tightness of 2020 TRQ quotas. The price of quota for spinners needing quota is 1000-1200 RMB a ton or 6.77 to 8.12 cents a lb. Brazilian Middling 1 1/8 can be purchased after 1% tax and VAT at 85.50 cents, which is a big discount to the new much higher cash prices, and when the cost of quota is added it jumps to 92.50-93.50 cents a lb. However, merchants have been willing to discount the bonded warehouse stocks, which are now two years old and of lower quality. The hope is that the announced processing quota will be released any time. Export-focused mills prefer the use of imported yarn or cotton to avoid any future issues with Xinjiang cotton. The concerns over quality of the Xinjiang new crop is increasingly playing a role as well.

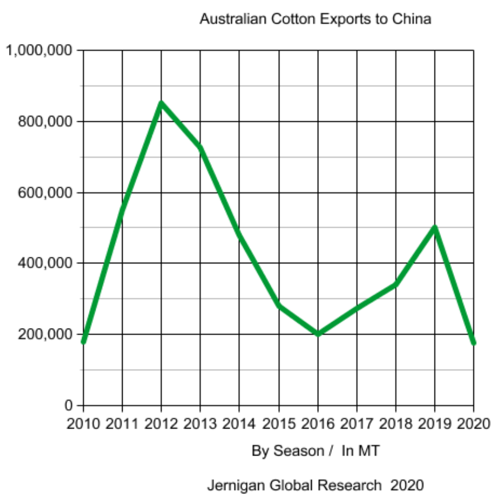
A sizeable volume of Indian cotton moved off to Chinese mills last week as the discount of Indian increased as Chinese price gains outpaced even those in India. Indian Shankar-6 is popular with many Chinese spinners since many of its spinning features are close to those of Chinese domestic cotton. An SM 1 5/32 CCI was offered at 225 points on Dec, which placed the price at 71 cents on most days, CFR and 81.22 cents before quota cost landed the port. This was at a large discount to the Thursday cash cotton index of 96.85 cents, even after buying TRQ quota the discount was over 8-9 cents a lb. Overall, a large volume of Brazilian, Indian, some US, and other styles sold to Chinese spinners through a combination of sales from the bonded warehouse and new sales from merchants.

TURKEY INCREASES APPAREL AND TEXTILE EXPORTS IN SEPTEMBER

Turkey's September exports reached a new all-time record 16 billion USD, which reflected a 4.8% year on year increase. Apparel exports increased by 15% to 1.6 billion USD, while textile exports grew 12.8% to 1.1 billion USD. Chemical, machinery, and auto exports also expanded. The growth in apparel and textile exports occurred despite the unofficial trade dispute with Saudi Arabia, which is a very important Middle Eastern market with exports in 2019 reaching 3.2 billion USD. Saudi Arabia is reported to have issued a de facto ban on Turkish imports by not allowing imports to clear customs. The dispute is over Turkey's foreign policy in the Middle East, which is at odds with the kingdom. Apparel exports are reported to be impacted, with several major brands being forced to change origins on shipments to the kingdom. Mango, H & M, and Inditex all operate stores in Saudi Arabia and use Turkey as a sourcing base. Turkey's annual apparel exports to Saudi

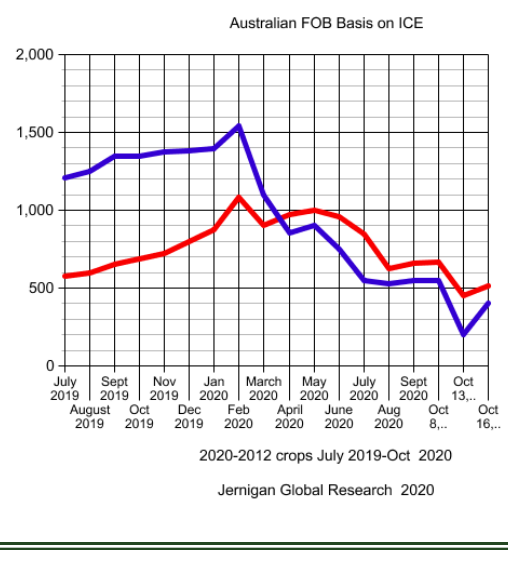
Arabia reached 598.5 million USD in 2018.
The September export surge was led by strong growth in exports to Europe, including exports to France, which increased 12.8%, plus 10.6% to Germany. It grew 5.6% to all the EU. Exports to the Americas rose 22%. The rebound in exports is aiding cotton import demand. Turkey's domestic cotton crop was down sharply in 2020 as growers turned to other crops. Fresh import demand has been limited in recent weeks. Turkey imported 76,566 tons of cotton in July, pushing total 2019/2020 imports to a record 995,000 tons or 4.571 million bales. These imports have left spinners with some inventories to work through. The unsold Greek crop is expected to move to Turkey.
In 2019/2020 Turkey imported 166,045 tons or 762,894 bales from Greece or about 16% of imports. Brazilian cotton has expanded market share due to the aggressive basis position.

AUSTRALIAN BASIS LEVEL FALLS SHARPLY AS CHINA ISSUES UNOFFICIAL EMBARGO



Australian cotton has been the most popular upland style in China over the last 5-10 years, as the growth drew a widespread following due to its extremely long staple, up to 40 mm and excellent quality that included 32 and higher strength. This has allowed it to become a substitute for Pima in 60 count yarns and also a popular blend with the poor quality domestic ELS styles. The growth has enjoyed almost unlimited post-Wuhan virus demand, which has pushed the CFR basis to record levels as drought has limited supply. In June of 2018, Australia was harvesting a 4.8 million-bales crop, while at the same time in the pre-US trade war world July futures stood at 95 cents. The CFR Asia basis, despite the futures level, was at 1700 points on July for a SM 1 5/32 which yielded 110.000 cents a lb. This price exceeds some of the most heavily discounted US Pima offers over the last 60 days. This extremely successful season was followed by 2018/2019, when the country produced 2.2 million bales and ICE futures had fallen sharply to 78 cents. However, the Australian CFR Asia basis for a Middling 1 5/32 stood at 2050 points on May 2019 futures. This represented more than a 700-800-point premium to a US style. The reason was Chinese demand, which had to be rationed by price.

2020 has been a tough year for the world. Australia was enjoying a robust economy as it entered the year. Earlier it had won the title "The Lucky Country" as it experienced a record period of prosperity. This followed a period of record exports to China year after year and a surge of inward investment. First came the drought, which caused the 2020 cotton crop to plunge to only 625,000 bales. Then came the Wuhan Virus that brought the Chinese economy to a halt, followed by a collapse in the global economy when the virus became a pandemic. The interconnectivity of China and Australia gave way to the largest exporter of cotton to China becoming a Chinese trading group that invested in a cotton farming operation that became a major part of the industry. This group was a very aggressive buyer of Australian cotton, both the 2020 and 2021 crops early in 2020, outbidding all other merchants by 15-20 Australian dollars a bale on any given day, which resulted in the group buying a very large portion of the small 2020 crop and a hefty position in the 2021 crop



at prices exceeding 600 Australian Dollars per bale. This trading group shocked the Australian industry when it went into administration, defaulting on a record volume of contracts for the 2020 and 2021 crops. This cost growers and the industry millions, as growers and traders were forced to liquidate positions at large losses.

Over the past weekend, China's NDRC quietly told spinners with outstanding 2020 TRQ import quotas that any Australian cotton shipped past October 11th would not be allowed under the quota, which carries only a 1% import tax. However, there appears to have been some off the record discussion that spinners using the TRQ quota for Australian cotton will have its 2021 TRQ quota levels cut. This follows a slowdown in any buying by state-owned trading companies for the last several months. This action occurred at the same time China issued the same instructions to Chinese utilities and trading groups to halt the import and purchases of Australian thermal and coking coal. Ships with coal afloat are not being allowed to unload. A Chinese mining company is a big investor in NSW coal production. These bullying tactics in trade follow actions to halt Australian barley, wine, beef, and other imports. China is attempting to force Australia to buckle to its will. The spat started when Australia backed an investigation into the origin of the Wuhan Virus. China has also arrested and threatened Australian citizens in China. Several major Chinese violations of Australian sovereignty through influence peddling and the acquisition of Australian companies have also tested relationships.

The actions triggered a collapse in the FOB basis in Australia on October 13th. Most merchants withdrew any bid for remaining 2020 crop bales. Merchants are holding long basis positions in this crop and also have added to positions amid the absence of the collapsed Chinese trader. The FOB basis had been near 500-550 on Dec prior to the ban. The 2021 crop presently being planted was bid for over the weekend at 575 on May 2021 futures, but by Tuesday, October 12th the basis had fallen to 450 on May. The 2022 crop also experienced a sharp fall, dropping to 370 Points on May 22nd compared to Monday's 450 points on.

Australian exporters had become too dependent on Chinese demand, with exports to such traditional markets as Indonesia collapsing. August cotton exports reached only 20,215 tons, down sharply from 55,883 tons a year ago. China took 16,569 tons or 81.7% of all exports, and Indonesia took only 150 tons. Vietnam has become the second largest market, taking 1,809 tons in August with India and Bangladesh small buyers. The CFR basis levels has simply shut most non-Chinese markets out of the market. In the 2018/2019 and 2019/2020 seasons, over 60% of all Australian cotton exports moved to China.

Prior to the quiet instructions from the NDRC, the CFR export offering basis in Asia and China for Australian styles had already declined sharply to levels not seen in years as Chinese state trading companies avoided purchases of Australian, and spinners experienced weak demand for the higher count yarns. It would appear that, while the NDRC instructions were just issued, the spinners appeared to expect some actions and had avoided taking up large blocks of the 2020 crop offered at cheap CFR basis levels. A small offtake from bonded warehouse stocks has occurred in retail volumes, but traders and merchants appear caught with some volume of unsold stocks held in these warehouses.

In CFR Asian export offers, both 2020 and 2021 crop offers of a SM 1 1/8 and Middling 1 5/32 have now dropped to a discount to US styles of the same quality in Green Cards. This reflects a major collapse in premiums from the levels that prevailed for the 2019 crop when an Aussie Middling 1 5/32 traded at an 800 point or more premium to a US Green Card 31-3-37. When China blocked US cotton from being imported under the WTO TRQ quota, the average basis for a SM 1 1/8 type initially dropped 250 points during the 60 days that followed. At the height of the trade dispute, the discount extended another 200 points or so until the US had sold volumes into other markets. Thus, the premium reduction was less for the US because of its lower premium for a specialty high grade. A US SM 1 1/8 has been widely consumed and did not depend on China for offtake. It was more about the volume deficit being created from being blocked from the Chinese market. The discount displaces Brazilian and other growths. For Australia, the years of premium to US and Brazilian eventually slowed consumption of the Australian styles to small volumes in the main non-Chinese markets, with large volumes only moving when the basis discount occurred or under specialty conditions. Until the Wuhan Virus and the Xinjiang camps changed sourcing patterns, China dominated the sourcing for ELS products. Their spinners learned and appreciated the extremely high quality of the Australian crop, with it's very long staple and higher breaking strength, and learned to use it instead of or blended with Pima and other ELS cotton, making the premium easy to justify. Some Chinese groups promoted the Australian to its end customers, and a very loyal following developed. The trade war followed by the virus and then the boycott of Xinjiang cotton changed the ELS consumption pattern. India has replaced China for many companies in ELS sourcing followed by a sharp increase in ELS use in Pakistan, Vietnam, Bangladesh, and Peru. These markets do not have the Chinese experience. The collapse in ELS prices also made US Pima very competitive. The much narrower premium differentials have reduced the incentive for attempting to blend. Moreover, the SUPIMA program is a success with its traceability and verification links.

Thus, Australian cotton must now regain lost market share in the larger non-Chinese markets that have a sizeable high-grade consumption base, such as Bangladesh, Vietnam, Indonesia, and others. India, for the moment, appears to be a much-reduced upland import market and more of a competitor with its abundance of CCI Strict Middling 1 3/16 2019/20 offers at 300 on landed an Asian mill. That is at a 1200-point discount to the most aggressive Aussie offer. The move by China to block Aussie cotton under the WTO mandated annual 1% import quota follows the move to do the same with US cotton. This appears to defeat the whole spirit of the quota and undermine the intent of the quota. It also comes as China continues to exploit the WTO subsidy limits and undermine other suppliers in targeted products. For Australian growers, it means reduced income in the near-term, but it will also allow exporters to again broaden their markets and force the marketing efforts of Cotton Australia to look at new markets. It may also encourage new investment in higher count yarn production in some of the markets, which has allowed China to dominate the sector.

As the week ended, the domestic FOB basis in Australia had stabilized. After most merchants pulled all bids for 2020 crop, a few returned with a 400 on bid, which compares to the pre-embargo bid of 550. 2021 crop bids improved to 510 on May, while 2022 crop bids stood at 420 on May 2022. Both of these were 25-50 points off the lows. Even bids were noted for the 2023 crop at 515 points on May 2023. These conditions suggest the panic has passed, and that CFR basis levels for these Australian crop years reached a discount to US for the first time in many years, but they found a value point. Australian growers in New South Wales received a boost from Mother Nature as the general security irrigation allocation was increased 9% to 26%, which will likely boost rice acreage in the southern valleys.

PAKISTAN DOMESTIC PRICES HIT NEW HIGHS TRIGGERING ADDITIONAL IMPORT OFFTAKE

Pakistan's domestic cotton prices have continued to advance as the size of the crop appears to continue to shrink and as growers complain about returns, even at the current domestic price levels. By Wednesday, the domestic price in Sind reached 9,700-10,000 Rupees per maund or 71.94-74.16 US cents a lb., while in Punjab prices reached 9,500-10,500 rupees or 70.45 to 77.87 cents a lb. These prices were at a premium to most imported lots, which resulted in very active offtake of imported cotton. The domestic crop is reported to have been hit by new pest attacks in Sind, with whitefly causing sizeable losses. Import interest has concentrated on Brazilian, US recaps, West African, and Afghanistan cotton. Tanzanian and Ugandan styles have continued to move off as well, and Sudan Acala also sold. Increased ELS usage is being noted, with US Pima and Giza moving.

The 2020 Afghanistan cotton crop is estimated to have reached a record after following a larger crop in 2019/2020 due to an improvement in seed distribution and a government effort with demonstration plots. Afghanistan was a notable cotton producer in the post-Soviet war days, producing 250,000 bales or more. Helmand province, which borders Pakistan, is a large producer, and Balkh province, which borders Uzbekistan, is another. This cotton is moving into Pakistan via the land routes. In 2019/2020 it appears domestic production reached 125,000 standard bales and may have reached 140,000 bales this season, a larger volume in 150-160 kg bales. An old gin reopened in Helmand this year, which has further aided the sector. The government also provided growers with seed and inputs. This region was badly damaged during the wars and is a major Taliban district. The support effort has caused growers to switch from poppies. With investment in irrigation infrastructure and support to growers, cotton production could expand. This cotton will be absorbed in Pakistan this season.

As we mentioned the previous week, Pakistan's spinners are cleaning up any discounted cotton, which is making US and Brazilian recaps popular along with Mexican and others. The sharp rise in Chinese prices has opened up the way for increased open-end single count yarn exports to China, which further boosts demand for Pakistan's cotton yarn exports.

US EXPORT SALES SLOW; EXPORT SHIPMENTS CAUSE CONCERN

As we discussed several months ago, the US/China trade deal changed trading dynamics, forcing the US CFR basis to uncompetitive levels. This has made the US give up its role as the major supplier to many non-Chinese markets. We have outlined the dependency this has placed on sales to China for the US to near its current estimated export targets. New export sales for the week ending October 8th illustrated this, with gross sales of only 98,900 running bales of upland for 2020/2021. China purchased 33,200 running bales and canceled 13,200 bales for net sales of 20,000 bales. The canceled sales were rolled to 2021/2022. The largest buyer was Pakistan, which purchased 36,500 bales of mostly US low grade recaps as it remains the most active import market outside China. Guatemala purchased 14,900 bales, while sales to Vietnam declined to only 13,800 bales. Turkey returned in small volume at 10,400 running bales. Pima sales remained quite active at a net 17,800 running bales, with the major buyers being China 5,900 bales, Bangladesh 4,800, and India 4,200 bales.

Export shipments remained below expectations at 192,600 running bales of upland and 12,700 of Pima. These dismal shipments come as US shippers report difficulty in getting an adequate number of empty containers shipped to inland loading points. The problem is with the surge in imports in containers coming into the US and the shipping companies' quick turnaround. In September, it was reported that 417,795 containers were unloaded at the Los Angeles port. However, 281,438 containers were then returned and shipped back to the exporting destinations empty instead of being sent inland where they are needed by cotton shippers and others. Both Long Beach and Los Angeles ports reported a flood of imports from China in September, and both are the main entry point for all ecommerce trade from China. The question is how much of the slow cotton export shipments are linked to problems with getting containers at inland loading points? The EWR data continues to suggest shipments should be higher, and Census Bureau data confirms some under reporting by exporters.

We have been of the opinion that export shipments have been under reported by 400-500 bales based on EWR and Census Bureau data. The level of shipments is raising issues as time advances, and they are far below the level needed by the US to reach export targets. Weekly sales when adjusted for carryover sales need to average near 173,000 running bales to reach export targets, and shipments need to reach near 275,000 running bales.

INDIA'S BULL MARKET IN PRICES CONTINUES; NEW CONCERNS OVER WEATHER

The drivers in the trend of firmer world prices last week were the continued advance in Indian spot prices, further increase in CCI floor prices, and firm CFR export basis levels. It is clear that in the sourcing arena India is a clear winner in the shift from China. Total September exports rose 5.27% to 27.4 billion USD. Cotton consumption is increasing, and its high-end cotton spinners are enjoying record demand from new ELS orders as brands and retailers diversify from China. Indian exporters of textile and apparel and other products report a shortage of containers, especially in the inland container depots. Vessels leaving India are full. These conditions have helped the CCI's strategy to push prices higher to be successful. Last week, the CCI is believed to have again sold a block of 300,000-400,000 bales and also raised its floor price by 700 Rupees per candy by October 15th. The average cash price in India has corresponded, reaching over 67 cents a lb. for a S-6 at the gin. All these gains have occurred as daily arrivals have increased to 80,000 -90,000 bales a day, which now includes new crop from Gujarat and Maharashtra.

The CCI is rapidly gearing up to buy seed cotton at the MSP, but the main issue for now appears to be forcing growers to dry the seed cotton to below 12%. The strict buying policy of the CCI on seed cotton moisture levels has been one of its keys to success in raising the quality of Indian cotton it handles, which has helped CCI cotton carry a premium and aided in moving volumes of stock. The slow movement higher in Indian spot prices and CCI floor prices has limited the discount of Indian cotton to Brazilian. This has allowed merchants to hold firm on the Brazilian CFR basis, even as Ice moved beyond 69 cents, while also even allowing a small appreciation in the basis. As discussed, Indian cotton has begun to move into Chinese mills as the Chinese domestic price has surged by over 15% since reopening after the National Day holidays.

Heavy rains and storms have been triggered from a low-pressure system over Maharashtra, Telangana, and Andhra Pradesh. The rains have now extended into Gujarat and also coastal Karnataka. Another new low-pressure system is expected to form October 19th in the Bay of Bengal. This will produce very heavy rains in coastal Andhra Pradesh and also Telangana. Heavy rains are then expected October 20th in the large cotton areas of Marathwada, Maharashtra, Telangana, and Andhra Pradesh. Expectations are that cotton output has been impacted, with crop losses and a reduction in quality expected. These storms are damaging quality, reducing yields, and also delaying seed cotton movement. It means that any cotton that does move will have excessive moisture in the seed cotton.

ICE FUTURES REACH 70 CENTS FOR FIRST TIME SINCE PANDEMIC

For the first time since February the nearby Dec ICE futures reached the 70-cent level on Friday, as futures continued to react to global developments instead of leading the price direction. For the past 30 days, ICE futures price movement has lagged the slow grind higher in global physical prices, which has provided support, preventing futures from experiencing any significant price correction and leaving the long-term uptrend intact. Prior to Friday's surge to just over 70 cents, ICE futures had slowly been attempting to move higher, experiencing several sessions in which prices experienced an early price surge and then a late sell off that erased most of those gains. The impetus for the move higher came from developments in China and India. As we have spent much of our time talking about this week, in a very unusual collaborative move, China's entire cotton, man-made fiber, Viscose fiber, and yarn complex surged sharply higher each day consecutively since returning from the National Day holidays. The gains ranged from 11%-20%, with the highest gains in cotton yarns. This triggered a wave of buying of imported cotton and cotton yarn as the gains in the international market were limited to 2.43%-3.8%. These developments were accompanied by a 2.43% gain in India's domestic cotton prices and an increase in the CCI floor prices. Non-Chinese demand was led by Pakistan and Bangladesh, with most other spinners out of the market due to the higher prices. On the supply side, some losses are now expected from the late season low pressure systems that have damaged the crop in India and remaining concerns that the US crop will still fall below 17 million bales.

ICE futures encountered resistance from new hedge selling pressure, first in the US, where growers received their highest prices of the 2020/2021 season, and also from merchants having the renewed confidence to take up a notable volume of the African Franc Zone crop in new sales tenders, which were successful. While broad mill offtake was lacking, demand was strong enough from China, Pakistan, Bangladesh, Turkey, and Vietnam to give merchants the confidence to hold CFR basis levels firm, despite the futures gains, a major change that has been slowly developing over the past 30 days. Actually, we calculate that the Brazilian basis has appreciated about 50 points on average following the volume of offtake this growth has enjoyed as it remains at large discounts to US styles.

The latest On-Call report showed a 3,082-contract increase in On-Call sales that were unfixed, which was focused mostly on the 2020/2021 crop year. Total unfixed On-Call sales stand at 103,805 contracts. The CFTC COT data showed that through Tuesday the Managed Funds, Other Reportable and Non-Reportable speculative Funds were the buyers, while the Trade was the seller. The Managed Funds' net long position reached a new high of 59,942 contracts, suggesting this group is now moving toward 75,000 or so net long position.

We expect global physical prices to continue to push higher, which supports ICE futures. This should allow ICE futures to return to the 72.50-75.00 area. Volatility, as we discussed last week, will likely increase as we enter the final part of the US election cycle and China continues its rather aggressive foreign policy. The price gap between Chinese yarn prices and imported yarn prices suggests record cotton yarn imports, which will provide significant support to cotton use in Vietnam, India, Pakistan, Uzbekistan, and others. It may provide a boost to some weak markets such as Indonesia.

Cotton import demand is limited by the cost of the TRQ quota, and its shortage and the processing quotas should fill quickly when issued. Chinese cotton quality is down, which will increase import demand for Middling 1 1/8 and better cotton. The destocking of the record old crop stocks in bonded warehouses will open the way for merchants to move excessive stocks to these warehouses. This has not been an option for six months for any volume. Regarding our discussion on the 2021/2022 strip of futures, they continue to be underpriced to us relative to corn and soybeans in the US.

@Globalej
@JerniganGlobal
Eddie Jernigan
Register for Research
info@JerniganGlobal.com
ed.j@jernigancg.com
JerniganGlobal.com