XINJIANG TEXTILE SUPPLY CHAINS FACE SOURCING ISSUES

US EXPORTS HAVE TO BE REDIRECTED

MOVEMENT OF SUPPLY CHAINS OUT OF CHINA ACCELERATE

US/BRAZILIAN BATTLE FOR EXPORT SHARE CONTINUE

JERNIGAN GLOBAL
KNOWLEDGE IS THE NEW CAPITAL

CHINA UNDERESTIMATED THE US POSITION AS RIGHT/LEFT UNITE; NO RETURN TO POST-JUNE 18 CONDITIONS

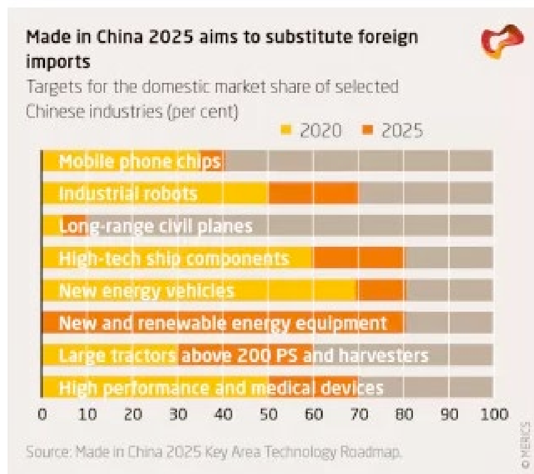
Steve Bannon/Tom Freidman interview on CNBC

2019 Belt & Road Summit

Over the past week it has become clear that Xi Jinping, despite his time spent in Iowa as a young man, has lost touch with US sentiment. His isolation as supreme ruler for life and the stifling of any opposing view has left him misunderstanding the US. These are some of the revelations that have surfaced since the total breakdown of China/US talks. The importance of many of China's actions outside the talks, and why the US side pushed for transparency and a clearly written agreement, has also been revealed. Some of the revelations have been shocking. Late last Thursday, the US Department of Commerce announced that Huawei and 70 of its affiliates were banned from buying parts from US companies, and that any sales had to be approved by the US government. They were also banned from the US telecom network. This was a significant move by the US to protect their network and security. Huawei reported global revenue in the first quarter of 70 billion USD, reflecting the scale of its global business. It appears the rise of Huawei and many of the other Chinese super companies have their roots in the "Thousand Talents Plan." It was a plan established during the 2008 global financial crisis to take advantage of a weak US and of the West, to gain the needed technology to build super companies. The plan centered round the recruiting of expats of Chinese ancestry to obtain key scientific and technological knowledge. By 2014, an estimated 4,180 agents were in the field. This became the roots of the Made in China 2025 program made public by Xi Jinping in 2017. Against such a backdrop, it is clear that this entire trade dispute has expanded into much more than just trade.

These conditions explain what appears to be a major

shift in US political, business, and even Wall Street opinion in the US. Last week, a joint interview of two opposing political pundits is being described as a watershed event and a turning point. CNBC, a major business channel in the US, brought together two well-respected experts from opposing political camps. From the left side of the political aisle was Thomas Friedman, a political commentator and three time Pulitzer Prize-winning writer who writes a weekly editorial column for *The New York Times*. He is also the author of the best-selling book on globalization, "The World is Flat." Friedman is well known for his anti-Trump views. For the right was Steve Bannon, a media executive, former executive chairman of Breitbart News, Harvard graduate. He is a former advisor to President Trump and a key architect of the Trump China policy. The two came together to praise how President Trump was managing the China trade policy, and also the need to correct China's actions in trade and policy. The agreement shocked the audience, as they shared the same views on almost every point. There were several highlights in the interview. First, both thought the Chinese misreading of the US's position was the largest intelligence failure of the decade. Second, China had to change its business model, and the current model could not continue. And third, a call is now being made to cut off all Wall Street access to China.



Focus on advanced technologies
Key sectors targeted by Made in China 2025

- New generation information technology
- High-end computerised machines and robots
- Space and aviation
- Maritime equipment and high-tech ships
- Advanced railway transportation equipment
- New energy and energy-saving vehicles
- Energy equipment
- Agricultural machines
- New materials
- Biopharma and high-tech medical devices

China - Brain Gain

Thousand Talents Program

- Professors in famous foreign universities
- Technical and management personnel holding senior positions in international corporations
- Entrepreneurs with full intellectual property rights to certain technologies

- Each participant gets
  - 1 Million Yuan (US $ 150K)
  - Pension
  - Healthcare

This breakthrough was followed by the former chairman of Goldman Sachs tweeting praise for the tariffs and the need for a hard reaction to the excessive hubris of China. This marked an important reversal in attitude. The Bannon/Friedman discussion also praised Chinese Vice Premier Liu as a reformer. Their opinion was that Xi Jinping reneged on all the key points of the trade agreement, after being influenced by hardliners who had just returned from the second Belt & Road Summit with the opinion that China did not need the US and should aggressively follow its own path. On Friday, the South China Morning Post carried comments from the *CCP Economic Daily* that compared the trade dispute with the Korean War in a rather bizarre way. The headline story said China had no alternative but to retaliate by imposing tariffs on US imports. "If anyone thinks that China is bluffing, it will only be another major miscalculation after the war to resist US aggression and assist North Korea." This was a reference to the Korean war in 1953, when it was said that people did not believe Chinese troops would cross the border between the two Koreas. "We will take countermeasures against anyone who puts tariffs on us." There is now speculation as to what such comments may mean. Rumors were in circulation that China was launching anti-trust investigations into several US companies, and concern also mounted over possible retaliation against Apple and Starbucks, both of which have large operations in China.

XINJIANG TEXTILE AND APPAREL SUPPLY CHAIN DRAGGED INTO REEDUCATION CAMPS DEBATE

The Wall Street Journal sent a team of reporters to Xinjiang to investigate the reeducation camps that have imprisoned more than one million Uyghurs. Their findings showed the government's policy had entangled the Xinjiang cotton and textile and apparel industries in the controversy. The WSJ investigation found that Xinjiang produced yarn manufactured in plants using Uyghur labor from the reeducation camps, indicating imprisoned workers had moved into the supply chain of major global major brands. They cited several of the largest apparel brands in the world in the report. A portion of the research was focused on the giant cotton and textile hub of Aksu. The reporter visited what has been called the largest mixed-colored yarn plant in the world, located in Aksu. This mill was very involved in the government's large-scale reeducation program, which they called "vocational training." Workers in another large grey yarn mill were interviewed and also showed involvement in the reeducation efforts. Additional evidence also showed that the reeducation effort involved closed facilities under military management to provide un-radicalized workers to the textile plants. It also revealed that the local camps led sweeps through Uyghur communities to pick up workers. Further investigations showed companies were forced to make payments or donations to the local Xinjiang security to pay for the cost of the reeducation. The investigation showed that the yarn flowed into end products being sold under the brand name of some of the world's largest brands, many of which are cut and sewn in Cambodia and other locations, using Chinese fabrics.

Xinjiang re-education camps

Xinjiang textile plant

This has the potential to disrupt the Chinese textile and apparel supply chain as much as the US tariffs, since many of the products involved have been moving into the European market. The reporters contacted the brands involved, which resulted in the brands instructing all suppliers to suspend using yarn from those plants. They also committed to a review of their supply chains to avoid using the Xinjiang plants. The report also discussed Xinjiang's role in Chinese cotton production, the investment of multinational firms in Xinjiang, and their role in the reeducation effort. This report by *The Wall Street Journal* was quite important, and could have significant ramifications for sourcing and for the cotton, textile, and apparel industry of Xinjiang. Xinjiang's cotton expansion and success has been driven by heavy government subsidies, which means considerable government involvement in every aspect. The record investment in the textile and apparel industry has turned Xinjiang into a powerhouse, with the number of operating cotton spindles now equal to that of Turkey. One of the goals of the industrialization was to provide full employment to the local population, and to integrate them into the Chinese economy. The success of this effort now has the Xingang operations intertwined throughout the massive Chinese textile and apparel supply chain. It also makes it very difficult for companies sourcing in China to have a fully transparent supply chain, and to avoid any involvement in the Xinjiang issues. In many instances, the brand itself does not have the relationship with the Xinjiang plant, but it is a second-tier supplier or contractor instead. Nonetheless, a link to the reeducation effort has serious liabilities, especially in Europe.

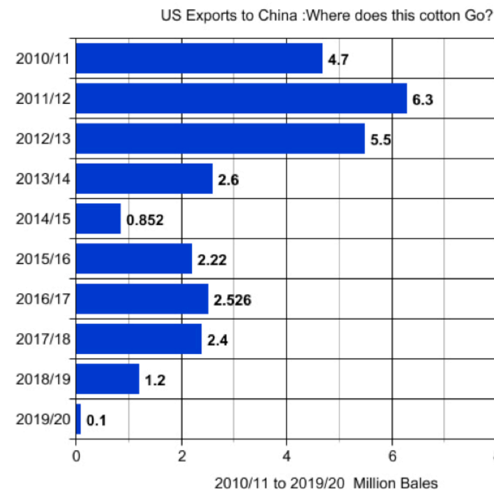
Aksu, Xinjiang's new textile hub

Thus, the reeducation camps in Xinjiang are a negative entanglement regarding sourcing by European firms, and will cause some additional movement of supply chains away from the risk. The size of the textile and apparel exports to the EU is larger than in the US, which collectively places a large block of textile and apparel exports at risk, and will impact Chinese consumption of both cotton and man-made fibers.

US COTTON EXPORTS WILL HAVE TO BE REDIRECTED

The importance of these developments to the cotton trade and the global textile and apparel industry is that a return to the status quo that existed prior to June 2018 is very unlikely, and a significant decoupling of the US/China trade relationship is occurring. This leaves the cotton market facing a new trade matrix, as China has dominated world cotton trade since it began to modernize. China's peak influence occurred in the 2011/2012 to 2013/2014 period. As it pertains to cotton trade, today's drama goes back to the policy of China's since 2010, when it first moved to openly and totally ignore WTO guidelines regarding subsidies and policy. The second part of that policy was that there were no objection from the US or any country, as the cotton trade kept silence. An important change of policy occurred out of the market mayhem of 2010/2011. Prior to the price explosion of 2010/2011, the role of the Reserve was diminishing, and the expectation was that the cotton market was moving to be totally opened. However, the impact of the Reserve being caught with limited stocks when prices surged to over 200 cents resulted in the State planners reasserting influence in the name of price stability. A collapse in prices resulted in political pressure from domestic cotton growers for the Reserve to support prices. This brought about a reemergence of the role of the Reserve and the procurement of approximately half the 2011 domestic crop, and almost all of the 2012 and 2013 crops. The procurement and resulting subsidy violated every limit established by WTO and disrupted world trade for the next 7-8 years, eventually impacting every other cotton exporter in the world. Despite this, not one complaint was filed at the WTO, with both US and Brazil silent.

As China accumulated record Reserve stocks, it depended on cotton imports for consumption, which helped maintain the silence of critics of the subsidy. China's cotton imports in 2011/2012 reached a record of 24,533 million bales,

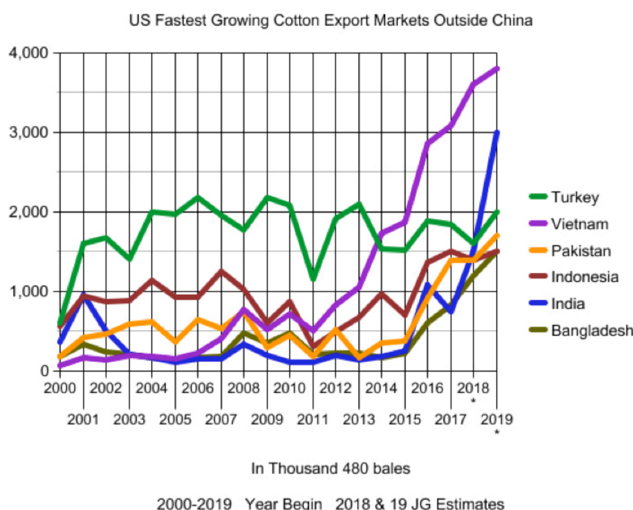


reflecting 54% of total world trade. From this point, imports continued to play a major role, before China again disrupted world trade by limiting imports to focus on forcing domestic mills to use Reserve stocks. With imports falling to only 4.406 million bales in 2015/2016, China's role in world trade was reduced to only 12.43%. Today, the Reserve stocks have fallen sharply, with stocks expected to be very small after completion of the 2019 auctions. This means the Reserve is expected to again procure both domestic and imported cotton, with imports expected to reach 11 million bales or more. This will increase imports to near 24.25% of world trade in 2018/2019.

As we prepare for 2019/2020, it appears that world trade flows will be influenced by China's placement of a 25% duty on general cotton imports from the US, including those imported under the WTO mandated 894,000-ton quota. The exceptions appear to be cotton imported into the free trade zones and under the processing quota. This opens the

opportunity for Brazilian and Australian cotton to meet the needs of China. It creates a sizeable hurdle for the US to push exports past the 14 million bales level, without a crop disaster in a major producing region. If one assumes a minimum US ending stocks of 3.5 million bales, and domestic consumption of 3.0, then any crop of over 20 million bales begins to pose challenges. During periods of larger carryover, the pressure begins with a much smaller crop. This is why the prospect of a 21-22 million bales crop creates such anxiety. The highest level of US exports since the elimination of the Step-2 payment is 15.847 million bales, and the US exported 2.526 million bales to China that season.

US exports to China have ranged from a low of 852,000 bales in 2015/2016, to a high of 6.311 million bales in 2011/2012. The record level of imports occurred in the 2005/2006 period of Step 2 payments, when shipments from the US reached an all-time record of 9.089 million bales. Since 2002, the US has exported 1-2 million bales every season to China, with the exception of 2015/2016. Thus, the question is where the US cotton will move, absent the lack of access to the Chinese market. Since 2015/2016, Vietnam has been the largest cotton market for US cotton exports. 2018/19 exports have already reached 3.442 million bales, which is a new record. There is a real question regarding this market's ability to continue to expand use at the recent pace. The growth has been fueled by cotton yarn exports to China. Vietnam still imports 80% of its fabric needs, mostly from China. This has reduced the correlation of cotton use to apparel exports. While US exports to Vietnam may continue to expand, the US faces stiff competition from Brazil for the 2019/2020 season. Brazil has moved into position as the second largest supplier to Vietnam. The record 2019 Brazilian crop suggest US export growth to Vietnam will be nominal in 2019/2020.



The second most important export market for the US outside of China is Turkey, where since 2001 they have purchased from 1.16 to 2.187 million bales. Currently, Turkey is facing a potential financial crisis from record USD debt that will soon come due, large trade deficits, and major ongoing political conflicts with the US. At times, these conditions have affected the ability of spinners to import cotton. Given the constraints on credit, US exports of cotton in 2019/2020 should be able to reach near two MB, but will also face serious competition from Brazil, which has become a major supplier.

The potential to grow US exports to offset the loss of China rest in four markets – Pakistan, India, Indonesia, and Bangladesh. The largest potential is Bangladesh, which is the second largest cotton importer behind only China. We expect Bangladesh to be one of the top beneficiaries of the movement of supply chains out of China. Cotton imports in 2019/2020 could reach 8.5-8.75 million bales. Historically, Bangladesh has focused heavily on Indian and Central Asian cotton. Uzbekistan has always been popular, but Uzbekistan exports have fallen sharply over the past several years, and will soon likely disappear, which has opened up the opportunity for US and Brazilian cotton. India is also a major supplier. However, that role is also steadily falling, as India itself moves toward larger imports amid a crisis with yields. US exports to Bangladesh in 2018/2019 have already reached a new record at 940,800 running bales. 2019/2020 exports have the potential to increase to near 1.5 million bales if the US is competitive.

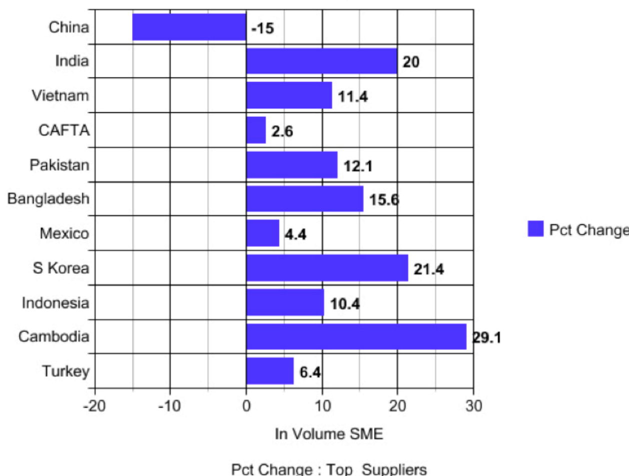
Indonesia has emerged as a more important market in recent years, with US exports reaching a record 1.503 million bales in 2017/2018. So far, 2018/2019 sales have reached 1.2872 million bales. It is unlikely the US can increase sales past the 1.25-1.50 million bales level, given the limited expansion in cotton use. The smaller Australian 2019 crop will open up new opportunities, if the 2019 US crop provides the needed high grades. Pakistan has become an important market, with the US exporting 1.391 million bales in 2017/2018. This volume will be matched in 2018/2019, as Pakistan total imports reach three million bales. Pakistan has a crisis in yield that is limiting its ability to meet its cotton needs. Pakistan cotton use has improved as the new power plants have increased electricity supply to mills, and an increase in sourcing is occurring in Pakistan. The inability to increase yield suggests that Pakistan will remain an importer of 2.7-3.5 million bales in the near term. The US has the potential to meet half that volume. Brazil has become a major competitor, with its SLM 1 1/8 styles very popular. We expect a reduced role of Indian styles in the future to open the opportunity for increased US exports. 2019/2020 US exports could increase to 1.5-1.7 million bales.

India has emerged as an important export market for the US cotton since the 2016/2017 season, when the current cotton yield crisis began to have a significant impact on production. India has purchased 944,900 running bales already in 2018/2019, the second largest volume on record. It imported 1,081,000 bales in 2016/2017. Total 2018/2019 exports are likely to be near 1.5 million bales, a new record. Exports in 2019/2020 will continue, due to the inability of India to increase yield amid the lack of BT technology. Overall, US exports to India have the potential to double in 2019/2020. Indian cotton consumption has the capability to expand, as increased sourcing moves to India from China.

Collectively, US exports have the potential to increase to these six countries by close to two million bales, which will help offset the loss of the Chinese market, but the US still faces tough competition from Brazil. We are assuming Brazil will divert a much larger volume of its cotton to China. For example, in 2019/2020, if China imports 11 million bales, we would expect over 50% to be met from Brazilian styles, which would be aided by the much smaller 2019 and 2020 Australian crops.

MOVEMENT OF TEXTILE AND APPAREL SUPPLY CHAINS OUT OF CHINA UNDERWAY

The March US textile and apparel import data revealed a massive move to source outside of China, indicating that US brands and retailers have had some success in find new sourcing location during the 10 months since the China/US trade war began. The data showed significant gains by India, Vietnam, Pakistan, and Bangladesh, which means these countries are increasing cotton use and overall exports. There has been a sizeable boost in sourcing from second tier suppliers such as Thailand, Haiti, Jordan, Italy, and Turkey, as well as a surge in imports from the smaller exporters like Ethiopia, Eastern Europe, and others. Some increased transshipment is also showing up, with an increase in imports from countries that have very little textile and apparel infrastructure. The increased sourcing from cut and sew centers such as Cambodia, Jordan, and others also mean Chinese fabric shipments to these regions have increased. Moreover, there is strong evidence that Chinese companies are moving out of China and building supply chains in new regions that have not drawn global attention.



The March US import data also contained some good news for cotton, as market share in the apparel market rebounded to nearly 45%, up sharply from 2018's record low market share of 41.46%. One reason for the increase is the switch from China, where the over concentration of sourcing has aided the expansion of man-made fiber use. Because of the "Chinese Price" of polyester fiber, which has been heavily subsidized by the 2008/2009 stimulus package, production capacity has more than doubled. As a result, Chinese man-made fiber apparel is the cheapest in the world. The US Department of Commerce has ruled on yet another anti-dumping case of China selling polyester texturized yarn below the cost of production in the US at an unfair price. Two US polyester yarn producers brought suit, one a US firm actually owned by a Chinese company. The Department of Commerce ruled that the three largest exporters would face a duty of 459.98%, and another a duty of 32.04%. At the same time the case was also brought against three Indian exporters, but they were found only to face countervailing duties of 7.09% to 20.45%.

The influence of subsidies on the Chinese domestic polyester price is having global consequence. Many of the new plants set up after 2008 were given highly favorable loans and other incentives by the central and local governments to put in the new capacity. It has now come to light that, also in 2008, China launched a major industrial spying program called Thousand Talents Plan to obtain the latest technology and science from across a host of industries by recruiting Chinese living abroad to work undercover. The program has since morphed into the "Made In China" initiative that was first announced in 2017 by Xi Jinping. It has also become clear that the local governments have been active in providing loans, credits, and incentives for the sector to expand outside of the central government's stimulus. This overcapacity is now evident in the feedstocks, as well as fibers. Adding to the pressure on the prices is the increased

supply coming from recycled polyester and nylon.

The shifting of supply chains is switching the dynamics to fabric, as new cut and sew operations out of China are established by Chinese firms to avoid the possibility of tariffs. The cheaper price is being transferred to the fabrics. In other locations, Chinese man-made fiber fabric prices are much cheaper, after freight and taxes, then locally produced fabric, due to the much lower cost basis that starts with the feedstocks and flows into the fibers. Even a 25% duty on many apparel items may still keep the Chinese man-made fiber apparel competitive in the US. For example, the recent antidumping cases on poly yarn have found the subsidy rate much larger than the 25% duty.

China has also announced a new series of incentives to help offset the tariffs. First, there is a further reduction in the VAT, which became effective April 1st. The VAT rate was cut 3% on textiles, which, according to a recent study, resulted in a savings of about 100-120 Yuan a ton for cotton yarn, or 14.56 to 17.46 USD a ton. This, however, adds up. In one of the major yarns-producing provinces, companies experienced a total saving of nearly 346 million Yuan, or 50.36 Million USD. The second incentive was a cut in the social security tax, which was lowered on May 1st from 20% for workers to 16%.

INCREASED ORDERS FOR NATURAL FIBERS NOTED

The March US apparel import data revealed that natural fibers could be beginning to enjoy new popularity. Total apparel imports in volume terms increased by 5.5% from a year ago, and total textile and apparel imports grew 2.7%. The growth in apparel imports was focused on natural fibers. Cotton apparel imports increased by 4.7%, wool 1.5%, with the strongest growth coming in the silk and vegetable fiber group, which includes silk, hemp, jute, flax, linen, and others. It is a small category, but growth surged 29.3% in March alone, and 20.48% in the first quarter of 2019. This illustrates the challenge for cotton, as natural fibers return to favor. Silk and vegetable fiber apparel imports in the first quarter reached 507.234 million USD. Contrary to the general trend, imports from China were up 14%, with it the top supplier and a market share of 48.5%. China has a sizeable lead in many of these fibers. For example, hemp is enjoying a surge in popularity, and Chinese companies have lead the way in developing the technology to "cotton-ize" hemp, which allows it to be blended with cotton and other fibers, and to also have a different hand. China is also the third largest flax producer and the largest silk producer. Imports were up sharply from the other suppliers – Vietnam +29%, Indonesia +25%, Italy +11%, India +35%, and Bangladesh +73%. Over the last 12-15 months, Vietnam appears to have increased the use of hemp and silk in several new apparel offerings.

Overall, total textile and apparel imports from China in March fell 15% in volume terms, while India was the second largest supplier, with the total volume of shipments exceeding Vietnam and reaching more than one-third the level of China, with imports up 20.8%, which was impressive growth. A deeper analysis into the Indian surge in imports revealed several things. In cotton apparel, imports in the first quarter was up 14.63%, making India the fourth largest supplier. Non-apparel cotton items imports were up 8.93%, with cotton products accounting for 53.35% of all imports into the US. This growth is supportive to expansion in cotton use in India. Another major trend emerged in which US companies have switched sourcing of luggage and hand goods to India. Non-apparel, man-made fiber product imports were up 25.42% in volume terms in the first quarter, which came from handbags and luggage imports that increased by 49.4%. Imports of man-made fiber floor coverings also showed strong growth. In silk and vegetable fibers, handbags and luggage were up over 92%.

CHINA MAN-MADE FIBER FABRICS DAMAGING COTTON USE IN VIETNAM

Vietnam was the third largest supplier to the US in March, with growth of 11.4%, and the second largest supplier of cotton apparel. Cotton, however, is under pressure from man-made fiber in Vietnam due to the role of Chinese fabric that is imported by the apparel industry. Vietnam's strong growth in cotton use is linked to the production of cotton yarn, which is exported to China. This has allowed companies to avoid China's import controls on cotton, and to utilize the lower global world price. The booming apparel sector is driven by fabric imports from China. More than 80% of Vietnam's fabric use comes from fabric imports, mainly from China. Domestic fabric production has been slowly growing, but a number of factors have held back expansion. First, China is the largest fabric producer in the world, and its major companies have the benefit of scale and subsidies. This makes it cheaper, in many instances, to ship the fabric from China. Second, Chinese companies have been a significant investor in Vietnam and are providing fabric to the cut and sew operations from their plants in China. Third, Vietnam has learned from the

environmental disaster that occurred in China, as a result of the fabric dyeing and finishing industry. This has required expensive investment in environment controls in any new plants, and some Vietnam provinces have not allowed investment in these industries at all. China finally has the ability to supply the Vietnam apparel companies with the most advanced quality, performance, and technical fabrics.

Vietnam is the second largest supplier of man-made apparel imports to the US, with a market share of 17.66%, compared to China's market share of 38%. Man-made fiber apparel accounted for 55.25% of all apparel imports from Vietnam in the first quarter of 2019. Comments from many of the cut and sew operations state they have limited choices in cotton fabrics, and many times they depend on the selection provided by the Chinese exporters. South Korea is the second largest provider of fabric imports after China, with a much smaller market share. Cotton apparel accounted for 41.92% of all apparel exports to the US in the first quarter, compared to a share of 41.37% for 2018. Cotton faces competitive disadvantage in Vietnam that will not change very easily unless Chinese exporters place a greater emphasis on cotton. The price advantage of polyester fiber vs. cotton in China remains a driver, with the average polyester price near 57 cents vs. over 102 cents for domestic cotton. Since the dramatic increase in polyester capacity, polyester fiber has enjoyed a much larger price advantage against cotton, which has reduced cotton's market share of fabric production in China.

PAKISTAN SOURCING EXPANDS IN USA

In volume terms, Pakistan was the fourth largest supplier to the USA in textiles and apparel in March, with the volume up 12.1%, exceeding that of Bangladesh and Mexico. For the first quarter, Pakistan was the fifth largest supplier after China, India, Vietnam, and Mexico. Pakistan's full first quarter exports to the US increased by 10.2% in USD terms to 758.358 million USD. Pakistan exporters focus on cotton, resulting in cotton products accounting for 89.4% of all shipments to the USA. March exports to the USA were the second highest in volume terms since October 2015. The largest volume imported since October 2015 was in January 2019. Almost half the import volume was made-ups. The largest apparel group sourced from Pakistan was men's & boy's cotton knit shirts, which accounted for nearly a third of all apparel imports, and posted strong 37.5% year-on-year growth in the first quarter.

Overall, Pakistan's total textile and apparel exports in March reached 1.0889 billion USD, down 9.47% from a year earlier in USD terms. Apparel exports equaled 430.2 million USD of that total, with yarn and cloth exports accounting for 277.5 million USD. Pakistan continues to have a very serious trade imbalance, with the March trade deficit reaching 2.176 billion USD.

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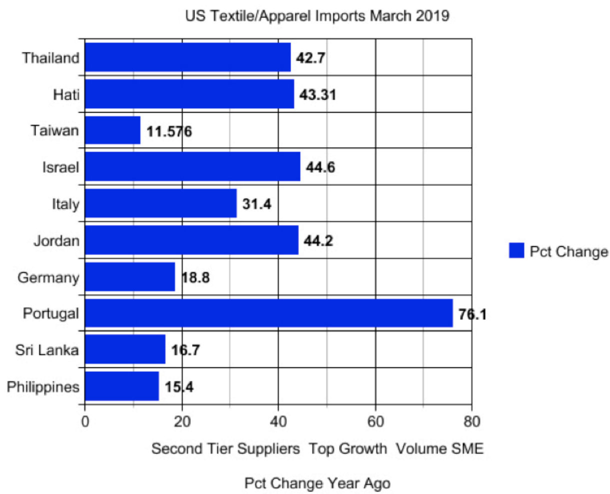
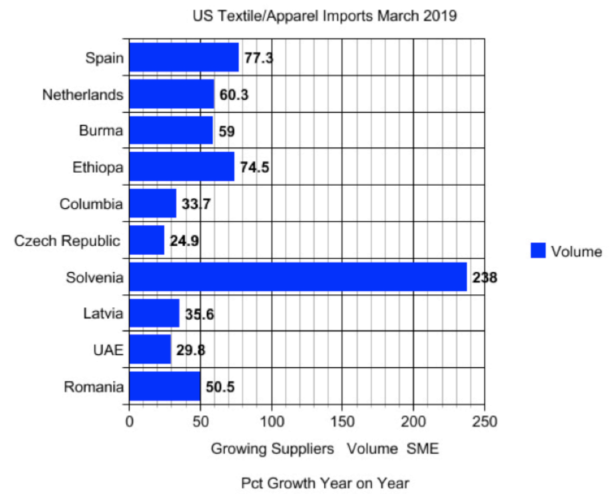
FIELD TO CLOSET™ NASHBROUGH COTTON™

INCREASED SOURCING FROM SMALLER PROVIDERS





US textile and apparel imports from almost all second-tier supplier surged in March, as companies developed new supply chains, some of which offered new opportunities for cotton use. Others depended on Chinese fabric, and others appear to raise the fear of transshipments. Bangladesh remained a source of expanded shipment, with March shipments up 15.6% in volume. Total first quarter shipments increased by 15.1%. Nearly 75% of all imports were cotton apparel. Bangladesh's denim sector continues to expand, making it the third largest supplier of denim apparel in the first quarter. Mexico has enjoyed a rebound in shipments to the US, which appeared driven by increased sourcing of denim products.

Cambodia, which is almost like a colony of China, saw imports grow by 29.1%, as it continues to enjoy duty-free entry, which comes even as China's influence in the country expands. Cambodia has zero cotton-spinning capacity, and imports 100% of its fabric, mostly from China. Imports are pretty evenly split between cotton, which is centered on six product groups, and man-made fiber. Turkey is expanding its footprint in the US, as Lira/USD weakness increases the country's ability to compete. Turkey was the tenth largest supplier to the US in March, with volume up 6.4%. The growth, however, is not coming from cotton apparel or products, which account for only about 31% of shipments, but from increased sourcing focused on man-made fiber products, such as floor coverings.

Thailand is proving to be a winner, as increased companies are sourcing from the country, with March shipments up 42.7%. The growth is the result of an increase in imports of made-ups. Thailand is also attracting a host of more advanced investments in a new supply chain for several industries. The cut and sew centers that use Chinese fabric have enjoyed a substantial surge in March orders as well, with imports from Haiti up 41.4%, Israel +44.6%, Burma +59%, and Jordan +44.2%. Several new suppliers are showing up in the March data. Portugal is getting new orders and saw March imports increase by 76%. Eastern Europe is drawing new attention, as the data suggests the volume was small, but imports in March from Slovenia and Hungary were up over 200%, while imports from Ukraine also increased. Increased movement of companies into Bulgaria, Moldova, Ukraine, and Georgia has been noted. Ukraine has attracted interest as a cut and sew center where EU companies export the fabric, its cut, make, and trim in Ukraine, and then the finished apparel is sent back to the EU. Serbia is drawing new investment in textiles and apparel from Turkey and China. Chinese companies have announced new investment in yarn and socks in Serbia. China has viewed Serbia as its gateway to the EU for its Belt and Road initiative, which is drawing significant investment in the country's infrastructure and industrial sector. The infrastructure projects appear to be drawing Turkish firms. One Turkish group announced an investment in a cut and sew and dyeing operation. Another one set up an apparel production plant, and another has set up an open-end spinning plant in southern Serbia. Italy has also invested, with an Italian hosiery group operating four plants.

AS FUTURES FALL BRAZIL BASIS FIRMS BUT NOT UNIFORMLY

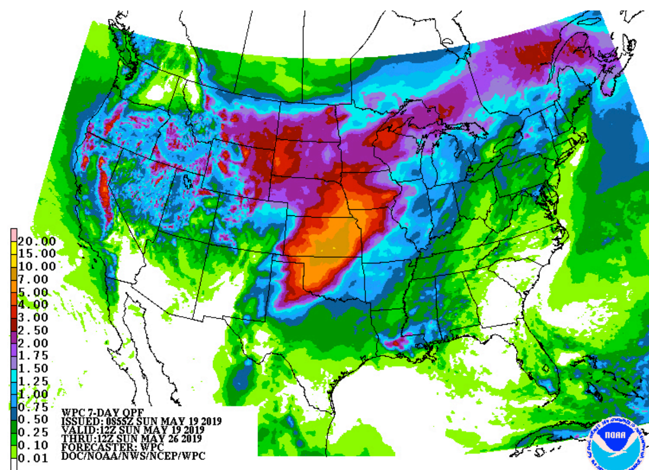
As the month of May got underway, Brazilian exporters were aggressively offering Brazilian 2018, 2019 and 2020 crops, undercutting US styles. As we have discussed for months, Brazil is under serious pressure to move a record volume of all three-crop years to export. The country has very little storage capacity, and thus there is little ability to manage large carryovers. Prior to the futures collapse, which started on May 6th, the CFR basis for a Brazilian Middling 1 1/8 had fallen to 700-800 points on July futures. July futures have collapsed since the breakdown of the China/US talks, with July losing just over 1100 points. The CFR Asia export basis has firmed from 100 to 150 points, depending on the merchant and style. However, some merchants have left basis levels unchanged. Export trade has been very active, with a large volume of 2018 and 2019 crops selling to China, Turkey, Pakistan, Indonesia, and other destinations.

After a more than 1100 point drop in ICE futures, attention is now focused on the China National Cotton Reserve Corp entering the market for Brazilian styles, which have become quite popular with Chinese mills. Brazil is the preferred alternative to US styles, and the Reserve needs to restock. It has already purchased a block of the 2019 crop late last year. At the current price levels, the Reserve could accumulate much of the surplus 2019 Brazilian crop, which is now pressuring the market. We expect the Reserve could buy 500-750,000 tons near the current price levels. This will be an important market factor in taking the pressure off Brazilian offering prices.

Today, the standard Brazilian Middling 1 1/8 2018 crop is offered at 875-1025 points on Dec 2019 futures, for June–August shipment, at the same level on Dec for October-December shipment, and at the same level on March for January-March 2020 shipment. Then, the 2020 crop is offered at 600 on July 20 futures for August-October, and at 800 on Dec 2020 for October-December shipment. In summary, you can obtain a Brazilian Middling 1 1/8 at a very attractive basis level for shipment from today well into 2021. Adding to the willingness of the exporters to sell is renewed weakness in the Real/USD exchange rate. The Real fell to a new post-election low of 4.1117 on Friday, as Brazilians took to the street to protest budget cuts. This marked a more than 3.4% depreciation since April 30th. Brazilian farmers were large sellers of soybeans to traders last week. The estimate is that, as the Brazilian basis surged on the trade woes, growers sold over 800,000 tons of soybeans. Between May 6th and May 15th, growers registered sales of 2018, 2019, 2020, and 2021 cotton crops on the BBM for 63,783 tons, or approximately 293,051 bales. Brazil is clearly the preferred supplier to China in the new trade matrix.

US WEATHER DEVELOPMENTS AND PRICE BEHAVIOR SUGGEST COTTON ACREAGE MAY NOT REACH EXPECTATIONS

US agriculture is in crisis, as the industry takes a major hit in the China/US trade decoupling, since agriculture was one of the largest segments of exports to China. Since the breakdown of the trade talks, cotton and grain prices have collapsed. However, corn prices reversed their slide, as additional rains prevented planting of both corn and soybeans in the key mid-western states. Nationally, as of last Monday, May 13th, only 30% of the US corn crop was planted vs. 66% normally, and only 11% in Illinois vs. 82% normal, 6% in Indiana vs. 57% normal, and 4% in Iowa vs. 76% normal. Given the weather since then and the seven-day outlook, the feeling is building that less than 50% of the intended corn crop will get planted. The final planting dates for corn begin on May 10th and end on June 5th for the main corn belt. Soybean final planting dates for the Mid-West extend to June 15th–25th for the same region.



Soybeans are behind, but still have some time. In the south, soybean planting in Louisiana reached 53% vs. 75%, MS 33% vs. 69%, Missouri 5% vs. 23%, and Arkansas 21% vs. 53%. The crisis is in corn, and by Thursday Dec 2019, corn futures had rallied more than 30 cents off Monday's lows, which some are calling a decade low. For cotton growers in areas where they can still plant corn, the collapse in Dec 2019 cotton, down over 10 cents even after recovery, means they are switching to corn in areas of Texas and other places where they can. Cotton in the 60s is just not profitable. For other growers, the anger over how the trade dispute has been handled has a record interest in the prevented payment option. In the Mid-South, 200,000-250,000 acres or more will likely not be planted because of flooding, which will prevent planting.

Across East Texas and the Rolling Plains, the continued excessive rains may give growers the option of taking the insurance payment on prevented acreage, as the deadlines to plant arrive. Generally, the cotton price for insurance was set at near 74 cents. Plus, there is a payment for cottonseed. When all combined, the total price is near 80 cents a lb. for lint. Under prevented planting, depending on which insurance option the grower purchased, they can receive approximately 30% of the total payment based on historical yield, and end the season with no cost. In a year where only record yields and a recovery in price will make a full season crop worth it, the prevented plant option will be the most attractive option in years. The Texas High Plains has three major planting deadlines for cotton – May 31st, June 5th, and June 10th. These dates are extended in Oklahoma. After the planting deadlines, growers can plant for period of 25 days, but insurance benefits decline with each day planting is delayed.

These conditions make the final US-planted acreage a moving target. The March USDA planting intentions placed the crop-planted acreage at 13.78 million acres, which was below the NCC survey. Since that time, flooding has hit the Mid-South, and prices have collapsed. Texas remains the wild card, as growers have the best moisture profile in several years, so it is hard to imagine nothing is planted to take advantage of that. Because of excessive moisture, prevented planting is a rare option that will be used this season. Then comes much lower abandonment. The early optimism regarding a 22-23 million-bales cotton crop has faded.

ICE FUTURES DROP OVER 1100 POINTS AS MARKET UNCERTAIN ABOUT THE CHINA/US DISCONNECT

Since 2000, China has held the global cotton market firmly in its grip, as it assumed the role of the world's largest cotton importer, then the world largest consumer of cotton, and, for a while, the world largest producer of cotton. The height of the influence came in the 2010-2014, as China accumulated over 60% of the world's cotton stocks in its Reserve inventory, and, at the same time, imported record volumes of cotton. Every rumor of Chinese selling or buying moved the markets. Then came the negative influence of a sharply reduced import volume since 2015/2016. Now, after the US and global markets suffered through the Reserve's drawdown, impacts on world trade have been thrown into flux by the China/US trade dispute, and by China's refusal to enter into a transparent and open trade agreement that ensures compliance. China has been left to exert its will in world trade since joining the WTO, with little control or effort to make it conform to the rules it agreed to. Nineteen years after joining the WTO, China's state-owned conglomerates are the largest in the world, and it's heavily subsided over capacity is causing havoc for cotton, with its cheap polyester.

The breakdown of the move toward a trade agreement between the USA and China triggered a massive collapse in ICE futures, which extended over 1100 points before stabilizing. The move was driven by the Speculative Fund moving from net long to net short.

At the same time, the global cotton trade was sent into panic as China's role in world trade changed, and the market faces the most dramatic changes since developing China joined the WTO. A lot of uncertainly exists as to how the movement of supply chains out of China will impact cotton use, and how the US will meet its higher export targets without Chinese access. It remains very difficult to take the emotion out of the market. ICE futures are heavily influenced by US export prospects and ending stocks. Chinese export cancellations are haunting the market. Many of the sales were made at much higher prices, which in itself increases the risk. China canceled a large purchase of US pork on Thursday, which is, of course, a very essential import. This appeared to raise the risk that a large block of the outstanding cotton sales for 2018/2019 and 2019/2020 would be canceled. Some internal rumblings in China are calling for an outright ban on all US agriculture imports. The US has 91,500 running bales of Pima sales unshipped, and 644,700 running bales of upland. For the 2019/2020 period, the US has 1,838,600 running bales of upland, and 1,500 bales of Pima, which are open. The Pima sales would appear secure from a commercial standpoint, but the greatest fear is over a direct banning of all shipments.

As we have discussed many times, the need for Brazil to ship remaining 2018 crop stocks and ship even a greater volume of 2019 crop to export remains one of the mot negative influences. Brazil simply cannot manage any accumulation of stock. The situation reminds us of what the soybean and corn industry went through when soybean and corn production surged in Mato Grosso, and farmers and the industry lacked storage, which caused aggressive selling at times at very cheap discounted basis levels. The losses this caused resulted in the government providing loans to finance on farm storage, and incentivizing the grain industry to invest in storage facilities, which now allows for much better management of crop movement. For now, any such construction of cotton warehouses is at least 12-24 months away, if it occurs. This means that, for now, the selling pressure from Brazil will continue. The Brazilian CFR basis has firmed since the collapse in futures. However, the firmness is not universal, with some merchants remaining very aggressive. Today, Brazilian 2018, 2019, and 2020 crops are offered in a range of 800-900 points on the cover month basis a Middling 1 1/8 for shipment from June 19th through March 21st. Such basis levels, combined with the collapse in ICE futures, resulted in a large volume of Brazilian cotton selling last week. In direct contrast, the CFR basis for African Franc Zone high grades and Indian styles moves to a record premium to Brazilian. After weeks of significant offtake, supplies of African Franc Zone high grades are becoming very tight. The average basis for an African Franc Zone SM 1 1/8 has firmed to 1250-1350 points on July for prompt shipment. This reflects a 300-400-point premium to a Brazilian, or US E/MOT SM 1 1/8 offer. The tightness in high grades has also widens the premium of the Strict Middling African Franc Zone types to near a 200-point premium over a middling grade. The spread between an AFZ Middling 1 1/8 and Brazilian of the same type is near 200 points premium the AFZ. Indian Shankar 6 is only nominally offered, but the CFR basis is at an amazing 1500 points on July, as the local price ex the gin sits at over a 1300 point premium to ICE futures levels.

The pressure from Brazilian selling remains a feature. On Thursday and Friday, the US Dollar posted very strong gains, resulting in the Real and the Brazilian financial markets coming under significant pressure. The country experienced street protest over budget cuts, and the Real fell more than 3% against the USD, down 1.5% on Friday alone, to a low of 4.1117 per USD. This is not far from the record low of 4.1730. The weakness triggered additional farmer selling in soybeans, cotton, and other crops, which, in turn, ignited selling Friday in these markets. The Australian Dollar also fell sharply to .6866, but the sharply lower crop means little additional selling was triggered. Fears also increased regarding capital flight from China, as the RMB/Yuan fell to 6.9179 per USD, which was near its year low and down .50% just on Friday.

ICE futures came under selling pressure again as the week ended, amid increased tension between the US and China, and the Dollar strength triggering new hedge selling. Some merchants are lowering US 2019/2020 crop basis for the type offers such as Middling 1 1/8 and SLM 1 1/8 to match the Brazilian offers, in order to attempt to capture the non-Chinese business as much as possible. The concern over the lack of US high grade stocks has the spread in Middling 1 1/8 offers and the Green Card classed 31-3-36 as wide as 400 points out of some merchants. The battle for export offtake remains a major feature in export trade between the US and Brazilian styles.
The CFTC COT report revealed that, as of Tuesday, Managed Funds had moved to a net short position of 24,828 contracts. Additional aggressive selling has occurred since then, which suggests the position is now near 30,000 contracts net short, which is one of the largest net short positions in years. The Other Reportables were large sellers, but remain net long. The small Spec is now net short 2,092 contracts. So far, demand has been good on the weakness, but spinners'

confidence remains very shallow, and no one is willing to chase any rally. Polyester fiber prices in China came under additional pressure last week, falling to near 56 cents. Ex plant and Viscose fiber fell 2-3 cents a lb. to 79-80 cents. The cotton price decline has outpaced the polyester price, with the CFR Asia/Poly spread ending the week at only 19 cents, and cotton is now at a discount to Viscose fiber. These developments suggest we have entered an area where cotton consumption can increase. Two main issues remain negative. Brazil's need to move record volume to export, and the changing supply chains have undermined confidence. Overall, the 65 area should provide support, but we are in unusual times, and the first and second largest exporters need additional export offtake. For now, one of those exporters is shut out of the largest import market, which continues to make us negative until proven otherwise.

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