Cotton Outlook 2018

World Long Staple Market

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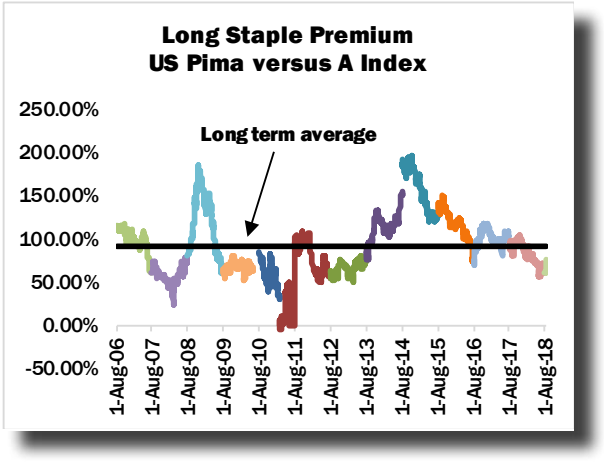
World long staple market: an uncertain outlook

Mike Edwards, Editor, Cotton Outlook

Our annual Long Staple Special Feature is published at a potentially significant moment in the evolution of the world market for upland cotton. Notwithstanding the short-term fluctuations of the market, underlying bullish sentiment has steadily been building, as the unexpected strength of world raw cotton consumption during the 2017/18 season, coupled with the disposal of additional Chinese stocks, has influenced the statistical outlook. In late May, the Cotlook A Index surpassed the dollar mark, a level last recorded over six years ago and attained on only a few occasions in more than half a century since the Index came into being.

Price outlook

What this means for the long staple sector only time will tell. At present, long staple prices appear, by historical comparison, to be relatively cheap in relation to upland values. Even after the sharp downturn of the latter in early August, the Cotlook Long Staple Premium (calculated as the margin by which our Pima quotation exceeds the A Index) currently stands at just over 70 percent, compared to its long-term average of 91 percent.



In comparison to upland values, long staple prices lacked volatility during the 2017/18 season. Our benchmark quotation (Pima Grade 2, 1-7/16", CFR Far East) began the marketing year at 153.00 cents per lb and gained ground progressively over the next few months. By mid-December, the value had risen to 166.00 cents. Expectations at that time favoured a further increase in prices, but it transpired that the market had instead reached a plateau, as demand from major import markets was not sufficient to sustain the earlier upward momentum. By late March, prices were once again on a downward trajectory as shippers sought to stimulate mill customers' flagging interest. The quotation ended the season on a relatively stable note, at 158.00 cents per lb, while the price indication reflecting supplies from the 2018/19 crop was quoted at a premium of 100 points.

Egypt also enjoyed a good early tempo of sales, which dropped off later in the season. Nevertheless, as the marketing campaign draws to a close, cumulative sales are nearly 50 percent greater in volume than those recorded in 2016/17.

International trade

In view of the relative cheapness of long staples alluded to above, one might anticipate that international demand during the season ahead

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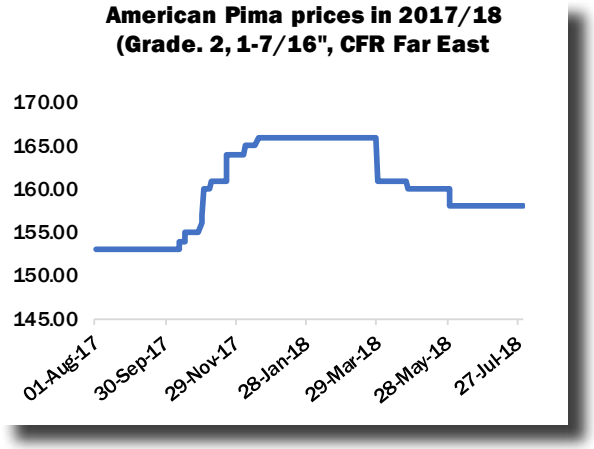

will also be well supported. Thus far, as each of our American contributors observes, sales of Pima have been encouraging. By the start of the 2018/19 season, sales of Pima for shipment during the marketing year ahead stood at 221,300 running bales, nearly 19 percent more than forward commitments at the same point a year earlier and the highest since the beginning of the 2011/12 marketing year.

However, the failure of prices to maintain their upward momentum during the second half of the 2017/18 season raises some questions with regard to the demand side of the market. As Mr. Dhuria notes, since a relatively small number of major players affect supply and demand in this specialised sector of the world cotton market, a change in one of those can provoke a significant shift in the market's dynamics. The escalating trade conflict between the United States and China clearly has the potential to become one such influence. Since July 6, both Pima and upland cotton are subject to an additional import tariff of 25 percent (unless shipped under 'processing trade' quota or destined for mills in

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a Free Trade Zone). Thus far, established trade flows have not been seriously disrupted, but the diminishing prospect of an early resolution to the dispute promises more uncertainty to come.

Supply and demand

The behaviour of world prices may also be influenced by the prospect of an increased supply available to the international market during the season ahead. A glance at the outlook for 2018/19 crops suggests that US production will consolidate the increase of output achieved last season, that Egypt will see a second successive season of recovery, but that output in China will slip further, having fallen dramatically in 2017/18. The global forecast of approching 473,00 tonnes would represent an increase of eight percent over the estimate for 2017/18.

USDA predicts that a strong increase in yields will more than offset lower Pima plantings, to produce the largest crop since the 2012/13 season. USDA's August supply and demand forecast placed Pima output at 779,000 bales (480 lbs) or just below 170,000 tonnes. Stocks, which had reached a low point at the conclusion of the 2016/17 campaign, recovered significantly during 2017/18 and are predicted to have doubled by the end of the coming season.

Egypt's recovery in output has seen a significant shift in the varieties cultivated: the recent rise of Giza 94 has been consolidated in the long staple sector, and in extra-long staples, Giza 96 looks set to emerge in the season ahead. The upturn coincides with ambitious plans, outlined by the Chairman of the Holding Company, to modernise the ginning and textile operations held in the public sector.

The anticipated further decline of the Chinese long staple crop reflects in microcosm some of the issues

faced by the country's cotton sector as a whole. Foremost amongst the challenges to be confronted is perhaps that posed by the need to mechanise the production model, without prejudice to fibre quality. Our contribution from Changzhou Keteng provides some interesting insights in this regard.

Indian long staple output continues to fall well short of local consumption. The improvements of upland yields during the early part of this century, and this season's sharp increase in Minimum Support Prices, would seem likely to militate against a shift in producer preferences toward long staple varieties. Moreover, at the time of writing, rainfall is lacking in those states (Tamil Nadu, Karnataka and Telangana) in which long staple cultivation is concentrated.

On the demand side of the equation, consumption trends are, as ever, difficult to discern with any confidence. Very little exists by way of statistical information relating specifically to long staple consumption and one is frequently left to extrapolate on the basis of such production and foreign trade data as are available.

Despite the ostensible attractiveness of long staple prices alluded to above, our forecasts imply a modest downturn in world long staple consumption. At this early stage, forecasts are mostly maintained, but a small reduction is shown for Pakistan, where competition from synthetics such as Tencel is mentioned, and China, where the trade conflict may impinge on consumption of American Pima.

At this early stage, world production is thus forecast to modestly exceed consumption during the season ahead. Whether the long staple sector can restore its customary price premium over the upland market remains to be seen.

World LS Output (tonnes)

	2017/18	2018/19	2018/19 v 2017/18
United States	152,407	169,607	11%
Egypt	61,188	90,000	47%
of which:			
ELS	3,744	4,000	7%
Giza 86	23,646	22,000	-7%
Giza 94	33,798	64,000	89%
Sudan	6,000	7,000	17%
Uzbekistan	2,000	7,000	250%
Tajikistan	1,500	1,500	0%
Turkmenistan	26,000	26,000	0%
India	96,900	90,000	-7%
Peru	5,000	5,000	0%
China	70,000	60,000	-14%
Israel	12,000	8,000	-33%
Spain	4,000	5,500	38%
Total	**436,995**	**469,607**	7%

World LS Consumption (tonnes)

	2017/18	2018/19	2018/19 v 2017/18
India	165,000	165,000	Unch
China	155,000	150,000	-3%
Pakistan	35,000	30,000	-14%
Egypt (ELS, G86, G89)	25,000	25,000	Unch
Bangladesh	13,500	15,000	11%
United States	6,532	6,532	Unch
Latin America	12,550	12,550	Unch
Europe (inc. Turkey)	22,000	22,000	Unch
South East Asia	13,500	13,500	Unch
Others	3,000	3,000	Unch
Total	**451,082**	**442,582**	**-2%**

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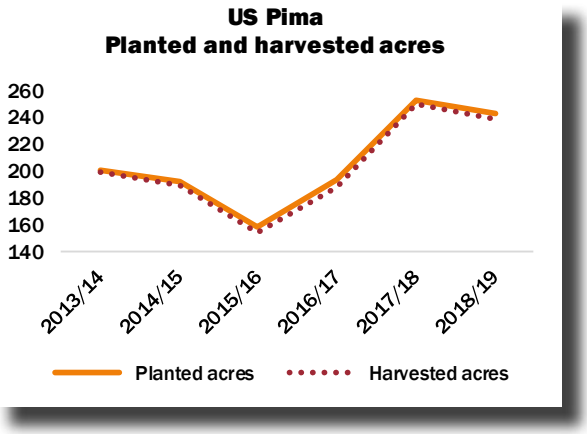
Pima fundamentals and the season ahead

Ernie Schroder,
CEO, Jess Smith and Sons

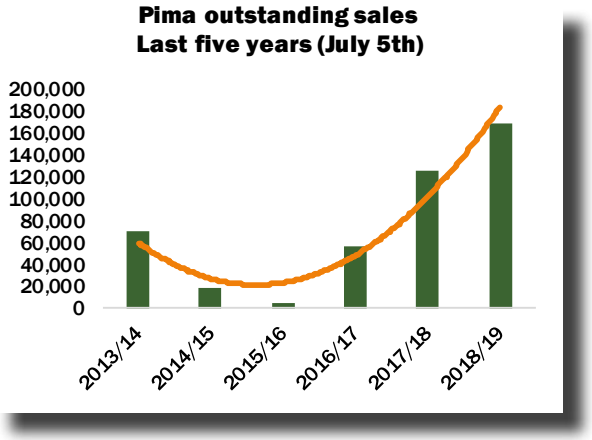
US Pima

At present, with all the external forces pressing on the commodity space, we will, without hubris, attempt to review the current US Pima fundamentals and give our best assessment of what can be expected in the season ahead. In our review, we will be looking at the last five crops, from 2013/14 to 2017/18, in order to determine how we think the 2018/19 Pima crop might fare.

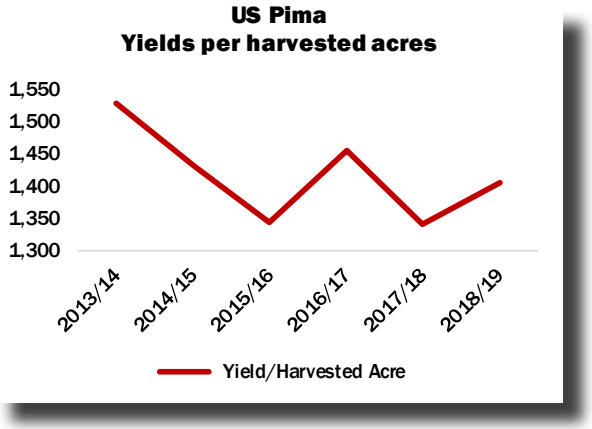
As can be seen in the chart, US Pima plantings fell from the 2013/14 to 2015/16 crop years, but began to rebound in 2016/17, continuing the upward trend until last year, only to fall off slightly in the current 2018/19 season. Better expected yields on account of much improved growing conditions this year should erase any negative impacts to production, which is presently predicted by the USDA to be 700,000 480-lb bales, unchanged from last year.

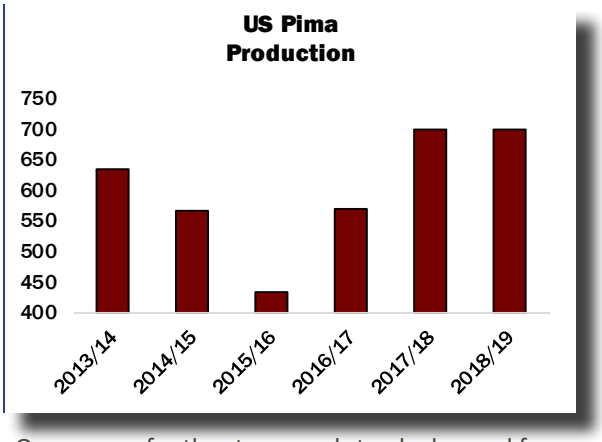


Meanwhile, USDA currently predicts that US Pima exports will fall by 30,000 bales (of 480 lbs) to 600,000 bales in total; however, it is much too early to carve this estimate in stone, and there are already signs that the total figure might be too low. One such indicator can be seen in the chart of Pima outstanding sales, as recorded at the beginning of July, for the last five years: by July 5, 2018, the 2018/19 crop year was way ahead in terms of



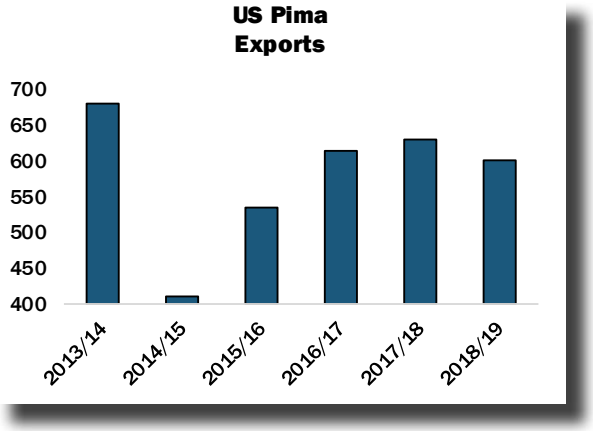
outstanding sales of US Pima, showing 169,600 "running" bales sold compared with only 124,900 bales sold at the same moment last year. This strong demand for Pima, so early in the season, undermines the notion that exports will be down this year. The USDA's cautiousness, though, may be informed by the current trade battles between the US and China, which is the largest importer of US Pima. Another indicator of demand strength is the firm price action seen over the last two months. 2017/18 "old" crop Pima prices have fallen by two cents, but the 2018/19 "new" crop price has held strong, and is, somewhat surprisingly, currently quoted at a cent higher than "old" crop.





One reason for the strong and steady demand for US Pima is that while extra-long staple cotton used to be confined to luxury items like fine sheets and custom shirts, today we see US Pima used in everyday products, such as jeans, t-shirts and socks, where its plush feel is gaining appreciative fans. Supima, the branding group for US Pima, reports nearly 150 brands around the world selling US Pima products. In response, mills, especially in China, that have never spun extra-long staple cotton before, are starting to build capacity and spin US Pima into fine yarns.

The US Pima crop currently appears to be in good condition, according to anecdotal accounts from growers, who are reporting that plants "look better than last year." This gives us confidence that the USDA's production estimate should be met.

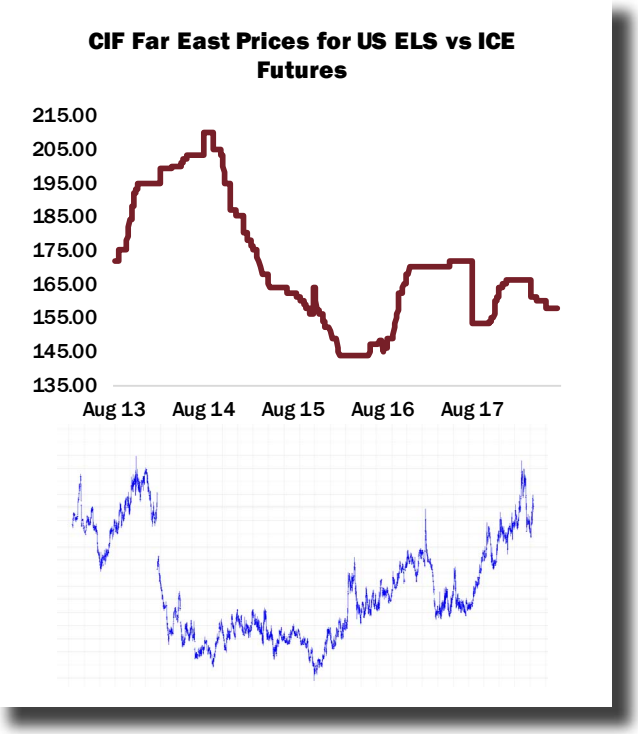


Looking at the current balance sheet, using USDA estimates, we see ending stocks building since an interim low of 64,000 (480-lb) bales during the 2016/18 crop season, with 107,000 bales for the 2017/18 season, and 177,000 bales predicted for 2018/19. This increase in stocks has pushed 'S/Us' (stocks to use ratios) for the 2018/19 crop up to 28 percent from this year's rather tight 16%. Normally, this upward movement could be a cause for concern; however, 28 percent isn't an especially burdensome S/U. Moreover, as mentioned above, prices are holding strong, and demand, as seen in overall sales, is very good.

Besides using the S/U ratio to judge whether supply is tight or sufficient, and hence to forecast future price movements, we also have our sister market for upland cotton and ICE futures (see adjacent chart) to help us forecast forward prices. As the chart shows, there is a reasonable correlation between ICE futures and US Pima CIF Far East Asia prices. Meanwhile, higher and lower

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Beg. Stocks	187	125	259	136	64	107
Production	634	566	433	569	700	700
Consumption	23	25	25	29	30	30
Exports	680	410	534	614	630	600
Ending Stocks	125	259	136	64	107	177
Stocks/Use	18%	60%	24%	10%	16%	28%

upland prices usually move more or less in tandem with US Pima prices. However, in the last year, we have seen ICE futures climb to highs in the mid-90 cent area, while US Pima prices have gone sideways. The higher prices on the ICE futures platform might explain why US Pima prices have held as steady as they have, and with new crop quoted higher than old, despite the build-up in stocks.



Forecasting where the 2018/19 US Pima market is headed is made more difficult by the ongoing trade dispute between China and the US, as cotton is one of the commodities falling under tariff restrictions. There is a case to be made that the effect on US Pima will be less significant than that on upland due to the Chinese quota structure. Even if that proves untrue, however, and in the short term we experience some pain, over the longer term, trade flows will adjust to the new reality, and cotton will find a way to be spun into yarn, because ultimately, demand for raw cotton is created downstream, whenever someone buys a shirt or pair of jeans.

Using the above as our guide, we expect that if the tariffs continue through the 2018/19 season, the US Pima market will trade at similar prices to those seen in the 2017/18 season. However, if China and the US can get back on good terms, and the tariffs are removed, we think the fundamental forces acting on the upland market are so strong that ICE futures will move to new highs, supporting US Pima prices to similar, and probably higher prices than last year.

The outlook for US Pima

Jarrell Neeper, President, Calcot

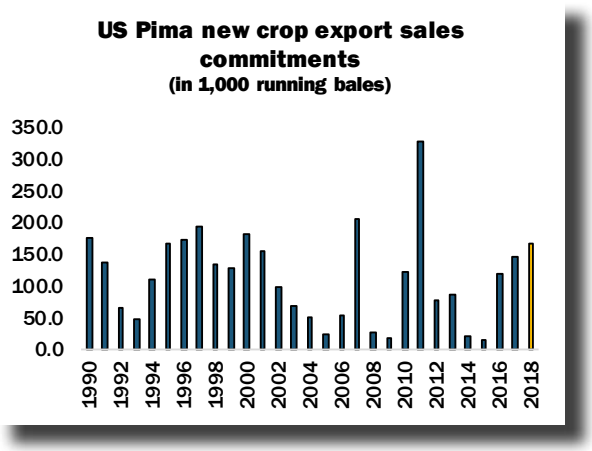
The 2017/18 crop year was mildly disappointing for US Supima growers. US yields were down almost 7 percent from the previous year despite a nearly 15 percent increase in Arizona yields, year on year. Ironically, California growers were hurt by too much water as the wet winter delayed plantings and encouraged insect infestations, primarily lygus. Luckily, overall California yields were not as bad as originally feared.

The other disappointment for Supima growers was a slowing offtake as the season wore on. Despite a good start and relatively strong sales through the end of January 2018, sales trickled off to the slowest rate of growth since the 2011 crop year.

Helping to compensate for poor yields, the early sales pace enabled prices to appreciate during the crop year. Far Eastern quotes for American Pima moved from $1.53/pound in August to a high of $1.66/pound by the middle of December. The quotes stayed at that level until the end of March when reality finally set in and Cotlook dropped the quotes to $1.61/pound. They have since dropped another three cents per pound, placing them much closer to actual trading levels.

At the time of writing, as we approach the new crop year beginning August 1, there are signs of encouragement as new crop sales are at their best level since the beginning of the 2011 crop year. For the week ended July 12, 2018, those for delivery after August 1 have climbed to 166,800 running bales. China, India and Pakistan account for the bulk of these sales. With another two and a half weeks to go, that number could climb closer to 180,000 plus bales.

From a crop perspective, things are much better than a year ago, especially in California. Water allocations



were not as generous as they should have been so acreage did not climb to the levels suggested in USDA's prospective plantings report, falling short by an estimated 20,000 acres. Still, the weather has been nearly ideal during the growing season and insect activity has been reported as almost non-existent. Mid-July temperatures are quite warm so it's possible some fruit shed may take place, but overall, growers are satisfied. Yields are more mixed in Arizona, New Mexico and in and around El Paso, Texas; however, overall yields look to be slightly above average.

Calcot projects a crop estimate of 738,000 statistical bales versus 700,000 in 2017. California production is expected to be higher by 48,000 bales with slight decreases noted in the other three states.

US Pima production

(in 1,000 480lb bales)

	2017/18	2018/19
Arizona	30	26
California	630	678
New Mexico	14	12
Texas	26	22
Total	700	738

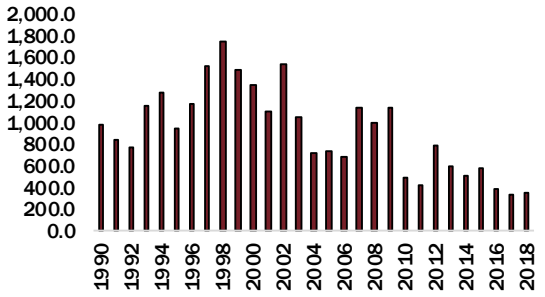
USDA projects 2017 ending stocks at 107,000 bales, which is up from 64,000 bales a year ago, and stocks may very well, be slightly higher than that as meeting final year end export shipments of 630,000 bales looks a bit suspect. Still, stock levels are not overly burdensome.

Calcot believes that 2018 exports will be 680,000 bales, the largest since the 2013 crop year when they were the same. Assuming that's the case, then stocks should be very little changed from this year.

Crop Year	2012	2013	2014	2015	2016	2017 Est	2018 Proj
Beg Stks	269	187	125	259	136	64	107
Prod	780	634	566	433	569	700	738
Imports	4	7	3	3	2	3	0
Tot Sup	1053	828	694	695	707	767	845
Domestic	22	23	25	25	29	30	30
Exports	844	680	410	534	614	630	680
Tot Off	866	703	435	559	643	660	710
End Stks	187	125	259	136	64	107	135

Stocks are not overly burdensome on a global scale either. Subtracting out Chinese estimates from total world estimates shows that beginning stocks in both 2017 and projected stocks in 2018 are historically very low.

World less China beginning stocks. Extra-fine cotton



Source:: ICAC: (1,000 480-lb bales)

Statistics from the ICAC (the only publicly available aggregation of world ELS data), suggest that world minus Chinese beginning stocks of extra-fine cotton are estimated at 354,000 bales, up only slightly from 2017 when stocks were estimated at 335,000.

China is an important player in the world ELS market. In the 2016 crop year, production of ELS cotton in Xinjiang Province was just over 900,000 bales, which contributed to a large build-up of supplies inside China. Fortunately, very little has been exported in recent years so the impact on world pricing appears minimal. This justifies looking at the world supply/demand picture without the influence of Chinese stocks.

What does give observers and US suppliers heartburn, though, is the recent tariff squabble with the US. China is a very reliable buyer of US Pima due to the licensing program with Supima. In the five-year period covering the 2012-2016 crop years, China was the largest customer of US Pima cotton, four of the five years and the second largest in the fifth. The share of US exports going to China averaged almost 46 percent. In the 2017 crop year, the share has dropped a little but still accounts for almost 37 percent of US Pima purchases.

In response to the US increasing tariffs on steel and aluminum and electronics imports from China, the Chinese hit back with a 25 percent tariff on agricultural goods, including cotton. Now the US is suggesting it might just raise tariffs on all $500 billion or so of Chinese imports.

There are ways around the Chinese tariff but that's not really the answer to the problem of increasing protectionism. And it certainly won't make US growers feel much better in the short term. So, despite the relatively constructive US and world balance sheets, prices could enter a period of uncertainty, which generally means negative price movements, until clarity of sorts is realized.

To summarize, Calcot believes that US production in 2018 will be 738,000 bales and exports 680,000 bales, leaving a pretty healthy balance sheet. However, the US/Sino trade spat is a major cause of concern which could potentially put the export estimate in serious jeopardy, unless the situation is resolved in relatively short order.

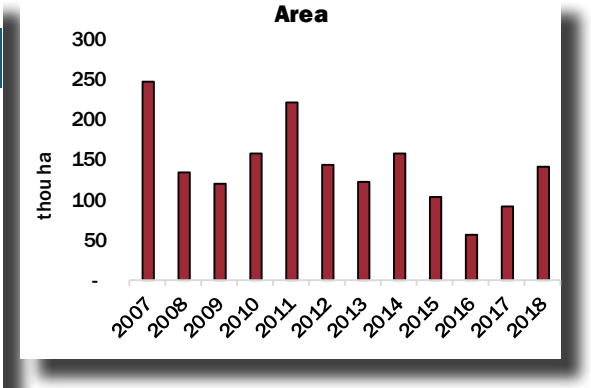
Egypt

Ray Butler,
Managing Director,
Cotton Outlook

According to the Cotton Arbitration and Testing General Organisation (CATGO), the final area sown to cotton this year is in the region of 336,000 feddan (virtually acres). The area sown will thus be the largest since the 2014/15 cotton season. The accompanying table compares the data released by CATGO for this year with those published for last year in the April 2018 edition of the 'Egyptian Cotton Gazette'.

Egyptian sowings

in feddan (1 feddan = 1.038 acres)		
ELS varieties:		
	2017	**2018**
Giza 45	58	-
Giza 87	3,079	-
Giza 88	832	-
Giza 92	5,075	8,662
Giza 96	5,369	9,092
Subtotal	14,413	17,754
Long staple varieties:		
Giza 86	67,977	88,134
Giza 90	8,460	5,358
Giza 94	110,352	196,426
Giza 95	15,352	28,085
Subtotal	202,141	318,003
Total	216,554	335,757
Others	-	250
Grand total	**216,554**	**336,007**

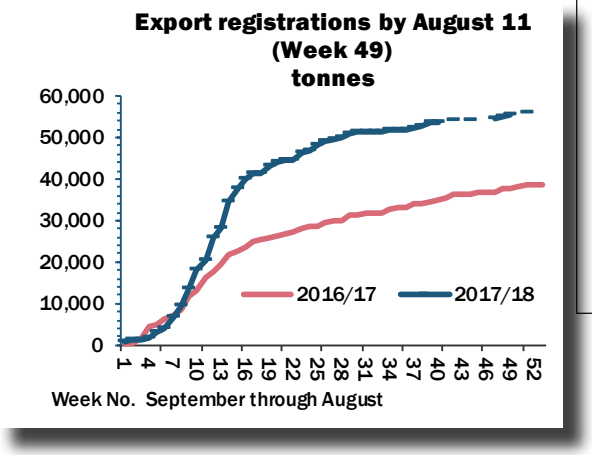


The dominant variety today, Giza 94, has been sown on substantially more than twice the area devoted to Giza 86 (which covered by far the largest area prior to last year). Another observation is that the area under extra-long staple styles has expanded.

Based on average yields over the past two or three seasons (depending on the variety), Egypt

might be expected to produce some 64,000 tonnes of Giza 94 and 22,000 of Giza 86, with output of extra-long staples (Giza 96 and Giza 92) increasing modestly, to slightly over 4,000 tonnes. This would give a combined total of, say, 90,000 tonnes (the figure shown in our World Long Staple Production table). The balance of output (almost 10,000 tonnes) is attributable to Upper Egypt varieties (most of which fall short of the typical long staple parameters and are mainly consumed domestically).

Egyptian export registrations (for shipment by August 31, though this date is typically extended by one month) had risen by August 11 to over 55,500 tonnes, or nearly half as much again as by the same date a year earlier. Sales registered for India, the main buyer, had increased to 31,000 tonnes, versus just over 17,000 tonnes a year earlier. Registrations to India this year of Giza 94 alone were over 18,000 tonnes.



The increase in exports has resulted in an expanded import requirement for upland cotton to meet the spinning requirements of the domestic industry. From August through April (the latest month for which data are available) imports exceeded 87,000 tonnes, which represented a year-on-year increase of almost 18 percent. Most of the gain concerned imports from Greece, Sudan and Benin. Substantially less cotton than a year ago was imported from the United States.

Egyptian mill consumption in 2017/18 is estimated at some 140,000 tonnes, which would be an increase of eleven percent from the previous season. This would include perhaps 25,000 tonnes of long/extra-long staples, a few thousand tonnes from Upper Egypt and the balance – somewhat over 100,000 tonnes – of imported lots.

Egypt to restore its global position among extra-long staple cotton producers

Dr. Ahmed Moustafa Mohamed,
Chairman,
Cotton & Textile Industries Holding Company

The Egyptian Holding Company for Cotton and Textile Industries has prepared a comprehensive restructuring study for 25 affiliated companies, in collaboration with an international consulting office (Werner).

This study was carried out over a year and a half, with the objective of reviewing and analyzing the current situation (both domestic and international) and setting out recommendations consistent with international standards and best practice in the cotton and textile sectors. In addition, it aims to exploit Egyptian cotton's competitive advantage to the maximum, by increasing the area cultivated with long and extra-long staple cotton, in coordination with the related ministries and authorities. In this way, Egypt can restore its international standing among ELS cotton-producing countries.

The seven-year implementation period for the restructuring plan started in February 2018 and will end in 2024. The dimensions of the plan, which will comprise four phases, are: operational/technical, marketing, human development and financial.

The key objectives of the plan are highlighted as follows:

1. **To restore Egypt's annual cotton production**. In the 2016/17 season, Egyptian cotton production fell to its lowest level, following a reduction of cultivated area, as farmers refrained from cotton cultivation and preferred to produce other crops that offered better profitability, as shown in the accompanying table.

Production		Cultivated Area (Feddan) (Approx. Acre)	Season
Ton (000)	Kantar (000)		
54	1,072	248,820	2015/2016
36	710	131,605	2016/2017
69	1,377	216,554	2017/2018
110	2,200	338,000	2018/2019(Planned)
130	2,600	400,000	2019/2020 (Expected)

2. **To support the Cotton Research Institute.** (Ministry of Agriculture) in developing new high-yielding varieties offering good yarn specifications. The new Giza 96 seed is expected shortly to become a commercial variety. This is an extra-long staple variety, with high yarn specifications, which will fulfil spinners' expectations and meet their various needs.

3. **To reform the public sector ginning mills**. The number of public sector ginning mills, currently 25, is being reduced and reconfigured into 11 facilities. That number includes a newly-established ginning mill located in Fayoum Governorate. This new unit will be assigned specifically to Upper Egypt (long staple) cotton.

The reconfigured 11 ginning mills, including the newly established factory, will be equipped with the latest ginning machinery and technology. The newest one has already received new machinery from Bajaj Steel Industries in India. Its launch is

scheduled for September 2018 in order to be ready to receive output from the 2018/19 cotton season.

In this context, cotton lint will have 'zero contamination' and will be produced in universal density bales in accordance with international specifications and tested before pressing by the latest High Volume Instrument (HVI) technology.

In addition, a tracking system will be applied, using a bale identification system that entails tagging a barcode on to the cotton bale. This barcode identifies all the technical specifications of the cotton, as well as comprehensive data detailing the owner, the variety, area of cultivation, weight, date of ginning and any other data required. This information will be linked to the General Authority for Arbitration and Cotton Testing (CATGO) in Alexandria.

4. **To reform the public spinning and textile companies.** These factories are to be developed and upgraded with the latest technology to replace the existing machines that have not been modernised for over 30 years, with negative effects on both the quantity and quality of yarn and fabric produced.

   In addition to enhancing the quality of traditional textile goods, the intention is to offer new products, such as denim and low-cost fabrics.

   The six-year reform of the spinning and textile sectors will run from early 2019 until 2024 and cost approximately 1.2 billion US dollars. By the end of this plan, it is anticipated that spindleage and yarn production will have doubled, while looms and fabric production will rise to several times the current level. In addition, new technology will have been introduced into the dyeing and finishing processes.

5. **The human factor** will contribute to the success of the restructuring plan. Thus, more attention will be given to training and improving the capacity of manpower to cope with this new phase, as well as reform of marketing policies and fashion centres.

More effort needed for Egyptian cotton to regain its market share

Mohamed Hassan,
Director,
Kea Impex

There is no doubt that Egyptian cotton has faced many challenges in the last few years, which have had a negative effect on its market share. The two biggest problems were irregularity in both production and quality, especially in the 2014/15 and 2015/16 seasons.

Then, as regards both issues, a notable recovery took place in 2016/17 and 2017/18, alongside the appreciated efforts of the Egyptian cotton traceability project and DNA authentication test. All this resulted in a fair reallocation of brand sales for Egyptian cotton products, which was reflected in the equivalent purchase of Egyptian raw cotton.

Despite that, Egyptian cotton's market share is still below the level it deserves, and much effort will be needed to reach that level. Overcoming the problems of production and quality will not be enough, as there is another big challenge facing Egyptian cotton buyers all over the world, namely the instability and undefined nature of Egyptian cotton price levels, especially over the past six or seven years.

"What is the expected price level for Egyptian cotton in the new season?"

This always appears to be a question that has no answer. A reply is not forthcoming until the season starts and even then one must expect huge variation and gaps in price throughout the season!

Both the unstable price level and/or big changes in price through the season are making Egyptian cotton a risky commodity in which to deal.

Since, as I believe, there is "no sale without a buyer", so we as sellers have always to match buyers' requirements, in which price is the main factor.

What the buyer of Egyptian cotton needs is:

- regular supply in both volume and quality, which is almost obtainable now;
- competitive and narrowly changing price levels.

I believe that Egypt has to work on ensuring the above factors for a minimum of three consecutive years, in order to regain the share of the world market that we deserve. In order to reach our target, two main elements of the cost chain (besides a reasonable margin of profit) are in serious need of adjustment.

1. **Farmers' asking price:** there is no logic in farmers insisting on obtaining triple the price, whatever the increase of planting costs, especially after a good recovery of yields, which have almost double compared to 3/5 years ago. Farmers have no additional burdens to bear after selling their cotton, in contrast to shippers, who face many costs and risks until the moment of sale.
2. **Bank lending rates are too high:** we cannot talk about adjusting costs while lending rate for financing our trade business is an average of 22 percent annually as was the case last season or even an average of 20 percent, as is forecast for the coming season.

Even the substantial devaluation of the Egyptian currency following the flotation of the pound was not sufficient to absorb the increased costs of exporting the commodity due to the above two factors.

Action is needed by the government to work on redefining farmers' asking prices, as well as a special discounted lending rate for Egyptian exporters.

In addition, work is needed to minimize price disparities, which may require Egyptian exporters to change their business model. They should stop holding long-term positions and seeking profits that are difficult to obtain and result in a slowdown of demand, with the price gap ultimately paid at a later stage to the financing bank!

Lastly, the above measures are urgently required in the new season, which will see production rise by almost 60 percent. Otherwise, ending stocks could be historically high.

2018 Xinjiang Long Staple Outlook

Xinjiang Yinlong International Agricultural Cooperation Co., Ltd.
E-commerce Information Department

Xinjiang long staple production in 2018/19

Area and production forecast

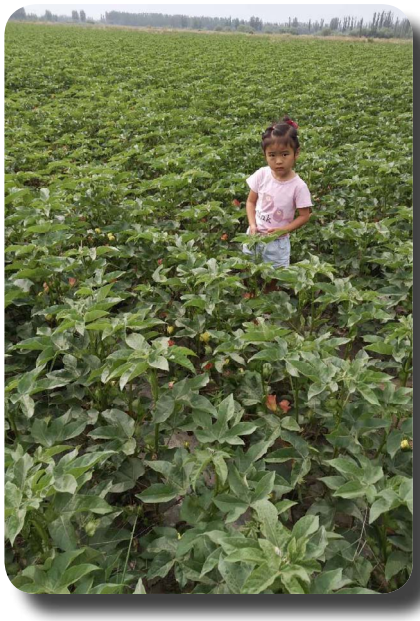
The cultivated area of Xinjiang long staple cotton has declined sharply (by 20-30 percent, to around one million mu or 66,667 ha) in 2018/19, due to the crop's relatively low returns compared to those from upland cotton during the previous season. The root cause of this price differential is the consistently weak downstream demand for long staples over the last two years, which is already felt at the upper end of the long staple supply chain. We predict that output in 2018/19 will be around 65,000 tonnes.

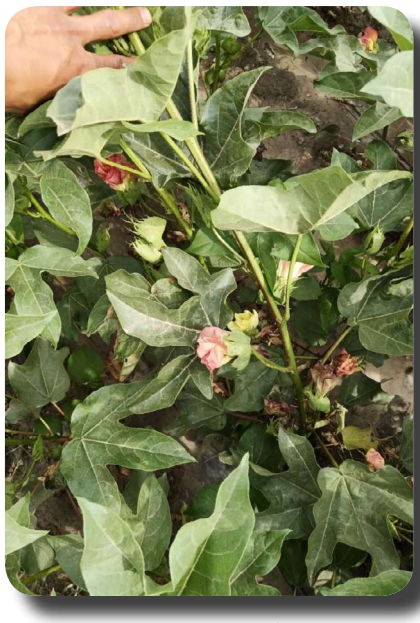
Crop development

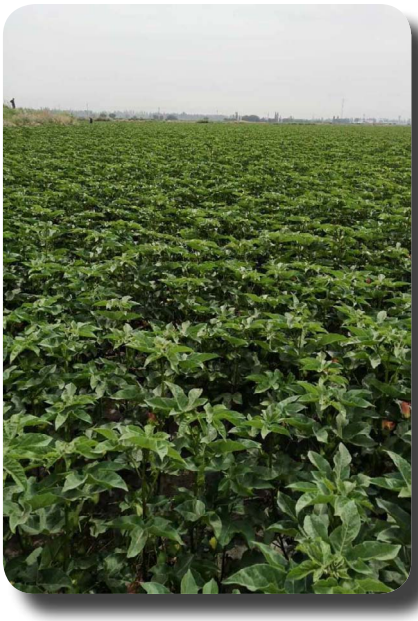
Although the development of long staple cotton plants was briefly affected by the high winds and low temperatures witnessed in most regions of Xinjiang in early May, widespread damage was avoided as temperatures recovered in the following two months. The crop's growth in southern Xinjiang was only slightly damaged by the adverse weather. At the time of writing, the long staple crop has entered the topping stage and continues to make good progress.

Quality issues and trends

Despite improvements in such quality parameters as Micronaire and strength in 2017/18 compared to







the previous two seasons, recent achievements in fibre length are still considered 'unsatisfactory' (fibres with a length of over 37mm account for less than 30 percent of the total). Moreover, the trash content (normally at two to three percent) has also been higher than average. In order to make the lint suitable for spinners of fine count yarns, it will need to undergo additional processing to remove the foreign matter. This will increase costs substantially and affect production and delivery schedules.

For 2018/19, the local administration in Xinjiang has begun a process of extensive structural reform for the supply side of the long staple industry, guiding growers to optimise planting and to select good quality, high-yielding varieties to meet market requirements. Farmers are also being encouraged to explore an integrated business model that combines production and sales, and the local government is planning the establishment of a 'Cotton Industry Alliance' in the main producing areas of Shaya County, Awati County, Kuche County, Xinhe County and Aksu City. A total of 1.5 million mu (including 500,000 mu in Awati County) of 'order-based planting' has been implemented, as has a strategy for promoting the 'Fenghai' and 'Cotton Industry Alliance' long staple brands. It is our belief that this autumn, we will see better yields and higher quality from crops harvested this season.

Xinjiang long staple consumption in 2017/18

Production of Xinjiang long staples over the last three years (2015/16, 2016/17, 2017/18) has been 140,000, 200,000 and 80,000 tonnes, respectively, with consumption ranging from 120,000 to 150,000. The gap has mainly been filled by crops imported from Egypt, Israel, Spain, and especially US Pima, which now accounts for around 80 percent of China's imports of long staples. USDA data show that China's Pima imports during the past two seasons (August/July) were 42,000 and 33,000 tonnes, respectively. In 2017/18, by mid-July, about 50,000 tonnes had been shipped and 3,500 more awaited shipment.

Xinjiang long staple supply and demand and inventories in 2017/18

Latest inspection data reveal that around 80,000 tonnes of 2017/18 Xinjiang long staple lint have been ginned so far, while the carryover volume from the previous season was 80,000-90,000 tonnes, and imports (including US Pima shipped and other origins) are estimated at more than 50,000. The total supply this season is therefore around 220,000 tonnes, which is ample to satisfy domestic consumption.

At the same time, 2017/18 long staples have been moving to market relatively slowly. We can find new crop cotton only in the warehouses of the larger-scale enterprises in Shandong, Jiangsu, Henan and Hubei. The scope for price negotiation is generally considered to be very small. On the one hand, freight costs have remained high: most ginners require that spinners procure supplies from Xinjiang and arrange their own freight eastwards, with the consideration that long staple supply will be under pressure due to decline of output. On the other hand, most traders in the 'mainland' still have stocks from the 2015/16 and 2016/17 crops available for purchase.

Xinjiang long staple market trends in 2018/19

In the current climate, the market price of Xinjiang long staples has been falling. The asking price for Type 137 lint is 25,000 yuan per tonne in Xinjiang, and 600 yuan more in 'mainland' warehouses, but most spinners are still holding off from making purchases and waiting for further developments in the market. Over the longer term, the planned transformation of the domestic cotton textile industry should mean that the proportions of high-count combed and carded yarns will continue to increase, and long staple consumption will also grow rapidly so the short supply situation will remain. Given the decline of Xinjiang long staple area in 2018/19, plus the decrease in output of Egyptian Giza, and the Sino-US trade war, long staple imports may well be subject to unforeseen changes, allowing scope for the development of the domestic long staple sector in the future.

Xinjiang Long Staple Analysis

Changzhou Keteng Textile Co., Ltd.

Long staple balance sheet and the changing trend of ending stocks

Ever since 2014, the confidence of China's textile industry has been recovering gradually, High-count yarn has been a particular beneficiary of the improved outlook: its international competitiveness has been maintained and strengthened, and the long-term growth of China's consumption of long staples has appeared more certain.

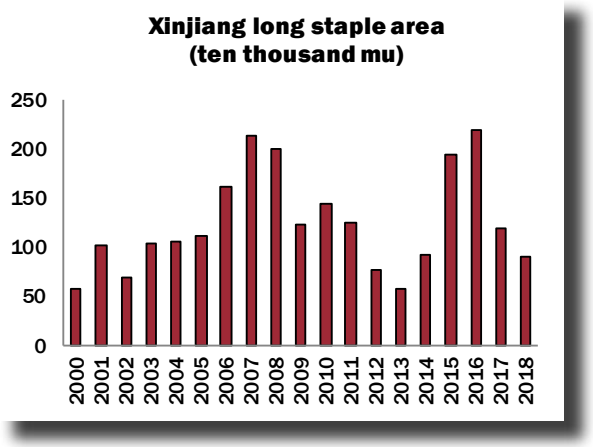
However, in the past three seasons, upland cotton prices have been increasing year on year, and producers have managed to achieve better incomes as a result. At the same time, serious labour shortages have emerged during the long staple harvesting period, so domestic long staple planted area and output have declined sharply, which has led to the gradual shrinking of ending stocks, as the chart below shows:

10,000 tonnes	16/17	17/18	18/19
Beginning stocks	5.8	12.1	6.5
production	19	7.6	8
imports	4.2	4.9	5.5
Consumption	16.7	18	16
Ending sStocks	12.3	6.6	4

Note: domestic balance sheet during the past three years includes 2018/19 forecast. However, it is possible that the figures for imports and consumption will be subject to revision owing to the uncertainties arising from the Sino-US trade war.

Domestic supply and demand forecast for 2018/19

2018 planted area and yield forecast



Source: China Association of Agricultural Science Societies. Cotton branch

The area on which long staples have been cultivated in Xinjiang in 2018 is estimated to be 850,000/900,000 mu (56,667/60,000 ha), which is about 25 percent lower than last year. Around 800,000 mu are located in the main producing region of Awati County, and the forecast of overall output is roughly unchanged from 2017 at 70,000/80,000 tonnes. Yields in some regions were significantly reduced last year (by as much as

50/60 percent in certain areas) due to adverse weather during the growing period, resulting in an unexpectedly low output. However, climatic conditions this year have been relatively normal, so yield is expected to recover to average levels, assuming no disastrous weather event in the next three months, and this might make up for the decline in area.

Crop growth

Despite some damage to fields and plastic mulching film caused by high winds early in the sowing period, losses to the crop were restricted by a successful and timely replanting campaign. However, the pace of crop development has been relatively slow since then, in consequence of low temperatures and wet weather. At the time of writing (mid-July), plant growth was about one week behind last year's schedule, but was generally proceeding well under high temperatures, with plants at the boll-setting stage.

Domestic demand trend

Overall, demand for domestic long staples is showing a steadily increasing trend. From the spinner's point of view, a comparison between the movement of Xinjiang long staple prices and those of US Pima, the two main sources of supply, is unavoidable. When output of Xinjiang long staples increases, as seen in 2016/17 for instance, prices for US Pima fall accordingly. However, while price is a significant factor influencing demand, it is not the only one, as the different growths have different quality and performance profiles, each with its own merits.

For example, the mechanized processes used in the production of US Pima clearly allow for consistently superior foreign fibre control. However, a limited number of farms and ginning mills producing long staples in Xinjiang are now also able to generate optimal results across the whole process from sowing to ginning. Many of those facilities achieving better control of foreign fibres can command a premium as high as 4,000/5,000 yuan per tonne.

A large-scale domestic spinner has commended producers of Xinjiang long staples on recent improvements, but indicated that the only factor that limits use of Xinjiang long staples, and holds back prices, is the presence of foreign fibres. This makes it impossible to meet the requirements of high-end orders, even if in general fine count demand is unaffected. This is obviously a problem that Xinjiang long staple producers have to confront.

By contrast, while Pima performs better in terms of cleanliness and spinnability, the incidence of honeydew in certain seasons can cause significant problems. Moreover, against the background of the trade war, the cost of Pima is now subject to great uncertainty. Even if spinners have access to 'processing trade' import quotas, if their fine count yarns are being used in downstream products destined for the domestic market, they will have to pay higher tariffs, which will affect the relative price of the two sources of supply.

Meanwhile, another issue that cannot be ignored is whether the trade war will result in an overall decline in final consumption of cotton goods, which would involve a decrease in orders for high-end yarn. At this stage, it is impossible to know.

Future prospects

All in all, we can see that there remains a supply gap for long staples. In recent years, the supply from Egypt has failed to consistently meet our spinners' needs for fine-count production, due to quality setbacks, high prices and export restraints. As a result, more spinners have turned to US Pima to fill the gap.

The principal reason behind the decline in area devoted to long staples in Xinjiang is the poorer returns they offer in comparison to upland crops, especially since picking costs have been increasing year on year. The transition from handpicking to machine harvesting is a systematic process that involves changing to different seed varieties and ginning processes as well as harvesting methods. The process of mechanisation in Xinjiang's upland cotton sector has been under way for some considerable time and is now fairly well advanced, whereas the transition is slower and more difficult for long staple growers in the region. However, their higher harvest costs, labour shortages and relatively poor efficiency mean that machine-picking will certainly become a future trend. At present, there are already some leading growers who have started relevant trials, as our survey results show.

Varieties

Last year, growers conducting a machine picking trial on a 1,000-mu area of long staple cotton found that about 80 percent of the seed cotton produced had high levels of contamination and low cleanliness, and had also suffered declines in length and strength. The reasons proposed for these outcomes included the fact that the trial variety failed to meet the crop height required by the machine picking process and was insensitive to defoliant. In addition, the high trash component, fibre viscosity, small cotton bolls, poor fibre length and strength have all been associated with the early use of defoliants.

Ginning issues

Another grower planted a pilot area of 600 mu with four varieties, one of which was extra-long staple (42/44mm) that produced a crop with low Micronaire and a 'wool-like' feel, meaning that it was not suitable for machine picking. However, no such problems emerged for the other three styles and the results of the trial suggested a cost reduction of 1.0-1.5 yuan per kilo for machine picking in comparison to hand picking. However, a further complication is that most of the existing ginning equipment is incapable of handling machine-picked long staple seed cotton. The cost to upgrade machinery for the purpose of processing mechanically harvested long staple cotton is estimated in total at between 20 and 30 million yuan. The cost is prohibitive for most enterprises in the short term.

In response to these problems, however, we propose the following as possible solutions.

1. **Industrial development:** State-owned bodies or large private enterprises could be prevailed upon to

set up further projects and then publicise the outcomes, so as to encourage further investment in long staples. The incentives are clear: savings of 1.5 yuan per kilo via machine picking could allow earnings to increase by 450 yuan per mu (without taking into account any loss of quality).

2. **Cooperation between seed companies, cotton producers and spinners to develop new cotton varieties:** If we look further ahead, long-term financing from investment bodies, such as state-owned support funds, could provide for more research and development of cotton seed varieties, the benefits of which would be exploited by the textile sector. This would solve the problem of the long payback period for return on investment.

3. **Xinjiang long staple branding:** to attract more resources into the industrial development process so as maximise the value of the end product.

In summary, we are optimistic about the quality and future performance of Xinjiang long staples. The climate in Xinjiang is suitable for long staple production and Xinjiang long staples demonstrate good results in terms of various quality parameters, including length, strength, Micronaire, uniformity and spinnability. We believe the potential is there for the large-scale cultivation and production of long staples in Xinjiang, provided those involved in production and distribution work together to achieve a consistent improvement of brand value, strengthening of consumption and enhancement of the competitive position of our fine count yarns in the global market.

Branding is the driving force of ELS cotton

Mr. I J. Dhuria,
Director,
Vardhman Textiles

Extra-long staple cottons (also known as ELS or extra-fine cottons) are a high-value, premium commodity with a reputation for superior quality and better spinnability. ELS cottons have a staple length of 1-3/18" or longer and enjoy the excellent fibre strength that is required to manufacture the fine-count yarns destined principally for top-quality textile products.

Boom in global cotton production coincides with decline in ELS cotton production

If we look at historical trends in global cotton production, we can see that in the early 80s, total cotton production was less than 15 million tonnes, of which about 950,000 tonnes or 6 percent were extra-long staples.

	Global cotton Production	World ELS Production	Share of ELS in total cotton
	(in million tonnes)	(in Thousand tonnes)	
1981-82	14.99	961	6.4%
1991-92	20.68	893	4.3%
2001-02	21.67	769	3.5%
2017-18	25.97	422	1.6%
Percentage Change in 2017-18 from 1981-82	0.73	-0.56	

Source: ICAC

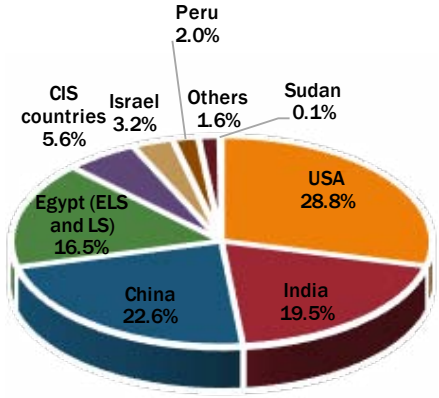
Today, global cotton production has boomed to 25.97 million tonnes per year, while the reverse is true for extra-long staples: annual ELS production has declined to less than 450,000 tonnes (as per the latest production estimates for 2017-18) and the current share of extra-long staples in global cotton production is a mere 1.6 percent.

Geographical distribution of ELS cotton

Production

The production of ELS cotton is now limited to just a few areas around the world. More than 85 percent of

Global ELS cotton production (Latest Five-year Average)



Source: ICAC

ELS production takes place in only four countries: the US, India, Egypt and China. So fine-count spinners are always looking to the dynamics of supply and demand in these four territories to inform their decision-making.

If we look at the history of ELS cotton production in these four countries from the early 80s onwards, certain trends emerge.

Firstly, Egypt's share of global ELS and long staple production has decreased drastically from more than 50 percent in 1981-82 to just 16 percent in 2017/18.

As a counterpoint, according to the most recent data, the Chinese share of ELS production has improved from 13 percent in 2010/11 to 17 percent in 2017/18.

The Indian contribution to world ELS stocks has been more or less constant over the time frame: about 17 percent in 1981/82 and 18 percent in 2017/18. However, in terms of volume, ELS production has dropped from 164,000 tonnes to 78,000 tonnes during the period, meaning that ELS production in India has more than halved in just under 40 years.

Meanwhile, significant growth has taken place in the production of US Pima cotton. Its stake has increased from a mere 2 percent in 1981/82 to 36 percent (now the largest share) in 2017/18. In terms of quantity, US Pima production has grown from 17,000 tonnes to 151,000 tonnes in the same period.

ELS cotton Production

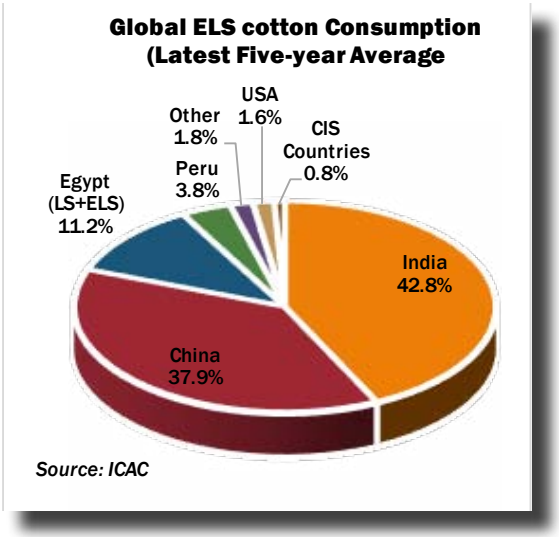
	World Total	Egyptian	US Pima	India	Chinese
1980-81	961	490	17	164	
1991-92	893	288	87	141	
2001-02	769	313	152	80	97
2010-11	485	133	110	63	125
2017-18	422	67	151	78	70

Percentage share in world ELS cotton

	World Total	Egyptian	US Pima	India	Chinese
1980-81	100%	51%	2%	17%	
1991-92	100%	32%	10%	16%	
2001-02	100%	41%	20%	10%	13%
2010-11	100%	27%	23%	13%	26%
2017-18	100%	16%	36%	18%	17%

Consumption

On the consumption front, more than 80 percent of ELS cotton is used by only two countries: India and China. Both of these cotton-producing economies have their own domestic supply lines for ELS cotton but cannot meet demand from local production alone. Therefore, they are dependent on other countries, mainly the US and Egypt, to make up the balance of the requirements of their markets.



Trade

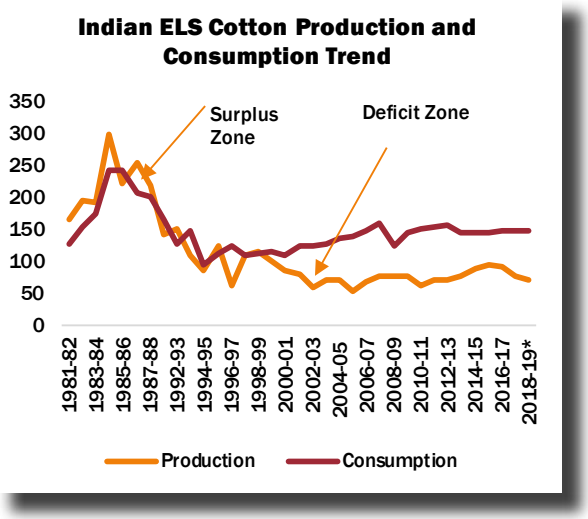
Of course, it is a simple process to extrapolate from the discussion of production and consumption above that the US and Egypt (in that order) are the primary exporters of ELS cotton to both India and China, the principal consuming markets.

The profile of ELS cotton use in India

Historically, India's consumption of ELS cotton has been focused on supplying textiles to manufacture the country's traditional garments. In the early 1990s, Indian production of ELS cotton was greater than the quantity consumed, but now the situation has been reversed. Since the introduction of Bt. seed to India in 2002/03, total cotton production has increased but the quantities of ELS cotton grown have diminished.

Currently, India consumes between 145,000 and 150,000 tonnes of ELS cotton a year, against a production figure of about 78,000 to 95,000 tonnes. The shortfall of 60,000 to 70,000 tonnes is made up by imports.

However, if we look at the at the data relating to fine-count consumption available from the Office of the Textile Commissioner of India, we see that India produces about 180,000 tonnes of fine-count yarn (60's and above), which requires almost 250,000 tonnes of ELS cotton lint. Therefore, it is assumed that some cotton is 'over-spun' to meet the deficit.



Why is India dependent on ELS imports?

The simple fact is that domestic supply cannot meet demand in India; however, quality considerations play a part too.

In addition to its suitability for spinning higher counts, ELS cotton from particular origins offers certain advantages for the finished product that cannot easily be reproduced using cotton from elsewhere. For instance, Egyptian cotton lends a unique lustre to the finished textiles, while growths that are picked mechanically, such as US Pima, Israeli Pima and Spanish ELS, produce a contamination-controlled end product.

Furthermore, certain brands request particular growths for use in the manufacture of their products. For instance, many clothing and home textiles lines use a Supima tag as a marketing device and a mark of quality for their customers.

United States and Egypt – main sources of ELS supply

Egypt and the United States have been India's main suppliers of ELS cotton for many years. Over the last five seasons, imports from the US have averaged about 32,000 tonnes and those from Egypt about 16,000 tonnes.

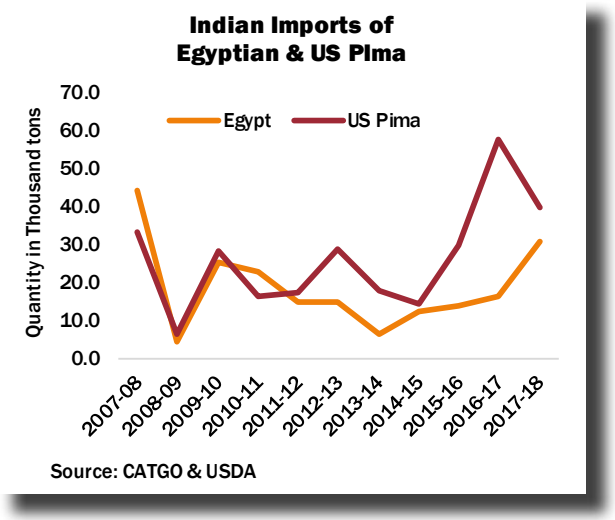
With production of ELS cotton in India likely to remain range-bound, and consumption consistent or increasing as the markets grow for branded goods and home textiles, the country's dependence on the US and Egypt for supplies of ELS shows no signs of diminishing in the years to come.

Egypt

However, if we look at the trends for imports from these two countries over the last ten years, we see that Indian imports of Egyptian cotton have fallen overall.

A number of factors have contributed to the decline of imports of Egyptian cotton. including:

- a deterioration in the quality parameters of Egyptian cotton as a result of private seed companies mixing seeds from long staple varieties with those of medium staple varieties.
- in 2014-15, the Egyptian Ministry of Agriculture and Land Reclamation announced the cancellation in the following season of its recently introduced policy of cash subsidies for farmers. With no support from the government, farmers' interest in growing cotton was drastically reduced, resulting in a smaller area under cotton in 2015-16: 104,500 hectares against the 157,900 thousand hectares in 2014-15.
- in the 2016-17 season, the area under cotton was reduced even further, giving rise to record lows for area and output, of 55,300 hectares and 35,500 tonnes.
- in August 2016, a U.S. retail chain accused an Indian textile manufacturer of using cheaper, non-Egyptian cotton in bed sheets and pillowcases marketed as containing Egyptian cotton. The Indian manufacturer acknowledged the accusations, admitting that some of their products had been falsely labelled as 100-percent Egyptian cotton.



So, a continuous reduction in the supply of Egyptian cotton, together with quality concerns, a lack of genuine seeds for ELS and suspicions about authenticity have all shaken buyers' confidence in Egyptian cotton, and the result has been a lower profile for Egyptian ELS on international markets.

However, the Egyptian government is now taking measures to address the situation. Since marketing year 2015-16, the authorities have been in charge of seed production and supply in an effort to improve cotton quality.

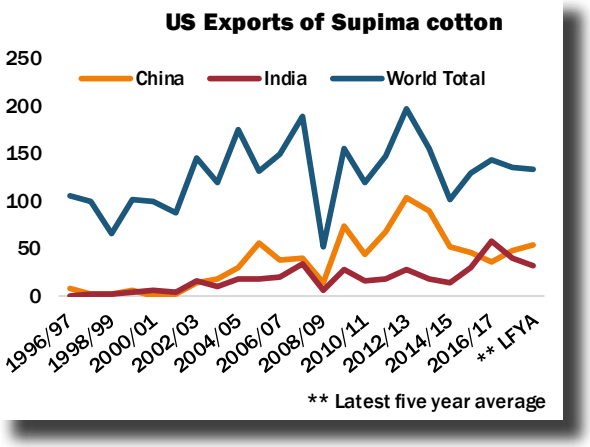
Furthermore, to crack down on fraudulent practices and protect quality standards as well as the reputation of Egyptian cotton, the Cotton Egypt Association began in 2016 to license the use of the Egyptian CottonTM logo to suppliers and manufacturers all over the world. Products displaying the logo have been certified as authentic by DNA analysis.

US

In 1954, a group of family cotton farmers in the US established an organization and branded their output of American-grown Pima cotton under the name Supima.

Since then, thanks to a highly successful campaign to promote the quality and traceability of Supima, the US has become the most desired origin for ELS cotton. US Pima is seen as supreme among the ELS growths and is preferred by many brands and end consumers over all other ELS varieties.

At present, the US accounts for almost 60 percent of the world's ELS exports, with China and India together importing about 65 percent of total US production. In



by China averaged about 70,000 tonnes; the equivalent figure for India was 19,000 tonnes.

Moreover, in the last three years, Indian imports of US Pima cotton have increased, surpassing those of China in 2016/17 with a record 57,000 tonnes. Such a large quantity was required principally in order to meet the demand for Supima-tagged products from brands, some of which had shifted their buying interest, particularly for home textiles, from China to India.

China's own ELS production in 2016/17 was a record 197,000 tonnes following the 125,000 tonnes produced the year before. Despite this increase in domestic supply, though, Chinese ELS consumption remained more or less steady in that year: 135,000 tonnes in 2016/17 compared with 130,000 tonnes consumed a year earlier.

Here, too, the reason may lie in the diversion of nominated business by brands from China to India: apparently, Chinese spinners could not be induced to increase production of fine count yarns, despite the surplus availability of ELS cotton from the domestic crop.

Conclusion

To sum up, demand is great for ELS cotton, especially for use in high-end, luxury home textile products. The appetite of major brands in India for these goods has increased in the last couple of years, prompting a rise in consumption of ELS cotton in India.

However, brands and end consumers remain concerned about the authenticity of the ELS cotton used to manufacture these premium products. Therefore, traceability is just as important a consideration as the attributes of the finished products. To ensure authenticity by way of a traceability mechanism is the driving force that generates demand for ELS cotton and differentiates one growth from another, as in the case of Supima.

Indian consumption of ELS cotton is likely to remain high in years to come, and therefore so is India's reliance on Egyptian and US Pima, as brands identify these as trustworthy and desirable origins.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WORLD'S FINEST COTTONS
An American Original.
Generations of quality,
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